Urgent Warning About *SOME* REITs

REITs, or Real Estate Investment Trusts, have been in existence for half a century. Under IRS regulations, these companies are viewed as pass-through or conduit entities. That means that if they pay out a very high percentage of their otherwise taxable income in the form of distributions to shareholders each year, the REITs themselves pay no federal income tax. (Since their income is not taxed at the corporate level, REITs' distributions are not eligible for the favorably low individual federal income tax rates on dividends that most "regular" corporations offer.)

A recent change in federal regulations regarding dividend payments by REITs can cause investors some major negative surprises. This report explains that change and its possible implications.

Under the new rules, an REIT may choose to pay as much as 90% of its common-stock declared distributions each year in the form of stock, and as little as 10% in cash, without violating its pass-through status. Shareholders must be notified if the board of directors or trustees decides to declare "dividends" of this sort, and holders are given a choice (within narrow limits) of which type of distribution they prefer. Regardless of which type of distribution (stock or cash) an investor receives, the full amount of the dividend per share IS TAXABLE in the current year. (This is very much like receiving a distribution from a mutual fund, which is taxable even if it is invested in more fund shares rather than taken in cash.)

The vast majority of shareholders in REITs own such investments mainly for their current cash income streams. If a board of a REIT declares a dividend payable largely in stock rather than in cash, holders will lose the major benefit that they bought for: cash income. In effect this is a massive dividend cut! Therefore many holders will sell their common REIT shares. The resulting imbalance of buyers and sellers will drive the price of the shares down. Two early examples of REITs that have taken "advantage" of the new optional rules are Simon Property Group (NYSE: SPG) and Vornado (NYSE:VNO). Their maximum cash portions of newly declared dividends in the first quarter of 2009 are 10% and 40%, respectively. Investors are urged to check their favorite stock-chart websites to see the price responses in those REITs' shares. Their declines have been sharp!

Not only will individual investors tend to sell their shares in REITs that elect to pay "dividends" mostly in stock, but it appears that mutual funds and closed-end funds will do so as well. Their reason will be tax implications. They will need to report to holders on 1099s, and holders will pay taxes on, the full value of distributions declared, while very little cash will have been received. This will deplete the assets of funds as they will be required – as conduits themselves –to pay out *in cash* some "income" not actually received in cash. MORE ON NEXT PAGE.

Why would an REIT's board choose to pay dividends in paper rather than in cash? The answer is simple: it keeps cash in the corporate treasury. The predictable boilerplate language will cite the ability to strengthen the balance sheet and conserve cash for attractive investment opportunities. The truth from a stockholder viewpoint is that their cash dividends have been cut severly! It is reasonable to assume that those REITs that implement the new formula will be those that are weakest – i.e. those for which paying their historical dividend rate is the greatest burden. Thus the choice to take this new option can be seen by investors as an indicator of fundamental attraction or lack thereof.

CALL OR WRITE YOUR REIT's BOARD CHAIR!

If you now own, or are considering buying, any REIT's common shares, it would be a wise move to contact them without delay about their intention regarding dividend policy. The phone numbers of companies are always listed at the end of their press releases, found conveniently on any free Internet charting package. (We like BigCharts.com.) Or you can go to the corporate website and look. Do not let yourself be intercepted by the PR person; insist on being able to reach the board chair directly, by e'mail, phone, or snailmail. You don't want your message filtered or discarded! Financial PR people are allowed to say only what they have been told to say, and they will say that no decision has been made on the issue. That is not good enough for your information and decision-making purposes. So insist on getting past the barrier to leave a strong message of disapproval – if you agree with our thesis.

Feel free to pass along this essay to other investors! Thank you for visiting **R-i-i.org** and for taking the time to read this message.