Top Line Assessment of the Nontraded REIT Industry – 3rd Quarter 2013

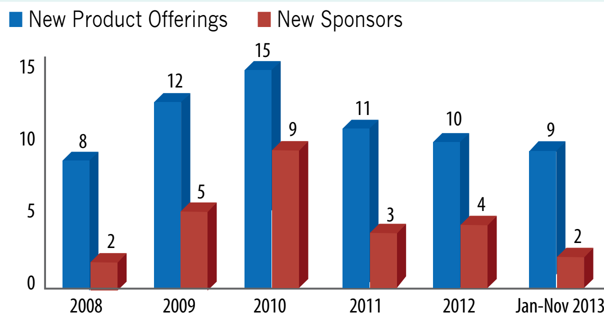
Throughout 2013, the nontraded REIT industry has continued to set records in terms of the number of full-cycle events that have been completed and the record levels of new capital that have been raised. For example, new capital received from investors during the first nine months of 2013 totaled $15.3 billion, more than the total capital raised in all of 2009 and 2010 combined. With seven full-cycle events having been completed through November 2013, no doubt there are funds being "recycled" by investors from liquidating REITs into effective REITs, but the full extent of that source of funds is difficult to measure.

As these are significant milestones for the industry, intuitively one might assume that this means the industry is experiencing a period of growth. However, key indicators signal a market that is currently experiencing a period of contraction as we note declining trends in terms of total assets under management, the number of nontraded REIT sponsors, and the number of new offerings being declared effective.

The charts and details below are intended to provide further insight:

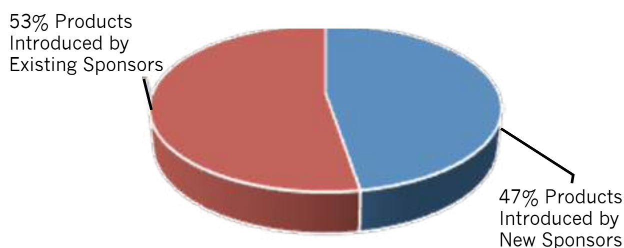
1. Between 2009 and 2011, the industry experienced significant growth in terms of the number of new entrants and offerings. The primary reason for this was the limited ability of REIT managers to get easy access to credit and capital as they had done during the previous five to six years.

Total New Product Offerings and New Sponsors by Year
2008 through November 30, 2013



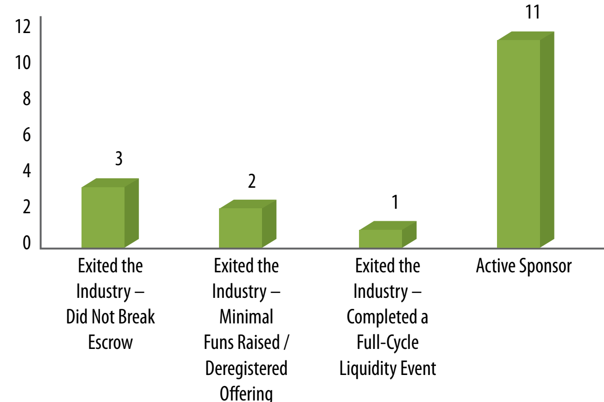
2. As it relates to the 38 offerings that were introduced into the market between 2009 and 2011, 53% of the new offerings were sponsored by existing managers and 47% were sponsored by new entrants seeking alternative means to new capital.

New Offerings Between 2009 - 2011
New vs. Existing Product Sponsors



3. Of the 17 new sponsors that introduced new offerings between 2009 and 2011, as of the end of 2013, only 11 remain. Additionally, for the first time we are seeing an increase in consolidation among the sponsors themselves as nontraded REITs are merging. This consolidation is also a milestone for the industry as never before has there been a merger between two industry leaders like what we will see once the announced merger has been completed between Cole Real Estate Investments and American Realty Capital Properties.

New Sponsors Between 2009 – 2011:
Status as of November 2013



4. As a result of the $15.8 billion in liquidity events that have taken place to date, total industry assets are expected to decline back to 2010 levels by early 2014.

