

Real Estate Capital Markets Update – June 9, 2004

Volume 6, Number 10

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, that 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".

Interest Rate Monitor					
Date	Federal Funds Rate	Prime Rate	10-Year Treasuries	3-Month Libor	Date of Federal Reserve Board Meeting
6/4/2004	1.00%	4.00%	4.75%	1.41%	June 29-30

Special Comment: *Commercial Mortgage Alert*

We recommend that readers interested in the mortgage side of the real estate capital markets, including both conventional as well as securitized offerings, take advantage of the opportunity to obtain a 3-issue trial subscription to *Commercial Mortgage Alert*, the weekly newsletter we depend upon to provide us with the latest developments in real estate finance and securitization.

Commercial Mortgage Alert, which is published and distributed every Friday morning, provides a thorough and comprehensive analysis of all forms of real estate finance including commercial mortgage-backed securities, conventional mortgage loans, mezzanine financial structures, as well unsecured offerings of bonds by real estate investment trusts.

If you would like to take advantage of this opportunity, please click on the following link to start your free, 3-issue, trial subscription:

<http://www.cmalert.com/Public/Newsletter/FreeTrial/index.cfm>

Special Comment: World Competitiveness Rankings

Each year, the Institute of Management Development of Switzerland publishes its World Competitiveness Rankings, as follows:

Nation	2004		2003	
	Score	Ranking	Score	Ranking
USA	100.000	1	100.000	1
Singapore	89.008	2	86.093	4
Canada	86.626	3	80.664	6
Australia	86.046	4	80.623	7
Iceland	86.015	5	80.153	8
Hong Kong	85.765	6	79.235	10
Denmark	84.378	7	80.855	5
Finland	83.636	8	86.688	3
Luxembourg	83.083	9	87.693	2
Ireland	80.303	10	79.032	11
Sweden	79.578	11	77.401	12
Taiwan	79.543	12	71.071	17
Austria	78.933	13	75.550	14
Switzerland	78.809	14	79.426	9
Netherlands	78.613	15	76.600	13

While a comparison of 2004 over 2003 rankings is certainly instructive, a review of the rankings over an extended period of time is truly enlightening, as neither Japan nor any portion of “old Europe” have ranked in the top 10 since 1997!

	2004	2003	2002	2001	2000	1999	1998	1997	1996	1995	1994	1990	1980
USA	1	1	1	1	1	1	1	1	1	1	1	3	2
Sweden	11	12	12	11	14	14	16	19	14	12	9	--	--
Canada	3	6	7	9	8	10	8	6	12	13	20	--	--
Australia	4	7	10	12	1	11	12	15	21	16	16	--	--
Germany	21	20	17	13	13	12	15	16	18	6	6	4	4
Taiwan	12	17	20	16	17	15	14	18	19	14	22	--	--
U.K.	22	19	16	17	15	19	13	9	20	15	14	--	--
France	30	23	25	25	22	23	22	22	4	19	13	--	--
Japan	23	25	27	23	21	26	20	17	27	4	3	1	1
Korea	35	37	29	29	29	41	36	30	26	26	--	--	--
China	24	29	28	26	24	29	21	27		31	34	--	--

Special Comment: Survey Finds High Anxiety Over Possible Drop in Commercial [Real Estate] Values

A Survey of 120 large investors found that concern is growing about potential price drops for commercial buildings, and office properties in particular. Analysts with PricewaterhouseCoopers, which conducted the survey, say the level of concern is the highest respondents have shown about possible value decreases since the beginning of the economic downturn in 2001.

Real Estate Capital Markets Scoreboard: Money Rates	June 8, 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)	1.09% - 30 days 1.22% - 60 days 1.34% - 90 days
London Inter-bank Offered Rate (LIBOR) (Rate on deposit-based transactions between banks in the Eurocurrency market)	1.17875% - 1-month 1.41000% - 3-months 1.71000% - 6 months 2.23250% - 1 year
Foreign Prime Rates	Germany – 2.000% Japan – 1.375% Great Britain – 4.250%
U.S. Treasury Securities	4.75% - 10-year

Special Comment: Senior Loan Officer Opinion Survey

The Federal Reserve Board's most recent opinion survey of Senior Loan Officers (April 2004) showed a significant loosening of overall lending practices. According to the survey, 23% of the domestic banks participating in the survey reported easing of underwriting requirements for large and medium size commercial and industrial (C & I) borrowers and almost 20% of the participants noted an easing of underwriting standards for smaller C & I customers.

As one would expect, demand for loans from C & I borrowers is growing rapidly, with 29% of the banks surveyed noting increased demand from large and medium C & I borrowers and 38% reporting growing demand from smaller customers.

Reflecting the competitive conditions currently existing in the commercial real estate lending market, 11% of the banks reported "looser" standards for commercial real estate loans.

The survey clearly reflects the banking industry's "benign economic outlook" for the U.S. economy, combined with an extremely liquid and competitive lending environment.

Special Comment: Federal Reserve Board Releases Beige Book Economic Survey

The Federal Reserve Board's most recent Beige Book analysis of economic activity confirmed the continued recovery taking place in the U.S. economy with economic indicators generally positive and all Federal Reserve Board Districts reporting upward trends.

