Non-Traded REITs

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In this paper, I examine differences between non-traded and traded REITs by using available financial data. Findings indicate that there are many differences along a number of dimensions between non-traded and traded REITs. For example, non-traded REITs hold fewer properties, employ lower leverage, generate lower return on invested capital (ROIC) and funds from operations (FFO) and pay a greater fraction of their income in dividends. There does not appear to be significantly different dividend yields. These findings have public policy implications especially considering how their dividends may be funded and how non-traded REIT shares are purchased.

INTRODUCTION

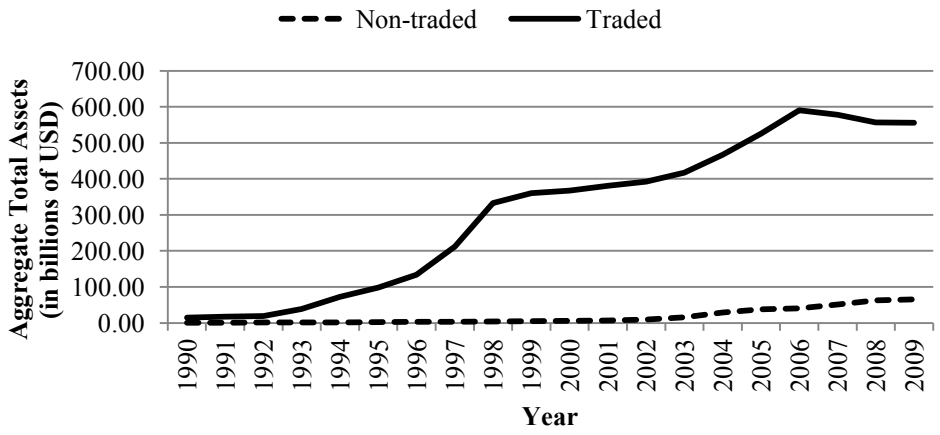
A REIT is a publicly held or privately owned company that invests in and manages a portfolio of income producing commercial properties or mortgages. A REIT is created based on the Internal Revenue Code (Sections 856-858) to become a pass-through entity that distributes significant portion of its earnings and capital gains to its shareholders. REITs do not pay corporate taxes as long as qualification standards are met; however, distributed earnings and capital gains are taxed at the shareholder level.

Non-traded REITs are organized just like publicly traded REITs in terms of their legal and governance structures. They are both subject to the same regulatory oversight by the SEC and the Sarbanes–Oxley Act of 2002. However, there are differences between the two types of REITs in terms of their formation, management and size. Typically a non-traded REIT is formed by a sponsor firm that packages properties or capital from different sources (individual or institutional investors) into a REIT structure. According to Farrell (2006) non-traded REITs may have a finite life, about ten years, and cease to exist with an Initial Public Offering (IPO), a merger or liquidation of properties. Non-traded REITs may be managed by a third party (REIT having no employees) and/or its shares are sold to investors by a broker-dealer that may be related to the sponsoring firm. A sponsor firm may receive fees for services (day-to-day, asset management or advisory) it provides to a non-traded REIT either directly or through its subsidiaries. By comparison, most publicly traded REITs have their own management teams and boards.

In terms of size, it is interesting to note that while aggregate total assets of traded REITs are much larger than that of non-traded REITs, the growth rate of aggregate total assets of non-traded REITs has been higher in the recent past. According to SNL Financial, aggregate total assets of non-traded REIT were $6.07 billion compared to $367.48 in aggregate total assets managed by public REITs in 2000. Aggregate total assets of non-traded and traded REITs grew to $65.24 billion and $555.49 billion, respectively in 2009. These increases represent a 30 percent and 4 percent aggregate total assets growth rated of non-traded and traded REITs, respectively. Non-traded REITs continue to attract more capital. According to Joanna Randell of REIT Café, non-traded REITs received approximately $8 billion in 2010

and expected to get more than $10 billion in 2011. Figure 1 reports the aggregate total assets of non-traded and traded REITs over time.

