

Understanding REIT Distributions & the Tax Considerations



For over five years, Cottonwood Communities, Inc., (“CWREIT”) has paid consecutive monthly distributions to its investors.¹ While providing investors an opportunity for a stream of income, CWREIT’s structure as a real estate investment trust (“REIT”) comes with tax considerations that are important to understand.

Return of Capital (“ROC”)

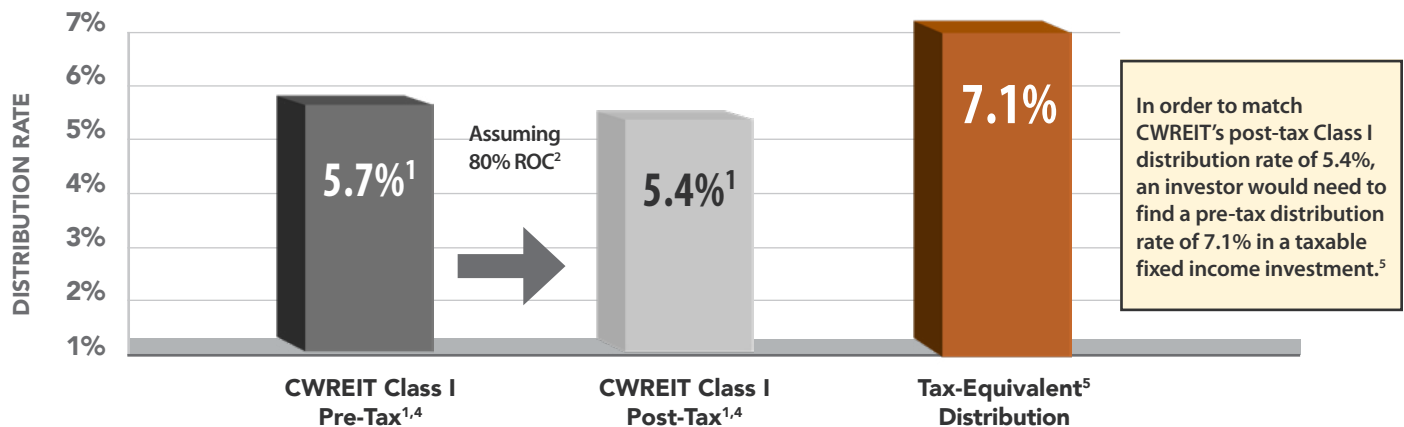
Due to various factors associated with real estate, such as depreciation and amortization, a portion of distributions that would otherwise be treated as ordinary income, may be characterized as ROC. **Taxes on ROC distributions are generally deferred until redemption, at which time they are treated as capital gains.**²

Qualified Business Income (“QBI”)

Under the “Tax Cuts and Jobs Act of 2017,” a portion of distributions not considered ROC and thereby subject to ordinary income taxes may qualify for a **QBI deduction of up to 20%.**³

- For example, investors in the highest tax bracket in 2024 would have their effective Federal Tax Rate **reduced from 37.0% to 29.6%.**

CWREIT Class I Distribution Rate Illustration⁵



Performance varies by class. Past performance is no guarantee of future results. The 7.1% assumes that the shares are sold/redeemed and capital gains taxes (20% assumed) have been applied in this illustration as such. **Absent of redemption or sale, the tax equivalent distribution would be 8.5% with capital gains applicable at a later date.** Distributions are not guaranteed.

FOR ILLUSTRATIVE PURPOSES ONLY AS OF FEBRUARY 29, 2024. THIS TAX INFORMATION IS PROVIDED FOR INFORMATIONAL PURPOSES ONLY, IS SUBJECT TO MATERIAL CHANGE, AND SHOULD NOT BE RELIED UPON AS A GUARANTEE OR FORECAST OF TAX EFFECTS. THIS MATERIAL ALSO DOES NOT CONSTITUTE TAX ADVICE TO, AND SHOULD NOT BE RELIED UPON BY, POTENTIAL INVESTORS. EACH INVESTOR SHOULD CONSULT THEIR OWN TAX PROFESSIONAL FOR GUIDANCE.

1) Past performance is no guarantee of future results. There can be no assurance these objectives will be achieved. Distributions are not guaranteed and may be funded from any source, without limitation, including cash flow from operations, asset sales, borrowings, offering proceeds, advance or deferral of fees, expense reimbursements or return of capital. CWREIT funded total distribution paid during the nine months ended September 30, 2023, which includes net cash distributions and distribution reinvestment by stockholders, with \$4.7 million from prior period cash provided by operating activities, \$29.2 million from additional borrowings and \$1.9 million of offering proceeds from issuance of common stock pursuant to the distribution reinvestment plan. CWREIT funded total distributions paid during 2022, which includes net cash distributions and distributions reinvested by stockholders, with \$23.0 million prior period cash provided by operating activities, \$9.1 million from additional borrowings, and \$2.2 million of offering proceeds. **2)** ROC is not equivalent to Return of Principal. ROC is a tax designation which considers taxable income after non-cash, tax accounting adjustments such as depreciation and amortization. ROC distributions may reduce an investor’s tax basis in the year the distribution is received and can generally defer taxes on that portion until the investor’s shares are redeemed. However, at redemption, the investor may be subject to higher capital gains taxes as a result of a lower cost basis due to the ROC distributions. Although since inception CWREIT distributions have been characterized as 100% ROC, the above illustration assumes 80% ROC. ROC percentage may vary significantly in a given year and, as a result, the impact of the tax law and any related advantage may vary significantly from year to year. *(Footnotes continue on page 2)*

