EVIDENCE BASED INVESTING

WHY EVERY HEALTH CARE PROFESSIONAL SHOULD CONSIDER COMMERCIAL MULTIFAMILY REAL ESTATE INVESTING

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INTRODUCTION

Physicians have historically been heavy investors in paper assets like stocks, bonds, and mutual funds. From 1982 to 2000, the United States saw the greatest bull market in history. During that time, investors could park their money in mutual funds and watch the magic of compound returns.

Unfortunately those days are gone.

In fact, the decade that followed crushed investors with a -9% return from the Dow (for the whole decade). As physicians we already lose a decade of prime earning years to obtaining our medical education. The last thing we needed was a second lost decade to the stock market.

Tired of the volatility, unpredictability, and anemic long-term returns, many physicians have been searching for investments outside of the traditional paper asset financial advisory model.

In their search for better investments, more and more physicians are turning to real estate.

While high-quality commercial multifamily real estate is one of the most proven asset classes in history, some have shied away from getting started due to lack of information, insufficient experience, and insufficient capital, just to name a few.

In this Special Report, I will seek to demystify the subject of commercial multifamily real estate investing as well as provide an overview that discusses the What, Why, When, and How of investing. I will also provide you the convincing collection of research that led me to diversifying into this asset class.

THE WHAT OF MULTIFAMILY REAL ESTATE INVESTING

When I first got started, I thought the only way to own real estate was to be the landlord. So I purchased a few quads (4-unit properties). What I didn't realize then and it would have helped me tremendously, is that there are several types of multifamily properties. Let me overview them quickly here.

RESIDENTIAL REAL ESTATE: 1 – 4 UNIT PROPERTIES

This designation encompasses single family homes, duplexes, triplexes, and quads. Some people do make money in this asset class, but without the economies of scale that come with bigger properties, this asset class tends more often than not to leave a bitter taste in the mouth of most investors. It is operationally intensive, subject to ebbs and flows in both value and income, valued based on per square foot comps vs. income, and primarily subject to full recourse lending.

SMALL APARTMENTS: 5 - 70 UNITS (TECHNICALLY COMMERCIAL)

These properties can begin to take advantage of some economies of scale. However, they tend not to reach the full potential due to the fact that on-site management typically does not make economic sense in this sized property. Consequently, off-site management is more economical at this size, but also tends to underperform. Additionally, full recourse lending remains the main option for these properties.

COMMERCIAL MULTIFAMILY (70 UNITS AND UP)

These sizes warrant professional on-site management and can maximize economies of scale for larger and safer returns. Those who tend to invest in this class are high net-worth individuals, private investment companies, REITs, and AAA rated life insurance companies. Due to the fact that commercial multifamily can provide a stable return in a hard-asset that is inflation resistant, it is typical to see these life-insurance companies have 25% or more of their entire portfolio in real estate.

Now that I have defined the range of properties you can invest in, you should ask yourself a couple of questions before you start looking for properties. The first is, "do you want to be an active or passive investor?" Passive investors have no involvement in the operations of the property. They do their due diligence to find a good operator on the front end prior to investing and if successful reap the rewards of regular income and equity growth on the backend.

As the name implies, active investors are actively involved in the operations of real estate. Active investors can act as property managers, asset managers, or both. Property managers are involved in the day-to-day operations of the property. They collect rent, respond to complaints, arrange repairs, and the numerous other duties that property management requires. Asset managers oversee the property manager. They also create the operating budget for the property, the plan for capital improvements, and the exit strategy.

As busy professionals, many physicians do not have the time, interest, or inclination to be actively involved with real estate. For those, passive investing is likely the better option. The key with passive investing is due diligence. Thorough investigation of the market, neighborhood, asset and the asset manager is critical prior to investing.

Once you have decided if you are better suited for passive investing or active investing, the next question to ask is "residential or commercial real estate?"

As stated previously, residential real estate encompasses one to four units. Due to the relatively low entry price, most active real estate investors initially assume that residential real estate is their only option.

This is exactly how I got started as a real estate investor. I purchased several 4-unit apartments (quads) as rentals to create additional income and ramp-up my retirement plans. In the beginning, this is where I thought I had to start. Over time however, I found that owning the smaller residential income properties was not as profitable as I wanted or needed and I eventually turned to commercial multifamily real estate. Let me explain why.

WHY COMMERCIAL MULTIFAMILY REAL ESTATE?

A recent investor poll by Morgan Stanley and the latest listing of *Forbes* show that:

77% of all millionaire investors own real estate while 90% of the Forbes 400 of wealthiest individuals either made or retain their wealth in real estate.

In fact, J.P. Morgan went so far as to suggest that real estate investing should no longer be considered an alternative investment. To quote them, **"the reality is that investment portfolios focused on the 'Big Two Traditionals,' bonds and equities, are forcing investors to compromise – either by sacrificing return for lower volatility or enhancing return at the expense of higher risk."**

The report contined, **"Real estate may offer a way out. This is why we believe real estate is increasingly being viewed, not as an alternative, but as an essential portfolio component."**

During my own transition into commercial real estate investing and subsequently as an investor in several commercial multifamily projects, I have come to understand the long-term benefits of this asset class. There are downsides of course, just as there are in any investment. However, for me commercial multifamily is an important part of my long-term strategy.

Commercial multifamily real estate has many attractive benefits:

- Principal Protection / Superior Risk-Adjusted Performance
- Current Income
- Principal Pay Down
- Appreciation
- Several Tax Benefits
- Inflation Protection
- Evergreen Business Model
- Asset Protection and Leverage
- Economic Cycle Protection
- Diversification
- Large Investable Universe

Now let's go over each one in more detail.

PRINCIPAL PROTECTION.

Multifamily investments have the best risk-adjusted return (Sharpe-Ratio) of any real estate asset class and have one of the lowest failure rates of any real estate investment. In fact, it is such a stable asset class that it is a significant portion of almost every AAA rated insurance company.

Figure 1 shows average returns and Sharpe ratios for all of the major commercial real estate asset classes. The Sharpe ratio measures the risk-adjusted return.

In other words, the higher the Sharpe ratio, the better the return per unit of risk. It should be no surprise that over any 10, 20, or 30 year period commercial multifamily real estate has the best returns with the lowest risk of any other class of real estate.

FIGURE 1: ANNUAL COMPOUND RETURN (ACR%) & SHARPE RATION (SR)

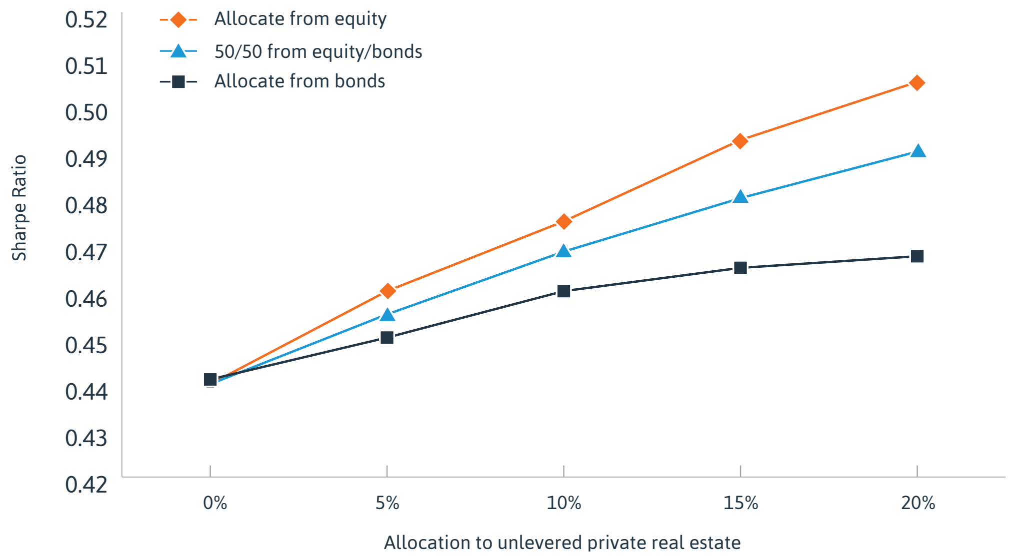
	Years	5	10	15	20	25	30
Commercial Multifamily	ACR%	12.50%	11.64%	11.85%	10.06%	10.19%	11.72%
	SR	1.27	1.45	1.64	0.72	0.64	0.71
Industrial	ACR%	13.54%	11.98%	11.93%	9.25%	9.66%	10.56%
	SR	1.51	1.45	1.32	0.44	0.43	0.47
Office	ACR%	14.64%	11.85%	11.44%	7.80%	7.89%	9.70%
	SR	1.45	1.07	0.85	0.19	0.13	0.24
Retail	ACR%	15.58%	13.00%	10.90%	9.34%	10.34%	10.39%
	SR	1.66	1.33	0.85	0.47	0.55	0.45
Hotels	ACR%	14.38%	10.36%	13.37%	10.56%	9.30%	NA
	SR	1.25	0.70	0.84	0.45	0.26	NA
TOTAL	ACR%	14.10%	11.92%	11.21%	8.68%	9.07%	10.18%
	SR	1.61	1.37	1.11	0.36	0.35	0.40

