



Welcome to the 1st Quarter 2010 issue of the BACELINE INVESTMENTS Newsletter. We hope to provide valuable information, help educate our clients and share our company's happenings.

The Investment Script Changed with the Seasons

As we entered 2009, the script coming from the investment community was fairly consistent—"not sure where the world is going, I have lost money (a lot or a little) and I am not doing anything." Throughout the year, the script changed with the seasons and the investment community seemed to begin crawling out of its bunker mentality in the Summer. The stock market improved, certain economic indicators showed signs of life and investor confidence began to rebuild. In addition, the prospect of earning zero or near zero on investible funds began to have its impact on the investor's mindset.

From Fall to Winter, the script shifted again. Especially in the real estate investment arena. For certain investors the script changed to the following: 1) they stated their belief that there is opportunity in the commercial real estate investment sector to buy low; 2) they decided to act at some time in the not too distant future on this belief, and 3) they decided to find a real estate investment partner to help them take advantage of the opportunities being presented in the marketplace. These shifts resulted in new activity for our firm as we purchased two properties in the fourth quarter and one on January 15 at prices not seen in many years.

While it is too early to draw general conclusions from the most recent changes in the script coming from investors, their language has changed and they are acting or are getting ready to act. This new found activity will be the catalyst for growth and opportunity. We are looking forward to being a part of turning the investor's script into reality and capitalizing on the opportunities in front of us in the upcoming year.

David Puchi
Managing Partner-Capital Development

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Baceline's "Green" real estate program promotes sustainability and profitability. Our new Sustainable Initiatives Program has an environmental impact and will also have a positive financial impact. This program will reduce operating costs and enhance property value and profits - leading to stronger returns for investors.

RECENT CLOSINGS

Recent No Debt Fund III Closings

Western Avenue Plaza ~ South Bend, IN
Closed on December 30, 2009

Investing in Commercial Property : The Benefits of Private Equity Vs. REIT Investing

You hear it almost daily in the financial press, with one commentator or pundit lamenting that "...commercial real-estate will be the next shoe to drop....," as the American economy continues to go through the process of deleveraging from its recent bout of speculation and mal-investment.

It is true that nearly "...\$1 trillion in commercial-real-estate loans will be maturing over the next three to four years...", but while many private and public real-estate investments made during the past 10 years are underwater and will have difficulty re-financing, (thus forcing fire sales as the ominous debt balloon payments mature), this deleveraging process presents tremendous opportunities to astute investment managers who with their acquisition acumen and operating expertise can pick up fundamentally sound properties at steep discounts to loan values, actively manage a turn-a-round strategy, and then sell these improved assets at a profit for their investors.



So how does an investor capitalize on this opportunity to purchase commercial real-estate after a historically dramatic valuation correction? Does it make more sense for an investor to purchase shares in a publicly traded Real-Estate Investment Trust,(REIT), or make an investment in a private equity fund focused on the direct ownership of commercial property?

Commercial real-estate investing offers four main advantages to investors: diversification of an investment portfolio in to a less correlated asset class, a dividend stream to investors seeking income, the inflation hedge one benefits from owning a hard asset, and the opportunistic timing for value creation that comes from investing in an out of favor asset class which has seen significant corrections from a recent high.

REIT's have made a strong recovery year to date, posting a 24% gain in 2009, although this is after a 37% decline in 2008, and 18% in 2007 respectively. Wall Street Analysts attribute much of this rebound to the "... influx of fresh capital generated through secondary offerings and asset sales..." which helped REITs to recapitalize over-leveraged balance sheets, alleviating investor concerns about the potential for insolvency driven by looming corporate and property level debt maturities. After a spate of high profile REIT bankruptcies, "...since March of 2009 more than 60 REITs have raised \$20 billion worth of public equity, and a couple dozen more companies have raised \$7 billion worth of unsecured debt...." This has tempered many of the financing issues that put downward pressure on many REITs stock prices, and allowed them to recapitalize their balance sheets by reducing leverage. Because of these restructuring efforts, many securities analysts feel REIT shares are already trading at fair market value, especially given their recent run-ups. Public REIT investors have likely gotten ahead of themselves, and "...while bottom fishing may be a smart strategy for (direct) buyers of physical property, the true bargains have already been snapped up in publicly traded real estate investment trusts...."

