Blue Vault Brief:

2012 Year in Review

February 28, 2013

Introduction and Historical Overview

While the fiscal cliff was avoided by Congressional actions on the last day of 2012, uncertainty remains within the U.S. economy driven by concerns regarding Federal debt limits, the rate of growth of entitlements, the costs of PPACA (Obamacare) implementation, the impact of payroll tax increases on consumer spending, and the budget compromises necessary to avoid sequestration, scheduled to hit on March 1. But amidst this uncertainty, the nontraded REIT industry exhibited positive signs of growth as capital raise exceeded 2011 levels, the industry welcomed several new institutional players into the market, and the number of full-cycle events grew significantly compared to previous years.

Key Highlights for 2012

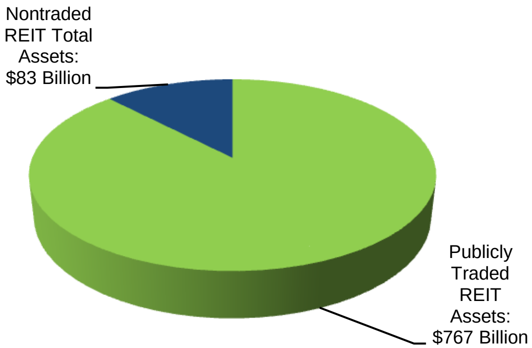
- Assets under management remained relatively flat at an estimated $83 billion due to the full-cycle events that took place during the year.
- 10 new offerings became effective during the year.
- Early estimates indicate that the industry raised $10.5 billion in new capital.
- Four full-cycle events took place in 2012, following only one in 2011. Three full-cycle events have already been announced and are anticipated to close in 2013.
- The top-5 sponsors raised 60% of all new capital in 2012.
- Real property purchases in 2012 were $13.9 billion, up slightly from $13.3 billion in 2011.

Historical Offering Overview

The first known public nontraded REIT was created in 1990, approximately thirty years after Congress passed the REIT Act. Since that time, the nontraded REIT segment has grown significantly as a percentage of all public REITs. As of December 2012, the public REIT market totaled $850 billion in real estate assets and consisted of 243 REITs of which 71 (or 30%) were categorized as "nontraded" REITs.

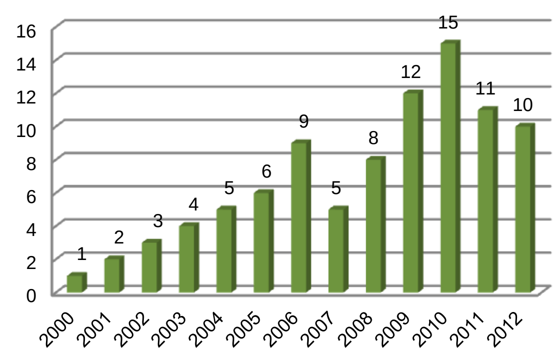
While REITs that are traded on a major stock exchange are more well-known among investors and have historically been the most popular way to purchase real estate securities, as the chart to the right illustrates, the nontraded REIT market has gained in popularity over the past decade as there have been a total of 91[1] nontraded REIT product offerings declared effective by the SEC since 2000. Of this total, roughly 53% have been introduced within the past four years.

Total Pubic REIT Market Size: $850 Billion* as of December 31, 2012



*NAREIT, *REIT Watch, December 2012*

New Nontraded REIT Offerings by Year



[1] Includes REIT offerings that are currently fundraising, closed to new investments, or that experienced a full-cycle event between January 1, 2000 and December 31, 2012.

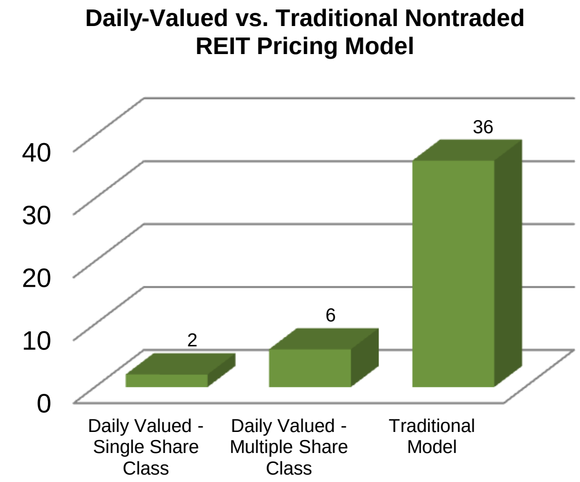
2012 Trends & Highlights

Offering Innovations

When compared to publicly traded REITs, nontraded REITs are consistently criticized for their limited liquidity and their inability to regularly price shares. But in 2011 and throughout 2012, the industry began responding to this criticism by introducing "daily-valued" offerings. As of February 28, 2013, there are a total of eight nontraded REITs that provide daily valuations and enhanced liquidity features.

