BREIT Dividends:
Evidence of a Ponzi Scheme?

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*Preliminary. Please do not distribute.

Some have suggested that because the BREIT dividends are larger than their earnings (NOI), it is evidence of a Ponzi scheme. I disagree and this is why. Paying dividends greater than earnings (NOI) is not evidence of a ponzi scheme in and of itself. The earnings and dividend amounts are unrelated, or at least they don't need to be related, unless management wants them to be related. One way to think about it is if managers believe they have good investment opportunities, they will pay out less dividends than they earn (retained earnings). In contrast, if they believe they do not have enough +NPV investments to use all of the earnings or capital they have, they will distribute larger dividends than they have earnings. This makes sense especially with the BREIT. If they have a significant amount of capital that wants to come in the fund and they need time to invest it into illiquid assets, they will likely return it back to their investors in order to give themselves time to place it prudently.

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0.1 Dividend vs. Earnings Examples

Here are three examples to help illustrate how dividends could be different than earnings (NOI) and still give the investors the same monetary value. You will notice that when managers are returning dividends which are larger than earnings, in essence what they are doing is swapping fund ownership. They are decreasing the ownership (claims on future cash flows) of old investors and giving it to new investors. It should also be noted though that investors could maintain their current ownership simply by reinvesting the amount that the dividend is larger than the NOI back into the fund. I make extreme assumptions in magnitude of the NOI in order to make it easier to differentiate.

Assumptions: Let's assume the fund's assets (not including the NOI in this period) are worth $100M and there are 100,000 shares outstanding. Let's also assume the NOI for the period is $25M. This would make the total value of the assets worth $125M before dividends and each share worth $1,250 before any distribution. Let's also assume $50M wants to enter the fund. However, the share price isn't determined until after the dividend is paid, so they can determine share price at issuance. It will be based on the post dividend assets and post dividend number of shares.

There are three scenarios mathematically displayed below. You'll notice that the post dividend monetary value is the same in each scenario, $1,250 per share. As dividends increase, share values decrease, but the overall monetary value stays the same.

0.2 Ponzi Scheme

The reason this isn't a Ponzi scheme is that the share price decreases as the dividend amount increases. A Ponzi scheme would be one where investors believed their ownership (or claim on future cash flows) didn't decrease as dividends increased.

Table 1
Scenario Value Analysis

	A	B	C
Beginning Assets	$100,000,000	$100,000,000	$100,000,000
NOI	$25,000,000	$25,000,000	$25,000,000
Assets + NOI	$125,000,000	$125,000,000	$125,000,000
less dividend	$(0)	$(25,000,000)	$(50,000,000)
post dividend	$125,000,000	$100,000,000	$75,000,000
# of shares	100,000	100,000	100,000
price per share	$1,250	$1,000	$750
dividend per share	$0	$250	$500
Issuances	$50,000,000	$50,000,000	$50,000,000
	$40,000	$50,000	$66,667
Total Assets	$175,000,000	$150,000,000	$125,000,000
Total Shares	140,000	150,000	166,667
Price per share	$1,250	$1,000	$750
Dividend (original)	$0	$25,000,000	$50,000,000
Share Value (original)	$125,000,000	$100,000,000	$75,000,000
Total Value (original)	$125,000,000	$125,000,000	$125,000,000
Value per share (original)	$1,250	$1,250	$1,250

- Scenario #1: Manager pays no dividend

$$Assets_{a,t} = Real\ Estate\ Assets + NOI$$

$$Assets_{a,t} = \$100M + \$25M = \$125M$$

$$Original\ Shares_t = 100,000\ shares$$

$$Share\ Price_{a,t} = \frac{Assets_{a,t}}{Original\ Shares_t}$$

$$Share\ Price_{a,t} = \frac{\$125M}{100,000\ shares} = \$1,250\ per\ share$$

$$Share\ Price_{a,t} = \frac{Assets_{a,t}}{Original\ Shares_t}$$

$$Dividend_{b,t} = \$0M$$

$$Dividend\ per\ share_{b,t} = \frac{\$0M}{100,000\ shares} = \$0M\ per\ share$$

$$Assets_{b,t} = Real\ Estate\ Assets + NOI - Dividends$$

$$Assets_{b,t} = \$100M + \$25M - \$0M = \$125M$$

$$Share\ Price_{b,t} = \frac{Assets_{b,t}}{Original\ Shares_t}$$

$$Share\ Price_{b,t} = \frac{\$125M}{100,000\ shares} = \$1,250\ per\ share$$

$$New\ Shares_t = \frac{\$50M}{\$1,250\ per\ share} = 40,000\ shares$$

$$Total\ New\ Shares_t = Original\ Shares_t + New\ Shares_t$$

$$Total\ New\ Shares_t = 100,000\ shares + 40,000\ shares = 140,000\ shares$$

$$Assets_{c,t} = Real\ Estate\ Assets + NOI - Dividends + Issuances$$

$$Assets_{c,t} = \$100M + \$25M - \$0M + \$50M = \$175M$$

$$Share\ Price_{c,t} = \frac{\$175M}{140,000\ shares} = \$1,250\ per\ share$$

$$V_{i,t} = Share\ Price_{c,t} + Dividend\ per\ share_{b,t}$$

$$V_{i,t} = \$1,250\ per\ share + \$0M\ per\ share = \$1,250\ per\ share = Share\ Price_{a,t}$$