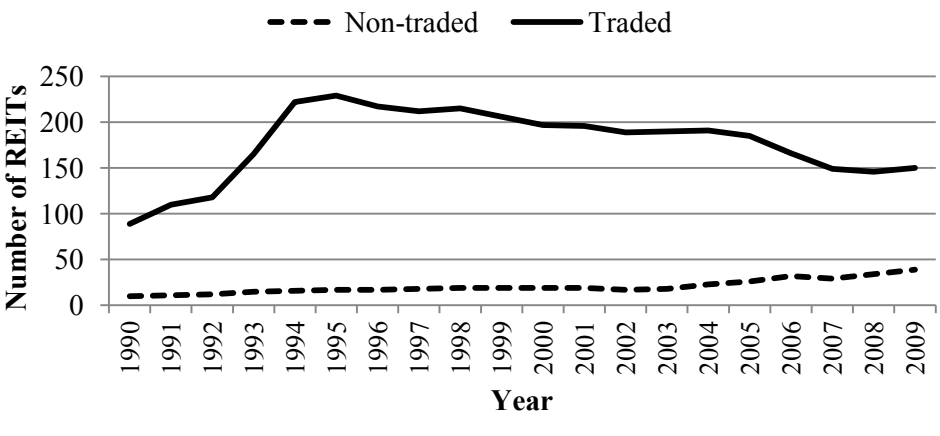
FIGURE 1
AGGREGATE TOTAL ASSETS OF NON-TRADED AND TRADED REITS
1990 - 2009



Source: SNL Financial

The aggregate total assets growth rate of non-traded REIT accelerated after 2003 while that of traded REITs have contracted since 2006. The number of REITs in each group is shown in Figure 2 and complements the trends observed with their total assets.

FIGURE 2. NUMBER OF NON-TRADED AND TRADED REITS
1990 - 2009



Source: SNL Financial

In this paper, I examine the differences between non-traded REITs and traded REITs along a number of financial dimensions based on available financial data. In addition, I also attempt to quantify the effects of no listing on REIT valuation. The paper is organized as follows. The next section provides

characteristics of non-traded REITs followed by a section on data and methodology. Section four presents results and section five provides conclusions.

CHARACTERISTICS OF NON-TRADED REITS

Existing literature on non-traded REITs is very limited. Still industry experts and followers appear to agree on some characteristics of non-traded REITs. I summarize those characteristics from an investment standpoint without categorizing them:

i. An important characteristic of non-traded REITs is that their share price does not fluctuate. According to Farrell (2006) sponsor of a non-traded REIT establishes its share price. Mattox (2006) suggests that the share price of a non-traded REIT would be reset if independent appraisals indicate that underlying property valuations have changed.

ii. Hogan (2010) claims that non-traded REITs introduce greater diversification to a portfolio because they have low correlation with stocks and they provide a consistent dividend yield. The low correlation in this context reflects relatively constant values of non-traded REITs similar to direct real estate investments.

iii. Non-traded REITs may have higher dividend yields than that of public REITs. According to Kimbrell and Chitty (2010) the average dividend yield on non-traded REITs was 6.53% in 2009. Farrell (2006) and Morrissey (2009) report dividend yield ranges from 6% to 7% and from 6% to 9%, respectively.

iv. According to an industry executive, Nicholas S. Schorsch, investors purchasing shares of non-traded REITs can avoid paying significant premiums to net asset values when traded REITs can only be purchased at a premium in the stock market.[1] Even though this is reasonable, it does not explain why a non-traded REIT sponsor would not initiate an IPO process to capture the premium.

v. Non-traded REIT shares are not liquid, limiting investors' ability to exit an investment if circumstances change. According to Farrell (2006) investor redemptions are very restrictive, typically it is limited to 3% of the fund per year and can be eliminated at any time by the sponsor. Morrissey (2009) suggests that there are penalties associated with early redemptions that can be 10% of an investor's initial investment.

