CNL Securities

Investing in Commercial Real Estate: Understanding Non-Traded REITs

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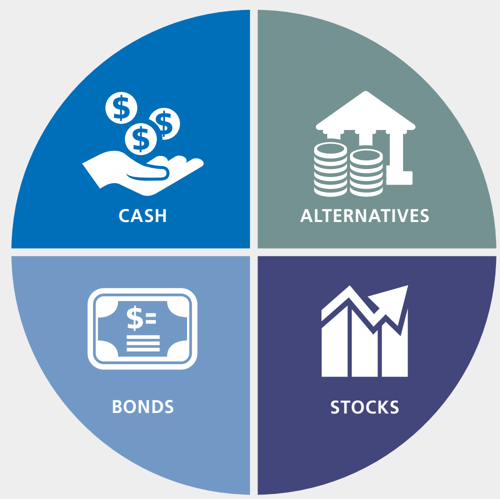
In addition to the traded options most investors are familiar with, institutions and the extremely wealthy have diversified their investment portfolios in search of returns from less liquid, alternative assets and investment strategies.

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, retail investor.

As markets have become more unpredictable, retail investors have sought assets that are less correlated with the daily price variations experienced in the stock market. 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



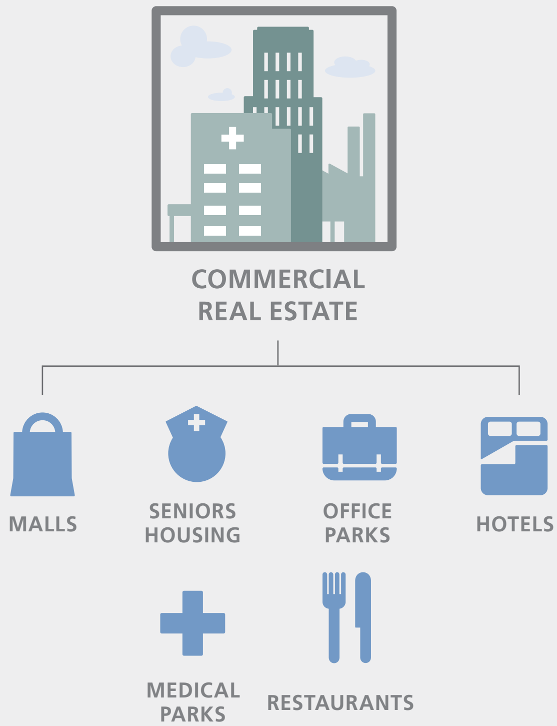
The diagram is for illustrative purposes only. Asset classes can be allocated in varying amounts to help meet an individual's personal investment needs.

It's important to note that institutions and high-net-worth investors have different investment goals than retail investors and often invest with different terms and conditions, particularly with regard to fees and expenses. Additionally, benefits and risks for each asset class should be considered prior to investing.

COMMERCIAL REAL ESTATE AS AN INVESTMENT

Commercial real estate — or a 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, seniors housing communities, hotels and restaurants (refer to Figure 2).

Figure 2.
Examples of Business Properties



There are two main reasons why retail investors have expanded their investment universe to include real estate. First is the potential for ongoing rental income from properties leased to creditworthy tenants. Well-located commercial properties in supply-constrained markets may provide future returns by attracting and retaining long-term tenants.

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. 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 full potential or a business-critical property may be undervalued, because real estate demand is focused elsewhere.

POTENTIAL BENEFITS OF INVESTING IN COMMERCIAL REAL ESTATE

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

- **Offer Diversification.** Investing in real estate may provide diversification into an asset class outside the stock market that has a low, historical price correlation to traditional investments, such as stocks and bonds.
- **Enhance Returns.** Adding commercial real estate to an investment portfolio may provide competitive returns in a long-term investment strategy.
- **Mitigate Exposure to Rising Inflation.** Hard assets such as real estate have generally performed well during periods of high inflation. This is one of the reasons why investors have often looked to more tangible, hard assets when traditional investments start to decline in value.

POTENTIAL RISKS OF INVESTING IN COMMERCIAL REAL ESTATE

Along with the potential benefits, direct ownership of commercial real estate comes with risks. These 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 Underwriting Criteria.** Economic, legal, regulatory and tax factors, which may vary by market, must be taken into account before investing.
- **Real Estate Value Fluctuations.** As with all investments, the values associated with commercial real estate can fluctuate.

TRADED AND NON-TRADED OPTIONS

Today's market offers options for retail investors seeking to add commercial real estate to their portfolios. Traded options include real estate mutual funds and traded real estate investment trusts (REITs), 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 that provides retail investors access to commercial real estate outside the stock market — non-traded REITs. Although 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's common stock offering. As capital is raised, the REIT acquires properties and 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. Rental income is collected from tenants, which the REIT passes along to investors in the form of distributions.

