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NET LEASE ADVISOR

APRIL 2008

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Holland+Knight

Calkain Companies, Inc. recently spoke with a number of professionals from the leading real estate law firm, Holland & Knight, to discuss current real estate market issues and trends.

CALKAIN: The debt markets are in the forefront of the media and therefore, investors' minds. What is your view of today's debt climate and how it will progress over the next year?

HORN: There is a widespread view that debt has been underpriced relative to risk for the last couple of years. Spreads have increased since the subprime meltdown, but treasury rates have dropped, so borrowing rates are not much higher than they were six months ago. The subprime meltdown has affected different parts of the capital market differently.



Dennis Horn

The uncertainty in the Commercial Mortgage-Backed Securities (CMBS) market and the related hit on capitalization for financial companies has created a dual lending market. Banks and CMBS lenders have become very cautious. CMBS lenders in particular, which accounted for over \$300B in bonds in 2006, have cut way back because of fears that they will end up with the loans on their balance sheets or face bond pricing that they did not predict when they closed the loans. On the other hand, life companies, who do not depend on the capital markets, have their pick of deals and anecdotally, are doing pretty well right now.

The equity market has not reached equilibrium. Sellers still expect CAP rates at 6% or lower for prime office product. Buyers are squeezed by unpre-



James Spitzer

dictable mortgage rates and lower loan to value loans and want to compensate by paying lower CAP rates for their product. The result has been a slow down in deals, at least in the DC market. There is also some uncertainty about what kind of yields equity should expect in this market.

The underlying office market, at least in DC is strong. Rental rates continue to go up and vacancy is fairly constant. I understand that other markets are weakening, and some of our submarkets, like Dulles, are weaker than they were a year ago. The condo market is dead in DC.

SPITZER: On the construction side, middle market loans ranging from \$50-\$100 million still seem available. The more difficult it is to obtain financing, the more onerous the terms. Also, the increase in coverage requirements and the consequent increase in equity requirements are proving quite stifling. Preferred equity yields have increased significantly. In effect, a decrease of 10% in debt may result on increased costs on those funds of 20% IRR. On the permanent loan side, the loss of securitized debt has increased costs and decreased availability of long term debt and lowered the amounts available. Again, this is felt most acutely in loans greater than middle market.



Curtis Sano

CALKAIN: In your position, you run the real estate practice for all of the Holland & Knight offices. What sort of feedback are you getting from your colleagues as it relates to the current commercial real estate investment market?

SPITZER: By and large on the sale and acquisition side, it is deer in the headlights time and velocity on new deals is at the low end with Sellers not wanting to lower prices too much and Buyers looking for significant discounts. It is of course

aggravated by the lower amount of debt available and the high cost of mezzanine debt and preferred equity. Existing developments seem generally to be moving forward, but this is being tested on larger transactions by availability of debt.

CALKAIN: REITs and large institutional investors are beginning to change their business and investment models in an effort to change with the markets. Have you seen any of this with your practice and if so, what specifically are you seeing change?

SPITZER: While we have not seen any immediate change with the reduction in liquidity (both difficulty in raising debt, cost of debt and lower leverage limits), REITs are finding and will find that both acquisitions and new developments have become more difficult. This is compounded by the overall disconnect between buyers and sellers which has resulted in a major reduction in velocity of transactions. Accordingly, there has been and will be an increased emphasis on improving operating results at the same time the growth in rent increases has halted. To compound this, certain segments, primarily retail will continue to struggle to maintain prior levels of gross rental receipts. In particular, where retail is based on percentage rents, and there may be an increase in discontinued operations and difficulty in attracting tenants to new operations.

CALKAIN: National retailers have begun targeting specific areas of the country where they have deemed it to be a potential for high demographic growth. What trends are you observing for retail growth throughout the US?

SANO: The trend is towards mixed-use. Almost every project that was previously office or multifamily residential now has some retail component to it.



Nicholas Milano



Grant McCorkhill

MILANO: The Central Florida and Palm Coast areas of Florida, Chicago and Mid-Atlantic regions are ripe and enticing areas for growth and retail developers have noticed this.

How Passive is a Net Leased Real Estate Investment?

THE CHALLENGE

Three partners own a real estate investment outside their immediate area. The property is encumbered by a net lease, limiting the Landlord's responsibility to roof and exterior walls. The remaining maintenance of the HVAC, parking area, plumbing, etc. all fell under the duties of the Tenant. Occasionally, the Tenant contacted the Landlord for minor roof repairs, which were promptly attended to via local contractors who were paid by the Landlord.