Source: NCREIF, 2008

One of the reasons multifamily is the safest real estate asset class is that it represents an investment in the basic need of shelter.

Figure 2 shows what happens to people's portfolios when they diversify into commercial real estate. Whether they sell off a portion of their equities to buy real estate or sell off a portion of their bonds, the Sharpe ratio of their portfolio improves.

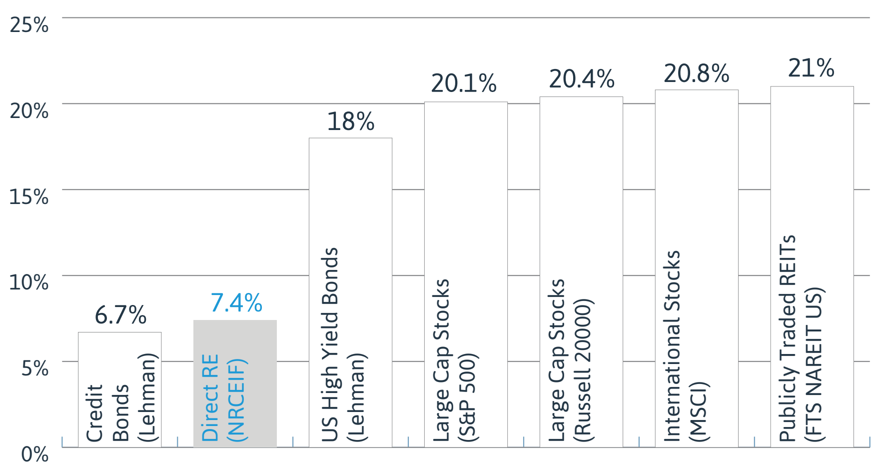
FIGURE 2: COMPARISON OF SHARPE RATIOS FOR INCREASING ALLOCATIONS TO PRIVATE REAL ESTATE, FUNDED FROM EQUITIES, BONDS OR 50/50 SPLIT



Source: Barclays, NAREIT, JP Morgan Asset Management

Another way to measure risk is in terms of volatility. Historically, real estate has had significantly lower volatility than other asset classes. Volatility is one of the reasons I stopped investing in the stock market. While that decision may not be right for you, diversification into this stable, non-volatile asset class can strengthen most portfolios.

FIGURE 3: RISK LEVELS OF DIRECT REAL ESTATE VS. EQUITIES AND PUBLICLY TRADED REITs



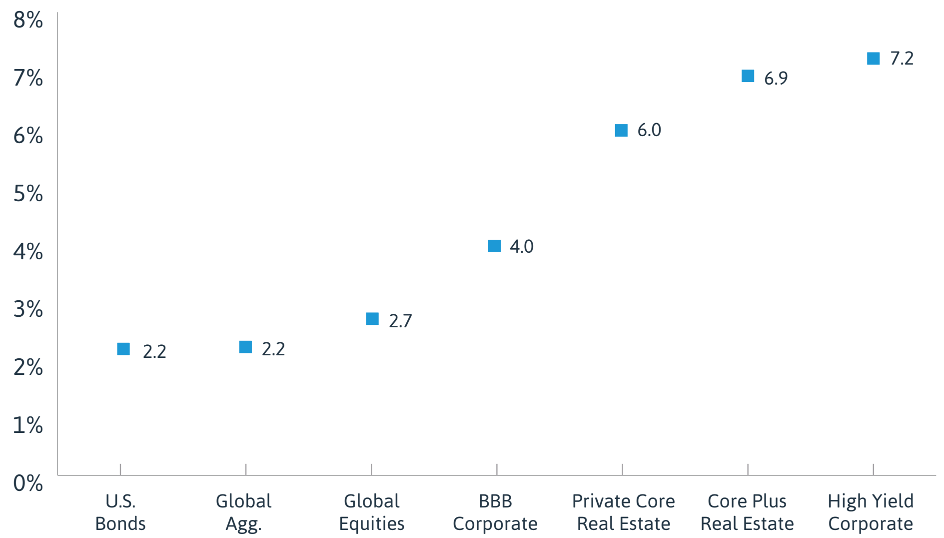
Source: KBS Capital Market Group

Next, and very important to me personally, is **current income (i.e., cash-flow)**. This is monthly, quarterly, or annual cash in your pocket after expenses have been paid. Cash flow is the income left over after subtracting operating expenses and any mortgage payments from gross operating income (collected rent). This net distributable income becomes yield for the investor.

The yield from my real estate is an integral part of my financial plan. I use that cash to allow me to work fewer shifts in the emergency room. I now work part-time which affords me the opportunity to be more actively involved with my children and their lives. Ultimately, my plan is to provide myself with retirement income that I cannot outlive.

Commercial multifamily real estate will allow me to retire much earlier than my colleagues and live off of the cash-flow without having to touch the equity that I have built up.

FIGURE 4: INCOME YIELD COMPARISON (AS OF MARCH 2012)



Source: Barclays Capital, MSCI, NCREIF, Bloomberg, JP Morgan Asset Management

Certainly, other investments like bonds and some dividend stocks can provide the investor with some yield. However, as Figure 4 shows, that yield tends to be too low for my needs. It is quite rare to find yields as attractive as you can obtain with real estate without having to take on significantly higher risk.

Principal pay down is considered by many to be the safest of all wealth creation tools. Each and every month, the residents of your property are paying down your mortgage. At the end of every year, your equity grows regardless of rent growth, market conditions, etc. Of course, you need to use leverage on the property to get this benefit, but safe 60% to 75% LTV loans with attractive interest rates, make this a nice benefit.

Appreciation is another way that the real estate investor grows his or her equity. Residential real estate (1-4 units) is primarily valued by the comparison or "comp" method of appraisal. In this method, the appraiser searches for recently sold properties of similar size, with similar amenities, and in close proximity to the subject property. By comparing the sales prices of those properties with the subject property, the appraiser can determine a value. Unfortunately, this model gives the investor little to no ability to affect the value of the property.

By comparison, commercial real estate valuation is determined by the money it brings in. With these properties, net operating income (NOI) largely determines the value of the property. NOI is simply the net between gross income and all expenses (with the exception of debt service). If NOI goes up then the property appreciates.

Unlike residential real estate, commercial real estate gives the investor the opportunity to force appreciation.

To better understand this concept, let's look at the components of NOI. As previously stated, NOI is gross operating income minus operating expenses. Consequently, the owner of investment real estate can raise the value of his or her property by increasing income (raising rents, creating new income sources, or increasing retention) or by decreasing expenses. Successful commercial real estate investors do an excellent job growing NOI to drive the appreciation of their properties.

