

TOP STORY: \$519M CVS Sale-Leaseback: Largest In Company's History

By Michelle Napoli

Woonsocket, RI—In what is said to be the largest such deal in the drugstore retailer's history, CVS Corp. closed on a \$519-million sale-leaseback of 163 properties with affiliates of Staubach Capital Partners, based in Dallas, and a group of approximately 12 other investors. The properties were either owned or ground-leased pharmacies in 22 states, and average out to a little more than \$3.18 million each.

The purchase is being financed through a securities offering underwritten by ABN Amro, Credit Suisse First Boston, Morgan Stanley and Suntrust Capital Markets. A provisional rating of A3 was assigned to CVS Lease-Backed Pass-Through Certificates Series 2004-1, which mature in January 2027, by Moody's Investors Service.

CVS was represented in the deal by the Boston-based law firm Mintz, Levin, Cohn, Ferris, Glovsky and Popeo PC, which pooled environmental, real estate, securities and tax attorneys to handle the transaction. The firm has represented CVS in a total of \$2.5 billion of sale-leasebacks over the past six years. "The success of such a substantial deal, the largest in the history of CVS sale-leaseback transactions, is reflective of the results achieved when the skills and expertise of professionals in several practice areas are integrated," said Andrew R. Urban, co-managing partner of Mintz Levin and a partner in its real estate practice, in a statement.

Chalk it up to the recent holidays, tight lips or both, but spokespersons at Staubach and CVS did not respond to NET LEASE forum's inquiries for additional information by press time.

Staubach Capital Partners works with investment-grade corporate real estate users and property investors in sale-leasebacks, credit-tenant leasing, tax-deferred exchanges and long-term real estate investments, and has completed more than \$7 billion of transactions since 1995. It has been known to buy sale-leaseback portfolios and then resell individual properties into the 1031-exchange market. Its Website even boasts an endorsement from CVS treasurer Phil Galbo: "After completing over 400 sale-leaseback transactions worth \$1.3 billion, I'd say you're just what the doctor ordered for our balance sheet." Clearly, they'll have to update those numbers.

INSIDER: CNLR's Craig Macnab

By Michelle Napoli

Craig Macnab joined Orlando, FL-based Commercial Net Lease Realty Inc. as CEO in February 2004, adding president to his title several months later. Now, as the company refocuses on its retail sector roots, Macnab's background will no doubt come in handy. His own roots in retail go way back: prior to joining CNL, he was CEO of JDN Realty Corp., a shopping center developer acquired by Developers Diversified Realty Corp. in 2003. As Macnab approached his one-year anniversary with the net-lease REIT, NET LEASE forum editor Michelle Napoli spoke with him about the company's activities in 2004 and its strategy for 2005, including why it is refocusing on the retail sector.

Q: What was 2004 like for the company?

A: The company now has 100% focus on the retail category. The market continues to be extremely competitive in the freestanding, single-tenant, credit market for small-dollar assets. The leveraged buyers are paying very aggressive cap rates, and we're taking advantage of that to some extent; we've culled and trimmed small amounts of our portfolio. We've sold in round numbers somewhere around \$45 million of properties this year at aggressive cap rates. By the same token, we have sold about \$50 million of properties this year that we developed or in our 1031 exchange business, and again those cap rates have been very aggressive. We've had to adapt our strategy to target different categories of retail where we can play in sectors that are slightly less competitive and also generate yields that are accretive to our shareholders.

Q: What do you expect for 2005?

A: We are looking to acquire \$150 million of properties at cap rates consistent with those that we have realized in the past—the high eights to the low nines. It's obviously not easy; we have to focus on portfolio transactions, we have to structure solutions for either our tenants or existing owners of properties, and the emphasis there is on structured solutions. In the third quarter [of 2004] we had a transaction similar to that where we closed on a portfolio of drugstores; it was a structured solution for the seller, and it came in at cap rate that was higher than 10%. We have since then turned around and sold four of those properties, taking advantage of the aggressive demand for quality real estate at a price that generated a handsome gain.

Q: Can you expand on your refocusing on the retail category? Before you joined the company, it looked to expand to other property types.

A: In the second half of 2003 we acquired a large office building in Washington, DC and with the benefit of hindsight the purchase of this building, where the government is tenant, was a terrific acquisition. For us it's by far our biggest asset; when we finish our capital expenditure plan, which is substantially complete at this time, we'll have nearly \$175 million invested in this property and it is worth at least 15% more than that today. So that value has been created in a short, 12-month timeframe.

That was a well-executed acquisition, and obviously the credit of the US government is as good as it gets. By the same token, that was an opportunistic transaction, and our core presence in the real estate community, our legacy, is primarily retail. The internal core competencies are aligned in underwriting, conducting due diligence and sourcing retail transactions, and that is what we're focusing all of our energies and people on at present. I don't want to say forever because nothing is forever, but in the near term and as far as I can see, we are focusing on retail. Office and industrial are no less competitive than retail. They are definitely big markets and if we were to capture a small share it would be meaningful; however, in the retail arena, particularly as we broaden our categories, we are finding plenty of good opportunities to build value for our shareholders.

Q: Explain what you mean by 'broadening of categories.'

A: We are expanding the categories of retail to increase the deal flow and opportunities that we are seeing. This is not to say we are compromising the real estate fundamentals or the quality of the real estate. As an example, we just purchased a car dealership in metropolitan Atlanta from a national automobile retailer. This location is on a street that has a traffic count of about 75,000 a day. We have a credit tenant and a terrific real estate location from one of the nation's best operators in that category of retail. We continue to try to identify other segments, categories of retail that have quality real estate locations with experienced operators, and we're in the early stages of completing some transactions in those areas. Those categories might include things like convenience stores; at this point in time we have not purchased a convenience store, but I suspect by the summer we will have completed our first convenience store acquisitions. The existing knowledge we have makes us very well qualified to pursue those; if you think about it, good convenience store locations are key corners of real estate that are very conducive to impulse shopping. This is a type of real estate that we have underwritten for a long time. While this category is new to NNN, it's a real estate class that other people have had a lot of success with for a long period of time. There are some other categories of retailers that are a little less traditional that we're going to be pursuing opportunities with as well, particularly into '05.

Q: Is this essentially expanding to a wider spectrum of credit in terms of the tenants you are willing to underwrite?

A: The short answer is yes. But what we're looking for at the end of the day is a number of things. We need to have yield to make this activity add value to our shareholders. We need to have lease structure; we're not going to compromise on the terms and conditions of the lease, because that's something you've got to live with for the duration of the lease. In addition to that, there are the fundamentals of the real estate location that we're pursuing and that, at the end of the day, is what's really important. And the final piece is credit. We've done a good job of avoiding a number of these types of tenants. We don't own electronics today or Kmart's—even though that name has new interest—but retailers come and go and at the end of the day, you're left with the real estate. One of the things that makes Commercial Net Lease Realty of value to our shareholders is that about 40% of the value of our assets is in the land, and that value is probably increasing, as they're not creating any more land, particularly in good locations.

