

Mortgage Fund Flows, Capital Appreciation, and Real Estate Cycles

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Abstract

This paper hypothesizes and analyzes an interaction between the commercial real estate market and the commercial mortgage market. Using quarterly U.S. data from 1978 to 2008, we find a positive feedback loop between mortgage fund flows, which measure changes in mortgage capital supply, and commercial real estate capital appreciation. Specifically, past real estate investment performance positively affects mortgage capital supply, and likewise, changes in mortgage capital supply affect property valuation in the same quarter. In the analysis, the CMBS spread to swaps are used to validate the use of mortgage fund flows as a measurement for changes in capital supply in the period from 1997 to 2007. This positive feedback loop is likely an important driving force behind real estate cycles.

JEL classification: G12, E32, E44

Key words: real estate cycles, commercial real estate, mortgage fund flows, positive feedback loop

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