And while there may be much applause over this innovative product design from sponsors within the industry, the true measure comes by analyzing how well these offerings are being received by investors and financial advisors. One way to do that is by calculating the amount of time it takes to "break escrow" and raise the minimum offering proceeds. Our findings to date indicate that there is no significant difference between the amount of time it takes newly launched daily-valued REITs to break escrow compared to those nontraded REITs with a traditional pricing model . However there are significant differences in the amount of capital raised when these two REIT types are compared. Based on preliminary sales data, we estimate that daily-valued nontraded REITs collectively raised less than $100 million in 2012 which is less than one percent of all capital raised for the year.

It is important to note that the innovation taking place within the industry is not limited to daily pricing. In fact, a second trend we observed in 2012 was the introduction of products with multiple share classes. Several sponsors introduced product offerings with different share classes, reduced selling commissions, and lower overall fees and expenses. By creating these multiple share classes, it is evident that the industry is looking for ways to expand market share and appeal to new types of investors. Tapping into a broader audience of investors who may be interested in adding a direct real estate component to a brokerage wrap account or who are looking for a pure fee-based product might be a key component in helping nontraded REITs move into the category of mainstream investment vehicles.



2012 Trends & Highlights

Valuation Methodology

One of the most important issues raised as a result of the introduction of daily-valued and multiple share class products is the need for a more standardized methodology for estimating net asset values (NAV). In an effort to promote uniformity, consistency in valuation techniques, and methodology disclosures, the Investment Program Association (IPA) is currently working on a Share Valuation Practice Guideline that is expected to be released during the first quarter of 2013.

In particular, the proposed guidelines reference best practices used by institutional real estate managers such as using Generally Accepted Accounting Principles (GAAP) as the foundation for preparing net asset values. Furthermore, these proposed guidelines recommend the use of independent third-party experts, define the frequency and timing of valuations, and suggest the need to have a separate valuation committee within a nontraded REIT's Board of Directors. While these "Best Practice Guidelines" are voluntary, it is hoped that the majority of the industry will adopt these guidelines in order to promote a more fair and balanced measurement comparison of NAV-based performance.

2012 Trends & Highlights

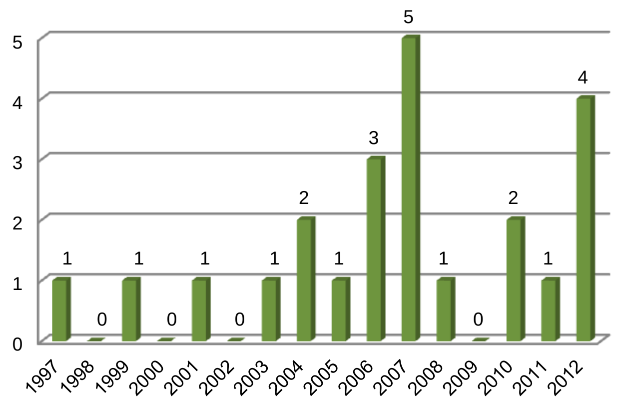
Full-Cycle Events

In addition to improvements in valuations, the nontraded REIT industry has also made significant improvements as it relates to returning capital to investors. Not only did we see a trend develop in 2012 for better and more frequent share redemption options, we also began to see the rebirth of full-cycle events. In fact, as the chart to the right illustrates, there were just as many full-cycle events that occurred during 2012 as had been completed in total over the previous four years.

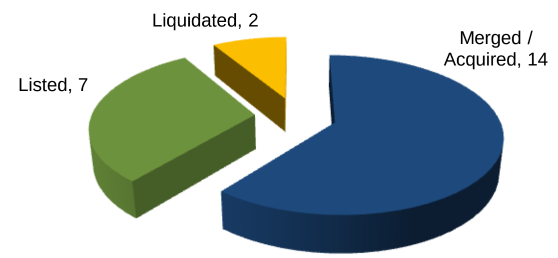
Including the four liquidity events in 2012, the cumulative number of full-cycle events that have taken place since 1990 increased to 23. Of the completed liquidity events in 2012, three were listings on a national exchange and one was a merger with another entity. While the most common exit strategy for liquidation has been via an acquisition or merger of a nontraded REIT with another entity, during 2012, the industry noted the most listings on a national stock exchange since the industry began in 1990.

