MJ PARTNERS
REAL ESTATE SERVICES

REAL ESTATE UPDATE

SECOND QUARTER 2003 MARKET NEWS FOR THE REAL ESTATE PROFESSIONAL

Market Focus

The New Age Real Estate Investor Long Haul or Quick Joy Ride?

No one would argue that today's economic landscape drastically differs from experiences in 1999 and 2000. The equity markets are struggling to shake off three consecutive years of negative returns. The economy is enduring months of lackluster growth, rising job losses, stagnant business spending and uncertainty surrounding corporate reporting and profits. Multiple rate cuts over the past eighteen-months pushed interest rates to 45-year lows with the cloud of deflation causing the Federal Reserve to consider further rate cuts to prevent additional slides in the inflation rate.

The upside to lackluster equity markets and historically low interest rates is strong demand for real estate investments. Over the past three years, the average equity market investor has seen the value of their portfolio decrease substantially. When compared to three-year average annual returns for the Dow Jones Industrial Average (-8.2%), the S&P500(-16.1%) and the NASDAQ (-33.5%) respectively, a mid-level single digit return in real estate investments appears very attractive. In addition, low yields in the bond market and higher corporate credit risk is causing greater capital flow out of the bond market and into real estate investments.

"The combination of declining interest rates and increased flow of capital into real estate significantly reduced the capitalization rates on assets with quality tenants," states Vince D'Amico, Vice President of MJ Partners Real Estate Services.

Consider the following, the yield on 10-year Treasury Notes has fallen over 200 basis points over past 24 months. In May, the Fed warned of possible danger of deflation. Most commercial lenders are taking the Fed's comments to heart and have yet again shown a willingness to reduce interest rates. Traditionally, most lenders have maintained a spread of 150 to 200 basis points between commercial mortgage rates and 10-year Treasuries. With the drastic reduction in interest rates this spread would result in commercial mortgage rates that conceivably could go below 5.25%. At some point lenders have to deviate from this practice and set a floor for commercial lending which in many cases is currently targeted at 5.5%. However, even with a floor placed by lenders, the drastic reduction in mortgage rates can yield a substantial increase in cashflow that ultimately results in higher value for the corresponding asset.

INTEREST RATES VS. CAPITALIZATION RATES

A decline in interest rates from 9% to 5.5% has a significant effect on the capitalization rate for a property. In a sample transaction where the loan to value is 75% and the required rate of return on equity is 10%, a 350 basis point drop in the mortgage rate will result in a corresponding 230 basis point drop in the cap rate. A property previously selling at a 10% cap rate when interest rates are 9% would still be attractive to an investor if the cap rate is reduced to 7.7% because the cost of capital was reduced to 5.5%.

The negative returns posted by the Dow Jones, S&P500 and NASDAQ causes investors to seek out safe haven investments. For equity investors to consider real estate to be a safe haven investment speaks volumes about the demise of most equity investments over the last three years. In today's real estate environment, a compounded return on equity of 7% or 8% per annum is achievable. When compared to negative returns for the past three years from the major indices, many would consider this return to be exceptional.

The question remains, what will happen when the economy recovers and the equity markets return to positive territory? How quickly will the typical equity investor opt out of real estate investments in favor of more traditional investment vehicles? What affect will this have on the health of real estate investing and the rapid appreciation experienced by many types of real estate? And lastly, what will happen when these new-age real estate investors realize that selling a property requires a longer time frame and is more like turning a battleship than a speedboat?

Since selling property is not nearly as quick as selling investment instruments (i.e. bonds, stocks, mutual funds) many investors could be in for a rude awakening when they realize how long it may take to recoup their equity from a closed real estate transaction. The end result may be new-age sellers that are more motivated by timeframes than price and are forced to sell their assets at a discount in order to close more quickly. This could be the sign that the valuation of real estate is starting to revert back to more normal levels. When this happens, watch for the seasoned real estate investor to step in from the sidelines and return to investing in real estate at pricing levels that are more in line with the property's true value range.

MJ Partners Capital Services
Rate Check

How low can interest rates go? Rates continue their downward trajectory as yields on the benchmark 10-year Treasury notes slid to 3.12% in June even though the stock market rose 20% from its pre-Iraq lows. Fueling this favorable rate scenario are signs that the Federal Reserve is poised preemptively act to combat deflation and tepid economic growth with further rate cuts.

Alan Greenspan, Chairman of the Federal Reserve, said that the agency is more inclined to be "taking out insurance against economic weakness". Meanwhile, consumer prices excluding food and energy increased in April by their smallest amount since 1966. The combination of little evidence of an economic rebound and anti-deflation rhetoric sent bond yields down. Yields on 10-year Treasuries may fall 25 to 40 basis points by year-end.

The outlook for the economy continues to be slow growth through the summer until the impact of the double fiscal stimulants of lower rates and the recent tax cut can work its way through the economy. Growth is expected to accelerate into the 3% to 3.5% annual range in the fourth quarter of 2003.

The combination of lower rates and intense competition from commercial real estate mortgage providers presents favorable positive leverage fundamentals to real estate investors. Even as vacancies rise and rents soften, there is a deep and competitive market for multi-family, industrial and retail loans. Loans on office buildings are available for buildings with a solid tenant base and with minimal rollover risk. Rates for 10-year loans on quality assets ranges from 5.0% to 5.5%.

Financing for other asset classes may be difficult but not impossible. While financing for speculative office may be sparse, there are signs that lenders are beginning to consider hotel financings, especially for high-end product. There is a liquid market for senior living deals. MJ Partners Capital Services recently funded a $27,285,000 first mortgage on a nursing home that was guaranteed by HUD under their 232-program. The rate was fixed at 5.75% for 30 years.

Borrowing at the current rates for well-leased commercial properties provide dramatic positive leverage and increased cash flow. Borrowers should take advantage of these historically low rates while it lasts.

Notes

MJ PARTNERS SALES/LEASES/FINANCING

- **Lydia Nursing Home, Robins, Illinois.** First mortgage fixed at 5.75% interest rate for 30 years. Loan Value: $27,285,000
- **Royal Plaza Condominiums, Des Plaines, Illinois.** Initiated joint venture for residential development. Value: $10,000,000
- **Storage USA Franchisee Self Storage Facility, Dallas, Texas.** 76,025 square feet, 658 units. Sale Price: $9,750,000
- **371 W. Ontario Street, Chicago, Illinois.** 33,000 square foot River North commercial building. Sale Price: $2,600,000
- **956 Northpoint Blvd., Waukegan, Illinois.** Represented Lake Forest College in the lease of 15,000 square feet. Lease Rate: $5.50 per square foot net.

MJ PARTNERS EXCLUSIVE LISTINGS

- **Laraway Secure Storage, Michigan City, Rockford and Joliet, Illinois.** Three single-story self storage facilities. List Price: $1,895,000
- **Extra Space Storage, Lauderhill, Florida.** 86,425 square feet, 878 units. List Price: $5,500,000
- **Devon Self Storage Portfolio, Philadelphia, Morrisville, Pennsylvania; Lawrenceville, New Jersey; Lanham, Maryland.** Four state-of-the-art self storage facilities with drive-through access 381,130 square feet, 3,306 units. List Price: $45,000,000.

MJ PARTNERS
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150 South Wacker Drive
Suite 450
Chicago, Illinois 60606
312.726.5800
312.726.2905 fax
info@mjpartners.com

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