Unlisted, Registered REITs; an Investment Designed for Brokers

Unlisted, registered REITs (Real Estate Investment Trusts) deserve a worse reputation than they apparently have. Yield-seeking investors continue to plow cash into them, and the brokers that market them clearly won't let a bad idea get in the way of a commission. This is a curious animal; registered, meaning the security has to meet all the disclosure, reporting and other requirements of public securities, but not listed meaning there's limited or no liquidity. The registration feature no doubt gives comfort to the retail investor, but the absence of liquidity represents a substantial drawback.

You'd think that if you've gone to all the trouble of registering a security you'd want it to be publicly traded. However, these unlisted securities can charge underwriting fees of up to 15%, leading to an immediate 15% loss of value for the client. A public market quote that reveals this loss would be quite an inconvenience for the underwriter and issuer. Furthermore, the absence of a public market dissuades any sell-side research from covering the company, because there are no commissions to be earned on secondary trading activity. Inland American Realty is one such security, and in September Massachusetts announced a settlement with five brokers over improper sales of unlisted registered REITs including Inland American Realty. I wrote about this in June. Five firms, including Ameriprise, had been stuffing unwitting clients with a bad investment because of the high fees it generated. At least regulators are on the case. The Federal securities regulator, FINRA, also has a website that warns investors about this type of security. The warnings are out there. Why would any firm that truly puts its clients' interests first continue to push such poor investments?

Yesterday, I was at a conference and I picked up a brochure from one firm titled, “The Case For Investing in Non-Traded REITs”. Among the supposed advantages are, “Illiquidity that favors the long term investor.” Are they serious? How does illiquidity favor any kind of investor, short term or long term?? It favors the issuer, because there’s no public market to expose how poorly their securities are valued. Another related benefit is that they are, “Not subject to public market volatility.” But again, public markets allow you to exit your investment. It’s your choice, you can always decide to ignore the information public markets give you, but as with most information it’s better to have it than not.

If your broker markets unlisted, registered REITs, they’re not wholly focused on investment products that are designed with your best interests in mind. You should draw the appropriate conclusion.