vi. Commissions associate with initial purchase of non-traded REIT shares are relatively high. According to Farrell (2006), they are between 8% and 9%, but Morrissey (2009) suggests that initial investment commissions paid to brokers and advisors can reach to 15%.

vii. A non-traded REIT is designed to have a set termination date. According to Farrell (2006), it is 10 to 12 years and investor's return depends on the exit price. Investors would have to commit to a long time period before making any non-traded REIT purchases. Typically, shareholders exit their investment via an IPO, a merger or liquidation. The actual total return of a non-traded REIT investor is determined by, not only the initial purchase price and dividends received over time, but also the exit price. If the market conditions at the time of termination are not favorable, then investors can experience significant losses.

viii. A sponsor of non-traded REITs may cut dividends and or reduce the share value if property investments do not perform as expected. For example, Cole Credit Property Trust II, Inc. (Cole REIT II) reduced the value of its commons stock to $8.05 from $10.00 in June 22, 2010.[1] Cole REIT II made this change in response to a new reporting requirement by the Financial Industry Regulatory Authority (FINRA) that reported per share value estimate cannot be older than 18 months.

ix. In the extreme case, dividends payments may come from new capital raised through share sales or borrowing. Currently there is no mandate as to source of dividends payment. Some industry advocates support a mandate that dividend payment be funded through operating cash flows.

x. There is also the issue of conflict of interest between non-traded REIT investors and a sponsor/manager. A sponsor/manager may earn property acquisition, finance and management

fees. If these transactions are not at arm's length, then investors of non-traded REITs would suffer possible losses.

xi. There is limited transparency with non-traded REIs making it difficult to assess and monitor their investments and operations. Even though they are subject to the same regulation as publicly traded RIETs, there are not many analyst specialized in non-traded REITs.

DATA AND METHODOLOGY

The data set used in this study is provided by SNL Financial and covers a time period from 1990 to 2009. There are 460 REITs in the sample; 86 non-traded and 374 traded. The distribution of non-traded and traded REITs across property types are shown in Table 1. Non-traded REITs appear to concentrate in diversified, office, hotel and retail (other than regional malls and shopping centers) type property holdings.

TABLE 1
PROPERTY TYPES OF NON-TRADED AND TRADED REITS

This Table reports the distribution of non-traded and traded REITs across property types. The data is provided by SNL Financial and covers a time period from 1990 to 2009. There are 460 REITs in the sample; 86 non-traded and 374 traded.

Property Focus	Non-traded	Percent of non-traded REITs	Traded	Percent of traded REITs
Diversified	24	27.91%	52	13.90%
Health Care	8	9.30%	22	5.88%
Hotel	9	10.47%	50	13.37%
Industrial	3	3.49%	24	6.42%
Manufactured Homes	2	2.33%	6	1.60%
Multi-Family	7	8.14%	49	13.10%
Office	16	18.60%	52	13.90%
Regional Mall	1	1.16%	15	4.01%
Retail: Other	8	9.30%	12	3.21%
Self-Storage	1	1.16%	24	6.42%
Shopping Center	6	6.98%	41	10.96%
Specialty	1	1.16%	27	7.22%
Total	86		374	

Table 2 reports descriptive statistics of variables based on financial statements. I use these variables to compare non-traded and traded REITs. Most of these variables do not meet the properties of a standard normal distribution; therefore, in my comparisons I use t-tests as well as Wilcoxon signed rank tests on medians.

TABLE 2
DESCRIPTIVE STATISTICS

This Table reports the distribution of non-traded and traded REITs across property types. The data is provided by SNL Financial and covers a time period from 1990 to 2009. There are 460 REITs in the sample; 86 non-traded and 374 traded.

