NetLeaseX CAPITAL

SENIOR PARTICIPATING PREFERRED

Superior Returns in Commercial Real Estate with Substantially Mitigated Risks

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Introduction

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Investing in preferred equity is an excellent way to earn attractive returns in real estate while mitigating downside risks.

But even higher returns are available to preferred equity investors if they are able to couple their preferred return with an equity kicker in the underlying property in which they invest. Ron Zimmerman, president of NetLeaseX Capital LLC (“**NetLeaseX**”) knows the “ins and outs” of this technique and has written about it in a featured article he wrote for the *Scotsman Guide* (for which a link is provided to the right).

In this white paper, we discuss how NetLeaseX works with high net worth investors, family offices, equity funds, and institutional investors (collectively, “**NetLeaseX Investors**”) to structure investment relationships with real estate investors and developers (collectively, “**Sponsors**”) in order to achieve superior returns with substantially lower risks than are generally available in the market.

By Ron Zimmerman

President
NetLeaseX Capital LLC

STRATEGIZE WITH PREFERRED EQUITY

THIS SLICE OF THE CAPITAL STACK COMBINES HIGHER RISKS WITH HIGHER REWARDS

Compared to senior-debt and mezzanine financing, preferred equity is probably the least understood layer of commercial real estate financing and the most difficult to raise in a property's capital stack. One reason for this is that many potential preferred equity investors often fly under the radar of commercial mortgage brokers and project sponsors. ■ Potential preferred equity investors often include high net worth individuals, specialized wealth-management firms known as family offices, and other types of developers or investors who seek equity-like returns with less risk than common equity. Not only can commercial mortgage brokers tap into these financing sources to help structure preferred equity investments for their clients, there are techniques they can use to increase their fees and, in some cases, carve out and acquire interests in their clients' projects for a nominal investment. ➤

Photo illustration by Karen Steichen

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“Strategize with Preferred Equity”

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Reprint can be downloaded at NetLeaseX.com/articles

The *Scotsman Guide* is a leading industry publication for commercial real estate lenders and loan brokers.

We use “Senior Participating Preferred” in the title of this white paper to be concise. A more accurate description of the investment discussed in this white paper is senior preferred equity with a common equity interest “kicker” to provide the investor with a share of operating and sale proceeds.

Direct Investments: A Growing Trend for High Net Worth and Family Office Investors

NetLeaseX sources direct investments for investors to enable them to make preferred equity and co-GP investments and bridge, mezzanine and stretch loans.

Many investors are seeking direct investments over investing in real estate equity and loan funds because:

- Investors can disintermediate real estate funds; thereby, bypassing layers of fees to the fund and intermediaries and payment of a promote to the fund.
- Investors can conduct due diligence on Sponsors and properties based on their own criteria rather than relying on fund sponsors whose interests and concerns may be different than those of the investors.
- Investors can target property types and locations rather than "hoping" that fund managers have made appropriate selections.
- Investors have more flexibility in making decisions about exit strategies, as they can sell their investments or loans at any time, whereas fund investors may be subject to lock-up periods or other restrictions on selling their fund investments.
- Investors have more control over investing in a fund because they can:
  - Talk directly to the Sponsor and take the lead on behalf of NetLeaseX in structuring the transaction, including pricing and negotiating levels and types of covenants.
  - Require the right to approve certain actions as a manager of the property-owning LLC.
  - Control and authorize release of investment or loan proceeds based on the investors' conditions, which may include Sponsor affidavits.

How Investors Use the NetLeaseX Platform to Access Direct Investments

NetLeaseX operates a CLOSED platform.

- Only pre-approved investors can view NetLeaseX's pre-screened, structured financings.
- Before being approved, investors must provide NetLeaseX with detailed investment criteria, including the types of investments, minimum and maximum investment amounts, target IRR, minimum and maximum term and property types.
- After approval, NetLeaseX will contact investors by email when a structured financing has been posted to the platform that meets or exceeds the investment criteria previously provided by the investors.
- Investors can update their investment criteria at any time by logging into NetLeaseX's platform and accessing the platform's "My Dashboard" section.
- After reviewing NetLeaseX's write up, executed agreement with the Sponsor, if any, and documents that have been posted to the platform, investors can submit a non-binding, Indication of interest to notify NetLeaseX that they are interested in a particular posted structured financing.

How Investors Use the NetLeaseX Platform to Access Direct Investments (continued)

NetLeaseX operates a CLOSED platform (continued).

- Upon receipt of an investor’s Indication of Interest, NetLeaseX works with the investor to initiate due diligence, including providing the investor with any additional requested documents, setting up Zoom and/or conference calls with the Sponsor and/or providing support to the investor (and/or his/her advisors) due diligence and underwriting activities.

- An investor can cancel his/her Indication of Interest without cost or penalty at any time. Alternatively, an investor can modify the terms of a considered investment to:
  - Increase the investor’s preferred return and/or percentage of project ownership,
  - Require the Sponsor to increase its investment,
  - Obtain downside protection by providing for a “Minimum Target Price”, “Look-Back” IRR, fixed redemption fee, or fixed return multiple upon a sale (see page 17 for details),
  - Restructure NetLeaseX’s proposed investments to the investors’ preference, and/or
  - “Downgrade” the Sponsor to co-sponsor and take over the project (see pages 20 and 21 for details).

Why Preferred Equity?

Preferred equity is raised through a newly-formed entity (like an LLC), which is owned by the Sponsor, and which takes title to real estate. The NetLeaseX Investor's interest in the entity can be structured in several alternative ways that have in common the benefit of equity-like returns with a risk profile that is usually only available to debt investors.

How do we do it?

- All Sponsors must have an investment in the LLC that is subordinate to and is in a first loss position. If the project underperforms, the Sponsor's capital investment bears all of the losses before the NetLeaseX Investors' capital and preferred return are at risk.
- Typically, NetLeaseX Investors receive higher preferred returns than the returns that are available to owners of common interests.

No standard forms or terms and conditions for preferred equity investments

NetLeaseX 's counsel will draft documents to benefit NetLeaseX's investors as assignee of NetLeaseX's Agreement (see pages 44 to 46 for a summary of sample provisions that can be included in the LLC operating agreement).

Hedge against inflation and increasing interest rates

This is due to priority payment of a cumulative preferred return and as structured by NetLeaseX, ownership of common interests purchased for nominal consideration as an equity kicker.

Overview of Gap Financing

Mezzanine loans, preferred equity and co-GP capital all "fill the gap" between the senior debt and sponsor's equity.

NetLeaseX Investors' funds act as subordinate or gap financing to "fill the gap" between the Sponsor's senior debt and equity and, therefore, increase project leverage.

- The capital stack illustration on page 11 shows the relative risk and return of each level of capital invested in a Sponsor's project. The senior debt has with the highest priority of repayment with the lowest expected return followed by the holder of the mezzanine loan and then the owners of the project equity.
- All distributable cash flow will be paid first to the preferred equity investor and then the Sponsor. If a Sponsor seeks to raise co-GP capital as a way to further reduce his/her investment, the co-GP investor would be paid after the preferred equity investor and typically before the Sponsor.

Different Types of Gap Financing

Gap financing includes several time-tested financing techniques that increase financial leverage and enhance returns.

1

2

3

Mezzanine Loan

In lieu of loaning money to the Sponsor that is secured by a mortgage or deed of trust, a Sponsor can pledge his/her membership interest in the borrowing entity to secure repayment of a mezzanine loan. If the Sponsor defaults, the mezzanine lender can seize the Sponsor's pledged common interests by instituting a forfeiture action via a UCC-1 secured sale.