All of these things have to be looked at in tandem to determine whether the return is satisfactory for all the elements of risk that we're taking. In our underwriting process, different individuals are respectively accountable for each one of these categories, and in our real estate investment committee process, we look for each one of them to advocate the merits of their respective segments. It's a process that's rigorous, structured and a very integral part of how we're going to build value.

Q: What other initiatives are underway at Commercial Net Lease Realty?

A: We have a small development function that has had over a long period of time great success in developing build-to-suits, primarily drugstores, for our tenants. We've probably developed around 130 drugstores. This is a business that had an excellent 2004; we have very good visibility into 2005 and we are again slightly adapting the focus of that department to increase the complexity and value-add in projects, as over time I would expect our drugstore development business to decrease. In the near term, into 2005, we have a healthy pipeline of drugstores that we are building, most of which we will sell into this very aggressive market.

Q: What does this enable you to do?

A: One of the things this does is help as we develop and deliver solutions to our tenants. We're hopeful that we're going to complete a deal with a non-traditional retailer whereby, on a non-competitive basis where we're the sole party they're talking to, we're going to purchase a portfolio of sale-leaseback assets from them. And one of the things that's been valuable to them is our willingness to assist them in their internal development program through our own development associates. I don't want to overemphasize this area, but it's another arrow in our quiver. It's produced a healthy amount of value for our shareholders in 2004, and the outlook for 2005 is quite encouraging.

Q: Any other new developments over there?

A: We also have a small mezzanine lending business. We have underwritten properties as if the borrower defaults and we would have to own these real estate assets; if we do a good job of underwriting these, it's likely that the borrower will pay off these mezzanine loans and refinance them with cheaper money, and we're beginning to see that in our existing portfolio of mezzanine loans, which is testament to the fact that they were well underwritten. Returns are in the double digits for our mezzanine portfolio, and we'll continue to keep this as a small part of our business going forward.

Q: What are your expectations for the broader market in 2005?

A: There's no doubt about it that the demand for real estate assets has exceeded the supply of high-quality real estate. I'm going to focus my comments on retail—the cap rates are as aggressive as people can recall and maybe even better than that. I don't see that changing. There's a lot of discussion about what happens when interest rates increase, and clearly on the short end they are increasing, but I think what we're going to see is a flattening of the yield curve, with the long bond increasing but not increasing that much. There is still an enormous demand for high-quality real estate, given the predictable, consistent returns that people are able to obtain in this investment category. Those returns are more than satisfactory compared to alternative investments. In the REIT industry, we're going to continue to see inflows to the segment. The many big asset allocators—pension funds, etc.—are underinvested in real estate and are going to target this segment. So it's going to remain extremely competitive through 2005 and maybe beyond. No doubt about

it, as interest rates increase, the purely leveraged buyer is going to become a little bit less of a factor, but in the aggregate, money flows are going to favor real estate through 2005.

Deutsche Bank, Prada Complete Sale-Leasebacks In Europe

By Michelle Napoli

Frankfurt am Main, Germany—When Deutsche Bank AG announced a US\$1.2-billion, 5.27-million-sf sale-leaseback with Blackstone Real Estate Partners late in 2003, the bank's global head of corporate investments said it was exploring more opportunities to reduce ownership of its real estate portfolio. Indeed, Deutsche closed on another deal just as 2004 was coming to a close, this one priced at 300 million euros (or about US\$424.72 million based on currency pricing on Dec. 28, though the dollar has been continuously weakening) with Eurocastle Investment Ltd. The latest sale-leaseback encompasses a portfolio of 109 properties, predominantly office assets, totaling nearly 3.23 million sf; Deutsche will continue to occupy most of the space under medium- to long-term leases.

Eurocastle, which listed on the London Stock Exchange following a June 2004 initial public offering and is incorporated in Guernsey, one of the UK's Channel Islands, is an investment company managed by New York-headquartered Fortress Investment Group LLC. According to Fortress' website, "Eurocastle's business strategy is to invest in a diverse portfolio of European real estate securities and other asset-backed securities." A Fortress spokesperson did not respond by deadline to a request for additional information or comment.

The properties are spread among 90 cities and towns in Germany, "generally in city-center pedestrian areas," according to a formal announcement from Fortress and Eurocastle. "We are excited to complete this sale-leaseback transaction with Deutsche Bank, one of the leading financial service companies in the world," said Eurocastle CEO Wesley R. Edens in the announcement. "This investment opportunity allows us to fully deploy the capital we raised in our IPO and generate attractive risk-adjusted returns for our shareholders."

"With this transaction, Deutsche Bank is pursuing its strategy of focusing on core businesses and further optimizing the use of available capital," global head of corporate investments Dr. Axel Wieandt said in the bank's announcement. In addition, a Deutsche Bank spokesman was quoted in some press reports that it is "still open to sales" and that there are additional properties worth approximately 500 million Euros identified for disposition.

In Italy, meanwhile, the fashion house Prada Group agreed to a sale-leaseback for a portfolio of seven industrial properties with Spazio Industriale, a joint venture 25% owned by Milan-based Pirelli Real Estate and 75% owned by Soros Real Estate Investors. The deal, with a purchase price of 77 million euros (about US\$109 million based on Dec. 28 currency pricing), is expected to close by the end of January; the JV has an option to buy two more properties, as well.

The seven properties will be leased back to Prada under the equivalent of a triple-net lease; some leases expire in 2011 and the rest in 2017. The properties will be used as warehouses, laboratories, offices and a shopping outlet, Pirelli noted in its announcement of the deal, and are located in the textile district of Tuscany and in the Marche region. Lazard & Co. Real Estate was the financial advisor to Prada, while the JV was advised by Gianni Origoni Grippio & Partners.

Korpacz: Net-Lease Overall Cap Rates Up Slightly

By Michelle Napoli

Average overall cap rates for national net-lease sales edged up slightly from 8% to 8.04% during the third quarter of 2004 compared to the prior quarter, according to the Korpacz Real Estate Investor Survey, though average residual cap rates continued to decline, from 9.2% to 9.17%. Average marketing time for properties held firm at 3.7 months. The report noted that while there was a substantial increase in the number of net-lease properties on the market, few possessed the sought-after attributes of mature cash flow, desirable location and acceptable credit. "As a result, some investors have opted to stay on the sidelines until pricing levels decline and overall cap rates trend upward. 'When there are 27 offers on a deal, being first doesn't make us feel comfortable,' shares a purposely sidelined participant."

Short Takes

Bowers Joins Wells As CFO

Atlanta—Robert E. Bowers (see picture, right) has joined Wells Real Estate Funds as CFO. In addition to guiding the company's long-term financial structure and strategy, he will also direct its finance, corporate accounting, risk management, investor services and compliance organizations. Bowers' 20 years of financial services industry experience includes working in investor relations, debt and capital infusion, IPO structuring, budgeting and forecasting, financial management and strategic planning. He most recently served as a business financial consultant, "interfacing regularly with the Securities and Exchange Commission and providing strategic financial counsel to a range of organizations including the university system of Georgia, venture capital funds and public corporations such as NetBank Inc.," according to Wells. He also served as CFO of NetBank and CheckFree Corp.