We also anticipate liquidity events to continue at a fairly stable pace in 2013 as one nontraded REIT has already completed a full-cycle event during the first quarter and two more nontraded REITs have made public announcements of mergers and acquisitions that are anticipated to take place within the next two quarters.

Nontraded REIT Full-Cycle Events by Year



Breakdown of Full Cycle Events by Transaction Type: 1997 - 2012

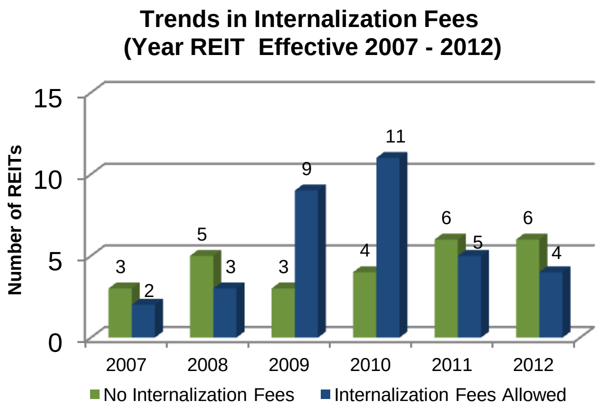


2012 Trends & Highlights

Internalization Fees

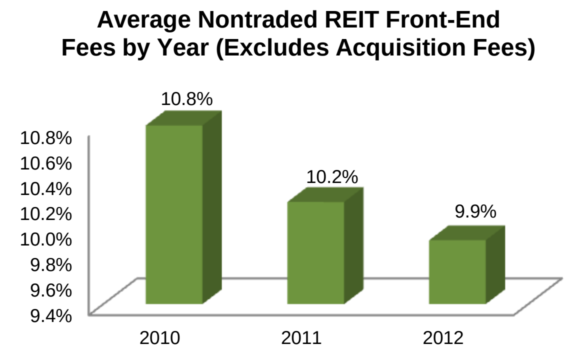
Prior to 2006, the payment of internalization fees was standard practice. These fees were designed to pay sponsors after determination by the board of directors that they no longer required the services of the external advisor and believed it to be in the shareholders best interest to “internalize” the management team by hiring its own employees to manage the day-to-day operations of the REIT. As a result of numerous class action lawsuits and the perceived negative impact that these fees have on investor returns, a shift has begun to take place over the past several years as more nontraded REITs have been moving away from this practice.

As noted in the chart to the right, 60% of all new offerings introduced in 2012 did not provide for the possibility of paying internalization fees in their prospectus. Moreover, during 2012, eight REITs that became effective between 2008 and 2010 and had previously allowed internalization fees, made announcements that they would waive or eliminate the payment of such fees.



Front-End Fees

In addition to the changes made to fees charged during the liquidation phase, nontraded REIT sponsors have also continued to make a concerted effort to reduce the up-front expenses paid by investors. Looking only at those REITs raising capital at the end of 2012, we find that the selling commissions, dealer manager fees, and marketing expenses paid up-front by investors declined from an average of 10.8% in 2010 down to 9.9% in 2012. Measuring the impact of a decline in fees using a sensitivity analysis model, we believe this decline in up-front fees could potentially result in increased annualized returns to shareholders of approximately 0.1 – 0.2% over time.



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2012 Trends & Highlights

Capital Raise

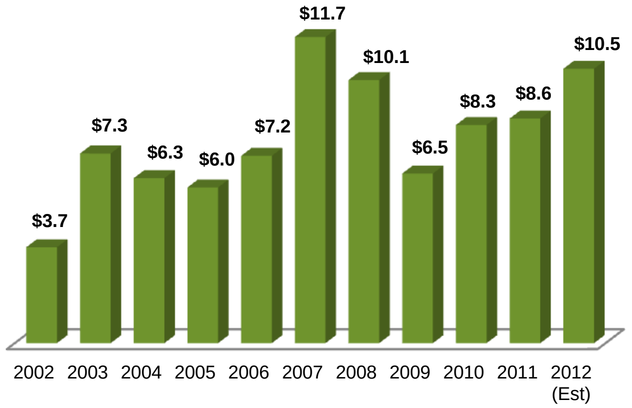
During 2012 there were a total of 53 nontraded REITs raising capital. Due to product closings, by the end of the year there were 43 offerings still raising capital. Based on current SEC filings and sales trends, it is estimated that the nontraded REIT industry raised approximately $10.5 billion in 2012 versus $8.6 billion in 2011. By comparison, the publicly traded REIT market raised a total of $73.3 billion during 2012 for all initial, debt and equity capital offerings.