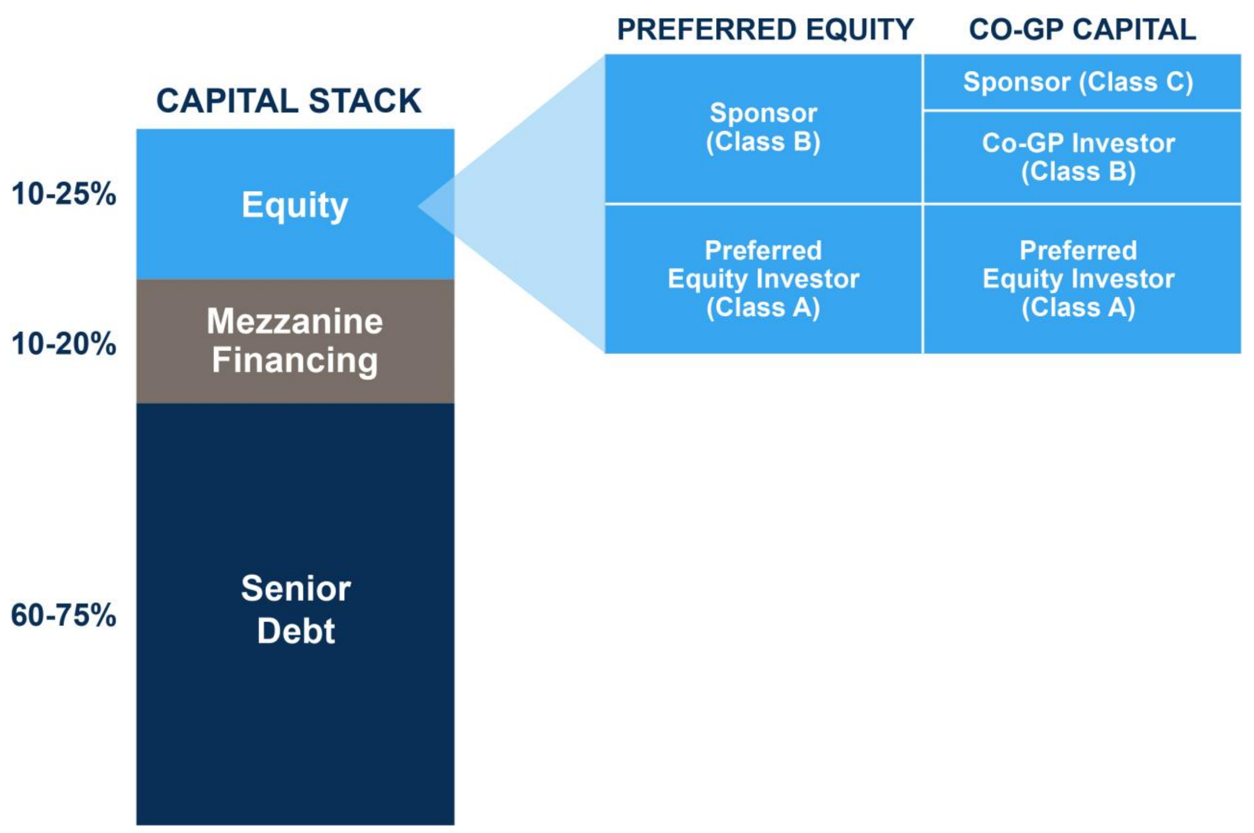
Preferred Equity

Often, senior lenders prohibit the use of subordinate debt – such as mezzanine financing. In such a case, the Sponsor will need to raise preferred equity through the Sponsor's entity. By implementing an A/B waterfall structure, the Sponsor's entity can issue senior Class A preferred to a NetLeaseX Investor and subordinate Class B preferred to the Sponsor.

Co-GP Capital

If a Sponsor needs or would like to maximize project leverage, the Sponsor can raise co-GP capital by having the Sponsor's entity issue one or more additional classes of preferred. In this case, the preferred equity investor would receive the Class A preferred, the co-GP investor would receive Class B preferred, and the Sponsor would receive the first-loss Class C preferred.

Capital Stack Illustration of Different Types of Gap Financing



If a Sponsor has less than 20% of the required equity contribution, in certain situations, NetLeaseX may work with the Sponsor to raise co-GP capital. If a Sponsor raises co-GP capital, a co-GP investor will receive:

- Proportional percentage of the Sponsor's promote.
- Portion of any fees and payments authorized to be paid to the Sponsor.

NetLeaseX Preferred Equity Platform for Hands-on and Experienced Investors

NetLeaseX's hands-on and structured investment approach facilitates higher returns with a lower level of risk than typical alternative commercial real estate investments.

Unlike crowdfunding websites and other sponsors promoting real estate investments, NetLeaseX's platform targets hands-on and experienced real estate investors who are capable of:

- Opportunistically investing in highly structured preferred equity investments,
- Analyzing, underwriting and conducting due diligence on commercial real estate projects (which may include site visits),
- Collaborating on the drafting and documentation of NetLeaseX transactions, and
- Providing input regarding the deal terms and conditions that NetLeaseX has negotiated with the Sponsor.

Instead of investing in a Sponsor's project, as discussed on page 20, a NetLeaseX Investor may:

- Pay the Sponsor to assign all of the Sponsor's predevelopment work to the NetLeaseX Investor, or
- Work with the Sponsor in another capacity or role that may include continued Sponsor collaboration and support, even if the NetLeaseX Investor takes over the project.

Projected Returns on NetLeaseX's Preferred Equity Investments

NetLeaseX targets Sponsors who are unlikely to receive as favorable terms as institutional developers with capital partners. This enables NetLeaseX's Investors to obtain better deal terms than are available from institutional project sponsors, which have access to other capital providers.

Based on the type of transaction (see page 43 for a sample list), projected IRRs can be as high or higher than 30% per annum for a term typically up to 5 years.

NetLeaseX's projected IRRs will be based on the:

- Profitability of the underlying property
- The deal terms that NetLeaseX negotiates with the Sponsors. Such terms may vary, in part, based on the following:
  - Percentage of Sponsor contribution relative to total equity to be raised
  - Sponsor's experience and track record
  - Sponsor's financial net worth
  - Sponsor's cash liquidity
  - Whether NetLeaseX believes a Sponsor has alternative sources of financing

Although projected returns may be lower, NetLeaseX also works with and raises preferred equity financing for institutional project sponsors for cash flowing, stabilized properties (see page 19 for more information).

Class A Preferred with Equity Kicker

At or before closing, the Sponsor and the NetLeaseX Investor will receive common membership interests by nominally capitalizing the LLC to which the property has been transferred. In addition, the Sponsor and the NetLeaseX Investor will receive preferred membership interests for their respective investments in the LLC.

The Investment Process - Forming a Joint Venture:

1. NetLeaseX's Investor and Sponsor each purchase 50% of the common interests in a newly-formed joint venture LLC.
2. NetLeaseX's Investor contributes 80% of the required project equity and receives Class A preferred interest.
3. The Sponsor contributes the remaining 20% of the project equity and receives the first-loss Class B preferred interest.
4. The Sponsor will receive credit for any funds previously invested in the project and any additional cash that, taken together, equates to 20% of the project's total equity.
5. The Sponsor is responsible for providing a personal financial statement and obtaining the senior debt financing and will need to sign any required recourse, indemnities, "bad-boy" carveouts, and/or completion guaranties.
6. Based on a 50/50 split of future profits, the Sponsor effectively receives a 30% promoted interest in the project or property. Alternatively, the Sponsor and NetLeaseX may agree to a multi-tiered waterfall in which the Sponsor earns a higher, stair-stepped percentage of profits when hitting certain project-level internal rates of return.

NetLeaseX Investors can invest in one or more different classes of preferred, including the senior/subordinated co-GP preferred class.

Waterfall Distribution at Sale of Project

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Net proceeds from the operation and sale of the project will be distributed as follows:

1

First,

Pay a **10.0%** cumulative annual return to the NetLeaseX Investor,

2

Second,

Return the NetLeaseX Investor's Class A preferred investment,

3

Third,

Pay a **10.0%** cumulative annual return to the Sponsor,

4

Fourth,

Return Sponsor's Class B preferred investment, and

5

Fifth,

The balance, **50%** to the NetLeaseX Investor and **50%** to the Sponsor, based upon the members' respective ownership of the common interests in the LLC.

Locking-in a Minimum Rate of Return on NetLeaseX's Preferred Equity Investment

When pitching NetLeaseX to raise equity, Sponsors present proformas to support their claims about the potential profitability of their projects.

- As a general practice, NetLeaseX uses the Sponsors' own, sometimes "inflated" IRRs, "against themselves." That is, NetLeaseX negotiates downside protection by requiring the Sponsors to "back-up" their projected IRRs. One way to do this is to ask the Sponsors to provide NetLeaseX Investors with a predetermined minimum profit participation.

- For example, NetLeaseX may require a Sponsor to agree to a minimum profit participation that is based on the Sponsor's projected IRR. If a Sponsor projects a 28% IRR on the NetLeaseX Investor's investment, NetLeaseX sets the minimum profit participation at a slightly lower IRR, which gives the Sponsor a cushion - say, a 22% IRR minimum profit participation.

- If a Sponsor does not have enough confidence to stand behind its projections and accept the minimum profit participation requirement, this may be a "red flag" that suggests that the Sponsor's project should be rejected as an investment or that the project would benefit from restructuring by NetLeaseX.

Many investors may view locking-in a minimum IRR as important (if not more important) as maximizing an investment's IRR.

Strategies for Obtaining Minimum Profit Participation

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Regardless of the minimum IRR to which NetLeaseX and the Sponsor agree, NetLeaseX Investors may use one of the following strategies to obtain a minimum profit participation:

1 Minimum Target Price

The Sponsor agrees to provide the NetLeaseX Investor with a minimum target price (**"MTP"**) for which the Sponsor would sell the underlying property.

- If the Sponsor sells the property for an amount equal to or exceeding the MTP, all distributions to the members will be based on the sales price of the property.
- If the Sponsor sells the property for an amount less than the MTP, all distributions will be based on the higher MTP.

2 "Look-Back" IRR

At the time of the sale of the property, if NetLeaseX's investor earned less than, say, an 18% internal rate of return (the **"Look-Back IRR"),** then the Sponsor will assign and transfer to the NetLeaseX Investor some of the Sponsor's Class B preferred in order to increase the NetLeaseX Investor's IRR to the 18% per annum Look-Back IRR.