Variable	Mean	Median	Standard Deviation	Minimum	Maximum	N
Total Equity-to-Total Assets (%)	45.5629	43.4900	27.5386	-523.4600	99.9700	3,944
Common Equity-to-Total Assets (%)	41.7848	39.1950	30.9167	-901.2300	99.9700	3,944
Properties-to-Assets (%)	73.5940	83.3200	25.7988	0.0000	122.3200	3,949
Total Debt-to-Total Equity (x)	1.9990	1.0700	5.3044	0.0000	95.6300	3,864
Return on Average Assets (%)	2.8919	3.2800	18.2152	-828.5700	145.3200	3,592
Return on Average Equity (%)	7.1228	7.7000	33.6067	-979.6700	949.5700	3,526
Return on Invested Capital (%)	8.4482	8.5700	2.7736	0.0100	40.4700	3,124
Number of Properties (Total)	179.8835	76.0000	362.8418	0.0000	10,267.0000	2,506
Portfolio Occupancy (%)	88.5181	92.8000	11.1728	0.0000	100.0000	1,531
Gross Leasable Area (sq. ft.)	31,273,975	16,510,726	52,169,448	56,336	494,779,000	502
Expense Reimburse-to-Rental Rev (%)	9.5925	3.3400	11.2820	0.0000	50.9200	2,268
Total Debt-to-Gross Properties (%)	57.8357	52.7900	57.8352	0.0000	995.7400	3,747
Interest Income-to-Total Revenue (%)	10.3148	1.4900	24.7058	-0.0300	679.2700	3,420
Loans-to-Assets (%)	6.5032	0.1800	16.4987	0.0000	99.7400	3,583
Interest Expense-to-Total Expenses (%)	23.7769	23.8950	15.3290	-125.8300	111.2000	3,822
Property Expense-to-Total Expenses (%)	27.8870	31.7000	22.7863	0.0000	717.9800	3,834
Funds from Operations-to-Total Revenue (%)	38.3051	39.9900	33.7491	-683.2600	262.9400	2,993
Dividend Payout Ratio (%)	149.4970	122.4200	125.7222	0.0000	984.2100	3,008
Dividend Yield (%)	5.4413	5.8400	5.6062	0.0000	195.3100	3,956
Common Dividends Paid-to-Common Equity (%)	12.2524	8.7263	88.0166	-1735.4658	2599.6888	1,866

I also estimate values of non-traded REITs based on comparable multiples from traded REITs and estimate the possible loss of value due to no listing of shares. I use only the 2009 data and estimate the following regression for this analysis:

$$(\text{MB})_i = \alpha + (\text{Status})_i + (\text{Infinite})_i + (\text{Age})_i + (\text{Number of Properties})_i + (\text{ROIC})_i + (\text{TDTE})_i + \varepsilon_i$$

Where, MB is the natural logarithm of market value of common stock per share-to-book value of common stock per share. Market value per share of traded REITs is based on the market price at the end of 2009. I estimate market values of non-traded REITs using a median Funds From Operations (FFO) multiple of the same property type REITs that are publicly traded. I estimate market values of non-traded REITs only if they have positive FFO in 2009. I also consider alternative definitions based on IPO price as well. Status and Infinite are dummy variables that have values of 1 if a REIT is non-traded and set up to exist forever, respectively. Age and Number of Properties are natural logarithms of age of a REIT since its initial public offering and number of properties held as of 2009, respectively. ROIC and TDTE refer to Return on Invested Capital and Total Debt-to-Total Equity in 2009, respectively.

I expect Status to affect MB negatively because non-traded REITs are not listed and therefore investors face a significant loss of liquidity. In addition, the structure of investing in non-traded REITs raise concern about agency problems and cost of investing. I expect all these negative factors outweigh any benefit investors would get due to non-listing of stocks. In addition, I expect ROIC and TDTE to have positive effect on MB because greater return on invested capital and higher leverage typically lead to higher MB ratios.

