WHITEPAPER

Know your Non-Traded REITs: An Insight into Non-Traded REITs and Their Evolution

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Driven by market pressures and regulatory changes, non-traded real estate investment trusts (non-traded REITs) have evolved over time to become more appealing to today's investors. Fund structures today offer greater efficiency and transparency while continuing to provide the benefits of indirect ownership in institutional-quality commercial real estate. This whitepaper will provide an overview of REITs of all types, focusing on non-traded REITs, how they have evolved, key features of today's product, the importance of technology-driven administration solutions and how innovations in analytics can be used to improve distribution.

What Is a REIT?

A REIT can be defined as a corporation that owns and manages a portfolio of real assets (e.g. commercial buildings or apartments) and real estate-related debt (e.g. mortgages).

In 1960, the REIT Act was passed by the U.S. Congress in an attempt to encourage small investors to participate in commercial real estate investments. Publicly-traded REITs are the type of REITs that the U.S. Congress envisioned under the 1960 Act. Public REITs are governed by the rules of the Securities and Exchange Commission (SEC) and are therefore subject to a significant amount of regulatory oversight.

Introduction of Non-Traded and Finite Life/ Closed-End REITs

Following the 1986 Tax Reform Act, several REIT simplification changes took effect. The changes made way for the initial non-traded REITs which were structured at a fixed share price (usually at $10 or $20 per share) for the duration of a continuous offering (usually two to three years) period. Finite life products (i.e. closed-ended funds) were also introduced, which are non-traded funds with a life of five to ten years (at which time they would seek a liquidity event).

The first non-traded finite life REITs were not hugely popular due to high upfront fee loads (generally a 7% selling commission and 3% dealer manager fees). In addition, the closed-end structure led to relative illiquidity, cycle-dependent life with arbitrary deadlines for exiting and other potentially limiting features that hampered net asset value (NAV) growth. In many ways they were "sold not bought" as a capillary network of brokers and financial advisors largely distributed the funds solely to retail investors as a means to add "core" real estate exposure to their investment portfolios. Furthermore, they were viewed as lacking in transparency and having dividend payout ratios not reflected in share values. All of the above, made way for an alternative product.

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Perpetual Life/Open-End Non-Traded REITs

Although they had their genesis in the early 2000s, the structure of the current-day, perpetual life (i.e. open-end) non-traded REITs became prevalent in 2017 in response to the market demand as discussed above. This current structure should not be confused with the REITs popular between 2009 and 2015.

Perpetual life non-traded REITs register their offering of common stock under the Securities Act of 1933, file SEC reports under the Securities Exchange Act of 1934, are not listed on any securities exchange or other trading platform and typically invest in a portfolio of direct real estate and real estate-related assets (including real estate securities) with low to moderate leverage.

Some of the more investor-friendly and institutional quality features of these non-traded REITs include:

- frequent and systematic valuations to establish and disclose NAV on a periodic (usually monthly) basis, leading to less volatility than with publicly traded REITs;
- enhanced opportunity for liquidity via regular redemptions at a time chosen by investors and at a specific NAV per share;
- open-end (indefinite-life) structure; and
- a streamlined management fee structure and lower and simpler selling fees, including no-load shares.

Many of the features of these new-style open-end non-traded REITs make them attractive for intermediaries like wire houses and registered investment advisors, which have not traditionally recommended non-traded REITs to their clients (mainly due to sales commission loads and illiquidity). The product is also attractive to broker-dealer networks that currently distribute non-traded REITs, including to their "for fee" and wrap account customers.

Key differences between the two types of non-traded REITs are summarized below:

Finite Life/Closed-End Non-Traded REIT	Perpetual Life/Open-End Non-Traded REIT
Fixed offering price	NAV per share (forward) pricing
Selling commissions: 7% to 10%	Selling commissions on load shares: 1% to 3.5%
Dealer manager charges (one-time): 2%-4%	0.50% to 0.70% annual trailing distribution fees
Advisory fees (trailing): • 0.75% to 1% annual base fee • 0.75% to 1% acquisition fee along with other real estate transaction-based fees • 15% of net gain on sale after 100% of capital returned plus 6%/yr cumulative return	Advisory fees (trailing): • 1.25% per annum of NAV, payable monthly • 12.5% of the annual total return, subject to a 5% annual hurdle amount and a high water mark
No practical liquidity until wind-down	Higher liquidity through redemption
Limited annual valuations	Monthly NAV per share (generally available within 15 calendar days of month end)
7 to 9 yrs closed-end (finite)	Open-end (perpetual)

Key Features of Today's Open-Ended Non-Traded REITs

(1) Different share classes with unique per-share NAV

Open-end non-traded REITs of today offer multiple classes of shares which are usually distinguished from each other by the value of the upfront selling fees and ongoing stockholder service fees.