The survey noted strong retail sales numbers in most Districts with the manufacturing, mining, energy, tourism, and service sectors all improving.

As expected, the survey noted that commercial real estate markets remain "soft", with most Districts describing activity as either slow or weak.

Public Real Estate Securities Capital Markets

Real Estate Capital Markets Scoreboard: Public Securities and Real Estate Performance Indices as of June 4, 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	-2.0%	+1.0%	-1.2%	+1.9%	+2.2%	+9.7%**
* Trailing 12-month period ended December 31, 2003.						
** Trailing 12-month period ended March 31, 2004.						

Real estate investment trusts (REITS) popularity and investment appeal is expanding globally as at last count, 19 other nations, ranging from Taiwan to France, have either enacted or proposed legislation allowing for tax-transparent (or tax-exempt) REIT structures.

Real Estate Capital Markets Scoreboard: Market Capitalization of REITs (number of shares multiplied by share price in \$ millions) as of June 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	173	240,133	141	218,491	24	15,939	8	5,703
Source: National Association of Real Estate Investment Trusts (NAREIT).								

If...the economy is improving, corporate earnings are up, retail sales are strong, inflation remains under control, commodity prices (except oil) are not increasing a worrisome amount, jobs are actually being created, and unemployment claims and the overall unemployment rate are nominally low...why are REIT investments performing so poorly?

It seems counterintuitive to note that just as the economy really appears to be achieving traction, which is required prior to businesses needing more space to house new

employees or new processes, REITs enter the investment doldrums, up a modest 2.2% on a year-to-date, dividend included, basis. As someone recently noted, "...from 'Hero' at the end of the first quarter 2004 (up 12.1%) to almost 'Zero' (up about 2.2%) at the end of May".

Real Estate Capital Markets Scoreboard: Offerings of Securities by REITs (in \$ millions) as of May 31, 2004				
	2003		2004	
	# of Offerings	\$ Value	# of Offerings	\$ Value
Initial Public Offerings	6	\$2,201	6	\$1,521
Follow-on offerings- Common Shares	76	5,083	45	4,435
Follow-on Offerings- Preferred Shares	57	4,417	30	2,835
Unsecured Debt	63	10,069	41	7,045
Secured Debt	6	1,358	0	0
Source: NAREIT REITWatch On-line.				

There appear to have been a number of factors weighing on the REIT market that when viewed on a cumulative basis may "explain" (if the actions of the stock market can ever be explained) the recent malaise in the REIT stock market.

For example, the combination of an improving economy featuring job creation leading to higher interest rates leading to increasing capitalization rates caused some investors to get the "vapors" about the future performance of REIT shares and to exit the REIT market.

We do not sense this is the start of a "Bear" market for REITs. Rather, we see it as a healthy and much needed reversion to more normalized net asset value pricing and dividend yields.

What may turn out to be the litmus test for the REIT industry is its continuing ability to raise equity financing because while no one was watching, a flock (17 at last count) REIT initial public offerings were files with the regulatory agencies, as follows:

Company	Property Sector
NorthStar Realty Finance	Real Estate Finance
Thomas Properties Group	Office
Capital Lodging	Hospitality
Gramercy Capital	Real Estate Finance
Bimini Mortgage Management	Real Estate Finance
New Century REIT	n/a
Strategic Hotel Capital	Hospitality
American Campus Communities	Student Housing
HomeBanc Corp.	Real Estate Finance
MortgageIT Holdings	Real Estate Finance

CNL Hospitality	Hospitality
Aames Investment Corp.	n/a
BioMed Property Trust	Medical Office/Research
Eagle Hospitality Properties Trust	Hospitality
Extra Storage Space	Self-Storage
Dasco Medical Properties	Medical Office Property
Global Signal	Wireless Communications Towers

Given the recent performance of the REIT market, it is unlikely that all of these deals will get done, at least on a near term basis, or at the terms proposed in the prospectus.

REIT merger and acquisition (M & A) has been minimal thus far this year, explained at first by REITs trading at premiums to net asset value and high valuation multiples and then by REITs trading at or slightly below net asset value and at moderate valuation models.

The most recent REIT M & A transaction involves the proposed acquisition of Keystone Property Trust (KTR) by a partnership comprise of ProLogis (PLD) and Eaton Vance Management for \$23.80 per Keystone share, in cash, an approximately 17% premium over Keystone's closing price on the date the transaction was announced.

Public Real Estate Debt Capital Markets

Issuance of Commercial Mortgage-Backed Securities January 1, 1995 through June 4, 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	33,300.0	11,700.0	45,000.0
Source: <u>Commercial Mortgage Alert</u> .			

As the chart above indicates, issuance of commercial mortgage-backed securities (CMBS) remains "robust" with investor's appetites for securitized paper seemingly inexhaustible.

While trading spreads for CMBS have widened modestly during recent days, underlying mortgage loan rates quoted by conduits remain extremely favorable as lenders actively compete for business.

