

CAPITAL MARKETS REVIEW

Shopping Center Business presents **Capital Markets Review** compiled by Gary Saykaly and Van Barron. Based in Atlanta, Saykaly and Barron are managing partners of BridgePointe Advisors (a merger between NewBridge Retail Advisors and CREFunding). 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.

The CMBS Market: A Mini-Meltdown

The CMBS market is witnessing a minor setback as the problems of the sub-prime residential mortgage continue to filter through to the commercial mortgage market. CMBS lenders are now seeing some of their aggressively underwritten loans being kicked out of their loan pools and the spread requirements of the bond investors increasing.

DRIVERS OF THE CMBS SITUATION

- The late-February meltdown in the sub-prime market has caused spreads to increase across the fixed-income markets.
- "B" piece buyers who basically drive the market feel that credit of the CMBS tranches has deteriorated and more stringent loan underwriting is required. In addition, the financing source for many "B" piece buyers — the CDO market — is requiring a higher yield.
- While AAA investors traditionally do not scrutinize the collateral of CMBS deals, they are now doing so, requiring the removal of low quality loans.
- Rating agencies are increasing subordination levels because of the weakening quality of loan underwriting, causing a smaller portion of the CMBS bonds to qualify for the low cost AAA ratings.
- Demand for credit-default swaps — which allows investors to reduce their exposure to potential losses on CMBS portfolios via a synthetic CMBS (CMBX) — continues to increase (50% increase since early March) with spreads increasing up to 80 basis points for the BB/BBB pieces.
- The market is cooling significantly to 10-year I/O structures (interest only) and will require a shorter I/O period going forward.

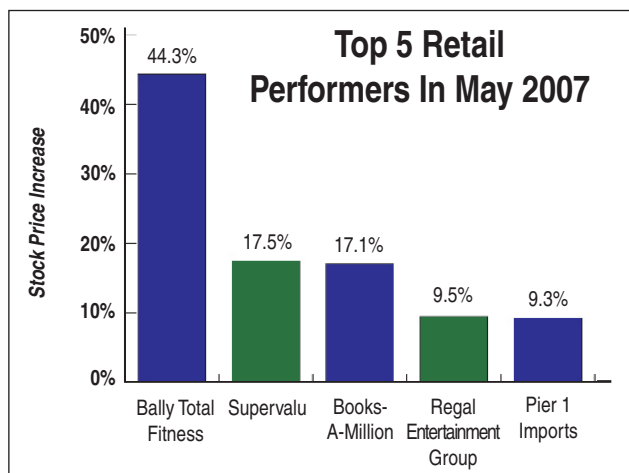
As a result of the above factors, CMBS lenders are facing the prospect of lower profits or significant losses on their existing loan inventory and as a result have increased loan spreads by approximately 25+/- basis points. This adjustment period could last until the CDO market improves and existing loan inventories are unloaded. We have been asked whether this is the unraveling of the CMBS market. The answer is: not at all. There is significant capital in the market that remains very interested in CMBS bond tranches. This is an adjustment period that long term is a positive for the CMBS market — forcing more discipline and tighter underwriting standards that will keep a major meltdown from occurring.

IMPLICATIONS FOR OWNERS/SELLERS & INVESTORS

As an owner/investor in a borrowing or selling mode,

this situation has a number of implications that need to be understood:

- With the public market exposure of the commercial real estate market, it is critical to monitor supply/demand factors in the overall capital markets arena (fixed-income, RMBS, CDO, derivatives, etc.), as any disruptions will filter through to real estate participants.
- Lenders will be more conservative in loan underwriting, focusing less on projected income, increasing amortizations and requiring more equity. As a result, borrowing costs will increase and available loan proceeds will decrease. As a seller, it is important to understand which lender your buyer is currently working with and the potential for a loan re-trade.
- Not all lenders are the same. The CMBS lending market is bifurcated. Some CMBS lenders are in better shape than others and less likely to increase spreads, whereas others have significant exposure and will have to increase spreads. This makes it even more important for you to work with a capital advisor that has real-time insight into the pricing requirements and motivations of the active capital sources. Also, if you as a borrower or your buyer have not locked rate, there is a chance the lender could re-trade the proposed loan terms depending on the lender.
- Sellers should question investors whose pricing is dependent on a 10-year I/O structure.



