Top Line Assessment of the Nontraded REIT Industry – 1st Quarter 2013

While some may believe the number "13" is unlucky, the year 2013 has been anything but that for the nontraded REIT industry. During the first three months of the year, nontraded REIT sponsors have raised $3.9 billion from investors, the second highest quarter for fundraising since 2Q 2007.

With the frantic pace of asset gathering comes the need to quickly invest those proceeds. However, the industry has been moving at a much slower pace compared to previous quarters as it relates to spending the cash on its balance sheet. Of the $87.2 billion in assets under management as of March 31, 2013, $5.1 billion was held in cash. In addition, acquisition volumes have been much lower compared to previous quarters as the industry purchased a total of $2.9 billion of commercial properties during 1Q 2013 compared to $3.2 billion purchased during 1Q 2012.

With the heavy volumes of capital flowing into the industry, no longer does it feel as though investors are uncertain about the future of commercial real estate. Proof of this euphoria can be measured in real results as full-cycle events have been on the rise and the talk of the industry for the past five months. With three deals valued at $6.58 billion having been completed during the first five months of the year and three more valued at $8.68 billion which are expected to be completed within the next 90 days, the industry continues to set new records.

Key Nontraded REIT Trends

- **Acquisitions** – Transactions for 1Q 2013 declined by 9.4% compared to 1Q 2012.
- **Dispositions** – Transactions increased significantly to $1.1 billion in 1Q 2013 compared to $0.3 billion in 1Q 2012.
- **Most Active REITs** – The five most active REITs acquiring properties were responsible for 48% of all transactions during 1Q 2013 while the five most active REITs disposing of properties during 1Q 2013 were responsible for 87% of all transactions.
- **Capital Raise** – Nontraded REITs raised $3.9 billion in 1Q 2013, up by roughly 50% compared to the $2.6 billion raised during 1Q 2012.
- **New Offerings** – Six new offerings have been introduced during the first five months of 2013. Only one out of six is managed by a "first-time" nontraded REIT sponsor.
- **Full-Cycle Events** – Three full-cycle events were completed during the first five months of 2013 with the most recent two events having been completed in May 2013.

This issue of the Nontraded REIT Industry Review will focus on the Hospitality sector and offer detailed commentary for nine out of twelve REITs that focus primarily on purchasing lodging properties. In addition, a discussion of the full-cycle events completed by Chambers Street Properties and Apple REIT Six, Inc. can be found at the back at the report.

Capital Market Overview

Continuing the trend that began during the first quarter of 2012, new capital raising records continue to be set primarily due to the recycling of proceeds coming from the listing and liquidation of closed nontraded REITs and the need among individual investors to purchase investments with above-average distribution yields. This trend is expected to continue throughout 2013 as current forecasts indicate sales for the year could surpass the high of $11.7 billion set back in 2007. In fact, as of May 2013, the industry is on pace to raise $12 billion or more in investor proceeds by year-end. Of important note, the top-5 fundraising REITs were responsible for 65% of all funds raised during the quarter and included:

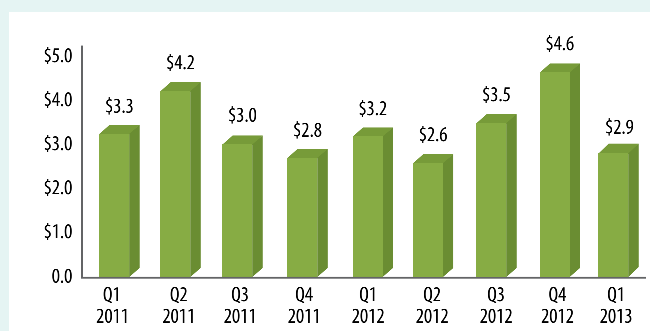
1.	American Realty Capital Trust IV, Inc.	$1,392.4 million
2.	American Realty Capital Healthcare Trust, Inc.	$585.7 million
3.	Griffin-American Healthcare REIT II, Inc.	$208.6 million
4.	Industrial Income Trust	$196.3 million
5.	Hines Global REIT, Inc.	$190.5 million

As capital raise has increased, total assets for the industry have also grown by 11.8% to $87.2 billion as of 1Q 2013 compared to $78.0 billion as of 1Q 2012. This figure is expected to fluctuate dramatically throughout the next several quarters as closed REITs complete full-cycle events and new effective REITs seek to maintain historical levels through capital raising, debt and acquisitions.