It is important to note that like all publicly traded equity securities, REITs are subject to the same market whims and volatility as their exchange peers. Like their financial service and insurance company counterparts REIT securities benefited from cheap financing, and their debt reliant capital structure tracked the performance of many US banking institutions during both the boom and bust periods of the past ten years. Despite claims of diversification, this recent credit crisis has shown the high degree of correlation between all public securities, particularly when leverage pressures force sales of assets in to an investment climate where buyers are scarce. A private equity fund that utilizes no or meager amounts of leverage is uncorrelated to the public securities market and would not face similar financing pressures to dispose of assets at an inopportune time. An investor in an unleveraged private equity real-estate fund can take comfort knowing that their investment return is based primarily on the income generation of in-place tenant rents, not asset inflation fueled by financial leverage and speculation where the realization of returns can only be recognized if a willing buyer materializes at the time of sale.

REIT and private equity investing have distinct tax implications that investors should also carefully consider. For the smaller retail investor REITs offer a vehicle to get exposure to a public company focused on commercial real-estate development, management, and investment through their traditional IRA or brokerage account without meeting the SEC's definition of an "accredited" investor. A REIT structure also allows public real-estate operating companies to avoid some corporate taxes, as long as they distribute 90% of their taxable net operating income to shareholders in the form of dividends. (For the individual investor though the distinction of income returns derived from a REIT versus a private equity investment may be moot, as the tax treatment of dividends is the same ordinary income rate for the beneficiary).

REIT's may be able to utilize their newly strengthened balance sheets and access to capital markets to be active acquirers of distressed real-estate or other REITs through a merger, but they may not be nimble enough to acquire enough undervalued property to greatly impact accretive returns to their investors. REITs only represent approximately 10% of commercial real-estate owned in the US market, and many hold portfolios that are highly concentrated in terms of both geography and tenant bases. On the other hand private commercial real-estate ownership is fragmented, with the vast majority of properties being held by individual families, private real-estate development companies, and pooled investment Funds managed by private equity sponsors like Baceline. A private equity commercial real-estate sponsor represents an attractive alternative to investors seeking portfolio diversification in an income yielding investment, that hedges inflation, in a discounted asset class that requires active operational expertise, but is not subject to the high degree of correlation to the public equity markets possessed by REITs.

2010 and What Lies Ahead....

2010 started out not quite the way I had intended. Just three days into the New Year, I separated my left shoulder skiing at Winter Park with my son, Jimmy. One could say that it was not a smart move to follow a group of slinky-spined ten year olds over a jump - particularly when one does not possess the same skeletal resiliency that one once had - and one would be quite correct in this case. So here I sit in a sling, being more sedentary than I like, which gives me ample time to reflect on the 2009 acquisition campaign and to look forward to 2010.

2009 was inevitably going to be a year of decreased acquisition and sales volume for all types of real estate. Because of the near meltdown of the global financial system in the fall of 2008, the continued lack of debt liquidity that began in mid-2007 and the general "shell-shocked" feeling that pervaded the real estate industry at this time last year, it is no surprise that sales volume throughout the US was down seventy to eighty percent from 2008. Although, even given these significant market difficulties, Baceline was able to buy 4 properties during the year, all at significant discounts to the market. We were able to make these acquisitions because we were well-positioned to act quickly, drive a hard bargain and close with cash. I see more of the same for 2010.

There are some signs that the markets are beginning to thaw. Lenders who no longer have a viable borrower are taking back properties and will have to deal with an increasing load of owned properties and bad loans. Owners of properties that have maturing loans will have a difficult time refinancing and some of these assets will have to be sold. Public REITs and pen-

sion funds will be under increasing pressure from Wall Street to rid themselves of underperforming properties in markets in which they do not have significant holdings. And, the first, new CMBS loan pool since 2007 was announced for this April, which, if successful, could lead to additional debt for transactions. Though these are promising signs that sales volumes for 2010 will not be as anemic as 2009, there are still some strong headwinds facing commercial real estate.

