Real Estate Capital Markets Update – April 13, 2004

Volume 6, Number 7

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".

Special Comment: First ULI-Sponsored Real Estate Capital Markets Conference Calls Scheduled for June 28, 2004—Michael Fascitelli, President, Vornado Realty Trust, to be Guest Speaker

We are pleased to announce that Michael Fascitelli, President of Vornado Realty Trust, has agreed to be the guest on ULI's inaugural Real Estate Capital Markets Conference.

The call will take place on Monday, June 28, 2004, from 11:00 am to 11:30 am, Eastern Standard Time.

Due to the anticipated number of participants, the call will be set-up as a dial-in, listen-only call and will feature a discussion between Mr. Fascitelli and Stephen Blank, ULI's Senior Fellow, Finance. Participants will be able to pose questions to the participants in advance by e-mailing their questions to **blank@uli.org**.

The discussion will focus on immediate as well as future real estate industry and real estate capital markets conditions—what is happening today, what is likely to happen tomorrow—information that participants can use immediately.

Logistical information such as registration, dial-in numbers, participant codes, etc. will be published in future issues of ULI's Real Estate Capital Markets Update.

We have maintained a list of all readers who responded to our Reader Survey published in the January 23, 2004 issues of ULI's Real Estate Capital Markets Update and will send each person a reminder notice before the call.

Questions, suggestions…? Please e-mail **blank@uli.org**

Real Estate Capital Markets Scoreboard: Money Rates	April 9, 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)	0.99% - 30 days 1.01% - 60 days 1.03% - 90 days
London Inter-bank Offered Rate (LIBOR) (Rate on deposit-based transactions between banks in the Eurocurrency market)	1.10000% - 1-month 1.14000% - 3-months 1.22500% - 6 months 1.50000% - 1 year
Foreign Prime Rates	Germany – 2.000% Japan – 1.375% Great Britain – 4.000%
U.S. Treasury Securities	4.19% - 10-year

Special Comment: March 2004 Employment Data Seriously Impacts Trading and Trend of Federal Funds Rate Futures

The impact of the employment data released on April 3rd showing that the U.S. economy created 308,000 jobs—significantly more than any economists or analysts predicted—sent shock waves through the debt capital markets and caused more than a few investors, analysts, and traders to reassess their "internal" timeline as to when the Federal Reserve Board (FRB) would increase the Federal Funds Rate.

While the equity stock market was relatively calm—the Dow Jones Industrial Average and the Standard & Poor's 500 Stock Index both increased a mere 0.9% and the NASDAQ Composite Index Increase 2.1%—bond prices declined significantly. As a benchmark for comparison, the yield on 2-year Treasury notes increased 23 basis points (or 0.23%) to 1.85%, the yield on 5-year Treasury bonds increased 26 basis points (0.26%) to 3.13%, and the yield on 10-year Treasury bonds increased 26 basis points (0.26%) to 4.14%. By any standard, these are big daily moves in interest rates and according to Economy.com, the increase in the yield on the 10-year Treasury bond was the largest one-day increase since March 8, 1996.

Before the April 3rd announcement (which included upward revisions to both January's and February's employment data), the common wisdom and market consensus was that the FRB would leave interest rates unchanged for the foreseeable future, say until at the least the Fall season. It would appear that the unanticipated job report has caused traders in the Federal Funds Futures markets to reassess the likelihood of an interest rate increase before September with the market now pricing an expected 25 basis point (0.25%) increase in the Federal Funds Rate in August.

Special Comment: Sources of Information

We are routinely asked to provide readers of ULI's Real Estate Capital Markets Update with assistance in locating specific information regarding a wide array of subjects such as historical capitalization rates, terms and conditions of recent mezzanine equity/debt transactions, glossaries and explanations, samples of documents such as joint venture agreements, term sheets…you get the idea.

Among our resources is the *Institutional Real Estate Newsline (IREN),* a weekly electronic newsletter that provides a digest of topical news and up-to-date information on institutional investment in real estate sourced from a variety of news sources.

Topics covered include manager searches, mergers, joint ventures, research, legislation, property transactions, development and industry conference updates. At our request, the publisher has agreed to provide readers with a free 4-week trial subscription to IREN and as well as a recently published transaction analysis report.

To obtain your trial subscription, please go to http://www.irei.com/trialpromo.html and enter “ULI Subscriber” in the “Promotional Code” field to receive your complimentary subscription and the report.

