

Real Estate Capital Markets Update – March 15, 2005

Volume 7, Number 3

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
3/11/05	2.50%	5.50%	4.51%	3.02%	March 22, 2005

Special Comment: Alice Connell, Group Managing Director, TIAA/CREF, to be Guest Speaker at 3rd 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. If you would like to suggest a question for the call, please e-mail blank@uli.org.

The call-in number will be: 1-719-785-9359

The participant code will be: 508131

The call will be recorded and available for playback for 30 days.

The replay call-in number will be: 1-719-457-0820

The replay pass code will be: 64743601

Special Comment: Notes from “The PunchLine...”

“Priced to Perfection”

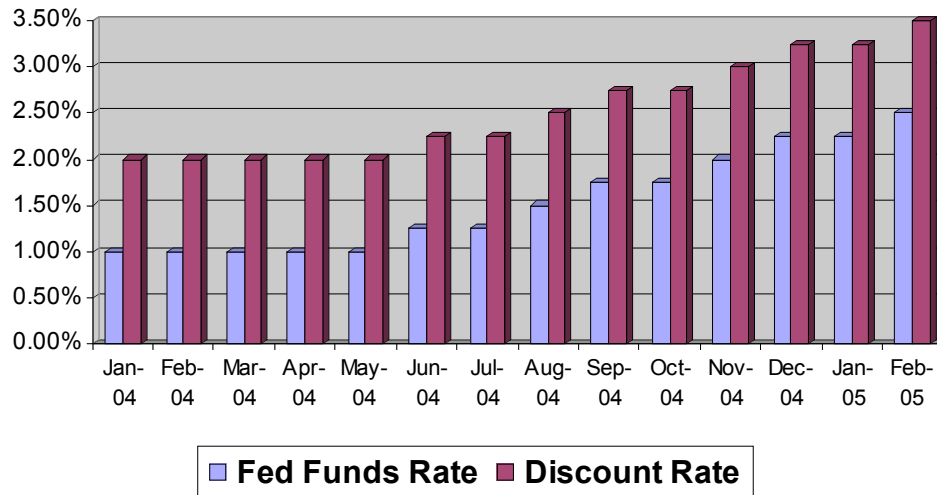
“A tough start to the new year has brought pause to the markets, hinting at a harsher business and financial landscape than was anticipated by many late last year. Despite impressive de-leveraging over 2003-4, corporations and the financial markets face several key hurdles. First, following two years of balance sheet repair, many corporations realize that a growth backdrop alone will not propel earnings growth. Many firms face tough outlooks and how they spend, refocus or redeploy their liquidity hoards will be the big story—in hiring and cap[ital] spending, but also in the increased carve-up and trading of business assets via mergers and acquisitions or leveraged buyouts. Bottom line—re-leveraging is underway and easy business forecasts just will not do. Second, the Federal Reserve itself may turn out to be an element of surprise, as it has now openly stated that rates have been too low for too long and that the policy backdrop may be encouraging some uncomfortable speculative directions. Rate hikes may become more aggressive than the 25 basis point moves to date. Third, macro budget deficits will surface intermittently in 2005 and include some very stubborn costs (energy, for one), issues regarding the cascading U.S. dollar and budget deficits, a consumer sector needing stimulus rushes and incentives to spend, accelerating competitive pressures across numerous sectors, and lingering geopolitical concerns.”

Special Comment: Federal Reserve Board Beige Book

Last week the Federal Reserve Board (FRB) released its survey of economic conditions in the 12 FRB districts nationwide. Overall, the survey noted expanding economic activity including:

1. Consumer spending characterized as “being steady to strong”;
2. Strengthening in the travel and tourism industries;
3. Improvement in the service industries (except airlines);
4. Expanding (but not accelerating) manufacturing activity;
5. The “High-Tech” sector was generally described as “positive”;
6. Business lending was noted as having strengthened in a number of districts;
7. Improvement was noted in the demand for industrial space; and
8. Labor market conditions were reported as improving or “picking-up” while wages gains remained modest.

Federal Funds Target Rate and Discount Rate



Special Comment: ULI Real Estate Capital Markets Data Source

Real Capital Analytics (www.realcapitalanalytics.com) is a national real estate research and consulting focused exclusively on the investment market for commercial and multifamily real estate and a key information supplier to ULI's Real Estate Capital Markets Update. Real Capital Analytics covers the four core property types—office, industrial, retail, and multifamily—as well as the major U.S. real estate markets, providing its clients with reports of investment property sales, investment market data, and trend analysis and interpretation.

Real Capital Analytics services include:

1. Capital Trends Monthly—reports identifying trends, interpreting data, and highlighting key aspects of the capital environment on both a local as well as national basis;
2. Searchable Transaction Database containing 12+ months of recent investment activity, including listings of currently available properties as well as buyers, sellers, and brokers presently active in the marketplace; and
3. Trends & Trades—In-depth regional reports containing information including recent property sales, pricing trends, average capitalization rates and prices per square foot, investor market composition, and active buyers, sellers, and advisors.