The disconnect between buyer and seller still remains sizeable, though not the huge chasm that existed last year. Whether the separation (pun intended) continues to slowly close, or there is a catalyst that forces a swifter closure remains to be seen. One catalyst would be the cessation of federal stimulus for the banking sector. The national and regional banks have been propped up, for the most part, by federal tax dollars. As a result, they have not been forced to recognize many bad loans and to eliminate these loans from their balance sheet. If this artificial safety net of tax dollars, or the regulatory equivalent, were reduced or eliminated, the pricing gap could compress. However, at this time, it does not appear the federal government has any such plans.

It is good to remind everyone that since Baceline is a niche investor, we engage in situational buying and selling. We can turn up good properties to buy in differing market cycles by continuing to have a presence in our markets and by furthering our relationships with buyers and sellers. This is one of Baceline's major strengths. In 2010, Baceline will continue to follow this course. And I will stay off the slopes.

Douglas Arnold
Chief Investment Officer

Baceline Investments' Performance

	No Debt Fund I ₍₁₎	No Debt Fund II ₍₁₎	No Debt Fund III ₍₁₎
1 Year	5.69%	6.40%	6.00%
3 Years	6.38%	6.42%	N/A
5 Years	6.68%	N/A	N/A

(1) Average annual distributed income only. Does not include change in property value.

GET TO KNOW US....

EMPLOYEE FOCUS- John Holman

John Holman is a man with thousands of miles of experience.

Mr. Holman began his professional career as a civil trial attorney involved in primarily insurance defense and medical malpractice cases. After five years, he co-founded Franchise Finance Corporation of America, (FFCA), an affiliate of EF Hutton and Company, with one of his clients.

Since then, he has worked as a Regional Marketing Director for three additional money management firms, McKinley Capital Management, Systematic Financial Management and Ashfield & Company, raising an additional \$1 billion, working primarily through financial planners and broker dealers. Mr. Holman has raised capital for all of the firms from both individual and institutional investors. John is a licensed real estate broker in the State of Colorado.

Mr. Holman received his BS, MBA and JD degrees from Arizona State University, a CFP certificate from the College for Financial Planning, and a CIMA certificate from the Wharton School of Business. Professionally, he has been active in the Investment Management Consultants Association, the Financial Planning Association, the Independent Petroleum Association of the Mountain States, the Association for Corporate Growth and CXO.

He has served on the Boards of the Arizona State Alumni Association, Valley Presbyterian Church and the Northern Nevada Chapter of the Red Cross. He is a founding member of the Seven Continents Running Club and enjoys running, snow skiing, hiking, biking, white water rafting and travel.

THE QUICK FACTS:

First thing you read in the morning: Wall Street Journal

Tea or Coffee?: Tea and Coffee

Favorite aspect of working at Baceline: The challenge of building another \$1 billion company purchasing all cash commercial real estate for investors.

Favorite Place to Run: I live near and run around Washington Park, but my favorite run is the 17 mile drive in Pebble Beach, CA. I was one of the first 26 people on earth to run a marathon on all seven continents, running with Marathon Tours. Accordingly, I am a member of the Seven Continents Club.

What got you into running: I got into running because I had to travel so much and it was one of the few things that I could do to exercise. Guess I kinda went overboard! I have run over sixty marathons and ultras on every type of terrain, including Antarctica.

Dream Vacation: Victoria Falls in Africa, accompanied by a photo safari.

Pets: In two weeks I will be getting a 8 week old golden lab to replace the one that I had to put down two years ago.

Many significant changes occurred in the real estate investment sector in 2009. 2010 now looks like a year where new opportunities will be presented that can be acted upon. The investment mentality seems to be coalescing with market opportunity and this leads to activity after a long period of stagnation. We look forward to the continued thaw and the resurgence of value creation in our industry.

Sincerely,

David C. Puchi
Managing Partner, Capital Development
Baceline Investments, LLC
www.bacelineinvestments.com



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