While optimizing NOI helps your cash flow, its biggest advantage can be seen in appreciation. To better understand how optimizing NOI drives up the value of your property, let's review commercial real estate valuation. The formula for calculating the value of commercial real estate is as follows:

Property Value = NOI / Capitalization Rate (Cap Rate)

In the simplest of terms, the capitalization rate is the rate of return an investor would expect to receive if he or she paid all cash for the property. Given this definition, the higher the cap rate is the better it is for the buyer. Conversely, lower cap rates benefit the seller. Cap rates are market specific. The cap rate for an apartment building will be different in San Francisco than it will be in Dallas.

By rearranging the above formula, the cap rate is calculated as follows:

Cap Rate = NOI / Value

To better illustrate how commercial real estate is valued based on this income approach, let's take a look at an example.

In this example, we will look at a property in an 8% Cap Rate market that increases its annual net operating income from $200,000 a year to $300,000.

Value = $200,000 / 0.08 = $2,500,000

Value = $300,000 / 0.08 = $3,750,000

By raising rents, decreasing expenses and increasing renter retention the astute property owner can maximize net operating income. As you can see, doing so can be quite lucrative in the form of forced appreciation.

As easy as this may look on paper, the truth is that whether your property appreciates in value and how quickly it does so is determined by a confluence of circumstances. These circumstances include buying the right property in the right market and using the right management strategies.

As I've said previously, having or hiring the right knowledge and skill is critical in successful real estate investing. Keep in mind that the above formula works in the opposite direction and can lead to loss of value as well.

Another often overlooked but material financial benefit of real estate investing is the **tax benefits**. The two biggest drags on your wealth are taxes and inflation.

Real estate has some of the best tax advantages of any investment out there.

Tax advantages such as:

- Deduction of expenses including mortgage interest against the income
- Depreciation
- Accelerated depreciation
- Tax-free refinances
- 1031 exchanges
- Legacy wealth transfers on a stepped up basis

Any W-2 employee can tell you that they are taxed based on their gross income and that those taxes are taken out prior to receiving their check. Consequently, they pay their expenses with their after-tax net income.

Real estate, similar to business, gets preferred tax treatment.

The owners get their gross income and can deduct their expenses including mortgage interest before having to pay taxes on the net income that is left over.

In addition to a better tax framework (business vs. personal), real estate investors are given phantom or paper losses called depreciation that also gets subtracted against the actual income of the property. The theory behind depreciation goes something like this. If you buy a physical asset whether it is a computer for a business or a property as an investment, it only has so much useful life before it will need to be replaced. Therefore the IRS allows you to write off or depreciate that asset over a given period of time.

Currently, for resident occupied real estate (cash flow homes and apartments) that time is 27.5 years and for other commercial real estate (office, retail, etc.) it is 39 years. They will not allow you to depreciate the value of the land, so that must be taken out of the equation before calculating depreciation.

To better understand depreciation, let's take a look at two examples. The first is a $300,000 residential rental triplex and the second is a $5,000,000 apartment complex. For the purposes of this example, we will assume the value of the land to be worth 20%.

Depreciation = $300,000 - ($300,000 x 0.20) = $240,000 / 27.5 years = $8,727.27

Depreciation = $5,000,000 - ($5,000,000 x 0.20) = $4,000,000 / 27.5 years = $145,454.54

What this means is that for each year of ownership, the real estate investor is allowed to deduct the above amount ($8,727 or $145,454) against his or her respective properties income in addition to the operating expenses. Depreciation is often called a phantom or paper loss, because this tax break is allowed to take place even when the property is making money and experiencing appreciation in value. And, unlike the computer, which does have a short useful time frame, real estate lasts much longer and goes up in value over time.

Think about it, if the above depreciation schedules were actually true for the useful life of real estate, then we would not see any single family homes or other residential properties older than 1987. Also those late 1980's homes would have gone down significantly in value from when they were first built. Perhaps now you are seeing why they call this a phantom loss.

Now, let's say that even after subtracting out the operating expenses and the depreciation, you are still seeing a profit that could be taxed as ordinary income by the IRS. Fortunately, the IRS gives you another tax reducing gift called accelerated depreciation. Accelerated depreciation is also known as cost-segregation. In this scenario, you can segregate all of the non-structural elements of the building from the building itself.

While the building still gets depreciated over the usual time frame, its contents get depreciated using an accelerated schedule of either 5, 7, or 15 years. This can create a much larger paper loss that is front-loaded in the earlier years of ownership as opposed to being spread out equally over a longer period of time. The time value of money for this benefit is significant.

Be aware that when you sell the property, you will be required to recapture all of the depreciation and accelerated depreciation that you took over the years and pay taxes on it. To defer these taxes, many investors use what is called a 1031 exchange. A 1031 Exchange allows the real estate investor to sell one property and exchange it for a like-kind property while deferring the capital gains tax. The tax is not erased, but it is deferred until the time that the investor either sells without doing a 1031 exchange or dies.

(Note, there are few other wealth transfer and estate planning options to manage the 1031 tax burden in your lifetime, but they are advanced and beyond the scope of this report).

Upon the death of a real estate owner, his or her heirs are allowed to inherit the property on a stepped-up basis. This erases the depreciation that was taken and resets the basis of the property to current market value at the time of inheritance. This is a huge wealth transfer benefit of owning real estate and one that over 90% of the Forbes 400 uses to manage legacy wealth through the years.

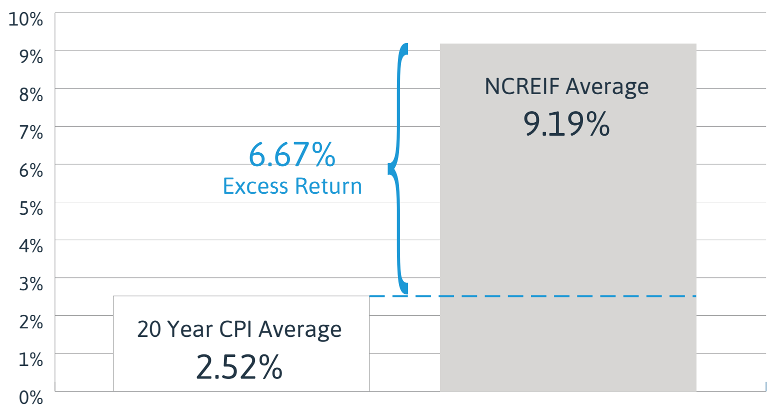
One last point about real estate, taxes, and refinances. Over time, equity can grow in a property due to the effects of appreciation and principal pay down. Smart real estate investors do not like to let that equity sit and do nothing. These investors will look to accelerate their financial growth and increase the velocity of their money. To do this, they refinance their property and harvest the equity that they have built so that they can go out and buy another property.

Fortunately for these investors, refinances are tax-free. Keep in mind that refinances are not free of fees and that re-leveraging a property back to a higher loan-to-value is not without its downsides. Having said that, professional real estate investors are quite adept at harvesting their equity to turn one property into two and then two properties into four - which grows their income and equity over time.

Another often misunderstood and significant benefit of commercial multifamily real estate is **inflation resistance**. Inflation is a silent tax that erodes the value of your money over time. Given recent fiscal policy that saw the Federal Reserve produce round after round of quantitative easing, it is no surprise that many fear that inflationary times are coming.

Commercial real estate has a proven track record as a stable hedge against inflation.

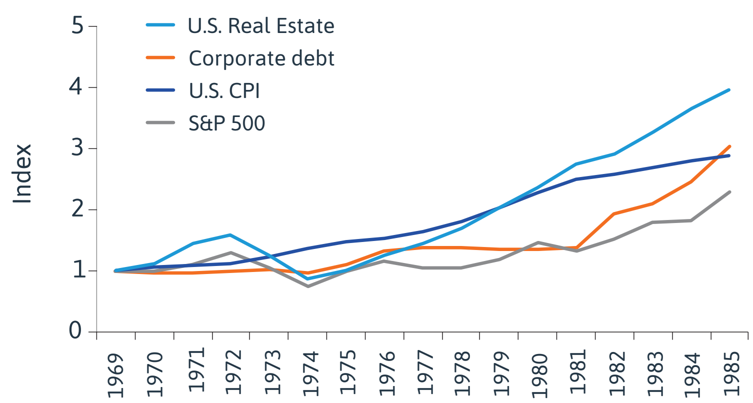
FIGURE 5: DIRECT REAL ESTATE AS AN INFLATION HEDGE



Source: NCREIF and U.S. Bureau of Labor Statistics 1993-2013

In fact, consider the graph below which shows the performance of real estate during the last significant period of inflation.

