

Real Estate Capital Markets Update – January 23, 2004

Volume 6, Number 2

Welcome to the update of ULI's Real Estate Capital Markets Web site. Updates are divided into four sections: public real estate securities markets, public real estate debt markets, private real estate equity markets, and private real estate debt (mortgage) markets. In each section, we feature Real Estate Capital Markets Scoreboards detailing selected performance indices for each of the real estate capital markets.

To expand site users' knowledge and understanding of the real estate capital markets, we will publish "knowledge" papers describing underlying market mechanics. In addition, we have provided links to other Web sites that provide related and relevant information. [Click here for links to other Web sites.](#)

Frequently Asked Questions (FAQs): In addition to knowledge papers, we have published answers to FAQs about the real estate capital markets. To go to FAQs, [click here.](#)

Glossaries of frequently used terms are available for readers' use. To go to the glossary section, which includes selected Web sites that provide glossaries and/or real estate term search engines, [click here.](#)

We want this site to be both useful and responsive to users, and we encourage you to e-mail comments and suggestions. If you want to send me an e-mail, click stephen@uli.org, add your comments, and click "Send".

Reader E-Mail/Telephone Response Requested: Would You Participate in an ULI-Sponsored Quarterly Real Estate Capital Markets Conference Call

Would you be interested in participating in a series of ULI sponsored conference calls where the current, near-term, and future state of the real estate capital markets would be discussed?

Our thought is as follows: We would schedule dial-in conference calls, on a quarterly basis, on a day and at a time convenient to the entire country, say the first Monday of each quarter at 11:00 am, Eastern Standard Time. The calls would last between 30 minutes and one hour.

Each call would begin with a brief interview and/or moderated discussion involving one or more established "players" active in one of the four quadrants of the real estate capital markets—public equity, public debt, private equity, private debt.

The discussion would center on immediate and future market conditions—what is happening today, and what is likely to happen in the near future—information you could use and act on that day.

Interested in possibly participating? Think it's a dumb idea? Either way, we need to hear from you. Please send an e-mail to blank@uli.org ; if you would like to leave a voice mail message, please call 202-624-7128 and key in # to by-pass the greeting and immediately leave a message.

Special Comment: Predicting the Economy

As we have noted on many prior occasions, predicting the future is a difficult and usually, a very unrewarding task. The task itself is made even more daunting when one looks at the real estate industry which is both cyclical and highly fragmented, with few if any true barriers to entry.

Fortunately, each year the *Wall Street Journal* publishes in-print and on-line (www.wsj.com) the results of an extensive survey of leading economists. The following is a summary of selected key projections and indicators for the U.S. economy and capital markets for 2004:

	December 31, 2003	June 30, 2004	Increase/Decrease		
3-month Treasury Bills	0.91%	1.32%	+0.41%		
10-year Treasury Bonds	4.25%	4.75%	+0.50%		
	November 30, 2003	May 30, 2004	Increase/Decrease		
Consumer Price Index (Year-over-Year Change)	1.9%	1.8%	-0.10%		
	November 30, 2003	May 30, 2004	Increase/Decrease		
Unemployment Rate	5.9%	5.7%	-0.20%		
		1Q04	2Q04	3Q04	4Q04
Growth in Gross Domestic Product (GDP)		+4.51%	+4.28%	+4.07%	+3.93%

Business Week also conducts a survey of leading economists (60 this year), the results of which are summarized below:

- 10-year Treasury yields as of 4Q04—5.6% (versus 4.25% at December 31, 2003)
- Federal Funds Rate as of 4Q04—1.7% (versus 1.0% at December 31, 2003)
- Consumer Price Index Inflation-1.9% Year-over-Year increase
- Unemployment Rate as of 4Q04—5.6% (versus 5.9% at November 30, 2003)
- Growth in Gross Domestic Product:
 - 1Q04—4.3%
 - 2Q04—4.2%
 - 3Q04—4.0%
 - 4Q04—3.8%

What can one discern from the surveys?

Clearly, the indicators show that the economy has turned a corner—maybe not **the** corner, but a corner nevertheless. The surveys indicate a firm consensus and conviction that interest rates are going to increase 50 basis points (0.50%) on a near-term (by June 30th) and as much as an additional 85 basis points (or 0.85%) on a long-term basis (by the fourth quarter of 2004).

Further, inflation will remain under control at less than 2.0% on an annualized basis and modest gains in employment are predicted with the unemployment rate declining to 5.6% by yearend 2004.

On a more practical note, we are often asked for one or more metrics or rules of thumb that one can follow to quickly get a sense of where the economy is going and if it is on track. While there is clearly no “one leading indicator” that one should follow (although we suspect every economist, including Federal Reserve Board Chairman Greenspan has one or more statistical “favorites”), we believe job growth is the key metric that drives a significant portion of the real estate industry.

