CNL Securities

Evaluating Non-Traded REITs

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A non-traded real estate investment trust's (REIT's) portfolio composition, advisor and management team, and financial performance can help individuals assess the potential of this asset class as an investment option.

Prior to investing in any offering, individuals should evaluate its potential as an investment opportunity. When it comes to non-traded REITs, investors should consider several factors to evaluate this potential. These include the REIT's portfolio composition, advisor and management team, and commonly used financial performance measures.

PORTFOLIO COMPOSITION

When examining a REIT's portfolio composition, it is important to assess the property's type, location, details and lease structure.

Portfolio Composition Characteristics

PROPERTY TYPE

- Does the REIT have a diversified portfolio, or is it invested in one asset class?

PROPERTY LOCATION

- Are properties in several regions or in a specific area? Are the markets healthy or experiencing turmoil?

PROPERTY DETAILS

- How many tenants lease a significant portion of the portfolio? Are properties fully leased?
- Is most of the portfolio invested in a single industry?

LEASE STRUCTURE

- Are properties managed or leased? If leased, are the leases short term or long term?

ADVISOR AND MANAGEMENT TEAM

The REIT's advisor and management team also can greatly influence its performance. Three important factors to consider are the team's overall strategy, expertise and track record.

STRATEGY

Given the uniqueness of different real estate markets, individuals should assess the skill with which the management team has analyzed the REIT's relevant market segment. For instance, does the current real estate market, does the economic landscape and do future expectations support investment in the REIT's asset types?

Advisor and Management Team Considerations

EXPERTISE

It is also important to assess the expertise of the advisor and management team. For example, does the management team have expertise in acquiring and managing assets in different geographies, commercial real estate segments and economic cycles?

TRACK RECORD

In addition, the advisor's and management team's track record merits careful attention. While past performance does not guarantee future results, questions to consider include:

- How many REITs has the management firm taken to full cycle?
- Has the management team managed REITs through all economic cycles?
- For full-cycle REITs, did investors receive their principal back and make income and/or capital gains?

FINANCIAL MEASURES

Finally, financial measures can be used to help assess a REIT's performance. Like all specialized sectors, the real estate industry has adopted standards for reporting on a non-traded REIT's performance. The two most common are *funds from operations* (FFO) and *modified funds from operations* (MFFO). Individuals also should consider the REIT's *net asset value* (NAV) and *distribution payout ratio.*

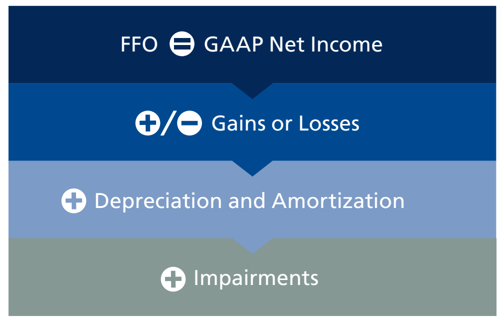
REITs also are required to comply with generally accepted accounting principles (GAAP) when filing financial statements. This provides consistency in the statements investors can use when analyzing a company's performance. Commonly used statements include cash flow from operations, the balance sheet and the income statement. Following is a description of frequently used industry standards and GAAP financial statements.