FIGURE 6: NOMINAL INFLATION RETURNS AND INFLATION INDICES, 1970-1985



Source: Standard & Poor's, Barclays Capital (8221), NCREIF, JP Morgan Asset Management

Another stability benefit of commercial multifamily investing is that it is 100% evergreen. Shelter is a basic human need that will never go away. In contrast, history is filled with products and industries whose time has come and gone. Whether it's the horse and buggy, the steam locomotive, Kodak film, or the rapidly declining print newspaper industry, most businesses have a useful shelf-life. The need for shelter on the other hand has stood the test of time.

As medical professionals, even with the accelerating regulatory burdens, we can be secure in the fact the healthcare as an industry will never go away. As a commercial multifamily investor I know that my preferred investment approach will be around well beyond the foreseeable future. It's also nice to not have to worry about what the talking heads on CNBC or Bloomberg have to say about the markets or being a sex-scandal away from a 50% stock drop.

For legal protection, business ownership structures like limited liability company's (LLC) can be used to hold the real estate and therefore shelter the owner's other possessions and assets from legal claims. This provides significant **asset protection**. Additionally, most investors will seek bank financing to purchase a property.

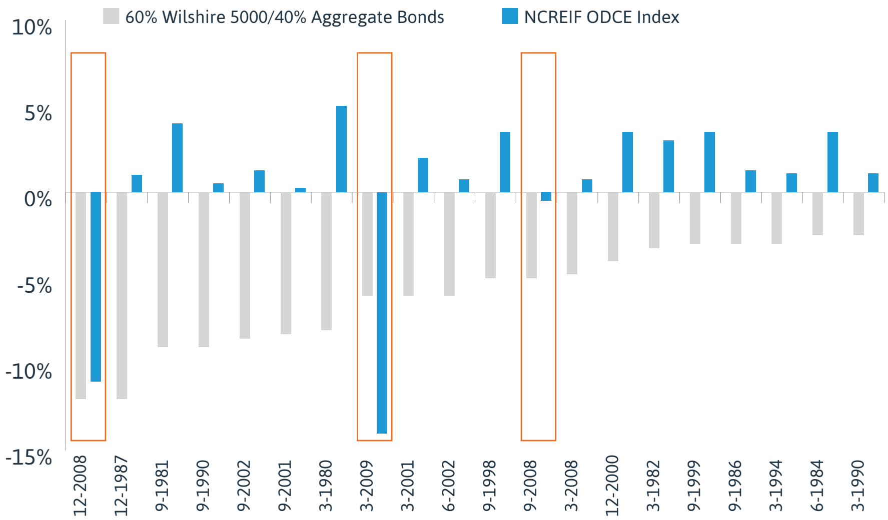
With bank financing, investors are allowed to put a small fraction of the purchase price down while the bank provides the rest. What other investment can you put 10% - 30% and control the entire investment? This use of bank financing is called leverage. Leverage can be a double edged sword. It magnifies profits on the upside, but can also compound losses on the downside. To minimize this risk, many larger commercial properties will qualify for non-recourse lending. With this type of financing, banks secure the loan with the physical property and do not require any further guarantee from the owner. In other words, the owner's risk of loss is limited to his or her initial capital contribution.

On first blush, this may not sound that significant. However, let me illustrate how significant the asset protection can be when leverage is combined with non-recourse lending.

Consider two investments valued at $1 million each. The conventional way to cover that $1 million in stock would be for the investor to pay $1 million. However, the $1 million real estate asset can be purchased with 25% down or $250,000. Now worst case scenario both investments and assume that they each go belly up, losing their entire value. In this scenario, the stock investor lost $1 million dollars. The real estate also lost $1 million, but the bank lost $750,000 while the investor only lost $250,000. This represents a 75% reduction in risk.

Finally, in addition to being an evergreen asset class, commercial multifamily apartments have a high degree of **economic cycle protection**. Since apartment leases are only 1 year in length, you have the ability to adjust to the demographics and economics of your local market much more readily than you can with 5, 7, 10, or even 25-year retail, commercial and industrial leases. It's also important to note that apartments, more so than any other real estate asset class, are population cycle dependent.

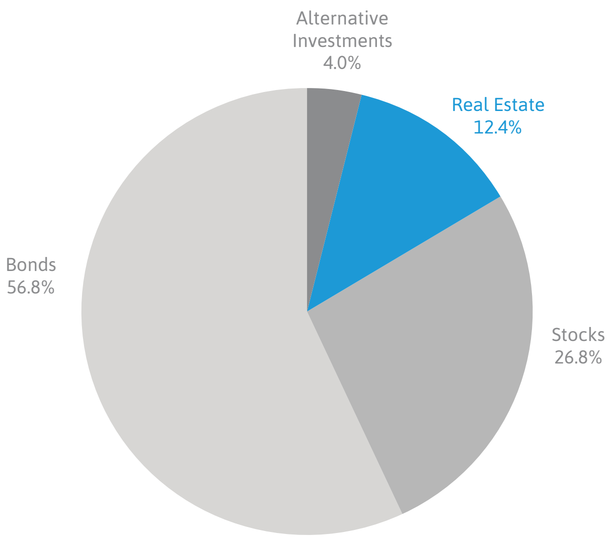
FIGURE 7: TWENTY WORST QUARTERS FOR 60% STOCK / 40% BOND PORTFOLIO RETURNS (Q1 1978 - Q1 2012)



Source: NCREIF, Barclays Capital, Wilshire, JP Morgan Asset Management

Figure 7 shows just how economic cycle resistant real estate is. It looks at the 20 worst quarters over the last 34 years for stocks and bonds. It then compares that with what real estate did. 17 of the 20 quarters that the economic cycles were down, real estate was up. Consequently, real estate offers the investor true **diversification** to strengthen their portfolio.

FIGURE 8: U.S. INVESTABLE UNIVERSE ($52.8 TRILLION)



Source: Securities Industry and Financial Markets Association, Morningstar, Prudential Real Estate Investors, 12/2010

Lastly, for those who are new to the idea of real estate, it is a multi-trillion dollar industry that represents a **large investable universe**. In fact, real estate represents the third largest asset class in the United States. Of the $6.5 trillion real estate market, multifamily represents $1.6 trillion.

What follows next includes two charts from the Fuller Report that was published in February 2013 and authored by Stephen S. Fuller, Ph.D. of George Mason University. They illustrate the economic impact and sheer size of the multifamily real estate market.

