

Real Estate Capital Markets Update – July 28, 2005

Volume 7, Number 9

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".

Key Rates			
	July 28, 2005	Year Ago	Increase/Decrease
Prime Rate	6.25%	4.00%	+2.25%
Federal Funds Rate	3.25%	1.00%	+2.25%
3-Month Libor	3.69%	1.69%	+2.00%
3-Month Treasury Bills	3.39%	1.44%	+1.95%
10-Year Treasury Bonds	4.19%	4.57%	-0.38%
30-Year Treasury Bonds	4.40%	5.30%	-0.90%
Telephone Bonds	5.74%	6.42%	-0.68%
Municipal Bonds	4.36%	5.15%	-0.79%

Special Comment: No Surprise...Federal Reserve Board Increase Rates for the Ninth Time

The Federal Reserve Board (FRB), as expected, raised the Federal Funds Rate 25 basis points (0.25%) to 3.25% at its regularly scheduled meeting held on June 30. The FRB also increased the largely symbolic Discount Rate 25 basis points (from 4.00% to 4.25%). Simultaneously, major money center commercial banks increased their Prime Rate from 6.00% to 6.25%. And as usual, the equity and debt markets “yawned” over the widely expected, anticipated, and already discounted event, with the theoretically sensitive 10-year Treasury bond closing literally unchanged for the day.

The FRB's next meeting is scheduled for August 8 at which time it is expected that the FRB will increase the Federal Funds Rate and the Discount Rate 0.25% respectively.

Base upon trading in the Federal Funds Futures market, two additional 25 basis point increases appear to be "baked" into the numbers for September and December respectively which would bring the Federal Funds Rate to 4.00% by yearend 2005.

Special Comment: John B. Levy, President of John B. Levy & Company, Inc. and author of the monthly *Barron's*/John B. Levy Company, Inc. National Mortgage Survey, to be Guest Speaker on 4th ULI Real Estate Capital Markets Conference Call

We are pleased 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 on Friday, September 23, 2005 from 11:00 am to Noon, Eastern Standard time.

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

The call-in number will be 1-719-785-9359; the participant pass code will be 508131. The call will be recorded and available for playback for 30 days.

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

Greenspan's Bubble...

"The significant rise in purchases of homes for investment purposes since 2001 seems to have charged some regional markets with speculative fever," Greenspan said. He also said that the increased use of exotic types of mortgages such as interest-free mortgages were of "particular concern." He said these type of mortgages left home buyers "vulnerable to adverse events" if home prices begin to fall. It marked Greenspan's most extensive comments on the possibility that the surge in housing prices in parts of the country could be creating a speculative bubble similar to the one on Wall Street that burst in early 2000.

Weary Households?

The increasing prevalence of adjustable and interest-only loans is adding to concerns that a bubble is forming in the nation's housing market, especially in the red-hot markets of California, south Florida, New York City, and elsewhere. Federal Reserve [Board] Governor Susan Bies this week warned of an "aggressive lending climate" on mortgages, and Federal Reserve Board Chairman Alan Greenspan also expressed concern. The dramatic increase in the prevalence of interest-only loans, as well as the introduction of other relatively exotic adjustable-rate mortgages, are developments of particular concern

Principal distortions, risks include:

- Disconnect between rising short-term rates and **long-term rates**;
- The unprecedented **housing-centered boom** and related spending;
- The awkward surge in **China's** growth and implications for commodity prices, exchange rates, financial stability, and geopolitics;
- Sustained pressures in **energy prices** and resulting re-direction of capital, global investment patters, and re-evaluation of [the] 'old economy':
- **Sector** and company dislocations;
- **Growth imbalances**—a still-adequate global upturn (particularly in Europe and Japan); negative implications of the U.S. current account; and setbacks in EU (European Community) reforms; and
- Simmering **geopolitical tensions**, including trade tensions and terrorism concerns.