3 Fixed Redemption Fee

In lieu of purchasing common interests in the LLC for a nominal consideration, the NetLeaseX Investor may require the Sponsor to issue straight preferred to the NetLeaseX Investor.

In lieu of receiving an equity kicker, the Sponsor will agree to pay the NetLeaseX Investor a fixed redemption fee (in addition to the preferred investment amount) when the LLC redeems the NetLeaseX Investor's Class A preferred.

The redemption fee that is paid to the NetLeaseX Investor will be paid in full before (as a senior preference) before the Sponsor receives any distributions whatsoever.

4 Fixed Return Multiple

Similar to a fixed redemption fee, a fixed return multiple requires the Sponsor to pay the NetLeaseX Investor a fixed return multiple (1.6X for example) based on a three-year investment (or 20% per annum). This structure is advantageous if the NetLeaseX Investor expects that the Sponsor will sell the property prior to the redemption date.

Changes in the IRR Based on the Timing of the Investment Return

Whether the Sponsor agrees to the MTP, Look-Back IRR, fixed redemption fee, or fixed return multiple, the NetLeaseX Investor will be able to calculate, up front, its minimum IRR based on a sale of the property by the Sponsor on the pre-agreed date of redemption of the NetLeaseX Investor's Class A preferred.

1 Preferred Redeemed Prior to Redemption Date

If the Sponsor agreed to an minimum target price (an MTP) or agreed to pay a fixed redemption fee or return multiple on the pre-agreed redemption date, then, the NetLeaseX Investor's IRR will increase if the property is sold before the pre-agreed redemption date.

2 Preferred Redeemed After Redemption Date

- If the Sponsor sells the property after the pre-agreed redemption date, and if the NetLeaseX investor owns common interests in the LLC, then the LLC will pay the NetLeaseX Investor a "guaranteed payment" (as defined in Internal Revenue Code Section 707(c)) equal to 8% per quarter of NetLeaseX's expected profit, based on the MTP.
- If the Sponsor sells the property after the redemption date, and if the NetLeaseX Investor owns straight preferred in the LLC, the LLC will increase the payment of the redemption fee at the same 8% per quarter as with the MTP.
- If the Sponsor fails to sell the property on or before one year after the redemption date, the Sponsor has pre-agreed in the operating agreement to list the property with a nationally-recognized real estate brokerage firm.
- If the Sponsor fails to enter into a purchase and sales agreement on or before 45 days after the Sponsor lists the property as described above, then the listing price will be reduced by at least 5% every 45 days until the Sponsor enters into a purchase and sales agreement.
- If the listing price is reduced to a price at which the Sponsor would receive no distributions, the Sponsor will agree to (a) transfer and assign his interest in the LLC to NetLeaseX's Investor, (b) the managers appointed by the Sponsor will resign, and (c) the NetLeaseX Investor will take control of the LLC and its property.

Restructure Preferred Equity Investment as a Second Lien or Mezzanine Loan

Many NetLeaseX Investors prefer making loans to Sponsors rather than making preferred equity investments.

During initial negotiations, NetLeaseX will work with Sponsors to restructure preferred equity investments as second lien or mezzanine loans (collectively, “Subordinated Loans”).

- A second lien loan secured by a junior mortgage on the Sponsor’s property, or
- A mezzanine loan secured by UCC-1 financing statement on the Sponsors' membership interests in the ownership LLC

Benefits to NetLeaseX's Investor:

- If successful, Sponsors will agree to pay NetLeaseX's projected IRR on the preferred equity investment as a fixed return on the Subordinated Loan
- If the senior lender precludes subordinate financing, the investment can be structured as a mezzanine loan rather than a second lien loan
- If the Sponsor fails to hit proforma numbers and the property is less profitable than expected, NetLeaseX's Investor would still earn the same return on the preferred equity investment as a fixed return on the Subordinated Loan
- Sponsor would bear the cost if the project's profitability falls short of underwritten expectations

This structure allows NetLeaseX Investors to maintain the potential for high returns while mitigating downside risk by shifting underperformance risk to the Sponsor.

Mitigating Risk and Enhancing Returns with Subordinated Loans

NetLeaseX's Investors can enhance their risk-adjusted returns by structuring investments as Subordinated Loans, which offer both downside protection and the potential for yields close to or the same as preferred equity investments

1 Mitigated Risk

- In some cases, Sponsors may pledge their net worth as additional security
- The loan guarantee supplements that collateral package to secure repayment of the Subordinated Loan

2 Increased Profits

- Require a minimum lock-out period before the Sponsor can prepay the Subordinated Loan
- Ensures NetLeaseX Investors earn a baseline profit even if the Sponsor refinances or sells sooner than the anticipated hold period

The combination of the Sponsor's guarantee and the Subordinated Loan collateral creates a robust risk mitigation structure to protect the NetLeaseX Investor's position.

Collateral and Controlled Draws for Subordinated Loans

If NetLeaseX's Investor makes a Subordinated Loan, the Sponsor will provide a comprehensive collateral package, such as:

Comprehensive Collateral Package

- A second mortgage on the Sponsor's project if a second lien loan, or pledge of Sponsor's common membership interest in the ownership LLC if a mezzanine loan
- Pledge of the escrow account holding the undisbursed Subordinated Loan proceeds, and
- Pledge of development rights, predevelopment work, and all other intangible rights.

Controlled Draw Process

- To mitigate funding and completion risk, NetLeaseX's Investor will implement a controlled draw process for the Subordinated Loan proceeds.
- Pledge of Sponsor's common membership interests in the ownership LLC
- Pledge of escrow account holding undisbursed mezzanine loan proceeds
- Pledge of Sponsor's development rights, predevelopment work, and intangible assets

Protecting NetLeaseX Investor's Position with an Intercreditor Agreement

NetLeaseX and its investor will negotiate an intercreditor agreement with the senior lender, seeking to include, in part:

1. Cure rights allowing the NetLeaseX Investor to remedy defaults under the senior loan

2. Option for the NetLeaseX Investor to purchase the senior loan at par if the Sponsor defaults

3. Consent rights for the NetLeaseX Investor on material changes to the senior loan

4. Limitations on senior lender's actions that could impair the NetLeaseX Investor's position

5. Affirmation of UCC foreclosure rights, enabling the NetLeaseX Investor to take control of the Sponsor's project, subject to the senior loan

6. UCC foreclosure provisions: These are crucial for balancing the senior lender's priority with the NetLeaseX Investor's ability to protect its position and recover its investment.

Making Preferred Equity and Loans to Seasoned Owners on Cash Flowing, Stabilized Properties

NetLeaseX helps high net worth and family office investors compete with equity funds and other institutional investors by providing funds to seasoned sponsors on institutional-grade properties.

NetLeaseX has found that many Sponsors prefer to partner with high net worth and family office investors rather than working with equity funds for “plain vanilla” preferred equity and loans, which are priced in a more efficient and competitive market.

Some reasons for this are as follows:

- Sponsors can develop more personal relationships with investors, which facilitates better communication.
- Sponsors believe that investors who invest their own capital make decisions more quickly than equity funds make decisions.
- Many Sponsors value strategic guidance and connections, which many investors can offer and which improves the prospects for success.
- Many Sponsors are seeking to develop programmatic investment relationships with private investment capital.
- Many investors have longer term investment horizons than equity funds.
- Compared to crowdfunding websites, many Sponsors prefer having one capital partner providing financing trying to work with groups of unsophisticated, retail investors whose funds are aggregated together in a crowdfunding equity raise.
- Direct investors can offer more flexible terms, including, for example, reducing the pay rate on the preferred return distribution until the Sponsor increases the property’s NOI to a pre-determined amount.

"Downgrading" the Sponsor to Co-Sponsor and Taking Over the Project

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After conducting its due diligence, if the NetLeaseX Investor does not want to invest passively or if the Sponsor is unable to procure senior debt financing on his own and/or does not have the financial resources to invest a minimally required amount in the project, the NetLeaseX Investor may propose that the Sponsor transfer its interest in the project to the NetLeaseX Investor. In return, the NetLeaseX Investor would:

- Pay the Sponsor a fee to walk away from the project. In consideration for doing so, the Sponsor will assign his rights to all pre-development work, including:
  - The Sponsor's financial projections, analysis and other work,
  - The work product performed by others, including, but not limited to architects, engineers, general contractors and land-use counsel,
  - All entitlements and/or approvals received from governmental authorities, and
  - All third party reports.

- Alternatively, the NetLeaseX Investor may allow the Sponsor to stay involved in the project in a more limited role and to receive (a) a promoted interest, and/or (b) fees for services as a developer or as a co-sponsor.

Mutual Benefits of "Downgrading" the Sponsor to Co-Sponsor and Taking Over the Project

Sponsor

- Sponsor receives a payment for work already performed and/or ongoing fees in a supporting role to the NetLeaseX Investor.
- If Sponsor stays involved in the project, the Sponsor would be able to develop a track-record for a successful and profitable exit.
- Develops a business relationship with the NetLeaseX Investor.