In the case of a non-traded REIT, the REIT ultimately seeks to provide liquidity to investors as it nears the end of its life cycle. This is done 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 note that investing in commercial real estate is a long-term activity. As such, there might be liquidations at less than the original amounts invested and 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.

SUITABILITY STANDARDS AND OTHER RISKS

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

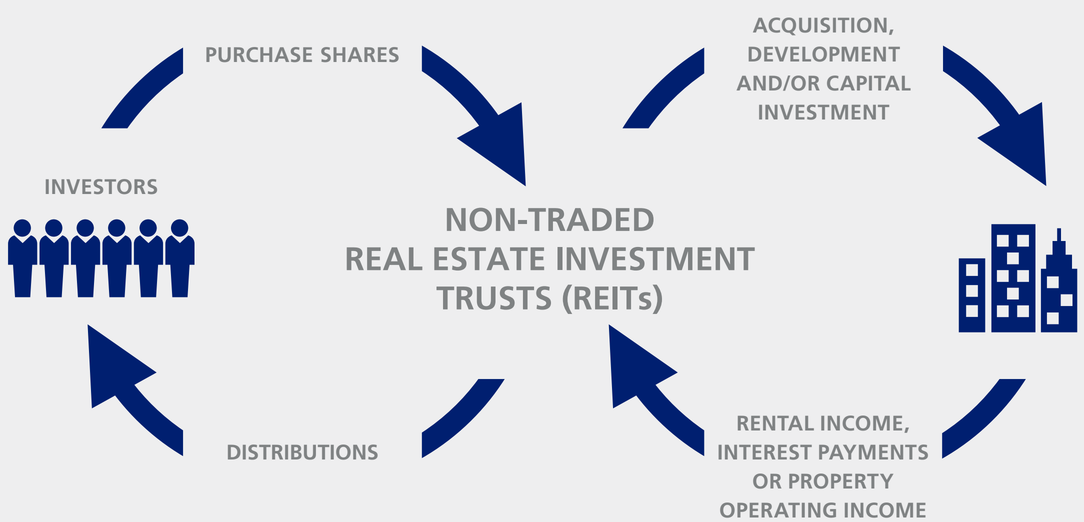
Besides limited liquidity and possible illiquidity, investments in non-traded REITs are subject to significant risks. These risks include limited operating histories, reliance on the advisors, conflicts of interest and payment of substantial fees to the advisors and their affiliates. An advisor should determine whether the risks associated with investing in a non-traded REIT 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 investments options in a portfolio depending on their liquidity and diversification needs. Detailed information about an investment, including its benefits and risks, can be found in the offering's prospectus.

CNL Healthcare Properties II is a non-traded REIT[2] that provides an opportunity for investors seeking income and growth for their portfolios. For more information about CNL Healthcare Properties II, please visit cnlhealthcarepropertiesii.com, or contact the managing dealer, CNL Securities, member FINRA/SIPC, at 866-650-0650. For additional information about real estate or non-traded REITs, visit cnlsecurities.com.

Figure 3.
Hypothetical Illustration of How Non-traded REITs Work



Non-traded REITs are complex and varied. Please read the REIT's prospectus carefully. In the early stages of a REIT, the investment typically exhibits greater risks which include: few or no properties, limited operating history, and having not yet elected or qualified as a REIT to obtain lower portfolio taxes to improve shareholder returns. Due to the high levels of investment costs and fees incurred with the REIT, early distributions will not be fully covered by cash flows from operating activities and will be paid from expense waivers, borrowings and offering proceeds. After the REIT has a couple of years operating history, the majority, if not all of the distributions should be covered by cash flow from operations. The REIT's limited redemptions and distributions are not guaranteed and subject to suspension, modification or termination by the REIT at any time. During the middle stages of the REIT's life cycle, leverage will typically increase and shareholders' votes are typically limited to a rare vote on major portfolio changes and members of the board of directors, as detailed in the prospectus and proxy. The REIT's management team and board of directors exercise independence over managing the portfolio's investments.

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

[2] CNL Healthcare Properties II intends to qualify and elect REIT tax status beginning with the first year in which it commences material operations, the taxable year ending Dec. 31, 2017, although there is no assurance the REIT tax status will occur within the stated time frame. If the company fails to meet the REIT qualification standards now or in the future, the company will be subject to increased taxes, which will decrease investors' returns.

RISK FACTORS

Investing in a non-traded REIT is a higher risk, longer term investment and is not suitable for all investors. Shares may lose value, or investors could lose their entire investment.