RESULTS

I report univariate comparisons of non-traded and traded REITs on Table 3. The Table shows the results of both t-tests on means and Wilcoxon singed rank tests on medians. I observe that non-traded REITs use less leverage as measured by Total Equity-to-Total Assets and Common Equity-to-Total Assets, but their interest expense-to-total expense ratio is higher than that of traded REITs. All these differences are statistically significant. These findings are consistent with the notion that non-traded REITs may be exposed to a greater cost of borrowing. Such a finding would suggest that non-traded REITs would be less likely to leverage their assets to seek growth.

Non-traded REITs are not as profitable as traded REITs when comparing Return on Average Assets, Return on Average Equity and Return on Invested Capital. Except for Return on Average Assets, they are all statistically significant. I also observe that traded REITs typically invest in three times as many properties and hold property portfolios three times as large as non-traded REITs. These differences are statistically significant. In addition, Funds from Operations-to-Total Revenue is lower while Dividend Payout Ratio is higher for non-traded REITs than that of traded REITs. Both of these differences are also statistically significant.

Comparison of dividend yields between non-traded and traded REITs are affected by how the dividend yield for non-traded REITs is defined. If I use SNL Financial reported dividend yields, non-traded REITs have lower dividend yields than traded REITs. However, this is affected by many 0% dividend yield observations for non-traded REITs reported by SNL Financial. This is true even though cash flow statements indicate that there were dividend payments to common stockholders. This reduces the usefulness of SNL Financial reported dividend yield to compare non-traded and traded REITs. Therefore, I also consider an alternative definition of dividend yield (Common Dividends Paid-to-Common Equity) that follows the same procedure for all REITs. Common Dividends Paid-to-Common Equity is computed as common stock dividends paid by a REIT divided by its book value of common equity; both variables are based on SNL Financial data. The result of this comparison finds no statistical difference between the two groups in terms of their dividend yield. Although not reported in Table 3, I also compare dividend yield of non-traded REITs computed as mentioned before and dividend yield of

traded REITs based on their market prices. I observe that non-traded REITs have higher dividend yields. However, this comparison is based on variables that are not computed in a similar manner.

TABLE 3
UNIVARIATE ANALYSIS

This Table reports results of univariate analysis based on REIT status. The data is provided by SNL Financial and covers a time period from 1990 to 2009. There are 460 REITs in the sample; 86 non-traded and 374 traded. I report p-values for differences in means and Wilcoxon signed rank test in medians.

Variable	Status	Mean	Median	Standard Deviation	Minimum	Maximum	N
Total Equity-to-Total Assets (%)	Non-traded	50.8059	51.2600	44.6181	-523.4600	99.9300	407
	Traded	44.9596	42.7000	24.7702	-117.1800	99.9700	3,537
	p-value	0.0097	0.0000				
Common Equity-to-Total Assets (%)	Non-traded	47.0246	49.7300	59.3239	-901.2300	99.9300	407
	Traded	41.1819	38.1200	25.6564	-117.1800	99.9700	3,537
	p-value	0.0500	0.0000				
Properties-to-Assets (%)	Non-traded	64.4387	73.7400	31.1464	0.0000	98.2900	410
	Traded	74.6546	83.8300	24.8943	0.0000	122.3200	3,539
	p-value	0.0000	0.0000				
Total Debt-to-Total Equity (x)	Non-traded	1.9659	0.7500	8.2507	0.0000	95.6300	384
	Traded	2.0026	1.1000	4.8732	0.0000	90.9000	3,480
	p-value	0.9318	0.0000				
Return on Average Assets (%)	Non-traded	-1.9165	2.5100	54.9241	-828.5700	53.9900	339
	Traded	3.3930	3.3300	7.0839	-122.6700	145.3200	3,253
	p-value	0.9318	0.0000				
Return on Average Equity (%)	Non-traded	1.7751	4.4500	20.3505	-214.1700	91.5900	318
	Traded	7.6529	7.9850	34.6027	-979.6700	949.5700	3,208
	p-value	0.0000	0.0000				
Return on Invested Capital (%)	Non-traded	7.2978	7.1600	2.8664	1.0400	30.0600	301
	Traded	8.5709	8.6800	2.7357	0.0100	40.4700	2,823
	p-value	0.0000	0.0000				
Funds from Op.-to-Total Revenue (%)	Non-traded	23.9320	31.6250	44.9729	-322.1400	119.4500	202
	Traded	39.3454	40.5100	32.5533	-683.2600	262.9400	2,791
	p-value	0.0000	0.0000				