Total Nontraded REIT Industry Assets:
2008 – 2014 (in $ Billions)

Additional Nontraded REIT Market Trends of Note:

- **Acquisitions** – Transactions for 3Q 2013 totaled $7.9 billion, 68% greater compared to 2Q 2013 and roughly $4.4 billion more than 3Q 2012.
- **Dispositions** – Real property sales by nontraded REITs totaled $2.2 billion in 3Q 2013, a 53% increase from the $1.5 billion sold in 2Q 2013.
- **Most Active REITs** – The five most active REITs acquiring properties were responsible for $3.7 billion of real property purchases representing 47% of all transactions that occurred during 3Q 2013. The five most active REITs disposing of properties during 3Q 2013 were responsible for 92% of all transactions.

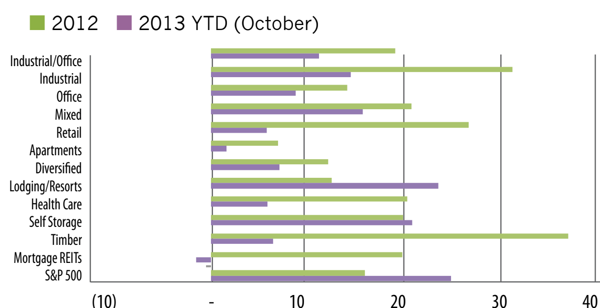
- **Capital Raise** – Nontraded REITs raised $6.5 billion in 3Q 2013, up by roughly 33% compared to the $4.9 billion raised during 2Q 2013 and an increase of 124% compared to 3Q 2012.
- **New Offerings** – Nine new offerings have been introduced through November 2013 with two out of the nine being managed by "first-time" nontraded REIT sponsors.
- **Full-Cycle Events** – Seven full-cycle events totaling $15.8 billion in equity were completed during the first 11 months of 2013 with two having been acquired by a third-party entity and five having listed directly on a national stock exchange.

This issue of the Nontraded REIT Industry Review will focus on the multifamily sector and offers detailed commentary for eight REITs that focus primarily on apartment properties. In addition, a discussion of the full-cycle event completed by Columbia Property Trust, Inc. can be found at the back at the report.

Capital Market Overview

Looking at the performance of the broader REIT industry, in general publicly traded REITs have seen a moderation of returns in most sectors compared to the robust results in 2012. According to NAREIT, the only two sectors that have not experienced lower returns between January and October 2013 are Lodging/Resorts and Self Storage. The most notable drops in year-to-date returns have been in the Mortgage REIT, Retail, Industrial and Healthcare sectors.

Investment Performance by Sector
FTSE NAREIT Indices and S&P 500



Source: NAREIT

In addition, the capital markets have been largely preoccupied during 3Q 2013 with the potential impacts of changes in the level of Federal Reserve asset purchases which have kept bond yields at historically low levels. The U.S. central bank currently buys $85 billion of Treasuries and mortgage-backed securities each month to keep downward pressure on borrowing costs. Policy makers have pledged interest rates will stay at almost zero while the outlook for inflation is no higher than 2.5% and unemployment remains above 6.5%. The jobless rate was at 7.2% in October and inflation was estimated at 1.2%. As the outgoing Fed Chairman Ben Bernanke says, "We need a stronger, more rapidly moving economy." Investors are hungry for yield-generating investments, which continue to favor sectors such as nontraded REITs with above-average yields.

