Glossary

The following is a glossary of terms referenced in the REIT industry and throughout this book. Some definitions are based on information provided by NAREIT and company-specific documents filed with the SEC; others were sourced from Barron's *Dictionary of Real Estate Terms* and from online resources such as Investopedia .com and Leasing Professionals.com.

adjusted funds from operations (AFFO) As explained more fully in Chapter 8, because it incorporates adjustments for noncash items and deducts recurring capital expenditures (defined later in this Glossary), AFFO represents a more normalized, recurring measurement of a REITS's FFO (i.e., earnings). Please also refer to Chapter 8.

basis point (bps) The daily, often tiny, percentage changes in financial instruments in a portfolio, such as the yield on a fixed-income security, are expressed in basis points. A basis point is equal to 1/100 of a percentage point, so 1 percent equals 100 basis points.

base rent The minimum rent due to a landlord, as defined in a lease. Please refer to the discussion of rent in Chapter 4.

base (expense) year As explained in Chapter 4, a base year typically is the first year of a lease, during which time the landlord determines the actual taxes and operating expenses associated with a tenant's occupying their space. After the base year, the landlord agrees to pay an expense amount based on base year expenses, and the tenant pays any increases in expenses over the base amount.

C-Corporations A C-Corporation is a legal entity that is separate and distinct from its owners. Corporations enjoy most of the rights and responsibilities that an individual possesses, such as the right to enter into contracts, loan and borrow money, hire employees, own assets, and pay taxes. The most important aspect of a corporation is limited liability; that is, shareholders of a corporation have the right to participate in the profits, through dividends and/or the appreciation of stock, but are not held personally liable for the company's debts.

capital expenses GAAP requires that certain expenditures be classified as capital expenses rather than operating expenses. There are two primary classifications of capital expenses, or "capex":

1. **Recurring capex** is money spent on improvements to a property that facilitate its leasing but that are nonstructural. Examples of such expenditures include leasing commissions and tenant improvement paid to lease a space, both of which are capitalized and then amortized over the life of the lease.
2. **Nonrecurring capex** is money invested in structural improvements that extend the life of a property, such as constructing a parking deck. Because they involve structural enhancements, nonrecurring capex dollars are not expensed; instead, they are capitalized into the basis of a property. So if a property was worth $25 million and the landlord builds a $5 million parking deck, all else being equal the new basis of the property would be $30 million.

capitalization rate A capitalization (or "cap") rate measures the expected unleveraged return of an asset. The cap rate for a property is determined by dividing the property's net operating income (NOI, defined later in the Glossary) by its purchase price. Thought of another way, cap rates are the inverse of a price/earnings ratio, where earnings are measured by property-level NOI. High cap rates generally indicate higher expected returns and/or greater perceived risk. Please refer to Chapter 8 for additional information.

cash available for distribution (CAD) Cash available for distribution better approximates a REIT's free cash flow than AFFO and, therefore, is a more meaningful denominator for determining a REIT's dividend safety. CAD is calculated by subtracting the following items from AFFO: capitalized interest expense and monthly principal and interest payments due on secured debt (excluding maturities). Please see Chapter 8 for more information.

cash NOI Cash NOI adjusts the NOI calculated from a REIT's statement of operations (also known as its income statement) to exclude the effects of straight-lined rent. Please see Chapter 8 for more information.

common area maintenance (CAM) "Common areas" are areas within a property that are used by all tenants, such as an office building's lobby, sidewalks, landscaping, parking lot lighting, and snow removal services. As explained in Chapter 4, certain lease structures allow a landlord to charge tenants for their proportionate shares of the additional cost to maintain a property's common areas. CAM charges therefore are additional rent charged for maintenance that benefits all tenants.

cost of capital Cost of capital is the cost a company bears to have a form of equity and debt capital issued and outstanding. The cost of common stock generally is considered to include the dividend rate paid to shareholders plus investors' expected equity growth rate, the two of which typically total between 8 and 12 percent annually. The cost of preferred stock equals the dividend or "coupon" payment associated with each preferred share. The cost of debt capital is the interest rate associated with each type of debt (e.g., mortgage loan or senior note) issued by a company. Please see Chapter 7 for additional information.

diversification See **portfolio diversification**.

