2014-006…HELPING OR HINDERING INVESTORS?

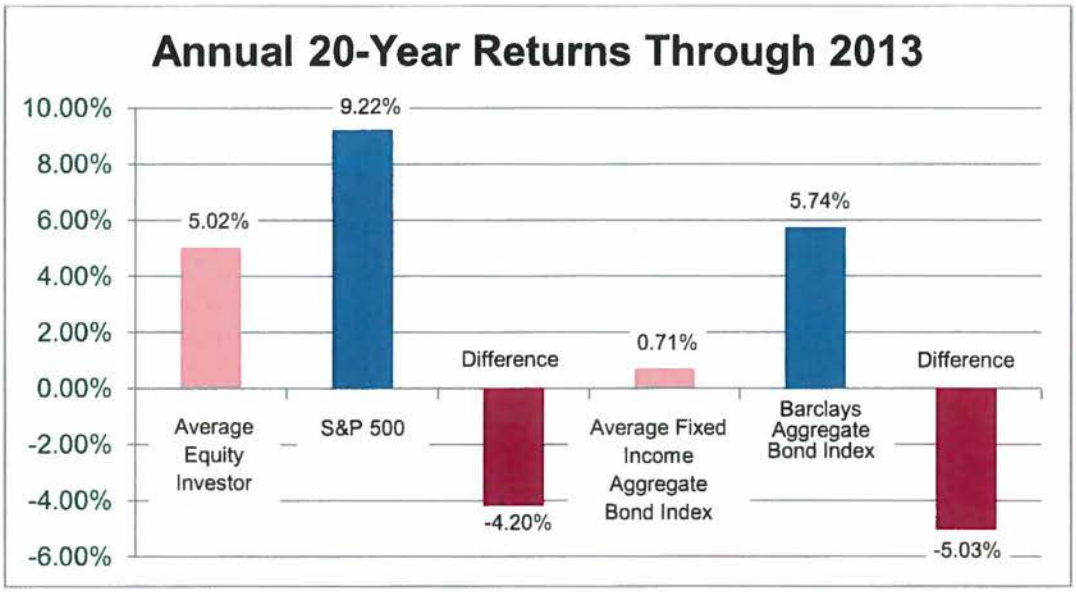
Hello,

I am writing this letter in response to some of the proposed rule changes in Regulatory Notice 2014-06, which I don't believe are structured to provide the best outcome for investors. Market forces are already reducing sponsor fees among the most popular offerings, providing a more value oriented product for investors. Sponsor companies that fail to adopt the more client-friendly fee structure are already losing market share and the confidence of advisors and investors. Since market forces are already solving many of the issues that have arisen in the non-traded REIT space, I fear the unintended consequences of some of these unnecessary rule changes may hurt investors more than they help them. Market efficiencies are already reducing sponsor fees, which are the biggest drag on performance for investors, and trying to substitute a flawed share pricing system with a different flawed pricing system is apt to lead to confusion rather than clarity.

NON-TRADED REITS ARE AN IMPORTANT INVESTMENT ALTERNATIVE, ESPECIALLY IN THE CURRENT MARKET ENVIRONMENT

Enforcement officials at the SEC and FINRA know that investor complaints often map an S&P downturn with a six month lag time frame. Anecdotal evidence indicates that client risk tolerance is higher when investments are going up, and that tolerance goes down when investments drop. Absent a material change in circumstances, shouldn't a rational investor have the same risk tolerance whether investments are rising or falling? We know that the most rational investors cannot completely remove the element of emotion when investing, much as we try to make logically informed decisions. To the contrary, Dalbar (see Exhibit 1) reports that investors routinely underperform the indexes on average precisely because they often buy higher and sell lower when they "know" they *should* be doing the opposite.