FIGURE 9: IMPACT OF APARTMENT RENTER SPENDING BY STATE

STATE	APARTMENT HOUSEHOLDS	HOUSEHOLD SPENDING	ECONOMIC CONTRIBUTION	DIRECT JOBS	TOTAL JOBS
Alabama	165,670	$2,907,246,174	$6,105,561,835	77,471	157,184
Alaska	29,665	$950,398,604	$1,995,949,809	25,326	51,385
Arizona	330,846	$7,968,907,653	$16,735,651,374	212,353	430,850
Arkansas	96,788	$1,768,812,615	$3,714,716,316	47,135	95,633
California	2,515,960	$75,987,998,469	$159,583,810,783	2,024,904	4,108,400
Colorado	324,167	$8,000,503,408	$16,802,006,209	213,195	432,559
Connecticut	182,250	$4,727,907,088	$9,929,165,728	125,988	255,621
Delaware	37,251	$913,256,515	$1,917,947,016	24,336	49,377
District of Columbia	102,311	$3,330,250,461	$6,993,921,016	88,743	180,055
Florida	995,483	$23,300,409,572	$48,933,624,087	620,902	1,259,770
Georgia	452,123	$9,603,760,454	$20,169,036,189	255,918	519,241
Hawaii	78,133	$2,709,542,300	$5,690,360,246	72,203	146,495
Idaho	44,300	$903,290,422	$1,897,017,038	24,071	48,838
Illinois	699,516	$16,362,150,184	$34,362,456,329	436,013	884,643
Indiana	283,221	$5,393,540,812	$11,327,075,508	143,725	291,609
Iowa	139,164	$2,878,048,678	$6,044,243,630	76,693	155,606
Kansas	121,822	$2,627,046,332	$5,517,108,928	70,005	142,035
Kentucky	165,147	$2,844,062,321	$5,972,868,247	75,788	153,768
Louisiana	150,855	$2,950,140,994	$6,195,646,044	78,614	159,504
Maine	46,197	$882,720,415	$1,853,817,583	23,522	47,726
Maryland	374,505	$12,003,493,276	$25,208,759,781	319,865	648,986
Massachusetts	430,665	$11,346,055,076	$23,828,061,574	302,346	613,441
Michigan	448,123	$8,290,663,570	$17,411,376,968	220,927	448,247
Minnesota	328,526	$7,122,384,717	$14,957,852,791	189,795	385,082
Mississippi	83,683	$1,402,839,062	$2,946,128,440	37,382	75,846
Missouri	235,955	$4,626,407,608	$9,716,004,780	123,283	250,133
Montana	30,576	$646,028,254	$1,356,735,967	17,215	34,928
Nebraska	98,761	$2,177,158,589	$4,572,291,301	58,016	117,711
Nevada	185,742	$5,117,031,510	$10,746,373,173	136,357	276,660
New Hampshire	61,787	$1,704,948,918	$3,580,594,975	45,433	92,181
New Jersey	505,333	$15,128,654,232	$31,771,968,508	403,144	817,952
New Mexico	66,758	$1,356,209,668	$2,848,201,182	36,140	73,325
New York	1,967,219	$53,568,595,965	$112,500,406,046	1,427,479	2,896,263
North Carolina	396,445	$8,098,038,621	$17,006,841,726	215,794	437,832
North Dakota	52,118	$1,132,689,035	$2,378,781,337	30,184	61,240
Ohio	547,108	$10,376,173,664	$21,791,195,556	276,501	561,003
Oklahoma	135,414	$2,736,844,990	$5,747,699,134	72,931	147,971
Oregon	224,260	$4,955,364,934	$10,406,854,187	132,049	267,919
Pennsylvania	524,037	$10,983,042,898	$23,065,692,938	292,673	593,814
Rhode Island	59,607	$1,292,176,899	$2,713,724,770	34,434	69,863
South Carolina	172,423	$3,339,269,530	$7,012,862,131	88,984	180,542
South Dakota	42,150	$869,129,262	$1,825,274,550	23,160	46,991
Tennessee	265,808	$4,995,765,927	$10,491,701,064	133,126	270,103
Texas	1,508,607	$36,187,710,880	$75,998,485,577	964,319	1,956,540
Utah	96,423	$2,343,360,635	$4,921,335,313	62,445	126,697
Vermont	23,381	$496,466,225	$1,042,637,965	13,230	26,842
Virginia	433,955	$12,828,693,630	$26,941,778,414	341,855	693,602
Washington	434,197	$11,490,800,973	$24,132,045,129	306,203	621,267
West Virginia	50,168	$807,570,490	$1,695,993,825	21,520	43,662
Wisconsin	316,068	$6,618,699,238	$13,900,053,536	176,373	357,849
Wyoming	18,018	$447,738,254	$940,303,446	11,931	24,208
U.S. TOTAL	**17,078,689**	**$421,500,000,000**	**$885,200,000,000**	**11,232,000**	**22,789,000**

Source: WeAreApartments.org, The Trillion Dollar Apartment Industry

FIGURE 10: IMPACT OF APARTMENT BUILDING OPERATIONS BY STATE

STATE	OPERATIONS SPENDING	ECONOMIC CONTRIBUTION	PERSONAL EARNINGS	DIRECT ON-SITE JOBS	TOTAL JOBS
Alabama	$551,767,800	$1,040,638,705	$333,591,363	6,808	18,840
Alaska	$104,623,424	$184,073,772	$57,971,546	1,135	2,982
Arizona	$1,239,779,465	$2,360,079,400	$778,849,297	14,043	37,085
Arkansas	$306,028,797	$531,104,347	$166,015,175	3,946	10,052
California	$11,101,997,864	$24,611,412,896	$7,775,898,145	98,249	299,513
Colorado	$1,093,245,407	$2,405,490,061	$766,605,544	12,714	34,566
Connecticut	$902,643,333	$1,660,174,114	$520,127,099	7,372	21,478
Delaware	$168,937,297	$299,780,923	$78,073,493	1,493	4,007
District of Columbia	$450,024,584	$586,076,196	$52,245,379	4,061	6,159
Florida	$4,251,007,058	$8,347,439,423	$2,774,494,149	42,354	129,761
Georgia	$1,739,454,384	$3,611,418,142	$1,150,063,923	18,622	54,979
Hawaii	$283,058,082	$521,825,867	$170,014,931	3,071	8,104
Idaho	$168,341,653	$272,217,610	$89,584,340	1,755	4,890
Illinois	$2,787,455,102	$6,067,980,070	$1,892,334,418	28,391	79,959
Indiana	$994,614,369	$1,911,348,344	$583,156,031	11,599	30,682
Iowa	$488,447,847	$779,551,724	$244,797,019	5,470	14,256
Kansas	$412,409,845	$737,499,988	$213,298,702	4,961	11,728
Kentucky	$579,056,379	$1,102,587,100	$325,539,937	6,658	18,195
Louisiana	$678,692,713	$1,313,829,915	$418,822,224	6,228	20,518
Maine	$163,971,174	$294,196,949	$97,796,458	1,779	5,248
Maryland	$1,609,780,547	$3,020,711,020	$917,693,552	15,115	43,279
Massachusetts	$1,857,839,147	$3,549,999,357	$1,115,553,078	16,656	47,168
Michigan	$1,782,163,271	$3,449,234,973	$1,121,102,241	18,627	53,502
Minnesota	$1,384,095,115	$2,715,388,940	$855,877,083	12,941	39,259
Mississippi	$304,789,373	$544,441,721	$169,114,243	3,581	9,905
Missouri	$812,361,016	$1,580,398,234	$462,219,202	9,641	23,667
Montana	$107,983,703	$189,969,499	$60,998,137	1,171	3,506
Nebraska	$387,552,992	$607,524,660	$191,289,646	3,844	10,837
Nevada	$637,504,130	$1,102,023,936	$360,061,568	7,747	18,228
New Hampshire	$256,142,252	$465,104,176	$139,137,265	2,405	6,741
New Jersey	$2,271,570,259	$4,675,209,613	$1,376,124,305	20,081	56,333
New Mexico	$194,081,824	$354,073,835	$113,686,029	2,574	6,373
New York	$8,463,772,537	$15,097,116,304	$4,362,147,960	76,244	192,022
North Carolina	$1,352,016,289	$2,501,976,043	$804,255,543	16,273	44,267
North Dakota	$187,441,605	$304,312,196	$91,653,828	2,033	5,424
Ohio	$1,847,218,354	$3,801,700,799	$1,181,941,556	22,330	58,837
Oklahoma	$438,896,200	$883,728,076	$275,410,394	5,490	14,852
Oregon	$579,592,470	$1,069,311,883	$335,603,631	8,572	19,197
Pennsylvania	$2,403,426,165	$5,106,978,489	$1,567,267,953	20,756	66,915
Rhode Island	$262,176,612	$463,166,683	$136,500,103	2,318	6,349
South Carolina	$620,147,238	$1,182,284,416	$371,401,778	7,234	20,570
South Dakota	$155,109,444	$232,444,717	$72,343,618	1,682	4,491
Tennessee	$878,820,446	$1,783,813,746	$549,407,872	10,973	27,217
Texas	$5,352,915,705	$12,405,661,570	$3,864,732,875	62,853	182,164
Utah	$335,678,652	$727,408,556	$229,100,881	3,753	11,704
Vermont	$82,899,910	$140,789,887	$44,970,640	899	2,597
Virginia	$1,934,864,404	$3,732,373,557	$1,119,620,896	17,514	54,458
Washington	$1,519,248,007	$3,008,119,106	$937,585,069	16,864	44,871
West Virginia	$170,771,693	$299,027,570	$89,565,706	1,974	5,157
Wisconsin	$1,214,974,691	$2,252,049,142	$726,589,006	12,491	36,336
Wyoming	$65,437,468	$105,740,117	$33,436,367	710	1,899
STATE TOTAL	**$67,936,828,097**	**$135,990,808,369**	**$42,165,671,196**	**686,054**	**1,931,126**
Spillover	-	$46,605,359,473	$14,590,100,923		405,147
U.S. Total	**$67,936,828,097**	**$182,596,167,842**	**$56,755,772,120**	**686,054**	**2,336,273**