If you would like to see a sample report from Real Capital Analytics, please “click” the e-link below:

http://www.rcanalytics.com/reports/OFF_0302_RCA.pdf

Real Estate Capital Markets Scoreboard: Money Rates	March 11, 2005
Prime Rate (Base rate on corporate loans by the largest commercial banks)	5.50%
Federal Funds Rate (Rate banks charge other banks for overnight loans)	2.50%
Discount Rate (Rate charged banks who borrow overnight from the FRB)	3.50%
Dealer Commercial Paper (Rate for high grade unsecured notes sold by major corporations)	2.74% - 30 days 2.83% - 60 days 2.94% - 90 days
London Inter-bank Offered Rate (LIBOR) (Rate on deposit-based transactions between banks in the Eurocurrency market)	2.82%- 1-month 3.02% - 3-months 3.27% - 6 months 3.68% - 1 year
U.S. Treasury Securities	4.51% - 10-year

Public Real Estate Securities Capital Markets

Equity real estate investment trusts (REITs) rebounded in February, if you can call a gain of approximately 3.1% a rebound.

What's causing the malaise in REITland is anybody's guess. The most fashionable answers include: recent articles highlighting high property sale prices and low property capitalization rates, indicating (to some) an irrational exuberance on many buyer's parts and the "potential" of a real estate pricing "bubble"; reaction to recent increases in the level of interest rates; and concerns regarding valuation issues as many REITs continue to sell at prices in excess of their estimated net asset value and/or at historically high earnings multiples.

The following chart details total returns for the various REIT property sectors for the month of February 2005 and on a year-to-date basis as well as dividend yields as of February 28, 2005:

	Total Returns		Dividend Yield
	February	Year-to-Date	
Office	+4.45%	-3.53%	5.19%
Industrial	+4.58%	-5.89%	4.21%
Office/Industrial Mix	+3.39%	-5.45%	5.71%
Shopping Center	+2.87%	-6.34%	4.65%
Regional Mall	+5.11%	4.73%	4.33%
Freestanding Retail	+3.49%	2.24%	4.70%
Multifamily	+2.76%	7.65%	5.08%
Manufactured Housing	-3.60%	9.24%	5.09%
Diversified	-1.07%	8.39%	5.21%
Lodging/Resort	-0.93%	7.16%	2.87%
Healthcare	+0.83%	7.17%	6.61%
Self-Storage	+2.75%	3.15%	4.05%
Specialty	+5.43%	2.12%	4.52%
Equity REIT Index	+3.07%	5.59%	4.79%
Source: National Association of Real Estate Investment Trusts (www.nareit.com).			

Real Estate Capital Markets Scoreboard: Public Securities and Real Estate Performance Indices as of March 11, 2005						
	Dow Jones Industrial Average	S&P 500 Stock Index	NASDAQ Composite Index	Russell 2000 Index	Morgan Stanley REIT Index	NCREIF All Property Index
2005	-0.08%	-0.98%	-6.15%	-3.80%	-6.35%	+14.5%*
* Trailing 12-months ended December 31, 2004.						

Real Estate Capital Markets Scoreboard: Market Capitalization of REITs (number of shares multiplied by share price in \$ millions) as of March 14, 2005								
	# of REITs	Market Cap	Equity REITs	Market Cap	Mortgage REITs	Market Cap	Hybrid REITs	Market Cap
2005	195	291,479	153	260,764	35	24,538	7	6,176
Source: National Association of Real Estate Investment Trusts (NAREIT).								

Real Estate Capital Markets Scoreboard: Offerings of Securities by REITs (in \$ millions) as of February 28, 2005				
	2004		2005	
	# of Offerings	\$ Value	# of Offerings	\$ Value
Initial Public Offerings	29	\$8,271	2	\$4,676
Follow-on offerings-Common Shares	79	7,338	6	437
Follow-on Offerings-Preferred Shares	61	5,858	5	409
Unsecured Debt	97	17,306	8	1,126
Secured Debt	0	0	2	1,910
Source; National Association of Real Estate Investment Trusts.				

Public Real Estate Debt Capital Markets

Issuance is reported by both originators as well as borrowers as “very strong and very competitive” with spreads reported as low as 75 basis points over 10-year Treasury bonds for an 80% loan-to-value, 10-year term loan, with two or three years of interest-only payments followed by payments based on a 25 year amortization schedule. The flow of capital entering the commercial mortgage-backed securities (CMBS) business at every level—from broker to banker to investor—was buttressed yet again when delinquencies for seasoned CMBS offerings—offerings outstanding more than 12-months—were reported at 1.78% as of the end of February.