Exhibit #1



Source: Dalbar Inc., 2014 Quantitative Analysis of Investor Behavior, Advisor Edition, p. 3

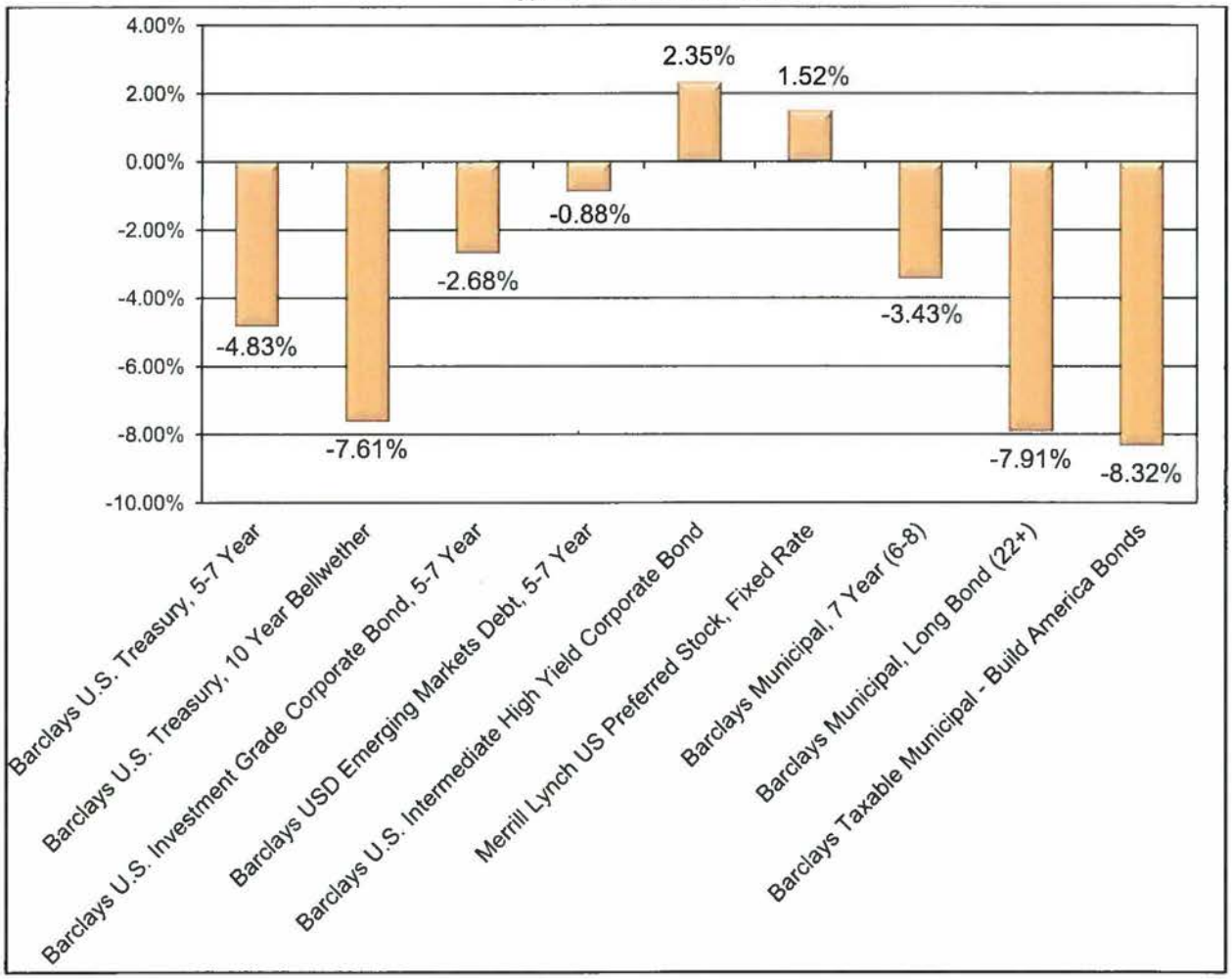
The current bull market for stocks is already well into its fifth year (the post WWII average is 4.6 years), and stock markets are nervously anticipating a correction, be it large or small. The thirty plus year bull market for bonds is teetering on the edge of (perhaps) a nasty reversal as the Federal Reserve tapers quantitative easing and begins to discuss raising interest rates. For a generation, investors have generally bought stocks for higher risk/higher growth opportunities and purchased bonds for (relative) safety. If the ten year treasury returns to its seven decade average of about 5.5%, the question isn't going to be if investors will suffer losses, but how bad those losses will be (Exhibit Two). FINRA has already warned advisors that they must educate clients about the potential for losing money in bonds in a rising interest rate environment. So if both bonds and stocks have increasing risk and it is difficult for investors to generate yield anyway, shouldn't the industry identify a viable alternative?

