MJ PARTNERS REAL ESTATE SERVICES

REAL ESTATE UPDATE

THIRD QUARTER 2000

MARKET NEWS FOR THE REAL ESTATE PROFESSIONAL

REITs on a Roll

Abby Joseph Cohen, the heralded Goldman Sachs & Co.'s chief equity strategist, helped lead a bandwagon of investors to REIT stock with her suggestion that the sector deserved more attention. After languishing in the market for the past three years, REITs indeed are on a roll.

Most of the 254 REITs are undertaking an aggressive approach of creating stockholder value through high-quality management, vertical integration and stock buybacks. The recent surge in REIT pricing, though, may be partially attributed to the reversal of technology stock performance. Wall Street's re-classification of REITs from growth stocks to value stocks has knocked the wind out of the sector since 1997. The recent volatility in the technology sector is sending investors flocking to safer havens in value stocks during the second and third quarters of this year. The REIT's high weighted-average dividend yield of 7.37% coupled with their discounts to underlying net asset values create bargain valuations.

REITS OUTPERFORM THE BROADER MARKET

REITs are demonstrating to analysts that their internal management strategies are beginning to enhance shareholder value. NAREIT's Public Equity 100 Index, a measure of the top 100 public REITs and real estate operating companies, has a year-to-date increase of 20.25% as of August 31, well ahead of the Dow Jones Industrial Average, NASDAQ Composite and S&P 500. FFO per share, the REIT industry's supplemental measure of financial performance, rose 8.7% in the second quarter compared with the same period last year. Among the top 175 companies tracked by analysts, three-fourths met or exceeded earnings expectations in the second quarter of 2000. Two-thirds of the companies met or exceeded expectations in the first quarter.

LODGING WAKES UP

Most asset classes are swept up in the resurgence. The continuing expansion of the U.S. economy has mostly helped the lodging, industrial, office and multi-family sectors. As of August 31, the lodging industry reports the highest year-to-date return at 32.08%. Industrial, office and apartment REITs follow with returns ranging from 22.00% to 24.40%. Sluggish but improving are regional malls (14.41%), self-storage (8.83%), shopping centers (7.93%), health care (7.23%), and manufactured homes (2.93%).

WILL IT LAST?

The recent surge in stock prices may not be a harbinger for REITs using their securities as currency to pay for new acquisitions. REITs will continue pursuing private equity through the use of off-balance sheet joint ventures, and raising cash through the disposition of non-core assets. Additionally, most REITs that have joint ventures are comfortable with 50% or more debt, where REITs previously would not have tolerated that much debt for properties directly owned. The effect of these joint ventures may increase their borrowing costs- a long time advantage of REITs over private investors. In addition the higher stock pricing is lowering the perceived "bargain valuation." REITs are trading at an average of 10% off the underlying net asset value, compared to 20% at the beginning of the year. Is the perceived discount to net asset value enough to attract fickle Wall Street interest?

Unless there is a fundamental shift by investors out of technology and growth sectors, the value play may be short lived and serve to strengthen only the strongest REIT operations.

NAREIT Market Index All REITs

All REITs	Year-to-Date	Dividend Yield	Market Cap
Health Care	7.23%	10.75%	$4,557,744
Self Storage	8.83	5.68	4,811,744
Industrial	22.39	6.34	9,978,579
Office	24.40	6.73	27,396,532
Apartments	22.00	6.72	26,351,354
Manufactured Homes	2.93	7.41	1,975,774
Shopping Centers	7.93	9.10	12,287,138
Regional Malls	14.41	8.38	12,163,823
Lodging/Resorts	32.08	10.23	7,634,020

as of August 31, 2000
Market Cap in thousands

Market Focus
Commercial Real Estate Financing

Every time that Mr. Greenspan and his committee have increased the overnight bank rate (which has been pretty often lately), banks have in turn increased their prime lending rates. Therefore, loans that are tied to the prime rate are experiencing increased interest rates. The current overnight bank rate of 6.5% is the highest it has been in 9 years, resulting in prime rates of 9.5% at most banks. The good news is that most financial experts do not predict another rate increase for the remainder of 2000.

With regard to permanent financing, interest rates offered by all lending sources are higher than they were two years ago but many times lower or the same as a year ago. That's because not all mortgages are based on the prime rate. Most permanent mortgages are based on indices like the treasury rate or LIBOR. There can be a disconnection between these indices and Greenspan's agenda of increasing rates. For example, between April and August 2000, the 10–year Treasury rate has steadily decreased from 6.50% to 5.70% and this volatility is likely to continue. Spreads (markups over the index rate) that are quoted by lending sources also are volatile and move almost on a weekly, sometimes daily basis.

You need to stay aware that an increase in interest rates may cause loan dollars to decrease. At what point do loan dollars start to decrease? The answer is found by determining the interest rate breaking point ("IRBP").

Let me explain. Lenders generally need to satisfy two main underwriting requirements in determining your loan amount: 1.) Maximum Loan to Value (LTV) Ratio and 2.) Minimum Debt Service Coverage (DSC) Ratio.

