Message from the Chairman

May/June 2007

The issue of the day pertaining to the building sales market in New York seems to be the current state of the credit markets. All types of lenders are implementing more conservative underwriting policies. This is causing financing to become slightly less readily available and is necessitating more equity for transactions. **These underwriting corrections have created a widening of spreads and a lowering of loan to value ratios which is creating a requirement for this additional equity.** This is, we believe, a positive and healthy development for our markets.

The lack of discipline in the lending arena in the late 80's exacerbated the problems the market encountered in the early 90's. While undisciplined lending was clearly not the major cause of the difficult market in the early 90's, this factor definitely added to the difficulties we all had to live through during that period. **During the past year or so, there has been a loosening of underwriting standards which allowed borrowers to purchase properties with less equity than considered healthy for the market and afforded novice purchasers access to essentially the same debt accessible to experienced players.** This dynamic exerted upward pressure on building prices and downward pressure on cap rates. The more conservative perspective lenders are taking towards the market has indeed widened spreads but base interest rates, for the most part, have remained stable. **There are still a tremendous number of lenders looking to pump money into the market. Moreover, there is nothing on the horizon (other than global upward rate pressures) indicating that interest rates will go up.**

The interest rate component of our market has such a significant impact that it is something we track very closely. Fortunately for our building sales market and unfortunately for the country, we have recently seen the weakest domestic growth since 2002. This growth is measured by Gross Domestic Product which is the broadest measure of economic output. In the first quarter of 2007 growth was only 1.3% (on an annualized basis), and it is expected that growth will be less than 3% well into 2008. This slow down in growth is representative of a weakness in consumer spending which accounts for 70% of our economy. This relatively weak growth is also a representation of what is a subtraction of drags on the economy, such as the housing sector and the fact that inventories in manufacturing, are fading. April sales were weaker than expected and while these drags on the economy do not seem positive, they serve to keep inflation and, therefore, our interest rates in check. Recent speculation is that growth will accelerate during 3Q07.

Fed Chairman Bernanke's major concern is inflation. In April the inflation data on an annualized basis was down to 2.3% from 2.5% in March. Without taking into consideration appreciation in rents, inflation was only 1.3%. The reason inflation is running so low is that there is actually disinflation in certain segments of the economy such as airfares, clothing and automobiles. **The Fed's comfort zone on inflation is 1% to 2% and we are rapidly approaching this comfort zone. With inflation in check the reasons are limited as to why interest rates should rise.** Low unemployment will typically exert upward pressure on rates. While unemployment has remained cyclically low, it would have risen in the first quarter from 4.5% to 4.7% if not for the fact that the participation rate had declined. Continued stable rates are reflected in the current yield curve. In fact, **in a recent Wall Street Journal survey, 74% of economists polled believe that interest rates would fall by the end of the year. This would be another stimulus for our already frothy building sales market.** Based upon these circumstances, the federal funds rate should inevitably follow the trend in nominal domestic demand downward in the coming year unless inflationary data reverses.

Another important factor affecting the market today is the continued escalation in rental prices across all product types; residential, retail, hotel and office. As rents and room rates have increased the low supply of available space in the city has prompted developers to reposition some developments from residential (previously the only option based upon recent land prices) to hotel or office. This supply will not be delivered to the market in time to inhibit climbing rents throughout the next 12 months, which is continuing to place upward pressure on building prices. This same dynamic is affecting the retail space market. Retail condos are among the hottest of all product types today, with prices reaching into the several thousand dollars per square foot range in some areas. The hotel segment to the market continues to grow as hotel construction is booming all over the city. The number of tourists that visited New York in 2006 was actually 44 million, up from the 41 million estimate at the

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end of the year. It is predicted that 46 million tourists will visit the city in 2007.

Hotel occupancy rates have been fueled by the fact that the dollar has been weak and 75% of economists are currently predicting that the dollar will fall even further, creating additional stimulus to the hospitality sector of the market. The strength of the condominium market, as reported in the last "Message", has the development site market remaining strong. Surprisingly, the effect of the expansion of the exclusion zone for 421-A benefits and the certificate program has seemed to have little or no impact on the marketplace (other than the fact that affordable buildings constructed to generate sellable tax certificates have all but dried up). There is an absolute tangible effect that these changes will have yet, it does not appear to be affecting the underwriting practices of developers.

From a brokerage perspective, it is more important than ever to maximize the exposure that a property gets as the amount of new money coming into the marketplace is unprecedented. There are new and unheard of buyers paying top dollar for properties. Sellers, who choose not to implement a full marketing program for their properties, are sure to leave significant dollars on the table as the most aggressive buyers are not as readily identifiable as they have been in the past. It is our estimate that had the sellers of our last 300 transactions asked us to only market the property to our top 100 prospects, that perhaps only 75 of these transactions would have closed. We are in a new phase of the market where every buyer needs to be qualified and taken seriously as vast amounts of capital are being deployed into the market from non-traditional sources.

Anticipate continued strength in the market throughout the balance of the year and keep a watchful eye on the political horizon in early 2008 as that variable may have a most profound effect on the future health of our market place.

Very truly yours,

Robert A.Knakal
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During Mr. Knakal's 24 year career, he has sold over 940 buildings having an aggregate marketvalue of over $5.0 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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