Acquisitions

While it is typical for acquisition volumes to decline at the beginning of a new year, the volume of new properties purchased during the first three months of 2013 was unseasonably low with 32 nontraded REITs out of a total of 73 purchasing $2.9 billion worth of commercial properties compared to $3.2 billion purchased during 1Q 2012.

Nontraded REIT Real Property Acquisitions by Quarter
as of March 31, 2013 (in $ Billions)



The five most active nontraded REITs in terms of acquisitions during 1Q 2013 were:

1.	Hines Global REIT, Inc.	$ 646.4 million
2.	KBS Real Estate Investment Trust II, Inc.	$239.0 million
3.	Cole Credit Property Trust IV, Inc.	$185.4 million
4.	Phillips Edison - ARC Shopping Center REIT, Inc.	$161.1 million
5.	American Realty Capital Trust IV, Inc.	$149.3 million

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Notable acquisitions that occurred during 1Q 2013 include:

- KBS Real Estate Investment Trust II, Inc. acquired an office campus consisting of eight office buildings totaling 610,083 rentable square feet located in San Jose, California ("Corporate Technology Centre") for a total purchase price of $239.0 million.
- Hines Global REIT, Inc. acquired Riverside Center, an office complex containing 509,702 rentable square feet located in a suburb of Boston, Massachusetts, for $197.3 million.
- KBS Real Estate Investment Trust III, Inc. acquired an office property containing 609,368 rentable square feet of office space and 68,677 rentable square feet of retail space in Minneapolis, Minnesota for a total purchase price of $124.0 million.
- American Realty Capital New York Recovery REIT, Inc. purchased an office building located at 216-18 West 18th Street in the Chelsea neighborhood of Manhattan for a total purchase price of $112.0 million.
- KBS Strategic Opportunity REIT, Inc. acquired three office properties containing a total of 517,974 rentable square feet located in Austin, Texas (the Austin Suburban Portfolio) for a total purchase price of $76.0 million.

Dispositions

The increase in the number of nontraded REITs moving into the Maturing and Liquidating LifeStages over the past twelve months is the key driver behind the large increases in both the number and volume of commercial properties being sold in 1Q 2013. By definition, nontraded REITs in the Maturing and Liquidating LifeStages are focused on refining their portfolios through dispositions in order to improve their metrics for listing and/or positioning the portfolio for sale.

The five most active nontraded REITs in terms of dispositions during 1Q 2013 were:

1.	Hines Real Estate Investment Trust, Inc.	$455.2 million
2.	KBS Real Estate Investment Trust, Inc.	$278.9 million
3.	Inland American Real Estate Trust, Inc.	$115.3 million
4.	Behringer Harvard Real Estate Investment Trust, Inc.	$78.9 million
5.	Cole Credit Property Trust III, Inc.	$55.2 million

Notable dispositions that occurred during 1Q 2013 include:

- KBS Real Estate Investment Trust, Inc. sold 40 of the PB Capital Properties for an aggregate purchase price of $240.9 million.
- Behringer Harvard REIT I, Inc. sold its 5 & 15 Wayside property for a contract sales price of $69.3 million.
- Inland American Real Estate Trust, Inc. sold a 27-property retail portfolio for a total of $50.8 million.
- Hines Real Estate Investment Trust, Inc. sold its 50% interest in Distribution Park Rio in Rio de Janeiro, Brazil for net proceeds of $43.2 million.
- Landmark Apartment Trust of America, Inc. sold a 350-unit multifamily property for $38.2 million.