The REIT was recently organized and has a limited operating history on which investors may evaluate operations and prospects for the future. The REIT is a *blind pool* offering that is in the initial stages of property acquisitions and has made limited investments.

This is a best-efforts offering and if the REIT raises substantially less than the maximum offering amount, it may not be able to invest in a large variety of portfolio assets, which will subject investors to greater risk.

Non-traded REITs are illiquid. There is no public trading market for the shares. The REIT does not expect to offer a liquidity event in the near future and investors should be prepared to hold shares for an indefinite period of time. If investors are able to sell their shares, it would likely be at a substantial discount.

There are significant limitations on the redemption of investors' shares under the REIT's redemption plan. The REIT can determine not to redeem any shares or to redeem only a portion of the shares for which redemption is requested. In no event will more than five percent of the weighted average of all share classes of the outstanding shares be redeemed in any 12-month period. The REIT may modify, suspend or terminate the redemption plan at any time. Holding periods may be waived for qualifying events.

The REIT is obligated to pay substantial fees to its advisor, managing dealer, property manager and their respective affiliates for their services in managing the day-to-day operations of the REIT based upon agreements that have not been negotiated at arm's length, and some of which are payable based upon factors other than the quality of services. These fees could influence their advice and judgment in performing services. In addition, certain officers and directors of the advisor also serve as the REIT's officers and directors, as well as officers and directors of competing programs, resulting in conflicts of interest.

There is no guarantee of future distributions or that distributions will be paid at all. Due to the high levels of investment costs and fees incurred during the REIT's initial phase, distributions will not be fully covered by cash flows from operating activities and will be paid from expense waivers, borrowings and offering proceeds. For the year ended Dec. 31, 2017, approximately 30 percent of cash distributions were covered by operating cash flow and 70 percent were funded by offering proceeds. For the year ended Dec. 31, 2016, distributions were not covered by operating cash flow and were 100 percent funded by offering proceeds. Distributions paid from sources other than operating cash flow, now and in the future, are not sustainable, can reduce investors' overall return and may be dilutive.

The per-share amount of distributions on Class A, Class T and Class I shares will differ because of the timing of certain class-specific expenses. Specifically, distributions on Class T shares and Class I shares will be lower than distributions on Class A shares because the REIT is required to pay ongoing distribution and servicing fees with respect to the Class T shares and Class I shares. These fees are not applicable to Class A shares.

If the REIT fails to maintain its qualification as a REIT for any taxable year, it will be subject to federal income tax and net earnings available for investment or distributions will be reduced.

The use of leverage to acquire assets may hinder the REIT's ability to pay distributions and/or decrease the value of shareholders' investments.

There are significant risks associated with the seniors housing and healthcare sectors, including market risks impacting demand, competition from other entities, litigation risks and the cost of being responsive to changing government regulations. The REIT's success in these sectors is dependent, in part, on the ability to evaluate local conditions, identify appropriate opportunities and find qualified tenants or, where properties are acquired through a taxable REIT subsidiary, engage and retain qualified independent managers.

Read the prospectus, including the Risk Factors section, for full details.

GENERAL NOTICES

No offering is made to residents of New York, Maryland or any other state, except by a prospectus filed with the Department of Law of the state of New York, the Maryland Division of Securities or the respective state securities administrator. Neither the U.S. Securities and Exchange Commission, the attorney general of the state of New York, the Maryland Division of Securities nor any other state securities administrator has passed on or endorsed the merits of the REIT's offering or the adequacy or accuracy of this piece or the REIT's prospectus. Any representation to the contrary is unlawful.

This is not an offer to sell nor a solicitation of an offer to buy shares of the REIT. Only the prospectus makes such an offer. This piece must be read in conjunction with the prospectus in order to understand fully all the objectives, risks, charges and expenses associated with an investment and must not be relied upon to make a decision.

The information herein does not supplement or revise any information in the REIT's public filings. To the extent information herein conflicts with the prospectus, the information in the prospectus shall govern. The prospectus is available on sec.gov and cnlhealthcarepropertiesii.com.

Forward-looking statements are based on current expectations and may be identified by words such *as believes, expects, may, could*, and terms of similar substance and speak only as of the date made. Actual results could differ materially due to risks and uncertainties that are beyond the REIT's ability to control or accurately predict. Investors should not place undue reliance on forward-looking statements.

Managing dealer of CNL Healthcare Properties II is CNL Securities, member FINRA/SIPC. Shares are offered to the public through selling firms. Selling firms are reminded that the REIT's communications must be accompanied or preceded by a prospectus.

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CHPII-0518-00065-013-INV

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