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2007 Investment Strategies

As a follow-up to our 2006 Retail Capital and Investment Market Snapshot, set forth below are insights on market trends and strategies that should be considered in today's market.

TRENDS TO WATCH

While the current market remains "capital long" (abundant) from an investment and debt/equity capital standpoint, there are certain trends that are impacting the market:

- Investment transaction volume is slowing and investment pricing continues to be bifurcated and random among the Class A, A-/B+ and B/C assets.
- Return on costs (and profit margins) for new developments continues to drop due to rising costs — land, materials, labor and pre-development requirements. Increased project size for many developers has dramatically expanded contingent liabilities levels and completion timelines.
- Commercial delinquency rates are starting to rise at the bank level.
- While the fundamentals for retail have held, the softer residential housing and mortgage market could lessen the demand for retail space. According to REIS, retail vacancies are expected to rise in 2007 and net absorption has already started to drop off. At the same time, the retail sector will see 39 million square feet of completions versus 28 million last year.
- The recent meltdown in the CMBS market, where spreads are widening, provides an additional amount of uncertainty to the market and will have an impact on asset pricing.

2007 STRATEGIES

Hedging Uncertainty

The uncertainty regarding the direction of interest rates, cap rates and the overall capital markets can be hedged via a number of investment vehicles:

- *Pre-Sales:* A pre-sale allows a developer to lock today's cap rates prior to the completion of a development project. The cost of this hedge is a premium on today's cap rates. However, over the last few years, the cap rate premium has dropped from 50 to 75+ basis points to 10 to 40 basis points depending on the project and timeline. To gain control of property in today's world, many hyper-competitive investors are now considering pre-sales. A well structured pre-sale can also result in more aggressive construction loan terms.
- *Forward Commitments:* Locking in today's interest rates on upcoming financings is no longer an expensive insurance product. Lenders are currently willing to go out 18+ months on forward commitments with a premium of 1 basis point per month of the forward.

- *Derivative Products:* The evolution of the capital markets has created effective ways for owners to hedge their interest rate, loan underwriting and asset pricing risks. Interest rate swaps/options and treasury lock structures, synthetic CMBS positions (CMBX) and real estate derivatives (just emerging) provide a vast array of hedging options. The evolving market for real estate derivatives will allow developers/owners/investors to: hedge a variety of risks, go short on the market, diversify portfolio holdings, enhance yields, adjust exposure and make bets on market direction.

Private/Limited Placement vs. Wide Exposure

In this particular market cycle, we are finding that many buyers do not want to review investment offerings that are being "mass marketed," regardless of whether their pricing could be hyper-competitive. In many situations, a buyer may get more aggressive for an opportunity on a limited offering basis. If the seller wants to test the market demand for an asset, a private/limited placement could provide a "zero risk" strategy and a free market value appraisal. In the event that pricing expectations are not met, the seller's property is not stigmatized in the market as a "shopped" asset. The wide exposure approach can always be utilized after exhausting the private/limited placement avenue.

Monetizing Asset Value While Minimizing a Taxable Event

Many owners and developers would like to take advantage of the aggressive investment market and pull out embedded equity gains in their real estate properties or portfolios without an outright sale. A few alternative strategies could be employed to monetize asset value:

1. *Equity recapture structure* — for assets with existing debt, securing a non-participating equity loan that can fund up to 90%+ of the asset value. The owner maintains full control of his or her asset, but monetizes embedded equity gains without triggering a tax event.
2. *High leverage capital engineering:* restructuring the entire capital stack in today's aggressive market where senior lenders are willing to fund additional layers of the capital stack which can provide an after tax benefit.
3. *Partial interest sale:* sell a limited or majority interest in the asset while maintaining management and leasing responsibilities/fees. Investors are willing to accept a set return or a percentage of the overall project.
4. *Installment sales:* structure a sale based on an installment sale, where the taxable event is deferred until the receipt of future payments.

