



CAPITAL MARKETS REVIEW

Shopping Center Business presents *Capital Markets Review* compiled by Gary Saykaly and Van Barron. Based in Atlanta, Saykaly and Barron are the principals of NewBridge Retail Advisors, an entity that provides retail asset owners with the transaction and capital market solutions to maximize their investment objectives, including dispositions, acquisitions and recapitalizations.

INSIDE CAPITAL MARKETS REVIEW THIS MONTH

MARKET OVERVIEW

Investment Market

In today's heated investment market, all owners — regardless of whether they are short or long term operators — are analyzing the benefits of selling one or more properties.

Challenge

As we mentioned in previous issues, unfavorable existing debt can seriously impact the marketability

and pricing of an asset. Unfavorable debt can be described as debt terms (i.e. LTV, loan constant, specific requirements) that negatively impact the leveraged returns and flexibility of investors at today's pricing levels. Given that most investors are leveraged return driven, the investors will reduce their pricing to a level that will increase the leveraged return closer to that achievable if the property was financed with a market based loan. The choices at this point for a seller are:

Strategy	Description
Sell "as is"	Sell with the existing debt but accept a reduced purchase price that would indicate an above market cap rate (i.e. 50 to 150-plus basis points) — and diminish the project's profit.
Hold the asset	Hold the asset and avoid taking advantage of the current market.
Prepay	If the loan provides for yield maintenance, prepay the loan and incur what could be significant penalties — decreasing net sales proceeds close to or below the levels seen in the "sell 'as is'" scenario. In addition, the loan might have a lock-out period preventing prepayment at the current time.
Defeasance	If the loan provides for defeasance, basically acquire a basket of acceptable government securities that can be utilized as the swapped collateral in the defeasance process — thereby tying up the seller's capital and creating a new obligation. There are companies that now specialize in securing the optimal basket of securities for owners at the lowest possible cost.

As the above scenarios illustrate, an owner's ability to take advantage of the current investment market conditions is significantly hampered with negative existing debt.

Solution

While negative existing debt can post a challenge, there is a strategy that owners can pursue to take advantage of the current market: selling a partial interest of the asset.

How It Works

An investor would acquire a percentage of the pro-

ject (25 percent to 75 percent) based on the value of the project without the current existing debt in place. The existing owner would thereby be able to take advantage of the current market but at the same time remain an owner and continue to earn fees (i.e. management fees), etc. Depending on the percentage of interest sold, the resulting proceeds could significantly exceed the net proceeds available via an outright sale with the existing debt scenario. The investor would be simply looking for a set preferred return and an overall IRR (upon the ultimate sale of the property or its interest). This strategy can also be utilized to recapitalize a project that better suits the objectives of the

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This information was compiled by Gary T. Saykaly of NewBridge Retail Advisors.

partnership. An additional benefit to the seller is the reduced transaction costs versus a traditional sale.

As an example, Impresa — one of the leading edge companies in this arena that has secured 18-plus institutional and private market investors — would structure the deal as follows: (See chart at right.)

As shown, a market sale (8.25 percent cap rate and resulting 12.47 percent lev C-O-C) would yield a price of \$24 million (and net proceeds of \$10.8 million). However, with existing debt a price of \$24 million would only provide for a 5.89 percent leverage C-O-C.

In that regard, investors (in an attempt to secure a comparable yield to market) could reduce the price to \$18.6 million. This scenario would leave the seller with net proceeds of only \$5.1 million (a significant loss in profit). According to Impresa's scenario, by selling only 50 percent of the project an investor could actually secure higher proceeds and remain an equal partner. Obviously, the higher percentage sold, the higher the proceeds to the owner. (See chart below.)

Scenario	Existing	Market
Year 1 NOI	1,996,785	1,996,785
Interest Rate	7.50%	6.00%
Amortization Period	18	30
Debt Service	(\$1,363,787)	(\$1,393,075)
Loan Balance	13,450,000	19,362,764
LTV	56%	80%
Year 1 Net Cash Flow	632,998	603,710
Cap Rate	8.25%	8.25%
Price	24,203,455	24,203,455
Year 1 Lev C-O-C	5.89%	12.47%
Break-even Price	\$18,600,000	n/a
Break-even Cap Rate	10.74%	n/a
Sales Proceeds	5,150,000	\$10,753,455

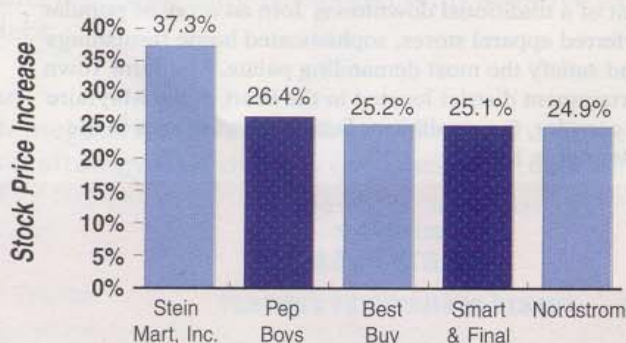
PARTIAL INTEREST SALE

Equity % Sold	Proceeds
25%	\$ 2,688,364
30%	\$ 3,226,036
35%	\$ 3,763,709
40%	\$ 4,301,382
45%	\$ 4,839,055
50%	\$ 5,376,727
55%	\$ 5,914,400
60%	\$ 6,452,073
65%	\$ 6,989,745
70%	\$ 7,527,418
75%	\$ 8,065,091

With the difficulty of acquiring 100 percent interests in today's market, the investor is able to place capital into a qualified opportunity and achieve all the resulting benefits — i.e. tax benefits (depreciation, interest expense, etc.) and attractive returns. In addition, by structuring the partial interest investment in a tenant-in-common structure, 1031 exchange buyers gain access to incremental opportunities to avoid the capital gains.

RETAILER NEWS

Top 5 Retailers In October 2003



Top 5 Retailers Since Jan. 2003