Hospitality Sector Overview

Making a decision to invest in a Hospitality property is not just about buying a property, it is also about making a decision to buy and manage an operating business. This is in large part due to the fact that revenue and expenses are driven by a broad range of categories that go beyond the standard components found within the rest of the commercial real estate world. As a result, Hospitality properties derive income not only from the rooms they rent each night, but also from food and beverage, resort operations, parking, conventions and other sources. Furthermore, the ability to manage operators and franchise relationships coupled with effective cost management, strong new business generation and market pricing savvy, are key strengths of superior owners and operators.

Due to its unique place in real estate investing, the Hospitality sector has its own vocabulary to describe its operations and property sub-segments. Listed below is a brief glossary of Hospitality related terms:

- **Hotel** – distinguished by its access to rooms and amenities from a main lobby, generally in multi-story properties.
- **Full Service** – a complete level of service from food and beverage, concierge, busboys, business centers, workout rooms and conference facilities.
- **Extended Stay** – designed with mini kitchens and sometimes, small living areas, for guests who lease rooms for large blocks of nights.
- **Limited Service** – without many of the amenities and services of a full service hotel.
- **Select Service** – providing certain services to meet specific needs of clientele.
- **Motel** – have an entrance to a room on the outside of the property, usually in close proximity to parking.
- **Resort** – a destination hotel with vacation amenities including skiing, beach, golf, spa, etc.
- **ADR** – Average Daily Rate – The average room rate per night charged across the entire hotel.
- **Occupancy** – percentage of the number of hotel rooms occupied per night.
- **RevPAR** – Revenue per Available Room – total room revenue divided by the average number of available rooms (some rooms may be offline for maintenance or upgrades).
- **Expenses** – range from staff (housecleaning, front desk, maintenance, food and beverage, etc.) to utilities, real estate taxes, insurance and department related costs, especially in food and beverage areas.
- **Franchise** – also called flag or brand – the name of the hotel chain that provides room marketing, promotion and reservation services in return for a fee and/or percentage of the room revenue.
- **Operator** – the management company who runs the business of the hotel. Can be the owner of the hotel or a third party company.
- **Seasonality** – the tendency of hotel occupancy and room rates to fluctuate depending upon demand in different seasons of the year. This will vary by property location and type.
- **Key** – industry slang for hotel room.
- **Lodging** – same thing as Hospitality.

The Hospitality sector has continued to experience an improvement in fundamentals since 2Q 2010. As the number of business and vacation travelers has continued to increase over the past four years, so has room revenue and department revenue. According to data from Smith Travel Research, the U.S. hotel industry reported an Average Daily Rate (ADR) increase of 4.3% as of year-end 2012 versus 3.7% as of year-end 2011 for the upper upscale chain segment of the hospitality sector. Moreover, forecasts for 2013 indicate stability and a continued increase throughout the year.

In addition, per recent data from PKF Hospitality Research, Revenue per Available Room (RevPAR) is expected to increase by 6.0% and national occupancy rates are expected to increase to 62.1% by the end of 2013. While this level may be slightly below the pre-recession peak of 63.1%, the firm notes that this increase surpasses the long-run average occupancy level of 61.9%. Taking a more detailed look at occupancy levels, luxury, upper-upscale and upscale chain segments within the hospitality sector are projected to have occupancy rates of 70% or more through 2016.

As of March 31, 2013, there were twelve nontraded REITs offered by seven sponsors that either concentrate solely in the Hospitality sector or had significant investments in the sector. A total of $8.5 billion of hospitality assets were under management as of 1Q 2013 in 410 properties with 57,847 rooms. Participants include the Apple family of REITs, Carey Watermark, Moody National, Inland American, Behringer Harvard Opportunity REIT II, Lightstone Value Plus REIT I and II and CNL Lifestyle. Premium content for all of these companies has been included in this quarter's report except for CNL Lifestyle which was discussed in the 4Q 2012 report and Inland American which will be reviewed in the upcoming 2Q 2013 report focusing on the Retail sector.