Multi-Asset Offerings

There is no question that multi-asset offerings secure more investor interest than single-asset offerings in today's market. In-

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vestors are looking to grow their portfolios and gain economies of scale. In that regard, investors should consider coming to market with more than one property at a time, regardless of whether the assets will be sold together to one buyer. While the assets do not have to be similar, they should have some common characteristics. We have successfully utilized the following approach to maximize the value of a portfolio:

1. Go to market as a portfolio.
2. Position and support the assets individually.
3. Encourage flexible bidding formats.
4. Require individual asset offers for all grouped and portfolio offers (allowing the seller to determine the optimal asset combination).

Portfolio offers cause the individual asset bidders to get more aggressive and vice versa. In addition, in the event that the portfolio investor wants to “kick out” a non-fit asset (before or after acquisition), the seller has an existing market created.

Real Estate Derivatives Corner

Last month I co-authored an initial article on the emerging real estate derivatives market in the United States. The article provided a macro level overview of the real estate derivatives market and the key indexes which the derivative products will be written off of.

Representatives of our company recently had the opportunity to attend the 1st Annual Commercial Real Estate Derivatives Conference in New York City and speak to key participants — interdealer brokers, derivative traders, investment banks creating the derivatives and the Index providers. The conference covered a variety of subjects — the uses of derivatives, mechanics of derivative instruments, pros and cons of the index providers, the creation of liquidity in the derivatives market and the key participants. It was clearly evident that the investment banks are in full gear trying to establish a real estate derivatives market in the U.S. An example of the recent momentum: CB Richard Ellis and derivatives specialist Reech AiM just announced they plan on launching a global series of six property hedge funds worth \$4.79 billion that will invest in property derivatives.

Example uses of property derivatives that were discussed included:

Example 1 – A developer that is planning on a portfolio of assets would like to hedge against future market downturns buys a Put on the index that best correlates with its asset pool. If there is a market downturn, the fund would take a loss on

Pre-Disposition Financing

Sellers have often wondered whether they should lock in aggressive financing in today’s market to increase the marketability of the asset to leverage-driven investors and improve the asset’s position in the event that interest rates increase. While many investors are leverage driven, not all assets should be leveraged prior to going to market. Assets that should be leveraged include stabilized assets (especially Class A assets under \$20 million and most Class B/C assets) and those assets appealing primarily to private market investors. Assets that should not be leveraged include larger Class A assets, assets appealing to institutional/REIT or TIC investors, redevelopment projects, or those assets with upside or value enhancement possibilities. An interim strategy is to secure a number of preliminary quotes with aggressive lenders of the day.

the assets it ultimately sells. However, the increased value of the Put (resulting from the drop in the related index value) offsets the loss of value of the properties.

Example 2 – An investor feels that the West Coast retail market is ready to see a significant increase in valuation. The investor buys a Call on the West Coast retail index to capitalize on this expectation.

Example 3 – An owner feels that its rental income is overweighted in West Coast Office and underweighted in Southeast Retail. The owner goes short via a Return Swap on the West Coast Office Index (pays the return on this index) and goes long via a Return Swap on the Southeast Retail Index (receives the return on this index).

Example 4 – A hedge fund has taken in \$2 billion to place in real estate assets but cannot invest the money quickly. A futures contract on the desired index is acquired for the required period of time (i.e. until real estate opportunities are found).

Additional real estate derivatives insights will be provided each month.

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The information contained in this section was accurate as of May 9, 2007.

