CAPITAL SQUARE

721 EXCHANGES

A TAX DEFERRAL STRATEGY FOR REAL ESTATE

INTRODUCTION TO REITS AND OPERATING PARTNERSHIPS

Real estate investment trusts (REITs) typically own their real estate in an operating partnership known as an OP. The OP is structured as a partnership to obtain favorable tax treatment under the Internal Revenue Code. Section 721 of the Code provides favorable treatment for owners who exchange their real estate for OP units. This is commonly referred to as a 721 exchange, OP transaction or UPREIT.

OP Unit holders receive a share of cash flow from each of the properties in the OP. They typically receive the same rate of return on their equity as REIT stockholders receive on their stock.

Summarized below are numerous benefits to owners who enter into OP transactions, including the reduction of risk by diversifying compared to ownership of a single property. Also, OP distributions are protected compared to ownership of a single property because the OP owns a large portfolio of properties.

WHAT IS A 721 EXCHANGE/OP TRANSACTION?

In a Section 721 exchange, the owner exchanges real estate for OP units of a REIT. Instead of receiving cash in a taxable transaction, the owner receives OP units. Unlike a taxable sale, the gain is deferred under Section 721.

Section 721 is similar to Section 1031 governing like-kind exchanges, another popular method of deferring gain on the sale of investment real estate. Section 721 exchanges have become a popular strategy among real estate owners looking for diversification and other benefits described below.

