

What Every Investor Should Know About Non-Traded REITs

A non-traded real estate investment trust, or REIT, is an entity that owns and generally manages income-producing real estate. Non-traded REITs pool funds from many investors to purchase a portfolio of properties, which may consist of office buildings, shopping centers, hotels, apartments, timber-producing land, et cetera. They are sold as income-producing investments and often claim that they do not have the volatility associated with today's equity markets. Some non-traded REITs are sold in public offerings but are not registered for trading while other non-traded REITs are sold in private offerings. Non-traded REITs are similar to the limited partnerships that proliferated in the 1990s, however, and suffer from many of the same problems and risks.

The problems and risks associated with non-traded REITs include:

- **Illiquidity** - Non-traded REITs do not trade on a national securities exchange and are not easily traded. Even in cases where secondary markets are available, they often traded at significant discounts. In addition, early redemption is restricted and the redemption price may be priced below the purchase price or current price.
- **Valuation** - The lack of trading means there is no market value. REITs must be valued using models and guesswork. They are often misleadingly valued at cost on statements sent to investors.
- **Volatility** - The supposed lack of volatility is an illusion caused by lack of trading and misleadingly failing to adjust the purchase price to reflect changes in the real estate market and the particular assets held by the REIT.
- **Fees** - Like most alternative investments, fees are high (often 15% or more of offering proceeds) and erode returns.
- **Commissions** - Selling agents often receive 6% to 7% of the offering proceeds.
- **Distributions** - Distributions are subject to suspension and may be eliminated. They often represent a return of investor capital and consist of borrowed funds instead of profits from operations.
- **Opacity** - Lack of transparency with regard to the management and operation of non-traded REITs, as well as misrepresentations and lack of disclosure of the risks affecting the investments, are problems noted by regulators.
- **Due Diligence** - Brokerage firms that sell non-traded REITs often fail to perform adequate due diligence, often relying on assertions by the promoters rather than conducting an independent investigation.
- **Conflicts** - Conflicts of interest involving transactions that affect non-traded REITs are common. Often times, transactions occur at inflated prices and involve inflated fees.
- **Lack of Due Diligence** - Non-traded REITs are generally sold to investors by independent broker-dealers. These broker-dealers are required to conduct (or have) adequate due diligence to understand the substance, features, risks and rewards of the non-traded REIT. They are also required to adequately train their brokers regarding the products so that the brokers can provide balanced disclosures to investors. Unfortunately, many broker-dealers fail to satisfy these obligations.



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