This is neither an offer to sell nor a solicitation of an offer to buy the securities described in the [CWREIT prospectus](#), as amended and supplemented (the “Prospectus”). The offering is made only by the Prospectus and this material must be preceded or accompanied by the Prospectus. Neither the Securities and Exchange Commission nor any other state securities regulator has approved or disapproved of the securities or determined if the Prospectus is truthful or complete. In addition, the Attorney General of the State of New York has not passed on or endorsed the merits of the offering. Any representation to the contrary is unlawful. **Securities offered through Orchard Securities, LLC, a member of FINRA and SIPC. CW Markets Group is a Branch Office of Orchard Securities, LLC.**

3) Subject to various conditions under current federal tax provisions through the end of 2025. **4)** CWREIT's distribution rate reflects the current month's distribution annualized and divided by the prior month's net asset value ("NAV"), which is inclusive of all fees and expenses. NAV based calculations involve significant professional judgment. The calculated value of our assets and liabilities may differ from our actual realizable value or future value which would affect the NAV as well as any distribution rate information derived from that NAV, and ultimately the value of your investment. As the distribution rate is calculated based on NAV, the distribution rate presented will be impacted should the assumptions on which NAV was determined prove to be different. For further information, please refer to the "Net Asset Value Calculation and Valuation Guidelines" in CWREIT's prospectus, which describe our valuation process and the independent third parties who assist us. CWREIT's pre and post-tax distribution rate for all share classes as of February 29, 2024 were as follows: Class I: 5.7%; Class D: 5.45%; Class T: 4.85%; Class A: 5.7%. **5)** The tax-equivalent distribution refers to the pre-tax distribution rate an investor in a hypothetical taxable investment would need to receive to match the 5.4% after-tax distribution rate of CWREIT's Class I share class assuming that all income earned on the hypothetical fixed income investment is taxed at the top ordinary rate of 37% and assuming that 80% of CWREIT's distributions are treated as a ROC, (including the impact of taxes that would be payable upon redemption). The ordinary income tax rate is subject to change in the future. Tax-equivalent distribution rate for the share classes are as follows: Class I: 7.1%; Class D: 6.8%; Class T: 6.0%; and Class A: 7.1%. The illustrative example does not include state or local taxes. Investors could be subject to state and local income taxes imposed by their state or municipalities which could lower the after-tax distribution rate received by the investor. Fixed income investments are not the same as an investment in CWREIT and may have other advantages, including other tax advantages, and individual investors should consult their tax advisors.

SUMMARY OF RISK FACTORS

- An investment in our shares is speculative, illiquid and involves a high degree of risk and there is no guarantee that investors will receive any return or that they will not lose their entire investment.
- No public market exists for our shares. A stockholders' ability to dispose of their shares will likely be limited to repurchase by us.
- Our share repurchase program is subject to restrictions and our board of directors may modify or suspend our share repurchase program at any time.
- Purchases and repurchases of shares of our common stock are made based on the most recently disclosed NAV per share at such time, NAV does not currently represent our enterprise value and may not accurately reflect the actual prices at which our assets could be liquidated on any given day, the value a third party would pay for all or substantially all of our shares, or the price that our shares would trade at on a national stock exchange.
- Our board of directors may amend our NAV procedures from time to time.
- Distributions are not guaranteed and have in the past and may in the future be funded with offering proceeds, and we have no limit on the amounts we may pay from such sources.
- We depend on our advisor to select investments and to manage our business.
- We pay substantial compensation to our advisor and its affiliates, which increases the risk that our stockholders will not earn a profit on their investment.
- Certain of our officers and our directors are also officers and directors of our sponsor, advisor and their affiliates and, as a result, are subject to conflicts of interest, including conflicts arising from time constraints and the fact that the fees our advisor receives for services rendered to us are based on our NAV, which our advisor is responsible for determining.
- Stockholders' interest in us will be diluted if we issue additional shares.
- Stockholders' interest in our assets will also be diluted if our operating partnership issues additional units.
- There are restrictions on the ownership and transferability of our shares of common stock.
- If we fail to qualify as a real estate investment trust and no relief provisions apply, our NAV and cash available for distribution to our stockholders could materially decrease.
- We will be subject to risks generally associated with the development and operation of real estate including, but not limited to, economic risks, legislative risks, tax risks, environmental risks, financing risks, liquidity risks and lack of diversification.
- The outbreak of widespread contagious disease, such as the novel coronavirus, COVID-19, could adversely impact our operations and the value of our investments.
- Inflation and its adverse consequences on our operations.