THE WALL STREET JOURNAL. ONLINE

January 3, 2005

YEAR-END REVIEW OF MARKETS AND FINANCE

Real-Estate Market Defies Forecasts With a Steady Climb

Commercial Property Seen Gaining Further in 2005; Housing Finally May Cool

By RAY A. SMITH
Staff Reporter of THE WALL STREET JOURNAL
January 3, 2005; Page R16

Real estate, from single-family housing to real-estate investment trusts, turned in a stronger-than-expected performance in 2004, surprising analysts and market watchers who thought an improving stock market and rising interest rates would drive investors away from the secto

But the white-hot housing market is expected to cool a bit in 2005, though the commercial real-estate sector is expected to grow even stronger.

THE YEAR-END REVIEW

See the complete **Year-End Review of Markets & Finance.**[1]

Though mortgage rates rose in the beginning of 2004, they fel back and remained relatively low. In June, the average 30-yea fixed-rate mortgage stood at 6.29%, up from 5.71% in Januar according to Freddie Mac. By October, it was back down to 5.72%. At Dec. 29, it was at 5.81%. That kept home buying strong. The number of existing single-family homes sold in the U.S. is expected to have risen 7.9% to record 6.58 million in 2004, up from the previous record of 6.1 million in 2003, according to the National Association of Realtors.

The price of a median existing single-family home is expected to have risen 6.9% to $181,700 in 200 from $170,000 in 2003 -- just slightly slower than the 7.5% increase recorded in 2003. Sales activity was strongest in the West and South. The rate of price increases was exceptionally strong in Californi and Florida, while more modest in the Midwest.

Raphael Bostic, an associate professor at the University of Southern California, expects the housing market to slow in 2005, because of rising interest rates as the economy strengthens and the increasing cost of building materials. "This doesn't mean the housing market will stop," he says. "But I don't thin we will see the type of appreciation we had been [seeing] anymore."

A CHANGING LANDSCAPE

[2]

State of the Market[3]: See an interactive map of the U.S. housing market, and how sales and prices have fared in a dozen cities in the third

Meantime, the commercial real-estate sector scored gains. Th stocks of REITs, companies owning real estate or mortgages that must pay out at least 90% of their taxable income in the form of dividends, delivered total returns (stock-price appreciation plus dividends) of 32.1% in 2004, up from nearl quarter.

37% in 2003.

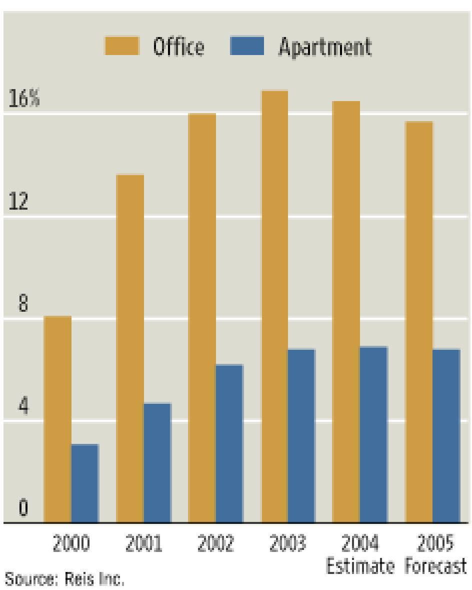
The full-year performance is surprising because REITs' total return was down 5.7% in the second quarter, in part on fears that rising interest rates would make their stocks less attractive than other investments and on fears their shares were overpriced.

A record net $7.55 billion flowed into real-estate mutual funds in 2004, according to fund tracker AM Data Services, of Arcata, Calif. That was up from the then-record $4.5 billion of 2003. Real-estate mutual funds were the top performers among "specialty" mutual-fund categories, delivering an averag total return of 31.4%, according to Morningstar Inc.

Darren Rabenou, client portfolio manager at JPMorgan Fleming Asset Management, the asset-management arm of J.P. Morgan Chase & Co., cites a number of factors for REITs' continued success 2004, including improved real-estate fundamentals, a tepid overall stock-market recovery, and, especially, REITs' dividend yields. Though those yields are down from about 5.6% in 2003, they still are more attractive than other investments. The average dividend yield for REITs was 4.7%, comparec with 1.7% for companies in the Standard & Poor's 500-stock index, according to Morgan Stanley.

Rising More Slowly

While the housing market and sales of commercial properties have remained strong since 2000, vacancy rates for commercial real estate have recently started to fall, or rise more slowly. Vacancy rates for the top 64 metropolitan markets in the U.S.



Source: Reis Inc.

Some analysts and financial planners have expressed concerns, however, that REIT stocks are overpriced and th investors shouldn't count on such big gains going forward.

Investors weren't only snatching up REIT stocks, but properties as well. Transaction volume for apartment complexes, warehouses, office buildings, malls and shoppi centers with purchase prices of more than $5 million rose t $159.7 billion in 2004, from $120 billion in the year-earlie period, according to Real Capital Analytics Inc., a New Yo real-estate research firm.

It wasn't just big investors gobbling up properties. The number of apartment, retail, office and industrial propertie that changed hands in the $500,000-to-$10 million range is projected to have risen 23.3% in 2004, to 31,688 deals fron 25,684 a year earlier, compared with the more than 13% increase in 2003, according to the research division of Marcus & Millichap Real Estate Investment Brokerage Co. Encino, Calif.

Signs of improved fundamentals also fueled interest in the sector. The average vacancy rate for the nation's 64 biggest office markets was expected to fall to 16.5% at the end of 2004 from 16.9% at the end of 2003, the first annual declin since 2000, according to Reis Inc., a New York real-estate research firm. Conditions in the apartment, industrial and retail markets also improved, according to Reis.

"The economy is improving," says Raymond Torto, a principal of real-estate research firm Torto Wheaton Research in Boston. "We think that bodes well for what has happened and what will happen 2005 for all real-estate sectors."