Personal Finance

Advocating Direct Investments Through Education

IPA

Investment Program Association

"Knowledge is empowerment"

Direct Investments are playing an increasingly important role in client portfolios as many investors seek differentiated opportunities that provide the potential for returns uncorrelated to the traditional equity and fixed-income markets. However, in many cases, they need a better understanding of these types of investments before they feel comfortable choosing investments such as *Non-Traded REITs*, *Equipment Leasing*, *Oil and Gas*, and *Managed Futures* in their investment portfolio.

This guide is intended to help investors develop a better understanding of these types of investments, specifically with regard to how these investments work, how an investor's capital is put to use in these investments, and, most importantly, the risk-reward characteristics of these respective investments and the potential impact they can have when added to a traditional investment portfolio. It is important to note that investors interested in Direct Investments should read the prospectus for each individual opportunity carefully, with particular attention to the risks section, before investing in these types of programs.

The Investment Program Association (IPA) is an industry trade association comprised of broker-dealers and direct investment sponsors working together to provide investors with tools and education resources like this guide to increase your knowledge of Direct Investments and empower you to consider adding them to your portfolio.

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The Investment Program Association presents:

GUIDE TO UNDERSTANDING DIRECT INVESTMENTS

- Non-Traded REITs
- Oil and Gas Programs
- Equipment Leasing
- Managed Futures

VIRGINIA B. MORRIS AND KENNETH M. MORRIS

GUIDE TO UNDERSTANDING DIRECT INVESTMENTS

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LIGHTBULB PRESS®

Your Investment Portfolio

With the right advice, you can broaden your investment horizons.

A traditional investment portfolio contains a combination of stocks, bonds, cash or cash equivalents, and the mutual funds or exchange traded funds (ETFs) that invest in those **asset classes**.

But if you want your portfolio to help you meet your financial goals, it can't just be any combination of assets: You need an investment strategy. That's why, when you collaborate with a financial adviser, the adviser's first task is to assess your needs as a client, based on a thorough review of your investment objectives, attitudes toward risk, and the amount you have available to invest.

Your adviser can then determine the appropriate investment mix, or **asset allocation**, for your portfolio. Part of this process is to provide a regular review and periodic reevaluation of your portfolio to see that it continues to suit your objectives and risk tolerance.

DIRECT INVESTMENTS

INVESTMENT STRATEGIES

Creating an investment strategy means developing a plan that maps out your choice of investments, how they fit into your portfolio, and the reasons you might sell. But putting a strategy in place isn't as simple as it may sound. That's because you'll probably have a combination of short-term, mid-term, and long-term objectives, which range from an immediate need to buy a house or send a child to college to a long-term need to plan for retirement. So you'll actually need a strategy that suits each of these different time horizons.

Your time frame and even your investment objectives are likely to change as you meet some goals and revise others. So in allocating your money to the various asset classes in your portfolio, you and your financial adviser must determine the optimal mix of liquidity, capital preservation, growth, income, and future security.

IT'S ALL IN THE TIMING

Short-term. A few months to up to three years. Emphasis on capital preservation.

Mid-term. Three to ten years. Balance between protecting your assets and achieving the growth necessary to afford your goals.

Long-term. More than ten years, possibly even 40 or 50 years. Growth over an extended period.

THE FULL RANGE OF ASSET CLASSES

	ASSET CLASS	FEATURES	CHARACTERISTICS
TRADITIONAL	**Stocks**	An equity investment in a corporation, which gives an investor ownership of a small part of the company. Stocks are highly liquid and trade on an exchange or quotation service. Trades incur commissions, fees, or both.	The price of a stock moves up or down depending on how much investors are willing to pay for it at the time. Income may also be paid out in the form of dividends.
TRADITIONAL	**Bonds**	A loan, also known as a fixed-income security, that pays interest over a fixed term, or period of time. Bonds may be issued by corporations, the US Treasury, states and cities, and federal, state, and local government agencies. Overseas companies and governments may also offer bonds to US investors.	Bonds promise to pay a steady income of regular, fixed-interest payments until maturity. In the secondary market, the price of a bond changes as interest rates change.
TRADITIONAL	**Cash**	Bank accounts, money market funds, CDs, and Treasury bills are considered cash investments.	While cash is the most liquid, its real value decreases over time because of inflation.
ALTERNATIVES	**Direct Investments**	Long-term investments in limited partnerships or corporations investing in businesses such as real estate, equipment leasing, and energy exploration and development. By making a direct investment in one of these programs, an investor becomes part owner of the hard assets of the enterprise.	Investors realize income from the business and in some cases capital gains at the end of the investment term. There may also be tax benefits. Direct investments are largely untraded and no formal secondary markets exist.
ALTERNATIVES	**Managed Futures**	Structured as limited partnerships that invest in global financial and commodity futures markets. The primary intention is to provide portfolio diversification benefits by producing returns that are noncorrelated to traditional asset classes. The trading strategy is typically a systematic approach using computer programs to analyze market data and determine market direction and risk management for all trades.	Managed futures take long or short positions in over 150 global markets, including currencies, agricultural products, and stock indexes. Liquidity and fund pricing is typically available on a monthly basis. Managed futures funds are a growth product and will not produce an income stream.

TRADITIONAL TO ALTERNATIVE

While some mix of traditional asset classes is likely to yield satisfactory investment returns for the average investor, you may also look for non-traditional opportunities, such as **direct investments** and **managed futures**, commonly known as alternative investments, to put your money to work. These alternatives have the potential to provide balance in an otherwise conventional portfolio as well as to increase your current income.

Of course, before adding new asset classes to the mix, you'll want to be sure you understand their risks as well as their strong points. With your financial adviser, you can investigate the ways in which different types of investments put your money to work and identify the ones that interest you the most.

DIRECT INVESTMENTS

Risk and Return

Once you understand the relationship of risk and return, you can make smarter decisions.

Investment of any kind comes with a certain degree of **risk**. From one perspective, the greatest risk is that you may lose all the money you have invested, and more. But there's also the risk that you may earn too little and have to scale back your financial goals.

In general, the risk of losing money on an investment rises as the potential **return**, or payoff, increases. On the opposite side, the risk of earning too little grows as the return decreases. Or, to put it another way, seeking higher returns requires taking higher risks.

ESTIMATING RISK

No investment has a fixed level of risk or guaranteed return. In addition, past performance can't predict future results and doesn't guarantee return. What performance history may provide, however, is an overview of the risk-return relationship of various asset classes.

With traditional investment classes, such as stocks and bonds, it's easy to check performance history since this information appears in a number of readily accessible financial resources, both online and in print.

In contrast, the return on direct investments is harder to track. There's less information readily available and a limited range of similar investments that you can compare to the ones you're considering. That's where a financial adviser can help—by explaining the particulars of any new investment opportunity, including direct investments.

RISK TOLERANCE

Understanding your own risk tolerance is also important to investment success. If volatility makes you anxious, then high-risk investments may not be right for you. But a portfolio concentrated in low-risk assets poses the real risk of not earning enough to beat **inflation** or meet your financial objectives.

Serious investors minimize their risk and help stabilize their returns by:

- Allocating their assets among different classes and subclasses
- Diversifying their investments within each asset class among investments of varying degrees of risk

The level of the risk you take depends on the type of investment you make.

HIGHER RISK

- **Futures, options, and other derivatives**
- **Speculative stocks and mutual funds**
- **Direct investments in oil & gas**
- **Mining, precious metals**

MODERATE RISK

- **Growth stocks**
- **Small-company stocks**
- **Medium-rated corporate, municipal, and zero-coupon bonds**
- **Growth mutual funds**
- **Rental real estate**
- **Non-traded REITs**

LIMITED RISK

- **High-rated corporate, municipal, and zero-coupon bonds**
- **Balanced mutual funds**
- **US Treasury bonds and notes**

LOW RISK

- **Savings accounts**
- **Money market accounts**
- **CDs**
- **US Treasury bills**
- **Fixed annuities**

Please note, asset allocation and diversification do not ensure a profit or guarantee against a loss.

TYPES OF RISK

The risk you face by investing in a specific asset class, industry, or market is called **systematic risk**. It's the product of the recurrent ups and downs of the marketplace, which is influenced by economic and political factors you can't predict or control but which may have a significant impact on the value of your portfolio.

Stock market volatility, the impact of rising inflation on the value of fixed-income investments, and the consequences of political turmoil are all examples of systematic risk. One way to help protect your portfolio value may be to include investments that are insulated from certain of these risks or provide a **hedge** against them. Rising energy prices that result from political tensions, for example, may have a negative impact on the stock market, but may increase the income value of an investment in energy production.

Nonsystematic risk is inherent in a specific investment. It results from factors such as management decisions, new technologies, or the introduction of competitive products. With due diligence, you and your adviser should be able to uncover many of these issues up front, so that you can take them into account in deciding whether or not to purchase one investment rather than another, similar one.

Direct investments generally have increased risk exposure but often have higher return potential and can help portfolio diversification.

RETURN IS NOT JUST A NUMBER

The ultimate success of any investment is what you get back for what you put in. But the way you measure that success is not always simple. That's because in calculating return you need to account for both the growth of the investment and the income it pays, less any fees. Together growth and income represent the **total return** on your investment.