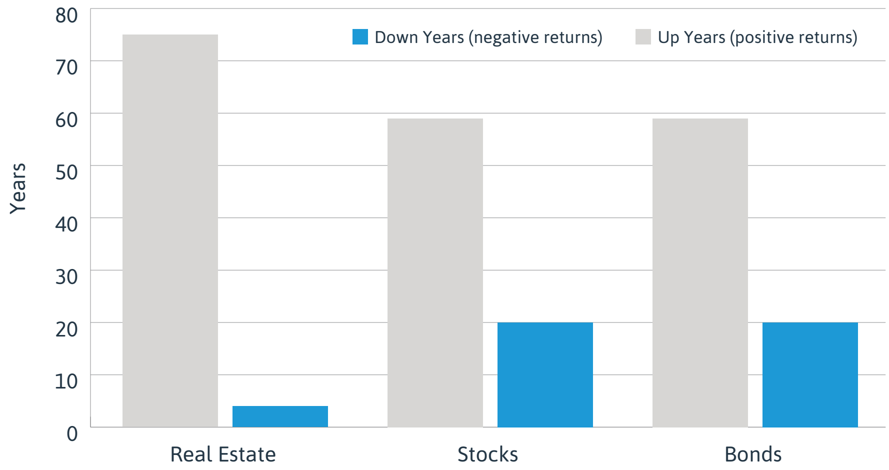
Source: *WeAreApartments.org, The Trillion Dollar Apartment Industry*

THE WHEN OF MULTIFAMILY REAL ESTATE INVESTING

As Figure 11 shows, real estate has a strong historical track record for having far more up years than down years and providing investors with quality returns. Additionally, commercial multifamily real estate is the safest of all real estate investments. In general, it's always a good time to invest in multifamily.

However, there are three factors that have aligned to make this the best time ever to invest and will carry this trend forward for years to come. In fact, many feel these trends will continue for decades. Let me explain.

FIGURE 11: UP AND DOWN YEARS FOR REAL ESTATE, STOCKS AND BONDS (1934-2013)



Source: NCREIF, Bloomberg, Barclays, Lehman, RCG

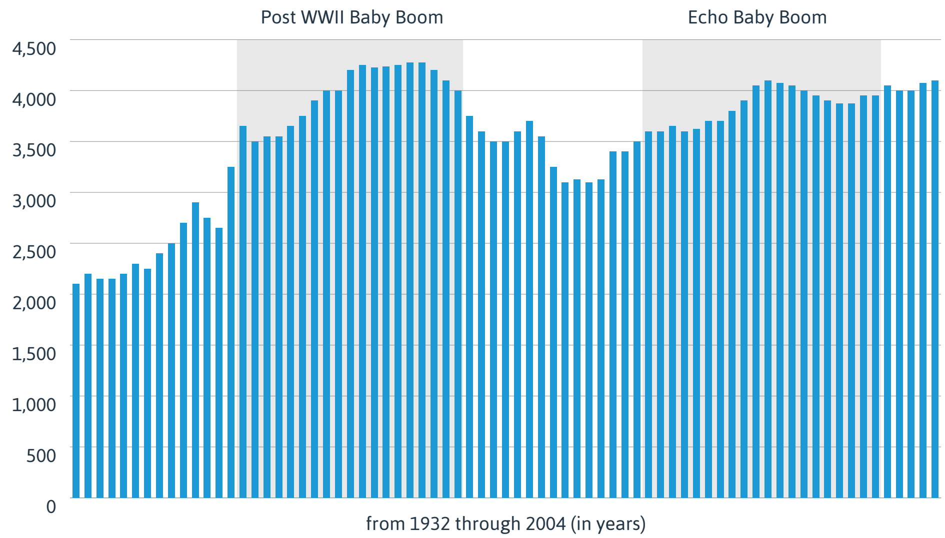
The information I am about to present should make each and every one of you stand-up and take notice. This is the reason why I say that every medical professional should consider having some commercial multifamily real estate in their portfolio. In essence, it is a trifecta of simultaneous windfalls that are driving this space now and well into the future.

- Population Dynamics / Increased Demand
  - Baby Boomers
  - Echo Boomers
  - Immigration
- Constrained Supply
- Trend away from home ownership

POPULATION DYNAMICS

As of this writing, the U.S. population is just under 318,000,000 people. About half of those people are either Baby Boomers (born between 1946 and 1964) or Echo Boomers (born in the early 1980's to 2000).

FIGURE 12: US REGISTERED BIRTHS 1933 - 2004 (IN THOUSANDS)



Source: US Census Bureau

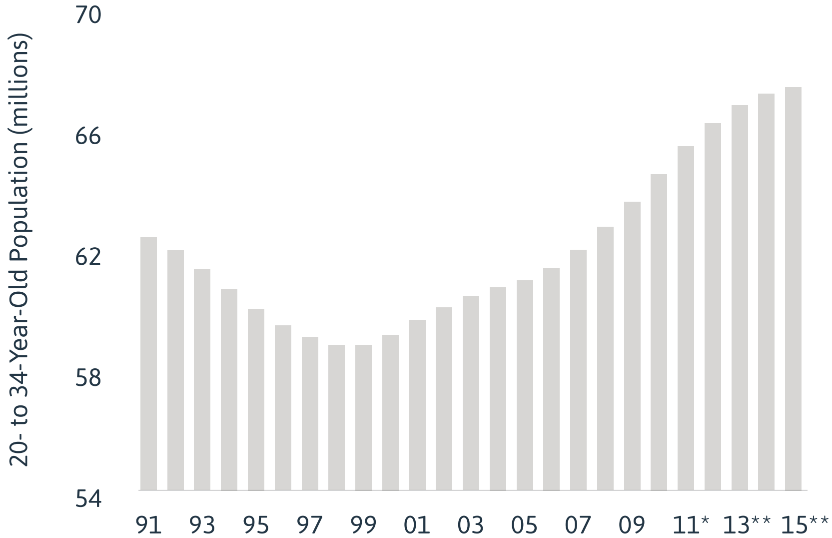
The Echo Boomers are also referred to as Millennials or Generation Y. Figure 12 shows just how massive these two groups are.

Why is this fact important? The two largest renter groups in the U.S. are ages 18-30 and over 55. It just so happens that the Echo Boomers and the Baby Boomers coincide with those age groups.

For those over 55, it is true that once they downsize and start renting, they tend to remain renters for the rest of their lives. Studies also show that seniors continue to enjoy longer and healthier life spans.

As for the Millennials, they represent a large population wave of people who rent much more frequently than any other age group and stay in apartments longer than the generations who preceded them.