RETAIL REIT UPDATE

REIT	Stock Symbol	Dividend Yield	Current Price As Of 5/9/07	Stock Price % Change From Previous Periods	
				4/10/07	1/3/07
SHOPPING CENTER					
Agree Realty Corp.	ADC	5.70%	\$34.42	0.20%	-0.15%
Acadia Realty	AKR	3.00%	\$26.98	-0.63%	7.92%
AmREIT	AMY	6.00%	\$8.33	-2.57%	-1.07%
Cedar Shopping Centers	CDR	5.60%	\$16.40	0.00%	3.08%
Developers Diversified Realty	DDR	4.10%	\$64.85	0.22%	2.53%
Equity One, Inc.	EQY	4.20%	\$29.11	6.75%	11.62%
Federal Investment Realty Trust	FRT	2.60%	\$90.35	-2.00%	7.66%
Inland Real Estate Corp.	IRC	5.40%	\$18.29	-0.92%	-2.66%
Kimco Realty Corp.	KIM	3.00%	\$48.50	-1.14%	7.51%
Kite Realty Group	KRG	3.90%	\$20.37	-0.29%	8.64%
Ramco-Gershenson	RPT	4.90%	\$37.93	5.30%	-0.08%
Regency Centers	REG	3.20%	\$81.95	-3.47%	4.97%
Saul Centers	BFS	3.40%	\$53.48	-2.05%	-4.31%
Urstadt-Biddle Properties	UBA	5.10%	\$18.25	-3.90%	-2.82%
Weingarten Realty	WRI	4.10%	\$49.00	1.89%	6.50%
ENCLOSED MALL					
CBL & Associates	CBL	4.90%	\$41.50	-9.55%	-3.31%
Feldman Mall Properties	FMP	8.10%	\$11.32	-11.22%	-10.80%
General Growth Properties	GGP	2.90%	\$61.97	-5.71%	19.91%
Glimcher Realty Trust	GRT	7.00%	\$27.70	2.14%	3.28%
PREIT	PEI	5.10%	\$44.72	-5.59%	16.25%
Simon Property Group	SPG	3.00%	\$113.83	-0.59%	12.73%
Taubman Centers	TCO	2.70%	\$55.83	-6.67%	9.38%
FACTORY OUTLET					
Tanger Factory	SKT	3.50%	\$41.56	3.46%	6.51%
OTHER RETAIL REITS					
Colonial Properties Trust	CLP	5.50%	\$49.40	4.33%	6.03%
Cousins Properties	CUZ	4.30%	\$33.96	3.60%	-2.30%
Entertainment Properties Trust	EPR	5.00%	\$61.53	-1.19%	5.09%
National Retail Properties	NNN	5.90%	\$24.30	-0.12%	7.14%
PUBLICLY HELD COMPANIES					
CB Richard Ellis	CBG	n/a	\$37.59	11.34%	11.71%
Forest City Enterprises	FCEA	n/a	\$68.00	-0.64%	17.91%
Jones Lang LaSalle	JLL	0.60%	\$117.18	12.59%	27.37%

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This information was compiled by W. Van Barron of BridgePointe Advisors.

