As an investment concept, I like REITs, and so should small investors. Real estate investment trusts give ordinary investors the ability to own office buildings, apartments, hotels, storage centers, medical facilities, industrial warehouses, malls, movie theaters, gas stations, and even data centers where large computer systems for big online retailers and Internet businesses are stationed. REITs are organized in a way so that there is no tax at the corporate level in exchange for the company distributing 90% or more of its profits as a dividend to shareholders. Dividends from REITs are not qualified, so it helps to hold them in tax-advantaged accounts. But, as much as they afford small investors the ability to own unique properties, like any investment, REITs can get too expensive. And despite trailing the broader stock market in 2017 and posting losses so far in 2018, most REITs still aren?t priced low enough to deliver big returns in the future. In this article, we?ll show you how to assess REITs, and highlight some possibly cheap ones in an otherwise expensive sector.

Making the assessment

While many investors look at a P/E ratio to appraise a stock, that doesn?t work for REITs. That?s because accounting rules allow real estate investors, including REITs, to take a big depreciation charge every year. So a REITs earnings or ?net income? almost always look tepid. Luckily for an investor, that charge doesn?t reflect economic reality well, and the real cash flow the properties inside a REIT are generating is usually significantly higher than stated earnings. That?s why, instead of looking at earnings, knowledgeable REIT investors look at another metric that all REITs publish, but is still poorly reported in the business press, called ?funds from operations? or ?FFO.? **Basically, FFO takes earnings or net income and adds back the depreciation charge and any profits a company may have made from selling property instead of renting it out or ?operating? it, which is its main business.** Now, adding back all the depreciation may be too generous because property owners must consistently pour money into properties for upkeep, and, even then, properties get old and obsolete. In other words, FFO isn?t an accurate reflection of reality either. However, FFO is a standardized metric that helps investors compare different companies that own similar or different types of property. And it?s a better starting point than net income, from which investors can subtrac

Price/Earnings Ratio, we constructed a Pr ... IT

Index ETF (VNQ). The results show that t

That?s not a cheap price. Investors seeki ... ’s

true that REITs have much lower debt bu

companies are covering their dividends w

Company	Ticker	Price/FFO
Simon Property Group	SPG	14.13
Equinix	EQIX	36.26
ProLogis	PLD	19.92
Public Storage	PSA	19.59
AvalonBay Communities	AVB	19.10
Welltower	HCN	15.68
Equity Residential	EQR	18.73
Digital Realty	DLR	18.28
Ventas	VTR	13.16
Boston Properties	BXP	19.06
Essex Property Trust	ESS	19.15
Realty Income	O	17.09
Host Hotels & Resorts	HST	12.16
General Growth Properties	GGP	14.40
Vornado Realty Trust	VNO	9.83
HCP	HCP	14.51
Alexandria Real Estate Equities	ARE	20.71
MidAmerica Apartments	MAA	15.36
ExtraSpace Storage	EXP	19.66
Regency Centers	REG	18.00
UDR	UDR	19.16
Iron Mountain	IRM	16.28
SL Green	SLG	15.71
Duke Realty	DRE	21.08
Federal Realty Investment Trust	FRT	19.82
Average		17.87

Sources: Company Financials and Zack’s

doesn?t mean future returns will be high.

What looks cheap?

Vornado, a company that owns retail and office property looks like the cheapest stock on our list, with a P/FFO of around 10. But since its one-year FFO number is likely inflated due to one-time rearrangement of its property portfolio, including a spinoff, investors will have to do some digging to arrive at an estimate of *?normalized?* FFO. That leaves Host Hotels and Resorts with a P/FFO of around 12. Hotels are, of course, the most economically sensitive property type, with their one-night leases that consumers and businesses slash from their budgets quickly when the economy falters. For that reason, they typically trade at lower multiples than other property types. Still, a multiple of 12 seems compelling, and Host has a good portfolio of 96 hotels with nearly 54,000 rooms encompassing upscale properties including Marriotts, Hyatts, and Westins in major U.S. cities, five Ritz-Carltons, and Le Meridien Piccadilly in London. It also has a few properties of more economy brands, and they are centrally located in cities as well. Besides a compelling Price/FFO ratio, the next thing investors should want to know is if Host?s 4% dividend yield is safe. The firm pays a quarterly dividend is $0.20 per share, and FFO per share for Q3 2017, the last reported quarter, was $0.33 per share. A dividend soaking up less than two-thirds of FFO shouldn?t be in jeopardy. And while it is of some concern that FFO per share declined in Q3 2017 from $0.37 in Q3 2016, FFO per share held steady for the three quarters before that on a year-over-year basis. The other stocks that have lower P/FFO ratios are either healthcare companies like Ventas (VTR) or retailers like Simon Property Group (SPG). The companies that own healthcare facilities have not grown dividends in recent years, and the retailers are under pressure from Amazon.