Percent return is your total return divided by the price of the investment. To get the whole story, you also need to consider the return over time, or the **annualized return**. That's the percent return divided by the number of years you own the investment. For example, if your investment increases by 20% in one year, that's a stronger return than realizing that same 20% increase over 3 years.

You also need to consider tax implications. While some investments may produce smaller annual returns, the rate at which they are taxed—for example, the lower rate on long-term capital gains or tax-exempt status of certain municipal bonds—has the effect of increasing your actual return.

Direct investments may offer significant tax advantages both in terms of capital gains treatment and deferred taxation.

However, because tax laws are always subject to change, you need to recognize that an investment strategy that depends on current tax law may not always meet its objective. In addition, the tax code is complex, so you should always consult your tax adviser to be sure you understand what's involved in being eligible for certain tax benefits and the potential tax risks you face. In addition, direct investment income doesn't qualify for the lower tax rate that applies to most dividend income.

RISK AND TIME

Volatility and **liquidity** are hallmarks of risk. Volatility is a measure of the changing value of an individual investment, a portfolio, or an entire market. The more often the value changes, or the more quickly the changes occur, the greater the volatility.

Volatility adds risk, especially in the short term, to investments such as stocks because their prices are as likely to fall as to rise as market conditions and investor attitudes change. But if you hold stocks for an extended period, you are more likely to see a potential increase in value. That isn't the case with investments where volatility doesn't diminish over time, such as high-yield bonds.

Liquidity is the ease with which an investment can be converted to cash with little or no loss of value. In general, the more liquid an investment is, the less risk it poses to your principal, but the lower the return it is likely to provide over the long term. In contrast, some investments — described as illiquid — generally pose a greater risk. For example they may be difficult to sell quickly because of a limited market or may carry a penalty, sometimes substantial, if you cash out before their term expires. But they may also provide the potential for a much stronger long-term return.

DIRECT INVESTMENTS

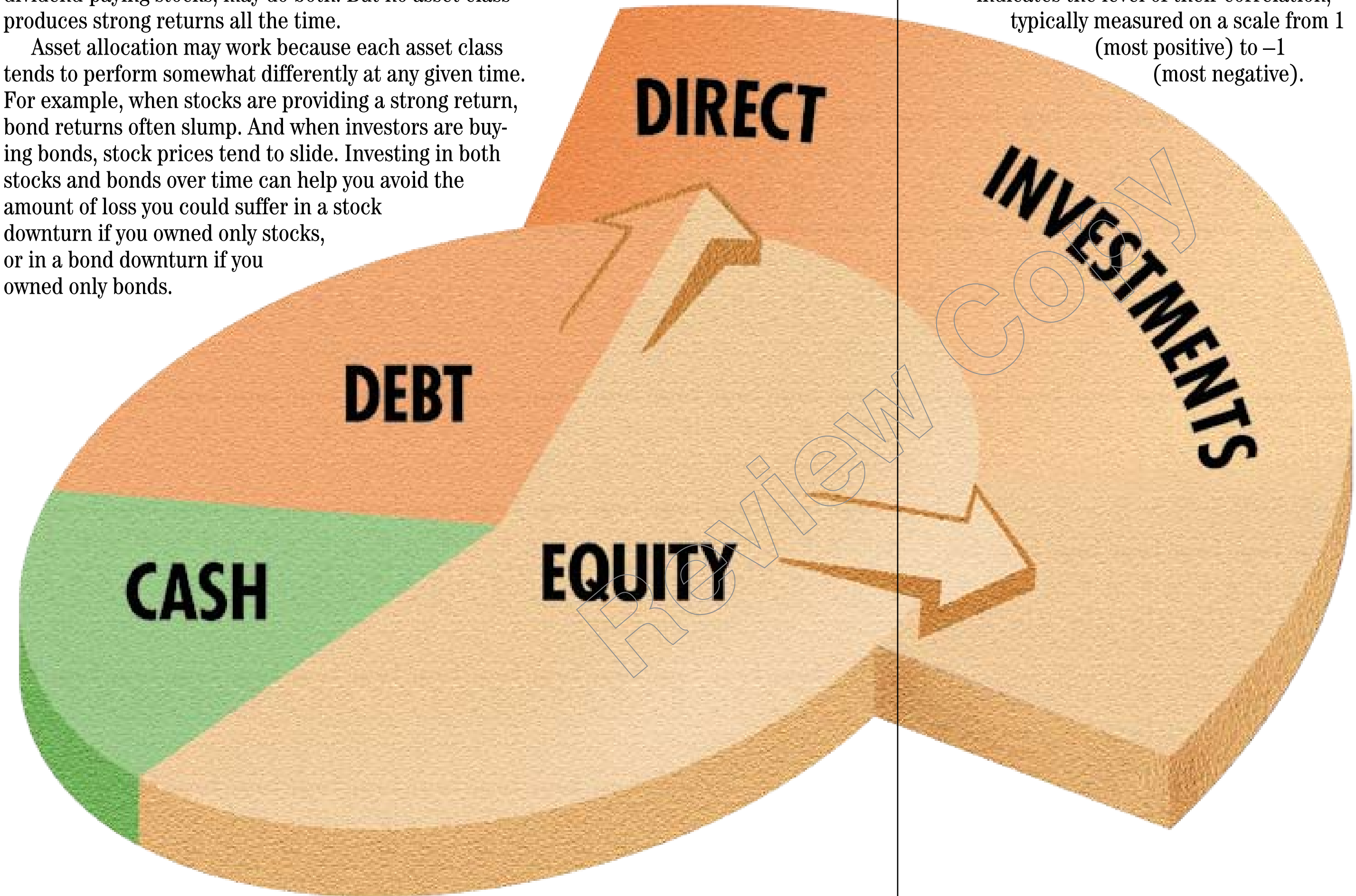
Asset Allocation

By expanding the number of asset classes you use, you can add depth to your portfolio.

Asset allocation is a strategy that involves selecting a mix of investments as you seek to achieve your financial objectives at a level of risk you can tolerate. Determining what percentage of your portfolio you allocate to each **asset class**, or investment category, can be one of the most important decisions you make with your investment adviser.

Some asset classes have the potential to increase the value of your portfolio, and others to provide regular income. Some categories, such as dividend-paying stocks, may do both. But no asset class produces strong returns all the time.

Asset allocation may work because each asset class tends to perform somewhat differently at any given time. For example, when stocks are providing a strong return, bond returns often slump. And when investors are buying bonds, stock prices tend to slide. Investing in both stocks and bonds over time can help you avoid the amount of loss you could suffer in a stock downturn if you owned only stocks, or in a bond downturn if you owned only bonds.



MODEL PORTFOLIOS

Most **asset allocation models**, or plans, tend to focus on **securities**—stocks and bonds, mutual funds and ETFs—plus cash equivalents that can be easily liquidated, such as CDs and US Treasury bills.

The basic approach is to assign a percentage of your total investable assets to two or more of these asset classes, or investment categories. There are some standard models—such as 60% stock, 30% bond, 10% cash—that some pension funds use to produce the returns they need to meet their obligations to retired workers. Other models, which may emphasize other asset classes or include alternative investment categories such as **futures** or **direct investments**, are designed to help achieve certain goals or reflect different tolerances for risk.

Being invested in multiple asset classes means that the classes producing stronger returns at any given time can help balance the ones that are faltering. Adding **alternative investments** to your investment mix creates additional opportunities for achieving this balance.

JUST LIKE THE OTHERS—OR NOT?

The extent to which asset classes perform similarly to one another is called **correlation**. Positively correlated assets are affected in the same way by certain systematic risks and their returns tend to move in the same direction. Negatively correlated assets are affected differently by economic and political events and their returns tend to move in opposite directions. The extent to which assets perform similarly or differently indicates the level of their correlation, typically measured on a scale from 1 (most positive) to –1 (most negative).

Many alternative investments tend to have low to negative correlations to traditional asset classes, as their values don't tend to move in tandem with equity or bond markets. Though it may seem counterintuitive, adding higher-risk, negatively, and noncorrelated assets to your portfolio can reduce the overall volatility and risk within your portfolio and increase your potential return.

ALTERNATIVE DIVERSIFICATION

Tangible or hard assets, such as real estate, leased equipment, and energy resources, have received increasing attention over the past few years as tools in the diversification kit. That's because returns on hard assets tend to be noncorrelated to the returns on publicly traded securities. What's more, there's enough variety within this class to create a combination of investments that may be negatively correlated as well.

APPROACHES TO ALLOCATION

Depending on your situation, you may want to take a more or less aggressive approach to allocation.

Aggressive investors are willing to accept more volatility in the short term, require less current income, and have a long-term time frame in which to achieve their goals. A sample aggressive allocation model might be 60% stocks, 20% bonds, 10% cash, and 10% direct investments.

Moderate investors aim to buffer volatility, need to balance short-term and long-term goals, and often have less than ten years until retirement. A sample moderate allocation model might be 55% stocks, 30% bonds, 10% cash, and 5% direct investments.