SLB Study: Reporting Differs On Proceeds In Operating Lease Accountings

Atlanta—A recent study by the financial analysis lab at Georgia Institute of Technology's College of Management found that public companies differ in how they report the proceeds of sales when the leasebacks are accounted for as operating leases. That differs from those accounted for as capital leases, in which case there is much more uniformity and, according to the study, clearer generally accepted accounting principles. The study, Cash-Flow Reporting Practices for Sale and Leaseback Transactions, found "many more operating leases where the proceeds were reported as investing rather than financing cash flow." It concludes that as a result, for investors looking to free cash flow as part of their analysis of potential company investments, "calculations of free cash flow that use net capital expenditures, or gross capital expenditures net of the proceeds from asset disposition, may not be comparable across firms."

Lone Star To Buy BI-LO, Bruno's

Greenville, SC—Lone Star Funds reached an agreement to buy BI-LO Holdings LLC from Dutch retailer Ahold for up to US\$660 million. BI-LO Holdings is the parent company of BI-LO LLC and Bruno's Supermarkets Inc., supermarket chains that currently operate a total of 455 stores in seven states. The deal is expected to close in the first quarter. "We will now become a regional supermarket operator, one that will be fast-moving, flexible and responsive," BI-LO president and CEO Dean Cohagan said in announcing the agreement. "Our goal is to be the best supermarket business in the Southeast."

Will Many Burger

What would amount to about 1,000 Burger King restaurants could close in 2005, according to a recent filing with the SEC by Quality Dining Inc., one of the largest Burger King franchisees in the US, with 124 locations. "As a result of Burger King's poor performance, [Burger King Corp.] and its franchisees undertook financial restructuring initiatives and are projected to close approximately 10% of the restaurants in their US system by the end of 2005," the filing states. Burger King Corp., however, denied that the closings were forthcoming; an unidentified company spokesperson told industry publication Restaurant Business that the filing is "100% wrong" and "an egregious error." Quality Dining, which is being taken private by a group of shareholders including CEO Daniel B. Fitzpatrick, attributes its below-industry-average annual growth projections in part to Burger King's performance and marketing programs. Burger King, meanwhile, reported in early December that November sales in its US system were up 9.1%, the 10th consecutive month of positive same-store sales in the US. According to an industry analysis included in Quality Dining's filing, Burger King has the second-largest share, at 17%, of the country's hamburger quick-service market; McDonald's Corp. is the leader of the category.

S&P: Outlook For Drugstore Chains "Mixed"

New York City—The US drugstore industry has "a relatively above-average business profile, as industry fundamentals are very good due to favorable demographics and the structure of the US healthcare system," according to Standard & Poor's Ratings Services credit analyst Diane Shand, who recently authored a report on the industry. The report, titled Mixed Outlook for Rated US Drugstore Chains, also notes that "the sector is less vulnerable to economic downturns than other retail sectors because of the large portion of profits derived from prescription sales." The sale of the Eckerd chain during 2004 and the resultant consolidation in the industry "should bring greater price discipline to the industry," according to S&P, while the acquirers, CVS and Jean Coutu, are likely to "improve the operations of the acquired stores and increase marketing spending. This could intensify competition over the near term and put pressure on regional and independent drugstores, as well as on weaker national drugstore chains like Rite Aid Corp."

Institutional Investor More Than Doubles Commitment To Net-Lease JV

New York City—An institutional investor advised by AEW Capital Management LP of Boston has increased its equity commitment to a joint venture with Lexington Corporate Properties Trust, more than doubling its investment. The investor committed another \$50 million of equity and LXP another \$21.4 million, bringing the JV's total equity to \$121.4 and increasing its acquisition capacity to \$345 million, assuming 65% leverage. The JV has purchased 11 properties for a combined cost of \$110.5 million since forming in April 2004. Most recently, it acquired a 107,210-sf office building in Canonsburg, PA net-leased to Ansys Inc. through December 2014 for \$14.9 million, and six retail properties net-leased to Kmart Holding Corp. through December 2018 for \$24.1 million. The Kmart stores total about 714,522 sf and are located in California, Illinois, New York, Ohio and West Virginia.

Carey REIT Suspends Fundraising

New York City—Corporate Property Associates 16-Global Inc., a non-traded net-lease REIT managed by WP Carey & Co., suspended its best-efforts offering of securities as of Dec. 30, 2004. The REIT "has decided to suspend fundraising for an unspecified time period in order to bring into balance the rate of fundraising and the rate of investment," Carey said in a filing with the SEC, because "it believes that it is prudent to cease taking in additional money until CPA:16-Global has made additional real estate acquisitions." It may restart the sale of securities during the second quarter of 2005.

SLBs Among Targets Of LaSalle Japan Fund

Tokyo—LaSalle Investment Management Inc. concluded fundraising for its Japan Logistics Fund, with commitments from more than 20 investors in the US, Europe and Asia-Pacific region. The fund expects to acquire about US\$1.5 billion of modern logistics facilities in Japan, including existing facilities, build-to-suits and sale-leaseback deals. Key distribution nodes such as Tokyo, Narita, Nagoya, Yokohama, Osaka and Kobe will be a focus. The fund has already bought two properties for US\$230 million; in Ichikawa City it will build a distribution center for Nippon Express Co., and in Kashiwa it will develop a large-scale logistics facility.—Michelle Napoli

Recent Transactions

INVESTMENT SALES

Sperry Van Ness represented Marketplace Partners II LP in its recent sale of a Rite Aid property in Fallbrook, CA (see picture, right) for \$5.4 million at a 7.9% cap rate. The buyer, a private investor, was represented by CB Richard Ellis. The 16,708-sf building, which has a drive-through, was built in 1999 and is subject to a 20-year triple-net lease.

Upland Real Estate Group Inc. brokered the sale of three net-leased Back Yard Burger properties in Alabama and Georgia. A 3,452-sf property in Florence, AL sold for \$1.6 million, a 2,460-sf property in Macon, GA went for \$1.7 million and a 2,800-sf asset in Milledgeville, GA went for \$1.6 million. Upland represented the seller, a preferred developer; the three buyers were private individuals, one of which was doing a 1031 exchange.

Both buyer and seller of the 76,319-sf Creekside Plaza shopping center on Agoura Road in Calabasas, CA were represented by Faris Lee Investments. Family trust Mar LLC paid \$21.7 million to local developer W Calabasas LLC for the asset as part of a 1031 exchange. The grocery-anchored shopping center was built in 2001 and is 100% occupied. A challenge to the deal was finding a buyer who could put down almost 35% equity and assume a loan with an interest rate higher than today's market rate, according to Faris Lee.