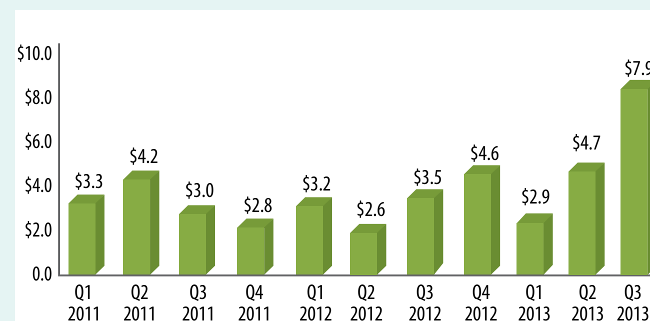
The REIT industry has been impacted by the compression of capitalization rates, creating an environment of low yields, and making attractive acquisitions more difficult to find. As the economy continues its slow recovery, eventual increases in interest rates combined with low capitalization rates may squeeze returns for those nontraded REITs that are currently in the acquisition phase, but allow for more use of leverage while the low rates last. Debt capital appears to be available as CMBS loans totaled $56.6 billion year-to-date and could total about $80 billion in 2013, 30% more than was expected as 2013 began.

Nontraded REIT Acquisitions

As a result of the significant capital raise, nontraded REIT commercial property acquisition volumes have also broken new records. As noted in the chart below, nontraded REITs (both open and closed) purchased approximately $7.9 billion of commercial real estate properties during the three months ending September 30, 2013. This represents a 68% increase over the prior quarter and a 126% increase over 3Q 2012.

In addition, year to date transaction activity has also increased significantly with real property purchases through September 30, 2013 totaling $15.5 billion compared to $9.3 billion purchased during the first nine months of 2012.

Nontraded REIT Real Property Acquisitions by Quarter
as of September 30, 2013 (in $ Billions)



Similar to the previous quarter, during 3Q 2013, 37 nontraded REITs were active in acquisitions with the top five REITs being responsible for roughly 47% of all real property acquisitions during this period.

The five most active nontraded REITs in terms of acquisitions during 3Q 2013 were:

1.	American Realty Capital Trust IV, Inc.	$1,020.8 million
2.	American Realty Capital Trust V, Inc.	$ 893.9 million
3.	Griffin-American Healthcare REIT II, Inc.	$ 671.9 million
4.	Inland American Real Estate Trust, Inc.	$ 597.6 million
5.	American Realty Capital Healthcare Trust, Inc.	$ 536.5 million

Nontraded REIT Dispositions

Due to the increase in the number of nontraded REITs transitioning into the Maturing and Liquidating LifeStages during the first nine months of the year, we continue to see large increases in both the number and volume of commercial properties being sold. During the third quarter, there were 12 REITs that were actively disposing of $2.2 billion worth of commercial properties. The top five represented 92% of the total volume in terms of dollars.

The five nontraded REITs representing 92% of the total volume in terms of dollars during 3Q 2013 were:

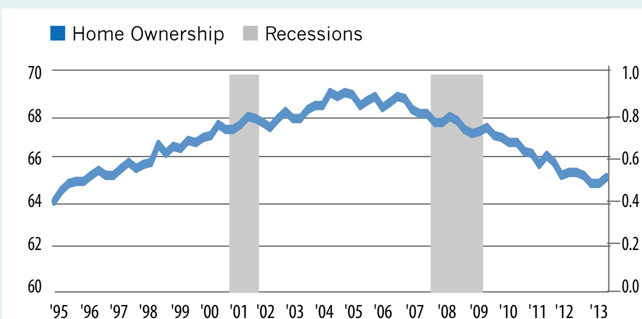
1.	Inland American Real Estate Trust, Inc.	$1,095.1 million
2.	Hines Real Estate Investment Trust, Inc.	$ 550.0 million
3.	CNL Lifestyle Properties, Inc.	$ 195.4 million
4.	Dividend Capital Diversified Property Fund, Inc.	$ 129.1 million
5.	TIER REIT, Inc.	$ 86.5 million

Multifamily Sector – Commercial Market Fundamentals

The multifamily sector is impacted by changes in demand which are in turn driven by both broader economic trends and the changing demographic makeup of the U.S. households most likely to rent apartments. On the supply side, construction has remained at a sustainable level. Additionally, as mortgage rates have risen, there has also been a slight uptick in the number of new construction permits for multifamily properties signaling some optimism by developers that the demand for apartments will continue to remain strong.

