

Real Estate Capital Markets Update – April 16, 2005

Volume 7, Number 5

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
4/12/05	2.75%	5.75%	4.35%	3.14%	May 3, 2005
Year Ago	1.00%	4.00%	4.35%	1.14%	-----
Change	+1.75%	+1.75%	+0.00%	+2.00%	

Special Comment: Alice Connell, Group Managing Director, TIAA/CREF, Guest Speaker at 3rd ULI Real Estate Capital Markets Conference Call

Alice Connell, Group Managing Director of TIAA/CREF, was the guest speaker on ULI's Real Estate Capital Markets Conference call held on April 5, 2005, from 11:00 to Noon, Eastern Standard Time.

The call was recorded and will be available for playback until May 5th.

The replay call-in number is: 1-719-457-0820; the replay pass code is: 68238560.

Special Comment: John B. Levy, President of John B. Levy & Company, Inc. and author of the *Barron's*/John B. Levy Company, Inc. National Mortgage Survey, to be Guest Speaker on Fourth ULI Real Estate Capital Markets Conference Call

We are please to announce that John B. Levy, President of John B. Levy Company, Inc. and author of the *Barron's*/John B. Levy National Mortgage Survey, will be the guest speaker on ULI's Real Estate Capital Markets conference call which will be held during the week following Labor Day.

Given the unique experience, perspective, and knowledge of our guest speaker, the discussion will focus exclusively on the conventional and securitized real estate mortgage capital markets.

If you would like submit a question, please e-mail: blank@uli.org

Special Comment: Notes and Quotes from "The PunchLine..."

"A Slow-Moving Car Crash"

A menacing combination of heightened interest rate uncertainty, renewed highs in oil prices, and select sectoral pressures are taking a toll on financial markets. And with more interest rate uncertainty and recognition both at the Fed [Federal Reserve Board] and outside that credit risk may not be appropriately priced, a turn in spread dynamics may also be at hand. Moreover, strains in several individual sectors such as autos, airlines, pharma, tech and insurance have become an issue. In particular, it's becoming unmistakable that even the steady upward adjustment to macro growth estimates is inadequate to guarantee all company earnings models. Deeply embedded in the low rate/easy money backdrop is the unusually large role of the U.S. housing boom in the world economy. If the balance sheets of the household sector have appeared robust despite tepid job growth, it is because of a great run in asset inflation, primarily in property values. And this asset boom has nourished household spending. After all, sitting on such wealth, why should the U.S. consumer stop spending and start saving. However, a dangerous self-reinforcing circle has developed. Strong U.S. consumption has kept China's exports strong. Rapid reserve growth in Asia feeds back into the U.S. and supports low rates and a desperate search for yield. The result is an unusual and precarious alignment of economic and financial levers that may unravel in concert".

"On BubbleWatch"

"Last week, the Financial Stability Forum, a group of national and international central banks and regulators, pointed to the levels of liquidity as one of the main risks to the stability of the world financial system. Following a meeting in Tokyo, the FSF said that, according to some of its members, tight credit spreads and low long-term interest rates suggested some in the market might be under pricing risk."

"Fed's Yellen: Economy Supports More Lending But Beware"

- Concerned Re Growing Commercial Real Estate Loan Concentrations
- Fears Banks May 'Cut Corners' on Managing Credit Risk