Torto Wheaton Research recently published a benchmarking chart which puts job growth into a usable perspective. As background, readers should note that the U.S. economy, since the first quarter of 2001, has lost 2.7 million jobs.

Monthly Job Growth	Job Growth Benchmark	Gain of a Percentage Basis
- 0 -		0.00%
126,000	October 2003 Increase	1.15%
136,000	10-Year Average	1.26%
190,000	30-Year Average	1.75%
245,000	1990s Type Expansion	2.27%

Source: Torto Wheaton Research: “*TWR About Real Estate*”.

So, when it was reported that 126,000 new jobs were created in October 2003, the gain, while substantial, was less than the most recent 10-year average. December 2003's reported job growth of an anemic 1,000 new jobs can only be considered disheartening at best. And for the umpteenth time, we caution readers that one month's numbers do not establish trends.

Real Estate Capital Markets Scoreboard: Money Rates	January 23, 2004
Prime Rate (Base rate on corporate loans posted by the largest commercial banks)	4.00%
Federal Funds Rate (Rate banks charge other banks for overnight loans)	1.00%
Discount Rate (Rate charged banks who borrow overnight from the Federal Reserve)	2.00%
Dealer Commercial Paper (Rate for high grade unsecured notes sold by major corporations)	1.02% - 30 days 1.03% - 60 days 1.04% - 90 days
London Inter-bank Offered Rate (LIBOR) (Rate on deposit-based transactions between banks in the Eurocurrency market)	1.1000% - 1-month 1.1200% - 3-months 1.1700% - 6 months 1.3500% - 1 year
Foreign Prime Rates	Germany - 2.000% Japan - 1.375% Great Britain - 3.750%
U.S. Treasury Securities	4.07% - 10-year

Public Real Estate Securities Capital Markets

By any standard or measurement, 2003 was an outstanding year for real estate investment trust (REIT) investors with the Morgan Stanley REIT Index (ticker symbol: RMS or \$RMS.X) up approximately 37.0%, an astonishing performance given the state of real estate fundamentals.

Real Estate Capital Markets Scoreboard: Public Securities and Real Estate Performance Indices as of January 23, 2004						
	Dow Jones Industrial Average	S&P 500 Stock Index	NASDAQ Composite Index	Russell 2000 Index	Morgan Stanley REIT Index	NCREIF All Property Index
2003	+24.8%	+25.8%	+49.5%	+46.3%	+36.9%	+7.8%*
2004	+1.1%	+2.7%	+6.0%	+7.0%	+1.3%	n/a

*As of trailing 12-months ended September 30, 2003.

Realty Stock Review, a well-regarded, public real estate securities-centric publication, recently published its analysis of the performance of the 100+ public real estate companies which comprise the Morgan Stanley REIT Index. According to its analysis, the 10 top performing companies were as follows:

Company	Symbol	% Increase
Ventas	VTR	105.5%
Acadia	AKR	78.8%
Senior Housing	SNH	78.6%
Trizec	TRZ	75.9%
Chelsea	CPG	72.7%
General Growth	GGP	68.4%
Developers Diversified	DDR	62.1%
Equity Inns	ENN	61.6%
Mills	MLS	60.3%
Entertainment Properties	EPR	57.8%

Source: *Realty Stock Review* (www.rsr.com).

Significantly, the 10 companies listed above represent a wide array of property sectors including: health care, neighborhood shopping centers, senior housing, office, outlet retail, regional mall, hospitality, and free-standing retail.

Real Estate Capital Markets Scoreboard: Market Capitalization of REITs (number of shares multiplied by share price in \$ millions) as of January 23, 2004								
	Number of REITs	Market Cap	Equity REITs	Market Cap	Mortgage REITs	Market Cap	Hybrid REITs	Market Cap
2003	171	224,729	144	204,801	20	14,703	7	5,225
2004	173	233,442	146	212,913	20	15,364	7	5,165

Source: National Association of Real Estate Investment Trusts (NAREIT).

For 2004, real estate securities analyst's estimates of REIT performance on an industry-wide basis vary widely, with no consensus estimate available to guide investors.

Projected total rates of return—dividend income plus or minus change in share price—fall into four benchmarks, as follows:

1. 0.0% total return, thereby implying that the return from dividends (which currently average approximately 6.0%) will be fully offset by a 6.0% +/- decrease in overall share values.
2. 15% positive total return, implying an increase in share values of 9.0% +/- combined with an average 6.0% dividend.
3. 5.0% to 10.0% negative total return, which translates into a decline in share values 11.0% to 16.0%, combined with an average 6.0% dividend.
4. 11.0% (and possible higher) negative total return, implying a significant decline in share prices (over 17.0%) combined with an average 6.0% dividend.