I recall the halcyon days of the mid-nineties when huge portfolio gains prompted financial planners to speculate on a changed paradigm of technology and productivity, when the 5% rule for generating income was deemed anachronistic. Some went so far as to posit that financial plans should be forecasting 6%, 7% or even 8% portfolio withdrawal rates. By contrast, in March of 2013, the Wall Street Journal featured an article by Kelly Green entitled "Say Goodbye to the 4% Rule." With the S&P 500 offering an average dividend of 1.4% (and potentially subject to a significant correction), the ten year treasury paying less than 3% (and potentially subject to rising interest rate risk) and cash/cash equivalents at less than 1%, I wonder if the next WSJ article will be "Say Goodbye to the 2% rule."

Exhibit #2

The Effect of a 1% Rise in Interest Rates

Hypothetical Total Return



Yeld	0.95%	1.75%	2.32%	3.58%	6.10%	7.18%	1.53%	3.23%	4.00%
Duration	5.77%	9.36%	5.00%	4.73%	3.75%	5.66%	4.97%	11.23%	12.33%

The table illustrates hypothetical examples and does not represent the return on any particular investment. Data as of 12/31/12. Effective duration is used for the preferred index and modified adjusted duration for all others. The performance figures are for illustrative purposes only and do not account for all factors that may potentially impact returns.

With stock valuations near all-time highs, bond and cash instrument yields near all-time low yields, and more investors approaching or in the midst of retirement, it is small wonder that investments in non-traded REITs have surged. It is difficult to recall a more challenging time or greater need than now for a discussion in the professional investment community about utilizing non-traditional asset classes (aka. alternatives) in conjunction with the traditional three asset classes. Major endowment funds (Exhibit Four), insurance companies, foundations, pension funds and extremely high net worth investors have long understood the benefit of these asset classes as a means of reducing volatility in a portfolio and (potentially) generating higher returns. If the simple addition of a fourth asset class can simultaneously increase the potential return and decrease volatility, why hasn't everyone invested in alternatives? If one adds the feature of a much higher income/distribution rate

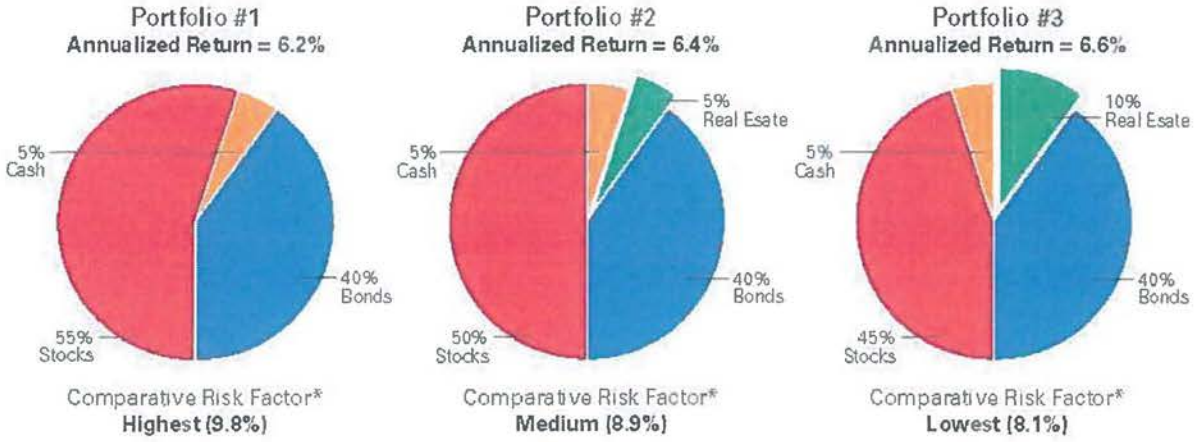
(5-8.5% on current offerings) it would appear that failure to include such this asset class borders on financial malpractice. One might also posit that adding asset classes with a lower correlation to stocks constitutes the execution of modern portfolio theory circa 2014.

