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Sales of nontraded REITS, other illiquid investments surge amid hunt for yield

Industry shakes off unflattering headlines of 2011, 2012 to set sales record

By Bruce Kelly | *July 31, 2013 - 2:54 pm EST*

Sales of nontraded real estate investment trusts and other illiquid securities known as "direct-participation programs" are roaring, according to the Investment Program Association, a trade group, and Robert A. Stanger & Co. Inc., an investment bank.

Equity capital flows to such illiquid securities, including nontraded REITs and nontraded business development companies, hit record levels in the first half of the year, totaling more than $10.7 billion, the highest half-year total for the industry. That's an increase of 65% compared with the year-earlier period.

The direct-participation industry typically sells $10 billion to $11 billion in products a year, almost exclusively through independent broker-dealers. That makes this year's tabulation of sale over the first six months of 2012 that more startling.

Stanger credits a significant part of the increase in fundraising to "recycling" of funds received from investors from other REITs that have had "liquidity events", such as selling portfolios or listing on an exchange.

About $3.6 billion of such liquidity event occurred in the second half of last year, and the pace accelerating to a staggering $11 billion in liquidity events this year, according Stanger.

The boom in sales in nontraded REITs comes after a series of unflattering headlines in 2011 and

2012 that highlighted REITs' struggles after the credit crisis. Some of the largest REITs have suffered sharp devaluations, wiping out billions of dollars in shareholder equity, and regulators have began a series of investigations in broker-dealers' sales practices regarding the products.

Nontraded REITs raised more than $8.5 billion in the first half of the year, while sales of nonlisted BDCs topped $2 billion.

And while investors have been pouring cash into these illiquid programs, that cash has been focused largely on two firms. According to Stanger, two broker-dealer managers, Realty Capital Securities LLC, an affiliate of American Realty Capital, and FS Capital Partners LLC raised more than half the equity capital in the industry. Through the end of June, Realty Capital Securities, which primarily distributes REITs, raised close to $4.5 billion, while FS Capital, which distributes BDCs, raised $1.3 billion.

“Investors in today's yield-starved environment are eager for sources of above-average income and for the portfolio diversification provided by investments in hard assets and smaller companies,” Kevin Hogan, chief executive of the IPA, said in a statement. “These external concerns will continue to underpin investment in the second half of 2013.”