Household formation in the U.S year-to-date at 380,000 has been well below historical averages of 1.1 million. With the decline in homeownership rates to 65.1% in 3Q 2013, the lowest rate since 1995, one would expect demand for apartments to be strong. Vacancy rates for rental units actually rose 0.1% in 3Q 2013 to 8.3%, but are down 0.3% for the year, and well below the peak of 11.1% in 2009. Average rent per unit continues trending upward to $736.

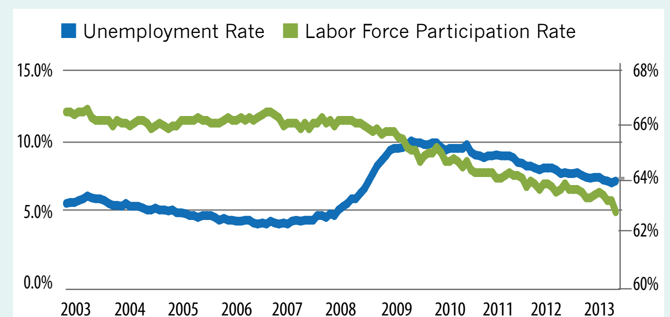
Unemployment and Labor Participation



Source: U.S. Census Bureau

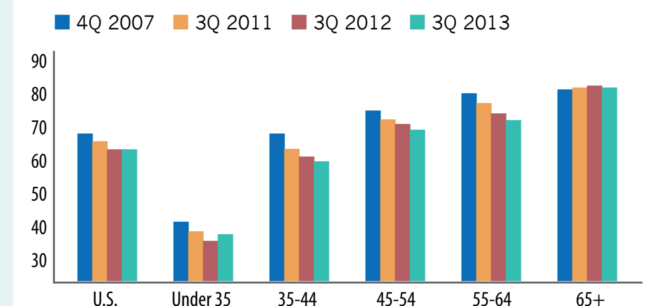
However, economic headwinds persist, with unemployment still high this late into a recovery at 7.2%, and disturbingly, the lowest labor market participation rate in decades. When viewed together, one could easily conclude that the lower unemployment figures are largely due to lower labor market participation. Demographics are also playing a role, as the share of millennials (young adults in the prime renting age group, roughly under age 35) living with their parents rose from 31.4% in 3Q 2012 to 31.6% in 3Q 2013. The home ownership rates among the under-35 age group do continue to decline, and this age group is most likely to rent in urban environments, in core markets.

Unemployment and Labor Participation



Source: U.S. Bureau of Labor Statistics

U.S. Homeownership
by Age Group



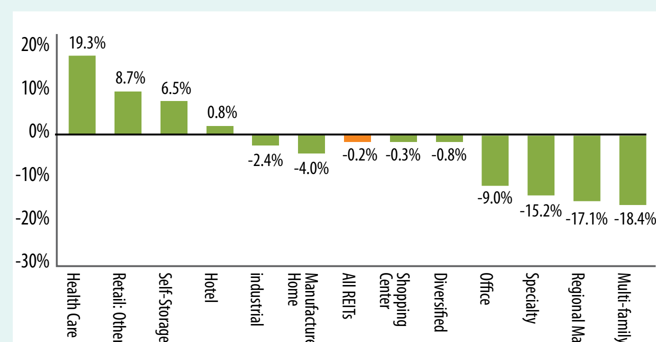
Source: U.S. Census Bureau

Investors in apartment properties are observing a plateauing of prices, with average cap rates in the top markets continuing to sit around 5.5% according to RCA. The volume of multifamily sales has sagged in a number of core markets, with a pickup in secondary markets, which is a normal step in the process of real estate recovery. Investors are also beginning to build new properties, with the purchase of developable land up by almost a third from a year ago at this time, according to RCA, with the majority of the planned developments in multifamily construction. We may be seeing a transition from "a robust acquisition market to a robust development market," according to Byron Carlock, Jr. of PricewaterhouseCoopers.