We believe the primary reason for this 22% increase in equity capital raised was a direct result of the full-cycle events that occurred in 2012. In addition, the closing of several large offerings during the first and third quarters also had a positive impact on fundraising.

Looking ahead to 2013, we are optimistic that the industry will be able to maintain a level of capital raising of at least $9 billion or more assuming that:

- at least three full-cycle events occur during the year,
- the market for daily-valued and multiple-share class nontraded REITs continues to improve,
- investor perceptions of nontraded REITs and commercial real estate investments remain positive,
- distribution yields offered by effective REITs remain attractive compared to other asset classes, and
- Financial Advisors continue to view nontraded REITs as a key component of a well-diversified portfolio.

Historical Nontraded REIT Sales (in $ Billions)



2012 Trends & Highlights

Sponsor Trends

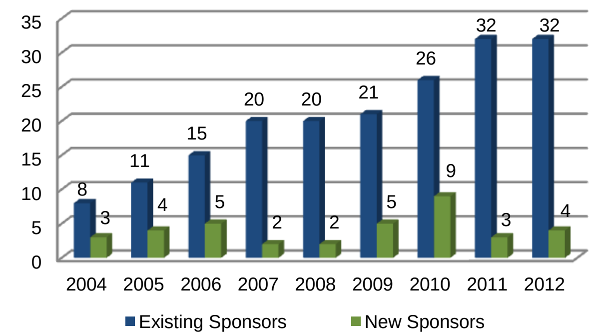
As of December 2012, 36 companies managed the 71 nontraded REITs that make up the nontraded REIT industry. As noted in last year's report, while we continue to see a relatively high volume of new product introductions on an annual basis, the number of new sponsors entering the space has remained relatively low. As a result, it is primarily existing sponsors that continue to launch new product offerings rather than new entrants.

Looking beyond the number of nontraded REITs, we find that there are also some encouraging trends underway in terms of the number of sponsors that have completed full-cycle events. By the end of 2012, ten out of 36 industry sponsors had completed full-cycle events, up from eight in 2011. The two sponsors that completed first-time full-cycle events during 2012 were AR Capital and Healthcare Trust of America.

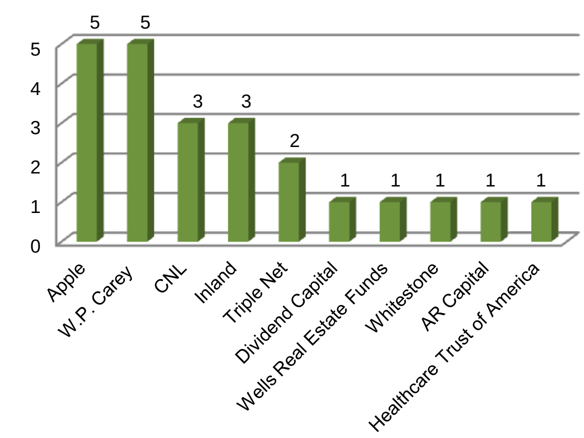
In terms of market share, we note that the top five sponsors raised approximately 60% of all new capital in 2012. Of these sponsors, all of them have managed nontraded REITs for three years or more. By comparison, those sponsors with first-time REITs that have been effective for two years or less raised only 11% of all new capital during the same period.

Historically, the best way to measure the market's receptivity to a new sponsor was to measure the amount of time it took to meet the minimum offering requirements. In 2011, we found that of the three new sponsors that introduced nontraded REITs to the market for the first time, none of them were able to meet the minimum offering requirements within the same year they became effective. However, in 2012 three of the four new sponsors introducing new offerings were able to meet these requirements within the same year.