Conservative investors want income-producing investments and are concerned about the risks in seeking long-term growth. They may have major short-term financial responsibilities or have large amounts invested in their own businesses. A sample conservative allocation model might be 30% stocks, 50% bonds, 15% cash, and 5% direct investments.

MANAGING YOUR ALLOCATION

As the value of your investment portfolio increases or decreases, and as your financial goals and time frames change, you will probably want to modify your initial asset allocation. Your financial adviser may suggest you review and rebalance your portfolio once a year, or you may prefer to make a change when one traditional asset class is 15% more or less out of line with the allocation you've chosen.

The small percentage, 5% to 15%, that you allocate to alternative investments may remain the same, although the subclasses within this category may shift as your needs change.

In addition, brokerage firms and other financial advisers regularly revise and refine the allocation models they suggest to their clients to take current economic conditions into account.

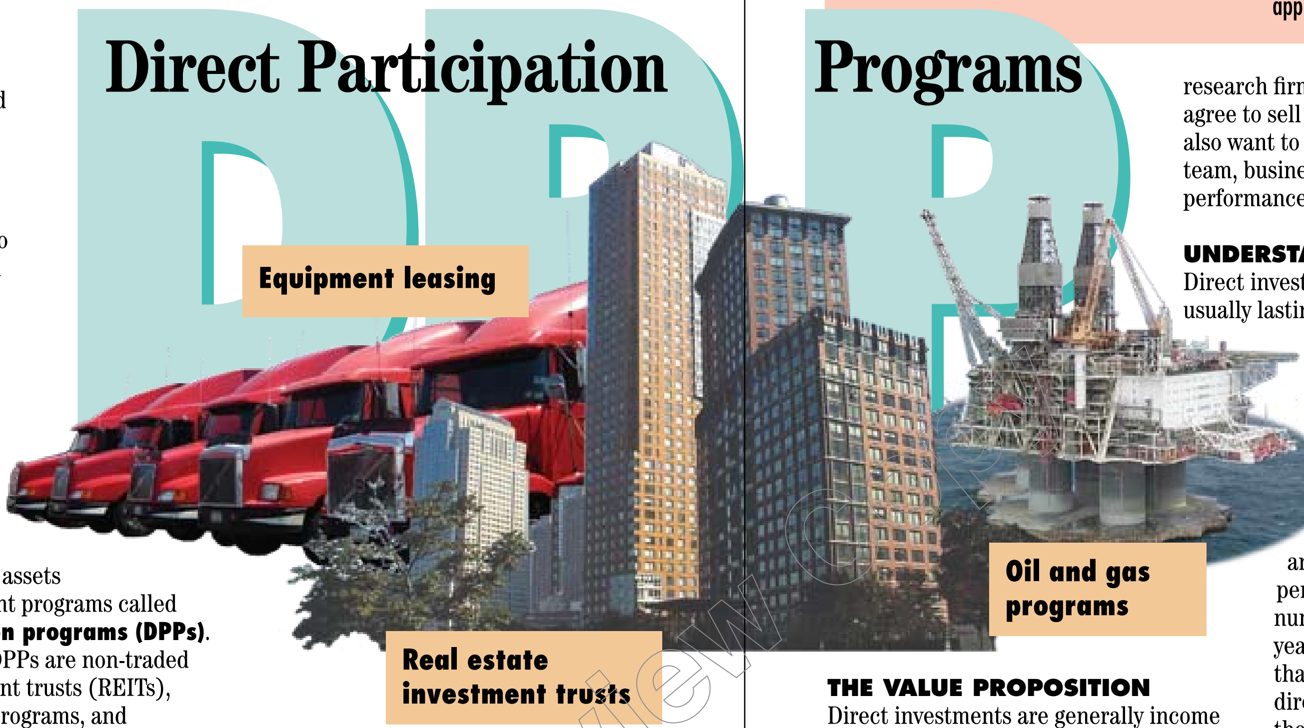
Direct Investment Overview

A snapshot of this asset class can help you picture where it might fit in your portfolio.

Direct investment in **tangible, or hard, assets**, such as real estate, leased equipment, and energy resources, is an alternative asset class you may want to consider adding to your portfolio. When you invest this way, you own a share of the actual assets of an operating company and may benefit from the assets' value, typically the income they produce.

One way to put money into tangible assets is through investment programs called **direct participation programs (DPPs)**. The most common DPPs are non-traded real estate investment trusts (REITs), equipment leasing programs, and energy exploration and development limited partnerships.

Direct Participation Programs



A DIFFERENT APPROACH

Investing through a DPP gives you partial ownership of actual physical assets.

REIT

For example, if you invest in a non-traded REIT, you're a part owner of the real estate holdings of the REIT. If you invest in an equipment leasing program, you're part owner of the actual equipment offered for lease by the corporation. And if you invest in an oil development partnership, you're part owner of the partnership's wells and the proceeds of oil sales.

In fact, the pooled investment structure of DPPs is sometimes described as a way to provide the average investor with opportunities previously available only to the wealthy. Because you invest as part of a group, you don't need the means to acquire a large percentage stake in the venture or fund your own start-up company to invest in new businesses.

BUSINESS STRUCTURE

In each case, the sponsors who offer DPPs pool your funds and the funds of other participating investors—typically 1,000 or more of them—to make investments they have identified as appropriate to the program's investment goals. The sponsors are responsible for managing the assets of the program as long as it continues to operate and for devising an appropriate strategy for ending it.

The legal structures that provide the foundations for different types of direct investment programs vary. REITs are a special type of corporation. Equipment leasing businesses are structured as limited liability companies (LLCs) or limited partnerships. Energy ventures are formed as limited partnerships. In practice, however, the investments behave as limited partnerships, regardless of their differing legal structures.

In most cases, a limited partnership has a **general partner**—in this case the sponsor—who runs the business and a number of **limited partners** who invest but aren't involved in the partnership's operation or liable for losses beyond their own investment.

A SUITABLE CHOICE?

Despite their potential advantages, DPPs aren't right for all investors. There are net worth and income thresholds you must meet, which vary from state to state and by type of direct investment. And there are upfront fees that may be as high as 16% of the amount you invest.

For these reasons and others, you should get professional advice before considering any direct investment. Your adviser can determine whether you meet the requirements and help you evaluate whether direct investments are appropriate for you.

THE VALUE PROPOSITION

Direct investments are generally income investments that seek to provide a regular stream of dividend payments based on real estate rentals, mortgage payments, equipment leases, and oil or natural gas sales.

In some cases, investors realize **capital gains** at the end of the investment term from the sale of their interest. Many direct investments also provide tax benefits, including tax deferral on a portion of the regular distributions paid to you, tax deferment for depreciation, depletion allowances, and other deductions.

DPPs are not without their risks though, including the risk of rental property vacancy, mortgage defaults, lease defaults, loan defaults, equipment failure, dry oil wells, and dropping energy prices, among others. But many of the risks are nonsystematic, and relate to specific investments, so you can protect yourself by researching the venture's management, quality of assets, performance history, and business plan.

Much of this analysis is performed in the normal course of due diligence by independent research firms and by broker-dealers before they agree to sell any DPP. Your financial adviser will also want to evaluate the sponsor's management team, business strategy, track record of program performance, and financial strength.

UNDERSTANDING THE APPEAL

Direct investments are a long-term commitment, usually lasting between 7 and 12 years, though terms vary. The programs are non-traded, which means there are no formal secondary markets—no NYSE or Nasdaq—where you can resell your investment interest.

While informal secondary markets exist, particularly for the most successful programs, and some have buyback provisions, the penalty for selling can be stiff, and the number of transactions permitted per year is low. In fact, most advisers agree that you probably shouldn't consider a direct investment if you go into it with the expectation of reselling.

Yet the illiquidity of a direct investment can help insulate you against the volatility of the market because it's not subject to daily fluctuations in price. As a result, a direct investment can have a stabilizing effect on your portfolio.

A BRIEF PARTNERSHIP HISTORY

Limited partnerships are a uniquely American vehicle for setting up new businesses. They originated in the pre-Revolutionary War period when the country was still under the dominion of England, and the British refused to issue charters to American businesses. American merchants, left to their own resources, pooled their capital and credit in order to share the risks of trading their goods.