EBITDA Earnings before interest, taxes, depreciation, and amortization.

economic cycle The natural fluctuation of an economy between periods of expansion (growth) and contraction (recession).

economic indicator According to Investopedia.com, an economic indicator is a piece of economic data, such as the weekly employment report, used by investors to interpret the overall health of the economy.

equity market capitalization (EMC) A company's equity market capitalization is calculated by multiplying the stock price times the number of common shares outstanding. If the REIT is an UPREIT or has a DownREIT structure, the number of operating partnership (OP) units outstanding should be added to the common share count before multiplying by the stock price. Please refer to Chapter 8 for additional information.

escalation clauses Provisions in a lease that allow a landlord to pass through increases in operating expenses subject to the first- or "base"-year expense levels. Rent escalations usually occur on an annual basis and tend to be tied to increases in the Consumer Price Index or are expressed as fixed periodic increases. Please refer to Chapter 4 for additional information.

exchange-traded fund (ETF) According to Investopedia.com, an exchange-traded fund (ETF) is a marketable security designed to track the performance of an index, a commodity, bonds, or a basket of assets. Unlike mutual funds, an ETF trades like a common stock on a stock exchange and experiences price changes throughout the day as they are bought and sold.

Fannie Mae The Federal National Mortgage Association (commonly known as Fannie Mae) was established as a federal agency in 1938. In 1968 Congress chartered Fannie Mae as a private shareholder-owned company. Fannie Mae is a government-sponsored enterprise that operates in the U.S. secondary mortgage market, rather than making home loans directly to consumers.

fee simple interest Also referred to as "fee simple absolute" and "fee simple estate," fee simple interest in a property indicates the owner has absolute ownership of a property and the unconditional right to dispose of it. For example, most homeowners have a fee simple interest in their homes and can sell the property at their convenience or transfer ownership to an heir upon their deaths.

Freddie Mac Created in 1970, the Federal Home Loan Mortgage Corporation (commonly known as Freddie Mac) is similar to Fannie Mae in that it is a government-sponsored enterprise whose mission is to provide liquidity to the secondary mortgage market.

FTSE NAREIT REIT indexes Indexes published by the National Association of REITs (NAREIT) to track the performance of REITs. The FTSE NAREIT REIT indexes are not publicly traded; they simply aggregate performance data on the component REITs.

full-service lease A lease in which the tenant pays the landlord a fixed monthly rent that includes an expense stop calculated off of a base year. The landlord then pays all the monthly expenses associated with operating the property, including utilities, water, taxes, janitorial, trash collection, landscaping, and so forth. The tenant gets "full service" in exchange for the monthly rent and does not have to contract with service providers directly. Please refer to Chapter 4 for additional information.

funds from operations (FFO) A supplemental though more broadly used measurement of REIT earnings, created by the REIT industry in 1991 and recognized by the SEC in 2003. FFO is the REIT equivalent of earnings. Please refer to Chapter 8 for more detail.

Garn–St. Germain Act of 1982 The federal law that deregulated the savings and loan industry.

generally accepted accounting principles (GAAP) The set of rules considered standard and acceptable by Certified Public Accountants.

Global Industry Classification Standard (GICS) According to the website www.msci.com/gics, MSCI and Standard & Poor's developed the GICS in 1999 to create an efficient investment tool that would capture the breadth, depth, and evolution of industry sectors. GICS is a four-tiered industry classification system that originally consisted of 10 investment sectors, 24 industry groups, 67 industries, and 156 subindustries. On September 1, 2016, Real Estate will become the 11th GICS sector.

gross absorption According to CBRE (www.cbre.us), the absorption rate is the rate at which rentable space is filled. Gross absorption is a measure of the total square feet leased over a specified period with no consideration given to space vacated in the same geographic area during the same time period. (See also **net absorption**.)

gross lease A lease wherein the tenant pays a fixed monthly rent to the landlord; the landlord pays the property expenses, which includes insurance, utilities, and repairs, and usually property taxes. Please refer to Chapter 4 for additional information.

hedging According to Investopedia.com, a hedge is an investment to reduce the risk of adverse price movements in an asset. Hedging is analogous to taking out an insurance policy. If you own a home in a flood-prone area, you will want to protect yourself financially from the risk of flood damage—to hedge, in other words—by taking out flood insurance.