Exhibit #3

WHY REAL ESTATE?

While stocks and bonds have their place as traditional instruments of investment, investors are increasingly considering alternative investments such as real estate, hedge funds, private equity and exchange traded funds in an attempt to generate overall enhanced performance of their portfolios. Historically, real estate has been relatively un-correlated to the broader stock and bond markets. Said differently, investments in real estate may not fluctuate as much as other investments based on the broader stock market, and therefore real estate can help to diversify a portfolio.

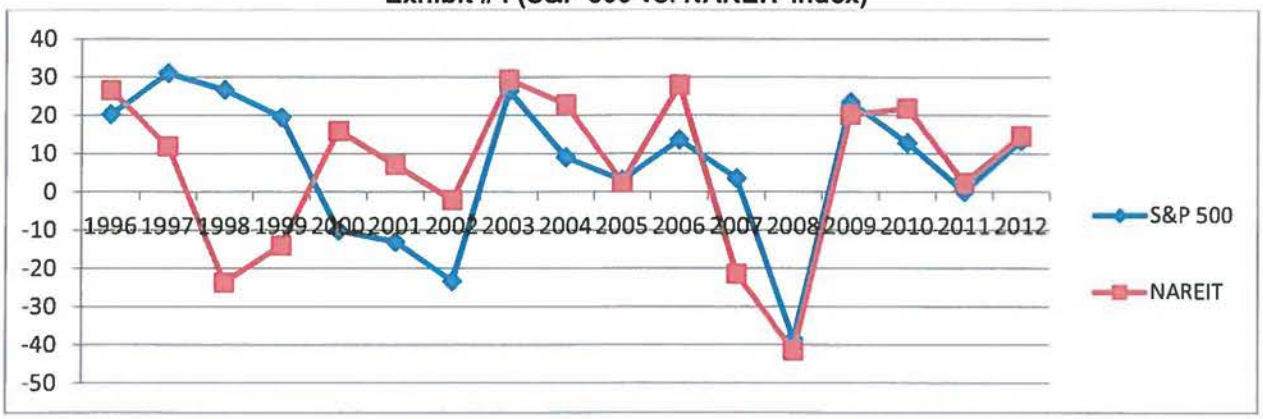
Average Annual Return and Standard Deviation, December 1996 - December 2011



Standard deviation is used to measure risk.* **Sources: S&P 500; Federal Reserve database in St. Louis (FRED). The stocks are the S&P 500 Large Cap Index, The raw data for treasury bond and bill returns is obtained from the Federal Reserve database in St. Louis (FRED). The treasury bill rate is a 3-month rate and the treasury bond is the constant maturity 10-year bond, but the treasury bond return includes coupon and price appreciation. Real Estate – NCREIF Property Index (NPI). NPI is based on institutional investments and data is presented without the effects of leverage or fees. United Realty Trust will utilize leverage, and be responsible for paying fees that will be dilutive to the potential distributions and total returns generated for its investors. All specific investment valuation data used in the calculation of the NPI Index is appraisal based, as opposed to actual transaction based information. PPR data as of 12/31/11. **Note:** Investors cannot invest in indices. Past performance does not guarantee future results.

Twenty years ago, one could be considered properly diversified with a mix of large, medium and small capitalization stocks, U.S. and non-U.S. based companies, stocks split between growth and income strategies, and diverse stock selection methods ranging from active management to quantitative analysis. However, recent trends show that globalization has led to an overall convergence of stock market volatility regardless of these types of diversification, and alternative investments may be the only way to effectively diversify in this context.