	Class D	Class I	Class S	Class T
Upfront Selling Commissions	Up to 1.5%	None	Up to 3.5%	Up to 3.0%
Upfront Dealer Manager Fees	None	None	None	0.50%
Ongoing Stockholder Servicing Fee (per annum, payable monthly)	0.25%	None	0.85%	0.65% financial advisor 0.20% dealer
Purchase Availability	Through fee-based (wrap) programs, certain registered investment advisors, and other institutional and fiduciary accounts		Through brokerage and transaction-based accounts	

Most non-traded REITs will also cap their total upfront selling commissions, dealer manager fees and stockholder servicing fees at 8.75%. Upon reaching that limit, shares will automatically convert into Class I Shares with an equivalent NAV. When that happens, the non-traded REIT no longer pays the trailing commission, the broker no longer receives the trailing commission, and the investor is no longer subject to the trailing commission expense allocation.

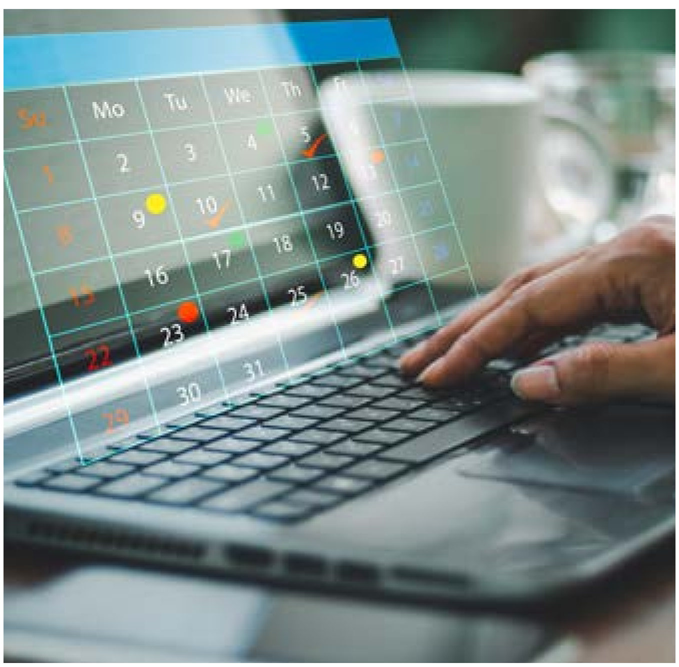
Additionally, shares with trailing commissions may also convert to a class with no trailing commissions if: the company lists its shares of common stock on a securities exchange for trading; the company is sold; or, if the FINRA limits on underwriting compensation with respect to the offering are reached. FINRA rules limit total underwriting compensation to 10% of the gross proceeds of the offering. For purposes of this rule, each Form S-11 registered offering by the non-traded REIT is considered a separate "offering" for which the underwriting compensation and gross proceeds must be monitored.

(2) Frequency of NAV and purchase dates

These non-traded REITs are typically structured such that its NAV is calculated on a monthly basis (generally within 15 calendar days after month end). This NAV calculation is important not only because it represents shareholder return for the period, but also is the valuation then used for raising new capital and for redeeming shares of existing holders. Frequency of the monthly NAV strike is based in part on the timing of valuations provided by independent third parties, which is often on a rolling basis where every asset is appraised on a rotating cycle.

Shares are available for purchase on each business day. Share purchase price of each class will typically be the prior month's NAV per share for such class as of the last calendar day of such month. The price will also include/be net of any applicable upfront selling fees (which typically vary by share class to suit different segments of the investor population).

Also investors can typically purchase pursuant to accepted subscription orders as of the first calendar day of each month. To be accepted, a subscription request must be received in good order at least five business days prior to the first calendar day of the month.



(3) Redemptions/liquidity

Redemptions typically take place on a monthly basis but can also be structured at a quarterly cadence. Most non-traded REITs also subject redemptions to short-term trading discounts (e.g., if the shares are held for less than a year, they will be redeemed at 95% of NAV per share).