Number of Existing vs. New Sponsors by Year



Number of Full-Cycle Events by Sponsor



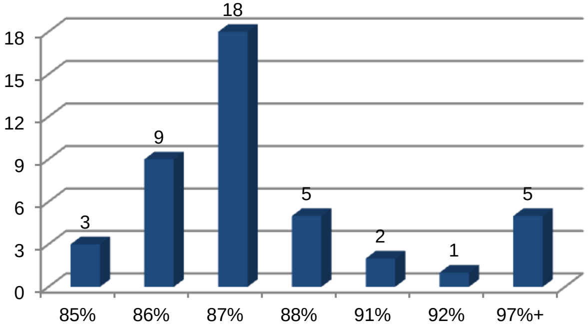
2012 Trends & Highlights

Amount of Proceeds Available for Investment

As a result of the industry continuing to lower up-front fees and expenses paid by investors, we continue to see an increase in the average amount of proceeds available for investment. While this is a relatively small improvement, we believe this is the biggest and most important enhancement the industry can make. Over the long term, increasing the amount of investor proceeds that are used to purchase real properties has a direct impact on long-term total returns.

While primarily influenced by the new daily-valued and multi-share class product offerings, as the chart to the right illustrates, of the 43 nontraded REITs that were effective at the end of 2012, approximately 19% are investing 91% or more of investor proceeds into real property. This compares to 2011 results that showed 16% of all effective REITs invested 91% or more of investor proceeds into real property.

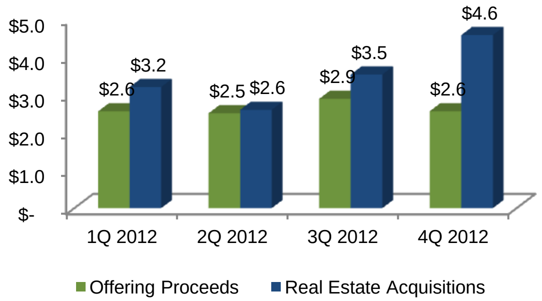
Effective Nontraded REITs Segmented by Percent of Gross Proceeds Available for Investment



Real Property Acquisitions

Nontraded REITs purchased a total of $13.9 billion in real properties during 2012 with $4.6 billion in transactions occurring in Q4 2012 alone. A significant portion of this Q4 activity may be attributed to concerns surrounding the looming “fiscal cliff” and the motivation property sellers had to close deals before year-end in order to avoid higher capital gains taxes in 2013. As illustrated in the chart to the right, the unusually high ratio of acquisitions to capital raise in 4Q 2012 compared to the previous three quarters leads one to believe that a portion of the activity was indeed motivated by the desire to avoid higher capital gains tax rates.

Offering Proceeds vs. Real Estate Acquisitions (in $ Billions)

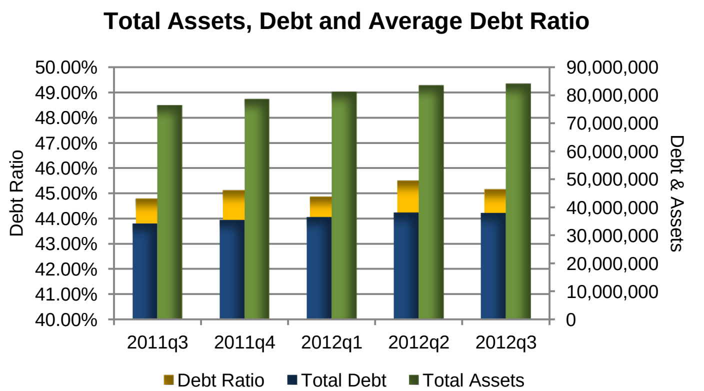


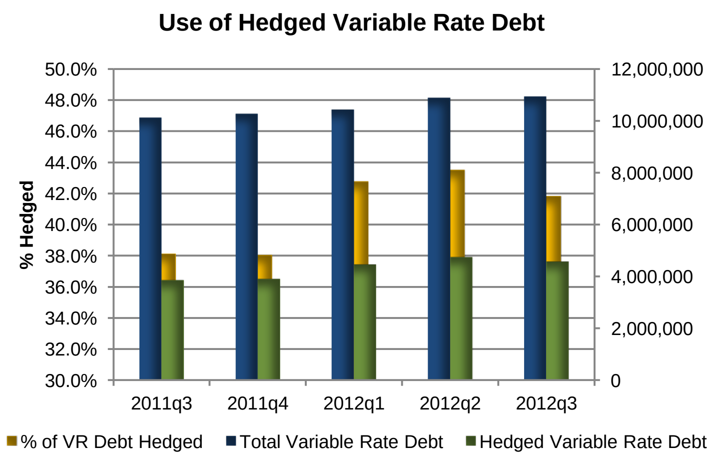
Use of Debt

The credit markets have continued to improve over the past three years making it easier for sponsors to finance new property purchases. Taking a historical look over the past five quarters, we find relative stability in the weighted average debt to total asset ratios as the ratio increased slightly from 44.8% in 3Q 2011 to 45.2% in 3Q 2012.