NetLeaseX Investor

- Source profitable opportunities in projects where a Sponsor has performed most or all of the initial work.
- Further mitigate risks by taking over a project rather than passively investing with an untested Sponsor who is unable to procure senior debt financing and/or is unable to make a minimally required financial investment in the project.

What Can Preferred Equity Be Used For?

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Sponsors can use preferred equity in a myriad of ways, including coupling it with senior debt financing.

For example, preferred equity may be used to:

- Fund the ground-up development of real estate projects
- Acquire profitable real estate investments
- Acquire land, pay for entitlements and other pre-development expenses
- Fund an interest reserve with the Sponsor's senior lender
- Cover the shortfall on senior loan due to failure of a rebalancing test [1]
- Renew any expiring interest rate cap agreements
- Fund any shortfall in loan proceeds when refinancing senior loan
- Pay any required capital improvements and/or needed renovations
- Fund a reserve to pay for any future tenant buildouts and/or leasing commissions
- Acquire nonperforming and sub-performing senior and mezzanine debt at a discount
- Cover unfunded capital calls from limited partners

Higher Yielding Returns in Opportunistic Investments

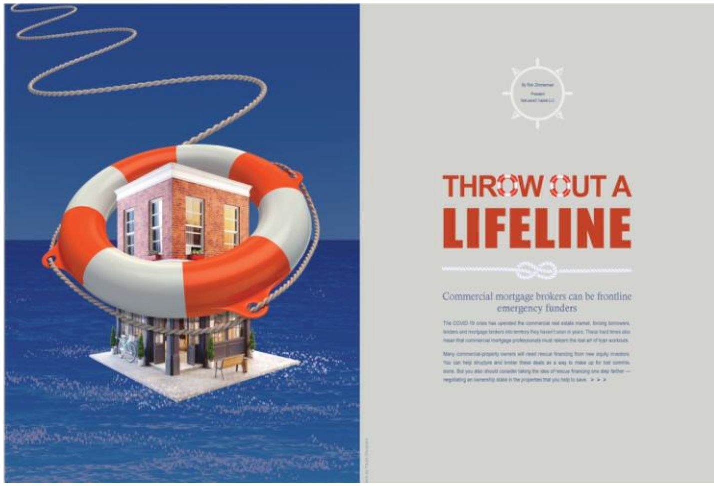
- Monetize a Sponsor's equity without giving up control of the property
- Buy out existing limited partners
- Raise capital without paying pre-payment penalties or defeasance costs

Lower Yielding Returns in Stabilized Properties

1. A rebalancing test reviews the extent to which the property's net operating income (NOI) covers the debt service. If it does not cover the debt service by an amount that is satisfactory to the lender (i.e., the debt service coverage ratio is too low), then the borrower may be required to pay down principal on the senior loan.

Providing Rescue Financing to Facilitate Loan Workouts

As highlighted in Ron Zimmerman's second feature article and follow-on article in the *Scotsman Guide* and an article on FamCap.com (for which links are provided to the right and on the next page), preferred equity can also be used to provide rescue financing to facilitate loan workouts.



"Throw Out a Lifeline"
Scotsman Guide Commercial Edition
July 2020

Rescue financing works like bridge equity, a temporary infusion of cash up to three years. This is typically enough time for properties that haven't become permanently impaired to return (or close to) their historically higher values.

Generally, rescue financing can be used to fill an "equity gap" in a property's capital structure due to the current market conditions where:

- Refinancing is not possible
- A loan is approaching maturity, and/or
- Current market value of the property makes a sale unattractive

"Ride to the Rescue"
Scotsman Guide Commercial Edition
August 2020

Providing Rescue Financing to Facilitate Loan Workouts (continued)

Proceeds from rescue financing can be used to:

- Cover additional interest expense to the senior and/or mezzanine lender due to increase in interest rates,
- Cover any operating deficits,
- Gain leverage to facilitate favorable loan workouts with CMBS and other types of lenders to reduce interest rates, extend maturity dates, and/or release or otherwise reduce personal loan guaranties,
- Fund an interest reserve for the senior loan,
- Pay down a portion of the senior loan,
- Fund major capital expenditures and/or renovations, and/or
- Fund tenant buildouts, and/or pay leasing commissions.

"NetLeaseX Capital Offers Family Offices Direct Access to Rescue Financing Investments in Real Estate"
Famcap.com
October 2023

Famcap.com is a leading industry website for high net worth and family office investors.

Identifying Distressed Properties in CoStar's Database

NetLeaseX uses data collected by CoStar Group, Inc. to identify properties in distress for any reason, including, for example, an upcoming maturity on senior loans secured by the properties. NetLeaseX does this by searching for properties with high vacancy rates and/or secured by CMBS loans that:

(a) have been placed on watchlist,

(b) are currently delinquent,

(c) and/or have been transferred to special servicing for, among other reasons, the following:

- The property has experienced a precipitous drop in annual net operating income for any reason
- Imminent or actual maturity default
- Requirement for a large unfunded capital expenditure
- Loss of one or more major tenants
- Borrower bankruptcy
- Death of a loan guarantor

Obtaining CoStar's Data about Properties Identified by NetLeaseX Investors

If you, as a potential NetLeaseX Investor, would like to find a particular property and/or is interested in providing rescue financing for distressed properties, please let us know by:

- Clicking on the Investor Portal button at the top of NetLeaseX's website
- Filling in a detailed intake form which will ask you to input your investment criteria

NetLeaseX provides potential NetLeaseX Investors with CoStar information regarding particular properties. Please call 513-621-1031 or send an email to ronz@NetLeaseX.com with your property addresses. NetLeaseX will email you CoStar's Full Underwriting Report and/or other CoStar-generated reports. CoStar's Full Underwriting Reports typically run between 100 to 140 pages and include, among other details, the following information:

- Details about the property
- Rent comps
- Construction summary in the property's submarket
- Sale comps
- Demographics
- Market report
- Submarket report
- Title data, including borrower entity, sponsor's name and address

If a property has a CMBS loan, the following additional information is available:

- Detailed loan information
- Special servicer commentary
- Historical financial information on the property

Infusing New Capital into Distressed Properties Overleveraged by Existing Financing

By providing rescue financing, NetLeaseX's investors can make profitable investments and provide owners with an alternative to selling at today's depressed prices.

By capitalizing on market conditions and an owner's distress, NetLeaseX's investors can pull multiple levers, including:

- "Squeeze-down" or dilute ownership interests of existing investors
- Force preferred equity investors to convert their ownership interests into common interests
- Obtain ownership interests or equity kickers based on temporarily depressed values
- Obtain a put or call option, drag-along, tag-along, right of first refusal and/or right of first offer rights from existing investors
- Obtain superseding voting and/or control rights from existing investors
- Obtain the right to determine certain elections regarding tax allocations, including, for example, depreciation, tax credits and "phantom income"

"Push down" existing investors in the waterfall priority order of repayment or, in the extreme, relegate existing investors to the bottom of the capital stack in the form of a "hope certificate" where existing investors earn a return of all or part of their investments and/or earn a profit only when:

- The NetLeaseX Investor earns a fixed redemption fee or fixed return multiple, or
- The property sells for a predetermined minimum amount

Infusing New Capital into Distressed Properties Overleveraged by Existing Financing (continued)

By willing to infuse new capital on behalf of a borrower, CMBS and other types of lenders are more likely to be open to a loan workout or restructuring. The problem is that many properties are presently overleveraged based on their current reduced financial performance.

In return for providing 80 to 90% of the new funds, with the Sponsor investing the balance, the NetLeaseX Investor will be able to lock-in a minimum return investment with the possibility of earning a much higher IRR if the value of the underlying property reverts to its pre-pandemic or historically higher value.

"Last Money In, First Money Out"

With the maxim of "last money in, first money out", rescue investors typically expect to be paid back first before the Sponsors, and their limited partner investors receive their investment back, along with agreed-upon project profits. NetLeaseX believes that this maxim should extend to the Sponsor's senior lender as well.

Accordingly, to mitigate downside risk, NetLeaseX requires Sponsors to allow NetLeaseX Investors and their counsel to talk to the Sponsor's senior and/or mezzanine lender(s) about how NetLeaseX proposes to structure the NetLeaseX Investor's proposed investment.

Require the Senior Lender to Subordinate its Loan to the Rescue Financing

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By infusing additional capital into a Sponsor’s property, a rescue investor, in conjunction with the Sponsor, can often negotiate concessions from the Sponsor’s senior lender as described below and on the following five pages:

- The NetLeaseX Investor offers a loan with soft terms, such as a single-payment loan at 3% interest due in three years.
- The senior lender will agree to subordinate its loan to NetLeaseX Investor’s loan which would; therefore, be secured by a first mortgage or deed of trust on the Sponsor’s property.
- The LLC makes a guaranteed payment (as defined in Internal Revenue Section 707(c)), as a priority distribution to make up for the below-market rate on the NetLeaseX Investor’s loan.