- <u>Scenario #2: Manager pays dividend equal to the NOI</u>

$$Assets_{a,t} = Real\ Estate\ Assets + NOI$$

$$Assets_{a,t} = \$100M + \$25M = \$125M$$

$$Original\ Shares_t = 100,000\ shares$$

$$Share\ Price_{a,t} = \frac{Assets_{a,t}}{Original\ Shares_t}$$

$$Share\ Price_{a,t} = \frac{\$125M}{100,000\ shares} = \$1,250\ per\ share$$

$$Share\ Price_{a,t} = \frac{Assets_{a,t}}{Original\ Shares_t}$$

$$Dividend_{b,t} = \$25M$$

$$Dividend\ per\ share_{b,t} = \frac{\$25M}{100,000\ shares} = \$250\ per\ share$$

$$Assets_{b,t} = Real\ Estate\ Assets + NOI - Dividends$$

$$Assets_{b,t} = \$100M + \$25M - \$25M = \$100M$$

$$Share\ Price_{b,t} = \frac{Assets_{b,t}}{Original\ Shares_t}$$

$$Share\ Price_{b,t} = \frac{\$100M}{100,000\ shares} = \$1,000\ per\ share$$

$$New\ Shares_t = \frac{\$50M}{\$1,000\ per\ share} = 50,000\ shares$$

$$Total\ New\ Shares_t = Original\ Shares_t + New\ Shares_t$$

$$Total\ New\ Shares_t = 100,000\ shares + 50,000\ shares = 150,000\ shares$$

$$Assets_{c,t} = Real\ Estate\ Assets + NOI - Dividends + Issuances$$

$$Assets_{c,t} = \$100M + \$25M - \$25M + \$50M = \$150M$$

$$Share\ Price_{c,t} = \frac{\$150M}{150,000\ shares} = \$1,000\ per\ share$$

$$V_{i,t} = Share\ Price_{c,t} + Dividend\ per\ share_{b,t}$$

$$V_{i,t} = \$1,000\ per\ share + \$250M\ per\ share = \$1,250\ per\ share = Share\ Price_{a,t}$$

- <u>Scenario #3: Manager pays dividend greater than the NOI (say \$50M)</u>

$$Assets_{a,t} = Real\ Estate\ Assets + NOI$$

$$Assets_{a,t} = \$100M + \$25M = \$125M$$

$$Original\ Shares_t = 100,000\ shares$$

$$Share\ Price_{a,t} = \frac{Assets_{a,t}}{Original\ Shares_t}$$

$$Share\ Price_{a,t} = \frac{\$125M}{100,000\ shares} = \$1,250\ per\ share$$

$$Share\ Price_{a,t} = \frac{Assets_{a,t}}{Original\ Shares_t}$$

$$Dividend_{b,t} = \$50M$$

$$Dividend\ per\ share_{b,t} = \frac{50M}{100,000\ shares} = \$500\ per\ share$$

$$Assets_{b,t} = Real\ Estate\ Assets + NOI - Dividends$$

$$Assets_{b,t} = \$100M + \$25M - \$50M = \$75M$$

$$Share\ Price_{b,t} = \frac{Assets_{b,t}}{Original\ Shares_t}$$

$$Share\ Price_{b,t} = \frac{\$75M}{100,000\ shares} = \$750\ per\ share$$

$$New\ Shares_t = \frac{\$50M}{\$750\ per\ share} = 66,667\ shares$$

$$Total\ New\ Shares_t = Original\ Shares_t + New\ Shares_t$$

$$Total\ New\ Shares_t = 100,000\ shares + 66,667\ shares = 166,667\ shares$$

$$Assets_{c,t} = Real\ Estate\ Assets + NOI - Dividends + Issuances$$

$$Assets_{c,t} = \$100M + \$25M - \$50M + \$50M = \$125M$$

$$Share\ Price_{c,t} = \frac{\$125M}{166,667\ shares} = \$750\ per\ share$$

$$V_{i,t} = Share\ PriV_t = P_t + D_tce_{c,t} + Dividend\ per\ share_{b,t}$$

$$V_{i,t} = \$750\ per\ share + \$500M\ per\ share = \$1,250\ per\ share = Share\ Price_{a,t}$$