Commonly Used Real Estate Industry Measures

GAAP Financial Statements

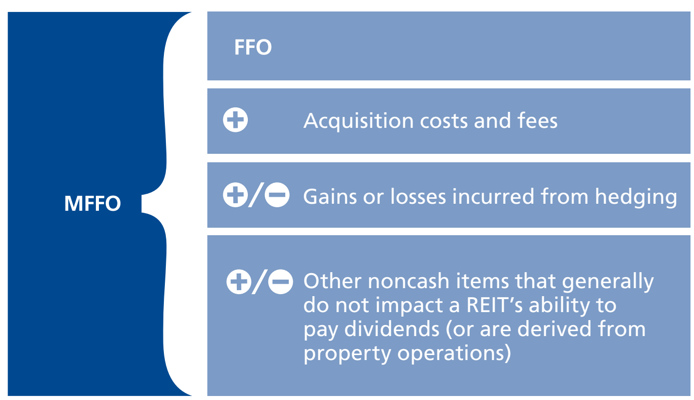
FUNDS FROM OPERATIONS

Regulations require depreciation and amortization to be recorded as expenses. Therefore, as a real estate portfolio grows, this expense becomes greater. However, real estate tends to appreciate more over time. Thus, expenses recorded due to depreciation and amortization may distort a company's earnings. To counter this, the National Association of Real Estate Investment Trusts, an industry trade group, created the FFO to measure a REIT's earnings, since it adds depreciation and amortization back into the net income.



MODIFIED FUNDS FROM OPERATIONS

Some REITs also use the MFFO as a performance measure. It is important to note that MFFO calculations are not yet standardized across firms and are often reported in different ways. Since this calculation is not universally recognized, it is advised you use this calculation in conjunction with other performance measures when evaluating a REIT. The MFFO is generally calculated as:



NET ASSET VALUE

Many firms also estimate a REIT's NAV periodically to provide updates on its per share valuation. The Investment Program Association, an industry trade group specializing in non-traded REITs, has developed guidelines to help standardize NAV valuations.

DISTRIBUTION PAYOUT RATIO

REITs calculate payout dividends as a percentage of cash flow from operations (explained below), FFO and/or MFFO for a given period. A healthy payout ratio is typically at or below 100 percent.[1]

CASH FLOW FROM OPERATIONS

Cash flow from operations refers to cash flow before any financial activities; it is the cash version of net income. However, while net income includes noncash costs (e.g., depreciation) and excludes other cash expenses (e.g., equipment purchases), cash flow adjusts income figures to a cash basis.

BALANCE SHEET

When looking at a REIT's balance sheet, it is important to compare data on a year-over-year or quarter-over-quarter basis. Examining the REIT's assets and liabilities is a good starting point. Individuals should note that the evaluation of assets and liabilities might be different for new versus more established REITs. Always refer to the REIT's latest filing for more information.

The Balance Sheet: Assets and Liabilities

Assets	Liabilities
• Total Assets	• Total Liabilities
• Cash	• Debt Ratio
	• Leverage Limits

INCOME STATEMENTS

Important information to glean from income statements includes total revenue, total expenses and net income.

Total Revenue
As with total assets, total revenue will likely rise every year or quarter during the capital raising phase of a non-traded REIT due to the increased number of properties held.

Total Expenses
Items to consider pertaining to total expenses include *property operating expenses* (i.e., property tax, insurance and maintenance costs); *general and administrative expenses* (i.e., accounting, audit, legal, personnel, tax and other professional service costs); *interest expenses* (i.e., the cost to service the interest portion of outstanding debt); and *miscellaneous expenses* (i.e., costs that do not fall in the other categories).

Net Income
Net income is calculated by subtracting total expenses from revenue. While this is a GAAP requirement, net income may inaccurately assess a REIT's operating results due to depreciation, as explained earlier.

IN BRIEF

A non-traded REIT's portfolio composition, advisor and management team, and financial performance can provide individuals with valuable information about its potential as a future investment. Investing in a non-traded REIT, however, may not be suitable for all investors. As a result, individuals need to carefully consider the factors that can impact the REIT's performance before making an investment decision. As with any asset class, individuals also should discuss all investment options and risk considerations with their financial representative.

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[1] "Cap Rate Spread: Leading Indicator for Non-Listed REIT Performance." *Seeking Alpha*, November 13, 2011, http://seekingalpha.com.

For additional educational materials on non-traded REITs, visit **CNLSecurities.com** or contact CNL Securities, managing dealer, member FINRA/SIPC, at **866-650-0650**.

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