The NetLeaseX Investor receives the same right to purchase common interests in the LLC for a nominal amount as NetLeaseX’s investor were to make a preferred equity investment.

This strategy is analogous to a lender providing debtor in possession financing to a company in bankruptcy where the DIP lender steps ahead and receives a first priority lien on the bankrupt borrower’s assets.

A senior lender may consider subordinating its lien if they believe that the Sponsor’s property is expected to increase in value by an amount exceeding the amount of the senior lender’s subordinated loan.

Provide Funds That Are on Equal Footing, or Pari Passu, with the Senior Mortgage

NetLeaseX CAPITAL

- The NetLeaseX Investor enters into an intercreditor agreement that provides the additional funding and contains equal-priority position on the title and other provisions.

- In the event of nonpayment and subsequent foreclosure, the rescue investor and senior lender would bear any losses in proportion to the funds they advanced under their shared first mortgage.

The NetLeaseX Investor receives the same right to purchase common interests in the LLC for a nominal amount as NetLeaseX's investor were to make a preferred equity investment.

By accepting this structure, a senior lender benefits by effectively extending credit to the Sponsor under the senior lender's first mortgage without the senior lender having to advance any additional funds.

Bifurcate the Senior Loan into A and B Notes

- The senior lender agrees to allocate a portion of the principal balance under the senior loan to an A note.
- The A note would continue to be secured by a first mortgage or deed of trust on the property.
- The senior lender and the NetLeaseX Investor agree to modify the terms of the A note by, for example, reducing the interest rate, extending the maturity date, and/or releasing the borrower from all or a portion of the loan guaranty.
- A portion of the senior lender's loan balance would be allocated to a B note. Often referred to as a "hope note" or "hope certificate," the B note would be pushed down to a lower-priority position in the property's capital stack. The repayment terms would be especially soft. For example, the senior lender may receive 50% of any net sale proceeds over X dollars in sales proceeds, which amount would be applied to the lender's B note. After receipt of any sale proceeds, the senior lender would write-off the balance of the B note.

The NetLeaseX Investor receives the same right to purchase common interests in the LLC for a nominal amount as if NetLeaseX's investor were to make a preferred equity investment.

Requiring the Senior Lender to Reduce the Loan Pay Rate to Facilitate Rescue Financing

If the senior lender objects to bifurcate and subordinate a portion of its senior loan into a newly created B note (see page 31 for an expanded explanation), an alternative strategy would be for the senior lender to agree to reduce the pay rate on the senior loan between 0 to 5% per annum or set the monthly payment based on a pre-agreed percentage of the property's monthly NOI.

- In this structure, only the unpaid interest on the senior loan would accrue as a B note and would be pushed down to a lower-priority position in the property's capital stack.

- Interest on the B note would accrue and be paid after the NetLeaseX Investor first receives back its initial investment and profit, whether a redemption fee or return multiple.

Benefits of the Senior Lender Reducing Pay Rate to Rescue Financing

Below are a sampling of the benefits

NetLeaseX Investor:

- Earn 14-18% per annum return (or higher) on a fixed income investment
- Hedge downside risk by "pushing down" existing investors in the property's capital stack
- Invest in the underlying property which would be subject to the senior loan with no recourse nor financial disclosure. The existing loan guarantors would stay in place.
- If a senior lender agrees to reduce the pay rate to 5% per annum, for example, on the senior loan, then, since payment of interest on the senior loan in excess of the pay rate is subordinated to payment of the family office investor's investment, its effective cost of capital is equal to the 5% pay rate.
- Instead of reducing the pay rate, the senior lender could agree to set the monthly payment based on an agreed upon percentage of the property's monthly NOI.

Senior Lender:

- Proceeds of rescue capital would be used to be increase the property's current NOI; thereby, increasing the value of the senior lender's capital without the senior lender having to advance any additional funds.
- Senior lender can facilitate a favorable outcome without having to foreclose, accept a short-sale, sell senior loan at a discount or subordinating a portion of the senior loan to the NetLeaseX Investor's rescue financing.

Benefits of the Senior Lender Reducing Pay Rate to Rescue Financing (continued)

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Below are a sampling of the benefits (continued):

Property Owners/Sponsors:

- With the rescue financing being raised is typically less than 10% of the balance on the senior loan, the property owner's overall weighted cost of capital on the senior loan should not significantly increase.

- If the senior lender agrees to an interest rate reduction on its senior loan, the property owner's weighted average cost of capital would increase even less or not at all relative to the senior lender's current interest rate.

- The Sponsor and their limited partner investors are able to receive some or all of their original investment back, plus some return, instead of being "washed out" in a foreclosure or short sale.

- NetLeaseX may be able to negotiate terms important to the Sponsor(s), including, for example, release or reduction of any loan and/or non-recourse carve-outs guaranties and/or delay or drop any senior lender rebalancing test.

Requiring the Senior Lender to Recognize the NetLeaseX Investor's Class A Preferred

As part of any rescue financing, the NetLeaseX Investor will likely enter into a Recognition Agreement with the Sponsor's senior lender.

Similar to an intercreditor agreement between a senior lender and mezzanine lender, preferred equity investors will typically want to enter into a recognition agreement with the senior lender to include, in part, the following rights:

- Right to force a sale of the underlying property at a price and upon terms and conditions as the NetLeaseX Investor may determine.
- Right to remove the Sponsor and take over the control and decision-making authority for the LLC.
- Right to receive notices of default from the senior lender and have an opportunity to cure defaults under the senior loan.
- Right to cause the LLC to terminate the management agreement and any affiliate agreements of the Sponsor, and to replace the property manager and other providers with third parties acceptable to the NetLeaseX Investor.
- Right to foreclose on a lien in favor of the NetLeaseX Investor to take over ownership of the Sponsor's interest in the LLC that owns the project.

Making Stretch Loans to Earn Equity Returns While Mitigating Downside Risk

NetLeaseX CAPITAL

As highlighted in Ron Zimmerman's second feature article on FamCap.com (for which a link is provided below), stretch loans offer NetLeaseX Investors a powerful tool to deploy more capital per transaction and earn higher returns compared to traditional real estate investments with similar risk profiles.

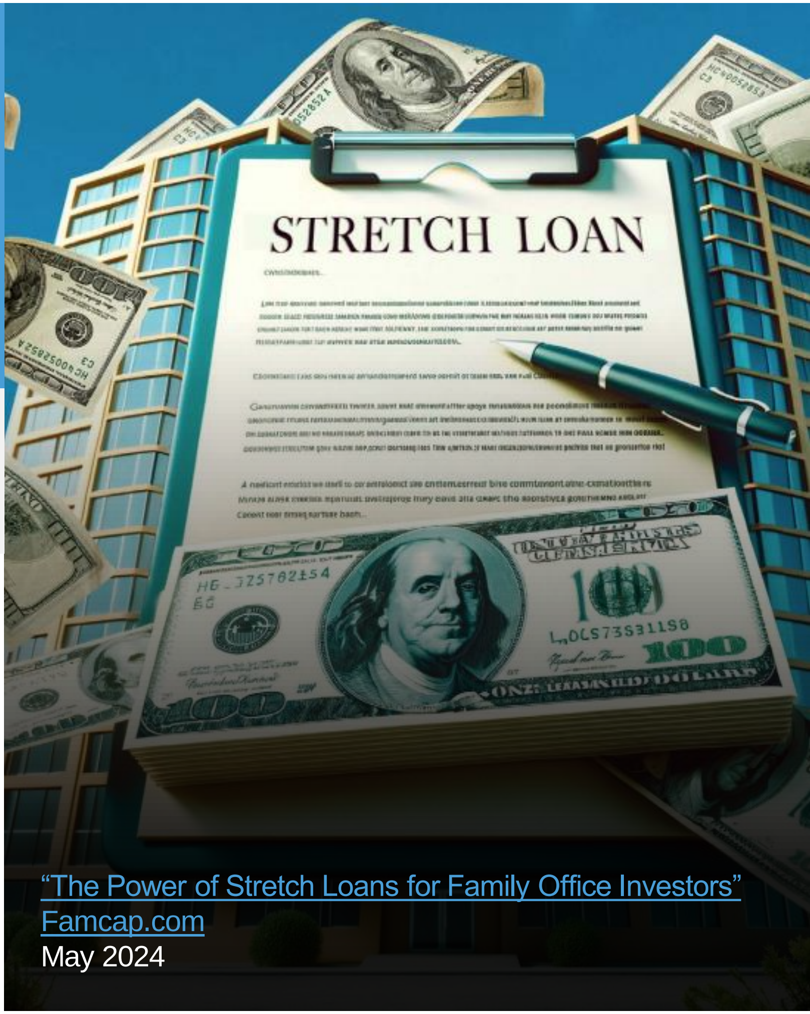
Stretch loans are high leverage loans that combine a senior loan and a preferred equity investment, providing flexibility and enhanced returns for NetLeaseX Investors.

