Prudential Mortgage Capital Company

Market Perspective

www.prudential.com/mortgagecapital
May 2004
Issue 5

Financing Matters

■ Over the past six months, floating-rate spreads have tightened by 25-50 bps, making for very enticing coupons. This tightening, coupled with a recent rise in Treasuries, has resulted in an ever-widening margin between floating- and fixed-rate pricing.

■ Equity investors' demand for top, grocery anchored-retail centers in major markets has strengthened lately, as evidenced by tightening cap rates for this property type compared to other retail types (eg. regional malls, power centers, neighborhood centers). Recognizing this increase in demand, lenders have been more aggressive in pricing and underwriting these centers.

■ Competition from banks for unstabilized transactions is fierce, as they desperately try to find new ways to place their money. Other new entrants, such as hedge funds and newly formed REITs, are also contributing to oversupply of capital in the unstabilized niche. And yet, the new entrants are "novices" in the area and tend to significantly under-price the risk involved and also not properly structure the loan to account for the degree of risk in the transaction.

■ Fannie Mae reports that multifamily delinquency rates remained stable in March at 0.24%. Citigroup reports that CMBS multifamily delinquency improved to 1.6% - still considerably higher than Fannie Mae multifamily mortgages.

■ After many reports showing a strengthening economy, the markets started to prepare for the inevitable rate increase. Yield on the 10 increased by 63 bps and swaps widened by 7.75 bps. Futures suggest the Fed may raise the overnight target by 25 bps at the August FOMC meeting.

Market Commentary

CMBS issuance continues its record pace and the spread tone remains positive. Last week, the market absorbed a $2.6 billion CMBS transaction (the largest in several years) at spreads tighter than expected. Clearly, investor demand for CMBS remains very strong as it continues to be attractive to fixed-income investors, relative to other similar alternatives. We expect to see approximately $5 billion in new issuance during May, and probably a similar amount in June.

Pru Fact

Prudential Mortgage Capital Company ranked 8th in the 2004 Top Lenders Survey, published by *National Real Estate Investor* in their May 2004 issue. Production numbers are 2003 full-year lending volume.

Market Trends

■ *Treasuries* April was full of upbeat economic news, with even the employment picture looking brighter. Investors certainly noticed and priced in the prospect for higher inflation and higher rates. The 10-year Treasury yield rocketed up from 3.84% to 4.51% by month-end.

■ *Corporate Spreads* The Lehman index reported that, on average, corporate spreads widened 4 bps for the month. The prospect of higher rates driving higher costs of borrowing led investors to demand wider spreads. Loan demand has picked up as borrowers rush to lock-in spreads before yields rise further.

Key Indices	5/6/04	4/8/04	Change
10-Yr Swaps	52.5	41.3	▲
Prime	4.00%	4.00%	No Change
DJIA	10,241	10,442	▼
LIBOR			
30-Day	1.10%	1.10%	No Change
60-Day	1.13%	1.12%	▲
90-Day	1.18%	1.14%	▲
*Treasuries**			
5-Yr	3.71%	3.22%	▲
10-Yr	4.61%	4.19%	▲
30-Yr	5.38%	5.03%	▲
*DUS Fixed Rates***			
5-Yr	5.19%	4.54%	▲
7-Yr	5.66%	5.05%	▲
10-Yr	6.06%	5.49%	▲
*DUS ARM Rates***			
5-Yr	3.17%	2.96%	▲
7-Yr	3.44%	3.20%	▲
10-Yr	3.70%	3.48%	▲

* 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	Slidell, LA	FHA	$14 Million
Affordable	Arlington, TX	Redstone	$14 Million
Retail	Springfield, VA	Conduit	$6 Million
Industrial	Deer Park, TX	FHA	$1.67 Million
Office	Billings, MT	Conduit	$8.3 Million
Apartments	Long Beach, CA	Fannie Mae	$15.6 Million