RETAILER STOCK AND CREDIT SUMMARY

Tenant	Stock Symbol	Moody's Credit Rating as of 4/7/07	Current Price As Of 4/30/07	Stock Price % Change From Previous Periods	
				3/30/07	1/1/07
DISCOUNTERS					
BJ's Wholesale Club	BJ	NR	\$34.53	2.07%	10.99%
Big Lots, Inc.	BIG	NR	\$25.93	2.07%	50.65%
Costco	COST	A2	\$53.57	-0.50%	1.32%
T.J. Maxx	TJX	A3	\$27.89	3.45%	-2.21%
Target	TGT	A1	\$59.37	0.19%	4.07%
Wal-Mart	WMT	Aa2	\$47.92	2.07%	3.77%
SPECIALTY STORES					
AutoZone	AZO	Baa2	\$133.04	3.82%	15.13%
Barnes & Noble	BKS	WR	\$39.53	0.20%	-0.45%
Bed Bath & Beyond	BBBY	NR	\$40.74	1.42%	6.93%
Best Buy	BBY	Baa2	\$46.65	-4.25%	-5.16%
Books-A-Million	BAMME	NR	\$16.68	17.13%	-26.46%
Borders Books	BGP	NR	\$21.11	3.38%	-5.55%
Circuit City	CC	Baa2	\$17.45	-5.83%	-8.06%
Dollar General	DG	NR	\$21.35	0.95%	33.35%
Family Dollar	FDO	NR	\$31.84	7.49%	8.56%
Foot Locker	FL	Ba1	\$23.79	1.02%	8.48%
Gateway Computer	GTW	WR	\$2.19	0.00%	8.96%
Gap, Inc.	GPS	Ba1	\$17.95	4.30%	-7.95%
Hibbett Sporting Goods	HIBB	NR	\$29.15	1.96%	-4.52%
The Home Depot	HD	Aa3	\$37.87	3.08%	-5.70%
Limited	LTD	Baa2	\$27.57	5.79%	-4.73%
Lowe's Home Improvement***	LOW	A1	\$30.56	-2.95%	-1.89%
Mothers Work, Inc.	MWRK	B3	\$35.00	5.61%	-11.14%
Office Depot	ODP	Baa3	\$33.62	-4.33%	-11.92%
Office Max	OMX	Ba2	\$49.22	-6.67%	-0.87%
Payless ShoeSource	PSS	B1	\$31.90	-3.92%	-2.80%
Pep Boys	PBY	B2	\$18.65	-2.30%	26.10%
PetSmart	PETM	Ba3	\$33.19	0.70%	15.00%
Pier 1 Imports	PIR	Caa2	\$7.55	9.26%	26.89%
RadioShack	RSH	Ba1	\$29.07	7.55%	73.24%
Regis Corporation	RGS	NR	\$38.23	-5.30%	-3.31%
Ross Dress For Less	ROST	NR	\$33.15	-3.63%	13.14%
Sherwin-Williams	SHW	A3	\$63.77	-3.44%	0.30%
Staples	SPLS	Baa1	\$24.80	-4.02%	-7.12%
Starbucks	SBUX	n/a	\$31.02	-1.08%	-12.42%
West Marine	WMAR	NR	\$14.70	-19.28%	-14.88%

All ratings are senior unsecured unless otherwise noted.

+ = Senior Implied

1 = On review for possible downgrade

▼ = Rating Decreased

▲ = Rating Increased

4 = Bank Credit Facility

* = Senior Subordinate

NR = No rated Issues

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** = Issuer Rating

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DEPARTMENT STORES					
JC Penney	JCP	Baa3	\$79.09	-3.74%	2.24%
Federated***	FD	Baa2	\$43.92	-2.51%	15.18%
Kohl's Corp.	KSS	A3	\$74.04	-3.35%	8.20%
Dillard's	DDS	B2	\$34.63	5.81%	-0.97%
Nordstrom	JWN	Baa1	\$54.92	3.74%	11.31%
Saks Inc.	SKS	B3	\$20.94	0.48%	17.51%
Stein Mart, Inc.	SMRT	NR	\$16.30	-0.12%	22.93%
DRUG STORES					
CVS	CVS	Baa2	\$36.24	6.15%	17.24%
Longs Drugs	LDG	NR	\$54.74	6.00%	29.16%
Rite-Aid	RAD	Caa2	\$6.14	6.41%	12.87%
Walgreens	WAG	Aa3**	\$43.90	-4.34%	-4.34%
GROCERY STORES					
A&P	GAP	Caa1	\$32.19	-2.98%	25.06%
Bi-Lo (Ahold USA)	AHO	Ba2	\$12.71	8.26%	20.13%
Food Lion (Delhaize American)	DEG	Ba1	\$96.35	5.07%	15.69%
Ingles	IMKTE	B2	\$35.96	-11.95%	20.71%
Kroger	KR	Baa2	\$29.51	4.46%	27.92%
Pathmark	PTMK	Caa2	\$12.62	-1.41%	13.18%
Safeway	SWY	Baa2	\$36.30	-0.93%	5.03%
Smart & Final	SMF	NR	\$21.76	-0.05%	15.13%
Supervalu	SVU	B1	\$45.90	17.48%	28.39%
Weis Markets	WMK	NR	\$43.04	-3.71%	7.30%
Whole Foods	WFMI	Ba1	\$46.79	4.33%	-0.30%
LEISURE & RECREATION					
Bally Total Fitness	BFT	Caa3	\$0.88	44.26%	-64.08%
Blockbuster Entertainment	BBI	Caa1	\$6.20	-3.73%	17.20%
Regal Entertainment Group	RGC	B2	\$21.75	9.46%	2.02%
United Artists	MGM	WR	\$67.25	-3.27%	17.26%

