



In This Issue

What the Lenders and Borrowers are Doing

MEET Lindsey Reeve

Changing the World, One Property at a Time

Welcome to the Third Quarter 2009 issue of the BACELINE INVESTMENTS Newsletter. We hope to provide valuable information, help educate our clients and share our company's happenings.

In looking at what the commercial real estate world is facing today-with values adjusting and general concern about the future of the industry, it is helpful to look back at the last event that caused a dislocation of substantial magnitude-the Savings and Loan Crisis. The S&L crisis occurred between 1989 and 1993. A change in the tax code, over leverage and overbuilding, combined with the failure of many savings and loans, caused commercial real estate values to plummet.

Current Value Cap Rates 4th Qtr

At the beginning of the S&L crisis, average cap rates (a key value determiner) were about where they were in 2007-around 7%. Subsequently values dropped and in 1990, it was part of the general consensus of thought that another office building may never be built in the nation. Cap rates continued to increase (prices fell) until they got around 10% on average. Then, the cycle reversed and an extremely long run of price increase incurred.

Today, we see substantial price adjustments occurring in certain areas of the country with certain properties. These low prices eclipse the low prices found at the peak of the S&L Crises. Other properties are sure to show more distress as the industry continues to adjust due to the lack of financing available, however, a new beginning has already developed for certain properties.

So, as we move through this cycle, its interesting to see the trends of the past and how they may lead us to some predictions about the future. The new beginnings that we are seeing starting to sprout, may be the harbinger of a new era of growth. In any case, it sure is fascinating to see the cycle turn right in front of our eyes.

David Puchi
Managing Partner-Capital Development



¹A commercial real-estate Capitalization Rate (or 'Cap Rate'), is defined as the initial rate of return on market value for a given property. It is a ratio that represents the relationship between a property's particular year's cash flow and the present value or the interest applicable to the cash flow. Cap Rate is usually presumed to mean 'overall annual' unless stated otherwise. An 'Overall Cap Rate' is calculated by taking the annual first-year net operating income produced by the rents associated with the property and dividing it by the property's overall value. There is an inverse relationship between a property's overall value and its indicative Cap-Rate yield. (ie. The higher the Cap Rate yield the lower the overall property value; the lower the Cap Rate yield, the higher the property's overall value).



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.

What are the Lenders and Borrowers Doing?

We thought it would be useful to give our readers a view of how lenders are dealing with the bad commercial real estate loans they have on their books.

First, a little background. As you may have read, a large amount of commercial real estate loans are maturing over the next few years. In excess of \$600 billion in loans mature from now through the end of 2011. The big problem for both lenders and borrowers is a lack of debt to refinance these loans. Unlike residential loans, most commercial real estate loans have balloon payments at the end of their terms which require either a refinance or sale of the property. During 2009, approximately \$280 million of loans have or will come due. The vast majority of these loans are not being refinanced so the question becomes - what are the lenders and borrowers doing?

The answer generally falls into one of three scenarios. First, for properties that are performing at levels high enough to meet debt service, lenders are showing a remarkable affinity for extending loan for a one to two year period in hopes that the property can ride out the debt crisis and be refinanced in the future. Under the second scenario, for properties that are performing below debt service levels, lenders have a more difficult issue. They have typically responded by extending the loan in exchange for the borrower bringing more money to the table to pay down the loan and replenish cash reserves. For borrowers who can come up with the additional equity, lenders are letting them live another day. In a lot of cases, borrowers are raising private capital to pay down debt or even pay off the debt at a discount. The third scenario involves those who cannot or do not want to come up with the additional equity.

In this case, the lender is given little choice but to take back the property through foreclosure. And lenders are doing that with increasing frequency. They have to in large part because an enormous amount of loans are becoming delinquent and falling into the third scenario. According to Real Estate Finance and Investment "about 56% of all com-

mercial real estate loans that have matured over the past 12 months are 30 days or more delinquent." That is truly a staggering number and it means that deteriorating conditions will force more properties into foreclosure.

This is where Baceline's opportunity to buy distressed properties comes into focus. The lenders need to get rid of the properties they foreclose, but what has their process been? Lenders want to sell for the highest price possible but buyers are currently pricing foreclosed assets much lower causing disconnect between distressed sellers and buyers. This has been the case since late 2008 and so far this year. Another factor adding to the disconnect is the lack of debt capital. This gives cash buyers, like Baceline, an advantage.

Lately, however, we have noticed a change in lender's attitude toward pricing. The other shoe has dropped on these properties and they are now priced to sell. In certain cases we have seen lenders dropping their price to meet our distressed pricing where we offer all cash and a quick close following our normal due diligence. Our current distressed real estate purchase Stoney Pointe is a good example. The lender foreclosed and put the property on the market for \$3.3 million (their loan balance) at the beginning of the year. We submitted a distressed offer and finally came to agreement with the lender at a purchase price of \$1.3 million over the summer. We are now set to close the acquisition. What tipped the scales in our favor we believe was an increasing backlog of foreclosed properties and a need to generate cash on the part of the lender.