Cushman & Wakefield represented iStar Financial Inc. in selling a 12-property portfolio to Oasis Net Leased Holdings LLC, according to GlobeSt.com. The \$157-million portfolio includes one development site and 11 office and R&D properties totaling more than 900,000 sf, much of which is net leased to local, regional and national tenants. Properties include 355 Wood Rd. in Braintree, MA and 3300-3800 W. Sahara Ave. in Las Vegas.

A portfolio of 16 buildings occupied by Sonic restaurants in eastern Tennessee and western Virginia was purchased by Spirit Finance Corp. for \$9.6 million. Spirit was represented in-house, while Sperry Van Ness sat in for the seller, an Oklahoma City-based private investor. Each of the 16 buildings measures about 1,200 sf. According to the seller's agents, "there were several full-price offers for individual stores and several offers for the entire portfolio, which sold for more than the asking price."

Thirteen non-core and substantially vacant properties were recently sold or subject to definitive agreements by American Financial Realty Trust for \$54.4 million. The properties total about 711,000 sf, about 77% of which is vacant or subject to short-term leases. The REIT's non-core property dispositions are ahead of schedule, according to the company.

Entertainment Properties Trust announced the opening and acquisition of the Grand Theatre 14 in D'Iberville, MS. Operated by Southern Theatres under a 20-year, triple-net lease, the cinema has 2,400 seats in 14 auditoriums.

A joint venture program of Lexington Corporate Properties Trust paid about \$50.5 million for two adjacent office buildings known as Sammamish Park Place in Issaquah, WA, about 15 miles from downtown Seattle. The seller was Schnitzer Northwest. The buildings total 202,544 sf and are net leased to Spacelabs Medical Inc., a subsidiary of OSI Systems Inc., through Dec. 14, 2014; OSI guarantees the lease. First mortgage financing of about \$32.8 million bears a fixed interest rate of 5%.

A nearly \$60-million, 1.7-million-sf portfolio of redeveloped former Safeway stores was sold in an off-market deal to Rainier Capital Management, GlobeSt.com reports. The 64 properties are 92% occupied under triple-net leases that average \$6 a foot with tenants such as Walgreens, the United States Postal

Service, Office Depot and CVS. The seller was a private investor in Dallas; the properties are located in multiple markets, with 20 in the Dallas/Fort Worth Metroplex.

FINANCE

American Financial Realty Trust closed on its sale of a 30% interest in Boston's State Street Financial Center to Canadian REIT IPC US Real Estate Investment Trust. The minority interest garnered \$60.3 million and the deal valued the property at \$763.5 million. "This transaction allows AFR to monetize a significant portion of its equity investment in the property," said president and CEO Nicholas J. Schorsch when the deal was first announced. "We have the opportunity to begin a relationship with IPC, which we hope will lead to other joint venture transactions in the future," he added. Holliday Fenoglio Fowler LP represented the American REIT in the deal.

DEVELOPMENT

Ramco-Gershenson Properties Trust purchased 465 acres of land in Jacksonville, FL, where it plans to develop a mixed-use shopping complex called River City Marketplace on 125 acres. The company sold about 19 acres of land to Wal-Mart, which will build a 203,091-sf supercenter store there.

SALE-LEASEBACK

Guilford Pharmaceuticals Inc. closed on the sale-leaseback of its 77,225-sf R&D facility in Baltimore with BioMed Realty Trust Inc. and assigned to BioMed rights it held under a separate agreement to purchase its headquarters building, a nearby 91,592-sf asset owned by Crown Royal LP. Total cost was about \$25 million, while net proceeds to Guilford from the sale were \$19.4 million. Guilford is leasing back both buildings under 15-year absolute net leases, each with two 10-year renewal options and annual rent increases of 3%.

GE Commercial Finance's franchise finance group completed a \$7-million sale-leaseback with Restaurant Resources for all of the company's 16 Pizza Hut franchises in western Illinois and eastern Iowa. Terms of the deal were not disclosed.—Michelle Napoli

Rating Update

The senior unsecured debt of the Walt Disney Co. was affirmed at BBB+ by Fitch Ratings, but its rating outlook was revised to stable from negative. The revision "reflects the steady improvement in Disney's credit metrics resulting from the company's improved financial performance and from progressive reduction in debt," according to Fitch.

Fitch placed the BBB senior unsecured debt rating of Sprint Corp. and the BB+ senior unsecured debt rating of Nextel Communications Inc. on Rating Watch positive following announcement of their planned merger. "Fitch's rating action recognizes the potential for the combined company to more effectively compete within the wireless industry, the expectation that the combined company through operating and capital expense synergies will be better suited to generate sustainable Ebitda and free cash flow growth as well as the initial financial profile of Sprint Nextel," the rating agency said. "The combination of Sprint and Nextel will create the third-largest wireless company in the country with approximately 35 million subscribers." Moody's Investors Service, meanwhile, placed Nextel on review for a possible upgrade and changed the rating outlook for Sprint to developing from positive. "Moody's believes the combination of these two smaller carriers will create a more effective competitor against the two largest wireless operators,

Verizon Wireless and Cingular,” it said. “The combined entity’s wireless service revenue [will be] the second-highest in the industry, behind Cingular and ahead of Verizon Wireless.”

The BBB senior unsecured rating of Comcast Corp. was affirmed by Fitch, and the rating outlook remains positive. Fitch cited “the scale and operating benefits Comcast enjoys as the largest multiple systems operator in the country,” as well as Comcast’s ability to generate free cash flow growth. —Michelle Napoli

SPECIAL BONUS SUPPLEMENT: TIC ROUNDTABLE

By Michelle Napoli

Participants:

Michelle Napoli, Editor, NET LEASE forum and TIC Monthly

Jeffrey Boehning, assistant VP, Inland Real Estate Exchange Corp.

Rob Hannah, CEO, TSG Real Estate

Pete Johnson, VP of marketing, For 1031

Christian Mimer, SVP of real estate, 1031 Exchange Options

Greg Paul, president, Omni Brokerage

Marc Paul, co-chairman and president, SCI Real Estate Investments

Scott Richter, VP of acquisitions and finance, Evergreen Development

Darryl Steinhouse, partner, Luce, Forward, Hamilton & Scripps

William Winn, COO, Passco Real Estate Enterprises
Michelle Napoli: Let’s start with equity-raising activity. It seems that industry-wide, the actual equity raised in 2004 fell short of projections. Why do you think that’s the case, and what are you expecting in 2005?

Greg Paul: It looks like for the fourth quarter, which was projected at \$925 million raised, there’s a good chance for once that reality is going to meet projections this quarter and could possibly exceed. It’s not year-end yet, but we checked with a variety of sponsors, and it looks like we’re going to come closest to meeting those projections than before, which would put us at a year-end total—in the tenant-in-commons that are sold as securities, which is what we track—at close to about \$1.5, \$1.6 billion for the year. And that puts us at more than double last year. So if you project for 2005, I’d say there’s a good chance we’ll double that and get over \$3 billion.

