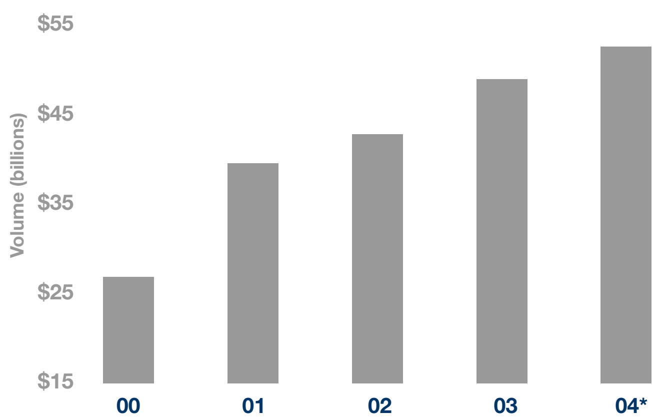
Multi-Family Loan Activity



- Yields Flat. While the Fed began to raise short-term rates, the rate on the 10-year Treasury remained in the low- to mid-4 percent range in 2004, well below expectations early in the year.
- ▲ Competitive Environment. The conduits, agencies and portfolio lenders each recorded higher loan volumes in 2004. Lenders were willing to compete on terms and proceeds.
- ▲ Improved Pricing. Loan spreads on all classes of apartment properties tightened in 2004. Class B/C assets with compelling stories to tell were often aggressively underwritten.
- ▼ Ballooning Deficits: For the year ended September 2004, the federal budget deficit reached $413 billion, or 3.6 percent of gross domestic product. Many economists predict that without significant narrowing of the deficit, interest rates will climb steadily.

Capital Markets: Despite Rising Rates, Borrowers Will Find Favorable Environment

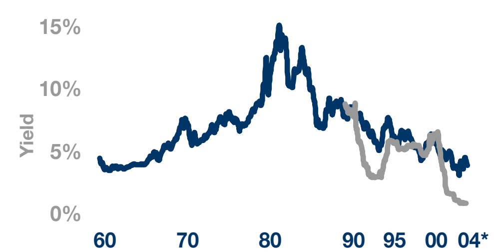
In 2004, the apartment financing environment was highlighted by competition between capital sources, tightening spreads and ample loan proceeds for borrowers. At the end of 2004, high-quality assets were being underwritten at 90 to 110 basis points over the 10-year Treasury, while lesser-grade properties were commanding deals from 110 basis points to 130 basis points. Spreads could contract further in 2005, as competition for deals remains intense, and lenders underwrite transactions using aggressive rent-growth assumptions for properties in many markets. Under these circumstances, buyers should take advantage of rates that are still low by historical standards, while sellers, in turn, are in a position to realize high asset prices and reinvest equity with low-cost debt. With property expenses well understood by lenders, and specific expense line items unlikely to suffer major spikes after rising in the past few years, conduit lenders are apt to maintain debt-service coverage ratios of 1.2x. Agency lenders and life insurance companies will underwrite at 1.25x to 1.3x.

Default rates on multi-family loans in CMBS pools have risen since 2003, with the increase attributable to loans made on properties in overbuilt markets. Nonetheless, conduits are expected to remain active in multi-family lending, as many CMBS investors prefer issues with a high concentration of apartment loans. Construction loan activity is brisk in some markets. Spreads are quoted at 150 basis points to 220 basis points over LIBOR on high-leverage (75 percent LTV) deals, and 120 basis points to 150 basis points for low-leverage (50 percent LTV) transactions.

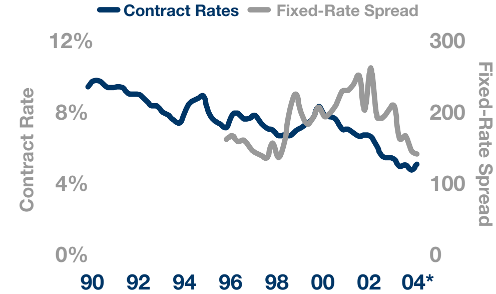
Forecast

- ▼ Rising Rates. The 10-year Treasury yield is expected to “catch up” to the Fed and rise 100 to 150 basis points in 2005 – still low by historical standards. Exogenous events such as a large-scale unwinding of foreign positions in Treasuries could send rates soaring within a short time frame, but remain unlikely.
- ▲ Tightening Spreads. Spreads usually tighten in an environment of rising rates and improving fundamentals, both of which are predicted for 2005.
- ▲ Willing Pool of Lenders. As 2004 closed, the apartment market in many locales was improving. A stronger economy in 2005 and rapidly escalating single-family home values in many markets support stronger performance in 2005. Lenders will remain very interested in the apartment sector.

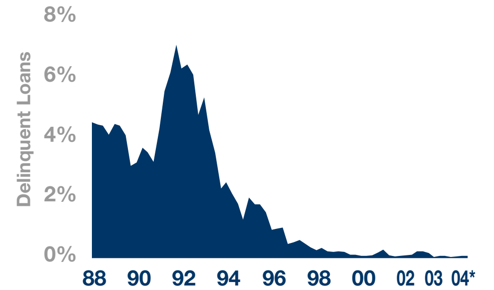
Yields Still Low



Apartment Loan Rates



Apartment Mortgage Delinquencies



* Estimate