

## Real Estate Capital Markets Update – January 21, 2005

### Volume 7, Number 1

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](mailto:stephen@uli.org), add your comments, and click "Send".

<b>Interest Rate Monitor</b>					
<b>Date</b>	<b>Federal Funds Rate</b>	<b>Prime Rate</b>	<b>10-Year Treasuries</b>	<b>3-Month Libor</b>	<b>Date of Federal Reserve Board Meeting</b>
<b>1/21/05</b>	<b>2.25%</b>	<b>5.25%</b>	<b>4.14%</b>	<b>2.70%</b>	<b>February 2, 2005</b>

### **Special Comment: Replay Instructions for ULI Real Estate Capital Markets Conference Call**

ULI's second Real Estate Capital Markets Conference Call was held on Tuesday, January 18 with Owen Thomas, Managing Director, Morgan Stanley as guest speaker, and Stephen Blank, ULI's Senior Fellow, Finance, acting as moderator. The 45-minute discussion focused on global real estate industry and real estate capital markets conditions.

The conference call was recorded and is available for replay. To access the conference call, dial 1-719-457-0820; when prompted, enter the replay pass code 64743601.

### **Special Comment: Alice Connell, Group Managing Director, TIAA/CREF, to be Guest Speaker at 3<sup>rd</sup> ULI Real Estate Capital Markets Conference Call**

We are pleased to announce that Alice Connell, Group Managing Director of TIAA/CREF, will be the next guest speaker on ULI's Real Estate Capital Markets Conference call. The call is scheduled for April 5, 2005, from 11:00 to 11:45 am, eastern standard time. Details regarding call in numbers and participant pass codes will be published in future issues of this publication.

### **Special Comment: Federal Reserve Beige Book**

On January 18, the Federal Reserve Board published its Beige Book survey of economic conditions in the 12 Federal Reserve Districts for the period late November 2004-early January 2005. The survey noted that economic growth was broadly based across nearly the entire U.S. In summary, the survey noted:

- Consumer spending remained strong with retail sales gaining strength as the holiday shopping season progressed.
- Commercial and industrial lending increased as companies continued to invest in plant, equipment, and additional inventory.
- While labor markets continued to firm, pressure to increase wages remained muted.
- In general, service industries reported steady to strong demand ; manufacturing activity strengthened across most regions.
- Commercial real estate conditions were reported to have improved in most districts; the residential markets remained strong.
- Inflation remained well controlled with little evidence that increased costs are being passed through to buyers.

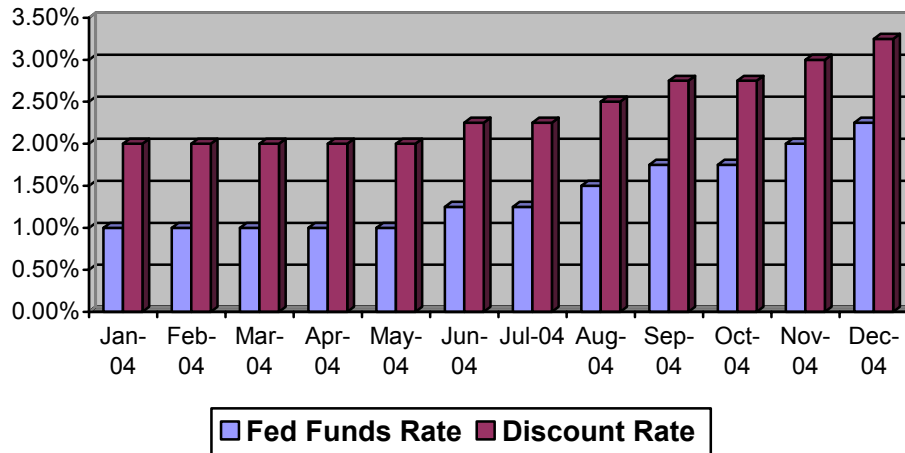
### **Special Comment: Basel II and Commercial Mortgage-Backed Securities**

As we have mentioned before, it appears that Basel II regulations will apply solely to the U.S.' largest 20 to 25 commercial banks, approximately 10 of whom will be required to adopt Basel II regulations and an additional 15+/- who will seek to voluntarily adopt Basel II, subject to approval by the Federal Reserve Board.