World Competitiveness Rankings

The following competitiveness rankings were developed by the Institute of Management of Switzerland. Note how the world has changed in the past 35 years as well as the past 10 years:

Country	2005	1996	1990	1980
United States	1	1	3	2
Sweden	14	14	-	-
Canada	5	12	-	-
Australia	9	21	-	-
Germany	23	10	4	4
Taiwan	11	18	-	-
United Kingdom	22	19	-	-
France	30	20	-	-
Japan	21	4	1	1
Korea	29	27	-	-
China	31	26	-	-

Date	Federal Funds Rate	Increase/Decrease	Discount Rate	Increase/Decrease
May 4, 2004	1.00%	-----	2.00%	-----
June 30, 2004	1.25%	+0.25%	2.25%	+0.25%
August 10, 2004	1.50%	+0.25%	2.50%	+0.25%
September 21, 2004	1.75%	+0.25%	2.75%	+0.25%
November 10, 2004	2.00%	+0.25%	3.00%	+0.25%
December 14, 2004	2.25%	+0.25%	3.25%	+0.25%
February 2, 2005	2.50%	+0.25%	3.50%	+0.25%
March 22, 2005	2.75%	+0.25%	3.75%	+0.25%
May 3, 2005	3.00%	+0.25%	4.00%	+0.25%
June 30, 2005	3.25%	+0.25%	4.25%	+0.25%
August 9, 2005				

Real Estate Capital Markets Scoreboard: Money Rates	July 28, 2005
Prime Rate	6.25%
Federal Funds Rate	3.25%
Discount Rate	4.25%
Dealer Commercial Paper	3.48% - 30 days 3.56% - 60 days 3.65% - 90 days
London Inter-bank Offered Rate (LIBOR)	3.53%- 1-month 3.71% - 3-months 3.95% - 6 months 4.22% - 1 year
U.S. Treasury Securities	4.27% - 10-year

Public Real Estate Securities Capital Markets

Real estate investment trusts (REIT) continue to rule the investment markets, outperforming every other equity index including the Dow Jones Industrial Average, the Standard & Poor's 500 Index, the NASD Composite Index, and the Russell 2000 for the period January 1 to June 30 (and in fact through today, July 28).

The next litmus test for the REIT industry will be second quarter earnings which are beginning to be reported and which from every indication appear to be in line with analysts consensus expectations.

Public Securities and Real Estate Performance Indices as of June 30, 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	-4.7%	-1.7%	-5.4%	-1.8%	+6.2%	+18.0%*

* Trailing 12-months ended June 30, 2005.

Market Capitalization of REITs (number of shares multiplied by share price in \$ millions) as of July 28, 2005								
	# of REITs	Market Cap	Equity REITs	Market Cap	Mortgage REITs	Market Cap	Hybrid REITs	Market Cap
2005	197	350,875	153	315,260	37	29,118	7	15,562

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

Offerings of Securities by REITs (in \$ millions) as of June 30, 2005				
	2004		2005	
	# of Offerings	\$ Value	# of Offerings	\$ Value
Initial Public Offerings	29	\$8,271	6	\$2,728
Follow-on offerings-Common Shares	79	7,338	30	3,123
Follow-on Offerings-Preferred Shares	61	5,858	21	1,850
Unsecured Debt	97	17,306	48	7,997
Secured Debt	0	0	2	1,910

Source; National Association of Real Estate Investment Trusts.

Public Real Estate Debt Capital Markets

Commercial mortgage-backed securities issuance continued to exceed the most optimistic of projections, ending the first six months of 2005 up 78% on a global issuance basis. U.S. issuance equaled \$72.1 billion as compared to \$43.6 billion during the comparable period, an increase of approximately 65%. Non-U.S. issuance equaled \$33.7 billion as compared \$15.8 during the first half of 2004, an increase of approximately 113%.

At this pace, issuance volume will crush 2004's record issuance of \$127 billion on a worldwide basis. As a matter of fact, volume projections of \$200 billion globally seem within reach if today's torrid pace continues.

What is driving this rush to securitize? First, and foremost, low interest rates combined with low spreads means low overall cost to borrowers. Next, serious and significant increases in property values based upon the interplay of improving property level fundamentals and lower capitalization rates yields increased loan proceeds. In fact, in many instances it pays for the borrower to pay prepayment penalties and refinance an existing loan rather than wait for the loan to mature.

And as if investors in CMBS did not have sufficient reasons, including relative value comparisons to other debt investments, to focus attention on the sector, delinquencies for seasoned CMBS transactions equaled 1.41% of outstanding balances as of June 30.

Issuance of Commercial Mortgage-Backed Securities January 1, 2000 through July 28, 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	76,400.0	38,900.0	115,400.0

Source: Commercial Mortgage Alert.

