

- **Yields Flat.** Bullish bond investors held long-term rates in the low-4 percent range in 2004, and the 10-year came in at approximately 4.2 percent at year end. A 100 to 150 basis point increase is forecast for 2005.
- ▲ **Competitive Environment.** Conduits, commercial banks and life insurance companies each recorded higher loan volumes in 2004. Lenders were willing to compete on terms and proceeds. Conduits, however, gained market share from the competition, especially life company lenders.
- ▲ **Improved Pricing.** Spreads on shopping center loans tightened in 2004, signaling intense competition among lenders and reflecting low interest rates. Lenders continued to sharpen distinctions between anchored and non-anchored properties.
- ▼ **The Fed Stirred.** As widely expected, the Federal Reserve began to raise short-term rates. The Fed Funds rate ended 2004 at 2.25 percent.

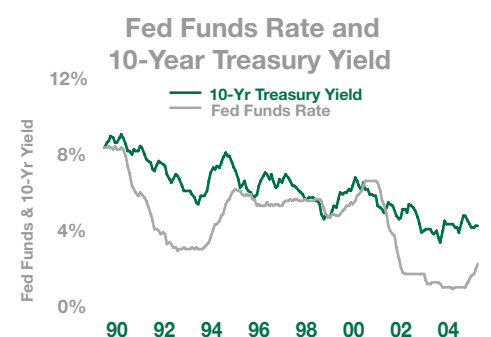
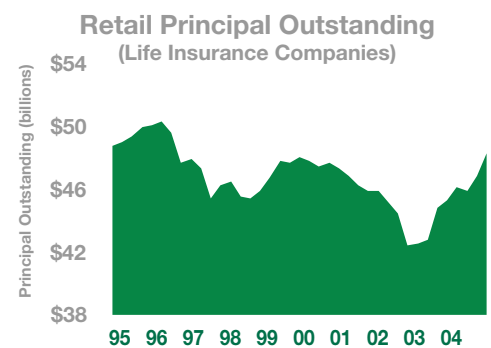
## Capital Markets: Competition Among Lenders Heating Up

Competition between lenders and tightening spreads characterized the financing environment for retail properties in 2004. At the end of the year, anchored retail properties were being underwritten at 110 basis points to 130 basis points over the 10-year Treasury, while non-anchored assets were commanding deals from 140 basis points to 180 basis points. Spreads could widen in 2005 if property performance is diminished by slower growth in consumer spending and if retailers rein in expansion plans. Additionally, grocery-anchored formats face stiffer competition from continued intrusions into their arena by Wal-Mart and Target. Well-located properties in high-growth markets will be underwritten aggressively by lenders, but owners of older assets in less desirable submarkets will have to shop for the best deals. Under these circumstances, buyers should take advantage of rates that are still historically low, while sellers are in a position to redistribute and differentiate equity. With property expenses well understood by lenders, and specific expense line items unlikely to suffer major spikes, conduit lenders are apt to maintain debt-service coverage ratios of 1.3x. Life insurance companies, while underwriting at similar levels, will shorten repayment schedules to reflect a more conservative lending approach.

Default rates on retail property loans in CMBS pools have remained relatively low. Retail property loans will continue to find their way into CMBS pools in 2005 as a means for issuers to enlarge and diversify offerings. Construction loan activity is brisk in some markets. Spreads are quoted at 150 basis points to 250 basis points over LIBOR for two- to five-year loans.

### Forecast

- ▼ **Rising Rates.** Contract rates on loans will increase as economic growth gains traction and Treasury yields rise. Events such as a large-scale unwinding of foreign positions in Treasury securities could send rates soaring, but are unlikely.
- **Stable Spreads.** As long as lenders have capital to put to work, spreads will remain relatively tight. A greater-than-expected slowdown in consumer spending and perceived higher risk, however, might force spreads to widen.
- ▲ **Lenders Become More Discriminating.** A segmentation of markets, submarkets and property subtypes will be more apparent in 2005, with good deals still getting done and lesser properties encountering mild resistance from loan sources.



### Retail Mortgage Delinquency Rate