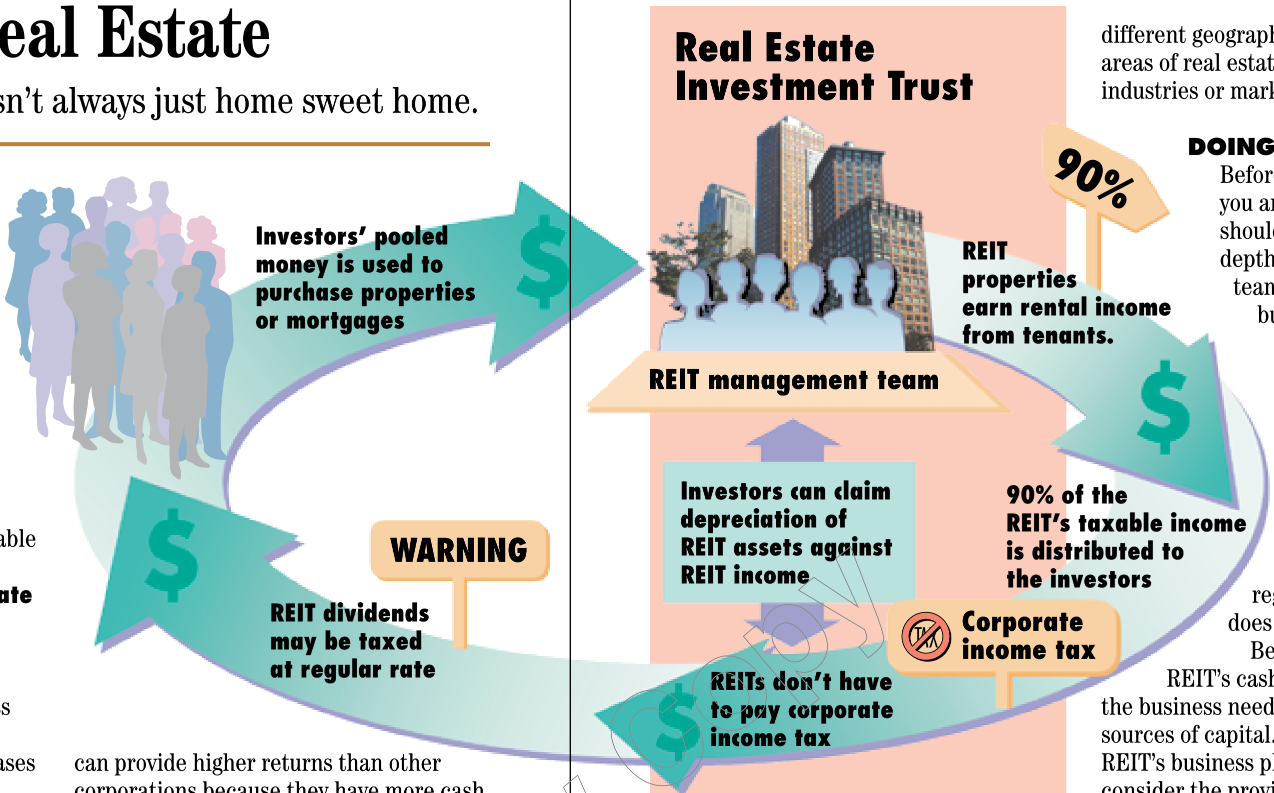
Soon a more formal partnership structure was developed, which became part of the economic foundation of the new country. In 1728, Benjamin Franklin's printing shop was a partnership venture. By 1748, he had enough investment income to devote himself to invention, scientific discovery, and the arts.

Investing in Real Estate

A real estate investment isn't always just home sweet home.

What comes to mind when you think about investing in real estate: Buying a new home—or a second one? Purchasing apartments or commercial buildings you can manage and rent out for income? Finding undeveloped land in a part of the country you think is destined to grow?

What you may not think about are shopping centers, office complexes, healthcare facilities, or low-income housing. Yet these income-producing commercial real estate investments, which in the past were primarily available to the very wealthy, are now more generally accessible through **real estate investment trusts (REITs)**.



WHAT'S A REIT?

A REIT is a corporation whose business is real estate. Using a pool of money raised from investors, the REIT purchases buildings or, less frequently, the mortgages on buildings. A REIT has a management team that's responsible for overseeing day-to-day operations and ensuring that the corporation is profitable. Among other things, that means the REIT is focused on producing a steady stream of revenue for its investors.

STREAMS OF INCOME

REIT income flows to you and other investors in the form of monthly or quarterly **dividends** based on rent or mortgage payments from the REIT's investments. Equity REIT dividends often increase as rent payments increase, which can provide a hedge against inflation—though the dividends can drop in a market downturn or if the properties lose value.

If you're retired, or you rely on income investments to supplement your annual earnings, REITs can provide a relatively stable **cash flow**. Similarly, you can use REIT income to fund college expenses or charitable remainder trusts. And, of course, you can use REIT income to make additional investments.

TAX BENEFITS

REITs don't have to pay corporate income tax—instead, they're subject to an IRS rule that requires these corporations to pay out 90% of their taxable income as dividends. As a result, REITs can provide higher returns than other corporations because they have more cash available for distribution. That, in part, is what makes them attractive investments.

A special benefit of investing in REITs is that you can claim **depreciation** of real estate assets against your dividend income. As a result, you may not have to pay tax on the income until no depreciation value is left—at some date in the future when your income tax rate may be lower. Or you may be able to defer payment until the REIT holdings are sold. Then the income is taxed at the lower long-term capital gains rates.

Another advantage of REITs is that they don't generate unrelated business taxable income (UBTI), an important consideration for investors who own these investments in a tax-deferred or tax-exempt account such as an IRA or 401(k), or in a charitable remainder trust. (UBTI results when an otherwise tax-exempt organization realizes any income from a taxable subsidiary.)

Because a REIT does not pay corporate taxes, taxable REIT dividends don't usually qualify for the low rate that applies to most equity dividends. Rather, when tax is due, it's at your current rate for regular income, up to 35% at the federal level. Long-term capital gains distributions, on the other hand, are taxed at the lower rate.

However, it's possible though not common for a non-traded REIT to fail to meet

WHAT DOES A REIT BUY?

An **equity REIT** buys rentable property. Its income is derived from the rent it collects.

A **mortgage REIT** buys the mortgages on rentable property, either of a specific type such as hotels, or a broad range of properties. Its income is derived from mortgage payments.

A **combination REIT** owns both rentable property and mortgages on rentable property.

Internal Revenue Code requirements for a taxable year and not re-qualify as a REIT. In that case, the REIT's tax exemption would disappear and its income would be taxed at corporate rates. Distributions to shareholders would no longer be required and could be eliminated entirely. The disqualification would last five years.

DIVERSIFIED REITs

The majority of REITs own property and often specialize in a particular type of real estate—such as apartment buildings, hotels, shopping centers, self-storage units, office buildings, hospitals and other healthcare facilities, or low-income housing developments. Some equity REITs are geographically focused, while others are national.

You can diversify your REIT investments by buying REITs concentrating in different geographic regions, different areas of real estate, or different industries or market sectors.

DOING DUE DILIGENCE

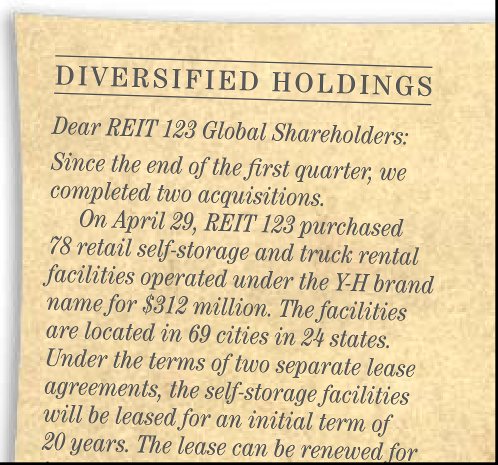
Before you invest in a REIT, you and your financial adviser should review the quality and depth of the management team and the company's business plan.

You'll want to consider the managers' experience in overseeing the types of properties the REIT owns, as well as their experience in the industry, market sector, and geographic region where the REIT does business.

Because so much of a REIT's cash goes to pay dividends, the business needs access to outside sources of capital. So in evaluating a REIT's business plan, you'll want to consider the provisions it has made for growth—specifically how it plans to raise new money. The options are:

- The sale of additional shares
- Mortgage debt secured by its real estate assets
- Corporate debt dependent on the company's overall creditworthiness

The REIT's overall debt level is another factor to consider. As the debt level increases, the opportunity for growth increases, as does the business risk—and hence your investment risk. You should check to see if a REIT's debt is at the portfolio level or at the individual asset level. Portfolio-level debt can be riskier than asset-specific debt because when debt is linked to a particular asset, the lender doesn't have any recourse beyond that asset if the tenant defaults.


DIVERSIFIED HOLDINGS

Dear REIT 123 Global Shareholders:

Since the end of the first quarter, we completed two acquisitions.

On April 29, REIT 123 purchased 78 retail self-storage and truck rental facilities operated under the Y-H brand name for $312 million. The facilities are located in 69 cities in 24 states. Under the terms of two separate lease agreements, the self-storage facilities will be leased for an initial term of 20 years. The lease can be renewed for

DIRECT INVESTMENTS

The REIT Marketplace

REIT siblings have a family resemblance, but they're not identical twins.

You can invest in REITs two ways. You can buy shares in **public corporations** that are listed on either a national exchange, such as the New York Stock Exchange (NYSE) or the Nasdaq Stock Market, or on a quotation service, such as the OTC Bulletin Board. Or you can invest in a **non-traded REIT**.

Both publicly traded and non-traded REITs are alike in the sense that both invest in income-producing real estate and pay 90% of their taxable income as dividends. Both are registered with and regulated by the Securities and Exchange Commission (SEC). And both must file quarterly and annual reports, publicly disclose material information, and hold annual shareholder meetings.

But there are also significant differences between the two that you can capitalize on as an investor.