We are now seeing other situational buying opportunities and are pursuing distressed acquisitions with similar characteristics. Stay tuned - it should be a very interesting time.

Douglas Arnold
Chief Investment Officer

GET TO KNOW US.... EMPLOYEE FOCUS- Lindsey Reeve

Meet our newest team member, Lindsey R. Reeve, Investor Experience Director. Lindsey joins our team from Welton Street Investments where she developed and maintained its Investor Relations department. She brings with her a strong client service mentality and commitment to address client's individual needs.

THE QUICK FACTS:

What you love most about your job at Baceline: I love meeting and interacting with all of our investors! I also love to problem solve and make a difference.

Biggest accomplishment in your career: Taking something from absolutely nothing and creating systems and processes that function independently and effectively like a well-oiled machine!

Favorite subject in school and why: This is weird (because I don't like it now) but I loved Algebra! I liked it because there was no half right or wrong answer. Nothing was subjective or left for interpretation. Operating in a world of absolutes was fascinating to me. I went on to college and got a journalism degree. Go figure!

Favorite magazine: This one is a little embarrassing because it is one of my guilty pleasures. And I could totally fib here to impress the audience and say something along the lines of Time or Newsweek...but sadly its US Weekly! People comes in at a close second.

Favorite coffee drink: My friends have nicknamed my Starbucks drink "crack on ice" but its official name is a "Quad Espresso over EXTRA Ice". Yes, folks, that translates to 4 espresso shots!

Dream vacation: I actually was fortunate enough take my dream vacation after I married the coolest guy in the world, and we ventured to Negril, Jamaica for our honeymoon. The laid back, tropical environment was AMAZING! The company wasn't too bad either...



Baceline's Changing the
Real Estate World,
ONE Property at a Time



What does a GREEN company look like? Does every employee recycle and ride the bus? Do they work during daylight hours in light-less offices, drinking filtered tap-water out of corn starch cups while planning their future retirement existence in homes made of rammed-earth?

In the modern sense, a Green company is one that can achieve its economic priorities and address its environmental and social impacts as well. This company is willing to make an investment in its future by reducing operating expenses, enhancing productivity, mitigating risk, and expanding their market share. With all of the uncertainty in the world right now, successful companies will focus on becoming more efficient and more effective at their primary task.

Baceline Investments engaged the services of a Sustainability Management firm to develop a comprehensive Sustainable Initiatives Program (SIP) to address the economic, social and environmental needs of its corporate headquarters, properties, tenants and operations. The goal of the program is to mitigate the environmental impacts of its assets and operations while educating and promoting sustainable technologies abroad to retail America's Main Streets. Phase I of the SIP kicked-off in January 2009 with twenty initiatives required of Baceline's Staff. The initiatives were designed to minimize the carbon-footprint of the daily office operations and build awareness regarding responsible business practices. Eleven people made up the initial group with one employee recognized as the Sustainability Captain. Initiatives for the group included bus pass and bicycle expense reimbursement programs, recycling and energy-savings routines, and the elimination of plastic bottles. The April Bike to Work Day was a premiere event for the company where employees got a chance to show off their Green stuff.

The first phase of the Property SIP kicked off this summer with a questionnaire to property managers at all of Baceline's assets regarding their need for sustainable improvements and to document the strategies that have been implemented since acquisition. The data from the questionnaire is being used to establish a USGBC LEED-EBOM benchmark score for each property and project future scoring possibilities considering various levels of investment in sustainable materials and technologies. Baceline Investments is intending to package this material and share their SIP program with its real estate tenants abroad to promote sustainability practices and create widespread and impactful change.

Baceline's decision for investing in a Sustainable Initiative Program is simple: because it makes economic sense. Sustainability initiatives can reduce operating expenses, provide free marketing and public relations, enhance productivity and improve the value of real estate. Green buildings have been proven in some markets to command higher rents, better absorption rates, and lower capitalization rates compared to non-Green buildings which are all measures of real estate value. The Appraisal Institute is currently developing standards that will allow MAI appraisers to determine the value of Green buildings and properly account for the various ways sustainable assets are worth more. According to the Urban Land Institute and United States Green Building Council, this value trend is expected to spread into markets across the United States as the economic benefits of sustainability programs are communicated abroad and the cost of the goods and services drop because of increased market demand.

The profitable company of the future has multiple avenues for success despite challenging market conditions and will utilize sustainability as a means for optimizing its internal operations and building stakeholder confidence. Sustainability initiatives are the key to creating healthy building environments, not to mention the answer to energy-independence, and a way to protect our Planet. The push from the private sector to adopt sustainable principles and practices may be our only hope of achieving the aggressive Carbon Footprint reduction goals set forth by the Kyoto Protocol that are now under consideration in the US.

Brian J. Levitt,
Carbon Energy Advisors, September 2009.

As real estate market dynamics and the investment community have begun to align in creating new transaction activity, it looks like the commercial real estate world is getting busy again. We look forward to working with all of our stakeholders as this all shakes out.

Sincerely,

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

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