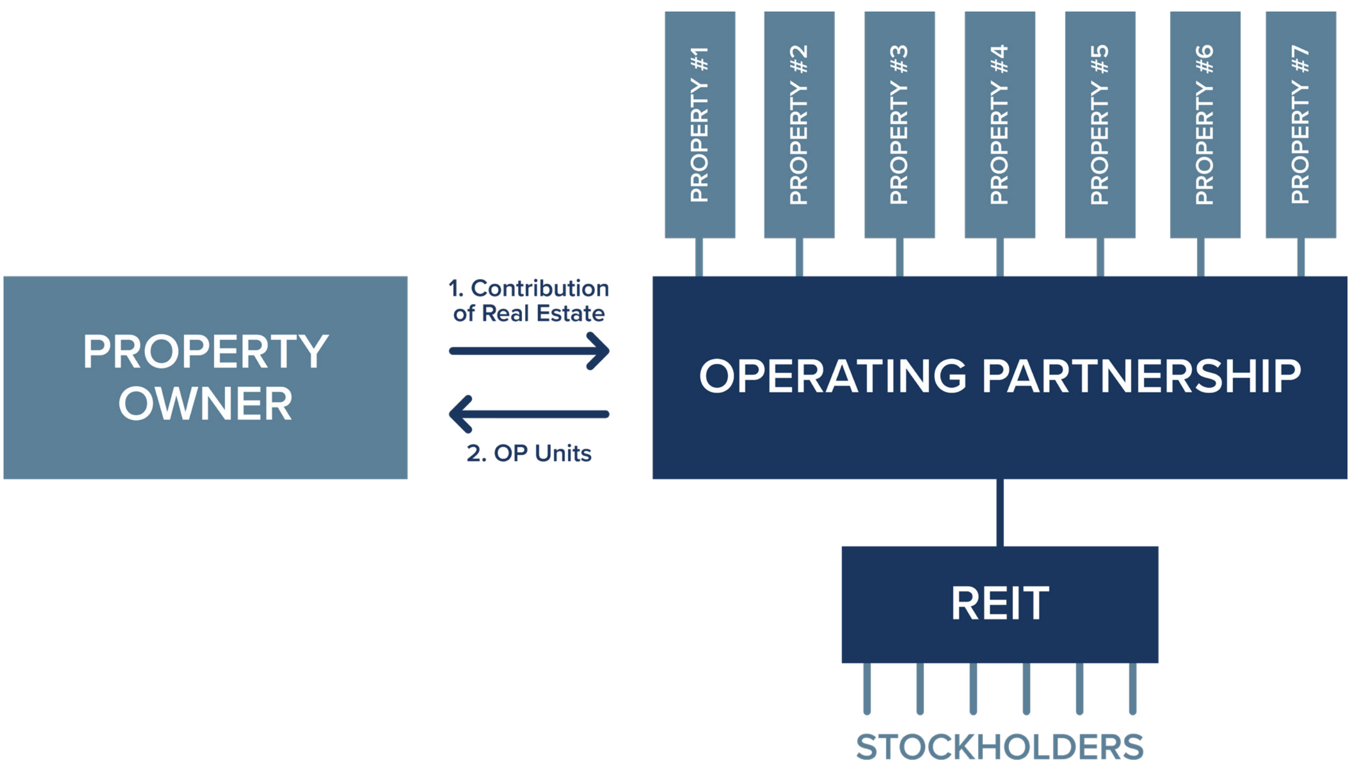
TAX BENEFITS OF SECTION 721

Section 721 defers taxation for owners of real estate who contribute their property to an OP. The gain that would be recognized in a taxable sale is deferred. The gain is deferred until the owner elects to sell the OP units in a taxable transaction. The owner has the ability to hold OP units indefinitely or time the sale to coincide with tax or financial planning strategies.

The tax deferral becomes permanent (the tax is essentially forgiven) upon death. The heirs, upon death of the OP holder, receive a stepped-up tax basis in the OP units (tax basis equal to fair market value). This means that the heirs can then sell free of taxes (federal and state). In this way, the deferral becomes permanent upon death.

Section 721 is a popular alternative to a taxable sale for real estate owners interested in a tax-favored investment with an institutional partner.

OP/UPREIT STRUCTURE



A 721 transaction allows an investor to exchange real property for operating partnership units, which may then be converted into REIT shares and sold.

BENEFITS OF SECTION 721 EXCHANGES/OP TRANSACTIONS

Owners of real property enjoy numerous benefits from a 721 exchange:

1. **No Taxable Gain.** The gain that would be recognized in a taxable sale is deferred under Section 721. The gain is deferred until the holder of OP units elects to sell in a taxable transaction. The gain will be forgiven upon death of the holder.

2. **Diversification.** Owners who exchange real estate for OP units have the safety net of a more diversified investment because the OP owns a large portfolio of properties. Owners can reduce their risk by diversifying in this manner compared to ownership of a single property. Also, the OP's portfolio of properties helps protect owners' distributions of cash flow

3. **Liquidity.** REITs typically provide a liquidity option that is not available in a direct real estate investment. OP units may be exchanged for REIT shares and, then, sold on the market to create liquidity for some or all of the investment. Liquidity in this manner is not available to direct owners of real estate.

4. **Estate and Tax Planning.** OP units are conducive to estate and tax planning because they can be divided among the partners of a partnership or members of a family. The divisibility of OP units permits some to hold and others to sell. This flexibility permits individualized tax and financial planning.

5. **Passive Investment.** Owners are able to convert actively managed real estate into a passive investment where a professionally managed, institutional REIT provides turn-key management and accounting services.

6. **Transparency.** REITs provide a high level of transparency and oversight by an independent board of directors.

These benefits can be obtained in a 721 exchange without triggering taxable gain (federal or state).

Target Property

For an OP transaction to be a viable strategy, the target property must meet the REIT's investment criteria. REITs typically acquire investment grade properties and also interests in such properties, for example, DST interests.

BENEFITS OF 721/UPREIT TRANSACTIONS

OP units may provide investors the following benefits:
Ownership of a diversified portfolio of institutional quality real estate via ownership of OP units
Deferral of taxes (federal and state) upon contribution
Realization of the economic benefits of the REIT's entire portfolio, including capital appreciation and distributions of operating income
Exchangeability of OP units into REIT shares
Full divisibility of OP units
Management of tax gain through partial conversion and liquidation of OP units over time
Upon death, receipt by heirs of a stepped-up basis in OP units

HOW IT WORKS

MECHANICS OF A 721 EXCHANGE

The process is simple. The property owner and the REIT mutually agree on the fair market value for the property. The purchase price is typically determined by independent third-party appraisals.

Debt secured by the real estate will be assumed by the OP or repaid at closing. The owner will be released from all liability on their loan.