TABLE 3
(CONTINUED)

Variable	Status	Mean	Median	Standard Deviation	Minimum	Maximum	N
Number of Properties (Total)	Non-traded	75.2838	27.0000	129.4775	0.0000	952.0000	303
	Traded	194.2701	85.0000	381.7830	0.0000	10267.0000	2,203
	p-value	0.0000	0.0000				
Portfolio Occupancy (%)	Non-traded	87.1742	93.2000	16.0460	0.0000	100.0000	165
	Traded	88.6804	92.8000	10.4279	37.9000	100.0000	1,366
	p-value	0.2411	0.0401				
Gross Leasable Area (sq. ft.)	Non-traded	11,885,954	5,010,478	13,452,595	56,336	45,957,000	88
	Traded	35,395,101	18,008,838	56,270,117	95,000	494,779,000	414
	p-value	0.0000	0.0000				
Expense Reimburse-to-Rental Rev (%)	Non-traded	6.6435	0.0000	10.6300	0.0000	44.5000	248
	Traded	9.9545	5.2800	11.3091	0.0000	50.9200	2,020
	p-value	0.0001	0.0000				
Total Debt-to-Gross Properties (%)	Non-traded	58.1869	56.9050	64.1957	0.0000	995.7400	356
	Traded	57.7989	52.5100	57.1367	0.0000	925.7600	3,391
	p-value	0.9128	0.0347				
Interest Income-to-Total Revenue (%)	Non-traded	17.4722	6.0000	25.6405	0.0000	134.5200	373
	Traded	9.4386	1.3500	24.4498	-0.0300	679.2700	3,047
	p-value	0.0000	0.0000				
Loans-to-Assets (%)	Non-traded	7.4548	0.0000	16.2410	0.0000	98.8800	373
	Traded	6.3927	0.2300	16.5273	0.0000	99.7400	3,210
	p-value	0.2393	0.6911				
Interest Expense-to-Total Expenses (%)	Non-traded	25.8423	25.8100	19.0615	0.0000	84.5600	393
	Traded	23.5402	23.8000	14.8265	-125.8300	111.2000	3,429
	p-value	0.0211	0.0694				
Property Expense-to-Total Expenses (%)	Non-traded	16.8972	12.4700	17.8159	0.0000	81.3700	395
	Traded	29.1493	33.2200	22.9570	0.0000	717.9800	3,439
	p-value	0.0000	0.0000				
Funds from Operations-to-Total Revenue (%)	Non-traded	23.9320	31.6250	44.9729	-322.1400	119.4500	202
	Traded	39.3454	40.5100	32.5533	-683.2600	262.9400	2,791
	p-value	0.0000	0.0000				
Dividend Payout Ratio (%)	Non-traded	190.3406	133.3300	159.9580	0.0000	971.4300	225
	Traded	146.1949	121.2100	121.9772	0.0000	984.2100	2,783
	p-value	0.0001	0.0000				
Dividend Yield (%)	Non-traded	0.3951	0.0000	2.1091	0.0000	18.1700	412
	Traded	6.0279	6.2500	5.5913	0.0000	195.3100	3,544
	p-value	0.0000	0.0000				
Common Div. Paid-to-Common Equity (%)	Non-traded	12.0306	5.8248	97.6794	-276.1111	1,590.9356	276
	Traded	12.2909	9.0537	86.2626	-1,735.4658	2,599.6888	1,590
	p-value	0.9669	0.0000				

