A2 – One Leather Street

The case outlines the acquisition and construction process set out by the Smith brothers. Harry wanted to get an understanding of the progress of the property and wanted some numbers indicating the financial situation of the investment. We have outlined the issues pertaining to the strategy and actions of Eric and Redstone.

Issues Pertaining to the Property

*Location of Office*

*Vacancy Rates based on Absorption Levels:*

*Thoughts on passing on Deposit Purchase*

*Crimson Group – Deal Breakdown*

Upon initial search for equity syndicators, it was clear that investors were not interested to invest in the project, given the circumstances and characteristics of the project. This was, however, not enough to deter the Crimson Group from wanting to invest, and we should question why. The Crimson Group has managed to leverage our position in a multitude of ways.

1. *Contingency Allocation*

The Crimson Group is being risky and inconsiderate with the terms set for contingency allocation. They have determined that there will be limited reserves for capital contingencies in order to ensure that the return to investors are higher. This means that potential renters of the property will have less money to spend on altering the space for their needs, which is an effective way of turning away potential renters. Capital cost contingencies have direct effects on the demand for property, and, will have a material impact on the vacancy rate of the property, given the already all-time-high vacancy rate of 13%.

1. *Debt Levels*

The Crimson Group has agreed to provide $1,939,000 of equity investment to the Smith brothers, however, is unable to give the money up-front, and will secure the loan through investor notes. These investor notes would then be charging interest across the full partnership and not just the Crimson Group, which would effectively increase the riskiness of the cash flows produced by the property. Not only is the Crimson Group structuring the materials of the deal to be in favour of their investors, they are also spreading their own leverage risk across the partnership, which will ultimately make the project more risky and prone to cash flow issues.

1. *Issues with time*

The equity syndication planned by the Crimson Group had first commenced in the beginning of April. Unlike how the brothers were accustomed to, the syndication process of the commercial property was going to take up to three months, meaning that the equity funding would be delayed and that Redstone would have to find a way to pay for all the expenses upfront using another loan or had to pause operations until the equity was syndicated by the Crimson Group. This is problematic because the extra three month delay will either cause the brothers to take on more interest expense or to incur expenses associated with the inability to charge leasers for a full three months.

Some other issues dealing with agreement specifics include:

1. *Tax Losses*

The Crimson Group has done a good job of covering their back through the fine-print of the agreement. Amongst the myriad of details, the Crimson Group has written into the contract that 99% of the tax losses will go to the investors. In other words, rebates from the government thanks to losses will be handed over to the investors of the syndicated equity issued by the Crimson Group. Essentially, the losses incurred will hurt twice as much because the Smith brothers will only be able to use 1% of the tax refund that the government pays out to the commercial property.

1. *Pre-tax Cash Flow*
2. *Cash Flow split*

*Architect*

*Contractor*

*Tenant Cash Flow Projections – Best Case vs. Worst Case*

*Storefront Issues*

*Licensing Issues*

*What to do now?*