

Perspective

MARKET

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Financing Matters

- The flow of equity capital into real estate continues to remain strong. Early indications are that, in spite of the significant rise in treasury yields, cap rates (i.e. investor yield requirements) have remained relatively stable.
- We have had increased interest in a new Fannie Mae product - Extended Maturity - which allows a borrower to lock a fixed rate deal that converts into a fully pre-payable, one-year floater at the end of the fixed rate term. For example, a borrower can choose a 9-year fixed plus one-year floater option, which tends to price inside that of a 10-year fixed-rate term.
- Loan spreads to treasuries have increased from June's month end due to a significant increase in the volatility of swap spreads, which widened by over 30 bps at one point due an announced record level Federal debt and increased hedging.
- CMBS spreads to swaps have remained steady despite the massive sell-off in treasuries and interest rate swaps.
- The higher rate environment and mid-summer doldrums may slow slightly near term originations, but rates are still attractive at current levels and an improving economy will ultimately help real estate markets.
- Bond markets started to be bearish during a testimony by Greenspan, where he stated that deflation was not a large concern and that the Fed did not foresee purchasing 10 year Treasuries. He also made qualified optimistic statements about the recovery.

Pru Fact

As of June 30th, 2003, our portfolio of Fannie Mae business has grown to over \$6 billion.

CMBS Commentary

Despite a massive sell-off in the treasury market and swap spread widening, CMBS spreads to swaps remained near historically tight levels. The sell-off in the treasury and swap markets drew some total return accounts back to CMBS as absolute yields were up more than 100bps from June. The more than \$5 billion of fixed rate CMBS paper issued during July was well received; although, we think the street's CMBS inventories may have increased. Secondary CMBS trading picked up as a result of volatility in the treasury and swap markets, but CMBS spreads held up well. We think spreads should remain firm to slightly soft, as the asset class still exhibits good relative value against corporates and other asset-backed securities.

Market Trends

- *Treasuries* Holders of Treasuries were stung by rising rates. The 10-year yield rose from 3.54% on 6/30 to 4.41% on 7/31 as more signs of economic strength emerged. Some suggest that the market is overextended, but no one sees a return to sub-4% rates.
- *Corporate Spreads* The average spread on the Lehman Corporate index declined 4 basis points in July, bringing the year-to-date decline to 59. Some new triple-B deals are getting done at spreads below 100.

Key Indices	8/11/03	7/10/03	Change
<i>10-YrSwaps</i>	47.0	36.8	▲
<i>Prime</i>	4.00%	4.00%	No Change
<i>DJIA</i>	9,217	9,036	▲
<i>LIBOR</i>			
30-Day	1.11%	1.11%	No Change
60-Day	1.12%	1.11%	▲
90-Day	1.13%	1.11%	▲
<i>Treasuries*</i>			
5-Yr	3.26%	2.52%	▲
10-Yr	4.36%	3.67%	▲
30-Yr	5.29%	4.70%	▲
<i>DUS Fixed Rates**</i>			
5-Yr	4.65%	3.86%	▲
7-Yr	5.23%	4.45%	▲
10-Yr	5.82%	4.99%	▲
<i>DUS ARM Rates**</i>			
5-Yr	2.82%	2.80%	▲
7-Yr	3.05%	3.03%	▲
10-Yr	3.32%	3.30%	▲

* On-the-run. **Tier 2 ++ levels. ARMS are non-convertible, 4.50 Cap.

On a Roll

Property Type	City, State	Capital Source	Deal Size
Apartments	Palm Desert, CA	Portfolio	\$25.7 Million
Storage	Houston, TX	Conduit	\$2.89 Million
Assisted Living	Hourma, LA	FHA	\$4.9 Million
Apartments	Fort Myers, FL	Conduit	\$9.8 Million
Retail	Dallas, TX	Conduit	\$3.9 Million
Apartments	Fairfax, VA	Fannie Mae	\$23.5 Million
Retail	Aberdeen, MD	Conduit	\$7.9 Million

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