CALKAIN: The bulk of large, institutional transactions in the US are in the Office sector. What transactional velocity have you experienced over the last year and what are your thoughts on 2008's office investment outlook?

MCCORKHILL: Suburban development seems to be slowing but development in the downtowns of large urban areas remains strong.

SPITZER: Starting in June or July, pricing deteriorated significantly and overall velocity, even in markets like NY, have been reduced to a snail's pace. With that said, there have been some deals completed at very optimistic numbers. There has not been enough distress to cause Sellers to reduce pricing. ♦

Given the passive nature of the lease structure, prompt monthly rental payments from the Tenant, and amicable Landlord-Tenant relationship, the property Owner never suspected reason to travel to the property for periodic inspection. The Owners know their local market, however are not in close enough proximity to maintain physical status of the building.

By the time the Owners learned of the Tenant's intent to vacate, there was insufficient time to investigate the condition of the building and inform the Tenant of necessary repairs.

JANIS SCHIFF

Appointed Section Leader of National Real Estate Section

Janis Schiff, a partner in Holland & Knight's Washington, D.C. office, was recently appointed Section Leader of the firm's 200+ lawyer Real Estate Section by Holland & Knight Managing Partner Howell W. Melton, Jr.

Schiff has extensive experience representing both landlords and tenants in commercial leasing of shopping centers, office buildings, restaurants, business parks, warehouses and unimproved land. ♦



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THE PROCESS

Property will require extensive Tenant improvements due to a high level of deferred maintenance. Tenant vacated the building, charging that the Landlord had not fulfilled their obligations to properly maintain their contractual obligations.

Tenant did not maintain the plumbing, HVAC, exterior landscape, interior walls, as well as many other items specifically named within the lease. An attempt to identify a monetary figure for damages and neglect on the building and surrounding property was initiated at great expense to the Landlord.

Additionally, a general contractor will be required to facilitate the repairs needed in order to re-Tenant the facility, furthering the financial burden to the Owner.

WHAT WAS DONE?

The Landlord hired a professional to drive to the area, document the status of the property and detail the physical condition of the building. Additionally, they have hired legal counsel to contact the former Tenant and filed suit to dispute the current disrepair of the building directly attributable to deferred maintenance in an attempt to recover damages.

WHAT COULD HAVE BEEN DONE?

Perform an annual inspection to routinely review the premises, condition of the building, Tenant viability, changes in the surrounding market, and use an independent third party to serve as a conduit to induce a sense of management on behalf of the Landlord.

Any defects or areas of deferred maintenance can be disputed and solved while Tenant is still occupying the facility, eliminating the dispute over date of occurrence, with previous records from past annual visits of the site. Detailed documentation is key, including photographs and specific dates of observations.

SUMMARY

This was an actual scenario that drove the Landlord to Calkain Site Services. As an independent third party, CSS professionals can perform a review of the existing asset, and also serve as a conduit for communication between the Tenant and Landlord. In addition to the physical condition of the property and improvements, CSS documents the characteristics of the surrounding marketplace, identifying potential shifts in the demographic makeup of the immediate area.

The trends, especially when observed and documented over time, can assist Owners in evaluating the effective life span of a real estate investment. Additionally, annual inspections and documentation will aid in holding the Tenant accountable for their specific lease obligations, and allow for a timely address of any potential deficiencies. ♦



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HIPP FAMILY FOUNDATION DONATES EMERGENCY VEHICLE TO NATIONAL HUMANE SOCIETY



Hipp Family Foundation in conjunction with Calkain Companies, Inc. recently made a significant contribution to the National Humane Society in Tampa, Florida. The donation was specifically allocated to purchase a new van used to provide local, mobile veterinary health services. The van is outfitted with state of the art emergency medical equipment and is ready to be deployed in the event of a national disaster.

Jonathan Hipp, President and CEO of Calkain Companies, Inc., is founder of Hipp Family Foundation. In an effort to give back to communities nationwide, a percentage of all Calkain profits have been pledged to Hipp Family Foundation.

Shortly after Hurricane Katrina devastated the Gulf Coast, Hipp met with Carol Childs, President of the Tampa chapter of the National Humane Society. As a long-time animal rights advocate, he wanted to ensure that they could continue performing such operations after upon learning of the organization's heroic efforts in rescuing and treating animals affected by the hurricane. "Calkain has always instituted a sentiment that it has an obligation to contribute to worthy causes especially in the local communities in which it serves," acknowledged Mr. Hipp.

Additional information about the National Humane Society in Tampa and the Health, Education, Rescue and Outreach (H.E.R.O.) services they provide can be found at www.nationalhumane.com. ♦



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