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Commercial Real Estate Remains Stalled

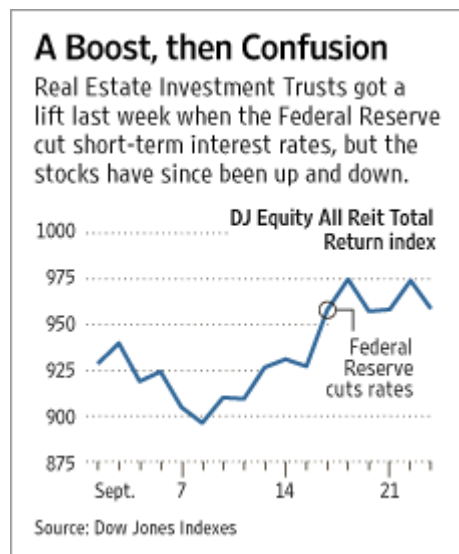
**Despite Fed Rate-Cut Jolt,
Near Paralysis Continues;
Marylebone Pulls Sale**

By **KEMBA J. DUNHAM**
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Last week's interest-rate cut by the Federal Reserve gave hope to many people who follow the residential real-estate market, but the commercial markets have shrugged it off.

Industry watchers say the new rate could boost consumer confidence, but so far it hasn't been enough to significantly ameliorate the credit crunch. One factor is that the 10-year Treasury yield, to which fixed-rate, commercial mortgages are closely tied, has risen in the past week, increasing borrowing costs. Thus, many commercial deals could remain stalled, experts say.

"While the interest-rate cut by the Federal Reserve definitely helped restore investor confidence in the near term, it will likely have little fundamental effect on commercial mortgage lending," said Alan Todd, executive director and head of CMBS research for JP Morgan Securities, a unit of J.P. Morgan Chase & Co.




In the days leading up to the Fed's announcement that it would lower its target for the federal-funds rate by half a percentage point to 4.75%, there was a lot of conjecture from those who track the industry about how the move would affect commercial real estate. The credit markets had been in a state of near paralysis in recent months following the mortgage-market meltdown, with fears that the lax underwriting standards that were rampant in residential lending were also commonplace on the commercial side. As a result, few banks were making new loans for commercial properties. The market for commercial-mortgage backed securities (pools of loans that are sold to investors as bonds) had nearly shut down because bond buyers began viewing them as too risky.

So when the Federal Reserve made the steep cut, it appeared to give a badly needed jolt to the commercial market. Here's why: the federal-funds rate is the interest banks charge one another for overnight loans.

Many industry watchers assumed that once lenders had a lower cost of capital, they would pass along the savings to borrowers. The day of the announcement, stocks of publicly traded real-estate investment trusts rallied, closing up 3.31%, although they have been volatile since, according to SNL Financial's Equity REIT index.

"The Fed is making a concerted effort to avoid an economic slowdown, and that will likely keep property-leasing demand healthy in the short term and continue to support the perception that real-estate values and assets are a good place to be," Wachovia analyst Christopher Haley said.

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Nonetheless, the credit crunch remains evident. Late last week, United Kingdom property company Marylebone Warwick Balfour Group PLC pulled the sale of its £495 million (\$1 billion) hotel portfolio for the second time, citing "current uncertainties in the markets" for the postponement of the deal.

"I think we're far from out of the woods yet," said Mike Kirby, chairman of Green Street Advisors, a Newport Beach, Calif., real-estate research company.

One reason is that the federal-funds rate has a greater impact on shorter-term financing, such as construction loans. Most long-term commercial mortgages are tied to the 10-year Treasury note, not the federal-funds rate. And the 10-year Treasury yield moved up in the past week (it typically moves independently of the federal-funds rate) increasing the cost to borrowers.

So the Federal Reserve's move has done little to allay bond buyers' fears. For those needing short-term loans, "it will help people make deals, but we don't see how lower interest rates will break up the logjam and cause bond buyers to buy hundreds of billions of dollars of bonds in all the asset classes," said Gary Mozer, principal with George Smith Partners, a Los Angeles-based commercial-real-estate finance firm.

Still, that doesn't mean some outlets aren't trying. Lehman Brothers Holdings Inc. has found buyers for \$8.9 billion of commercial-mortgage-backed securities that will be used to fund its joint-venture purchase with Tishman Speyer Properties of apartment company **Archstone-Smith Trust**, according to people familiar with the matter who say the buyers are "locked up." Lehman began to shop an additional \$3.1 billion in debt tied to the deal the day after the Fed cut rates. Lehman declined to comment, so it's unclear how well those bonds are selling.

Many industry watchers believe it will be months before the market fully recovers. "Some deals have gone through, and pricing for senior bonds is firming up, but the market is still a little bit choppy in trying to work its way back to health," said Tad Philipp, a managing director for Moody's Investors Service.

--Alex Frangos and Molly Dover contributed to this article.

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