- **Senior stretch loans are secured by first on real estate projects owned by Sponsors**

  NetLeaseX Investors can earn 14-16% or higher return at a loan-to-cost ratio of up to 93%

- **Junior stretch loans are secured by second mortgages on real estate projects owned by Sponsors or UCC-1 financing statements on Sponsors' membership interests in LLCs**

  NetLeaseX Investors can earn 25% or higher return at a combined loan-to-cost ratio of up to 93%



["The Power of Stretch Loans for Family Office Investors"](#)
[Famcap.com](#)
May 2024

When to Consider a Stretch Loan

NetLeaseX CAPITAL

NetLeaseX Investors should consider stretch loans when Sponsors face high costs of capital from non-bank lenders, such as:

- Acquiring transitional properties with insufficient rental revenues to cover required debt coverage ratios
- Sponsors unable or unwilling to sign recourse on conventional bank loans
- Funding project completion midway through construction

Stretch loans can also be an effective tool for rescue financing (see slides 28 to 40 for details), providing Sponsors with the necessary capital to overcome challenges and maximize the value of their properties.

In today's market, Sponsors and their limited partners may face unexpected challenges that can put their investments at risk, such as:

- Market downturns
- Increases in interest rates or construction costs
- Project delays or unforeseen expenses

> **In these situations, stretch loans can offer the flexibility, speed, and alignment of interests needed to help Sponsors navigate these challenges successfully.**

Investor Profile for Stretch Loans

NetLeaseX CAPITAL

While stretch loans may have loan-to-cost ratios up to 93%, the loan-to-value ratio after rehab or renovation is typically less than 75%.

This attractive risk-reward profile appeals to NetLeaseX Investors seeking higher returns with mitigated downside risk.

NetLeaseX Investors extend stretch loans for several key reasons:

- Desire to deploy larger amounts of capital per transaction compared to traditional equity investments
- Earning higher returns than conventional senior loans while maintaining a higher position in the capital stack
- Leveraging sophisticated real estate investing experience to partner with well-qualified and experienced Sponsors who manage day-to-day operations and oversee redevelopment or repositioning
- Securing predictable returns for NetLeaseX Investors through structured financing terms that reduce reliance on Sponsor performance in achieving proforma projections
- Maximizing control over the investment through senior positions and structured terms, and
- Ability to ride on the coattails of the Sponsor's profitable investments

NetLeaseX Investors seek to be paid on a gross rather than a net basis, avoiding the impact of:

Extraneous Sponsor fees such as development, asset management, acquisition, and construction management fees, and

Sponsor's promoted interest, which would reduce NetLeaseX Investors' returns

NetLeaseX Investor Benefits from Granting Stretch Loans

NetLeaseX CAPITAL

A stretch loan works like bridge equity in today's capital markets where Sponsors have been unable to raise relatively low-cost bank financing.

Invest higher in the capital stack for:

- Transitional properties requiring capital expenditures, renovation costs, and/or to fund unit turns without sufficient in-place rental revenues to cover debt service
- Development projects with significant Sponsor investment in time obtaining entitlements and have invested significant funds to pay for predevelopment expenses

For predevelopment project financing, NetLeaseX Investors can:

- Earn interest on the stretch loan instead of paying out predevelopment fees and costs like Sponsors
- Shift predevelopment risk to Sponsors, including the period before lease signing or marketing the project for sale

Taking a longer-term view than restrictive debt funds requiring minimum distributions to limited partners

Mitigating investment risk through Sponsors' capital contributions.

NetLeaseX Investor Benefits from Granting Stretch Loans (continued)

NetLeaseX CAPITAL

Increasing Returns when making a Stretch Loan

NetLeaseX Investors can earn 14-16% or higher fixed income returns with first lien positions on stretch loans at loan-to-cost ratios up to 93%, typically resulting in loan-to-value rates less than 75% after renovation or rehab

- Increase returns through internal leverage by selling a senior position in the stretch loan or hypothecating the stretch loan for additional borrowing
- Interest earned on stretch loans can be excluded from calculating Sponsor's capital contribution

Structuring Stretch Loans to Mitigate Risk

Stretch loans can be structured to mitigate NetLeaseX Investors' downside risk:

Require Sponsors to pledge additional collateral, such as:

- Mortgages or deeds of trust on Sponsors' personal residences, other real estate and/or other Sponsor-owned assets, and
- UCC-1 financing statements on:
  - All personal property, entitlements, permits, contracts, and architectural and engineering plans owned by the development LLCs, and
  - Members' membership interests in the development LLCs

Insist on full recourse to Sponsors

Require Sponsors to fund interest reserves out of pocket, not from stretch loan proceeds

Sponsor Benefits in Obtaining a Stretch Loan

Sponsor Benefits in Obtaining a Stretch Loan

High leverage without equity dilution

Stretch loans allow Sponsors to obtain high-leverage financing without diluting their equity stakes in their projects, enabling them to maintain a larger share of the potential upside while minimizing their initial capital contribution.

Lower pay rate relative to non-bank funded loans

To help Sponsors reduce carrying costs during the predevelopment or transitional phase, NetLeaseX Investors can reduce the "pay rate" on their stretch loans to 4% to 6% per annum, with the unpaid interest accruing and payable when the Sponsors pay back the stretch loan.

Faster and higher certainty to close relative to a preferred equity investment

Stretch loans can be executed more quickly than traditional preferred equity investments, providing Sponsors with faster access to capital and greater certainty of closing.

Interest paid on a stretch loan is tax deductible

Unlike preferred equity investments, the interest paid on a stretch loan is tax-deductible for the Sponsor, providing an additional financial benefit.

Stretch Loans as a Rescue Financing Solution

Increasing Returns when making a Stretch Loan

In today's market, unexpected challenges can put Sponsors' investments at risk. Market downturns, interest rate increases, construction cost overruns, delays, or unforeseen expenses create pressing needs for additional capital to:

- Cover increased interest expenses due to rising market rates
- Fund operating deficits
- Pay down a portion of senior loans
- Gain leverage for favorable loan workouts to reduce rates, extend maturities, or release/reduce guarantees, and
- Fund interest reserves, capital expenditures, renovations, tenant buildouts, or leasing commissions

Stretch loans provide Sponsors with the lifeline needed to navigate challenges and maximize property values.

As rescue loans, stretch loans are typically structured as second mortgages or mezzanine loans, with NetLeaseX Investors obtaining concessions from senior lenders to allow the rescue financing.

Comparing the Capital Stack Structures:

Conventional Preferred Equity and Senior Debt vs. Stretch Loan

NetLeaseX CAPITAL

The illustrations below demonstrate that Sponsors are projected to achieve a 45% IRR in both capital stack structures.

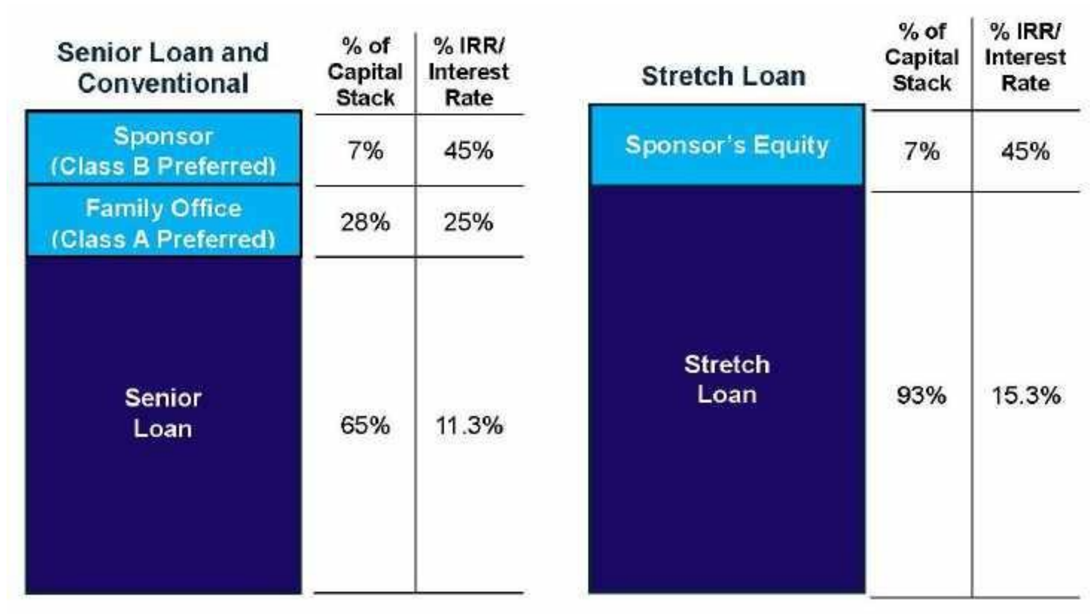
NetLeaseX Investors' 15.3% return on the stretch loan equals the weighted average return on:

11.3%

The interest rate on the senior loan portion, and

25%

The 25% IRR on the embedded Class A preferred.



If the Sponsor underperforms and fails to meet projected returns, the stretch loan structure ensures NetLeaseX Investors still earn the same 25% IRR on the embedded Class A preferred, ultimately shifting the underperformance risk to the Sponsor.