Of special note is the merger of Apple REIT Six, Inc. with BRE Select Hotels, an affiliate of Blackstone Real Estate Partners VII which occurred on May 14, 2013. The transaction value totaled approximately $1.1 billion. Additional details surrounding this transaction can also be found in this report on the page entitled "Full-Cycle Events Post March 31, 2013."

Based on a recent article written by Jones Lang Lasalle Hotels and Hospitality Group, it is expected that there will be a significant amount of property coming to market in 2013 due to the deleverage of CMBS loans. On a global scale, deal volume is expected to reach $33 billion over the next twelve months with the United States accounting for half of this deal activity. As it relates specifically to the nontraded REIT industry during the first quarter of 2013, those REITs that invest in hospitality properties have accounted for $237.4 million of acquisitions and only $8.3 million worth of hospitality property dispositions.

Notable Hospitality Transactions in 2012

- Inland American Real Estate Trust, Inc. acquired seven hospitality properties totaling 2,624 rooms for $525.1 million ($200,114/key), and sold 13 properties for $147.5 million.
- Carey Watermark Investors, Inc. purchased four properties totaling 1,120 rooms for $168.4 million ($150,357/key).
- Apple REIT Ten, Inc. completed $61.9 million ($106,357/key) in acquisitions.
- Apple REIT Nine, Inc. completed $16.7 million ($140,000/key) in 2012 acquisitions and sold 406 acres of land for $198.4 million.
- Lightstone Value Plus Real Estate Investment Trust I, Inc. purchased four properties for $30.9 million ($70,227/key).
- Lightstone Value Plus Real Estate Investment Trust II, Inc. purchased two properties for $16.7 million ($54,590/key).

Hospitality REIT Acquisitions in 1Q 2013

1. Carey Watermark Investors, Inc. acquired six properties for $124.5 million ($162,565/key).
2. Apple REIT Ten, Inc. purchased three properties for $54.5 million ($112,320/key).
3. Inland American Real Estate Trust, Inc. purchased the Andaz San Diego full service hotel for $53.0 million ($333,333/key).

Valuation Guidelines and Calculating Net Asset Values

As it relates to preparing estimated net asset values (NAVs), it is the goal of investors, broker/dealers and sponsors alike to have a transparent value that is not only consistent in its calculation but is also a reliable benchmark for measuring performance. Until recently however, the methodologies used by nontraded REIT sponsors to create NAVs varied greatly. As a result, on April 25, 2013, the IPA (Investment Program Association) issued voluntary guidelines for nontraded REIT sponsors to follow when calculating NAVs. While a complete overview of the *"IPA Practice Guideline 2013-01 Valuation of Publicly Registered Non-Listed REITs"* can be found at: www.ipa.com/guidelines/estimated-share-valuation-practice, below is a high-level overview of the recommended methodology according to those guidelines.

The IPA encourages each nontraded REIT to disclose detailed information in its SEC filings about the process used for estimating NAVs including the third-parties involved, the assumptions used and a tabular presentation of the current NAV estimate and the prior year's estimate for the components of NAV. Furthermore, as it relates to frequency, based on the nontraded REIT's offering status, the IPA recommends that these valuations be performed as follows:

i. Nontraded REITs conducting public offerings: the first valuation should be done at the earlier of (i) the commencement of a follow-on offering; or (ii) within 150 days of the end of the calendar month in which the first offering closes

ii. Existing Nontraded REITs not conducting public offerings: no later than December 12, 2013

iii. New Nontraded REITs: the first valuations disclosed no later than the earlier of: (i) the commencement of the follow-on offering, or (ii) within 150 days of the end of the month in which the initial offering closes, but in no event later than two years plus 150 days after breaking escrow

In addition, the "as-of" dates should be no more than 45 days before the date of disclosure (e.g. for a December 31 "as-of" date, no later than a February 14 announcement.) Once valuations commence, the IPA recommends that they be produced at least annually thereafter as of December 31 and disclosed as soon as possible after year end.

