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PRESS RELEASE

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FED MUST FIND NEW WAYS TO EFFECTIVELY MANIPULATE RATE HIKES

Once upon a time, the Federal Reserve Board altered monetary policy by raising and lowering the target for the Fed funds rate. Fed funds are the reserves that banks are required by law to hold in an account with the Fed.

For large banks, the amount is 10 percent of deposits.

The funds are essentially for safekeeping and can't be invested. However, since 2008, the Fed has had the power to pay interest on them.

Simply, in the Fed funds market, funds in excess of the 10 percent ratio can be invested and lent out within the Federal Reserve System.

Historically, those banks with more reserves than needed have lent to banks that didn't have enough funds, usually on an overnight basis. The problem is that all of the banks in the system now have way more reserves than they need because the Fed pumped large volumes of reserves into the system in an effort to contain the financial crisis and later to support economic growth.

"The question some experts are raising now is not when but if, when the time comes, the Fed will be able to successfully raise interest rates in response to an overheating economy," Cambridge Realty Capital Companies Chairman Jeffrey A. Davis observes.

Here's how it works: supply and demand creates prices. A rising supply of reserves pushes the price of reserves – the Fed funds rate – down. So to raise interest rates, the Fed must to find ways to get reserves out of the system.

Effectively, the central bank creates reserves out of thin air. In the past, the Fed had a relatively simple and effective way to pull reserves out of the system by selling securities from its stockpile of short- term U.S. Treasury bills. By selling these securities, the central bank withdraws reserves from the system by accepting reserves as payment.

This worked well enough in a pre-crisis era when the Fed was trying to manipulate a much smaller market. However, in today's world, there are nowhere near enough short-term Treasuries to soak up the $2.5 trillion in reserves that are out there.

Here's a further complication. The Fed doesn't have any Treasury bills left. It has let its holdings of Treasury bills mature, leaving it with none to sell as a way to pull money out of the system to raise rates.

So the Fed started buying longer-term U.S. Treasury bonds. Unlike Treasury bills, which are shorter-term government debts, bonds mature over a period of a year or longer. But it's unlikely the Fed will attempt to sell its bond portfolio for fear this would cause interest rates to spike, undoing all of the beneficial economic effects achieved over the last few years.

“It’s a brave new world. The expectation is that the Fed will find innovative ways to effectively use the various new tools it has in its toolkit, but we don’t have the same assurances as before,” Mr. Davis said.

One new idea the Fed has come up with is the overnight reverse repurchase agreements (ON RRP). Essentially, ON RRPs are overnight deposits the Fed can accept only from a much broader group of financial institutions than banks.

The interest rate on ON RRPs is supposed to act as a kind of floor for short-term interest rates, while the rate on reserves is supposed to act as a monetary magnet of sorts to lift rates higher. In theory, by manipulating these two rates, the Fed should be able to control other short-term interest rates, including the Fed funds rate.

“But it’s reasonable for senior housing/healthcare borrowers to approach interest rate timing issues with caution. With all the reserves in the system, interest rates may not be as responsive to prompting as we might like,” Mr. Davis said.

Privately owned since its founding in 1983 as a real estate investment banker specializing in commercial real estate properties, Cambridge today has three distinctive business units: FHA-insured HUD loans, conventional financing, and investments and acquisitions. The company is one of the nation's leading senior housing and healthcare debt and equity capital providers, with more than 400 closed senior housing transactions totaling more than $4.5 billion since the early 1990's, when the firm began its specialization in providing senior housing capital.

Cambridge has consistently ranked among the country's top five FHA-insured HUD lenders (now HUD Lean) over the last 15 years and offers an array of conventional lending options, including permanent construction and interim loans on either a floating or variable rate basis. The company's principal investment strategy includes direct property acquisitions, joint ventures and sale/leasebacks. The company has acquired 16 facilities totaling approximately $60 million.

Cambridge is the creator of *The Signature Experience*™, a four-step process designed to transform the traditional lender/borrower relationship and identify “ideal” capital solutions for worthy projects. The company has a national origination office in Los Angeles, and numerous correspondent and brokerage relationships nationwide.

Cambridge publishes the bi-monthly Capital Wisdom(R) electronic newsletter, which delivers company news and feature stories via e-mail to corporate friends and clients as well as monthly updates of other relevant news and breaking trends. Additional information is available on the Cambridge website, www.cambridgecap.com, and Cambridge can be reached at (312) 357-1601 or via e-mail to *info@cambridgecap.com*. The firm also has embraced social media and networking via Twitter at http://twitter.com/cambridgecap, via Facebook at http://www.facebook.com/cambridgecap, via blog at www.cambridgecap.com/blog and via Linkedin at http://www.linkedin.com/companies/454232, where information on the firm and its employees can be found.

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