FOLEY **EXECUTIVE BRIEFING SERIES**

RAISING REAL ESTATE EQUITY

"Raising Real Estate Equity" was the discussion topic for the September 19 (Boston) and October 3 (Chicago) presentations of the Foley Executive Briefing Series, moderated by Foley & Lardner LLP Real Estate Partner Stephen Burr. Mr. Burr was joined by Foley attorneys Kenneth Appleby, David Kantaros and Sven Riethmueller; as well as a panel of key players in the real estate finance and securities profession. The panelists addressed the raising of real estate equity from both institutional and retail sources, as well as their perspectives on the real estate debt markets. This briefing summarizes some key points raised in the panelists' discussions.

Raising Equity– Are Institutional Equity Providers Still Willing?

Institutional equity providers expect that institutional equity for commercial real estate investment will continue to be available because, bottom line, real estate generates an attractive return combined with reasonable long term stability. Thus investor interest remains high, despite recently chaotic debt markets. However, because of this chaos, institutional equity providers have become increasingly cautious about deals. These equity sources may be willing to finance only carefully structured, and increasingly larger, deals with established and stable partners who have demonstrated track records and a high degree of chemistry with the equity provider.

As with any challenge, within the challenge of this changing investment market there exist opportunities for new investment strategies.

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Raising Equity from Retail Sources – Is there as Equity Channel in the Securities Market?

Panelists emphasized that the securities channel offers real estate owners and developers a way to raise equity that is lower in cost and greater in flexibility than the more rigid institutional channels. The bottom line is, if institutional equity providers are unwilling to provide equity, retail investors may be willing to help.

The securities market has changed dramatically as a result of the Tenant-in-Common (TIC) industry, created by the publication of IRS revenue procedure 2002-22. That procedure, which allows real estate properties to be traded for fractional interests in real estate and thus allows a like-kind exchange and the deferment of capital gains taxes, created a distribution network of licensed securities representatives eager to sell real estate through the securities channel. The TIC industry continues to grow but TIC demand has begun to level off. As a result, the real estate securities market is becoming broader than the TIC industry itself and such new, securities-based products are being developed which may be attractive to those investors who are not looking for a like-kind exchange investment, or who are seeking to avoid the constraints of the TIC market: necessarily quick decisions, dearth of quality sponsors and options, and sometimes unreasonable sponsor expectations.

Industry reps noted that the securities channel is a real market, but is not necessarily universally accessible. To be a participant, one must have a demonstrated track record, experience and reasonable liquidity. The market also demands an active presence and a dedicated sales force – to both secure sponsorship and guarantee

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success of the syndication. So long as those conditions can be met, the retail channel is a realistic investment channel and a Wall Street alternative for many kinds of commercial real estate investment, including blind pool investments.

Investors are advised to keep in mind, as they consider the real estate market from a broader perspective, that the TIC industry is a very specialized piece of the real estate market – and its longevity isn't guaranteed. Today's sponsors are seeking more diverse deals with defined exit strategies, such as land banking, for example. Such deals, when properly structured, allow investors to hold raw land while lenders raise capital for development on that land. To maximize the tax advantage potential of any deal, access to experienced and knowledgeable legal counsel is essential.

Real estate companies considering using the securities channel must also understand that becoming a "sponsor" is not easy. Sponsors are expected to have experience, deal flow and commitment. The selectivity allows only the most qualified sponsors to build a reputation on the market, and an established sponsor can more easily facilitate quick and profitable sales.

Perspectives on the Real Estate Capital Markets from Debt Providers and Rating Agencies

Major credit rating agencies are currently under fire from critics who say they failed to give investors adequate warning of the risks associated with residential mortgage-backed securities, which are now plummeting in value as home loan defaults are soaring.

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But the ratings agencies do stand behind the merits of their industry – and industry representatives suggest there has been a trend among investors to examine only the yield, rather than the risk, of their investment. Agency reps advise that current and future investors would be wise to take all pieces of available information into account.

Lenders are thus rethinking their pricing and underwriting strategies, particularly among growing concerns that lenders are not adequately compensated for their risk taking. The bottom line is, the ratings agencies and the lenders are still in business but can be expected to be more careful and to underwrite more carefully.

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