Internal Revenue Service (IRS) The U.S. government agency responsible for the collection and enforcement of taxes.

Established in 1862 by President Lincoln, the IRS operates under the authority of the U.S. Department of the Treasury.

lease A lease is a legal agreement between a landlord (the *lessor*) and a tenant (the *lessee*) whereby the tenant agrees to pay a monthly sum for a defined period of time (*rent*) in exchange for the right to occupy the landlord's space. Please refer to Chapter 4 for additional information.

limited partnership (LP) interests A partnership between at least two partners, one of whom is passive and whose liability in the venture is limited to his amount invested, and the active partner, whose liability in the venture extends beyond his monetary investment. Please refer to Chapter 6 for additional information.

market rent The rate a landlord could charge a tenant to occupy space, based on the competing spaces and current market conditions. Please refer to Chapter 4 for additional information.

modified gross lease A lease in which the tenant pays rent plus the property taxes and insurance, and any increases in these items over the base year. Please refer to Chapter 4 for additional information.

MSCI® US REIT Index (RMZ and RMS) A real-time, price-only index, the ticker symbol for which is RMZ. At December 31, 2015, the RMZ tracked the price movements of approximately 150 equity REITs. Mortgage and hybrid REITs are not included in this index. MSCI® also publishes the RMS, a daily total return version of the RMZ, which encompasses the companies' dividend yields. The RMS is not a real-time index; total returns for the constituent REITs are published at the end of the day.

NAREIT The National Association of Real Estate Investment Trusts is the worldwide representative voice for REITs and publicly traded real estate companies with an interest in U.S. real estate and capital markets. Please see www.reit.com for more information.

net absorption Calculated as the amount of occupied square feet at the end of a period, less the amount of square feet leased at the beginning of a period, net absorption measures the square feet leased in a specific geographic area over a fixed period of time, after taking into account any space vacated in the same area during the same period. (See also **gross absorption**.)

net asset value (NAV) An estimate of the current market value of all of a company's tangible assets, including but not limited to its properties, less the sum of all of a company's liabilities and obligations. Please refer to Chapter 8 for additional information.

net, double-net, and triple-net lease As described in Chapter 4, there are three levels of "net" when referencing lease structures wherein expenses are paid by the tenant as part of total rent: (1) maintenance, which includes items like utilities, water, janitorial, trash collection, and landscaping; (2) insurance; and (3) taxes.

- A net lease generally implies that the tenant pays rent and the costs of maintaining the property; the landlord pays the insurance and taxes.
- In a double-net lease, the tenant pays rent, including the taxes and insurance; the landlord pays the maintenance costs.
- In a triple-net lease, the tenant pays rent to the landlord and pays all costs associated with maintenance, insurance, and taxes. The landlord essentially collects monthly "coupon" payments, as if he owned a bond.

net operating income (NOI) The owner's rental revenues from property less all property operating expenses, including taxes and insurance. The term ignores depreciation and amortization expenses as well as interest on loans incurred to finance the property. Please also refer to Chapter 8.

non-recurring capex See **Capital expenses**

operating partnership unit (OP unit) Units of ownership in a REIT that generally can be exchanged on a one-for-one basis into common stock of the REIT but that are not publicly traded. Please refer to Chapter 6 for more detail.

percentage rents Additional rent payable to the landlord, based on a percentage of the volume of tenant sales generated on a property. The percentage is usually based on base year sales volume. For example, a retailer's lease may require contractual rent plus percentage rents equal to 1 percent of sales revenue that exceed sales revenue achieved in the first year of operations. Please refer to Chapter 4 for additional information.

portfolio diversification The act of investing in different asset classes and securities (i.e., stocks and bonds) in order to reduce investment risk and to enhance the expected return from an invested amount.

positive spread investing The ability to raise capital at a cost significantly less than the initial returns that can be obtained on real estate transactions.

property cycle According to Wikipedia.com, the property cycle is a sequence of recurrent and predictable events reflected in demographic, economic, and emotional factors that affect supply and demand for property.

