

# MESSAGE FROM THE CHAIRMAN



All indications are that 2007 is going to be another extremely strong year for the New York Metropolitan Areas building sales market. There are five main reasons why we believe this is the case:

**Reason #1 - Capital Availability.** There is presently an unprecedented amount of capital available in the marketplace on both a debt and equity basis. Equity continues to pour in from many different sources as real estate is becoming a more of a generally accepted asset class across the nation. In the 1970's and early 80's, real estate investors were considered risk takers and cowboys. Today real estate can be purchased by the average American through REITS and, as my friend and client Ofer Yardeni says, "Real estate has replaced baseball as our national past time". **Given the extraordinary returns that have been achieved in the market during the past few years, an ever increasing amount of capital is slated to be deployed into the market.** Funds are being raised at record levels and this continues to exert upward pressure on demand. **On the debt side, many of the lenders that we have spoken to have indicated that 2006 quotas for the amount of money they wanted to put on the street were not met.** This has added pressure to their operations for 2007 and lenders are being more aggressive with their loan-to-value ratios and debt coverage ratios. **This need and desire to put more debt into the marketplace is accretive to this capital availability issue.**

**Reason #2 - Rental Growth.** We believe 2007 will demonstrate fantastic rental growth in both the residential and commercial sectors. Momentum has been building in the commercial office market with concessions being reduced and tenant improvement allowances being cut. The vacancy rate in both midtown and downtown has been dropping. These dynamics are putting upward pressure on commercial

rents. On the residential side, rent regulation continues to exacerbate the shortage of available supply with residential vacancy rates anywhere from 1-3% depending upon which report you read. Even at the high end, this is a miniscule vacancy by any measure. **Given most new construction has been and will, for the foreseeable future, continue to be for-sale housing, upward pressure on rents has investors underwriting rental growth of anywhere from 5% to 30% for this year.**

**Reason #3 - Low Supply of Available Product.** While 2006 will look, on the surface, like a year with tremendous sales volume, we must look at volume in two different ways. The \$31 billion of investment property sales in 2006 shows a dramatic increase over the sales volume in 2005. We believe, however, that this large increase in aggregate sales value was due mainly to several very large transactions. We believe that there was an unprecedented volume of sales of approximately 3.9% of the total stock of buildings in the City in the first half of 2006 (on an annualized basis). However, **we believe that the number of transactions in the second half of 2006 will show that activity slowed and that the total number of transactions in 2006 will be less than the total number of transactions in 2005.** We believe that this was due mainly to many discretionary sellers selling in the second half of 2005 and the first half of 2006 leaving primarily the very active traders buying and selling in the second half. **Presently we believe there is a relatively low supply of available product and with increasing demand across all market segments; this will exert continued upward pressure on pricing.**

**Reason #4 - International Demand.** We are seeing a continued increase in international demand for New York Metropolitan Area real estate. Given the dollar's relative weak position and the popular acceptance that New York City is the

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safest big city in the world and the financial capital of the world, we are seeing billions of dollars pouring into the market from foreign sources. This capital is often in transparent form for office buildings and hotels and is often camouflaged in the multi-family sector as it is deployed in the form of equity financing for local operators. This dynamic augments the demand that is already present domestically and will continue to keep upward pressure on the market.

**Reason #5 - Interest Rates. We believe that interest rates will remain steady during 2007 with most economists predicting an easing of rates during the second or third quarter of the year.** Inflation is still the most significant concern of Fed Chairman Bernanke and some indications are that we are not yet in "the safe zone" in terms of inflation fears abating. Given this, the Fed has not eased rates thus far in 2007 as the yield curve was predicting during the fall of 2006. We believe that rates will ease in mid-2007 as the effects of the national housing market slow down in 2006 will be tangibly felt across many economic indicators including unemployment. **With interest rates remaining relatively stable and yield expectation on behalf of buyers remaining steady, we anticipate that prices per square foot will continue to increase in conjunction with the rental growth that is anticipated.** Given the cap rate compression (which

we really believe was cash on cash return compression rather than cap rate compression) that the market has already experienced, **we do not anticipate cap rates falling further. Therefore, the appreciation in the market in 2007 will be directly related to the performance of the rental markets.**

In conclusion, 2007 should be another fantastic year for the marketplace. Key indicators to watch will include the movement of interest rates and the actual rate of rental growth in both the residential and commercial segments. Perhaps the most important variable to watch will be the performance of the consumer condominium market as it will have profound effects on land value and conversion property pricing.....stay tuned.....

Very truly yours,



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*During Mr. Knakal's 23 year career, he had sold over 900 buildings having an aggregate market value of over \$4.25 Billion. He was the top salesman, with partner Paul Massey, at Coldwell Banker Commercial(now CB Richard Ellis) in New York in 1986, 1987, and 1988 prior to forming Massey Knakal. In 1999 he was awarded Crain's New York Business "40 Under 40" awarded annually to 40 business people under forty years of age for outstanding achievement in the New York business community. In 2001 Mr. Knakal was named one of "The Top Dealmakers" by Real Estate New York Magazine. He has twice been the recipient of the Robert T. Lawrence Award in the Real Estate Board of New York's Most Ingenious Deal of the Year Contest. First in 2002, for the assemblage of the easterly blockfront of Second Avenue between 54th and 55th Streets. Then again in 2004 for the sale of the historic Gotham Book Mart at 41 West 47th Street. Please give a call if you have questions about your property or the market in general.*

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