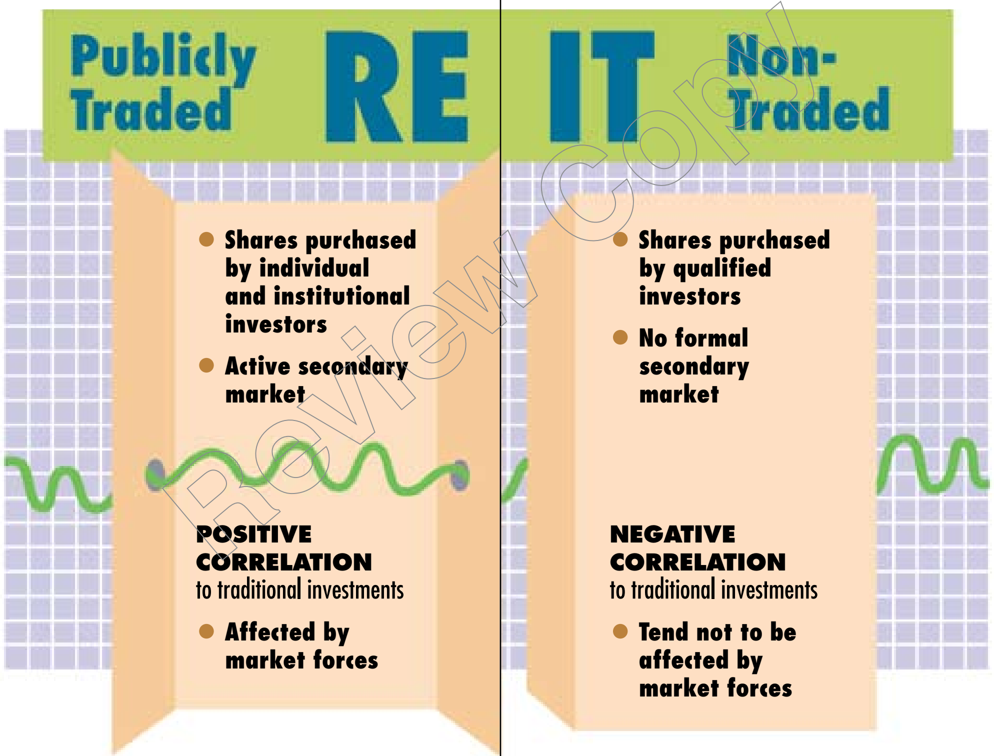
TRADED OR NON-TRADED

Many REITs are publicly traded. Their shareholders range from individuals to large institutions, such as pension funds, insurance companies, and mutual funds. And there's an active secondary market, where REIT shares trade at a discount or premium to—that is, for less than or more than—their **net asset value (NAV)**, or worth on paper.

Non-traded REITs are available to investors who meet certain suitability standards. Here, too, the list may include both institutions and individuals. But there is no formal secondary market for these REITs and shares trade infrequently—though most programs have a limited share redemption plan where you may be able to resell your shares to the REIT. These REITs tend to be noncorrelated with traditional investments, which means that they tend not to be affected by the forces, such as changing interest rates or corporate earnings reports, that affect other securities.

When REITs are publicly traded, however, they're subject to the pressure of meeting short-term expectations, just as other listed investments are. If these REITs seem to be providing stronger returns than other securities, they may attract added attention and their share price might rise. But if their returns are weaker than those of other securities, they face the risk that investors will sell—even if it means taking a loss—or put pressure on management to make changes.

Because the price fluctuations affecting publicly traded REITs tend to be driven by changing economic conditions rather than changing real estate values, these REITs tend to rise and fall with other equities in the marketplace rather than providing a hedge against volatility.



BEFORE YOU INVEST

In addition to performing your customary due diligence, including looking at management, business plan, and debt levels, you and your financial adviser will want to review the **prospectus** before investing in a REIT.

The prospectus will clarify the investment term, which is often 7 to 10 years, explain the provisions for selling your shares, suggest potential exit strategies, and specify the minimum purchase you'll be required to make and the income and net worth thresholds you'll have to meet. Each investment program has its own requirements.

The minimum investment is generally $2,000 to $5,000, representing 200 to 500 shares at $10 per share. To qualify, your minimum net worth generally needs to be $250,000 excluding your home and cars, or you need to have a gross annual income of $70,000 and net worth of $70,000. But many programs and certain states have substantially higher requirements both for investor net worth and minimum investments.

EXCEPTIONS TO THE RULE: CASHING IN, CASHING OUT

Near the end of the expected minimum holding period, a REIT may have a portfolio of profitable properties and have reached a large enough size to be taken public in an **initial public offering (IPO)** and listed on a stock market. In the case of a listing, you generally have the choice of selling your shares of the now-public REIT in the open market or continuing to hold them in your portfolio.

On the other hand, management may determine that **liquidation**—selling the assets—is a better exit strategy for a variety of reasons:

- The REIT may want to benefit from gains in real estate values
- The properties may have depreciated in value, making an IPO impractical
- The sponsor may want to roll the properties over into a new program

If the assets are liquidated, you will receive your proportional share of the sale price.

ROI IS KING

Although the **capital gains** potential of a REIT investment can be realized only on listing or liquidation, over the term of the investment you receive income in the form of dividend distributions. Payments are typically small in the early stages because the revenue of newly formed REITs generally consists of interest income on money market investments. That's where the program funds are parked before the properties are actually purchased. Revenues generally increase as the REIT invests in income-producing real estate assets.

PRIVATE CONTRARIANS

Venture capitalists fund certain non-traded REITs, sometimes referred to as incubator REITs, in the hope of launching them as public offerings in the future. An incubator REIT may deliberately invest in out-of-favor sectors, building up a portfolio of currently unpopular properties. When the properties return to favor and the portfolio is large enough, the non-traded REIT can go public, hopefully providing a significant capital gain for the investors. The long-term nature of a non-traded REIT investment allows time for this investment strategy to play out.

REIT RISKS

While investing in REITs may provide the potential for above average returns, you're taking certain risks as well. If rental space isn't in demand, as sometimes happens, high vacancy rates can limit your income. That's also true if tenants default or declare bankruptcy. And, if a REIT has too much debt, it may be forced to sell properties, often at a discount, to make its debt payments. In that case, you face the possibility of losing some or all of your investment.

Equipment Leasing

Each year, hundreds of billions of dollars worth of business-essential equipment is leased around the world.

Equipment leasing offers businesses an alternative to purchasing hard assets, especially items that are extremely expensive, such as airplanes, ships, or railroad cars, or those that may only be used for a relatively short period, such as medical or office equipment and software. Leasing may also offer an attractive financing alternative to traditional loans.

As an investor, you have the opportunity through a direct participation program (DPP) to put money into the equipment that is being leased and benefit from the steady income and potential for growth that leases generate. Direct participation in a leasing program may also be a good fit if you have a portfolio of more traditional investments, as leases tend to react differently than stocks and bonds to changes in the economy and may help insulate you from market fluctuations.

THE LEASING BUSINESS

The terms of a leasing deal are spelled out in a contract signed by the equipment provider, called the lessor, and the equipment user, called the lessee. The contract generally provides that the leased item will be returned in good condition. The lessor either sells it or re-leases it to a different lessee.

Some contracts, though, give the lessee an option to purchase the equipment, usually when the lease ends, or to renew at a favorable rate. In this case, the equipment fund is known as the **lender** and the company wishing to finance the equipment purchase is known as the **borrower**.

There are a number of reasons an organization may decide to finance equipment, which can be an attractive option both in booming and falling economic environments. In times of growth, a company may seek to finance its equipment to expand its business quickly but conserve its cash for other needs, such as research and development. In leaner times, a company may not want—or be able—to spend money to make large capital investments in equipment. For example, instead of paying $10 million for a new production line, a company may be able to finance the purchase over five years, paying $2 million annually, plus interest. This could free up cash to make a necessary purchase or pay down debt.

Leasing also allows companies to better match the costs of the equipment—the rentals they pay—to the revenues the equipment generates. This helps with their budgeting and capital management needs. Leasing also provides the flexibility to use long-lived equipment for a shorter period without having to buy it. And, for some companies, leasing also provides significant accounting or tax advantages.

MAKING THE INVESTMENT

When a DPP sponsor forms an equipment leasing company, it issues a prospectus or offering memorandum that details the business plan, including the types of equipment the company plans to buy and lease, the type of leases it plans to focus on, and a complete discussion of the risk factors. The document also describes the sponsor's equipment-leasing expertise. The sponsor's experience, resources, market reach, and prior performance are key criteria you and your adviser can use to evaluate an investment in a new leasing program.

As the leasing company begins operations, it pools investments from hundreds or thousands of participants and uses the money to buy equipment it will lease. When you invest, you generally don't know in advance exactly what equipment the company will be offering. Most equipment leasing DPPs invest in a wide range of sectors, industries, geographies, and lessees to achieve the greatest possible diversification and limit the risk of concentration.