Commercial Mortgage-Backed Securities Trading Spreads above 10-Year Treasury Bonds (in Basis Points)			
	12/29/04	7/21/05	Year-to-Date
10-Year Treasury Bonds	4.32%	4.28%	-0.04%
AAA	+70	+74	+4
AA	+77	+89	+12
A	+85	+100	+15
BBB	+127	+160	+33
BBB-	+167	+210	+43
BB	+325	+290	-35
B	+770	+700	-70

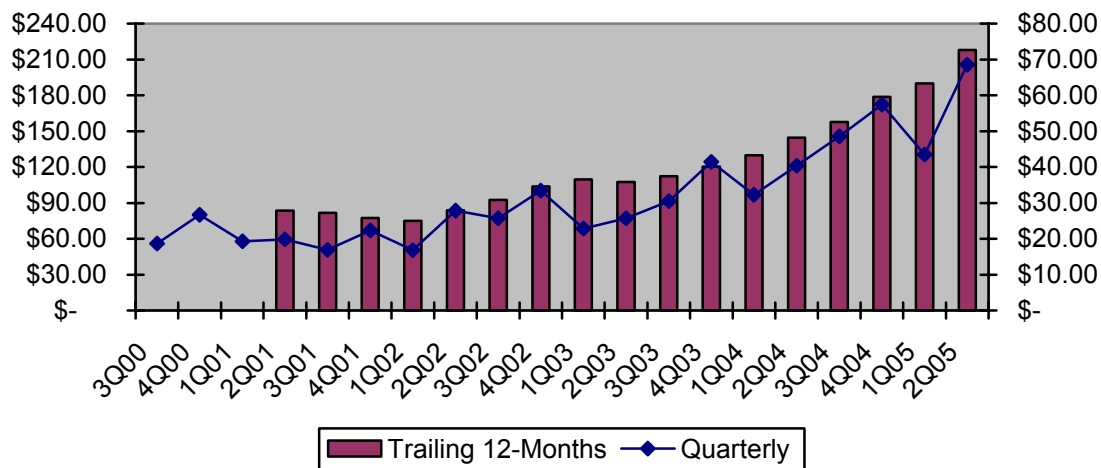
Source: Morgan Stanley.

Private Real Estate Equity Capital Market

According to data available from Real Capital Analytics, property acquisitions and sales continued at their torrid pace, with approximately \$68 billion of transactions completed during the second quarter of 2005. This represented an over 50% increase in transaction volume on a quarter-over-quarter basis.

On a trailing 12-month basis i.e., from July 1, 2004 to June 30, 2005, transaction volume increased approximately 15%. Nothing one sees on the horizon appears likely to dampen investors enthusiasm for property investments.

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



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%
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

A recently released survey by the American Council of Life Insurers of conventional commercial and multifamily mortgage commitments issued during the first quarter of 2004 noted transaction volume of \$7.3 billion, down approximately 18% as compared to the fourth quarter of 2004 and approximately 2.0% as compared to the comparable period in 2004.

The following chart provides a “snapshot” of first quarter 2005 lending by insurance companies:

Property Sector	Spread (in Basis Points)	Debt Service Coverage Ratio	Loan-to-Value Ratio (%)	Average Life (in years)
Multifamily	+123	1.78	65.9	8.1
Office	+131	1.75	62.8	6.8
Retail	+134	1.62	66.9	9.5
Industrial	+132	1.81	69.2	7.7
Hospitality	+194	2.03	63.6	7.9
Other	+133	1.61	69.2	10.0
Average	+133	17.4	65.9	8.1

In comparing the results of the survey against the measures noted in the prior quarterly survey one notes that average spread declined 18 basis points (from +151 to +133) while debt service coverage ratio declined from 1.83 to 1 to 1.74 to 1, thereby weakening slightly, while the loan-to-value ratio strengthened from 67.0% to 65.9%.

Real Estate Capital Markets Scoreboard: “Prime” 10-Year Commercial Mortgages						
	12/31/01	12/31/02	12/31/03	12/31/04	6/30/05	Year-to-Date
Prime Mortgages	7.33%	6.05%	5.80%	5.51%	5.17%	-0.34%
10-Year Treasuries	5.05%	3.81%	4.25%	4.22%	3.90%	-0.32%
Spread	2.28%	2.23%	1.65%	1.29%	1.27%	-0.02%
Source: Barron’s/John B. Levy and Company Survey.						