Issuance of Commercial Mortgage-Backed Securities January 1, 2000 through March 11, 2005 (in \$ Millions)			
	U.S. Assets	Non-U.S Assets	Total Issuance
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	18,600.0	8,200.0	26,900.0
Source: <u>Commercial Mortgage Alert</u> .			

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	3/9/05	Year-to-Date
10-Yr. Treasury Bonds	4.29%	4.32%	4.52%	+0.07%
AAA	+73	+70	+65	-10
AA	+80	+77	+73	-10
A	+89	+85	+82	-9
BBB	+129	+127	+128	-4
BBB-	+168	+167	+178	-4
BB	+361	+325	+310	-15
B	+830	+770	+750	-20

Private Real Estate Equity Capital Market

2004 was a record year for everything—record property sales, record conventional and securitized property financings, record low capitalization rates, and record low interest rates. Nowhere was the “weight of capital” more evident than in the property sales arena where, according to Real Capital Analytics, comparisons of 2004 versus 2003 noted that the value of properties sold increased 50%, the number of properties sold increased 36%, prices per square foot or per unit increased substantially, and capitalization rates continued there apparently endless decline.

The following chart compares Calendar Year 2004 to Calendar Year 2003 in terms of sales volume, number of properties sold, change in price per square foot or price per unit, and change in capitalization rates:

	Volume of Transactions				Pricing of Transactions			
	\$ Mil.	2004 Change	Properties	2004 Change	\$sf/unit	2004 Change	Cap Rate	2004 Change
Apartment	\$48,050	+63%	2,312	+38%	\$89,734	+26%	6.8%	-0.61%
Industrial	\$20,186	+42%	1,603	+26%	\$58	+21%	8.5%	-0.38%
Office	\$72,355	+57%	2,272	+38%	\$167	+6%	8.0%	-0.87%
Retail	\$38,012	+30%	2,054	+41%	\$131	+15%	8.7%	-0.50%
Total	\$178,602	+50%	8,241	+36%	-----	-----	7.7%	-0.61%

Source: Real Capital Analytics Inc.; based upon properties and portfolios \$5 million and greater.

The following charts provide data comparing transaction metrics for individual property types—office, retail multifamily, and industrial—for the period 2002 to 2004.

In reviewing the analysis which follows, it is astounding to see the magnitude of price increases and declines in capitalization rates.

Annual Summary – Office									
	Central Business District			Suburban			All Office		
	2002	2003	2004	200	2003	2004	2002	2003	2004
Volume \$ millions	\$19,764	\$21,888	\$32,184	\$21,399	\$24,055	\$40,171	\$41,163	\$45,943	\$72,355
# Properties	275	317	418	1,089	1,328	1,854	1,364	1,645	2,272
Average \$/sq. ft	\$196	\$199	\$217	\$136	\$132	\$141	\$160	\$157	\$167
Top 25%	\$265	\$270	\$294	\$173	\$172	\$193	\$189	\$187	\$208
Average Cap Rate	8.7%	8.4%	7.4%	9.5%	9.0%	8.1%	9.3%	8.8%	8.0%
Top 25%	7.8%	7.3%	6.6%	8.9%	8.1%	7.4%	8.6%	8.0%	7.1%

Source: Real Capital Analytics Inc.; based upon properties and portfolios \$5 million and greater.

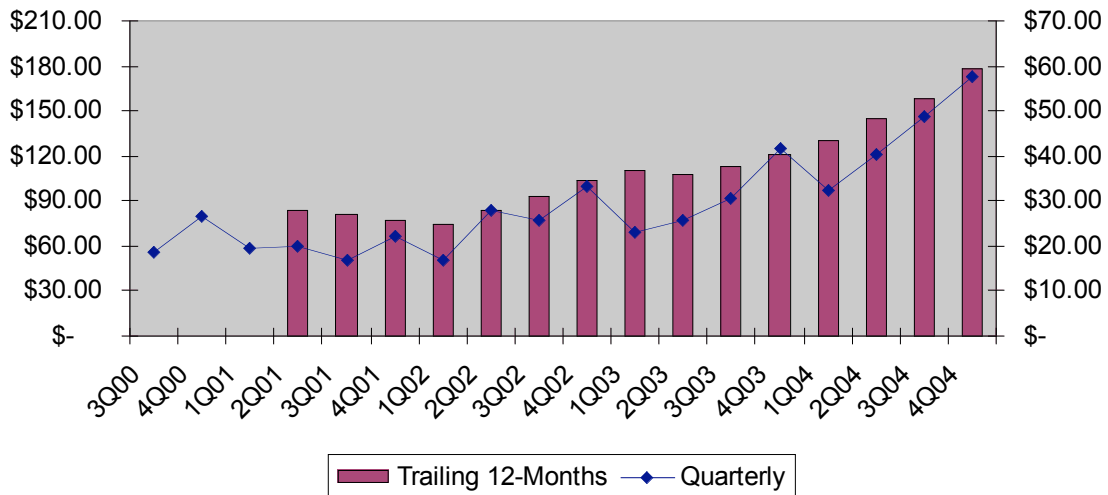
Annual Summary – Retail									
	Strip Centers			Malls and Other			All retail		
	2002	2003	2004	200	2003	2004	2002	2003	2004
Volume \$ millions	\$13,403	\$11,328	\$12,098	\$14,494	\$17,890	\$25,914	\$27,897	\$29,218	\$38,012
# Properties	307	454	666	884	1,002	1,388	1,191	1,456	2,054
Average \$/sq. ft	\$121	\$112	\$122	\$105	\$117	\$136	\$112	\$115	\$131
Top 25%	\$223	\$235	\$275	\$148	\$168	\$195	\$156	\$179	\$208
Average Cap Rate	9.2%	8.6%	8.2%	9.3%	8.6%	8.1%	9.3%	8.6%	8.1%
Top 25%	8.3%	7.6%	7.0%	8.8%	7.8%	7.3%	8.6%	7.8%	7.2%
Source: Real Capital Analytics Inc.; based upon properties and portfolios \$5 million and greater.									