Exhibit #4 (S&P 500 vs. NAREIT Index)



THE PROBLEMS FROM PRE-2008 FUNDS HAVE LARGELY BEEN ADDRESSED

Although my firm utilizes both traded and non-traded REITS, we have observed that traded REITS closely correlate to stocks generally. Therefore, while traded REITS are an important part of our portfolio model, we use non-traded REITS in order to obtain the aforementioned benefits of lower correlation and reduced volatility for our investors. Despite the astonishing performance of many non-traded REITs since the Great Recession, FINRA and the SEC appear to still be concerned about the poor performance of several non-traded REITs that were organized and funded during or prior to 2007. I believe that there were five primary causes of such poor performance, and that those flaws have, for the most part, already been addressed by the industry::

1. Many of the NTRs offered prior to the 2007 recession and stock market collapse charged higher fees, and were not structured to overcome the significant economic downturn and subsequent tepid recovery
2. Like residential investment property investors, sponsor companies took significant risks by leveraging real estate at levels greater than 50%, and purchasing property appraised at "frothy" prices.
3. Sponsor companies failed to more closely align their interests with investors, utilizing fee structures that benefited these companies by holding their portfolios for extended periods of time and with little incentive to return investor capital with profits in a timely manner. The most popular companies today often defer general and administrative fees by taking shares in lieu of cash, and further aligning with investors for a successful liquidity event.
4. In the past, Registered representatives were not required to do independent due diligence and demonstrate significant product knowledge. Now, FINRA has already mandated that advisors are required to perform due diligence independent of their broker/dealer.
5. Broker dealers didn't have tools in place to properly supervise and monitor advisor and client education. Now BDs are increasingly requiring testing and additional internal examinations if they offer non-traditional investment options.

I think the industry has made great strides to improve alternative products in all five of these areas. For years, the leadership at FINRA has engaged in relatively unproductive discussion with non-traded REIT sponsor companies over how to provide better information to investors and advisors. Industry leaders have both grappled with the difficulty of how to value an asset that by prospectus is

intended to be held for five to seven years and defies common valuation metrics of stock and bond markets, since by definition it is "non-traded," and has no readily available pricing mechanism. Sponsor companies have also been reluctant to alter an environment that has produced all-time highs in capital flows to new products, and record-setting returns to investors in much faster time cycles than have previously been experienced. Some sponsor companies have also used the complex pricing structure to engage in practices that have been less than helpful to advisors and investors. They have taken years to complete their fundraising, extended the life of their offerings through "add-ons", kept fee levels too high, and most importantly, failed to return capital to investors with a profit in a reasonable time period. Regulators, investors and advisors have been understandably perturbed by this recalcitrance. FINRA has enhanced examinations at the broker dealer and registered representative level to ensure that investors are well informed about the risks of the product, and that the advisors who offer this product are both well trained and well supervised. But FINRA has been unable to enhance the value proposition to investors. Clearly, FINRA executives hope to avoid a repeat of the number of complaints that dogged some of the programs that raised money prior to the Great Recession, saw sponsor company redemptions suspended, and had both distributions and share prices reduced.

CLIENTS ALREADY KNOW THE "PRICE" OF REAL ESTATE ISN'T "NET"

The proposed "solution" substitutes one arbitrary valuation of non-traded REIT shares for another. This approach ignores some of the industry best practices (enumerated further below) that actually provide better value to investors through reduced fees and improved investor/sponsor company alignment. If one looks at two comparable types of investments, the ill-advised nature of this solution becomes even clearer.

Let's contrast residential real estate ownership with an investment in a non-traded REIT. Though I don't have exact statistics to confirm this, it seems likely that many non-traded REIT investors also own their own home because of the minimum income and asset level required by prospectus (and many states) to own this sort of asset. Someone buying a home generally signs a HUD-1 form at the time of purchase, wherein many of the expenses of the transaction are disclosed in line item fashion. Although there is some variance by location, home buyers generally know that the cost of real estate brokerage, financing expenses, home inspections, surveys, lawyers, accountants and transaction fees add about 10% to the purchase of a new home. Except during real estate bubbles, it likely takes three to ten years before a homeowner can sell their home, recoup costs and make a profit. Imagine if the current philosophy of 14-06 were applied to home ownership. If someone buys a $100k home and is asked how much it is worth, they would say that their home is worth $100k. They wouldn't deduct the cost of selling the home and say, "I bought the home for $100k, but since it would cost me $10k to sell it, it is actually worth $90k." Clearly for the average person purchasing a house, the closest asset they have for comparison to purchasing a non-traded REIT, this valuation practice would be deemed absurd. Investors know that unless one is "flipping" real estate (much like a day-trader of stocks) the value of the real estate is really only important on two days: the day of purchase, and the day of sale. While it is helpful to have a sense of the value in between those two dates, every valuation method of a non-traded asset is somewhat flawed, whether one considers replacement cost, net operating income, capitalization rate, or comparable values.