Scott Richter: In terms of volume, we’re on pace to do \$150 million by the end of June 2005, which will be about double from what we did last year. But if I had to make a broad generalization about the industry, I would say it’s tougher to find real estate out there that fits the model. Cap rates have come screaming down; we’ve had a bump in interest rates throughout the year. In general, they’ve stabilized, but I think it’s tougher to find real estate that fits the model for our 1031s. In particular there’s a lot of demand on the multifamily side, and there just aren’t a lot of attractive properties out there.

Marc Paul: We'll close approximately \$300 million in new acquisitions; equity would be between \$100 million and \$120 million. Raising equity is not a problem. Real estate people by nature are overly optimistic. But I second Scott—it's very difficult to find deals. If you have a quality deal, the equity will come.

William Winn: Our year-to-year growth in equity raised has increased, but our expectations were higher because we thought we'd find more quality real estate to buy than we've actually been able to find. So we're all, I think, saying the same thing: We're trying to do what's best for the investor, but it's hard to find quality in the kind of market we're in. We're projecting a doubling of what we expect to do in 2004. But I'm sure a lot of us are projecting that kind of growth, because the demand is there for the equity side. It's a function of the market in terms of interest rates, cap rates, location and the product type which you're chasing. But everybody has a different strategy. Ours is, we're beefing up our acquisitions so we can penetrate the market better than we have in the past to try to increase opportunities for quality.

Darryl Steinhouse: The other area where the numbers got a little off is that a lot of the new sponsors were projecting that they were going to be coming out with their products, and at least some are finding that this is a little more difficult than they anticipated, and there's a lot of new sponsors coming out. But most of them are behind the schedules they anticipated six months or a year ago. But there is also a whole group out there that we see all the time, they're doing three, four transactions a year, \$5-million, \$10-million transactions with three, four, five investors. Those people are coming on more and more, but they're just under the radar. And some are doing large transactions, \$50-million transactions, but they're not being caught on anybody's radar screen because they're not going through broker-dealers.

Napoli: Is anyone surprised at the number of new sponsors that have entered the business this year? Any trends you see among them?

Marc Paul: There's a tremendous amount of new sponsors, far more than we could ever have imagined. However, the majority of them are very, very small. They're more the real estate-type syndications and really they're below our radar screen. At what point do you find a sponsor to be at a level where you're going to track them? If they're doing \$2-million deals, you probably wouldn't know they exist. When they start doing \$20-million average size deals and you start entering the institutional realm, yes, there's going to be a great deal more sponsors, but you're not going to see the same kind of prolific growth at that level as you are at a much lower level.

Winn: I also think that the broker-dealer community, where most of the distribution is in this business, has less tendency to approve and promote new sponsors' products to their organizations because of the lack of track record, experience, those types of issues. And so they find the fundraising side of it more difficult. And somebody might come out with a product that doesn't sell as quickly or at all, contrary to popular thought.

Napoli: How about For 1031? Being the newest of the sponsors represented, was it tough to get going?

Pete Johnson: The first couple of months were pretty difficult, but now I think we've proven ourselves in the market and to the channel partners that we deal with, which are mostly real estate brokers. Our deals range anywhere from \$2 million to \$20 million, so we were kind of all over the map, depending on where the real estate fits our acquisition criteria for our model.

Christian Mirner: Being on the broker-dealer side of the distribution channel, we get calls just about every day from people that want to explore entering the market. We don't often engage in those conversations because we're concentrating our efforts on what we consider to be the best-of-class real estate providers, those that have been doing it for a long time, have a track record, are sourcing good acquisitions in the marketplace. And we'd rather do a lot of their production as opposed to a little bit of production over a broader base of real estate providers. But I can say that there is interest from the institutional side of the business to enter this marketplace with an entrepreneurial partner. And I think we'll tend to see more of that type of joint venture, if you will, going forward, because they've looked at this space now, they've seen that

there has been some tax guidance that makes it more acceptable, removes the tax risk to a certain extent. So now they feel like there is a real opportunity in the market and they're going to bank on their relationships with those institutions or within the institutions to be a capital source, but also a profit source.

Marc Paul: What services will the institutional people bring to the table?

Mirner: They will be a joint venture partner, and they'll generally provide capital as well as be a member of the sponsorship group. They've got a profit motive, but they've also got the ability to provide capital to be able to transact the real estate transactions more quickly as opposed to doing a coordinated close, which can be troublesome sometimes.

Richter: We've all talked about how you're going to have a lot of new players; it's just the nature of how our economy works. But I agree with the earlier comments, specifically that it's a lot more difficult to do the mechanics of one of these transactions and also to interact with the broker-dealer community, as well as the investors, than a lot of the newer sponsors realize. And at Evergreen and some of the others around this table that are doing larger transactions and have those relationships, it seems it's going to be a lot easier for us to widen that gap with some of the newer sponsors as the demand continues to rise than it would be otherwise. The only concern with a lot of new sponsors is people failing and bringing a bad name to what we're doing here, because it is an investor service. And any time you have that kind of service, you don't want any messy issues. The new sponsors have the potential for bringing some of those up.

Jeffrey Boehning: One of the other things that we're seeing in terms of the complexity of putting these deals together—a year ago, we had about two lenders that we exclusively dealt with in doing the TIC business. Over the last three months we've developed that to six or seven lenders. That might also have an impact on the sponsors, the availability and understanding from the lender standpoint of what a TIC transaction is, and then also following that through, if it's a conduit loan, through to the securitization market.

Napoli: What are some of the other key factors new sponsors or potential new sponsors need to keep in mind? What are the common things they underestimate or don't take into consideration early enough that may be a problem?

Winn: In addition to being a real estate expert in buying the right real estate, they have to have expertise in negotiating loan documents so they don't conflict with the tax code related to 1031, and the securities code if you're doing a security. You're really looking at somebody who has to be an expert at tax, securities, legal as well as the loan documents and the real estate. It's complicated. And even though there might be a lot of new players, it's a question of whether they're doing it right, because we've been doing it from the beginning and of most of us have been at the table have been for years. The biggest risk is how those three main areas interact and conflict in the structuring of the transaction—how you get challenged on your 1031 and you have to pay penalties, or you're deemed a security when you sold it as real estate.

Marc Paul: You need two skill sets. On the one hand, you're playing in an institutional arena. You're competing with REITs and pension companies for major assets, which is one skill set. There are probably many large, institutional-type companies who can deal with that skill set and play in that playing field. But then, instead of having one investor, you have, say, 20 TICs in the deal. Now you have to be able to communicate with private investors. So the people that might have the best skill set in the institutional real estate field may not have the skill set or the infrastructure to deal with all the investor relations, investor questions, investor servicing that's required. For instance, SCI does not do any property management whatsoever, yet I have six full-time people in my accounting office and I don't even send out the checks.

Steinhaus: When I look at how the new sponsors have operated, most of them have not understood the processes. They believe they can come in, snap their fingers, they've always acquired real estate, and this will be the same thing. And it is more difficult than a typical transaction. They also don't understand the relationship between the tax code and the loan documents, and the concept of disclosing risk. If you have traditional real estate developers or real estate companies, you know when they're selling their product, that piece of real estate is the best piece of real estate anybody has ever seen in their life and their sales documents indicate that. With respect to risk, for those companies that come into the securities market, it's

a whole different approach and now you're disclosing the risk factors to your investors—and they're not usually thinking that way.