Annual Summary – Multifamily									
	Garden			Mid/High-Rise			All Apartments		
	2002	2003	2004	200	2003	2004	2002	2003	2004
Volume \$ millions	\$18,401	\$24,816	\$38,852	\$4,206	\$4,626	\$10,198	\$22,607	\$29,442	\$48,050
# Properties	1,136	1,455	2,006	140	219	306	1,276	1,674	2,312
Average \$/unit	\$64,419	\$66,278	\$80,380	\$136,897	\$118,465	\$157,967	\$71,458	\$71,207	\$89,734
Top 25%	\$84,247	\$92,008	\$113,768	\$214,873	\$172,291	\$238,636	\$91,258	\$101,655	\$126,402
Average Cap Rate	8.3%	7.6%	6.9%	7.3%	6.6%	6.4%	8.2%	7.5%	6.8%
Top 25%	7.6%	6.6%	6.0%	5.2%	5.7%	5.4%	7.5%	6.4%	5.9%
Source: Real Capital Analytics Inc.; based upon properties and portfolios \$5 million and greater.									

Annual Summary – Industrial									
	Flex Space			General Industrial			All Industrial		
	2002	2003	2004	200	2003	2004	2002	2003	2004
Volume \$ millions	\$3,129	\$3,553	\$6,693	\$8,606	\$10,676	\$13,493	\$11,735	\$14,229	\$20,186
# Properties	254	302	410	933	974	1,193	1,187	1,276	1,603
Average \$/sq. ft	\$84	\$85	\$90	\$40	\$42	\$50	\$46	\$48	\$58
Top 25%	\$125	\$126	\$132	\$63	\$65	\$81	\$86	\$87	\$98
Average Cap Rate	9.9%	9.3%	8.5%	9.5%	8.7%	8.5%	9.7%	8.9%	8.5%
Top 25%	9.2%	8.7%	7.7%	9.0%	8.0%	7.7%	9.0%	8.1%	7.7%

Source: Real Capital Analytics Inc.; based upon properties and portfolios \$5 million and greater.

Sales of Office, Industrial, Retail, and Apartments



Source: Real Capital Analytics Inc. (www.realcapitalanalytics.com).

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%
YTD	-0.4%	-0.3%	-0.5%	-0.3%	-0.5%	-0.4%	-0.4%	-0.3%

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

Private Real Estate Debt (Mortgage) Capital Markets

During the month of February, yields for 10-year Treasury bonds increased 9 basis points (0.09%) and spreads on conventional mortgage loans narrowed 9 basis points, fully absorbing the change in interest rates. The conventional mortgage business, as in the securitized segment, remains intensely competitive, with lenders looking for some term or loan condition—interest-only periods, reduced amortization schedules, lower debt service coverage ratios, increased loan-to-value ratios, reduced loan servicing fees, etc—with which they can use to differentiate themselves in the market place. Even the costs normally escrowed for payment of future leasing/re-leasing seem to be on the table and subject for negotiation.

Real Estate Capital Markets Scoreboard: “Prime” 10-Year Commercial Mortgages						
	12/31/01	12/31/02	12/31/03	12/31/04	2/28/05	Year-to-Date
Prime Mortgages	7.33%	6.05%	5.80%	5.51%	5.51%	0.00%
10-Year Treasuries	5.05%	3.81%	4.25%	4.22%	4.31%	+0.09%
Spread	2.28%	2.23%	1.65%	1.29%	1.20%	-0.09%

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