Basel II regulations will affect "regulatory capital", i.e., the amount of capital commercial banks will be required to maintain in reserve to support their business operations and investment portfolios.

In regard to commercial mortgage-backed securities (CMBS), it is estimated that commercial banks originate approximately 20% of the collateral underlying the issuance of CMBS and purchase approximately 30% of all newly-issued CMBS. Based upon recently published analysis, it appears that reserve requirements which were previously implemented in 2002 by commercial banks will likely prove sufficient to support current CMBS strategies.

## Federal Funds Target Rate and Discount Rate



### Special Comment: Foreign Investment in U.S. Real Estate in 2005

According to the Association of Foreign Investors in Real Estate ([www.afire.org](http://www.afire.org)), foreign investment in U.S. real estate has increased significantly during the past two years, driven in part by the continuing weakness in the U.S. dollar.

AFIRE recently noted that foreign investment increased approximately 59%, to \$385 million in 2003 as compared to 2002 and, when the dust settles, is expected to have increased approximately 12%, to \$431 million in 2004.

The two most active countries investing in the U.S. real estate markets are Australia and Germany.

<b>Real Estate Capital Markets Scoreboard: Money Rates</b>	<b>January 21, 2005</b>
Prime Rate (Base rate on corporate loans by the largest commercial banks)	5.25%
Federal Funds Rate (Rate banks charge other banks for overnight loans)	2.25%
Discount Rate (Rate charged banks who borrow overnight from the FRB)	3.25%
Dealer Commercial Paper (Rate for high grade unsecured notes sold by major corporations)	2.47% - 30 days 2.52% - 60 days 2.62% - 90 days
London Inter-bank Offered Rate (LIBOR) (Rate on deposit-based transactions between banks in the Eurocurrency market)	2.53%- 1-month 2.70% - 3-months 2.92% - 6 months 3.24% - 1 year
U.S. Treasury Securities	4.14% - 10-year

## Public Real Estate Securities Capital Markets

Real Estate Capital Markets Scoreboard: Public Securities and Real Estate Performance Indices as of January 21, 2005						
	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%	+10.8%*
2004	-3.6%	-3.6%	-6.5%	-6.2%	-5.6%	+12.4%**

\* Trailing 12-months ended June 30, 2004. \*\* Trailing 12-months ended September 30, 2004

In response to a short-term increase in interest rates, real estate investment trust (REIT) shares have traded down slightly since year end. Meanwhile, investors, money managers, and analysts wait for fourth quarter 2004 financial results.

As was the case last year, there is a wide dichotomy of views among real estate securities analysts regarding 2005's investment performance, ranging from -18% to +5%, with no central tendency or consensus.

Real Estate Capital Markets Scoreboard: Market Capitalization of REITs (number of shares multiplied by share price in \$ millions) as of January 21, 2005								
	# 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	193	292,329	153	260,825	33	25,182	7	6,320

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

According to the National Association of Real Estate Investment Trusts ([www.nareit.com](http://www.nareit.com)), publicly-traded real estate investment trusts (REITs) finished 2004 up 31.6%. The following chart details total returns by property sector as well as dividend yields by property sector as of December 31, 2004:

Property Sector	Total Return	Dividend Yield
Office	23.28%	5.44%
Industrial	34.09%	3.96%
Office/Industrial	19.59%	5.30%
Shopping Center	36.25%	4.53%
Regional Mall	45.01%	4.13%
Freestanding Retail	32.87%	4.69%
Apartment	34.71%	4.87%
Manufactured Home	6.40%	4.63%
Diversified	32.42%	4.92%
Lodging/Resort	32.70%	2.66%
Healthcare	20.96%	6.01%
Self-Storage	29.70%	3.91%
Specialty	26.85%	4.58%
<b>NAREIT Equity REIT Index</b>	<b>31.58%</b>	<b>4.66%</b>
Source: National Association of Real Estate Investment Trusts.		