Obviously, a lot can go right or wrong with any of the above forecasts, and much will depend on factors that have little to do with the real estate business per se such as the recovery of the overall economy, changes in interest rates, the performance of competitive investment sectors, etc. Clearly, REITs may be able to take advantage of increased acquisition opportunities as fundamentals improve and markets bottom out, or they can shoot themselves somewhere by issuing too much equity, by participating in new construction well in advance of demand, etc.

Real Estate Capital Markets Scoreboard: Offerings of Securities by REITs (in \$ millions) as of December 31, 2003				
	2003		2004	
	# of Offerings	\$ Value	# of Offerings	\$ Value
Initial Public Offerings	6	\$2,201	0	0
Follow-on offerings-Common Shares	76	5,083	0	0
Follow-on Offerings-Preferred Shares	57	4,417	0	0
Unsecured Debt	63	10,069	0	0
Secured Debt	6	1,358	0	0

Source: NAREIT REITWatch On-line.

Public Real Estate Debt Capital Markets

On a global issuance basis, 2003 was an excellent year for commercial mortgage securitization, with total issuance reaching approximately \$98.6 billion.

U.S. issuance of commercial mortgage-backed securities (CMBS) totaled \$77.8 billion, an increase of 51.3% as compared to 2002's issuance of \$52.1 billion. Issuance in the international markets equaled \$20.8 billion, a decrease of almost 28% as compared to 2002's issuance of \$28.7 billion.

For 2004, analysts are predicting total global issuance of \$95.0 billion comprised of \$70.0 billion of U.S. issuance and \$25.0 billion of non-U.S. issuance.

Issuance of Commercial Mortgage-Backed Securities January 1, 1995 through December 31, 2003 (in \$ Millions)			
	U.S. Assets	Non-U.S Assets	Total Issuance
1995	\$15,749.7	\$1,050.9	\$16,800.6
1996	26,365.3	930.3	27,295.6
1997	36,797.7	3,557.0	40,354.7
1998	74,331.7	628.8	74,960.5
1999	56,571.1	9,085.0	65,656.1
2000	46,849.4	12,116.4	59,010.8
2001	67,149.9	22,713.8	89,863.7
2002	52,073.3	28,705.9	80,779.1
2003	77,848.1	20,802.9	98,651.0

Source: Commercial Mortgage Alert.

In the international CMBS markets, 71 transactions were completed in 2003. While over 70% of the securities issued originated from four countries (the United Kingdom, Japan, France, and Canada), 13 separate collateral sources participated in 2003, as follows:

2003 Securitizations of Non-U.S. Commercial Mortgage-Backed Securities Collateral			
Collateral Source	2003 Issuance (\$ Millions)	Number of Deals	Market Share (%)
United Kingdom	\$7,063.7	14	34.0%
Japan	3,172.8	20	15.3%
France	2,686.4	4	12.9%
Canada	2,421.0	8	11.6%
Australia	1,438.8	13	6.9%
Germany	1,004.0	2	4.8%
Pan-European	939.4	3	4.5%
Switzerland	805.2	1	3.9%
Italy	515.2	2	2.5%
Global	469.0	1	2.3%
Belgium	130.5	1	0.6%
Poland	86.3	1	0.4%
Singapore	74.6	1	0.4%

Source: Commercial Mortgage Alert.

As the chart which follows indicates, total CMBS delinquencies equaled 1.62% of outstanding balances, an increase of 0.07% from November's 1.55%. The increase came exclusively from an increase of 0.07% in the 30/60/90+ day delinquent category.

	Total CMBS Delinquencies	30/60/90+ Days Delinquent	Foreclosure/Real Estate Owned
January	1.42%	0.95%	0.47%
February	1.39%	0.94%	0.45%
March	1.37%	0.92%	0.45%
April	1.54%	0.99%	0.54%
May	1.49%	1.00%	0.49%
June	1.50%	1.00%	0.50%
July	1.55%	1.05%	0.49%
August	1.58%	1.06%	0.52%
September	1.54%	1.07%	0.50%
October	1.70%	1.20%	0.50%
November	1.55%	1.04%	0.51%
December	1.62%	1.11%	0.51%

Source: Morgan Stanley CMBS Perspectives.

The modest nature of CMBS delinquencies certainly is one of the factors positively impacting trading spreads (and effectively interest rates charged borrowers). Trading spreads have continued to narrow, having reached levels below those achieved during the second quarter of 2003.

