

CAPITAL MARKETS REVIEW

Shopping Center Business presents **Capital Markets Review** compiled by **Gary Saykaly, Van Barron and H.L. Jackson III**. Based in Atlanta, Saykaly and Barron are managing partners of **BridgePointe Advisors**. Jackson is director of the company's investment group. **BridgePointe** is an entity that creates wealth for its clients' real estate portfolios through innovative capital and investment solutions, including debt, equity, joint ventures and investment sales.

Market Overview

This information was compiled by Mark Rowell and Gary T. Saykaly of BridgePointe Advisors.

STATE OF THE REAL ESTATE CAPITAL MARKETS

By Mark Rowell and Gary T. Saykaly, BridgePointe Advisors

In this market where sentiment and volatility can change quickly, any market commentary can become obsolete in a day. The commentary in this capital markets snapshot is as of December 3, 2007. While the market should be fine in '09, at this point it's hard to tell its fate for '08.

While the CMBS market and overall sentiment appeared to be improving in October, November saw a significant reversal where spreads gapped out to 50 to 100 basis points. In addition, pricing and demand for the CMBX (CMBS derivative hedging product) has spiked significantly. This was caused by a variety of issues including the news releases by Citibank and Merrill Lynch of significant losses on their mortgage holdings (and uncertainty regarding the extent of potential losses), significant rating downgrades by rating agencies and potential problems in the money market sector caused by investments in structured investment vehicles.

While the current capital market issues might be caused by increased worries for defaults, delinquencies and fundamentals, the primary driver is the state of the overall credit markets. A great example is the significant spread increase behind the

CMBS AAA securities, which have an extremely low chance of defaulting but are being negatively impacted in the market.

It is important to remember that "things are never as bad as they seem and never good as they seem." Wall Street does have the tendency for mania and some of the issues we are seeing are due to unnecessary panic. Regardless of the panic, the conditions could get worse before they get better. There is significant bond inventory to clear the market (the CMBS market still needs to sell over \$50 billion of paper), certain issues are still unfolding, and many uncertainties await the market in 2008 (i.e. presidential election, economic direction, holiday sales, etc.). However, there is significant capital waiting on the sidelines for any sign that we have hit the bottom. In addition, while there are concerns over the economy, it is important to note that the lower value of the U.S. dollar has had a positive impact on exports and therefore corporate. This has helped offset the negative economic impact caused by the residential market. Also, while foreign investors might be spooked by the current market, the lower value of the U.S. dollar will make U.S. investment opportunities even more attractive (especially when factoring in the increased returns). As of the time of this article, the price of oil was subsiding.

Set forth below is BridgePointe's Capital Markets Barometer, which provides insight on both the investment and capital market sub-sectors.

Basis Point Spread or Overall %			Considerations / Strategies
	Pre-Meltdown	30-Nov	
CAPITAL – DEBT, EQUITY, STRUCTURED FINANCE			
Fixed Rate Permanent Debt Financing-Conduit	90-120	200-290	Consider interim bridge or shop around as all lenders are not the same. A number of conduit shops have shut down and some are not currently quoting. Significant deliverability and price volatility issues. Do not expect significant improvement until bond inventory clears. Underwriting standards have become more conservative and income from sources such as master leases are not being considered. Spreads have not been this wide since 1997. Interest-only (I/O) is available for 1 to 3 years on 5/10-year loans but the lender will either require a lower LTV or an amortization catchup post-I/O period.
Fixed Rate Permanent Debt Financing-Non-Conduit (i.e. insurance co.)	120-175	200+	Life companies are extremely busy given the state of the conduit market and as a result they are being very selective. High quality (flight to quality) and larger deals execute well. The amount of leverage/LTV has decreased and amortization periods are usually set for 25 years (increasing the loan constant). Keep in mind that many life company loans get securitized and therefore the CMBS market does not have an impact. The general accounts of the life companies do not have unlimited funds.
Floating Rate/Non-Recourse	190-225	275-400+	See Bridge/Interim Financing.
Construction Financing-Non-Recourse	200-250	300+	Very little availability. Many of the key lenders in this niche have shut down their programs. While spreads for non-recourse construction money pre-meltdown decreased to the low 200 basis points range (providing a relatively viable spread above recourse), the spread difference between recourse and non-recourse loan will become recourse in the event the developer does not deliver what was initially intended (not the same collateral for the lender).
Construction Financing-Recourse	140-250	160-300	Banks offer the lowest cost of funds and are a good source of liquidity in this market. However, banks are busy and therefore selecting projects and sponsors that are strong. Overriding theme in this market is that profitable projects with strong sponsors will get done. The residential construction slow-down has impacted most banks, and there are exposure issues. Land loans, condominium and residential A&D are nearly impossible to get done.
Mezzanine/Junior Financing	9%-12%	See commentary	Availability is good (as the junior loan market has held up well), but spreads have increased: cash flowing properties (11.5%+) and non-cash flowing/new development or redevelopment (16%-19%). Preference for larger markets. Mezz can still bring the LTV to 85%-90%. Traditional equity sources are now looking at the mezz market, given the increased returns and lower risk.