As the following chart indicates, 2004 was an excellent year for the issuance of various classes of securities by REITs. In total, REITs raised approximately 60% more capital in 2004 (\$38.77 billion) as compared to 2003 (\$24.21 billion). Notably, 29 initial public offerings were completed, the largest number since the mid-1990s. Issuance was up in all categories, except secured debt, which suffered at the hands of the low interest rates available in the conventional and securitized mortgage markets.

Real Estate Capital Markets Scoreboard: Offerings of Securities by REITs (in \$ millions) as of December 31, 2004				
	2003		2004	
	# of Offerings	\$ Value	# of Offerings	\$ Value
Initial Public Offerings	6	\$2,201	29	\$8,271
Follow-on offerings- Common Shares	76	5,083	79	7,338
Follow-on Offerings- Preferred Shares	57	4,417	61	5,858
Unsecured Debt	63	10,069	97	17,306
Secured Debt	6	1,358	0	0
Source; National Association of Real Estate Investment Trusts.				

### Public Real Estate Debt Capital Markets

In 2004, \$127.58 billion of commercial mortgage-backed securities (CMBS) were issued on a global basis as compared to \$98.65 billion in 2003, an approximately 29% year-over-year increase. U.S. issuance equaled \$93.84 billion, a 20.5% year-of-year increase; non-U.S. issuance equaled \$33.75, a 62.2% year-over-year increase.

Non-U.S. issuance was dominated by issuance in the U.K. (\$15.25 billion) and “Euroland” (\$8.15 billion), followed by Japan (\$6.5 billion), Canada (\$1.9 billion), Australia (\$1.3 billion), Singapore (\$195.8 million); Taiwan (\$137.3 million), South Africa (\$128.8 million), China (\$99.1 million), and Mexico (\$56.6 million).

Collateral by property type included: office (35.4%), retail (30.5%), multifamily (12.3%), warehouse/industrial (7.6%), hotel (7.0%), mobile home (2.6%), nursing/retirement (0.7%), and “other” (3.8%).

Issuance of Commercial Mortgage-Backed Securities January 1, 1995 through December 31, 2004 (in \$ Millions)			
	U.S. Assets	Non-U.S Assets	Total Issuance
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	93,838.2	33,746.0	127,584.2
2005	-	-	-

Source: Commercial Mortgage Alert.

Delinquencies ended the year at near-record lows, with delinquencies on all CMBS equal to 1.10% of current balances and delinquencies for “seasoned” deals (offerings outstanding more than 12-months) equal to 1.74%. the senior housing, hotel-motel, multifamily, and industrial-warehouse sectors had the highest delinquency rates.

Real Estate Capital Markets Scoreboard: Commercial Mortgage-Backed Securities Trading Spreads above 10-Year Treasury Bonds (in Basis Points)						
	Trailing 12-Months			12/29/04	1/18/05	YTD +/-
	Low	High	Average			
10-Yr. Treasury Bonds	3.71%	4.81%	4.26%	4.32%	4.19%	+0.07%
AAA	+64	+85	+74	+70	+65	-5
AA	+71	+92	+81	+77	+72	-5
A	+79	+103	+90	+85	+80	-5
BBB	+114	+143	+128	+127	+124	-7
BBB-	+154	+176	+167	+167	+164	-3
BB	+315	+425	+376	+325	+315	-10
B	+760	+950	+85	+770	+760	-10

As the above chart indicates, trading spreads continue to narrow, evidence of the sheer weight of capital seeking income-producing investments such as CMBS. Rates in the CMBS lending market are reported as very attractive with originators ready and willing to compete for business.