ATTRACTIVE FEATURES

One of the appeals of a direct leasing program is that you and other participants collect a steady stream of rental income from the leased equipment. In some cases you may also realize additional income from re-leasing or selling the real assets at the end of the lease term in markets around the world. In other cases re-investment from excess cash flow from lease rentals could be reinvested into the fund throughout the offering period.

Leasing programs also offer potential protection against inflation, and diversification across industries, equipment types, equipment users, and geographies.

In addition, you can take advantage of accelerated depreciation and the tax benefit that provides. Usually you can depreciate your share of the cost of the equipment at a relatively fast rate, offsetting income you receive in the early years of the program and reducing your tax bill during this time.

This situation changes as the leases mature and the equipment is sold. While you continue to collect income, an increasingly larger percentage of that income is taxed at the rate for your income tax bracket.

RISK AND RETURN

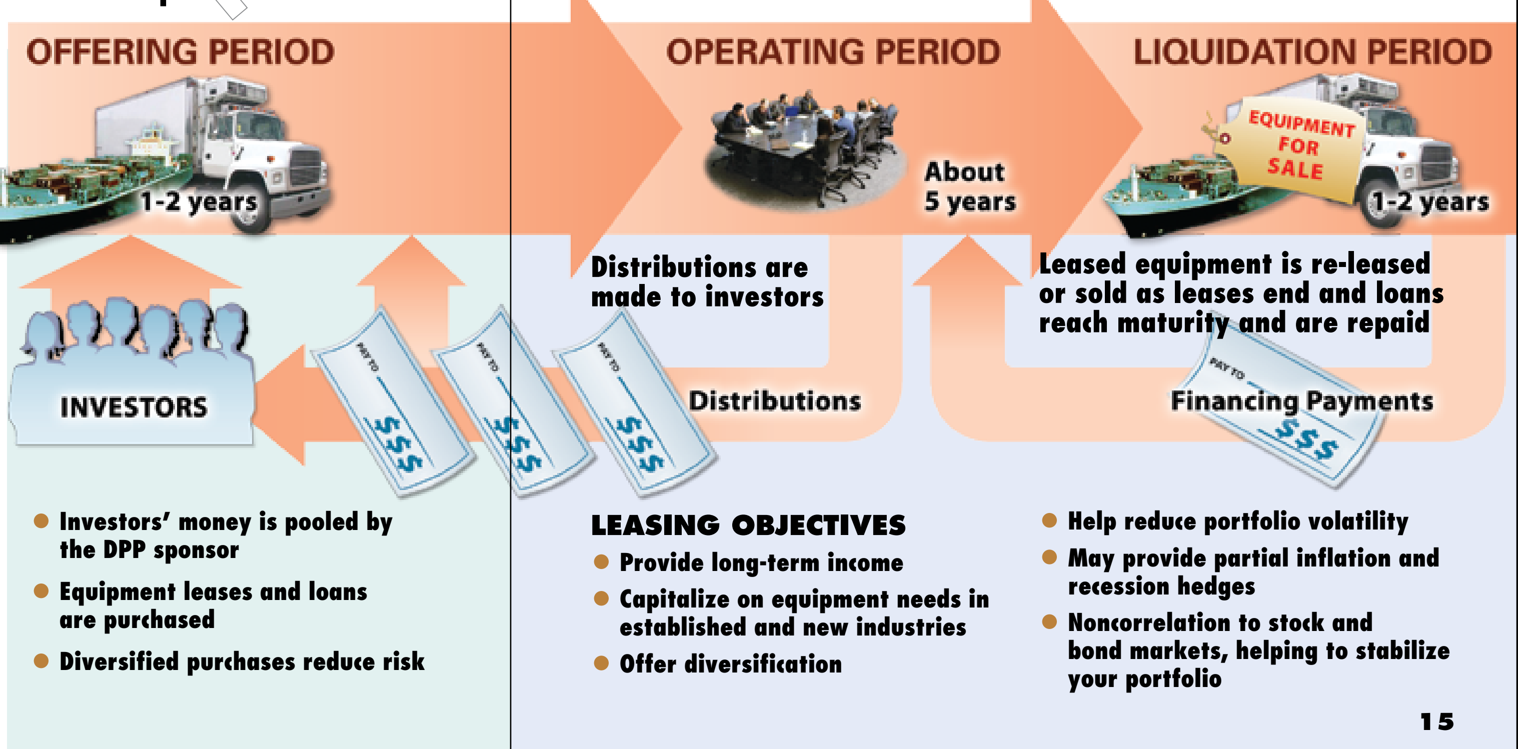
A diversified leasing program can be an attractive long-term investment, though it may also expose you to certain investment risks. On the plus side, the fact that the program is not traded can help insulate your portfolio from market volatility. When lessees make regular payments, the leases provide a steady stream of income. And because hard asserts are involved, if a lessee doesn't pay, the equipment can be reclaimed and then re-leased or sold.

On the risk side, there are costs involved in terminating leases and retrieving hard assets that can disrupt and reduce cash flow. That may be especially true in the case of lessee bankruptcy. Further, it may be difficult to re-lease or sell retrieved equipment depending on market conditions, especially if it is outdated or has been misused.

MARKET NEUTRAL

Equipment leasing may serve as a hedge against both inflation and recession. In inflationary periods, the hard assets from expiring leases may be resold at higher than expected prices and exceed expected yields. During recessions, companies typically defer new equipment purchases in favor of holding onto leased equipment, so lease renewals may increase.

When you invest, it's generally for a term of 7 to 10 years, divided into three phases:



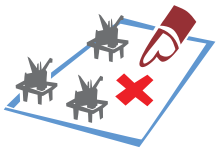
Oil and Gas Programs

You don't need cowboy boots and a 10-gallon hat to invest in oil and gas wells.

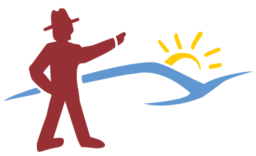
You can invest directly in energy exploration through a partnership that puts money into petroleum or natural gas drilling projects. Like other direct investments, an energy partnership invests in hard assets rather than shares of a corporation that is drilling for oil and gas. And assuming the venture is successful, the partnership provides income over an extended period that reflects the market price of the oil or gas that the wells produce.

THE ENERGY BUSINESS

There are two types of energy partnership programs—**developmental** and **exploratory**. Developmental drilling is done close to existing, productive sites,



which means that new wells have a good likelihood of being productive as well. Exploratory drilling, on the other hand, seeks oil and gas in new, untapped areas. That means there's a higher risk that more of the wells will be dry and a potential for higher returns from those wells that are discoveries.



Because there's enormous political and economic pressure to increase the amount of oil and gas produced in the United States, Congress provides major federal tax advantages to encourage investment in domestic drilling of both types. The primary benefits are the **intangible drilling cost (IDC)** write-off, which offsets regular income, and the **depletion allowance**. This deduction reduces the investment income on which you owe tax.

INTANGIBLE DRILLING COSTS

IDC

Intangible drilling costs (IDCs) are costs related to opening a well, including fuel, trucking, wages, drilling supplies, and whatever else is needed, except the actual drilling equipment. These costs are concentrated in the first year of a project, and the deduction may offset income up to your entire capital contribution to the partnership during that period.

From its beginnings, the energy industry has depended on not only entrepreneurship, but knowledgeable investors.

This one-time deduction may make direct energy investments especially appealing if you've received a lump sum—such as a pension distribution, proceeds from selling your business, or profits from exercising stock options—that would otherwise be taxable in the year you join the energy partnership.

An additional advantage is that the IDC deduction can also offset up to 40% of **alternative minimum tax (AMT) income** if you fall into that tax category.

A LIMITED RESOURCE

Because oil or gas wells draw on natural resources and will eventually be exhausted, Congress provides another tax incentive to encourage you to invest—the **depletion allowance**. You can take this allowance as long as the wells are productive to offset your tax liability on income you receive from oil or gas sales.

In addition, depending on the way an energy DPP is structured, you may be able to take a **depreciation allowance** for tangible drilling costs, such as equipment, against any income you receive.

RISK AND RETURN

Three factors affect the regular income distributions you receive from oil and gas direct investments:

- **Production volume**
- **Operating expenses**
- **Market price**

The more a group of wells produces, the more income the partnership generates, and the greater your potential income. But there is always the risk that a well won't produce enough to cover the cost of exploration or that it will be dry and yield nothing. High operating costs, however legitimate, can erode potential payouts. Ultimately, market prices are hard to predict as they are volatile and vary based on numerous global supply and demand characteristics.

TERMS OF INVESTMENT

Although some energy direct investments have seven-to-ten year terms, it's not unusual for these investments to be open-ended. A well produces oil or gas on a diminishing basis over a period of time, but its duration can only be estimated. When the well stops producing, the income stream of the investment ends too. So there is no single event that results in a final cash distribution or capital gain.

THE NATURE OF PARTNERSHIPS

Partnerships are organized in two tiers—**general partners**, who are responsible for running the business, and **limited partners**, who provide investment capital but have no personal liability for the decisions the partnership makes or any debts it might incur.

When you make a direct investment in a natural gas drilling partnership, for example, you generally invest as a general partner. The reason is that only general partners can write off intangible drilling costs against ordinary income, not just against passive investment income. Then after a year as a general partner you'll be converted to the status of limited partner.