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RATE WATCH

JUNE
2007

FROM BRIDGEPOINTE ADVISORS

To receive a quote for your transaction, please visit
www.bridgepointeadvisors.com or call (404) 446-4900.

MARKET PULSE

The information below is compiled on a monthly basis by BridgePointe Advisors (BPA) and represents actual quotes on properties represented by BPA, from lenders representing a cross-section of the lending community. BPA reaches hundreds of commercial lenders, offering a very comprehensive sample of the finance landscape. All spreads are for 10-year fixed-rate loans using the 10-year Treasury Index unless otherwise designated. The indicated rate is based upon the 10-year Treasury Index (4.63%) on May 8, 2007.

PROPERTY TYPE	LEVERAGE	DSCR	SPREAD	INDICATED RATE
Grocery Anchored Retail	85% LTV	1.10X	105	5.68%
Strong Anchored Retail	80% LTV	1.10X	95	5.58%
Weak Anchored Retail	75% LTV	1.20X	115	5.78%
Unanchored Retail	75% LTV	1.20X	125	5.88%
Single Tenant Retail A+ credit (1)	90% LTV	1.01X	95	5.58%
Single Tenant Retail—A+ credit	80% LTV	1.01X	95	5.58%
Single Tenant Retail—A credit drug	80% LTV	1.01X	110	5.73%
Single Tenant Retail BBB credit drug	75% LTV	1.15X	125	5.88%
Single Tenant Retail—Non-investment	75% LTV	1.30X	150	6.13%
High End Specialty Retail	80% LTV	1.15X	105	5.68%
High End Urban Retail	80% LTV	1.15X	105	5.68%
Mixed Use Urban Office / Retail	80% LTV	1.20X	115	5.78%

CAPITAL SOLUTION — TERRORISM INSURANCE: DO YOU NEED IT?

The terrorism insurance program is set to expire by year's end. If you own a commercial property, you probably do not have coverage unless you have financed said property after September 11, 2001. Many people have been asking, "Do I need it and can I still get coverage?"

Terrorism insurance is imperative for a strong commercial real estate market, according to the NAR (National Association of Realtors: Washington, April 24, 2007). If the terror-

ism insurance program were allowed to expire, coverage would become largely unavailable and unaffordable and the gears of commercial real estate would grind to a halt.

If you are purchasing or refinancing a property, you will be required to obtain terrorism insurance. This pertains to all commercial properties all the way down to small single-tenant properties in tertiary markets. The need for this coverage has caused confusion, frustration and a high cost to

the financing transaction.

One way to circumvent this problem is to be cognizant of your current coverage; most policies upon renewal have a check box to add terrorism to the policy for a nominal fee. If you plan on refinancing the property in the immediate future, take the extra coverage because to add it post-renewal is extremely expensive and you can be sure that all institutional lenders will require it.