Special Comment: Food for Thought…from *The PunchLine*…

“New Risk—Return Curve Maps Out a Strange Geography”

“Beware judging the world thru the pinhole of local perspectives. Numerous crosscurrents have recently emerged to challenge the simplistic assumptions of a building growth momentum and a long-term need for higher real rates to finance escalating deficits. Several new and different dimensions have resurfaced to underscore some of the complex and disorienting aspects of the business backdrop. This is true of the heightened geopolitical concerns (with the horrors of Madrid), of the disorienting boom in China (and the related fixing of currencies in Asia and the support of US financing needs), the run-up in energy and other commodities, of the leadership role of technology as an economic driver, of the strong speculative spirits that drove some markets over the past year or so, and of the difficult and unprecedented transformations in many industries and business sectors. All told, a wider range of business and financial paths need to be considered.”

Headlines and data appearing in *The Punchline*, a publication of Brookville Capital Management, come from widely available publications including national and international newspapers, trade journals, economic and industrial bulletins and news websites.

Public Real Estate Securities Capital Markets

Real Estate Capital Markets Scoreboard: Public Securities and Real Estate Performance Indices as of April 9, 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%	+9.0%*
2004	-0.1%	+2.5%	+2.5%	+7.4%	+2.7%	
*Trailing 12-month period ended December 31, 2003.						

Real estate investment trust (REIT) shares took a beating during the past two weeks with the Morgan Stanley moving from substantially positive (+9.4%) to just positive (+2.7%). While analysts postulate all types of explanations, it’s just too early to tell if REITs are finally a victim of sector rotation, or what.

Clearly, the numbers show less recent institutional investment inflows into the sector, but its just too early to conclude anything, especially as the performance of the balance of the market, as evidenced by all indices except the Russell 2000, an index representing the performance of small capitalization companies, is nothing to write home about.

Real Estate Capital Markets Scoreboard: Market Capitalization of REITs (number of shares multiplied by share price in $ millions) as of April 8, 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	175	242,356	145	219,573	22	16,999	7	5,784
Source: National Association of Real Estate Investment Trusts (NAREIT).								

Another REIT initial public offering was recently filed with the Securities and Exchange Commission.

Kite Realty Group (whose web site, www.kiteco.com, is presently “under construction”) is the successor to the business operations and assets of the Kite Companies, a family operated real estate owner and developer based in Indianapolis and formed in 1960.

Upon completion of the offering, Kite Realty will own 18 retail properties containing approximately 3.2 million square feet of gross leasable area (including non-owned anchor tenant space) and have 12 retail properties containing approximately 1.4 million square feet of gross leasable area (including non-owned anchor space) presently under development. The company will also own interests four additional existing commercial properties, a parking facility, and one commercial property that is currently under development.

The company’s portfolio includes properties located in: Florida, Georgia, Illinois, Indiana, New Jersey, Oregon, Texas, and Washington.

The company operates a real estate pension fund advisory business which is expected to remain privately-held.

Upon completion of the initial public offering, the company’s shares will be listed on the New York Stock Exchange under the symbol “KRG”.

Real Estate Capital Markets Scoreboard: Offerings of Securities by REITs (in $ millions) as of February 29, 2003				
	2003		2004	
	# of Offerings	$ Value	# of Offerings	$ Value
Initial Public Offerings	8	$2,646	2	$731
Follow-on offerings-Common Shares	82	5,471	22	2,222
Follow-on Offerings-Preferred Shares	64	5,192	14	1,504
Unsecured Debt	68	10,894	12	1,900
Secured Debt	6	1,358	0	0
Source: NAREIT REITWatch On-line.				

Another interesting development last week was the announcement by Inland Real Group, one of the largest private (non-traded) REITs that it intends to list its shares for trading on the New York Stock Exchange in early June. Inland owns and operates over 130 neighborhood and community shopping centers as well as a number of single tenant retail properties.

In *Emerging Trends in Real Estate 2004* it was noted that sponsors of private REITs had dominated some acquisition markets in 2003. While some critics postulated that the private REITs were overpaying for properties and would produce only average to below average rates of returns, the private REITs countered that there were acquiring high quality assets and using little leverage and sustainable cash flow models. Additionally, it was noted that the relatively high front-end cost associated with the private REIT format, combined with their inherent lack of liquidity, should cause investors to think long and hard about whether to invest or not.