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Bridge/Interim Financing- Same as 3rd line above	190-225	275-400+	High quality deals execute well. Spreads have increased significantly and a number of these lenders have pulled out of the market given the source of capital for their programs (CDO market). Strong sponsorship, adequate equity and a sound business plan (especially for redevelopments) is required. Banks offer a good alternative in this market if personal recourse is palatable.
Preferred Equity	16%-20%	18%-22%+	Equity and Preferred available. However, the appetite for equity placement has been impacted by the lower risk/high returns available via mezzanine loans and high-grade CMBS security tranches.

JOINT VENTURES AND INVESTMENT SALES

Joint Ventures	See commentary	See commentary	Joint venture activity will increase as small to mid-sized entities require a partner to provide a stronger balance sheet and/or increased equity requirement. There is an ample supply of development and capital JV partners, but they are very selective (especially with the decreased retailer expansion plans) and require a sound business plan based on supportable assumptions. In addition, they are increasing their return on cost requirements when screening opportunities.
Investment Sales	5.75%-9% cap rates	6.5%-12% cap rates	Investment sales activity is significantly down as the bid/ask spread between buyer and seller has widened. Given the current capital market situation, buyers are having difficulty engineering the required return at seller pricing requirements. Sellers are currently not under pressure to sell. Most of the active investors are getting very selective on their acquisitions — even on Class A assets where there has been a flight to quality and pent-up demand. Class B/C assets continue to see a decrease in pricing. Pricing for value-added opportunities has been impacted by more conservative underwriting by lenders and more conservative rent and lease-up/occupancy assumptions. In this market, “cash is king” and those buyers with internal equity and strong balance sheets have an edge. Projects with existing/assumable debt (at attractive terms) trade at a premium.

Some additional thoughts include:

- Forget the recent past — the rules are now different. Deals need to make sense and borrowers must have adequate relevant experience and reasonable financial strength.
- Flight to quality with quality projects and sponsors being funded. Borderline owners and projects are having difficulty and are forced to either delay a project or accept “higher test” capital.
- Increasing cap rates will filter through to the appraisers/appraisals and impact the assumed exit value for development/redevelopment projects (resulting in lower available loan proceeds).
- Loan rates are not the major issue, especially given that rising spreads have been partially offset by dropping treasury yields. The real issue behind the financing woes is the change in lender underwriting, deal/sponsor selectivity and decreased exit valuation assumptions.
- Lenders are no longer all created equally — it is not a homogenous market anymore and borrowers just can't call on any conduit and just get the financing funded.
- A commitment/application is only really a commitment when funds are wired. There is no certainty due to the ongoing volatility.
- Spreads on CMBS loans are very volatile and subject to wide change on a daily basis.
- Some stalwarts are on the sidelines waiting until the New Year to get back in the market. The release of holiday retailer same-store sales performance could provide a spark to the market (if positive).
- While the conduit, bridge and non-recourse construction financing market are having problems, the junior debt (i.e. mezz) and preferred equity and equity markets are still healthy.
- It is critical to have a capital markets advisor that can secure the optimal financing/capitalization structure/terms as it is possible to find a “best fit” lender (“needle in the haystack”) that is currently trying to buy market share and has a good portfolio allowing it to warehouse some loans.
- While yields and pricing are up, the capital stack can still be put together via alternative financing avenues and creative structures.

Regardless of the current market, it is important to know that deals are still getting done (capital, JV and acquisitions). However,

it takes more creativity and structuring to get a deal done. While some existing capital or investment sources are exiting the market, new sources are emerging every day to take advantage of the current market.

REAL ESTATE SECURITIES PERFORMANCE

While the overall stock market indices were down approximately 2% to 3% in November 2007, real estate related securities (ETFs, indexes, REITs, etc.), performed poorly during the month. See chart below:

	% Change	
	1 month	26 week
Broader Market Indices		
S&P 500	-2.94	-3.44
Dow Jones	-2.27	-1.33
S&P Retail Index	-2.92	-18.04
Real Estate & Retail Related Exchange Traded Funds		
Ishares Cohen & Steers Realty Index Fund ETF	-6.67	-17.17
Ishares Dow Jones US Real Estate Index ETF	-5.88	-18.49
ProShares Ultra Short Real Estate ETF	8.85	34.83
SPDR DJ Wilshire REIT ETF	-6.10	-18.20
Vanguard REIT ETF	-5.81	-16.77
Ishares DJ US Home Construction Index ETF	-13.75	-52.58
SPDR S&P Homebuilders ETF	-11.84	-45.43
Power Shares Building & Construction Portfolio ETF	-6.69	-10.80
HOLDRS Retail ETF	-0.05	-9.80
Power Shares Dynamic Retail Portfolio ETF	-6.28	-21.37
SPDR S&P Retail ETF	-3.95	-20.71
Retail Sector Indices		
Apparel	2.79	-15.61
Auto Parts	-3.05	-17.95
Department Stores	-8.73	-28.42
Discounter - Variety Stores	1.35	-6.55
Drug Stores	-4.82	-6.02
Electronic Stores	1.15	-4.63
Grocers	0.09	3.31
Home Furnishings	1.74	-18.04
Home Improvement	-7.82	-28.07
Specialty	-2.94	-17.92
Sporting Goods	-7.76	-12.58
Toys & Hobby	-17.66	-47.61
REIT Sectors		
Diversified / Industrial	-3.14	-8.87
Healthcare	5.13	2.74
Hotel	-9.30	-19.11
Office	-9.92	-22.99
Residential	-6.92	-22.05
Retail	-6.64	-13.90