

BACELINE INVESTMENTS *Newsletter*

2nd Quarter 2010



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DEBT FREE INCOME PROPERTIES:
The Ultimate Alternative Investment

Meet Mike Lotte

Welcome to the 2nd Quarter 2010 issue of the BACELINE INVESTMENTS Newsletter. We hope to provide valuable information, help educate our clients and share our company's happenings.

SIMPLE. STRAIGHT FORWARD.

On the verge of Oliver Stone's sequel to Wall Street coming out, it seems appropriate to look at a primary shift in the investor's view of financially engineered investment products that produce great fees and wealth for the sponsor of the product but leave the investor scratching their head at what happened to their investment. Much of what led to the financial crisis of 2008 and 2009 revolved around investments that were so complicated that at the end of the day hardly anyone understood what the actual investment was. Real estate mortgages that were leveraged up to 16 times were a prime example of this financial engineering to the point of being completely un-fathomable.

Today, the investor's mindset has shifted back to looking at investment products that are simple and non-financially engineered. In other words, understandable. Even the most sophisticated investment groups that we talk to are looking for investment concepts that they can get their arms around. The shift has also changed the real estate industry. Many of Wall Street's "smartest guys in the room" are no longer working in the sector as the investment products that they designed have imploded. As a result, some real estate investment companies have heard the voice of investors and are designing investments to be simpler, more straight forward, less debt laden and understandable.

The beauty of investing in real estate is that it is real, tangible and not so complicated. Unfortunately, it took a major shock to financial world for these basic concepts to come back into vogue. It's great to see that the investor is looking for simplicity again. It seems certain that Oliver Stone will again remind us that complexity and greed are tough pills to swallow, so we'll see if simplicity sticks this time around.

David Puchi
Managing Partner, Capital Development



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

University Commons ~ South Bend, IN
Closed on January 15, 2010

100,000 square foot retail repositioning
opportunity near
Notre Dame University

DEBT FREE INCOME PROPERTIES: The Ultimate Alternative Investment

The poor performance of traditional investments over the past five and ten years has caused a renewed interest in alternative investments. Historically, the returns of alternative investments, due to their investment structure and the assets that they purchase, have had a low correlation to the performance of traditional assets. Accordingly, they can perform well regardless of the performance of traditional assets and can help create a better performing investment portfolio for investors.

One alternative investment has performed very well due to its investment structure and the type of assets that are purchased to the point that it could be considered the ultimate alternative investment. That investment structure and area is where an investment sponsor buys well located, income producing properties for cash, without charging any front-end fees and subsequently investing a high percentage of the funds raised into the real estate. This article will discuss such an investment structure in commercial properties.

For many years, insurance companies and many individual investors have purchased commercial properties for cash to maximize their income and minimize their investment risk. Purchasing a property for cash eliminates the expense of debt service, the risk of foreclosure on a debt instrument, and the income from the properties rents is maximized.

Depreciation deductions from the buildings tax shelter a portion of the income. Therefore, an investor receives an after tax basis on income that is partially tax-free and partially taxable. In other words, an investor receives an income that is similar to owning both a tax-free bond and a taxable bond.

Owning income-producing properties free of debt also creates an investment that is the equivalent of a real estate backed bond. Very often corporations issue bonds to purchase buildings and equipment to produce their products. The buildings and equipment are many times purchased for cash, and the income from the corporations operations is used to pay the interest payments on the bonds. Eventually, the corporation repays the principal amount of the bond to its investors and the corporation keeps the real estate.

Buying debt free income properties avoids the middleman and allows investors to keep the real estate. The leases of the tenants that occupy the property provide the security for the payment of income, similar to a corporation's promise to make bond interest payments. And most importantly, the investors get to keep the potential capital appreciation from the sale of the real estate.

Investment sponsors that buy debt free income properties create an investment that is similar to a balanced account offered by traditional money managers. Money managers that offer balanced accounts to investors normally buy bonds for cash to produce income and stocks for cash for their capital appreciation potential. When income producing commercial real estate is purchased for cash, investors receive a bond like income and they have the potential for capital appreciation as a result of their real estate ownership.

Additionally, unlike a bond, the income from the properties can increase over time due to increased occupancy and increased rental rates. Such an increase in income not only increases the income to investors but can also increase the value of the property and its capital appreciation potential.

One of the factors that caused the recent crisis in our financial markets was the use of financial engineering by Wall Street to create complicated investment products with little or no economic merit, except that they generated huge fees for Wall Street. These products failed due to a number of reasons including their investment structure and the fees that were charged by their creators.

When an investment sponsor charges no front-end fees and buys well located, income producing commercial real estate for cash, the result is the equivalent of reverse financial engineering. There are no added bells and whistles. What is created is a balanced investment with very little risk, which produces income, tax benefits and capital appreciation potential.

Value managers, such as Warren Buffett, have historically bought companies with no or low debt that generate high positive cash flows from their operations. Debt free income properties do the same thing. There are very few investment sponsors that currently offer such investments...but there are some. Most real estate sponsors charge large front-end fees and use borrowing to acquire more real estate. There is nothing wrong with using a reasonable amount of leverage or borrowing to acquire income producing real estate, but there is a trade off. Income from property rents is reduced and investment risk is increased.

There is an inherent disadvantage to investors if a sponsor charges large front-end fees - less of the investor's money is invested into the actual real estate. Also, REIT's that are currently paying dividends to investors from borrowing or new investment capital pose a real risk to investors since the distributions are not coming from property rents.

To be considered the ultimate alternative investment what investment structure and type of assets are needed? Hopefully, now you have an answer to this question, and more importantly, an alternative investment solution for your clients!

John Holman
National Marketing Director

GET TO KNOW US....

EMPLOYEE FOCUS- Mike Lotte - Director of Leasing

Mike Lotte is an experienced real estate and business expert.

With 25 years of experience in development and real estate, Mike brings a strong background of management in the real estate sector to Baceline.

Mike's experience with all aspects of building, redevelopment and real estate daily management are key components to Baceline Investments.

THE QUICK FACTS:

Favorite thing about working at baceline:GETTING TO WORK WITH COMMERCIAL REAL ESTATE BROKERS ACROSS THE COUNTRY WITH ALL THEIR VARIOUS STYLES AND CULTURES

Tea or coffee:COFFEE

Favorite lunch spot: MID-VAIL

Most challenging thing work-wise over the last year:TRYING TO PREDICT THE FUTURE

Dream vacation: SKIING AND BIKING IN NEW ZEALAND ON THE SAME DAY

Newspapers or magazine: NEWSPAPERS ON-LINE

Best website for financial info:LOCAL NEWSPAPER

Pets? NO LONGER, YELLOW LAB FOR 15 YEARS

Favorite day of the week and why: FRIDAY - DUH?

One piece of advise to young professionals: PICK UP THE PHONE AND TALK TO SOMEONE OR IF YOU ARE FEELING REALLY CRAZY, KNOCK ON A DOOR AND GO TALK FACE-TO-FACE



Latest reports from sources show that the commercial real estate sector is at or near the bottom of the current cycle. With this news, a rebuilding of value is on the horizon and a small uptick in activity is already occurring. At the same time, spring has slowly sprung here in Colorado (recent snow on April 30th being an indication of how slow it's been) and we are looking forward to the growth that the season brings.

Sincerely,

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

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