

AN OVERVIEW OF COMMERCIAL REAL ESTATE FINANCE TRENDS IN REAL ESTATE 2004

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Interest Rates

Though there have been noticeable increases in interest rates at the end of the first quarter and beginning of the second quarter of 2004, rates are still near historical lows.

| Real Estate Capital Markets Scorecard: "Prime" 10-Year Commercial Mortgages Versus Treasuries Yields as of February 29, 2004 | | | | | | | | | |
|--|---------|----------|----------|----------|----------|----------|----------|---------|--------|
| | 7/31/98 | 12/31/98 | 12/31/99 | 12/31/00 | 12/31/01 | 12/31/02 | 12/31/03 | 2/29/04 | YTD |
| Prime Mortgages | 6.82% | 7.00% | 8.45% | 7.35% | 7.33% | 6.05% | 5.80% | 5.50% | -0.30% |
| 10-Year Treasuries | 5.50% | 4.87% | 6.52% | 5.11% | 5.05% | 3.81% | 4.25% | 4.01% | -0.24% |
| Spread | 1.32% | 2.13% | 1.93% | 2.24% | 2.28% | 2.23% | 1.65% | 1.49% | -0.16% |
| Source: Barron's/John B. Levy and Company Survey - reported in the ULI Capital Markets Update 3/23/04 | | | | | | | | | |

Property Types

As indicated by loan volume in 2003, apartments are still the most preferred property type for permanent lenders. Grocery-anchored retail centers have been highly favored in the past but are now subject to intense scrutiny with the sweeping changes in the grocery business as Wal-Mart changes the landscape of that industry.

| Origination Volume By Property Type | | | |
|--|-----------------------|-----------------------|-------------------|
| | 2003 (\$ Millions) | 2002 (\$ Millions) | Percent Change |
| Office | 25,320 | 17,843 | 41.9 |
| Retail | 18,481 | 13,082 | 41.3 |
| Multifamily | 49,862 | 41,042 | 21.5 |
| Industrial | 7,888 | 6,569 | 20.1 |
| Hotel/Motel | 2,830 | 1,336 | 111.7 |
| Health Care | 2,438 | 1,717 | 42.0 |
| Other | 9,191 | 4,861 | 89.1 |

Source: MBA Commercial Mortgage Banker Origination Survey

Mezzanine Financing

Mezzanine financing bridges the gap between traditional debt sources and owner equity. Programs that increase leverage to 85% with a minimum 1.10x combined debt service coverage ratio are plentiful and some are available at higher levels. Rates range from the low teens for the 85% LTV range with good stories and exit strategies to the higher teens for higher leverage deals. Most mezzanine lenders require a minimum return and have a minimum investment level of \$3mm to \$5mm. Some programs are available with a \$1mm minimum investment level.

Mezzanine financing is also becoming more prevalent for conduit and GSE lending as rating agencies and the GSEs clarify requirements for inter-creditor agreements and other loan terms.

HUD Insured Programs

221(d)(4) New Construction/Substantial Rehabilitation Multifamily Rental Apartments

- Facilities: Elderly developments (age 62 and over) are permitted but the facility can not contain mandatory meals or services associated with retirement service centers. HUD is prohibited from insuring loans for projects designed for transient housing, hotel, or student housing, though students are eligible occupants for family housing financed with insured loans. Loans in college areas must be underwritten at comparable rents for family housing.
- Maximum Term/Amortization: 40 years
- Minimum DSCR: The amount of debt that can be serviced by 90% of NOI.
- Maximum LTC: 90%.

223(f) Acquisition/Refinancing of Existing Apartments

- Facilities: Same as above but complexes must have been completed or substantially rehabilitated for at least three years prior to date of application.
- Term/Amortization: The lesser of 35 years or 75% of remaining economic life as determined by the appraiser based on information supplied by the physical and capital needs assessor.
- Minimum DSCR: 1.1765 times on net operating income (85% of NOI).
- Maximum LTV: 85%.
- Maximum Loan Amount: The insured loan amount can not exceed the lesser of the amount based on the Minimum DSCR, the Maximum LTV, the statutory per units limitations adjusted by the local high cost factor, or the greater of cost to refinance (defined below) and 80% of value for a refinance transaction or 85% of the cost to acquire the property.

The Refinance Dilemma

Many borrowers are faced with what appears to be a difficult decision when considering options on permanent loans: do I (1) refinance my loan today, locking in a favorable interest rate at today's valuations but endure a substantial prepayment penalty, or (2) wait until the loan no longer has a prepayment penalty and take my chances on where interest rates and property valuations will be? The questions and answers are similar to those faced by residential property owners looking to refinance their homes, with the solution being based on a cost/benefit analysis: do I recover my costs over a reasonable time period and are my discounted cash flows greater with one scenario over another?

Given that interest rates have been at all-time lows for an extended period and cap rates are lower than they have been for some time, the conventional wisdom is that both rates will increase in the near future, meaning that borrowing costs will be higher and loan amounts will be lower than those available today. Borrowers should carefully examine the discounted cash flows from refinancing and will probably find that it makes sense to refinance debt even with a substantial prepayment penalty if they feel that rates will increase by as little as 1.0% in the near future.