I use a regression analysis to examine the effects of loss of value due to trading status of REITs. I restrict the sample for this analysis to the latest year of available data, 2009. The characteristics of this sub-sample are provided on Table 4. Non-traded REITs in this sub-sample have lower MB and ROIC, hold fewer properties, use lower leverage and are relatively new when compared to traded counterparts.

TABLE 4
DESCRIPTIVE STATISTICS OF VARIABLES IN MULTIVARIATE ANALYSIS

I restrict the sample for the regression analysis to the latest year of available data, 2009. This Table report characteristics of the sub-sample. MB is the natural logarithm of market value of common stock per share-to-book value of common stock per share. Market value per share of traded REITs is based on the market price at the end of 2009. I estimate market values of non-traded REITs using a median funds from operations (FFO) multiple of the same property type REITs that are publicly traded. I estimate market values of non-traded REITs only if they have positive FFO in 2009. Age and Number of Properties are natural logarithms of age of a REIT since its initial public offering and number of properties held as of 2009, respectively. ROIC and TDTE refer to Return on Invested Capital and Total Debt-to-Total Equity in 2009, respectively.

Variable	Mean	Median	Standard Deviation	Minimum	Maximum	N
Panel A. All observations						
MB	1.6943	1.3067	1.6088	0.0638	13.0044	128
Age	16.0469	15.0000	12.7179	0.0000	56.0000	128
Number of properties	261.4400	105.0000	422.2845	1.0000	2,504.0000	125
ROIC	6.4802	6.3100	1.9100	2.3900	12.6600	118
TDTE	1.5716	1.3000	1.2945	0.0000	7.2000	128
Panel B. Non-traded REITs						
MB	0.5005	0.3660	0.3714	0.0638	1.2426	13
Age	2.3077	2.0000	1.4936	0.0000	5.0000	13
Number of properties	161.6923	51.0000	299.8142	2.0000	952.0000	13
ROIC	5.4392	5.7700	1.2228	2.3900	6.9100	13
TDTE	0.9669	0.5900	0.8342	0.1500	2.4100	13
Panel C. Traded REITs						
MB	1.8293	1.4284	1.6396	0.3368	13.0044	115
Age	17.6000	15.0000	12.4899	0.0000	56.0000	115
Number of properties	273.0179	117.0000	433.8096	1.0000	2,504.0000	112
ROIC	6.6090	6.4100	1.9440	2.8500	12.6600	105
TDTE	1.6400	1.3200	1.3218	0.0000	7.2000	115

TABLE 5
MULTIVARIATE ANALYSIS

I also estimate values of non-traded REITs based on comparable multiples from traded REITs and estimate the possible loss of value due to no listing of shares. I use only the 2009 data and estimate the following regression for this analysis:

$$(\text{MB})_i = \alpha + (\text{Status})_i + (\text{Infinite})_i + (\text{Age})_i + (\text{Number of Properties})_i + (\text{ROIC})_i + (\text{TDTE})_i + \varepsilon_i$$

Where, MB is the natural logarithm of market value of common stock per share-to-book value of common stock per share. Market value per share of traded REITs is based on the market price at the end of 2009. I estimate market values of non-traded REITs using a median funds from operations (FFO) multiple of the same property type REITs that are publicly traded. I estimate market values of non-traded REITs only if they have positive FFO in 2009. I also consider alternative definitions based on IPO price as well. Status and Infinite are dummy variables that have values of 1 if a REIT is set up to exist forever and non-traded, respectively. Age and Number of Properties are natural logarithms of age of a REIT since its initial public offering and number of properties held as of 2009, respectively. ROIC and TDTE refer to Return on Invested Capital and Total Debt-to-Total Equity in 2009, respectively.