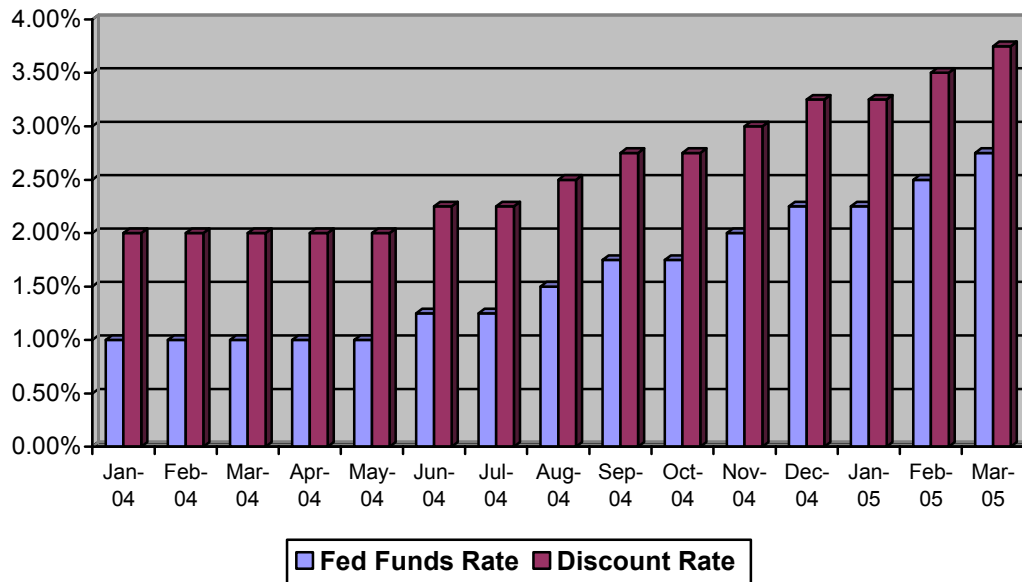
"San Francisco Federal Reserve Bank President Janet Yellen said Monday that economic growth 'noticeably above trend' is fueling stronger bank lending, but she said this is raising a number of 'areas of caution'. Yellen said she does not expect 'widespread problems' in the banking industry, but she did raise concern about growing real estate concentrations, potential delinquencies on commercial and industrial loans and easing loan terms and standards. Yellen...warned banks not to let lending growth 'outstrip' their risk management controls and their ability to attract deposits to fund their loans. Yellen also warned that in a rising interest rate environment, banks need to be aware of 'alternative scenarios' for the yield curve, and she said that some borrowers may find it harder to make variable rate loan payments. Rising rates may also make it more difficult to attract deposits as people seek higher returns, she said".

"More Bubble Talk"

"Commercial Real Estate Market Beginning to Resemble Bubble of the 1980s"

"Banks are taking big risks in commercial real estate and making themselves vulnerable because the market may be in a bubble similar to that of the late 1980s, Sovereign Bancorp's chief executive said. Many of the lessons learned in the last commercial real estate bubble have faded with time, and some people may have forgotten to use as much discipline."

Federal Funds Target Rate and Discount Rate



Real Estate Capital Markets Scoreboard: Money Rates	April 12, 2005
Prime Rate (Base rate on corporate loans by the largest commercial banks)	5.75%
Federal Funds Rate (Rate banks charge other banks for overnight loans)	2.75%
Discount Rate (Rate charged banks who borrow overnight from the FRB)	3.75%
Dealer Commercial Paper (Rate for high grade unsecured notes sold by major corporations)	2.86% - 30 days 2.97% - 60 days 3.03% - 90 days
London Inter-bank Offered Rate (LIBOR) (Rate on deposit-based transactions between banks in the Eurocurrency market)	2.95%- 1-month 3.14% - 3-months 3.41% - 6 months 3.81% - 1 year
U.S. Treasury Securities	4.36% - 10-year

Public Real Estate Securities Capital Markets

What's wrong with real estate investment trusts (REITs)? Just as property and market fundamentals start to improve (or least finally stabilize), there appears to be a shift in investor sentiment and inclination. In fact, some pundits are starting to note "Bearish" indicators in REIT-land. What the current change in investor sentiment shows is what we all know—that rapid and unexplainable changes in popular sentiment toward any asset class or segment defines the fickle nature of investment. Certainly, the recent ups and downs in the Treasury securities markets has affected investor psychology and caused "momentum" to shift on a dime.

Additionally, the reported activities of hedge funds who appear to be playing the REIT market through purchase (and more recently lots of sales) of Exchange Traded Funds is having its negative impact on the market.

And unfortunately, there is no one—individual or institutional investor alike—available and/or willing at this moment to fill the gap. Individual investors appear to be waiting for a clear direction in interest rates to emerge as well as for the recent volatility in the REIT Indices to moderate. Institutional investors are by their nature cautious and while some may sense a buying opportunity, they are normally slow to act.