Increasing use of Interest Rate Swaps and Hedges

Blue Vault Partners began reporting the use of interest rate swaps and other hedging instruments used by nontraded REITs to effectively fix rates on variable rate debt in 2012. Nontraded REITs increased their use of swaps and hedges during 2012 from 38.1% of variable rate debt hedged in 3Q 2011 to 41.8% of such debt hedged in 3Q 2012. The total of variable rate debt hedged through swap contracts increased 18.5% from 3Q 2011 to 3Q 2012. With rates on fixed rate debt near historic lows, we would also expect nontraded REITs to lock in advantageous rates by using more fixed rate debt. Of the 64 nontraded REITs with available data, we note total fixed rate debt increased by 11.5% while variable rate debt, including hedged debt, increased 8.0%.





Future Trends and Expectations for 2013

The nontraded REIT market is still heavily skewed toward older offerings as 76% of total industry assets are held by those REITs that are closed to new investments. As a result, as long as the stock market continues to stay strong and companies are willing to deploy capital through mergers and acquisitions, we believe 2013 could be another banner year for nontraded REIT full-cycle events.

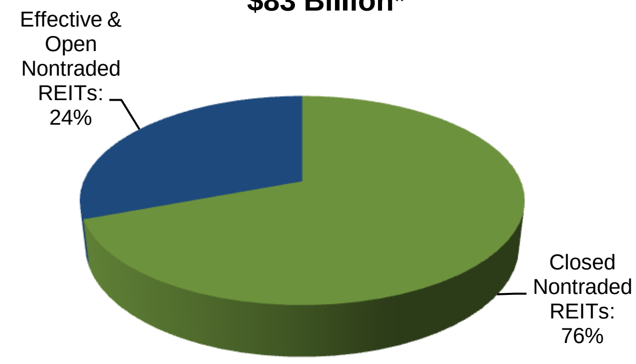
To date, early indicators are signaling the continuation of 2012 trends as one nontraded REIT has already completed it's full-cycle event and two more have announced their intentions to complete full-cycle events within three to six months. Those transactions include:

- The acquisition of American Realty Capital Trust III by American Realty Capital Properties that was completed on February 28, 2013.
- The proposed acquisition of Apple REIT Six, Inc. by BRE Select Hotels that is expected to close 2Q 2013.
- The proposed merger of Cole Credit Property Trust II with Spirit Realty Capital that is anticipated to close 3Q 2013.

These three nontraded REITs have estimated combined net real estate assets of $5.4 billion as of the end of 2012 and common shares estimated to be worth a combined $5.13 billion if these full-cycle events take place as planned.

In addition to these announcements, there remain at least four more REITs within Blue Vault's Liquidation LifeStage that we believe are poised to execute on an exit strategy in the relatively near future.

Total Nontraded REIT Assets: $83 Billion*



**Estimated as of December 31, 2012.*

Future Trends and Expectations for 2013

As it relates to the overall economy and the commercial real estate market, many economists and industry experts are forecasting a relatively positive outlook in 2013. Several key factors that support this and that have been highlighted in recent reports* include:

- the forecast for cap rates to hold relatively steady in 2013,
- the increased investment of foreign capital into U.S. markets,
- the continued recovery of the CMBS market,
- continued moderate GDP growth,
- and the steady increase in job creation.

And as long as financial markets remain strong, U.S. economic conditions improve, and the number of full-cycle events continues at a steady pace, we believe the outlook for fundraising in 2013 will also be positive. Keeping these factors in mind and looking back at historical trends, it is our estimate that the industry could see an increase above 2012 sales levels of approximately $2 billion or more allowing the market to potentially exceed 2007 levels of $11.7 billion.

**Sources: FTI Consulting, PREI Quarterly Outlook, Marcus & Millichap*

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