Real Estate Capital Markets Scoreboard: Commercial Mortgage-Backed Securities Trading Spreads above 10-Year Treasury Bonds (in Basis Points)									
	7/31/ 1998	12/31/ 1998	12/31/ 1999	12/31/ 2000	12/31/ 2001	12/31/ /2002	12/31/ 2003	1/22/ 2004	YTD +/-
10-Yr. Treas. Bonds	5.50%	4.87%	6.44%	5.11%	5.05%	3.81%	4.25%	4.04%	-0.21%
AAA	+86	+140	+124	+147	+130	+93	+72	+64	-8
AA	+98	+165	+144	+162	+150	+107	+80	+71	-9
A	+112	+190	+164	+177	+175	+122	+87	+79	-8
BBB	+150	+270	+210	+235	+225	+183	+134	+122	-12
BBB-	+200	+350	+295	+280	+265	+224	+182	+162	-20
BB	+275	+575	+525	+525	+575	+450	+425	+425	0
B	+450	+825	+800	+815	+1000	+950	+950	+950	0

Source: Morgan Stanley.

Based upon the investment popularity and performance of CMBS, one can reasonably project ample capital will be available to meet industry demand in 2004, including the estimated \$16.0 billion of CMBS loans maturing this year.

Private Real Estate Equity Capital Market

Real Estate Capital Markets Scoreboard: Survey of Initial Capitalization Rates								
	Multi- Family	Office- CDB	Office- Suburban	Retail- Mall	Retail- Neighborhood	Retail- Power	Industrial- Warehouse	Industrial- R & D
2Q98	8.5%	8.5%	8.6%	8.3%	9.1%	9.2%	8.7%	8.8%
4Q98	8.8%	8.7%	8.9%	8.6%	9.5%	9.6%	8.9%	9.1%
4Q99	8.8%	8.9%	9.0%	8.5%	9.2%	9.6%	9.0%	9.3%
4Q00	8.7%	8.6%	9.3%	8.9%	9.4%	10.1%	8.9%	9.3%
4Q01	8.6%	9.2%	9.8%	8.9%	9.5%	10.2%	9.1%	9.7%
4Q02	8.0%	9.0%	9.7%	8.7%	9.2%	9.5%	8.9%	9.7%
1Q03	8.1%	8.9%	9.5%	8.8%	8.9%	9.3%	8.7%	9.5%
2Q03	7.8%	8.7%	9.2%	8.4%	8.6%	9.0%	8.5%	9.4%
3Q03	7.6%	8.5%	9.0%	8.0%	8.3%	8.6%	8.3%	9.2%

Source: Real Estate Research Corp. (www.lerc.com).

Institutional Real Estate, Inc. (www.ieri.com) and Kingsley Associates recently released the results of their Eighth Annual Plan Sponsor Survey of more than 100 institutional real estate investment managers.

The survey, which is a must read for any interested in the institutional real estate investment/investment management businesses, noted that plan sponsors continued to lower that real estate rate of return expectations for real estate investments and are now expecting average rates of return equal to 8.0% in 2004 as compared to 8.5% in 2003, 10.0% in 2002, and 10.2% in 2001.

Real Estate Capital Markets Scoreboard: Transaction Volume and Investment Activity (\$ billions)				
Period	Total Number of Transactions	% Increase/ Decrease	\$ Value of Transactions	% Increase/ Decrease
Benchmark Period *	1,470		\$77.40	
01/01/98 – 12/31/98	1,189	-19.12%	\$62.10	-19.77%
01/01/99 – 12/31/99	1,061	-10.77%	\$50.80	-18.2%
01/01/00 – 12/31/00	745	-29.78%	\$42.40	-16.54%
01/01/01 – 12/31/01	940	+26.17%	\$46.60	+9.91%
01/01/02 – 12/31/02	1,293	+37.55%	\$56.60	+21.46%
07/01/20 – 06/30/03	1,604	+24.05%	\$59.11	+4.43%
*Benchmark period equals first six months of 1998, annualized.				
Source: Institutional Real Estate, Inc.				

Private Real Estate Debt (Mortgage) Capital Markets

Real Estate Capital Markets Scorecard: "Prime" 10-Year Commercial Mortgages Versus Treasuries Yields as of December 31, 2003								
	7/31/ 1998	12/31/ 1998	12/31/ 1999	12/31/ 2000	12/31/ 2001	12/31/ 2002	12/31/ 2003	+/- YTD
Prime Mortgages	6.82%	7.00%	8.45%	7.35%	7.33%	6.05%	5.80%	-0.25%
10-Year Treasuries	5.50%	4.87%	6.52%	5.11%	5.05%	3.81%	4.25%	+0.44%
Spread	1.32%	2.13%	1.93%	2.24%	2.28%	2.23%	1.65%	-0.58%
Source: Barron's/John B. Levy and Company Survey								

Rates remain low, capital is plentiful, all is well in the world of real estate!