According to the National Association of Real Estate Investment Trusts, REITs were down 1.55% in March and ended the first quarter of 2005 down 7.05%. The following details the performance of the various REIT property sectors for the month of March as well as at the end of the first quarter 2005:

Property Sector	Total Return for March 2005	Dividend Yield as of March 31, 2005	Total Return Year-to-Date
Office	+0.20%	5.71%	-3.34%
Industrial	-4.92%	4.53%	-10.52%
Office/Industrial Mix	-4.49%	6.*3%	-9.70%
Shopping Center	-2.63%	5.17%	-8.80%
Regional Mall	-2.77%	4.64%	-7.38%
Freestanding Retail	-2.30%	5.*3%	-4.48%
Multifamily	-1.70%	5.46%	-9.23%
Manufactured Home	+4.41%	5.00%	-5.24%
Diversified	+0.12%	5.2*%	-8.29%
Lodging/Resort	+0.08%	3.57%	-7.09%
Healthcare	-4.37%	7.*3%	-11.22%
Self-Storage	+2.75%	4.02%	+0.82%
Specialty	+5.43%	4.89%	-3.34%
Equity REIT Index	-1.55%	5.17%	-7.05%
Source: National Association of Real Estate Investment Trusts.			

Public Securities and Real Estate Performance Indices as of April 15, 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	-5.44%	-4.74%	-11.60%	-10.14%	-6.22%	+14.5%*
* Trailing 12-months ended December 31, 2004.						

Market Capitalization of REITs (number of shares multiplied by share price in \$ millions) as of April 12, 2005								
	# of REITs	Market Cap	Equity REITs	Market Cap	Mortgage REITs	Market Cap	Hybrid REITs	Market Cap
2005	193	289,456	152	259,351	34	24,065	7	6,040
Source: National Association of Real Estate Investment Trusts (NAREIT).								

Offerings of Securities by REITs (in \$ millions) as of March 31, 2005				
	2004		2005	
	# of Offerings	\$ Value	# of Offerings	\$ Value
Initial Public Offerings	29	\$8,271	2	\$794
Follow-on offerings-Common Shares	79	7,338	15	1,001
Follow-on Offerings-Preferred Shares	61	5,858	9	882
Unsecured Debt	97	17,306	20	4,164
Secured Debt	0	0	2	1,910
Source; National Association of Real Estate Investment Trusts.				

Public Real Estate Debt Capital Markets

What a (first) quarter! According to *Commercial Mortgage Alert's* commercial mortgage-backed securities (CMBS) database, approximately \$32.7 billion of CMBS were issued in the domestic market during the first quarter of 2005 as compared to approximately \$19.0 billion in the similar period last year, an increase of over 72%! Non-U.S. issuance increased from approximately \$8.0 billion in the first quarter of 2004 to approximately \$11.1 billion in the same period of 2005, an increase of almost 39%. Global issuance increased approximately 62% on a quarter-over-quarter basis.

Summary of Commercial Mortgage-Backed Securities Issuance			
Period	U.S. (\$ Millions)	Non-U.S. (\$ millions)	Global (\$ Millions)
1Q04	\$18,976.2	\$8,065.2	\$27,041.4
1Q05	32,680.7	11,091.5	43,772.2
% Increase	+72.2%	+37.5%	+61.9%

Source: *Commercial Mortgage Alert*.

One of the most important drivers of the CMBS is the continuing benign level of delinquencies which as of March 31 reached their lowest level since October 2001. Morgan Stanley recently reported that based upon its analysis of March 2005 remittance reports, delinquencies for “seasoned” CMBS transactions, i.e., transactions aged more than one year, had declined 0.18% to 1.59%, which they expected to further decline to approximately 1.30% by yearend 2005.

Issuance of Commercial Mortgage-Backed Securities January 1, 2000 through April 15, 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	34,600.0	12,200.0	46,800.0

Source: *Commercial Mortgage Alert*.