Cyclical Nature of the Apartment Sector

From an investment perspective, multifamily REIT shares are selling at a steep discount to NAV, according to consensus estimates compiled by SNL. This may be the result of cyclical trends in commercial real estate generally, as multifamily REITS were the first to rebound after the recession, and are now being discounted as investor interest shifts to sectors which recovered later or which have higher growth prospects at this stage of the recovery.

Mean Premium (Discount) to NAV



Source: SNL

Multifamily Sector – Nontraded REIT Overview

Of the 71 nontraded REITs analyzed in this quarter's report, eight had significant investments in multifamily properties. Combined, these companies own 217 properties and represent 8.0% of the nontraded REIT market in terms of assets under management. Additionally, these eight companies acquired a total of $793.6 million worth of properties during 3Q 2013.

	REIT	Total Assets	Number of Properties Owned	Number of Units Owned	Value of Properties Purchased During 3Q 2013
1.	Behringer Harvard Multifamily REIT, Inc.	$ 2,670.6	56	9,040	$ 0.0
2.	Bluerock Residential Multifamily Trust, Inc.	$ 167.9	6	1,252	$ 0.0
3.	KBS Legacy Partners Apartment REIT, Inc.	$ 375.1	9	2,599	$ 0.0
4.	Landmark Apartment Trust of America, Inc.	$ 1,360.3	59	16,928	$ 355.2
5.	Paladin Realty Income Properties, Inc.	$ 200.7	13	2,673	$ 0.0
6.	Resource Real Estate Opportunity REIT	$ 381.8	21	6,115	$ 105.3
7.	Steadfast Income REIT, Inc.	$ 1,145.7	51	12,189	$ 331.0
8.	United Realty Trust, Inc.	$ 27.0	2	139	$ 2.1

As it relates to the industry consolidation trend discussed earlier, in late July Resource Real Estate Opportunity REIT agreed to acquire all of the outstanding units of the Paladin Realty Income Properties operating partnership for $52.7 million. On September 17, 2013, the merger consideration was reduced to $51.2 million. Paladin Realty Income Properties, Inc., will be making a liquidating distribution of cash to its stockholders in an amount expected to be between $7.20 and $7.40 per share, assuming the deal closes by December 31, 2013. The total shares affected will be 7.721 million. Shareholders will not receive any ownership interest in Resource. Paladin will dissolve following the payment of the liquidating distribution.

Additional points of interest for this sector of nontraded REITs include:

- Collectively, total acquisitions made by these multifamily nontraded REITs during the first nine months of 2013 represented 9.1% of all property purchases made by nontraded REITs during this time period.
- The top two acquirers of multifamily properties during the first nine months of 2013 were Landmark Apartment Trust of America, Inc. with a total of $596.7 million in acquisitions and Steadfast Income REIT, Inc. with $548.1 million in acquisitions. Collectively, these two companies were responsible for 78% of all multifamily property purchases made by nontraded REITs during this period.
- The most active seller of multifamily properties during the first nine months of 2013 was Behringer Harvard Multifamily REIT, Inc. with $211.9 million in total dispositions. This REIT was also responsible for 72% of all multifamily property dispositions made by nontraded REITs during this period.

BlueVault PARTNERS, LLC

LifeStage Classification Overview

Nontraded REITs have a unique life cycle based upon their method of raising capital, acquiring assets, paying distributions, and, ultimately, creating a liquidity event and returning capital to investors. Blue Vault introduced the LifeStages™ classification and ranking system in 2010 in order to provide the industry with a better set of definitions to compare the operations of nontraded REITs.

Two distinct phases are present for a nontraded REIT, its "effective," capital raise phase and its "closed" phase, when it no longer accepts new investments.