You'll want to discuss how this two-step process works with your financial and legal advisers to be sure you understand the benefits and the potential risks.

PORTFOLIO IMPACT

Oil and gas programs can help diversify your portfolio and provide a long-term, partially sheltered revenue stream despite the potential risks they pose as an asset subclass. Since they're nontraded, long-term investments, their returns aren't correlated to stock and bond market returns and their value isn't affected by securities' market pressures. In addition, because oil is dollar-denominated worldwide, oil investments can also be a good hedge against a falling dollar as oil prices generally increase during inflationary periods.

One consequence is that energy DPP income may outpace returns on more traditional investments in adverse economic cycles. For example, natural gas and oil prices tend to increase with inflation, making income from the investment an ideal hedge against rising prices. Similarly, because demand for energy tends to be noncyclical, you generally continue to receive gas and oil income during recessions.

Managed Futures

Commodity pool operators invest in global futures markets to manage risk and capitalize on opportunity.

Adding managed futures to an investment portfolio of traditional assets, such as stocks and bonds, helps to reduce volatility while potentially improving return. These ups and downs in commodity prices are driven by very different forces from the forces that impact equity and bond prices. In other words, there's little or no correlation between this alternative asset class and the traditional asset classes.

DEFINING MANAGED FUTURES

Managed futures offer investors the opportunity to speculate in commodity futures markets around the globe through a vehicle established and managed by a commodity pool operator (CPO). That vehicle may be known as a futures fund, a commodity fund, or a commodity pool.

The CPO, which may be structured as a limited partnership, a fund, or a fund of funds, hires commodity trading advisers (CTAs) to produce profits by buying and selling futures contracts using the money raised from its investors. The CTAs act on a discretionary basis, which means the investors give them power-of-attorney to trade without having to secure approval of individual transactions. That allows them to make the instantaneous decisions that are often essential in futures markets.

As a CPO selects CTAs—and there are typically several—it evaluates both a trader's strategy in choosing when and what to buy and sell and his or her performance history. Combining successful traders who take different approaches, plus the fact that the CTAs can trade in more than 150 global markets, means the pool's holdings at any given time are likely to be highly diversified. Since futures contracts can be highly volatile investments, this variety is a key component in the CPO's long-term performance potential.

TRADING STRATEGIES

Most CTAs, known as trend followers, make buy and sell decisions based on technical indicators. This approach analyzes historical trends to determine the appropriate time to buy and sell to take advantage of an anticipated price movement up or down. These traders typically use automated trading systems that give buy—or go long—and sell—or go short—signals determined by an objective set of rules set by the CPO. With such a system, the trader's instincts and emotions aren't part of the picture.

A smaller number of traders use fundamental analysis to evaluate investments within a particular market sector or sectors by assessing their inherent value and profit potential. Some of these CTAs use automated trading systems as well, though some have more discretion in taking long and short positions.

Market neutral traders, on the other hand, focus on the profit that can be made on the spread, or difference between prices, in different markets or on different contracts in the same market. Some market neutral traders use options on futures contracts as well as futures contracts themselves to realize a profit.

FEES AND EXPENSES

Like many alternative investments, the fee structure of a managed futures fund includes both a management fee and a performance fee. And, as with other DPPs, the overall fees an investor pays are higher than those for making and holding an equity investment. There are also transaction fees.

The management fee is generally a specific percentage—such as 2%—of the assets being managed. The performance fee—up to 20%—is based on the pool's net trading profits and is usually paid only if the profits hit a predefined target.

The fees a CPO charges and the way they are collected and distributed are explained in its formal disclosure documents. You and your adviser should evaluate those costs as part of deciding whether to invest.

WHY INVEST?

The first and perhaps the best reason to add managed futures to your investment portfolio is their capacity to help manage risk by reducing volatility. But that's not the only reason.

Investing in managed futures has the potential to strengthen portfolio performance whether markets are rising or falling because CTAs trading for a commodity pool have the flexibility to buy or sell futures contracts on regulated financials and commodities markets across geographical and product boundaries. And because they are not correlated to traditional asset classes, managed futures potentially provide a positive return when stocks or bonds are slumping.

Investing in many markets also provides protection against natural or political events that may undermine returns in a certain country or region. Those events might include drought or excess rain that destroys grain crops or cross-border tensions that affect oil or gold prices.

EVALUATING RISKS

There are risks to investing in managed futures. In a particularly volatile environment, you could lose the entire amount you invested. The fact that commodity pools are typically highly leveraged also increases the risk of losses, just as it increases the potential for gains. And high fees can take a toll on positive returns.

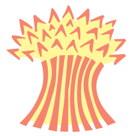
In addition, an investment in any limited partnership is more illiquid than an investment in the traditional asset classes because there is no organized secondary market for these products.

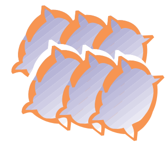
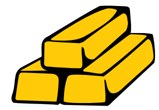
Though managed futures sponsors provide some liquidity, redemption options are limited, you must generally file a redemption notice in advance, and you may receive less than the amount you invested.

What Can Affect a Commodity's Price

While the same forces of supply and demand affect the shopper in the supermarket or the driver at the gas pumps, the futures market doesn't deal in five pounds of sugar or ten gallons of gas. Efficiency demands that commodities be sold in large quantities.

PRICES RISE WHEN	Bad weather ruins US wheat crop	Political turmoil causes oil shortage	Insects ravage cane crops	US inflation rate increases
WHAT THE CONTRACT IS FOR	WHEAT	GASOLINE	SUGAR	GOLD
PRICES FALL WHEN	Russia has bumper crop of wheat	Oil producers increase output	Health fad causes drop in sugar consumption	US inflation rate falls



HEDGERS AND SPECULATORS

Hedgers produce or use commodities and buy or sell futures contracts to protect their costs or ensure their profits. Speculators, on the other hand, are willing to take risk of losing money for the opportunity to profit from fluctuations in contract prices. They're essential for futures markets because they add liquidity, which keeps the markets functioning.

Evaluating Direct Investments

There are risks with direct investments, but you aren't left in the dark about them.

Direct investments in real estate, equipment leasing, and energy partnerships are sometimes described as riskier than more traditional investments in stocks, bonds, and mutual funds. While it's true that any investment poses a certain amount of risk, any blanket statements about the comparative risk levels—especially for direct and traditional investments—is over-simplified for a variety of reasons:

- **There are varying levels of risk within each category of direct investment. Energy exploration, for example, is riskier than drilling in an area with proven wells, but affords the potential for greater returns with discoveries.**
- **A number of traditional investments, including high-yield bonds and stock in newly public companies, may expose you to as much or even greater risk than many direct investments.**
- **Like traditional investments, DPPs tend to diversify their holdings to reduce risk.**

Concentrating on the risks these investments pose also ignores the fact that adding direct investments to a portfolio of traditional investments may actually reduce your risk. That's largely because the risks of a direct investment are the result of very different factors than those that affect a traditional investment.

Doing Due Diligence

There are a variety of government rules and financial industry procedures that the sponsors of direct investment programs must follow before they can offer their programs to investors. Among their responsibilities are preparing a business plan, identifying a program's management team, and explaining the risks they pose.

Direct investments, though not publicly traded, are typically registered with the Securities and Exchange Commission (SEC). The investment sponsor must comply with public disclosure and investor reporting requirements, just as publicly traded companies are required to do. Those documents are available from the sponsors.

In addition, broker-dealers who are offering a direct investment to their clients investigate the offering using what is known as **due diligence**. Using the findings of either its internal officers or an independent company, a broker-dealer reviews offering documents and any public materials on the sponsor of the new investment program, reviews legal and technical opinions of the program, conducts site visits, and interviews the management team. Their goal is to uncover any potential problems before they encourage you and others to invest.

EYES WIDE OPEN

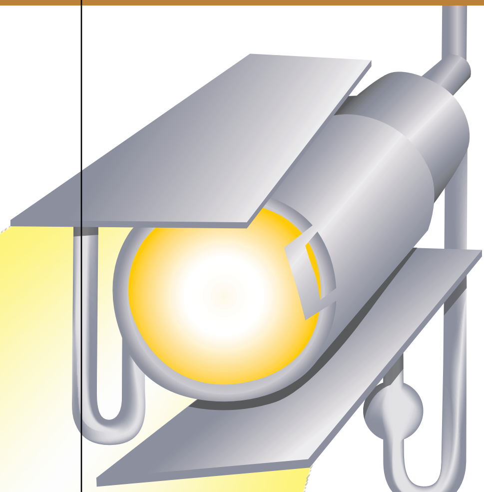
All partnerships and limited liability companies share risks relating to their management and business plan. In addition, each type of direct investment carries some specific risks.

REIT risks include:
- Inability to lease property
- Tenant defaults and bankruptcies
- Certain debt obligations

Equipment leasing risks include:
- Lessee default and/or bankruptcy
- Inability to resell equipment
- Debt obligations

Energy risks include:
- Wells that do not produce enough revenue
- Dry holes
- Price uncertainty

DIRECT INVESTMENTS



COMPETING FOR SHELF SPACE

One challenge DPP sponsors face when they want to offer a new investment program to the public is finding what's known as shelf space. That's a place on the long, highly competitive list of investment products a broker-dealer firm makes available to investors.