A COMPARABLE STRUCTURE DOESN'T REQUIRE A "NET" PRICE DISCLOSURE

A second investment with comparable features to a non-traded REIT is a variable annuity. Although there are important differences, I would not be surprised is many investors who have purchased a non-traded REIT also have purchased a variable annuity. Below is a comparison of a variable annuity with a surrender charge. Although we manage most of our clients investments as a Registered Investment Advisor and rarely utilize annuities, occasionally we have a client need for a guaranteed income benefit. If we utilize a commission oriented product, there is generally a surrender charge if the client redeems the contract in less than seven years. Whether we utilize non-traded REITs or variable annuities, we generally have immediate liquidity options in other parts of the portfolio. With both variable annuities and non-traded REITs, clients must sign forms and applications in several places acknowledging that the purpose of the investment is long-term, and that if they liquidate in the short term, they may not recover the total principle. Unlike a non-traded REIT, the subaccounts of variable annuities are valued daily. However, the SEC and FINRA do not require that the surrender penalty be deducted from that valuation on client statements. They have confidence that investors and advisors are familiar with the inherent penalty, and that trying to show a "net" value on statements causes more problems than it solves.

	Non-Traded REIT		Jackson National Perspective II	
Years Since Purchase	Stated Value	Redemption Value	Stated Value	Redemption Value
0	$100,000	n/a	$100,000	$91,500
1	$100,000	$92,500	$100,000	$92,500
2	$100,000	$95,000	$100,000	$93,500
3	$100,000	$97,500	$100,000	$94,500
4	$100,000	$100,000	$100,000	$95,000
5	$100,000	$100,000	$100,000	$96,000
6	$100,000	$100,000	$100,000	$98,000
7	$100,000	$100,000	$100,000	$100,000

SOME OF THE SUGGESTED CHANGES WOULD BE BENEFICIAL

This proposed rule change has some very helpful elements. I believe that while these changes put some pressure on sponsor companies to perform more efficiently, the best sponsors are already rising to meet this challenge.

1. It provides guidance on valuations so that Broker Dealers can be certain of what procedures must be followed, eliminating the sense that FINRA examinations have arbitrary or capricious standards.
2. It requires valuing the share price much earlier in the fund-raising process than was previously stipulated. This is an important check on the sponsor companies, whose business models should focus on quicker profitability of their offering. By not doing so, they risk losing the confidence of advisors and investors, which would have a negative effect on their ability to raise capital in future offerings.
3. The proposed rule change clarifies the standards for valuing shares and increases the frequency of updating those valuations. It also raises the standard for independent valuations, providing the most accurate information possible to investors and advisors.

THE PROPSED RULE CHANGE COULD HAVE ADDED MORE INVESTOR VALUE

A practical solution to the problem some of the unknown quantities associated with alternatives would consist of some or all of the below points:

1. A "best practice guideline" that actually reduces the cost to investors. The market leader (American Realty Capital/Realty Capital Securities at more than 60% and rising) has already implemented a reduced cost structure for most of their offerings.
2. They have eliminated the "internalization fee" whereby the sponsor company was paid a "bonus" to carve out the REIT management team from the sponsor company and allocate the team exclusively to the REIT.
3. They have generally reduced the fee charged to acquire portfolio assets from 3% of the purchase price to 1%.
4. They have generally eliminated the 1% fee charged to the fund for arranging financing.
5. They have significantly reduced the annual fee for General Administration by 1% or more, and in many cases, the fee is taken in the form of restricted stock, allowing the cash to be utilized for asset acquisition. This has the added benefit of aligning the interest of the sponsor company with investors. This in particular has served to allay doubts about whether or not sponsor companies in the past have failed to manage their portfolios optimally because they were content to charge annual management fees.

POTENTIAL UNINTENDED CONSEQUENCES

1. Investors who choose to "pre-pay" their advisor commission or want more income and less growth shouldn't be punished with what essentially amounts to un-realized losses to be shown on their statement.

