

## Real Estate Capital Markets Update – January 9, 2004

### Volume 6, Number 1

#### “4Q03”

The “Q” series is designed to provide a concise statistical, graphic and textual review of the activities of the real estate capital markets during the most recent calendar quarter.

#### Public Real Estate Equity Capital Markets

|                     | 4Q03    | Year-to-Date |
|---------------------|---------|--------------|
| Dow Jones Average   | +10.43% | +24.78%      |
| Standard & Poor’s   | +8.74%  | +25.79%      |
| NASDAQ Composite    | +8.72%  | +49.53%      |
| Russell 2000        | +12.58% | +46.30%      |
| Morgan Stanley REIT | +8.62%  | +36.93%      |

Real estate investments trusts (REITs) continued their incredible performance during the fourth quarter of 2004, ending the period up 8.62%. For calendar year 2004, REIT share prices were up almost 37%, the fourth consecutive year-over-year increase.

For 2003, REIT shares proved a superior investment to two of the four major stock indices, outperforming both the Dow Jones Industrial Average and the Standard & Poor’s 500 Stock Index.

Clearly, the perceived benefits of investing in real estate continued to resonate with both individual and institutional investors throughout 2003, regardless of the state of industry fundamentals, leading one to conclude that capital always conquers (or at least ignores for a while) fundamentals. How long this will last is anybody’s guess.

The following chart details the performance of REITs for the period 12-months ending December 31, 2003:

| Property Sector/<br>Sub-Sector | Year-to-Date<br>Total Return | Dividend Yield<br>(December 31, 2003) | Number of REITs in<br>Sector/Sub-Sector |
|--------------------------------|------------------------------|---------------------------------------|---|
| Composite Index                | 38.47%                       | 5.75%                                 | 171                                     |
| Office/Industrial              | 33.96%                       | 5.91%                                 | 37                                      |
| Office                         | 34.01%                       | 6.30%                                 | 21                                      |
| Industrial                     | 33.14%                       | 5.04%                                 | 9                                       |
| Mixed                          | 31.30%                       | 5.67%                                 | 7                                       |
| Retail                         | 46.77%                       | 5.13%                                 | 34                                      |
| Shopping Centers               | 43.12%                       | 5.33%                                 | 19                                      |
| Regional Malls                 | 52.24%                       | 4.87%                                 | 8                                       |
| Free Standing Retail           | 35.91%                       | 5.62%                                 | 7                                       |
| Residential                    | 25.90%                       | 6.11%                                 | 24                                      |
| Multifamily                    | 25.48%                       | 6.13%                                 | 20                                      |
| Manufactured Homes             | 29.99%                       | 5.66%                                 | 4                                       |
| Diversified                    | 43.00%                       | 6.11%                                 | 18                                      |
| Hospitality                    | 31.75%                       | 2.74%                                 | 15                                      |
| Health Care                    | 55.57%                       | 6.49%                                 | 13                                      |
| Self-Storage                   | 38.14%                       | 4.65%                                 | 3                                       |
| Specialty                      | 38.55%                       | 4.95%                                 | 7                                       |
| Mortgage                       | 57.39%                       | 8.57%                                 | 20                                      |
| Home Financing                 | 42.73%                       | 9.84%                                 | 12                                      |
| Commercial Financing           | 84.67%                       | 6.79%                                 | 8                                       |

Source: National Association of Real Estate Investment Trusts ([www.nareit.com](http://www.nareit.com)).

An interesting fact—of the 84 initial public offerings which raised approximately \$18.9 billion during 2003, two of the five largest were REITs, as follows:

1. China Life Insurance                      \$3.47 Billion
2. American Financial Realty              \$0.80 Billion
3. Maguire Properties                      \$0.80 Billion
4. Amis Holdings                              \$0.60 Billion
5. AXIS Capital Holdings                    \$0.54 billion

Merger and acquisition activity remained modest during 2003 and included 11 transactions. Transaction structures included: REIT-to-REIT mergers, an opportunistic investor acquiring a REIT, a private owner acquiring a REIT, and the conversion of a C-corporation to a REIT. Clearly, not the Tsunami many had been predicting.

### Public Real Estate Debt Capital Markets

| Commercial Mortgage-Backed Securities<br>Increase/Decrease in Trading Spreads in Basis Points<br>over 10-Year Treasury Bonds |         |          |                          |                  |
|--|---------|----------|--------------------------|------------------|
|  | 9/30/03 | 12/31/03 | Quarter-over-<br>Quarter | Year-to-<br>Date |
| AAA  | 79      | 72       | -7                       | -21              |
| AA   | 87      | 80       | -7                       | -27              |
| A  | 97      | 87       | -10                      | -35              |
| BBB  | 145     | 134      | -11                      | -49              |
| BBB-   | 195     | 182      | -13                      | -42              |
| BB   | 425     | 450      | 0                        | 0                |
| B  | 950     | 950      | 0                        | 0                |
| 10-Year Treasury   | 3.93%   | 4.25%    | +0.32%                   | +0.44%           |

Source: Morgan Stanley; Bloomberg LLP

With the exception of the double-B and single-B rated tranches, commercial mortgage-backed securities (CMBS) trading spreads ended the fourth quarter of 2003 at levels not experienced since the heady days of July 1988, immediately before the global capital markets shutdown in response to Russia's default on its Sovereign debt in August 1998. Importantly, the tightening of spreads occurred during a period when the yields on 10-year Treasury securities widened by 32 basis points, or 0.32%. On a year-over-year basis, spreads tightened substantially in the face of ever-widening 10-year Treasury yields which ended the year 45 basis points that on January 1, 2003.

