Message from the Chairman

MASSEY KNAKAL
Realty Services

July/August 2007

Dear Friends,

The topic on everyone's mind these days is the debt market and the question of whether the credit cycle has peaked. Recent activity in the capital markets has shown equity pricing off by 5%. Lenders are underwriting more conservatively and uncertainty about the future of the debt market is pervasive. **Here are some observations to consider in trying to determine what the short term and medium term may look like for the New York City Metropolitan Area building sales markets.**

While the declines in the equity market are certainly cause for investors to be concerned, it is important to keep this reduction in perspective. **Stocks have enjoyed a bull market since the fourth quarter of 2002 and over the past twelve months, U.S. Stocks are up over 25%. The recent reduction in equities of approximately 5% should be viewed as a "bull correction", a regular consolidation within a rapidly expanding bull market.** Sub-prime mortgages have been in meltdown mode for several months and other relatively low credit investments have experienced a similar spillover effect. We do not believe that New York Metropolitan Area real estate falls into this category. Lenders may underwrite more tightly but the faucet of flowing capital will not be shut off altogether. Recent closings we have had within the past week have proceeded with only minor adjustments to their debt structures. **Within the fixed income equity markets, higher quality bonds have gone up in price as investors are moving to safer assets. New York City real estate should be perceived by the market as a safe asset class. As prices of high quality bonds increase, the yields fall which will make lower yields on real estate look even more attractive.**

If we look at the U.S. economy in general, we have seen an increase in the unemployment rate to 4.65% in July which is the first tangible sign of labor market softening in this cycle. Much of the weakness in the employment sector is continued fallout from the national housing market woes and the sub-prime dynamic. Given this unemployment data and other recent signs of weakness in the national economy, it is now expected that the Fed will adopt a neutral balance of risks at their next meeting. **Gross Domestic Product is also expanding at a below trend rate which, coupled with the unemployment news, should assuage fears of rampant inflation by the Fed. The result of these market dynamics could mean an easing of rates in the future.** In fact, the Federal Funds Futures yield curve was pricing nearly a 0% likelihood that Fed Chairman Bernake would cut rates in 2007. That number had grown to about 30% on July 20th and has since spiked to nearly 100% today. This would be very positive for our market as well.

While the U.S. economy has seen growth below trend, global economies are expanding at a rapid rate which is increasing export productivity domestically. **The present widening of credit spreads and the cost of capital in the global economy, which is increasing, may mean that the current liquidity market is turning. It is extremely important that we realize that the move away from a liquidity driven market means that more speculative investments will be passed by to find more fundamentally based investments.** Recent turmoil in the capital markets may mark the end of the liquidity phase of the market but it could mean the beginning of a fundamentally sound investment market which we believe bodes very well for New York City's commercial real estate market.

In a recent speech by ex-Fed Chair Greenspan, he indicated that the liquidity market was not permanent but that it could be another 3-5 years before abundant liquidity dissipated. If the worst thing that happens, based on the current credit situation, is that additional equity is required for real estate acquisitions this is a fundamentally sound result. Similar to keeping in perspective the reduction in the equity markets, which has created a recent depressed wealth effect on investors even though over the past year their increase in wealth has been significant, the same dynamic appears for real estate. **If additional equity requirements result in real estate prices declining by 5 or 10%, our asset values would be significantly in excess of where they were 12 or 24 months ago. Keeping this fact in mind and realizing that there is still an overwhelming amount of equity available in the marketplace, should all leave us feeling confident that the future of our local building sales market is in great shape.** History illustrates that policy makers typically procrastinate before easing rates during post-asset-bubble phases, but they ease rapidly when they do.

Look for this reduction in rates coupled with global economic expansion to continue to fuel our market.

Very truly yours,

Robert A. Knakal
Chairman

Massey Knakal Realty Services First Half of 2007 Statistics

255	Total Number of Sales Transactions
332	Total Number of Buildings Sold
$1.185 Billion	Total Aggregate Consideration

During Mr. Knakal's 24 year career, he has sold over 940 buildings having an aggregate market value 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. **212-696-2500 x 7777**

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