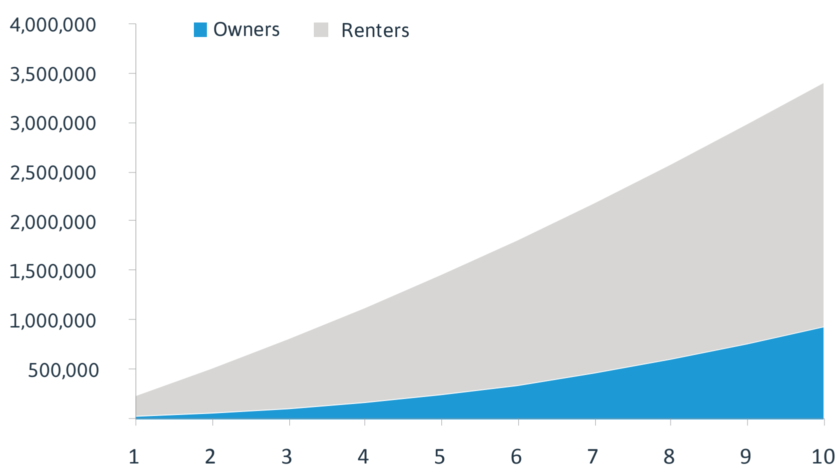
FIGURE 13: THE GROWTH OF ECHO BOOMERS



Source: ING Clarion, Moody's Economy.com

Regardless of the various political views on immigration, immigrants represent a massive pool of people who rent much more commonly than they own. In fact, the U.S. Census Bureau estimates that there is one new immigrant in this country every 40 seconds. Immigrants are also more likely to be life-long renters and never own a house of their own. The National Association of Home Builders studied the preferences of living situations amongst immigrants to this country. Figure 14 is from their 2012 report.

FIGURE 14: TENURE CHOICES OF NEW IMMIGRANTS OVER THE NEXT 10 YEARS

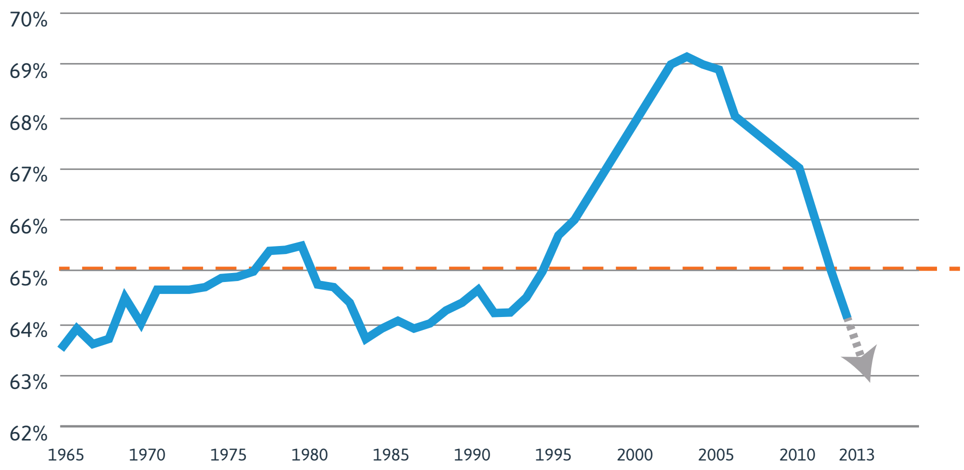


*assuming net immigration of 1.2 million over 10 years

Source: National Association of Home Builders, 2012

As you can see, the demand for rental units is massive. The above three groups are large enough to positively impact commercial multifamily for years and years. However, there is another trend that is driving demand. That trend is the decline in homeownership.

FIGURE 14: AMERICAN HOME OWNERSHIP



Source: US Census Bureau

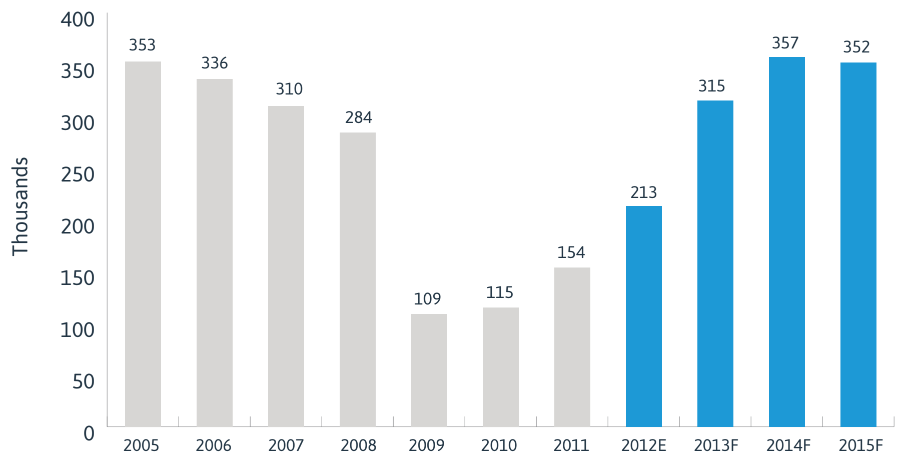
Homeownership continues to drop and every 1% drop represents 1,000,000 new renters. This trend has been sustained and multifactorial. Tight lending markets, upside down mortgages, foreclosures, the desire for urban living and mobility have all played a part in tarnishing homeownership as the American dream. As homeownership drops, so does rental vacancy rates leading to high apartment occupancy rates.

Now that we have examined the incredible demand in the rental market, let's look at supply.

CONSTRAINED SUPPLY

Currently there are 1,820,000 new households formed each year in the United States. In 2012, there were less than 300,000 new apartment units put into service. This supply and demand gap has been going on for years..

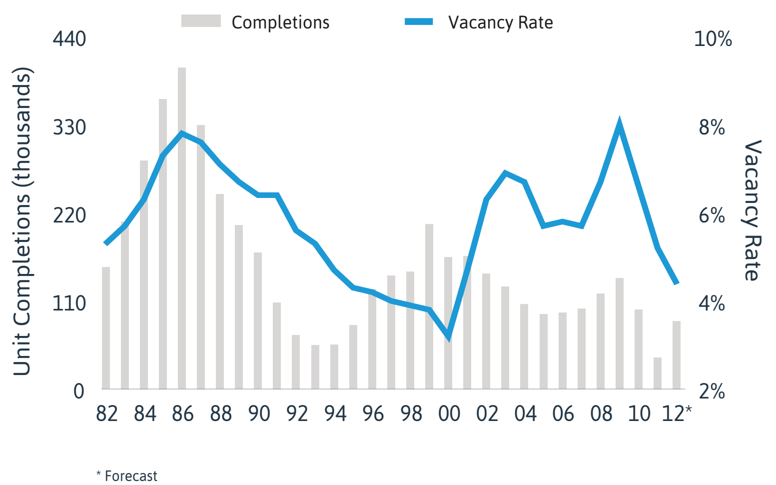
FIGURE 15: HISTORICAL AND PROJECTED MULTIFAMILY HOUSING STARTS



Source: U.S. Census, LEK

As you can see the combination of unprecedented current and future demand coupled with constrained supply is making the commercial multifamily real estate investing landscape hard to beat.

FIGURE 16: APARTMENT SUPPLY AND VACANCY TRENDS



Source: Marcus & Millichap Research Services, Reis Inc.

THE HOW OF MULTIFAMILY REAL ESTATE INVESTING

I believe that the best way for most doctors to invest in real estate is passive commercial multifamily. Having said that, let's go through the four different ways anyone can invest in real estate.

OPTION#1 – ACTIVE RESIDENTIAL REAL ESTATE

Many real estate investors begin and end their career here. We all know someone who has done this and as a consequence offers their stern admonition against managing "tenants and toilets." While there is truth that active management of real estate is not suited for everyone, it can be lucrative when done skillfully.

These investors should pick a business strategy and work with a team to implement it. Are you going to fix and flip distressed properties, focus on vacation rentals, deal exclusively with low-income government subsidized housing, provide student housing, senior housing, or some other strategy?

Due to the lack of economies of scale with residential real estate, the cash-flow can be small and inconsistent. Often times, the real wealth building power of residential comes from appreciation or paying off the loan. For all of the frustrations that can come with residential real estate, the IRS does allow one incredible tax break. Under certain circumstances with very specific requirements, the active investor can qualify for real estate professional status. This allows depreciation from the rental properties to be taken against earned income and therefore reduce the owner's overall tax burden.

As I alluded to previously, active residential real estate is the entry point for most beginning real estate investors. Many physicians know this and avoid real estate investing all together given their already busy lifestyles. What many don't know is that there are other options.