There are differences in how redemptions are handled if the redemption limit is reached in the specified period:

- For some non-traded REITs, in the event that the redemption limit is reached during a period or if the fund decides to repurchase some but not all of the shares submitted for repurchase during the given period, shares submitted will be repurchased on a pro rata basis. All unsatisfied repurchase requests must then be resubmitted after the start of the next period.
- For other non-traded REITs, if net redemptions in a quarter reach the 5% limit, then proration is applied to open redemption requests on the day the limit is reached. In this instance, no other redemption requests for the rest of the calendar quarter are accepted and all shareholders have equal access to the following quarter's redemption pool. The fund may begin accepting redemption requests again on the first business day of the next quarter, but will apply the 5% quarterly limitation on redemptions on a per-shareholder basis, instead of a first-come, first-served, per-share basis. This is employed to dampen the risk of a "run-on-the-bank" scenario -- particularly where larger shareholders or shareholders acting on a group basis under the advice of investment advisors might cause pressure to build very quickly in the new cycle.

  In this "flow-regulated" system each shareholder is ensured the ability to redeem—at any time during the in-process quarter—an equal portion of its investment calculated as of the last business day of the preceding quarter. The per-shareholder limit remains in effect for the subsequent/following quarter if total net redemptions reach a certain threshold during the current quarter. In effect, the flow-regulating effect continues for so long as available liquidity remains constrained relative to demand for liquidity.

Many of these considerations and provisions are written into the fund prospectus and are thus clearly disclosed to potential investors.

Deep and thorough data on buying patterns and preferences can be used to more effectively target product buyers.

The Way Forward

Open-ended non-traded REITs come with some investor-friendly characteristics that have helped distinguish them from other traditional REITs, such as the potential for increased liquidity through regularly occurring redemptions, lower fees and varying share classes. However, non-traded REITs of all types are complex legal structures, and investors should approach them through a thoughtful and disciplined approach. In addition to risk/return factors, fund managers should evaluate the expertise and stability of operational support including accounting, investor servicing, transaction processing, compliance reporting, distribution support and the degree of automated connectivity across the broker-dealer universe. These become considerations for fund managers as well since the absence of strong and stable support can act as a red flag to investors.

In addition to building a talented team of subject matter experts, fund managers must also consider and manage the multiple, unique reporting requirements to which non-traded REITs are subject:

- Periodic NAV calculation and supporting work documentation
- Quarterly preparation of financial statements and supporting documentation
- Quarterly REIT compliance testing
- Preparation of quarterly board materials and meeting minutes
- Treasury management
- Transfer agency / investor services (depending on the type of non-traded REIT)

Fund managers can create operating advantage by choosing a trusted and experienced third-party administrator to assume the operational burden of tracking these complex investments, calculating incentive fees, striking a NAV, managing redemption requests and producing the detailed documentation needed for SEC-required reporting. In looking for an administrator, managers should consider whether the provider has a dedicated team of professionals with specific expertise along with the right technology to support the unique needs of REIT structures. Technology should be customized to the nuances of REITs, with automation that reduces processing risk

Data has become a differentiating factor. Not only can it provide fund management with valued insights into fund performance and liquidity needs, it can also be used to pinpoint distribution opportunities. Not all advisers sell all products, and many sales efforts are sub-optimal without a data-driven analysis of viable prospects by product type. Deep and through data on buying patterns and preferences can be used to more effectively target product buyers.

The SS&C Advantage

As the alternative space become more complex and investors and regulators develop increasingly sophisticated requirements, fund managers must keep pace with technology and innovation.

SS&C's private markets industry solutions unlock a manager's ability to achieve their goals efficiently by delivering an automated and transparent administration experience with high touch client service.

We are also the largest retail alternatives transfer agency provider, supporting 19 of the top 20 public program sponsors. We have long-standing, proven capabilities for retail alternative products of all types. Our online portals bring transparency into transaction processes for broker-dealers and advisors and simplify capital-raising for asset managers. Rich data sets and interactive platforms deliver distribution insights to help identify the best opportunities.

SS&C offers a seamless, end-to-end solution from fund accounting and administration down to the individual investor statement. We offer the scale needed to handle the volume and velocity of the marketplace. With the recent addition of Blue Prism to the SS&C roster, we are ramping up the introduction of robotics automation to support the growing volume of subscription and redemption activity across millions of current retail investors supported by SS&C within these products.

Further Reading

- https://www.goodwinlaw.com/en/insights/publications/2012/02/evolution-of-the-non-traded-reit-industry-and-the-benefits-of-perseverance
- https://www.sec.gov/oiea/investor-alerts-bulletins/ib_nontradedreits.html
- https://www.ssctech.com/blog/helping-to-prevent-a-liquidity-crisis-for-non-traded-reits-1
- https://www.ssctech.com/resources-insights/whitepapers/are-reits-the-right-fit-for-you