

Investing in Commercial Real Estate: Understanding Non-traded REITs

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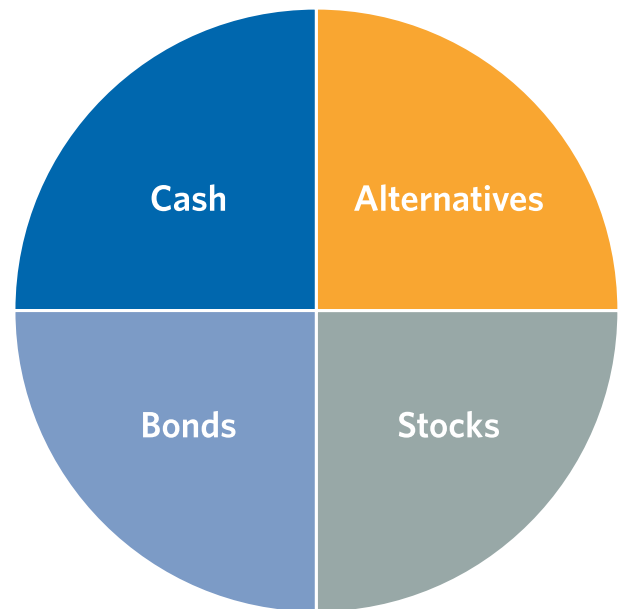
In addition to the traded options most investors are familiar with, institutions and the extremely wealthy have diversified their investment portfolios in search of returns from less liquid, alternative assets and investment strategies.

This is why high-net-worth individuals and large institutional investors like pension funds and university endowments have pursued investments in alternative assets typically unavailable to the average investor.

As markets have become more unpredictable, investors have also sought assets that are less correlated with the variations experienced with daily market prices. This has advanced an allocation model with four general investment options (refer to Figure 1):

- 1 **Traded stocks**, where a company issues securities representing ownership in a company.
- 2 **Bonds**, where a company borrows money from the investor for a specific time period at a fixed interest rate.
- 3 **Cash equivalents**, such as actual cash or assets that can be quickly converted into cash.
- 4 **Alternative investments**, such as real estate, commodities, hedge funds, private debt and private equity.

FIGURE 1. General Investment Options



The diagram is for illustrative purposes only. Asset classes can be allocated in varying amounts to help meet an individual's personal investment needs.

FOR INVESTOR USE

This information does not constitute a solicitation of an offer to sell and/or buy any specific security offering. Such an offering is made only by the applicable prospectus. A prospectus should be read carefully by an investor before investing. Investors are advised to consider investment objectives, risks, charges and expenses carefully before investing. There are no assurances an investment's stated objectives will be achieved.

COMMERCIAL REAL ESTATE AS AN INVESTMENT

Commercial real estate—or property that is used for business purposes—is one example of an alternative investment option. Examples of commercial real estate include malls, office and medical parks, senior housing communities, multifamily apartment buildings and restaurants (refer to Figure 2).

There are two main reasons why individual investors have expanded their investment universe to include real estate. First is the potential for rental income from properties leased to long-term tenants. In areas where construction is limited or property location is important, the demand for commercial properties on a multiyear-lease basis can be significant.

Second is the potential for investment growth. One of the most obvious growth opportunities is to buy a high-quality property that is undervalued due to economic conditions and sell it when markets improve in the future. But growth opportunities exist even in up markets. For example, a building in a prime location may require renovations or operational improvements to meet its potential or a business-critical property may be undervalued because real estate demand is focused elsewhere.

FIGURE 2. Examples of Business Use Properties



POTENTIAL BENEFITS TO INVESTING IN COMMERCIAL REAL ESTATE

Beyond income and growth, commercial real estate offers other investment benefits. Real estate:

May Offer Diversification

Investment in real estate may provide diversification into an asset outside the stock market that has low historical price correlation to traditional investments.

May Enhance Returns

Adding certain types of commercial real estate to an investment portfolio also may provide competitive returns in a long-term investment strategy.

May Mitigate Exposure to Rising Inflation

During historical periods of high inflation, hard assets such as real estate have generally performed well. Investors, for instance, have often looked to tangible and alternative investments when traditional assets are declining in value.