### **Private Real Estate Equity Capital Market**

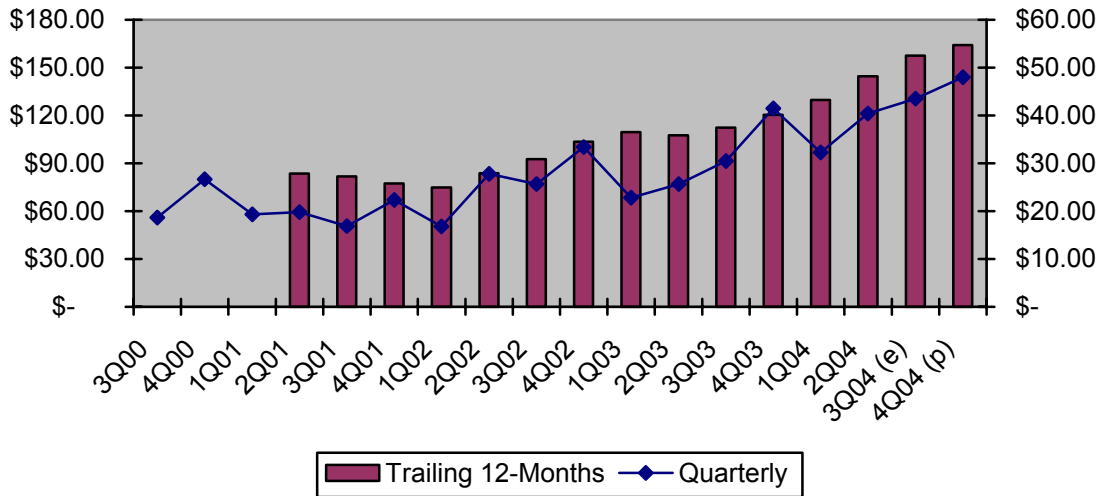
Capitalization rates continued their apparently inexorable decline during the fourth quarter of 2004, with all property sectors reaching lows not seen since...who can remember. Now we will see what a period of reflection does, if anything, to buyers pricing parameters. Will the “weight of capital” continue to push cap rates lower or will investors determine that current cap rates do not fairly reflect the risks associated with real estate investment.

**Real Estate Capital Markets Scoreboard:  
Survey of Initial Capitalization Rates**

	Multi-Family	CBD Office	Suburban Office	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%
4Q03	7.6%	8.4%	9.0%	7.9%	8.2%	8.4%	8.4%	9.2%
4Q04	7.2%	8.1%	8.5%	7.6%	7.7%	8.0%	8.0%	8.9%
<b>YTD</b>	<b>-0.4%</b>	<b>-0.3%</b>	<b>-0.5%</b>	<b>-0.3%</b>	<b>-0.5%</b>	<b>-0.4%</b>	<b>-0.4%</b>	<b>-0.3%</b>

Source: Real Estate Research Corp. ([www.rerc.com](http://www.rerc.com)).

**Sales of Office, Industrial, Retail, and Apartments**



## Private Real Estate Debt (Mortgage) Capital Markets

Real Estate Capital Markets Scorecard: "Prime" 10-Year Commercial Mortgages as of September 30, 2004									
	7/31/ 1998	12/31/ 1998	12/31/ 1999	12/31/ 2000	12/31/ 2001	12/31/ 2002	12/31 2003	12/31/ 2004	YTD
Prime Mortgages	6.82%	7.00%	8.45%	7.35%	7.33%	6.05%	5.80%	5.51%	-0.29%
10-Year Treasuries	5.50%	4.87%	6.52%	5.11%	5.05%	3.81%	4.25%	4.22%	-0.03%
Spread	1.32%	2.13%	1.93%	2.24%	2.28%	2.23%	1.65%	1.29%	-0.36%
Source: Barron's/John B. Levy and Company Survey									

Interest rates for "prime" 10-year commercial mortgages ended the year at near historical lows as lenders, flush with cash and budgets to meet, competed vigorously for deals. Spreads are now lower than they were in during the frothy summer of 1998, just before Russia defaulted on its Sovereign debt on August 18.

Will year-end 2004 mean a period of reflection by lenders or will it be full speed ahead? Obviously, much, if not all, depends on the actions of the Federal Reserve Board as well evidence that the economy is growing, which should affect the long end of the Treasury curve, in turn influencing conventional mortgage pricing.