Napoli: That's assuming you're structuring these as securities, so we really should tackle that topic. The majority of sponsors are selling their TIC deals as securities, but not all. Darryl, why do you advise your clients that it should be a security?

Steinhouse: Because the law says so.

Richter: End of story.

Johnson: I'd like to see that law.

Marc Paul: We disagree.

Steinhouse: There's federal law and there's state law. You look at the federal securities law and it's fairly certain that TICs should be treated as securities because you do have an investment contract. Your investors are not relying on their own efforts to develop these products; they're relying on the efforts of others. And second, if you go to a state like California, there are a lot of Department of Corporations releases and opinions which deal with this topic. And they're fairly specific that, if you have undivided interest in real estate tied to a management contract, you have a security, and you have to be a securities broker to sell them. In fact, there's a Department of Corporations release that says if it is an investment contract, a real estate broker is not allowed to sell it.

Richter: We've always held that belief. I'm not a lawyer so I'm not going to get into the individual issues of why it's classified that or not. Certainly any time you're bringing in more than 10 investors into a deal and splitting interest, I think that's a big one. Going interstate is another. It seems to us and our lawyers that securities rules prevail, and we just feel that that's the best way to go. And, frankly, we've been doing it that way and we like doing it that way, and we feel more protected that way and we feel our investors are more protected that way. So that's the crux of the matter.

Winn: From our perspective, there are benefits to the sponsor to do it as a security from the risk standpoint and benefits to the investor having the full disclosure. A lot of our investors are unsophisticated. They sold land or they sold four units and they don't have the level of sophistication to determine the risk factors without the disclosure. So there's a benefit to them because, even if their certified financial planner who is in the broker community is not sophisticated, the document has the risk factors in it. Also, on the sponsor side, the full disclosure protects us—if the property fails, more likely than not we can't be forced to provide a rescission [if], for example, we offered it as real estate and it is deemed a security later, or the investor used that as a defense to get their money back, we have that in the document and we have a less likely right of rescission. So there's two benefits. If it's gray, it would probably be better to do it in this fashion to protect both parties.

Napoli: For the non-securities real estate providers here, what makes your product different in your opinion?

Marc Paul: Everybody paints this industry with a broad brush, and I don't believe it's fair. Without question deals can be structured in different formats. And I agree the vast majority of the TIC products being sold today are clearly securities. But it's important to understand that deals can be structured in different formats. There's a lot of varying parts. For instance, the key issue in all of this is whether or not an investor truly retains control of his investment or not. SCI does not do any property management. We hire annual, renewable, third-party, national property managers to manage all of our portfolio. We believe you should have institutional quality properties and institutional quality third-party property management handling that aspect. And we truly have those contracts set up so that the property managers can be fired if the TICs do not feel that they're doing a proper job. In fact, we have fired property managers, the TICs have fired property managers and put somebody else in place. We have an opinion letter from the largest tenant-in-common law firm in the United States that states that the way we are presently doing things they believe

is not a security. But the main thing I just want to stress is that different structures can be done differently. And I agree most of them probably are securities, but not all.

Boehning: With the way you structure your deals, who coordinates the vote to fire the property manager?

Marc Paul: SCI remains as an asset administrator for a small fee. Just like the property manager, though, the asset administrator is on an annual renewable contract. And they are given the authority to do the things we require to collect the votes of the TICs. They're given the authority within the scope of their asset management or asset administration contract to make the small everyday decisions and send the majority decisions out directly to the TICs. For example, I think a key ingredient is absolutely keeping the control, the decisions with the TICs. We don't do property management, and I'm strongly considering the possibility of even getting out of asset management or asset administration and appointing a national third-party entity to be the asset manager overlooking the property management and reporting to the TICs.

Johnson: I would agree with everything that Marc said. And unless we all know each other's deal, it's an opinion. We have a [legal] opinion that says our deal should be construed by any court as a real estate deal based on our structure, which is very similar to Marc's.

Napoli: I'm curious from your points of view if you're concerned at all with the review that is going on by the NASD and the SEC. They may have bigger fish to fry, but clearly they're looking at what's going on.

Johnson: I would welcome the SEC looking into this and giving us guidelines. We're prepared to turn into a security tomorrow as a backup strategy. But we believe in our real estate structure and that's the flag we're waving today. I just think that there is more than one way to skin a cat.

Marc Paul: It's important to understand that we are all trying to comply and to do things properly in an uncharted, new industry. And we're all in the learning curve. But there's a lot of interest from the National Association of Realtors to make sure that their membership, particularly their commercial membership, is able to participate in this large industry. SCI is seeking a no-action letter from the SEC on structuring deals as solely real estate with some of the parameters that I mentioned earlier—no sponsor property management, perhaps no sponsor asset management and making sure that the TICs do retain control and, additionally, making sure that you have TICs that are suitable for the investments. We, for instance, do not take nonaccredited investors. This broad brush that's being painted as if all TICs are little, novice animals who know nothing about real estate, who must be protected from the big bad wolf, the sponsor—in many cases, it's not true. I have many clients who are very sophisticated, very affluent, very experienced.

Winn: I think it's also important to know that we differentiate the security from the tax requirements. So on the securities side of this business—and we've been doing this since '94—the regulations haven't really changed. Two and a half years ago when the RevProc [IRS Revenue Procedure] came out for tax guidance, which was referred to as the kind of the start of the industry, was just the communication to the world that the industry existed. But we've been doing securities transactions since '94 and our structure has been relatively the same through that whole period, and modified slightly after the RevProc.

Steinhaus: I think we put together the first what I would call modern-day transaction back in '94 with TMP that went through the broker-dealer network with big, thick offering and it was a harangue and big process. Back then TMP was trying to figure out how to not make it a security because the window was so much larger to walk through if you could make it a real estate product instead of a security. But when we looked at it as real estate tied to a management agreement, we couldn't come up with any conclusion but that it was a security. But I will agree that you can sell an undivided interest in real estate and probably not make it a security, it's just that you have to be very specific and you have to make sure that investors the are not looking to you to get their return. The whole concept is, are the investors looking at you to provide the return or looking to someone else?

Marc Paul: Bill mentioned disclosure, and I think that there are some things that the securities world does better than the real estate world. I think it does an excellent job of disclosure. And even on our real estate

product, we do a full PPM, a full disclosure at the identical level as if it was a security. We want the level of disclosure in these documents to be the highest possible.

Steinhouse: Is your main reason, then, for treating this as real estate as opposed to securities for the referral mechanism and the broader window that's available?