OPTION #2 – PASSIVE RESIDENTIAL REAL ESTATE

For years, many investors would buy a property, hire a property manager, bury their head in the sand and hope for good results. These investors felt like a property manager could insulate them from the headaches that come with being a landlord. Good property managers can definitely buffer some of the time commitment involved with residential real estate.

However, be aware that a good residential property manager is hard to find. Most charge 8% - 10% of gross income for management. That means if you are renting your single family house for $800 a month, the manager makes $80. This small amount of money will not sustain their business or put food on the table.

Consequently, residential property managers need to manage in bulk to make a decent living. That leaves them with little time to look after your property. Good residential managers do exist, but it is rare to find someone who will take care of your property as well as you would.

OPTION #3 – ACTIVE COMMERCIAL REAL ESTATE

Small strip malls, office buildings, and multifamily properties are in the range of the individual physician investor. To secure larger buildings, most physicians will have to form partnerships with other investors. These multimillion dollar properties come with multimillion dollar down payments. Larger properties also come with more economies of scale that allow for better cash-flow than residential real estate. Managing commercial property is serious business. I highly recommend you become an advanced learner before attempting to become an active commercial real estate investor.

Market and submarket analysis along with a sound business plan is just as crucial as picking a quality property that will provide ample cash-flow and appreciation over time. Previous management experience is desirable and may make the difference as to whether or not you will qualify for commercial lending. Keep in mind that some physicians are already familiar with active commercial real estate. It is not uncommon to see groups of doctors come together to purchase and manage the building that houses their urgent care, free-standing radiology center, or medical office.

OPTION #4 – PASSIVE COMMERCIAL REAL ESTATE

Realizing that the vast majority of medium and large commercial properties are owned by businesses and partnerships means that passive investing is commonplace in the commercial real estate space. This can be a very attractive option for the busy medical professional. Large partnerships formed to invest in commercial real estate are known as syndicates. There are numerous private real estate investment companies who specialize in various classes of commercial real estate and syndicate these types of deals.

These private real estate investment companies should have systems in place for acquisitions and operations. They should have a team that will consist at a minimum of a real estate attorney, an SEC attorney, CPA, real estate brokers, commercial real estate lender, and a property management company. They bring with them the expertise to manage the property and can qualify for an array of commercial lending including commercial banks, government sponsored entity (GSE), commercial mortgage-backed security (CMBS), and life insurance originations.

There are a range of ways these companies can take ownership:

- Limited Partnerships (LP)
- Limited Liability Companies (LLC)
- Delaware Statutory Trust (DST)
- Tenant in Common (TIC)

Limited partnerships and limited liability companies are the most common ownership structures used by private real estate investment companies. It is standard for the real estate company to be the general partner while the investors are limited partners. Delaware Statutory Trusts are gaining popularity in this space and largely replacing the old Tenant in Common (TIC) structure. TICs have fallen out of favor due to the requirement that all investors must qualify on the loan.

When you invest passively in commercial real estate through syndication, you are by definition a fractional owner. Instead of whole ownership of the property, you own a percentage of the property based on your initial capital investment and the entire amount of the raise. It is important to remember that the real estate investment company will also take compensation for their services on this investment.

Each company has its own compensation structure, but typical fees include:

- **Organization and Operations Fee or Acquisition Fee** – This is a one-time fee for developing the market, vetting the property manager, finding and evaluating the deal, negotiating and structuring the purchase, conducting due diligence, securing lending, and creating the partnership. It is compensation for the time, experience and expertise it takes to bring projects of this type to market. This fee varies usually between 1% to 5% of the purchase price.
- **Asset Management Fee** – This is an ongoing fee for managing the property and partnership, creating and implementing the capital improvement plan, maintaining reporting and distributions to the partners, and planning for and implementing liquidity events. Some firms will charge 1% of the asset value annually while others take 2% of gross income annually for ongoing management.
- **Carried Interest / Equity Participation / Promote** – Private real estate investment firms will carve out a percentage of equity and/or equity profit on any given deal. Typically, this participation comes in the range of 15% - 20%, but can be as high as 50%. This carried interest should be almost exclusively performance-based and is typically the largest benefit to the syndicator. In my experience, you want your asset manager/syndicator to be very motivated to perform well.

Just as any wise investor would perform due diligence on a property prior to investing, strict due diligence should also be completed on any private real estate investment company prior to investing with them.

How long have they been in business? What is their track record of performance? What is the background of the upper level management? Is there any pending legal action against them? Have they ever lost a project? Do they have references? Do you like them personally? Do they have the same business/ethics framework as you?

These are just some of the questions that need to be answered before considering investments in this type of structure. When evaluating any private real estate investment company, make sure you verify their track record. Stay away from companies that do not have a track record for consistent distributions of yield and double-digit overall returns.

REITS - THE MARGARINE OF REAL ESTATE INVESTING

This report would not be complete without some mention of REITs.
Just like real estate, butter has been around for thousands of years. Sometime in the 1800's someone decided that there was a need for something that looked like butter, tasted similar to butter, but wasn't butter. Along came margarine. Real estate investment trusts (REITs) are the margarine of the real estate investing world.

Let me show you why.

NAREIT, the National Association of Real Estate Investment Trusts, answers the question "What is a REIT?" in the following way:

A REIT, or Real Estate Investment Trust, is a type of real estate company modeled after mutual funds. REITs were created by Congress in 1960 to give all Americans – not just the affluent – the opportunity to invest in income producing real estate in a manner similar to how many Americans invest in stocks and bonds through mutual funds. Income-producing real estate refers to land and the improvements on it – such as apartments, offices or hotels. REITs may invest in the properties themselves, generating income through the collection of rent or they may invest in mortgages or mortgage securities tied to the properties, helping to finance the properties and generating interest income.

While REITs typically own real estate, investors in REITs do not. REITs are paper assets that represent interest in a company that owns and operates income producing properties. In essence they are real estate flavored stock. **As such, REITs are more than 85% correlated with the stock market.**

When discussing REITs, you encounter the following terminology – public, private, traded, and non-traded. Public REITs can be designated as non-traded or traded depending on whether or not they are traded on a stock exchange. Since traded REITs are traded on the stock exchange, they enjoy a high degree of liquidity just like any other stock.

Unfortunately, traded REITs tend to follow the economic cycles and can closely correlate with the stock market. This can lead to a higher degree of volatility than what is usually seen with physical real estate – without the tax advantages.

Private REITs and non-traded public REITs are not traded on an exchange. These are usually offered to accredited investors through broker-dealer networks. These REITs are illiquid and generally have high fees. They have been plagued with transparency issues as well as conflicts of interest.

Valuation of this stock is difficult and can be misleading to the investor. Due diligence is very important as the quality of non-traded REITs can vary widely.

HOW WILL YOU RETIRE?

In summary, I would recommend that every doctor or medical professional consider owning direct fractional investments in commercial multifamily real estate.

Commercial multifamily real estate is passive, inflation resistant, 100% evergreen, tax-advantaged, and can provide stable cash and equity returns.

For those whose portfolio is paper asset heavy, real estate can provide some needed diversification and stability. For those who are looking for better yield without having to sacrifice growth, real estate might be right for you. For those looking to decrease their exposure to high volatility investments, real estate may be the way to go.

Every physician should take a look at this asset class and see if it is right for them. Keep in mind that real estate can provide superior yield in the form of cash-flow as well as longer-term growth in the form of appreciation and amortization. Real estate is also highly tax-advantaged and can be an excellent hedge against inflation.

Realizing that I could gain access to these multi-million dollar properties without having to become a landlord has made all of the difference in the world to my financial success.

At NestEggRx, we offer education and information. If I can help you in further evaluating this asset class, please do not hesitate to contact me. For those who are interested in the opportunities available in today's market with a high quality private real estate investment company, please let me know and I'd be happy to make an introduction.

NEXT STEPS

To learn more about how you can benefit from this asset class, schedule a 15-minute phone consultation today. Don't hesitate as the consultation is complimentary and there is No Cost and No Obligation to you. We welcome the opportunity to assist you in reaching your financial goals.

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