$100K Non-traded REIT purchased w/ Commission***				
	Value	Shares Purchased $10/share	Representative Commission	Annual Dist. at $0.70/share
Year 1	$100,000	10,000	$7,000	$7,000
Year 2	$100,000			$7,000
Year 3	$100,000			$7,000
Year 4	$100,000			$7,000
Year 5	$100,000			$7,000
Year 6	$100,000			$7,000
Year 7	$100,000			$7,000
Year 8**	$100,000			$110,000
Totals		**10,000**	**$7,000**	**$159,000**

$100KNon-Traded REIT purchased at NAV and charged Annual RIA Fee***					
	Value	Shares Purchased $9.15/share	Annual Dist. at $0.70/share	Annual RIA Fee	Net Annual Dist. After RIA Fee*
Year 1	$109,290	11,944	$7,650	$1,366	$6,284
Year 2	$109,290		$7,650	$1,366	$6,284
Year 3	$109,290		$7,650	$1,366	$6,284
Year 4	$109,290		$7,650	$1,366	$6,284
Year 5	$109,290		$7,650	$1,366	$6,284
Year 6	$109,290		$7,650	$1,366	$6,284
Year 7	$109,290		$7,650	$1,366	$6,284
Year 8**	$109,290		$120,219	$1,366	$118,853
Totals		**10,929**		**$10,929**	**$162,840**

*RIA fee of 1.25%/year.
**Year 8 represents a sale of the investment at $11/share.
***Illustration represents a purchase inside of an IRA account thereby foregoing any tax implications. Example does not illustrate the use of dividend reinvestment.

2. The immediate pricing valuation requirement recommended in the current iteration may discourage the utilization of a product/asset class that might otherwise be very helpful to investors.
3. Has anyone checked with the IRS on this? Temporarily discounting the price of a NTR (assuming the "load" is eventually recovered and the share price eventually reflects the return of principal and profit) could lead to rampant use for Roth conversions. While Congress

sometimes implements policy that generates a burst in tax collection, if this process becomes popular, it will lead to significant losses in tax revenue in the future.

4. If this immediate pricing formula is adopted, advisors may not offer this important product to lower and middle income Americans. This would mean that low to middle income Americans have fewer choices and opportunities. Advisors already face increased regulatory responsibilities when it comes to client education and product due diligence, as well as an increased load on staff with paperwork requirements. These advisors also face rising healthcare costs, and as small business operators, eliminating a commission option makes an already challenging environment even more difficult.
5. The proposed changes stand to confuse the investing public rather than clarify any issues. People who purchase real estate as a medium to long-term hold (e.g. a non-traded reit) know that there is a "load" factor, and if they sell in the short term, they are unlikely to get all their money back.

In summary, I support some of the rule changes that have been proposed. Providing sponsor companies with a formula and timeline to adopt a uniform metric for appraising and reporting the values of non-traded REITS is very helpful. Giving broker dealers assurance that they can rely on those values is also very valuable. Shortening the time frame for raising capital and reporting appraised values will incentivize sponsor companies to carefully execute their business plan with diligence and serve the entire investment community.

I believe that an opportunity was missed to enhance the value of this investment structure and provide a more valuable benefit for investors. Making the best practices of ARC/Cole an industry standard would have provided a real value enhancement to investors and advisors.

I don't think the investor public will be better served by arbitrarily substituting one somewhat imperfect metric for reporting share price with another metric that is even more misleading. The current initial share price reporting is not perfect. FINRA and the SEC must recognize that this important vehicle to a vital asset class doesn't easily fit with traditional asset classes. I understand their desire to protect the investment public. However, I believe that the greater good is served by keeping the initial share reporting metric as it is, and tightening the reporting as the offering progresses. I strongly encourage the SEC to adopt the timeframe and metrics for subsequent share price reporting, to consider endorsing the industry practices that are already underway with sponsors reducing, eliminating or deferring fees, and to reject the requirement to report initial share prices net of some fees.

Sincerely,

Frederick P. Baerenz,
President & CEO, AOG Wealth Management