Marc Paul: We are real estate guys. I just have trouble making the leap that when a pension company sells me a piece of real estate through a real estate broker, that we analyze and as experienced real estate investors purchase and then aren't able to discuss it with other knowledgeable commercial real estate brokers that have clients who are interested in coming in on that deal. And then when you have accredited investors who are selling a piece of real estate, who have experience, who then appoint a knowledgeable third-party national property manager to run their asset, suddenly, without question, the security world tells us that we absolutely must have a broker-dealer who, in many cases, in my opinion, knows 1/100th of the amount that the experienced real estate people involved in the transaction do, but without question we must go to him for his wise counsel and sage advice to complete the transaction.

Napoli: What's your feeling on whether real estate agents should earn some kind of referral fee or some kind of fee in conjunction with a securities registered rep?

Mirner: We only offer the interest in property through the securities broker-dealer channel. We're just following the law. And the law states clearly that unlicensed people cannot receive securities commissions. So to us, it's black and white. If we did pay referral fees, we'd be breaking the law, and we want to be in this business for the long term. We're not willing to take that risk. And we believe that in addition to being a real estate transaction, the fact that it's wrapped in a security is ultimately a benefit to the investor from a disclosure standpoint.

Napoli: Rob, bring us up to speed on the status of your new no-action letter request with the SEC on this topic.

Hannah: They have been submitting requests for information to all the broker dealers that they're aware of that are involved in these transactions, and our no-action letter request is now mixed up in that. The concern right now is that since the NASD and SEC have written rules that state that broker-dealers cannot compensate non-securities licensed people, if they allow an exception here, could that impact other industries? That's part of what they're looking at. The problem that exists here is there is also a law that says real estate can only be sold where commissions are paid to a licensed real estate agent. It's a fact that we all have to recognize. Any securities broker in this country right now selling a tenant-in-common interest [may be] breaking the law if they get paid [for selling real estate without a real estate license]. The purpose of our no-action letter request is to clarify the law and ask for relief from both sides. It is a security, absolutely, and the fact that it's a security, in my opinion, is absolutely the best possible wrapper for this product because the investor needs all the possible disclosure and information they can possibly get. They are blindly and passively going into these deals. And many of them are doing it with a couple of days left before they have to otherwise pay a huge amount of money in taxes, so they're going in very quickly. They need to benefit from the securities and disclosure rules, everything that that side of the fence provides them. The problem is, it's also real estate, and you can't ignore laws that have been on the book in all 50 states of this country. But the commercial real estate world needs to be involved in these transactions. They are in many cases the cause for these transactions to start with. It is in all of our best interests, on an industrywide basis, to bring them in because it will grow the market. The market will become more efficient, more active, and I think that benefits the investor as well. I don't have a position on this, other than there is a conflict in the law that, as far as I'm concerned, will withhold our industry from moving forward in a productive, efficient manner unless we resolve this conflict. We cannot continue to go on ignoring the fact that there are other laws here that put us all in direct conflict of the legal requirements within these states without resolving it. If we're proactive and take a position and push that position forward for our own benefit now, we have the ability to help shape what that determination is. If we wait until somebody gets investigated or goes to jail, none of us are going to like the outcome. So my position is very simply that we, as an industry, have to be proactive and try to get the result that we want up front.

Marc Paul: I applaud Rob for requesting his no-action letter. But this is a no-action letter, not the no-action law. They're asking if, in a security, can a real estate broker participate in a real estate commission. We are in the process of applying for a no-action letter request that, if the deal is properly structured as a real estate TIC offering, we want to make sure the SEC agrees that it has no right of jurisdiction over us. In my opinion, Rob will either get an affirmative action of no action or they will not respond to his letter. I think the chances of getting a negative response are very, very low. But even if he got a negative response, it doesn't mean that another no-action letter request with a different set of deal points and structure would not have a different response.

Hannah: It's almost a legal historical moment in terms of how they're going to deal with this, because you have two sides of the coin that are trying to pretend the other side doesn't exist.

Steinhaus: You might have overstated the point about all 50 states because, when we went through it, there are different provisions in different states and they've taken different views. When we looked at all the 50 states, there are some that I believe clearly defer to the Department of Corporations in their state. And if the Department of Corporations approves it as a security, the Department of Real Estate may defer to that conclusion.

Hannah: But that's if it's determined to be a security and not real estate. If it is deemed to be real estate within that state, then only a licensed real estate broker can be compensated. Our research that Baker McKenzie did says that a tenant-in-common interest, because their deed in title is being transferred, a true fee interest, that they qualify as real estate under the real estate laws in all 50 states. And therefore the real estate compensation laws apply in all 50 states, and that's the basis that's stated in our no-action letter request. I believe that they also qualify as securities in most states, not all because the states vary even more widely in terms of what is the definition of a security in each state.

Napoli: What is the definition of "tied to a management agreement?"

Steinhaus: If you are selling an undivided interest, which the people are taking subject to a property management agreement, then it is deemed an investment contract.

Winn: In other words, they didn't invest in the project unless they agree to hire the manager that's proposed by the sponsor in the offering.

Steinhaus: If you're going with the sponsor's management team and you're looking to the sponsor for their profits, that's the investment contract.

Marc Paul: Probably the closest analogy that I can see to this business is comparing it to time shares. And my understanding some states have deemed [time shares] to be a security and some states have deemed them to be real estate and have made their own individual determinations of how they should be sold. It very well may be the same with this product.

Steinhaus: If you look at a real estate transaction and you buy it individually and you go hire, say, CB Richard Ellis or whoever to be your property manager, that's clearly not a security. The gray area is, where does it convert to a security and where it doesn't, because it's a bundle of sticks. If you have a situation where you put an administrator on top of it, you have more bundles of sticks. If you have an asset manager on top of that, you're getting much closer to a property management agreement. And there's no fine line. There is some authority in California that says, 'Well, even if you have a situation where there's no active management, if you're the one who bundled the whole process together and all the work took place up front to put these investors in place, your efforts have actually occurred already.' So yes, the investor did rely on the efforts of others, which was the bundling to put it together, but I don't know where that line is drawn. There's not a lot of case law distinguishing the upfront bundling versus the future active management.

Napoli: I think the hope is that someone will draw that line for everyone soon. We could probably go on about the securities and fee topics forever, but let's move on to another topic. The Delaware Statutory Trust was mentioned earlier; let's talk about the significance of that IRS ruling and its application.

Hannah: We have not done one yet. We continue to try to find ways to do them because I think it's a great structure if you can use it. I think that a master lease might solve some of the problems that you would have in what would otherwise not be a true triple-net or bondable-lease type of transaction. But the real issue is the limitations on the trustee; and it boils down to what I believe are sort of everyday real life issues, primarily in the capital markets. The trustee is limited from actions to the extent that it could not add capital in the event of a capital call, for instance, in a property. So try to go to the CMBS markets and shop a deal where there is no way you could ever add money to the deal if it needs it. You're not going to get a lot of attention or receptiveness in that scenario. So you need a deal that makes sure that the tenant pays absolutely everything, or a deal where the reserves would be so high that the lender would be convinced they would never need any more money other than what has been reserved. I think we all know sitting here today, in this market anyway, you couldn't sell that deal because the cash flow would be so low. It kills the deal economically. So you end up with the default being a single-tenant, triple-net lease type of a transaction. I think on its face it doesn't require that or narrow things down to that level, but it does as you work through what you can actually put together.