LTV is the loan amount in comparison to the value of the property. Depending on the property type and the Lender, maximum LTV for conventional permanent financing range from 65% to 80%.

DSC is your net operating income (NOI) divided by the annual sum of your monthly mortgage payments. Depending on the property type, lenders are generally seeking between a 1.20 to 1.35 DSC.

Because interest rates have been fairly low in recent years causing low debt payments, most loan amounts have been limited to the maximum LTV. For example, a property with a 200,000 NOI with a 10% CAP rate would be valued at $2,000,000. A loan at 8.25% would be limited to $1,500,000; 75% of the value even though a 1.30 DSC would support a loan of approximately $1,625,000.

Assuming a required 1.30 DSC, the IRBP varies depending on two moving pieces: the 1.) amortization period and 2.) the CAP rate. For example, a property that is valued at a 10% CAP rate and amortized over a 25-year period will have a IRBP of 9.2%.

The effect of a shorter amortization period causes the IRBP to decrease. If the amortization period

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>
> *— Neal Gussis, Senior Vice President, Beacon Realty Capital*

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decreased to a 20-year period, the interest rate could not rise above approximately 9.0% before you would experience a reduction in loan dollars.

Valuations based on lower CAP rates also cause the IRBP to decrease. If your property was valued at a 9.5% CAP rate and the loan had a 25-year amortization period the IRBP is reduced to 8.6%.

In a case where your property is valued at a 9.5% CAP rate and the loan is amortized over 20 years, the IRBP becomes a very low 7.6%.

This illustration shows that every loan varies as to what point your loan becomes limited by minimum DSC requirements. One thing is for certain, higher interest rates, in all cases, increases your debt payments and makes a loan more vulnerable to underwriting limits. There still are a variety of loan programs available at rates that can maximize loan dollars, but interest rates will continue to change. Long-term objectives should be used to determine your short-term financial decisions. With most permanent loans ranging in "eights" it still may be a wise move to consider financing alternatives. Also, investors looking to acquire properties will need to evaluate the return on their investment if interest rates rise because acquisition loan amounts could be decreased based on DSC requirements.

Neal Gussis is a senior vice president at Beacon Realty Capital, Inc., a financial services firm that arranges debt and equity transactions for commercial real estate owners. He can be reached at (312) 207-8240.

Notes

RECENT MJ PARTNERS SALES/LEASES

- **U-Stor-It Self Storage Portfolio, Chicago, Lincolnwood and Skokie, Illinois.** Seven facilities, 4,452 units, 413,400 square feet. List price: $38,000,000.
- **1224 West Van Buren Street, Chicago, Illinois.** 200,000 square foot office building sold for telecom redevelopment. List price: $13,000,000.
- **Stor-A-Way Self Storage, Peoria, Illinois.** Two facilities, 166,000 square feet, 1,153 units. List price: $6,000,000.
- **200 East Ohio Street, Chicago, Illinois.** Five-story, 30,309 square foot office building. List price: $2,395,000.
- **1920 North Clybourn Avenue, Chicago, Illinois.** 16,000 square foot lease to Thomasville Home Furnishings by Zierk's. Lease Rate: $32 per square foot triple net.
- **2320 North Elston Avenue, Chicago, Illinois.** 12,400 square foot development site. List price: $650,000.

MJ PARTNERS NEW LISTINGS

- **4532 West 55th Street, Chicago, Illinois.** Five-acre parking lot near Midway Airport. List price: $10,000,000.
- **18.23 Acre Commercial/Retail Development Site, Carol Stream, Illinois.** Divisible site on Army Trail Road near Stratford Square Regional mall. List price: $4,500,000 or $5.50 per sq. ft.
- **Allentown Mini Storage, Allentown, Pennsylvania.** 50,100 square feet, 463 units. List price: $2,600,000.
- **800 West Main Street, Plano, Illinois.** 163,000 square foot industrial complex. List price: $2,125,000.
- **2522 West Armitage Avenue, Chicago, Illinois.** 33,000 square foot two-story loft building. List price: $1,600,000.
- **1150 West Jackson Boulevard, Chicago, Illinois.** 12,375 square foot development parcel, prime West Loop corner at Racine Avenue. List price: $1,500,000.
- **Cicero Avenue near Lincoln Highway, Matteson, Illinois.** 28-acre development site near the Lincoln Regional Mall. List price: $1,100,000.
- **6732 West 51st Street, Forest View, Illinois.** 3.8-acre development site. List price: $825,000.
- **126 West Grand Avenue, Chicago, Illinois.** Two-story commercial building. List price: $800,000.

150 South Wacker Drive
Suite 450
Chicago, Illinois 60606
312.726.5800
312.726.2905 FAX
mjpartners@msn.com

Real Estate Brokerage ◆ Consulting

Bulk Rate
U.S. Postage
PAID
Chicago, IL
Permit #1737

JEFF JACOBSON
MJ Partners Real Estate Services
150 S. Wacker Drive, Suite 450
Chicago, IL 60606

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