Structuring the NetLeaseX Investor's Return

NetLeaseX CAPITAL

NetLeaseX Investors' profit participation can be structured as follows:

Set Accrued Interest to Provide NetLeaseX Investors with a Projected 50% of Project Profits

- The interest pay rate is set based on the property's affordability or NetLeaseX Investors' demands. The accrued interest is calculated so the combined pay and accrued interest approximates what the Sponsor would pay if borrowing from a traditional lender and accepting NetLeaseX Investors' preferred equity.
- NetLeaseX Investors can "lock in" their projected returns, regardless of the Sponsor's ability to meet proforma projections.

Purchase 50% of Common Interest in the Ownership LLC for a Nominal Amount

- As discussed in Ron Zimmerman's article, "Strategize with Preferred Equity", published in the Scotsman Guide, the NetLeaseX Investor and Sponsor could agree to capitalize the common membership interest in the ownership LLC at a nominal amount, such as $100.
- As part of the arrangement, family office investors could purchase 50% of the common interests in the LLC for just $50, simultaneously with providing 80% of the required equity in exchange for a Class A preferred interest.
- This strategy allows the NetLeaseX Investor to gain a 50% ownership stake in the Sponsor's property for a minimal equity investment, while still providing the Sponsor with the necessary capital in the form of Class A preferred interest to move forward with the Sponsor's project.

Making Debt-Free Preferred Equity Investments to Sponsors' Self-Directed Retirement Plans

NetLeaseX CAPITAL

Many real estate investors self-manage their retirement assets.

By using self-directed IRAs, investors are able to invest in real estate.

The problem, however, is that the retirement account's profits from properties that have debt financing are taxable.

For example, if an investor borrows 80% of a property's purchase price, 80% of the profit would be taxable in the retirement account. This tax is called Unrelated Debt-Financed Income **("UDFI")** tax.

Benefits of "leveraging" with preferred equity instead of debt.

- NetLeaseX's Investors can provide debt-free financing to Sponsors seeking to maximize their after-tax profit.
- Since the Sponsor purchased the property without debt financing, 100% of the Sponsor's profit will be tax-free and not subject to UDFI.
- On highly profitable transactions, Sponsors can justify "sharing the wealth" with NetLeaseX Investors since the Sponsor's tax savings would exceed the NetLeaseX Investor's marginal increase in profit. Accordingly, NetLeaseX Investors can make debt-free preferred equity investments and earn higher returns than are available from making first mortgage loans to Sponsors with the same risk profile.

Why Work with NetLeaseX?

NetLeaseX CAPITAL

NetLeaseX works as a gatekeeper, is cognizant of and won't waste your time, especially if NetLeaseX knows your detailed investment criteria.

Before we contact NetLeaseX Investors regarding any prospective investment, NetLeaseX has already analyzed and screened out unattractive sponsor proposals and performed many of the important tasks that are essential to considering proposed sponsor financings. These include:

- Working with Sponsors to better understand their financing objectives,
- Working with the Sponsors to put together a proforma,
- Calculating the capital raise based on a detailed Sources and Uses of Funds that NetLeaseX prepares with input from the Sponsor,
- Collecting and reviewing due diligence and working with the Sponsor to obtain any additional due diligence not initially provided,
- Negotiating with and obtaining a "meeting of the minds" of the terms of NetLeaseX's proposed financing,
- Drafting a detailed term sheet,
- Drafting an Agreement with the Sponsor (if the Sponsor signs NetLeaseX's term sheet),
- Collecting, reviewing, indexing and posting all due diligence, including third party reports, to NetLeaseX's web portal (as well as any additional documents requested by the NetLeaseX Investor),
- After closing, depositing into escrow with a title company designated by the NetLeaseX Investor any unused proceeds from the NetLeaseX Investor's preferred equity investment, and
- Submitting requests to the escrow agent, as directed by the NetLeaseX Investor, to release funds to pay for authorized fees, costs, and expenses as listed on the Sources and Uses of Funds.

Benefits to Sponsors of Raising Investment Capital from NetLeaseX Investors

Non-institutional sponsors benefit by working with NetLeaseX Investors as follows:

- By raising investment capital and developing a track record with NetLeaseX Investors, Sponsors enhance their ability to raise additional capital on subsequent transactions with NetLeaseX Investors and/or other investors, potentially with more attractive terms for them.
- Sponsors can view NetLeaseX Investors as experienced strategic investors that may provide ongoing advice to Sponsors and make introductions that help the Sponsors in future transactions,
- Sponsors have opportunities to develop relationships with “below the radar” high net worth investors, family offices, equity funds and other equity investors that the Sponsors would not have been able to reach on their own,
- Sponsors will be tested by Sam Zell’s “rope theory” (as shown below).
  - If the Sponsor performs (e.g., Zell’s lasso), then, on subsequent capital raises, the Sponsor will be able to use his portion of project profits and track record to attract capital on more attractive terms.
  - If the Sponsor fails to perform (e.g., in Zell parlance, makes a noose and hangs himself), the Sponsor will face a dilutive financial restructuring, incur heavy financial penalties, forced to sell the project at a below market price, and/or lose his project to the NetLeaseX Investor.

> **“I believe very strongly in the rope theory, which is that you find the best guy you can, and you give him the rope, and either he makes it into a lasso or hangs himself. And you combine the rope theory with the (deleted)-in-the-wringer theory, and you end up with one plus one equals three.”**
>
> Sam Zell quoted in “Zell’s Zealous ZigZag to the Top”, J. Linn Allen, *Chicago Tribune*, March 28, 1993

NetLeaseX's Project Types of Interest

NetLeaseX CAPITAL

Highest to Lowest Expected Returns

Purchasing and entitling land for sale to Sponsor or third party	Horizontal development of multifamily and housing projects	Ground-up development of multifamily and self-storage facilities	Help Sponsor monetize equity in Sponsor's and/or limited partner's interests in a stabilized, cash-flowing asset	Senior debt-free preferred equity financing to Sponsors seeking to avoid UBTI tax in self-directed retirement plan investments

Notes:

1. As discussed on page 17, NetLeaseX will work to lock-in the NetLeaseX Investor's profit by negotiating a "Minimum Target Price", fixed redemption fee or fixed return multiple for the top three project types listed above and other compelling investment opportunities.
2. If NetLeaseX is working to help a Sponsor monetize equity in a cash-flowing property or raising funds for an institutional-quality sponsor, NetLeaseX will sign a fee agreement with the Sponsor and raise the funds at market rates.

Design Features of NetLeaseX's Proposed Structured Financings

NetLeaseX CAPITAL

NetLeaseX will negotiate and memorialize all or most of the provisions described below into Agreements with the Sponsors seeking financing from NetLeaseX Investors.

If you have an interest in funding a particular transaction but would like to add additional provisions and/or restructure the preferred, you are free to do so. Upon receipt of your terms and conditions, NetLeaseX will present your proposal to the Sponsor for their review and consideration.

Selected Summary Operating Agreement Provisions.

Waterfall Priority Order. The preferred interests will be structured on a senior/subordinated or A/B structure where the NetLeaseX Investor will receive his/her preferred returns and investment in full before the Sponsor receives theirs.

LLC Management. The LLC will have three managers of which two managers will be appointed by the Sponsor and one manager will be appointed by the NetLeaseX Investor. All major decisions listed in the operating agreement will require unanimous consent of the managers.

No Capital Calls to the NetLeaseX Investor. If there is any capital shortfall, the Sponsor will be responsible to advancing such funds to cover it. If the Sponsor fails to cover any such capital shortfall, NetLeaseX's Investor will have the right to (a) replace the two managers appointed by the Sponsor and (b) purchase the Sponsor's interest in the LLC for $10. Alternatively, NetLeaseX's investor could require that the Sponsor agree to pledge its interest in the LLC to NetLeaseX's Investor. In the event the Sponsor fails to advance any capital shortfall to the LLC, NetLeaseX's Investor would be able to seize the Sponsor's interest in the LLC and take over or sell the project.

NetLeaseX negotiates the terms and conditions of the structured financing with the Sponsor to the benefit of NetLeaseX Investors.

Design Features of NetLeaseX's Proposed Structured Financings (continued)

No Financial Disclosure or Recourse for the NetLeaseX Investor to the Senior Lender. The Sponsor will be solely responsible for obtaining the senior loan without any financial assistance or support from the NetLeaseX Investor. If the senior lender is unwilling to proceed on this basis, the Sponsor will need to:

- Find another senior lender,
- Obtain a third-party loan guaranty, or
- Open discussions with NetLeaseX Investor to discuss a mutually beneficial solution.

Sponsor's Investment Drawn Down First. 100% of the Sponsor's investment will be drawn down first, before any funds will be used from the proceeds of the NetLeaseX Investor's Class A preferred investment.