Although the broker-dealers actually conduct due diligence, sponsors reimburse the firms for their costs as part of bringing the products to market.

BEING UP FRONT ABOUT THE FEES

The front-end fees for direct investments tend to be higher than comparable fees for traditional investments, sometimes running as high as 12% to 15% of the amount you invest.

There are additional fees, some paid during the program's term, including acquisition fees and asset management fees, and others associated with liquidating the program, such as disposition fees and incentive fees. However, DPPs are generally externally managed and therefore do not have any direct personnel costs or direct overhead expenses.

SIMILAR INVESTMENTS

It may help put direct investment in perspective if you consider the similarities between a DPP and a start-up business.

Like a start-up, the initial costs of a direct investment can be substantial—though only a percentage of a direct investor's dollars can be used for initial costs. Both require a long-term commitment. And, in both cases, the reality is that no new business is likely to provide the level of return you're seeking in the short term. But, over a longer period, the profits of a successfully operating business may not only allow you to recoup your initial expense, but potentially realize a return greater than that of other, more traditional investments.

EVALUATING SUITABILITY

Being qualified to make direct investments doesn't automatically mean they're appropriate additions to your portfolio. That's a decision you'll want to make for yourself after consulting your advisers.

You'll face a degree of risk. That's the nature of investing. But, in general, the greater the potential upside of an investment, the more risk you take on. For this reason, you must be comfortable with the idea of losing not just some, but all of what you put in.

Would a major loss mean you'd have to change your lifestyle in any way? Would you be seriously upset or angry? The answers should play an important role in your decision-making, especially if they're in the affirmative.

THE LIQUIDITY ISSUE

It's smart to think of direct investments as illiquid, since the opportunities to sell them are extremely limited and often costly. You may be able to transfer shares of successful direct investment programs to other interested investors in privately arranged transactions at little or no cost to you. One exception is that units of energy DPPs that drill wells on federal land must be owned by US citizens and can't be transferred to overseas investors.

Provisions in most DPPs—called redemption programs, liquidity, or buy-back provisions—may allow you to sell units back to the sponsor at a discount. Limits on the percentage of units that can be repurchased in one year vary from program to program, generally in the range of just 5% of the outstanding shares. The percentage of allowable redemptions and price formulas for buybacks are detailed in the program prospectus. There is a discount, often in the 5% to 10% range, that declines as the investment matures. The limits are in place to prevent large-scale redemptions that could jeopardize the DPP's ability to operate.

In addition, there are thinly traded secondary markets operated by the American Partnership Board and others where DPP units can also be sold, though often at substantial discounts, which could result in a major loss.

Finding a Good Fit

Some DPPs may fit your budget and suit your goals better than others.

Since direct investments are not publicly traded, you must meet certain financial thresholds in order to participate. While these qualifying levels are lower than the thresholds for private equity or hedge fund investments, they have the same purpose: to help ensure that you can afford to commit money to a long-term investment where your principal could be at risk.

There usually aren't specific age restrictions for purchasing DPP shares. If you're an older investor, you and your financial adviser may approach these investments not only as a source of potential income for yourself but, if you should die during the term, as a way to provide income for your heirs. Shares can be transferred without penalty to an individual or a trust. But you may want to check with your legal and tax advisers about possible tax consequences for the recipients.

MINIMUM INVESTMENTS

Most DPPs set minimum investment requirements, ranging from $2,000 to $5,000. In most cases, the offering price of each share or unit is fixed, and you're required to buy a specific number of units.

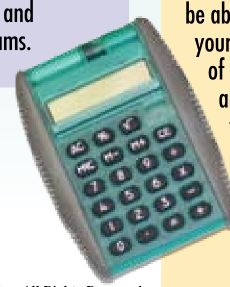
You may also be able to reinvest any dividends your DPP distributes to buy additional shares, sometimes at a discount. That option may be especially appealing if you hold your investment in an IRA, where the distributions continue to be tax deferred as long as they aren't paid out in cash.

REIT MINIMUM INVESTMENT $2,000

OFFSHORE DEVELOPMENT MINIMUM INVESTMENT $50,000

MAKING THE CUT

Salary and net-worth thresholds, which may exclude your home, furnishings, and cars, vary for different types of DPPs. In general, those for energy development are somewhat higher than for REITs and leasing programs.



A TAX CALCULATION

If you pay $10,000 for an energy DPP unit and are entitled to IDC write-offs of 90% against ordinary income, then you'll be able to deduct $9,000 from your income in the first year of your investment. If you are in the 35% marginal tax bracket, for example, you'll save approximately $3,150 in federal taxes for the year.

USING THE INCOME

One reason to consider a DPP is that you may have specific plans for the income it can potentially provide over a relatively long term.

If you have children or grandchildren who will be attending college during the investment term, regular income from a direct investment may be a viable supplement or partial substitute for a state-sponsored 529 college savings plan. While the income isn't tax free, as it is with a 529, there are usually tax benefits that allow you to offset part of what you collect.

If you're approaching retirement, you might plan to use the income from a DPP to replace some of your salary or supplement your pension or retirement plan income. It might also allow you to postpone taking distributions from your IRAs or certain qualified plans until you turn 70½. That allows more time for additional tax-deferred compounding.

You might also designate income from a DPP to fund a charitable remainder trust, to build a donor advised fund (DAF), or fulfill other gifting or long-term planning goals. Or, you might plan to use the money to make additional investments.

TWO FACES OF RETURN

While past performance isn't a guarantee of future results, and there's no assurance any investment will meet its objective, yields on profitable DPPs have tended to be in the 6% to 7% range annually. The Investment Program Association (IPA) Non-Traded Real Estate Index compares the historical income provided by several sponsors of non-traded REITs to the yield on publicly traded REITs and 10-year Treasury notes.

In some but not all programs, there's also potential for growth, in both amount of income and the value per share. That's particularly the case with certain REITs that purchase out-of-favor properties before they rebound or those that invest in growth areas. In addition, with REITs, you have the potential for a substantial payout when the holdings are liquidated or if the company is taken public.

As an investor, you need to consider not only the income stream plus potential increases in value, but also the possible tax implications in evaluating the return on direct investments and whether they're right for you. For example, tax savings can increase your cash flow in some stages of a DPP. But your tax bill may be higher in others.

Use the income for:
- **Salary replacement**
- **Retirement income supplement**
- **To delay IRA withdrawals**
- **529 plan contribution**
- **Donor advised fund or trust**
- **Additional investments**

INCOME VARIETY

The income you receive from a direct investment may be either a **return of investment** or a **return on investment**. Or, over the term of the DPP, you may receive both.

The former means that you are getting your money back, and that income is generally not taxable. The latter means that you are making money on your investment. Those amounts are usually taxable, though you may be able to offset your income for tax purposes with depreciation and other allowances.

All REITs are legally required to distribute 90% of the corporation's revenues, which are considered a return on your investment. Equipment leasing and energy DPPs have more flexibility in making distributions and detail their revenue sharing arrangements in their prospectuses.

In a sample equipment leasing DPP, for example, there might be a revenue sharing arrangement structured so that during the active operation of the business, the manager takes 1% of the cash distributions and 99% is distributed to investors. Once an investor has received the equivalent of a 100% return *of* his or her investment, plus an 8% return *on* the investment, then the manager takes 10% and 90% is distributed to investors. That 90% would be fully taxable, though it may be offset by depreciation allowances.

Comparing Direct Investments

While all direct investments are similar in some respects, real estate investment trusts (REITs), equipment funds, energy direct participation programs, and managed futures all have unique benefits and risks. This chart summarizes some of the principal characteristics of each type of investment:

	INCOME	GROWTH	LIQUIDITY
NON-TRADED REITS	• Potential for regular income	• Potential for growth	• Very limited liquidity
EQUIPMENT LEASING	• Potential for regular income	• Potential for growth	• Very limited liquidity
ENERGY	• Potential for income	• Potential for growth	• Very limited liquidity
MANAGED FUTURES	• No income	• Potential for growth	• Generally monthly liquidity

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CHANGE IN VALUE	ECONOMY	TAX CONSIDER-ATIONS	RISKS
• Assets should appreciate	• Recessions hurt • Inflation helps	• Potential capital gains • Depreciation deduction • UBTI does not apply	• Tenant default or bankruptcy • Failure to lease real estate • Too much leverage
• Assets depreciate	• Recessions help • Inflation helps	• Accelerated depreciation deduction • UBTI rules may apply	• Defaults or bankruptcy of lessees or borrowers • Obsolescence • Too much leverage
• Natural resources deplete	• Recession neutral	• Inflation helps • Intangible drilling costs deduction • Depletion allowance • Possible depreciation deductions • UBTI rules may apply	• Dry or commercially unsustainable wells • Mechanical problems • Price fluctuation
• Assets should appreciate	• Recession neutral • Inflation helps	• Potential capital gains • UBTI does not apply	• Trendless or choppy markets • Sharp market reversals