Effective REITs: Emerging LifeStage

Total Assets	Total Years from Initial Public Offering Launch	Number of Properties	Geographic Diversification
$0 – $100 Million	0 to 2	0 – 5	Highly limited

Characteristics	Debt Profile
Slow ramp-up of capital raise and start of acquisitions	Highly restrictive and higher cost — bridge financing

The number of new offerings in the nontraded REIT industry has declined over the past three years. One of the biggest barriers to entry for launching a new offering is raising capital for a blind pool of assets. Sponsors have been creative in meeting this challenge by adopting several different operational tactics. However, there are consistent attributes that mark the first 24-36 months of a nontraded REIT's life. The Emerging LifeStage is marked by the following:

- Effectiveness – the origination of the REIT, effectiveness declaration by the SEC and subsequent regulatory approval by the States.
- Breaking Escrow – usually set at $2 million, it is the level of capital raise required to begin investing activities and is sometimes a threshold level to commence capital raise in some states.
- Distributions – typically declared by the board of directors upon breaking escrow during the quarter or month prior to which they will be paid.
- Acquisitions – initial properties are typically purchased upon breaking escrow and when sufficient capital has been raised.

According to Blue Vault's quantitative analysis, there were 16 nontraded Emerging LifeStage REITs at the end of the third quarter. As noted in the table above, these REITs are relatively new to the market, with small portfolio sizes and widely varying metrics. The Emerging LifeStage shows particular traits and issues including:

- Distribution rates are typically much higher than the REITs' ability to pay from operational cash flow.
- Portfolios are typically blind pools so the majority of REITs in this LifeStage do not have assets under management to evaluate.
- The REIT experiences uneven capital raise flow and lumpy acquisition volume.
- Many metrics are also difficult to calculate during this LifeStage due to limited operational data and often result in "Not Meaningful" or "Not Applicable" operating ratios.

How effective nontraded REITs are at handling the issues noted above can determine how quickly it evolves into a more effective operating entity and experiences greater success in raising capital. Once an Emerging LifeStage REIT has begun to show some steadiness in its operations and has reached approximately $100 million in assets, it moves to the next LifeStage known as "Growth".

Growth LifeStage

Total Assets	Total Years from Initial Public Offering Launch	Number of Properties	Geographic Diversification
$100 Million – $1 Billion	1 to 4	5 – 20	Coalescing

Characteristics	Debt Profile
Acceleration of both capital raise and acquisitions	Introduction of lines of credit and debt pools

The nontraded REITs that have survived the Emerging LifeStage have accomplished a major objective: steadily increasing capital raising. To have continued success, sponsors must now begin to turn their attention to acquisitions and stabilizing the operating metrics of the REIT. On average, Growth LifeStage REITs have been capital raising for 12 -24 months and have assets of $50 - $500 million with between 5 and 20 properties.

The Growth LifeStage is marked by the following:

- Distributions – many nontraded REITs increase their distribution levels during this LifeStage to reflect the impact of recent acquisitions and improved cash flow from operations.
- Acquisitions – generally begin increasing in pace and dollar size as portfolio assets under management grow.
- Metrics – while still erratic, steady improvement in ratios are seen as the REIT increases in asset size.

There are currently 8 nontraded REITs categorized as Growth Stage. As can be seen in the LifeStage charts at the beginning of this publication, these REITs have matured somewhat when compared to Emerging REITS but are still relatively young, with smaller portfolio sizes and, improving yet, widely varying metrics.

The Growth LifeStage shows particular traits and issues including:

- Distribution rate still higher than ability to pay from operational cash flow however, as the REIT ages in the LifeStage, coverage metrics show improvement.
- Declining distribution deficits as the REITs grow in size and stability.
- Steadily increasing rate of capital raise flow and acquisition volume.
- Operating Ratios that are becoming meaningful and trending toward better performance.
- Fluctuating debt ratios and cash to total assets ratios until capital raise and acquisition volumes move more into synch..

A sponsor's greatest challenge in the Growth LifeStage is the management of incoming cash from capital raising with the long and lumpy acquisition cycle to add assets. Capital must be amassed in order to close properties, even when utilizing debt. Distributions must be paid on that amassed capital whether or not a property has been acquired yet to provide cash flow from operations. Distribution deficits continue to mount as a result.