Boehning: We're working within the DST framework to try to put a deal together. Just like Rob said, it would be a triple-net deal with reserves structure. Our attorney is working with some of the conduit lenders trying to get over the concerns that Rob mentioned. One of the practical applications we see a market for is putting together a portfolio of triple-net lease properties, and then selling the interests in the DST to multiple investors—that DST would own multiple properties. We've looked conceptually at a couple deals, but we haven't gotten to the point of buying a property and digging into it. But conceptually, we think we're comfortable and we think we can overcome the issues. It remains to be seen whether or not we can make it work.

Winn: The DST is a single borrower, which is a key difference.

Boehning: Is there any doubt that selling that interest in a DST would be a security or would be real estate?

Hannah: That is certainly a lot closer to the securities side. I'm not sure it's 100% there. Look at co-ops. In a co-op, you buy shares in a corporation. The corporation owns the property. Those have been deemed to be real estate and the real estate brokers sell those all the time. So I think there's a direct correlation there that gives you at least a 1% uncertainty.

Richter: We've used a DST one time, and it was a lot of brain damage. And we think we did it the right way, but we're not in a hurry to go back and do it again. I think we'll probably look for more rulings before we start jumping into that.

Napoli: The single-borrower DST structure would be more appealing to conduit lenders. Are lenders in general more receptive to financing TIC deals today?

Richter: We have five or six guys that we work with. We've had more demand from other lenders that want to get involved with us, and we have trouble with our existing pool of lenders. I think we're seeing a lot more receptivity to this marketplace as we do more volume. There's more competition on the lender's side. All of our guys are conduit lenders, and there hasn't been any problem getting money; but bringing in new lenders, it's a challenge teaching them the process.

Marc Paul: Absolutely. You have lenders that are knowledgeable and you make sure you select the knowledgeable lender, and you make sure that you get a knowledgeable lender's attorney or you fire the lender and move on to the next guy.

Napoli: What's the exit strategy for a TIC property and the individual investor? How do the TIC investors dispose of their TIC interests, if they so choose?

Marc Paul: You have a good lender; we negotiate up front in the loan docs the \$1,000 assumption charge. It's not deemed actually to be a loan assumption providing that the TIC does not own more than 49% of the

total asset. And as long as the new TIC investor is approved by the lender, they're brought in, and the only cost is a \$1,000 fee plus the legal cost to transact the exchange of the TIC interest. I've had TICs sell out of our deals. It's a lot easier to sell one of our TIC interests than it would be to sell your own wholly owned piece of real estate where you would have to take it to market. If done properly, it can be done very effectively. If it is not negotiated up front with the lender, you may have zero liquidity.

Hannah: We live in a world today where we enjoy a tremendous supply-and-demand balance, which is in our favor. And right now, if anybody had a tenant-in-common owner who wanted to sell an interest in a property, it would take about 10 minutes. In this room, it might take two minutes. We're at the bottom of the interest rate trough. Return expectations are very low. So if somebody was selling a deal right now that was two or three years old, it would be quite a bit higher in terms of its cash than the offerings. What will happen is that two or three years from now, when people are putting deals on the street that have an initial rate of return of 8% or 9%, or whatever the case may be, my experience is that they still sell and they sell very easily because there are so few of them out there. We haven't seen a wholesale onslaught, and I'm talking about even 10 at a time offered in the market to see what might happen and whether there will be any price variation. At best you might see one in the entire country at one time and it gets snatched up in the blink of an eye. I think that will probably continue for a period of time.

Marc Paul: That cap rate risk would apply whether or not you're a TIC or you buy your own wholly owned piece of property.

Richter: But the TIC investors are not thinking about cap rates and interest rates, they're thinking about clipping a coupon, right? Most of the investors, you have to face it: they're buying a bond essentially. And the only reason they're buying real estate is because they're getting around taxes.

Marc Paul: I would not want to classify the real estate property that I'm selling in any way as a bond.

Richter: No, clearly. But this is a way a lot of the investors are thinking about it. They want predictable, stable cash flow and principal protection and they want depreciation. They want all those things and the benefits of real estate, but with the protection of more of a bond-type security. Forgive me for bringing that word up. The exit strategy is really interesting, because if cap rates move a couple hundred basis points in five, six years when people think about exiting these properties, it's going to be a whole different kettle of fish when they go to get out of these things. And if there isn't a secondary market that's set up that's sufficient, you're going to get people that take advantage of that. You can get into that if there's a divorce or parting of ways, maybe a partnership that's invested in a TIC deal, someone's going to scoop this thing up for 80% of its value, potentially. So it's going to be an interesting time over the next four or five years when this debt comes due and some of these TICs have a decision to make.

Steinhaus: We've been doing this for 10 years and over \$1 billion of real estate, and we have had zero transfers among our sponsor clients. We've had deaths, family trusts, family limited partnerships, gifts. But no one has come out and said, 'I want to sell my undivided interest' among our sponsors.

Greg Paul: I think an interesting thing alluded to is when the market changes, when we see of these TIC deals decrease their distributions, and then you have somebody that's disillusioned with their investment or a death/divorce situation go to the secondary market—excuse me, the resale market—and then it's priced to the market, and so you're going to see the discounts start to come in to the nonperforming TICs that will then affect people's perception of the primary market or the market where these things are originated. And that could definitely have an impact on how these things are marketed and the interest people have in them down the road. I'm not sure how much you want to encourage liquidity, even though it's a primary topic in everybody's conversation. An investor wants to know the exit strategy, how liquid this is. But when we sell these as broker-dealers to our clients, we tell them it's illiquid and it's not a parking vehicle. You should anticipate holding it until the sponsor liquidates it. And I see liquidity or the resale market as an escape valve. It would be great if it would develop into a truly commoditized liquid market, but we're not selling it like that right now. And it's a mistake for anyone to encourage their clients to look at a tenant-in-common program as a parking vehicle.

Marc Paul: Agreed. But as an industry, the more liquid we can make it, the more attractive it is to the clients, the more it becomes something that's readily accepted as a way of doing business and something you need to push. The No. 1 question after I do presentations is about liquidity.

Napoli: What does a TIC deal's yield need to be to be competitive in today's market?

Marc Paul: Four years ago, the 10% cap rate buyers were selling all the products to the 9% cap rate buyers and laughing at them. The following year it was the 9% cap rate buyers and 8% cap rate buyers and 7% cap rate buyers, and on and on. With the right product, we could sell 6%.

Greg Paul: It would be 7%. If you get south of that, you need to have a real good reason, a credit tenant situation, somewhat of a value-added story to add to the income stream of it.

Boehning: I agree, 7% is kind of our magic number we're looking at right now.

Richter: We've gone below 7%, but we use 7% as a magic number. But it really varies by product type and the quality of the real estate.