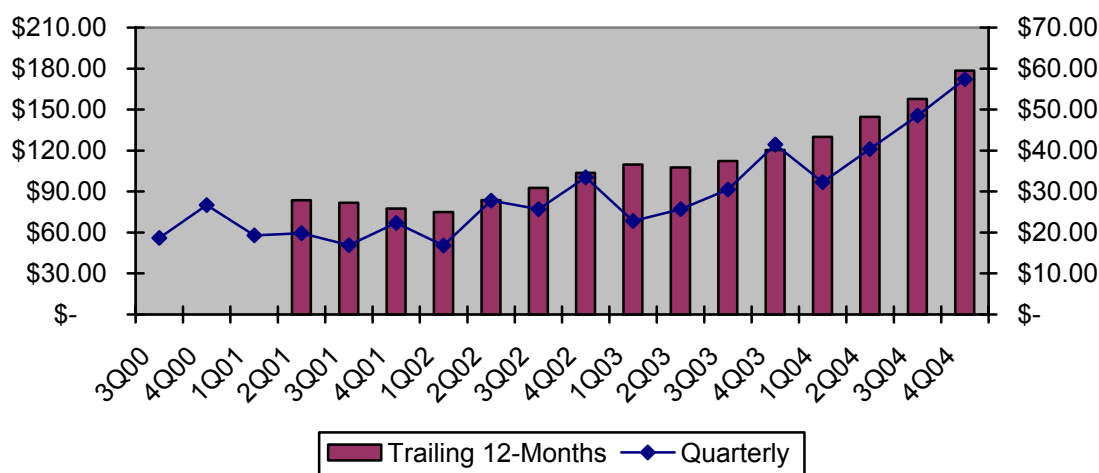
While spreads widened slightly during the past two weeks or so, indications are that the market remains robust with significant liquidity available.

Commercial Mortgage-Backed Securities Trading Spreads above 10-Year Treasury Bonds (in Basis Points)			
	12/29/04	4/13/05	Year-to-Date
10-Year Treasury Bonds	4.32%	4.34%	+0.02
AAA	+70	+74	+4
AA	+77	+83	+6
A	+85	+92	+7
BBB	+127	+136	+9
BBB-	+167	+186	+19
BB	+325	+310	-15
B	+770	+750	-20

Source: Morgan Stanley.

Private Real Estate Equity Capital Market

Sales of Office, Industrial, Retail, and Apartments (in \$ Billions)



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

According to the most recent survey of initial capitalization rates by Real Estate Research Corporation (see chart which follows), the significant inflow of capital into the real estate industry continues, reinforcing the present “Seller’s” market and forcing institutional investors, managers, and advisors to purchase properties at ever lower initial capitalization rates if they want to get money invested.

While we are heartened that real estate fundamentals continue to improve in most markets and property sectors, we remain perplexed that there is not more discussion regarding the levels of risk premiums associated with real estate investments as compared to risk free rates such as 10-year Treasury Bonds. With 10-year Treasuries trading at a yield of approximately 4.30%

and average capitalization rates equal to (and in many instances well below) 8.00%, the real estate over Treasuries premium has narrowed to less than 4.00% which seems “slim” given the risks associated with owning, operating, leasing, and managing real property investments. Many will take issue with our rationale given the paucity of returns from alternative investments and real estate’s winning “relative” value on a comparative basis.

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%
1Q05	6.9%	7.8%	8.3%	7.3%	7.5%	7.7%	7.8%	8.6%
YTD	-0.3%	-0.3%	-0.2%	-0.3%	-0.2%	-0.3%	-0.2%	-0.3%

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

Private Real Estate Debt (Mortgage) Capital Markets

Plenty of capital at very compelling and competitive rates, period!

Real Estate Capital Markets Scoreboard: “Prime” 10-Year Commercial Mortgages						
	12/31/01	12/31/02	12/31/03	12/31/04	3/31/05	Year-to-Date
Prime Mortgages	7.33%	6.05%	5.80%	5.51%	5.65%	+0.14%
10-Year Treasuries	5.05%	3.81%	4.25%	4.22%	4.40%	+0.18%
Spread	2.28%	2.23%	1.65%	1.29%	1.25%	-0.04%

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