Real Estate Capital Markets Scoreboard: Commercial Mortgage-Backed Securities Trading Spreads above 10-Year Treasury Bonds (in Basis Points)						
	Trailing 12-Months			12/31/ 2003	6/4/ 2004	YTD +/-
	Low	High	Average			
10-Yr. Treas. Bonds	3.21%	4.81%	4.17%	4.25%	4.74%	+0.49%
AAA	+64	+89	+74	+72	+81	+9
AA	+71	+99	+82	+80	+88	+8
A	+79	+109	+91	+87	+96	+9
BBB	+114	+161	+132	+134	+129	-5
BBB-	+154	+211	+178	+182	+169	-13
BB	+400	+430	+420	+425	+400	-25
B	+875	+950	+940	+950	+875	-75

As yet, mortgage underwriting appears to be holding up and the “stress” test many forecast has not occurred—yet. Delinquencies as of April 2004’s remittance reports remain at modest levels—1.43% of outstanding balances of all CMBS, down .0.6% from March 2004’s 1.49%.

Real Estate Capital Markets Scoreboard: Commercial Mortgage-Backed Securities Delinquencies for Trailing 12-Months			
	Total CMBS Delinquencies	30/60/90+ Days Delinquent	Foreclosure/Real Estate Owned
January-2003	1.42%	0.95%	0.47%
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%
April	1.43%	0.90%	0.53%

Source: Morgan Stanley *CMBS Perspectives*.

The property sectors with the highest reported percentage of delinquencies were: hospitality (4.50%); senior housing (3.09%); and multifamily (1.70%). The property

sectors with the lowest reported percentage delinquencies included: self-storage (0.22%); mobile home (0.50%); and mixed-use (1.03).

The states with the highest percentage of delinquent CMBS loans were: Texas (2.60%); Illinois (2.52%), and Pennsylvania (2.43%).

Private Real Estate Equity Capital Market

Notwithstanding the aggressive and seemingly unrestrained buying that appears to be going on in “Trophy” side of the private equity marketplace, a recent REIS Report survey noted that office and apartment building values went down during the first quarter of 2004 based on lower rents and less leasing. REIS’ survey of the top 50 U.S. markets noted that office values were down 1.8% to \$132.33 per square foot while apartment building values were down 1.4% to \$67,884 per unit.

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 May 31, 2004									
	7/31/ 1998	12/31/ 1998	12/31/ 1999	12/31/ 2000	12/31/ 2001	12/31/ 2002	12/31/ 2003	5/31/ 2004	YTD
Prime Mortgages	6.82%	7.00%	8.45%	7.35%	7.33%	6.05%	5.80%	6.07%	+0.27%
10-Year Treasuries	5.50%	4.87%	6.52%	5.11%	5.05%	3.81%	4.25%	4.74%	+0.49%
Spread	1.32%	2.13%	1.93%	2.24%	2.28%	2.23%	1.65%	1.33%	-0.32%
Source: Barron's/John B. Levy and Company Survey									

Conventional commercial and multifamily mortgage rates increased modestly over the past month primarily in response to increases in the benchmark 10-year Treasury bonds. Capital remains plentiful with lender's actively competing for business.

According to a recent survey by the American Council of Life Insurance (ACLI), life insurance companies issued \$7.5 billion in commitments during the first quarter 2004, an increase of approximately 3.2% over the \$7.2 billion of commitments issued during the comparable period in 2003.

The following chart details the results of the ACLI survey on a property sector basis:

First-Quarter 2004 Lending by Life Insurance Companies					
	Average Loan Amount (\$Mil.)	Spread in Basis Points	Debt Service Coverage Ratio	Loan-to-Value Ratio (%)	Average Life (Years)
Multifamily	\$14.7	+149	2.19	64.0	7.6
Office	13.2	+165	2.21	62.1	8.0
Retail	7.4	+158	1.83	66.4	8.4
Industrial	6.9	+155	1.85	67.4	7.8
Hotel	17.5	+236	2.14	63.6	8.5
Mixed-use	33.6	+202	1.69	67.7	10.8
Other	2.3	-177	15.1	70.4	8.7
Total	10.0	+161	2.02	64.9	8.2
Source: American Council of Life Insurers.					

According to a second survey by the ACLI, delinquency rates for commercial and multifamily property mortgages equaled 0.13% of outstanding balances (of \$200+ billion) as of the quarter ended March 31, 2004, the industry's most recent reporting period. Delinquencies increased 0.01% as compared to the fourth quarter of 2003's 0.12% of outstanding balances.

The following chart tracks commercial mortgage delinquencies as reported by the ACLI from March 31, 2003 through March 31, 2004:

Delinquency Rates by Property Sector (%)					
	3/03	6/03	9/03	12/03	3/04
Multifamily	0.14	0.06	0.06	0.04	0.03
Retail	0.20	0.27	0.18	0.04	0.09
Office	0.34	0.32	0.24	0.14	0.14
Industrial	0.17	0.18	0.10	0.14	0.12
Other	1.08	0.18	0.01	0.03	0.03
Total	0.29	0.24	0.18	0.12	0.13
Source: American Council of Life Insurers.					