Sophisticated sponsors have been able to utilize acquisition lines of credit and structured transactions to attempt to keep the acquisition pace ahead of capital raising. In doing so, debt ratios can become much higher than seen in Closed REITs. The advantage to investors and the sponsors, is that the acquisition pace can be slowed somewhat, to allow for the outstanding debt levels to be reduced, bringing debt and interest coverage ratios more in line.

When a Growth LifeStage REIT has begun to demonstrate stability and predictability in its operations and has reached approximately $500 million or greater in assets, it moves to the next Effective LifeStage, Stabilization.

Stabilizing LifeStage

Total Assets	Total Years from Initial Public Offering Launch	Number of Properties	Geographic Diversification
$500 Million – $1 Billion+	3 to 6	30+	Balanced

Characteristics	Debt Profile
Distinct formation of REIT personality	Beginning refinement and balance between fixed- and variable-rate debt

The final stage within the Effective Phase of a nontraded REIT is the Stabilizing LifeStage. Nontraded REITs in this LifeStage have demonstrated the ability to grow successfully and maintain significant capital raising levels. Some REITs in this LifeStage are completing follow-on offerings that have allowed them to grow to substantial levels of assets under management. Therefore, the asset size range of this LifeStage is broad, generally $500 million to $5 billion. Stabilizing LifeStage REITs typically raise capital for at least 24 months or more and own between 20 and 100+ properties and are also marked by the following:

- Formation of a Personality – in the earlier LifeStages, REIT's investment philosophy can appear disjointed due to the limited number of assets. As they grow, the investment strategy should become evident through new acquisitions, which define focus in property type, geography, credit and other measures.
- Continued Acquisitions – with increasing capital raise, acquisition pace should increase, especially if the REIT is able to obtain larger lines of credit and more attractive financing options.
- Metrics – the widely variable results shown in earlier LifeStages should begin to subside resulting in greater stability and more healthy metrics.

Stabilizing LifeStage REITs have also developed into substantial funds which have allowed them to show substantial improvement in operating metrics and diversification, especially when compared to Emerging REITs. There are currently 12 nontraded REITs categorized as Stabilizing with particular traits and issues including:

- Distribution rate moving in line (either up or down) with ability to pay from operational cash flow.
- The elimination of distribution deficits.
- Steadily increasing rate of capital raise flow and acquisition volume especially as the REIT approaches the end of its capital raise period.
- More advantageous debt structures and lower costs.
- More defined diversification with targeted acquisitions and dispositions to refine imbalances.
- Operating ratios that are trending toward better performance and stabilization.
- The addition of a follow-on offering or extension of the initial offering may occur depending on capital raise pace.
- Use of joint ventures and other sophisticated acquisition/ownership structures that demonstrate the power of the platform.

At the end of capital raising, a Stabilizing LifeStage REIT will transfer from Effective to Closed and move into the Maturing LifeStage.

Maturing LifeStage Overview

Total Assets	Total Years from Initial Public Offering Launch	Number of Properties	Geographic Diversification
Usually greater than $500 Million	4 to 8	30+	Balanced

Characteristics	Debt Profile
Refinement of portfolio through dispositions, targeted acquisitions, and debt policy	An increasingly sophisticated use of fixed-and variable-rate debt; portfolio and one-off executions; secured and unsecured, as well as senior debt and bonds with lower overall costs and rates

Once a nontraded REIT becomes closed to new investments, the REIT moves into the Maturing LifeStage. While some new capital may still be added to the REIT through Distribution Reinvestment Programs, active capital raising has ended. The asset size range of this LifeStage ranges from $500 million to over $2 billion with the median number of properties owned being 30 or more.

The Maturing LifeStage is characterized by the following:

- Refinement of the Portfolio – portfolio pruning that began in the Stabilizing LifeStage becomes more deliberate as the REIT moves toward a defined investment strategy through active dispositions and selective acquisitions.
- Metrics – Operating results move closer to their publicly traded counterparts with steady, predictable metrics.
- Valuation – Upon closing to new investments, assets must be valued within 18 months with several REITs accelerating their initial valuations to meet market demand for more transparency.