POTENTIAL RISKS TO INVESTING IN COMMERCIAL REAL ESTATE

Despite the potential benefits, direct ownership of commercial real estate comes with risks. These may include:

Less Liquidity

Selling commercial real estate may be complicated and time-consuming as a limited number of buyers and sellers exist at any given time.

Complex and Difficult Criteria

Economic, legal, regulatory and tax factors must be taken into account before investing, which may vary by market.

Real Estate Value Fluctuations

Like all investments, the values associated with commercial real estate can fluctuate up and down.

Cost Prohibition

Direct ownership can be expensive, up to millions of dollars for prime locations and properties.

Need for Active Management

Commercial real estate requires management of the buildings and leases, which can be labor-intensive.

Understanding these and other risks requires significant resources and knowledge. As with any investment, individuals should discuss their options with a Financial Advisor.

UNDERSTANDING REITs

While institutional investors have different investment goals and time horizons than retail investors, today's market offers options for retail investors seeking to add real estate to a portfolio. Traded options include traded real estate investment trusts (REITs) and real estate mutual funds, among others. Although traded real estate investment options offer higher liquidity to investors, they experience daily stock market volatility based on consumer sentiment.

There is an alternative, however, that provides retail investors access to commercial real estate outside the stock market—non-traded REITs. While these investments are less liquid than their traded counterparts, the REIT structure is aligned with the long-term nature of the real estate in which they invest. Non-traded REITs also seek to provide the diversification benefits that are frequently associated with commercial real estate.

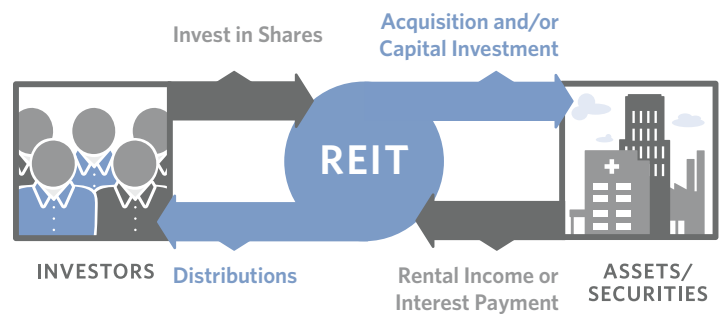
HOW REITs WORK

Figure 3 shows the basics of how a REIT works:

- 1 Investors purchase shares in the REIT. As capital is raised, the REIT builds an asset portfolio consistent with its investment strategy.
- 2 The REIT's management team oversees the property portfolio and may be involved with its day-to-day operations.
- 3 In the case of a non-traded REIT, the REIT completes the offering near the end of its cycle by either listing its shares on a public exchange or by liquidating its assets and distributing any available proceeds to investors.¹

It is important to understand that investing in commercial real estate is a long-term activity. As such, there might be liquidations at less than original amounts invested and sometimes illiquidity throughout the REIT's multiyear life cycle. However, this frees the REIT from some of the short-term pressures associated with the traded market, thus enabling the REIT's management team to focus on a long-term strategy.

FIGURE 3. How REITs Work



SUITABILITY STANDARDS AND OTHER RISKS

Non-traded REITs are not suitable to all investors. Suitability standards are extensive and generally require an investor to have a net worth of at least \$250,000, or a net worth of no less than \$70,000 and an annual gross income of \$70,000 or more.

In addition to limited liquidity and possible illiquidity, investments in non-traded real estate and REITs are subject to significant risks. These risks include limited operating histories, reliance on the advisors, conflicts of interests and payment of substantial fees to the advisors and their affiliates. Investing in these products is not suitable for all investors. A financial professional should determine whether risks associated with an investment in the shares are compatible with their client's investment objectives.

IN BRIEF

Individuals should discuss all investment options with their Financial Advisor—there may be room for traded and non-traded REITs in a portfolio depending on liquidity and diversification needs. Investors also should contact their Financial Advisor for additional information.

¹Liquidity events are not guaranteed and may be changed at the program management's discretion.

Financial Advisors are encouraged to visit www.CNLSecurities.com or contact CNL Securities, Managing Dealer, Member FINRA/SIPC at **(866) 650-0650**.

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