Only time will tell the merits of either side of the argument. In the meantime, we sense Inland has made a decision which will benefit its shareholders both immediately as well as for the long-term.

Public Real Estate Debt Capital Markets

During the past week, trading spreads for commercial mortgage-backed securities retreated slightly from their year-to-date lows as issuance volume remained ahead of last year’s torrid pace.

Through April 9th, U.S. issuance activity totaled $21.7 billion versus $17.0 billion in 2003, an increase of 28.7% while non-U.S. issuance (comprised of issues from Japan, Pan-Europe, the United Kingdom, Canada, Australia, Singapore, and Mexico) surged to $8.5 billion from $2.2 billion in 2003, an increase of 286%.

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	4/6/ 2004	YTD +/-
10-Yr. Treas. Bonds	5.50%	4.87%	6.44%	5.11%	5.05%	3.81%	4.25%	4.15%	-0.10
AAA	+86	+140	+124	+147	+130	+ 93	+72	+74	+2
AA	+98	+165	+144	+162	+150	+107	+80	+81	+1
A	+112	+190	+164	+177	+175	+122	+87	+89	+2
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	+415	-10
B	+450	+825	+800	+815	+1000	+950	+950	+950	0
Source: Morgan Stanley.									

An analysis of offerings completed during the first quarter shows that office properties comprised approximately 36% of the entire collateral pool, followed by retail property (31%), multifamily property (14%), industrial-warehouse property (6%), hotels (4%), and mobile home parks (3%). Clearly, the market favors plain vanilla property type and specialty properties need not apply.

Issuance of Commercial Mortgage-Backed Securities January 1, 1995 through April 9, 2004 (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
2004	21,700.0	8,500.0	30,200.0
Source: Commercial Mortgage Alert.			

Delinquencies on all CMBS offerings declined 10 basis points (0.10%) during March and now stand at 1.49% of current balances. Delinquencies on seasoned transactions (offerings outstanding more than one year) declined 12 basis points (0.21%) to 2.36% of outstanding balances. Needless to say, these numbers were a welcome surprise to issuers, traders, and investors alike and argue for a “soft landing” in CMBS-land.

	Total CMBS Delinquencies	30/60/90+ Days Delinquent	Foreclosure/Real Estate Owned
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%
January-2004	1.56%	1.08%	0.48%
February	1.59%	1.03%	0.56%
March	1.49%	0.96%	0.53%
Source: Morgan Stanley *CMBS Perspectives*.			

The three property types with the highest percentage amount of delinquencies were: senior housing (6.39%); hotel-motel (5.04); and multifamily (1.68%). The three property sectors with the lowest percentage of delinquencies were: self-storage (0.23%); mobile home (0.67%); and retail (1.04%).

The states with the highest percentage amount of delinquencies were: Pennsylvania (2.69%); Illinois (2.62%); and Texas (2.42%). The states with the lowest percentage of delinquencies were: California (0.50%); Maryland (0.59%); and Virginia (0.63%).

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%
4Q03	7.6%	8.4%	9.0%	7.9%	8.2%	8.4%	8.4%	9.2%
Source: Real Estate Research Corp. (www.rerc.com).								

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%
01/01/03 – 12/31/03	1,678	+29.78%	$68.40	+20.85%
*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 April 3, 2004									
	7/31/ 1998	12/31/ 1998	12/31/ 1999	12/31/ 2000	12/31/ 2001	12/31/ 2002	12/31 2003	4/3/ 2004	YTD
Prime Mortgages	6.82%	7.00%	8.45%	7.35%	7.33%	6.05%	5.80%	5.30%	-0.50%
10-Year Treasuries	5.50%	4.87%	6.52%	5.11%	5.05%	3.81%	4.25%	4.14%	-0.11%
Spread	1.32%	2.13%	1.93%	2.24%	2.28%	2.23%	1.65%	1.16%	-0.49%
Source: Barron's/John B. Levy and Company Survey									

According to the headline in the most recent Barron's/John B. Levy and Company Survey, it's "A Borrower's Market [as] Lenders battle to finance commercial properties".

As the above chart clearly indicates, rates are at their lowest level in "forever", driven primarily by the miniscule spreads (116 basis points or 1.16%) over Treasury yields that some lenders appear all to willing to accept.

And with the intense competition for new business comes we suspect some measure of…relaxation—hopefully not a lot, but a lowering none the less—in the application of underwriting standards and the practice of "safe lending".