

# Tax Advantages & Implications for REIT Investors



Real estate investment trusts ("REITs") offer investors an opportunity for a stream of income with potential tax advantages

## Return of Capital ("ROC")

A portion of distributions that would otherwise be treated as ordinary income, may be characterized as ROC due to various factors associated with real estate, such as depreciation and amortization. **Taxes on ROC distributions are generally deferred until redemption, at which time they are treated as capital gains.**<sup>1</sup>

## Qualified Business Income ("QBI")

Any portion of distributions not considered ROC and thereby subject to ordinary income taxes, **may qualify for a QBI deduction of up to 20%**, subject to various conditions under current federal tax provisions through the end of 2025.

## What does this mean when considering Cottonwood Communities, Inc. ("CWREIT")?

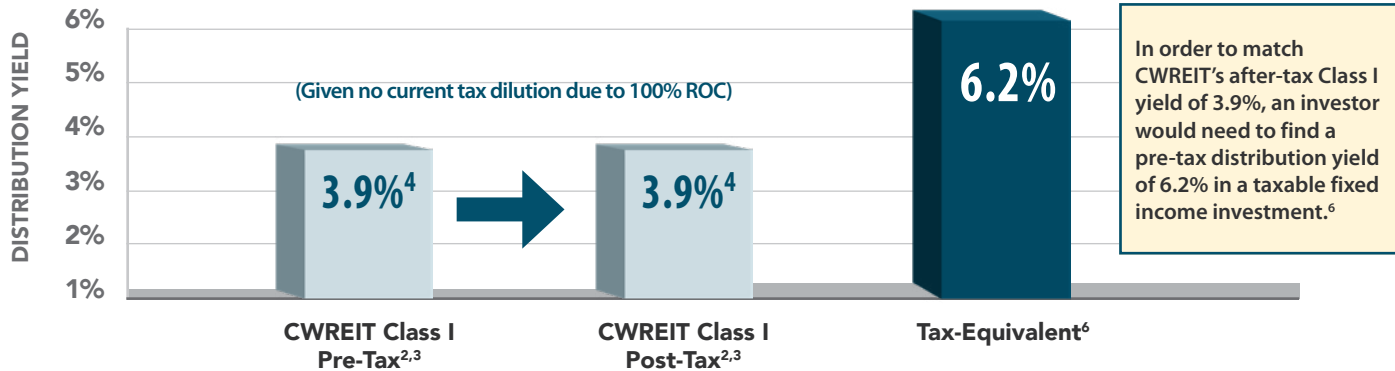
### 1. CONSISTENT DISTRIBUTIONS PAID<sup>2,4</sup>

Over 4 years of consecutive monthly distributions paid to CWREIT investors (as of February 28, 2023)

### 2. 100% ROC EACH YEAR FOR CWREIT SINCE INCEPTION (2018 - 2022)<sup>1,4,5</sup>

No current tax dilution on distributions and qualified for tax deferral

## CWREIT Class I Post-Tax Yield Advantage Illustration<sup>6</sup>



Performance varies by class. Past performance is no guarantee of future results. The 3.9% assumes that the shares are not sold or redeemed. Capital gains taxes will apply upon redemption/sale. Under this illustration, QBI is not applicable due to 100% ROC. Distributions are not guaranteed.

FOR ILLUSTRATIVE PURPOSES ONLY AS OF FEBRUARY 28, 2023. 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) Return of Capital ("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.

(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.

**2)** 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 distributions paid during the nine months ended September 30, 2022, which includes net cash distributions and distribution reinvestment by stockholders, with \$16.4 million prior period cash provided by operating activities, \$4.3 million from additional borrowings, \$9.6 million from offering proceeds, and \$1.6 million of offering proceeds from issuance of common stock pursuant to the distribution reinvestment plan (the "DRP"). CWREIT funded total distributions paid for the year ended December 31, 2021, which includes net cash distributions and distributions reinvested by stockholders, with \$11.1 million prior period cash provided by operating activities, \$5.0 million from additional borrowings, \$4.0 million from offering proceeds, and \$0.1 million of offering proceeds from issuance of common stock pursuant to the DRP. **3)** CWREIT's yield 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 yield information derived from that NAV, and ultimately the value of your investment. As the yield is calculated based on NAV, yield 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 yield for all share classes as of February 28, 2023 were as follows: Class I: 3.9%; Class D: 3.7%; Class T: 3.1%; Class A: 3.9%. **4)** Past performance is no guarantee of future results. There can be no assurance these objectives will be achieved. **5)** 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. **6)** The tax-equivalent distribution refers to the pre-tax yield an investor in a hypothetical taxable investment would need to receive to match the 3.9% after-tax yield 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 100% of CWREIT's distributions are treated as a ROC, (excluding 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 yield for the share classes are as follows: Class I: 6.2%; Class D: 5.9%; Class T: 4.9%; and Class A: 6.2%. 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 yield 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.