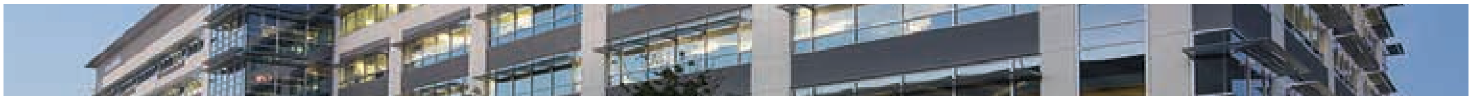

Investment Alternative: Income-producing investments in Commercial Real Estate and reducing exposure to market volatility

In 2018, direct investment into most income-producing commercial real estate (CRE) outperformed U.S. equity markets, with significantly less volatility, according to the National Council of Real Estate and Investment Fiduciaries. In addition, most publicly traded REITs underperformed the average private direct investment into income-producing CRE. During this time, many of the investors in Class A office CRE achieved total returns of 6 percent to 12 percent with minimal volatility. This relatively stable total return compares favorably to the volatile negative return of –4.4 percent for the S&P 500 Index that year.

In 2019, the U.S. economy continues to show strength, but that has not prevented volatility in the U.S. and many global equity markets. Global trade wars and tariffs have created uncertainty in the markets and, thus, market prices have been volatile, including the S&P 500 index, which was down over 6 percent in May 2019.

Investors looking to increase income from their investments, without the volatility of the stock market, have some investment alternatives to consider: Direct investments into income-producing commercial real estate with total transparency to the underlying assets and metrics.

DIRECT INVESTMENT INTO INCOME-PRODUCING CRE MAY PROVIDE A MORE STABLE TOTAL RETURN

Investing directly into income-producing Class A commercial real estate assets, with a value-add strategy to stabilizing the asset, can be an interesting alternative for income-seeking investors and advisers. Total return for this type of investment is based on actual rents collected (less operating expenses) and any increase in asset value created by the sponsor adding value to the property, as well as market dynamics improving for the specific asset. There is typically much less fluctuation in the actual NAV of the building in the short run, because there are few fundamental changes to a building and its cash flow in the short run.

This is very different than publicly traded equities and publicly traded REITs, where these equities trade at a multiple to their cash flows. There is no way for an investor to determine what the multiple or premium will be for a specific stock at any given time. The multiple will be determined by other investors and market participants and their willingness to pay a premium for an actual set of cash flows. In the traded equity markets, the fundamentals can remain unchanged for a specific company, but if investors suddenly decide that they will no longer pay 25x earnings and will only pay 20x or 15x earnings, the stock price is going to decline significantly in the short run.

With direct investment into income-producing CRE, there is no traded premium attached to the asset, and there is no short-term risk of massive multiple contraction, as there can be in publicly traded stock valuations. Publicly traded REITs can trade at a *discount* to actual NAV because shareholders of the REIT can just sell their shares on the open market as they seek immediate liquidity, causing a sharp decline in stock price, which has no link to actual fundamentals of the underlying CRE.

CERTAINTY OF DISTRIBUTIONS TO INVESTORS

An investor with a diversified portfolio of several income-producing Class A office buildings, consisting of multiple tenants in each building, should have higher certainty of the expected cash flow compared to publicly traded stocks and REITs. The value of the portfolio of direct investments into income-producing Class A office buildings will typically not fluctuate very much, as the assets are not liquid and might be valued one to two times a year. This can compare favorably to a portfolio of stocks that can fluctuate with significant volatility in the short term, depending on market conditions.

INSTANT LIQUIDITY VS. LONGER-TERM HOLD

Liquidity is the biggest differentiating factor between direct investment into commercial real estate and investing into equity markets. Direct investment into CRE is not for investors who will need their investment capital returned in less than two years. Direct investment into Class A commercial office buildings is usually made by institutional investors and some individual investors who are looking for some certainty of distributions from rental income, lower volatility of asset values and a more predictable approach to try and achieve a target total return objective.

INVESTMENT STRATEGY ALTERNATIVE: INCOME-PRODUCING CLASS A CRE

If investors are concerned about significant volatility in their investments in the short run, a viable alternative investment strategy may be direct investment into a diversified portfolio of income-producing Class A commercial office buildings, where there is transparency provided by the owner with regard to financing of the building, tenant composition, lease terms/lengths and the sponsor's view and evaluation of the local market.

FOR MORE INFORMATION

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