

## Fed Increases Key Rate – How are Apartment Lenders Reacting?

**W**e're bullish on apartments. Our outlook for the apartment market in Southern California is expressed in the adjacent lead article.

Multi-family and commercial loans continue to be the bulk of our loan volume. During the first six months of 2004, Venture West originated nearly \$500,000,000 of new loans, of which about 80% were secured by apartment buildings or commercial real estate. We fully expect that our full year results for 2004 will exceed the \$1.0 billion of loan originations we generated during all of 2003, even as the number of potential transactions – or market opportunity – has declined from the peak levels of 2003, largely because refinancing opportunities are on the wane.

We are firmly committed to expanding our reach within our core Southern California market – by adding production personnel and by working with our principal lenders to consistently bring the best loan pricing and terms to our clients and brokers.

On the reverse are details of a "Comedy & Magic Fun'draiser" we are co-sponsoring in August to raise funds for the Jason Allison Family Foundation and the Los Angeles Children's Center. We invite your participation for a fun evening for a wonderful cause.

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**O**n June 30, the Federal Reserve Board (FRB) raised its target for the federal funds rate by a quarter-point (0.25%), to 1.25%, an action that had been widely expected for some time. The fed funds rate is the leading barometer of short-term interest rates, and movement(s) can presage future Fed actions and the general tenor of market interest rates, including mortgage rates. This most recent action by the FRB marked its first increase in the federal funds rate target in four years.

The FRB's announcement included clear signs that, subject as always to its assessment of the economy and other factors, the fed funds rate could be expected to rise further over the coming months (at a "measured" pace in Fed parlance), perhaps reaching 3.00% (or perhaps higher) by the middle of 2005. Consistent with historical patterns, future Fed actions would likely be played out with several incremental increases, accompanied by further "hints" about the Fed's longer-term intentions.

Because the Fed had telegraphed its intention of beginning the process of increasing the fed funds rate, intermediate and long-term U.S. Treasury yields – which are determined daily by the marketplace – actually dipped slightly with the June 30th announcement. This resulted in a corresponding, though modest, decline in mortgage interest rates. However, these modest declines fell far short of the trough in Treasury yields and mortgage interest rates reached in June 2003 and briefly revisited in early 2004.

**What does this mean for property values?** By itself, this rise in the fed funds rate will have no impact upon property valuations. Rather, it is the expectation of future interest rates – whether higher or lower – and the

availability of financing, that have the most direct impact upon short-term actions by property owners.

A prolonged and sustained rise in the federal funds rate, other short-term interest rates and the all-important indices that are used to price adjustable-rate mortgages may eventually cool off the euphoria that has gripped our property markets for the past several years. The frenzy that appears to be present in the housing markets – buyers wanting to get in now while mortgage rates are still near 40-year lows and credit being widely available to almost anyone, and sellers wanting to cash in on their inflated home values – will gradually abate as mortgage rates rise in the coming year (if they do). For apartment building owners and buyers and sellers, the picture is perhaps a bit more involved. Apartment building rents throughout Southern California are expected to rise 6% to 7% in each of the next two years (if not beyond) and vacancy rates are projected to remain in the 2% to 3% range (essentially full market occupancy). For experienced operators, this potential revenue rise, low vacancy and low level of new construction will likely put continued upward pressure on property values, that will only be gradually tempered by a rise in building financing costs.

#### **Are lenders changing their approach to apartment loans?**

So what do these competing forces portend for the financing of apartment buildings over the coming months? To get answers to these questions, we called some of our major lenders.

*(continued)*





## VENTURE WEST FUNDING

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### Join us for a "Fun'draiser"

Venture West Funding is joining with the Jason Allison Family Foundation, Bear Stearns, and Impac Multifamily Capital Corp. to present a Comedy & Magic "Fun'draiser" on Wednesday, August 25, 2004, from 6:00 p.m. to 9:00 p.m. at the Hermosa Comedy & Magic Club.

The event will create public awareness and raise the funds needed for the care and treatment of our abused children in Los Angeles. The cover price of \$75 per ticket includes dinner and admission to the show. Please join us!