The real estate owner receives OP units with a value equal to 100% of their equity in the property (fair market value of the property less any debt assumed by the OP).

THE 721 ADVANTAGE

A Section 721 exchange offers many potential benefits, including:

- Deferral of federal and state taxes
- Ownership via the OP of a professionally managed, diversified portfolio of institutional-grade real estate
- Realization of the economic benefits of the REIT's entire portfolio, including capital appreciation and distributions of operating income
- Ability to convert OP units into REIT shares that can be sold on the market
- Management of tax gain through partial conversion and liquidation of OP units over time
- Full divisibility of OP units
- Upon death, receipt by heirs of a stepped-up basis in OP units (permanent tax-deferral)

LIQUIDTY OPTION — EXCHANGE OP UNITS FOR REIT SHARES

REITs typically provide liquidity via an option to exchange OP units for REIT shares that can be sold on the market. To obtain liquidity, the owner would exchange OP units for REIT shares, and then sell shares on the market.

The holder of OP units chooses when and how much of the OP units to sell. The decision to sell is made solely by the holder of OP units. This is a taxable transaction but provides liquidity not otherwise available in a direct real estate investment.

GLOSSARY

721 exchange – A Section 721 exchange permits real estate owners to contribute their property to a partnership in exchange for interests in that partnership on a tax-deferred basis.

1031 exchange – A Section 1031 exchange allows real estate owners to exchange their property for like-kind replacement property on a tax-deferred basis.

DST – Delaware statutory trust. An investment vehicle that allows a group of investors to purchase fractional interests in real estate.

FMV – Fair market value. The price that a property is likely to bring on the open market.

OP – Operating partnership. The entity through which a REIT typically acquires and owns its real estate.

OP Units – Operating partnership units, representing ownership of the OP that owns the REIT's real estate. These units may be converted into REIT shares.

REIT – Real estate investment trust. A company that owns income-producing real estate.

UPREIT – Umbrella partnership real estate investment trust. A REIT structure with an OP that allows owners of real estate to exchange their property for OP units.

READY TO LEARN MORE?

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Contact your financial advisor.

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CONSIDER THE RISKS

- No public market currently exists for our Shares, and we have no current plans to list our Shares on a national securities exchange.
- We have limited operating history and established financing sources and we cannot assure our stockholders that we will be successful in the marketplace.
- This is a "best efforts" offering and some or all of our shares may not be sold.
- We have not yet identified any properties to acquire with the proceeds from this offering.
- We set the offering prices of our Shares, including the scheduled increases, arbitrarily. These prices are unrelated to the book or net value of our assets or to our expected operating income. There is a dilutive effect to investors who purchase our Shares after the termination of any of our early investor discounts. We do not intend to conduct a net asset valuation ("NAV") or provide an estimated NAV per share.
- We may return a portion of your capital if our Advisor is unable to quickly identify suitable properties or if such properties do not generate sufficient cash to make anticipated distributions.
- If we raise substantially less than the maximum offering, we may not be able to invest in a diversified portfolio of properties and your investment will be more susceptible to fluctuations in the values of specific properties.
- We have no employees and are dependent upon our Advisor, Property Manager and affiliates.
- Our officers, directors, and the officers and employees of our Advisor and its affiliates may have substantial conflicts of interest because they also serve similar programs sponsored by our Sponsor.
- We will pay substantial fees and expenses to our Advisor and its affiliates, our Dealer Manager, and our Participating Dealers, which may increase the risk that you will not earn a profit on your investment.
- The income from any of our properties will be dependent on the ability of our Property Manager to successfully manage such properties.
- Our rental revenues will be significantly influenced by the conditions of the markets in which we operate and by demand for multifamily housing properties generally.
- If we do not qualify as a REIT, we will be treated as a corporation for federal income tax purposes.
- Our Advisor may face conflicts of interest relating to the purchase of properties, and such conflicts may not be resolved in our favor, which could adversely affect our investment opportunities.
- We may incur substantial debt, which could hinder our ability to pay distributions to our stockholders or could decrease the value of your investment.
- There are limits on the ownership, transferability and redemption of Shares.

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