Variable	Model 1		Model 2		Model 3	
Intercept	-1.3397		-1.3039		-1.1667	
	-5.2100	***	-4.8200	***	-5.3300	***
Non-traded	-0.9671		-1.1008		-1.1323	
	-4.4300	***	-6.1200	***	-6.4400	***
Age	0.0951					
	1.2700					
Number of properties			0.0325			
			0.8600			
ROIC	0.1979		0.2047		0.2084	
	6.8100	***	7.2300	***	7.4500	***
TDTE	0.0854		0.0947		0.0929	
	2.0300	**	2.2600	**	2.2200	**
Adjusted R^2	0.5241		0.5205		0.5215	

The results of the regression analysis reported in Table 5. I consider alternative specifications in six different forms. Each of these models accounts for about half of the variation in MB. Generally, I observe that the results of regression results support the expectations. Infinite life, age and number of properties do not affect MB in a statistically significant manner. I observe that ROIC and TDTE affect MB positively. These effects are also statistically significant. The coefficient for status dummy is negative and statistically significant in all specifications. I determine that MB ratio would be about 68% lower for non-traded REITs than that of traded REITs based on the transformed coefficient of status dummy if they were publicly traded.

TABLE 5
(CONTINUED)

Variable	Model 4		Model 5		Model 6	
Intercept	-0.9183		-1.2443		-1.4486	
	-4.8000	***	-4.5000	***	-4.9800	***
Non-traded	-1.2238		-0.9591		-0.9157	
	-7.0400	***	-4.2500	***	-4.1000	***
Infinite life			0.2161		0.2018	
			1.1000		1.0400	
Age			0.0677		0.0465	
			0.7900		0.5400	
Number of properties			0.0067		0.0138	
			0.1700		0.3500	
ROIC	0.1945		0.1818		0.1962	
	7.0200	***	6.3200	***	6.7100	***
TDTE					0.0859	
					2.0200	**
Adjusted R^2	0.5050		0.5084		0.5218	

CONCLUSIONS

In this paper, I examine differences between non-traded REITs and traded REITs based on available financial data. In addition, I attempt to quantify the effects of no listing on REIT valuation. I find that many dimensions of non-traded and trades REITs are different. For example non-traded REITs hold fewer properties, employ lower leverage, generate lower ROIC and FFO and pay greater fraction of income in dividends. I do not observe significantly different dividend yields and attribute the claims of higher dividend yield on non-traded REITs to difference in dividend yield computation. I also find that non-traded REITs would have lower market-to-book multiples if they were publicly traded.

Considering all this evidence there are two clear patterns that may make non-traded REITs a more problematic or risky investment than traded REITs. First, their ability to make dividend payments and maintain such high payout ratios may be limited if operations are not as profitable as traded REITs. If the high payout ratio is supported by greater use of outside capital, mostly in the form of equity, then non-traded investors are likely to suffer severe losses since this structure would not be sustainable. This necessitates a mandate on the source of dividend payments that dividends should be supported by operating profits and not by external capital. Such a mandate on how dividends are financed would make non-traded REITs even more credible to investors. Second, non-traded REIT portfolios may be concentrated in specific local markets. If these local markets were to experience a contraction, non-traded REIT investors would suffer significant losses. This may not be as much of a problem for traded REITs since they hold relatively larger property portfolios and I would expect that their concentration in particular local markets is limited. Third, it is not clear what justifies high transaction costs associate with non-traded REITs. It does not appear to be superior ROIC generated by non-traded REITs based on the available evidence.

ENDNOTES

[1] Randyl Drummer, Talking non-trade REITs with Nick Schorsch of American Realty Capital, September 29, 2010.
[2] http://sec.gov/Archives/edgar/data/1308606/000130860610000011/ccptii_8ka.htm

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