Reservations must be made in advance by calling Beth Tomaszkiwicz at Venture West, 310-364-3131 x241, or contact Beth at [Betht@ventwest.com](mailto:Betht@ventwest.com)

*People who work sitting down get paid more than people who work standing up.*  
– Ogden Nash

*The more I want to get something done, the less I call it work.*  
– Richard Bach

*Death is nature's way of saying, "Your table is ready."*  
– Robin Williams

*You can fool all the people all the time if the advertising is right and the budget is big enough.*  
– Joseph E. Levine

### Selected Indices Comparison

	07/02	07/03	07/04
30-yr. T-bond	5.420	4.600	5.220
10-yr. T-Notes	4.650	3.550	4.470
12 MTA	2.414	1.548	1.381
COFI	2.821	2.210	1.708
1-yr. CMT	1.960	1.050	2.160

### We're Lending in a Big Way (A Small Sampling)

- \$35 million loan package to refinance 10 apartment buildings located in West Los Angeles, CA
- \$8.0 million loan package to refinance 23 multiple-unit buildings located in San Diego, CA
- \$4.6 million loan to refinance a retail complex located in Beverly Hills, CA
- \$9.6 million loan package to refinance 5 apartment buildings located in Inglewood, CA
- \$3.0 million loan to finance the purchase of a single-family residence located in Los Angeles, CA
- \$12.5 million loan package to finance the purchase of 4 apartment buildings located in Orange County, CA

### Fed Increases Key Rate... *(continued)*

According to Paul Klenner, executive vice president at **Luther Burbank Savings**, a \$1.6 billion (assets) thrift – "We just moved from two-tier pricing to only one tier. Before, we were giving our best pricing to loans of \$1,000,000 and up. Now our best pricing is available on loans of \$500,000 and up. This will provide more money for the \$500,000 to \$1,000,000 apartment borrower at more favorable rates. We have tightened up our underwriting standards a bit. We moved up our qualifying rate slightly and are a little more conservative on debt service ratios. We consider upside potential on apartment rents, but we use actual rents to calculate debt service ratios."

At **Quaker City Bank**, a \$1.7 billion (assets) thrift being acquired by Banco Popular (at \$36 billion the 15th largest bank holding company in the U.S.), senior loan officer Mike Hershman said, "We noticed that several of our competitors have lowered their qualifying rate. We're still holding to the same qualifying rate and think this is not a good time to loosen up. However, it appears the apartment loan market is shrinking. If that's true, lenders will have to either deliver more dollars, or lower rates to stay competitive. We are looking at various ways to stay competitive; for example, we might adjust our pre-payment penalty, rate lock policy on fixed rates, alternative adjustable products, etc. Apartment loans have been strong. There will continue to be plenty of money available."

Tony Fire, a senior executive at **Commercial Capital Bank**, a rapidly growing \$4.7 billion (assets) bank, said, "We're bullish on apartments, especially in Southern California. We have made no changes in our underwriting standards. We will watch rates and the market, but we don't anticipate changes at this time. We are probably one of the most aggressive financial institutions in the multi-family marketplace in California. Most of us – both lenders and apartment owners – anticipated that the 40-plus year historic low rates would not stay low forever. This is a supply-constrained market. There is more demand for apartments than the available supply in Southern California. We will continue to underwrite loans that are prudent."

### Bottom line for apartment owners

We see financing costs for all property types rising, albeit gradually, over the coming quarters. For apartment building owners, purchasers and sellers, the cost to finance purchases, or to refinance existing mortgage debt, will increase, though at a rate less than the projected growth in apartment rents. Funds for financing apartment buildings will remain ample – there will continue to be a home for almost any apartment building. Many, if not most, lenders retain significant excess liquidity and capital that must be deployed. Certain lenders will remain, or seek to become, leaders in aggressively pursuing market share – by setting their underwriting interest rates at levels proximate to the fully-adjusted interest rate on ARM's (rather than at a margin over these rates), and by considering market rents in their evaluation of the future property cash flows from their collateral. Other lenders will likely become more cautious in underwriting apartment loans, in the belief that fully leveraged transactions (those at 75% loan-to-value) with adjustable-rate financing are subject to "payment shock" should short-term mortgage rates rise precipitously.

All in all, we at Venture West are enthusiastic about the apartment finance business, and the underlying apartment building business.

[www.venturewestfunding.com](http://www.venturewestfunding.com)