The IPA Guidelines also recommend that the board of directors for every nontraded REIT establish a committee of independent directors to perform the following functions:

i. Approve the engagement of one or more third-party valuation experts,

ii. Review and approve the proposed valuation process and methodology, consistent with real estate industry standards and the reasonableness of the assumptions utilized,

iii. Review the reasonableness of the valuation or range of values resulting from the process, and

iv. Recommend the final proposed valuation for approval by the board of directors.

In determining a REIT's NAV, the SEC looks to the accounting profession's standards as developed by the Financial Accounting Standards Board (FASB) for reporting standards to be followed by U.S. corporations. These Generally Accepted Accounting Principles (GAAP) have traditionally relied upon historical costs or "book values" for reporting assets and liabilities. In recent years, the trend has been toward "fair value" financial reporting. The fair values of the assets and liabilities on a REIT's balance sheet will differ from the book values that reflect only the historical costs of assets (less depreciation and amortization), and the original obligations of liabilities (less principal repaid).

Fair value is defined as: *the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.*

The FASB recently issued a proposal that would require investment property entities such as nontraded REITs to measure real estate investment properties at *fair value* if substantially all of their business activities relate to investing in real estate for total return including capital appreciation. *(ASC 820, Fair Value Measurements and Disclosures).* In simple terms, the REIT's properties are valued at what they could be sold for in a competitive market, and its liabilities are valued using current market interest rates for equivalent debt obligations.

The fair value of real estate is determined on the basis of a discounted cash flow approach, which includes future rental receipts, expenses, and residual values as the highest and best use of the real estate as rental property.

As stated in its guidelines, the IPA "believes that a valuation metric using GAAP as its foundational standard is a broadly recognized and accepted standard of valuation and performance measurement in the real estate industry." As a result, their methodology recommends the following four step process:

Step #1: Determination of the Gross Asset Value:

- Establish the fair value of wholly owned individual real properties using third party valuation experts (e.g. appraisers) consistent with ASC 820.
- Allocate the nontraded REIT's share of the fair value of assets and liabilities in joint ventures and non-wholly owned subsidiaries using the fair values of their assets less liabilities according to the agreements that allocate the economic interests between the parties.
- Establish the fair values of any other tangible assets (e.g. cash, receivables, prepaid expenses) that are not included in the fair values of real estate, but excluding intangible assets.

Step #2: Determination of Liabilities

- Use GAAP book value for current liabilities when it approximates fair value.
- Use "mark-to-market" for debt maturing in one year or more.
- For minority interests, use the proportion of fair value of assets less liabilities of the joint venture based upon provisions in the joint venture agreement.

Step #3: Preferred Securities, Special Interests and Incentive Fee Adjustments

- Calculate and deduct any NAV allocable to preferred securities.
- Deduct any estimated incentive fees, participations or special interests of sponsors, advisors, management or general partners based upon aggregate NAV of company and hypothetical liquidation of the company as of the valuation date in accordance with the relevant agreements.

Step #4: Determine the Per Share Amount

Divide the resulting aggregate NAV of the nontraded REIT allocable to common shareholders by the number of common shares outstanding (fully diluted).

''Daily NAV'' Nontraded REIT Products and Valuations

The publishing of NAVs for "Daily NAV" nontraded REITs that have been introduced in the last several years does not necessarily imply that the share prices are determined by more frequent appraisals. These REITs will comply with IPA and FINRA by utilizing third-party valuation firms to periodically appraise their real estate portfolios, but the daily adjustments to share price will be calculated based upon observable changes in such variables as lease terms, marked-to-market debt obligations and portfolio acquisitions and dispositions. The daily NAV's are designed more to give the REIT flexibility in the pricing of issuances and redemptions and the shareholders the "look and feel" of a listed REIT share.

Blue Vault Partners Perspective

Estimated share valuations and interim valuations are important tools for advisors and investors as it offers them an opportunity to revisit their original asset allocation strategy and can also serve as a checkup on a non-traded REITs performance until it is listed on an exchange or liquidated. We applaud the industry for its focus on defining best-practices and creating a standard protocol for all to follow as we believe it is critical for improved transparency, awareness and more mainstream acceptance of this investment vehicle.