As a result of the large number of REITs that were introduced in 2010, there are currently 26 nontraded REITs categorized as Maturing LifeStage that show particular traits and issues including:

- The distribution rate moves in line (either up or down) with the REIT's ability to pay from operational cash flow as measured by FFO or MFFO.
- No distribution deficits.
- Moderate acquisitions to fill missing gaps in the REIT's investment strategy.
- More advantageous debt structures and lower costs.
- Targeted, and sometimes substantial, dispositions to refine the portfolio and meet investment objectives.
- Operating ratios that are trending toward those of publicly traded REITs.
- Obtaining a credit rating on the portfolio to allow for public debt executions.

REITs move from the Maturing LifeStage to the Liquidating LifeStage once the REIT announces a definitive plan for a liquidity event via a sale or merger or becomes a self-managed entity which signals that the REIT is preparing to potentially list its shares on a national stock exchange.

BlueVault PARTNERS, LLC

Liquidating LifeStage Overview

Total Assets	Total Years from Initial Public Offering Launch	Number of Properties	Geographic Diversification
Usually greater than $500 Million	7+	30+	Refined

Characteristics	Debt Profile
Positioning for sale or listing on public exchange	An increasingly sophisticated use of fixed-and variable-rate debt; portfolio and one-off executions; secured and unsecured, as well as senior debt and bonds with lower overall costs and rates

After a nontraded REIT has completed the Maturing LifeStage and positioned its portfolio to meet its investment strategy, the REIT enters the final Lifestage in which it either liquidates its assets or lists on a public exchange. REITs moving into this LifeStage have typically spent six to 36 months in the Maturing LifeStage preparing for the sale of assets or listing on a national securities exchange. Nontraded REITs have been moving the time frames for both capital raising and closed LifeStages to shorter periods accelerating the movement to liquidity for investors.

The asset size range of this LifeStage is broad, generally $500 million to $10+ billion with 50+ properties in their portfolios. The Liquidating LifeStage is also characterized by the following:

- Selection of Strategy – while generally referred to as "list or liquidate", nontraded REITs can also create a full-cycle event by merging with another entity.
- Identification of Investment Banker – either late in the Maturing LifeStage or at the beginning of the Liquidating LifeStage, an investment banker is generally selected to assist the Board of Directors by identifying the exit strategy that is most beneficial for shareholders.

Because Liquidating LifeStage REITs are at the end of their nontraded lifecycle, the Board of Directors and Sponsor are primarily focused on pursuing exit strategies that will maximize value to shareholders. 2011 and 2012 have seen a record number of full-cycle events and this trend is expected to continue into 2014 as seven nontraded REITs are currently categorized as Liquidating. Additional, these REITs show particular traits and issues including:

- Metrics that mirror those of their publicly-traded counterparts.
- Refined capital market strategies with only selected acquisitions and dispositions.
- Obtaining a credit rating on the portfolio and placement of public debt, especially if a REIT is going to list its stock on an exchange.
- Offering of IPO shares as part of the listing strategy to ensure institutional ownership.
- Staggered share liquidation provisions for existing investors to prevent a "run on the bank" sale of shares that would negatively impact the remaining investors.
- Portfolio sale of some or all assets.
- Merger with another REIT that may be either an affiliate of the Sponsor or an unaffiliated third-party.
- Refinement of the Board of Directors, if listing, to add expertise and gravitas to satisfy the public markets.

As detailed in the 2013 Blue Vault Partners/University of Texas full-cycle performance study, nontraded REITs have exhibited returns slightly lower than their public and private benchmarks but with less volatility in returns over time. Blue Vault will be updating its study again in 2014 in order to incorporate recently announced full cycle events as well as to compare returns of investors who redeemed shares prior to full-cycle events to those who received liquidity as a result of the full-cycle event, measure the effects of certain real estate sectors and cycles on ultimate performance, and examine the impact of adding nontraded REITs to a blended portfolio of stocks and bonds over the past ten years.