HELM INVESTMENT MANAGEMENT

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REITs (real estate investment trusts) are companies owning, and usually operating, income producing assets such as apartments, shopping centers, offices, hotels and warehouses. REITs come in a variety of investment vehicles the most common of which are publicly traded shares on major stock exchanges. They are "hybrids" since they share elements of both fixed income and equities.

REITs are an efficient way for many investors to invest in large commercial real estate plays. Usually, the companies are diversified both in market sectors and geographically. They generally pay a significant dividend, presently around 4% and are immediately liquid. They are bought and sold based on the underlying and projected value of the REIT assets, expectations of future rent increases and distributable cash flow. They pay dividends that are taxed at the shareholder's ordinary income tax rate, similar to interest on bonds.

After several years of outperformance and a strong start in 2007, real estate securities have experienced a sharp decline in share prices. In fact, average REIT share prices declined 30% in 2007. There are multiple causes for this decline including the subprime mortgage market fall out, heightened turmoil in the financial sector, recession perception and the potential for decline in real estate values beyond residential real estate values.

One of the key REIT evaluation factors is net asset value ("NAV"). On the average, the price/NAV ratio since 1996 has been 103%. At the end of April, the ratio was 104%. Unfortunately, NAV is subject to internal manipulation and is neither well regulated within the industry nor part of generally accepted accounting principles.

A better evaluation factor is price/cash flow. The REIT average since 1996 is 12.1. As of April, the ratio was 16.1. REIT prices are often seen as harbingers of the future value of the underlying real estate. If that often quoted observation is true, REITS are still overpriced relative to both NAV and cash flow and so is the underlying real estate in general.

"In general," though, may not be an accurate assessment for various parts of the REIT market. Apartment REITs, which had average losses of 25 percent last year, were up 15.6% by the end of March this year. Self-storage REITs, down 25 percent in 2007 were up 31% at the end of April. Volatile, aren't they?

So are some REITs or specific REIT sectors, a "blue light special?" Probably not. This market still appears over priced and a likely underperformer in general. We are not currently recommending buying REITs.

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