Specified Uses of Funds. Working in collaboration with the Sponsor, NetLeaseX will prepare a detailed Sources and Uses of Funds and attach it to the Term Sheet and the Agreement with the Sponsor. The Sponsor's use of the NetLeaseX Investor's Class A preferred investment funds will be limited the uses listed on the Sources and Uses of Funds.

Escrow Net Proceeds from the NetLeaseX Investor Class A Preferred. At closing, 100% of the NetLeaseX Investor's preferred equity investment that is not used at closing will be deposited into escrow at a nationally-recognized title company designated by the NetLeaseX Investor. After closing, the Sponsor will submit an email to NetLeaseX and the NetLeaseX Investor requesting that the escrow agent release funds to pay for authorized fees, costs and expenses as listed on the Sources and Uses of Funds.

Design Features of NetLeaseX's Proposed Structured Financings (continued)

Failure to Redeem the NetLeaseX Investor's Class A Preferred on or Before the Redemption Date. If the Sponsor fails to sell the property on or before the redemption date, the Sponsor would agree to:

- Make a priority distribution in the form of a "guaranteed payment" (as defined in Internal Revenue Code 707(c)) for an amount equal to 8% per quarter of NetLeaseX's investor's investment for a period of one year,
- If the Sponsor fails to sell the property before one year after the redemption date of the NetLeaseX Investor's Class A preferred investment, the Sponsor will list the property with a nationally-recognized real estate sales firm. If the property fails to sell for such amount, the Sponsor will agree to reduce the sales price by say 5% every 45 days until the property sells. After any such reductions, if the listing price is lowered to a price where the Sponsor would not receive any distributions, the Sponsor will agree to transfer and assign its interest in the LLC to the NetLeaseX Investor, the two managers appointed by the Sponsor would resign and the NetLeaseX Investor will take control of the LLC and its property.

Restructure Preferred Equity as a Pari Passu Loan Participation with Senior Lender or Mezzanine Loan. In a rescue financing situation, NetLeaseX will include a provision in the term sheet and the Agreement with the Sponsor under which the NetLeaseX Investor can restructure the proposed transaction by negotiating with the Sponsor's senior lender that as a precondition to provide new capital, the NetLeaseX Investor's funding will need to be higher in the capital stack as a way to mitigate risk (see pages 29 to 31 for an expanded explanation).

NetLeaseX's Interest in Partnering with Experienced and Sophisticated Real Estate Investors

NetLeaseX is open to and encourages its investors to offer alternative financing structures and strategies and/or to suggest additional terms and conditions in NetLeaseX's proposed financings. This is especially true when providing rescue financing as part of a loan workout and dealing with obstinate CBMS lenders and their special servicers.

NetLeaseX welcomes its investors and their counsel to take the lead in negotiating with the Sponsor, the Sponsor's counsel and in the case of a loan workout, with the Sponsor's lender, special servicer and/or their counsel.

NetLeaseX Investor Portal

If you would like to see available NetLeaseX preferred, co-GP and/or other type of structured investments to review, you can click on the Investor Portal button at the top of NetLeaseX's website. After you do so, you will be asked to fill out a detailed intake form asking you about investment criteria, including, for example the following:

- Which of the following types of investment you're interested in
  - Preferred equity investment
  - Co-GP investment
  - Mezzanine loan
  - Rescue financing
  - Senior debt-free preferred equity investment to sponsors' self-directed retirement plans
  - Taking over projects from Sponsors
- Minimum and maximum investment amount
- Minimum IRR
- Property type(s)
- Property location(s)

You will also be asked whether or not you'd like to be notified of all newly posted investments or just those which match your investment criteria.

After you complete your intake form, you will be able to see all investments posted to NetLeaseX's website, including:

- NetLeaseX investment memorandum
- Proforma
- Detailed sources and uses of funds
- All due diligence

If you are interested in learning more about a particular investment, you can send an email through the investor portal to NetLeaseX or give us a call at 513-621-1031. We'll be able to discuss the investment further, you can request any additional due diligence and/or NetLeaseX will set up a conference call so that you can talk to the Sponsor directly.

Key Takeaways

NetLeaseX CAPITAL

- Preferred equity is higher in the capital stack than common equity and therefore a less risky investment.

- By receiving an equity kicker, projected returns on NetLeaseX's preferred equity investments can be similar to profitable common equity investments but with less risk.

Benefits to working with NetLeaseX:

NetLeaseX "Minimum Target Price", "Look-Back" yield, fixed redemption fee or fixed return multiple locks-in NetLeaseX's investor minimum rate of return.

No obligation, free look to review prescreened, structured preferred equity investments.

Ability to tweak NetLeaseX's Agreement or restructure NetLeaseX's proposed investment to your liking.

NetLeaseX's Fees and Costs

NetLeaseX will be compensated by one or more of the following ways:

- NetLeaseX will receive a "guaranteed payment" (as defined in Internal Revenue Code Section 707(c)) and a promoted or carried interest, which will be negotiated on a case by case basis based on the particular parameters of each property and project, payable at closing. NetLeaseX's fees are a project cost and will be borne by the members based on their proportional ownership interest in the LLC. If structured as straight preferred with a redemption fee or a "Look-Back" IRR, then NetLeaseX's guaranteed payment will be borne solely by the Sponsor.
- NetLeaseX has the option to reinvest all or a portion of its guaranteed payment pari passu to the NetLeaseX Investor's investment.
- If NetLeaseX is raising co-GP capital for a Sponsor, NetLeaseX may invest in the co-GP capital investment.
- NetLeaseX may receive a yield spread premium on the NetLeaseX Investor's investment, or
- NetLeaseX may receive a "promote" as negotiated by NetLeaseX and the NetLeaseX Investor, which may be 10-20% of the NetLeaseX Investor's return after the NetLeaseX Investor receives a minimum negotiated IRR.

About Us

NetLeaseX CAPITAL

Ron Zimmerman

Ron Zimmerman is president of NetLeaseX Capital LLC, an investment banking firm specializing in raising investment capital for real estate investors and developers. Mr. Zimmerman is also a real estate broker.

- Mr. Zimmerman has more than 38 years of industry experience as a real estate and distressed debt investor, raising investment capital for real estate investors and developers, and real estate brokerage. He has significant expertise in structuring real estate financial transactions, investment analysis, real estate finance, and the restructuring and workout of commercial and consumer loans.
- Mr. Zimmerman has experience in tiered financing of acquisitions, financial restructurings, and leveraged recapitalizations and worked as a consultant to real estate investors and developers on a national basis and acting as a strategic advisor for clients in complex IRC Section 1031 tax-deferred exchange transactions, net lease financing, and sale/leasebacks.
- Mr. Zimmerman has written several articles for industry publications and websites:

Three articles for the Scotsman Guide, a publication for commercial real estate lenders and loan brokers:

- “Strategizing with Preferred Equity” (December 2018) - featured article on raising preferred equity
- “Throw Out A Lifeline” (July 2020) and “Ride To The Rescue” (August 2020) – featured articles discussing rescue financing for real estate investors during the COVID 19 crisis

Two articles for Famcap.com, a leading website for high net worth and family office investors:

- “NetLeaseX Capital Offers Family Offices Direct Access to Rescue Financing Investments in Real Estate” (October 2023)
- “The Power of Stretch Loans for Family Office Investors” (May 2024)

- Mr. Zimmerman graduated with honors from the University of Cincinnati College of Business Administration, majoring in Real Estate and Finance.

You can download reprints of Mr. Zimmerman’s articles by going to **www.netleasex.com/articles**.

Let's Talk

If you have any questions and/or would like to discuss your criteria to invest in NetLeaseX's preferred equity investments described in this white paper and/or if you would like to discuss an alternative investment structure, please contact Ron Zimmerman:

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NetLeaseX
CAPITAL

THIS CONFIDENTIAL PROPOSAL (the “Proposal”) is being furnished to the recipient (the “Recipient”) solely for the Recipient's own limited use in considering whether to enter a business relationship with NetLeaseX Capital LLC (the “Purpose”).

NetLeaseX Capital LLC (“NetLeaseX”) has prepared this Proposal, which contains brief, selected and confidential information. This information does not purport to be all-inclusive nor does it purport to contain all the information that the Recipient needs in connection with the Purpose. Neither NetLeaseX nor any of its respective partners, officers, employees or agents makes any representation or warranty, expressed or implied, as to the accuracy or completeness of this Proposal or any of its contents and no legal liability is assumed or shall be implied with respect thereto. Actual results may differ from projections provided herein. The Recipient agrees that (a) the Proposal and its contents are Confidential Information, except for such information that is a matter of public record, (b) the Recipient, the Recipient’s employees, agents and consultants (collectively, the “need to know parties”) will hold and treat it in the strictest of confidence, and the Recipient and the need to know parties will not, directly or indirectly, disclose or permit anyone else to disclose this Proposal or its contents to any other person, firm or entity without the prior written authorization of NetLeaseX, and (c) the Recipient and the need to know parties will not use or permit to be used this Proposal or its contents in any fashion or manner detrimental to the interests of NetLeaseX or for any purpose other than the Purpose. This Proposal is not an offering of securities.