As in the case with most things real estate in 2003, it is difficult to reconcile the dichotomy one is confronted with—in the case of CMBS, lower trading spreads in the face on increasing 10-year Treasury yields and declining asset fundamentals. On the debt side, it can also be said that capital always conquers (or at least ignores for a while) fundamentals. How long this will last is anybody's guess.

CMBS delinquencies, as of December remittance reports, equaled a modest 1.62% of outstanding balances, an increase of 8 basis points (0.08%) during the fourth quarter of 2003.

The property sectors with the highest delinquency rates as of the December 2003 remittance reports were: senior housing (6.49%); hotel-motel (5.57%); and industrial-warehouse (1.65%). The sectors with the lowest delinquency rates were: self-storage (0.23%); mobile home (0.74%); and mixed-use (0.83%).

On a state-by-state basis, Texas (2.86%), Illinois (2.83%), Florida (2.55%), and Pennsylvania (2.42%) had the high percentage delinquencies.

## Private Real Estate Equity Capital Markets

It is too early to know the results of yearend surveys of investor attitudes, requirements, and appetites as of the end of 2003. Our sense, based on anecdotal evidence, is that capitalization rates remained unchanged during the fourth quarter of 2003 as more and more investors began to express concerns about the relationship between asset prices and yields, and property fundamentals and values.

| Capitalization Rates by Property Segment |            |      |              |
|--|------------|------|--------------|
|  | 12/31/2002 | 4Q03 | Year-to-Date |
| All Property                             | 9.30%      | n/a  | n/a          |
| Multifamily                              | 8.00%      | n/a  | n/a          |
| Office-CBD                               | 9.00%      | n/a  | n/a          |
| Office-Suburban                          | 9.70%      | n/a  | n/a          |
| Retail-Mall                              | 8.70%      | n/a  | n/a          |
| Retail-Neighborhood                      | 9.20%      | n/a  | n/a          |
| Retail-Power                             | 9.50%      | n/a  | n/a          |
| Industrial-Warehouse                     | 8.90%      | n/a  | n/a          |
| Industrial-R & D                         | 9.70%      | n/a  | n/a          |

Source: Real Estate Research Corporation (www.rrc.com).

Similarly, it is too early for the National Council of Real Estate Investment Fiduciaries to report the results of its analysis of fourth quarter operating results for the properties comprising its indices. We expect the results on a trailing 12-month basis to be relatively similar to those reported for the 12-months ended September 30, 2003.

| Historical Performance of National Council of Real Estate Investment Fiduciaries Property Indices |                                    |                                     |                           |   |
|---|------------------------------------|-------------------------------------|---------------------------|---|
|   | Trailing 12-months ended 9/30/2003 | Trailing 12-months ended 12/31/2003 | Trailing 12-Months Income | Trailing 12-Months Appreciation/Depreciation in Value |
| All Property  | 7.84%                              | n/a                                 | n/a                       | n/a   |
| Office  | 4.19%                              | n/a                                 | n/a                       | n/a   |
| Retail  | 15.28%                             | n/a                                 | n/a                       | n/a   |
| Industrial  | 7.52%                              | n/a                                 | n/a                       | n/a   |
| Multifamily   | 8.87%                              | n/a                                 | n/a                       | n/a   |

Source: National Council of Real Estate Investment Fiduciaries (NCREIF).

We will analyze the fourth quarter results of the Real Estate Research Corporation capitalization rate survey and the fourth quarter and trailing 12-month NCREIF returns in detail as soon as they become available.

## Private Real Estate Debt Capital Market

| 10-Year Prime Commercial Mortgages |         |          |                      |              |
|------------------------------------|---------|----------|----------------------|--------------|
|                                    | 9/30/03 | 12/31/03 | Quarter-over-Quarter | Year-to-Date |
| Midpoint of Range                  | 5.62%   | 6.00%    | +0.38%               | -0.05%       |
| Spread over 10-Year Treasury Bonds | 1.69%   | 1.75%    | +0.06%               | -0.48%       |

Source: Barron's/John B. Levy and Company Survey

Rates for conventional mortgage financing ended the survey period at attractive levels, although considerably above the low of 4.87% reached in May 2003. During the quarter, average rates for prime commercial mortgages increased 38 basis points with a majority of the increase reflecting increases in the yield on 10-year Treasury bonds. Capital remains available at competitive rates. According to the most recent survey by the American Council of Life Insurance, delinquencies remain at historically low levels.