R&D property Industrial buildings in which research and development (R&D) processes are performed, including any assembly, manufacturing, or office space required to support them. R&D buildings typically have a parking ratio of at least three parking spaces per 1,000 square feet, are one to two stories high, and feature interior clear heights of less than 18 feet.

Real Estate Investment Trust Act of 1960 The federal law that authorized REITs. Its purpose was to allow small investors to pool their investments in real estate to get the same benefits as might be obtained by direct ownership while also diversifying their risks and obtaining professional management.

real estate investment trust (REIT) A REIT is essentially a corporation or business trust that combines the capital of many investors to own or provide financing for all forms of investment real estate. A REIT is generally not required to pay corporate income tax if it distributes at least 90 percent of its taxable income to shareholders each year.

REIT Modernization Act of 1999 (RMA) The federal law that further increased REITs' abilities to operate as fully integrated operating companies, primarily by allowing REITs to provide tenant services through taxable REIT subsidiaries (TRSs). The RMA became effective in 2001.

recurring capex See **Capital expenses**

REIT Simplification Act of 1994 Predecessor to the REIT Modernization Act, the REIT Simplification Act was the federal law that streamlined the REIT structure, enabling management teams to operate their companies as more fully integrated businesses.

revenue per available room (RevPAR) The product of a hotel's average daily room rate (ADR) and its daily occupancy rate.

RMZ and RMS See **MSCI® US REIT index**.

Securities and Exchange Commission (SEC) A government commission created by Congress to regulate the securities markets and protect investors. In addition to regulation and protection, it also monitors the corporate takeovers in the United States. The SEC is composed of five commissioners appointed by the U.S. President and approved by the Senate.

straight-lined rent In compliance with GAAP, REITs "straight line" the rental income they receive by reporting the average annual rent to be received over the life of a lease instead of the actual cash received. The straight-lined rent adjustment REITs report is the amount to be added to or subtracted from GAAP rents to arrive at cash rents received. Please refer to Chapter 8.

taxable REIT subsidiary (TRS) Taxable REIT subsidiaries are stand-alone corporations for tax purposes that are owned directly or indirectly by a REIT. Created as part of the REIT Modernization Act of 1999, TRSs allow REITs to compete more effectively with other landlords by enabling REITs to provide nontraditional services to tenants or provide traditional real estate management services to third parties. TRSs also allow REITs the (limited) ability to invest in and derive income from nonrental real estate assets.

Tax Reform Act of 1986 The federal law that substantially altered the real estate investment landscape by permitting REITs not only to own but also to operate and manage most types of income-producing commercial properties. It also eliminated real estate tax shelters that had attracted capital from investors based on the amount of losses that could be created.

total market capitalization The sum of a REIT's equity market capitalization, plus the liquidation value of any preferred stock outstanding, and the principal amounts of debt outstanding.

total return A stock's dividend income plus capital appreciation, before taxes and commissions.

Transparency Corporate transparency describes the extent to which a corporation's actions are observable by outsiders.

Treasury inflation-protected securities (TIPS) First issued by the U.S. government in 1997, TIPS are a Treasury security that is indexed to inflation. According to Vanguard Investment Counseling & Research, TIPS are like most other bonds in that they are issued with a fixed coupon interest rate and a fixed maturity date. Unlike traditional bonds, TIPS have a principal value that the Treasury raises (or lowers) each month to keep pace with inflation. As a result, the semiannual coupon payments to investors also change, because they are derived by applying the fixed coupon rate to an inflation-adjusted principal amount.

triple-net lease See **net, double-net, and triple-net lease**, as well as Chapter 4.

UPREIT Umbrella partnership real estate investment trust. Please refer to Chapter 6 for information.