A CONVERSATION WITH THE CHAIRMAN

MASSEY KNAKAL Realty Services

2nd Quarter 2008

Dear Friends,

This month we sat down with Massey Knakal Chairman Robert Knakal to discuss a mid-year synopsis of today's economy and how it is affecting the New York City building sales market. We hope you find the interview insightful and informative.

Q **In a recent interview in the New York Observer you touched on the building sales market's reduction in volume and its cause. Can you expand on that?**

A When discussing today's market it is very important to specify what segment of the market you are addressing since all segments are not moving in concert. Many articles that you read today mention sales volume only relative to aggregate sales prices and don't reference the number of transactions. **During the first half of 2008, approximately $14 billion of investment properties sold in the city compared with $34 billion at the same point last year. This is a 59% drop in volume**. Some estimates are 50% and some are as high as 75%, depending on the source. The majority of these articles pertain to the market consisting mainly of larger transactions. The overwhelming majority of aggregate sales price over the last few years has consisted of relatively few (less than 100) very large transactions (there are over 5,000 investment property sales in the city each year). The 59% drop in volume is mainly due to the reduction in 9 and 10 figure sales. **In the market for transactions under $100 million we have seen volume reduced by only 21% in terms of the number of transactions and only 13% in aggregate sales price meaning the average sale this year has been at a higher price point. Importantly, this does not mean prices are increasing**. Prices have remained relatively unchanged from 2007 levels on a price per square foot basis. **It is our contention that the reduction in the number of transactions is due to supply constraints**. In the media so much negativity is being portrayed that potential sellers are deciding to delay putting product on the market. We are signing contracts on a daily basis for income producing properties at prices the sellers are very happy with. If we had more product we would move it very quickly. This short supply and the tremendous, yes tremendous, availability of financing from portfolio lenders is helping to buoy prices.

Q **Why are portfolio lenders so active today?**

A Well, there are many reasons and, after all, they are in business to lend money. It is generally considered that a portfolio lender's comfort zone is $30 million or less for an individual loan. If you look at the banking industry today versus what it was like a year or 18 months ago, you'll see that **bank loans are much more profitable today with substantially less risk. Spreads, or profitability, on each dollar deployed has escalated sharply**. A year ago, those spreads were only 25-50 basis points. Today, those spreads have increased to 250-300 basis points. This means that each dollar pumped into the marketplace is almost ten times as profitable to the lender. Moreover, **loan to value ratios used to be 75-85% and are now 60-65% meaning that the loans are less risky**. This is why we are seeing portfolio lenders from all over the region coming into the market and those that were marginal players are stepping up their activity.

Q **What is the state of the current credit market in general?**

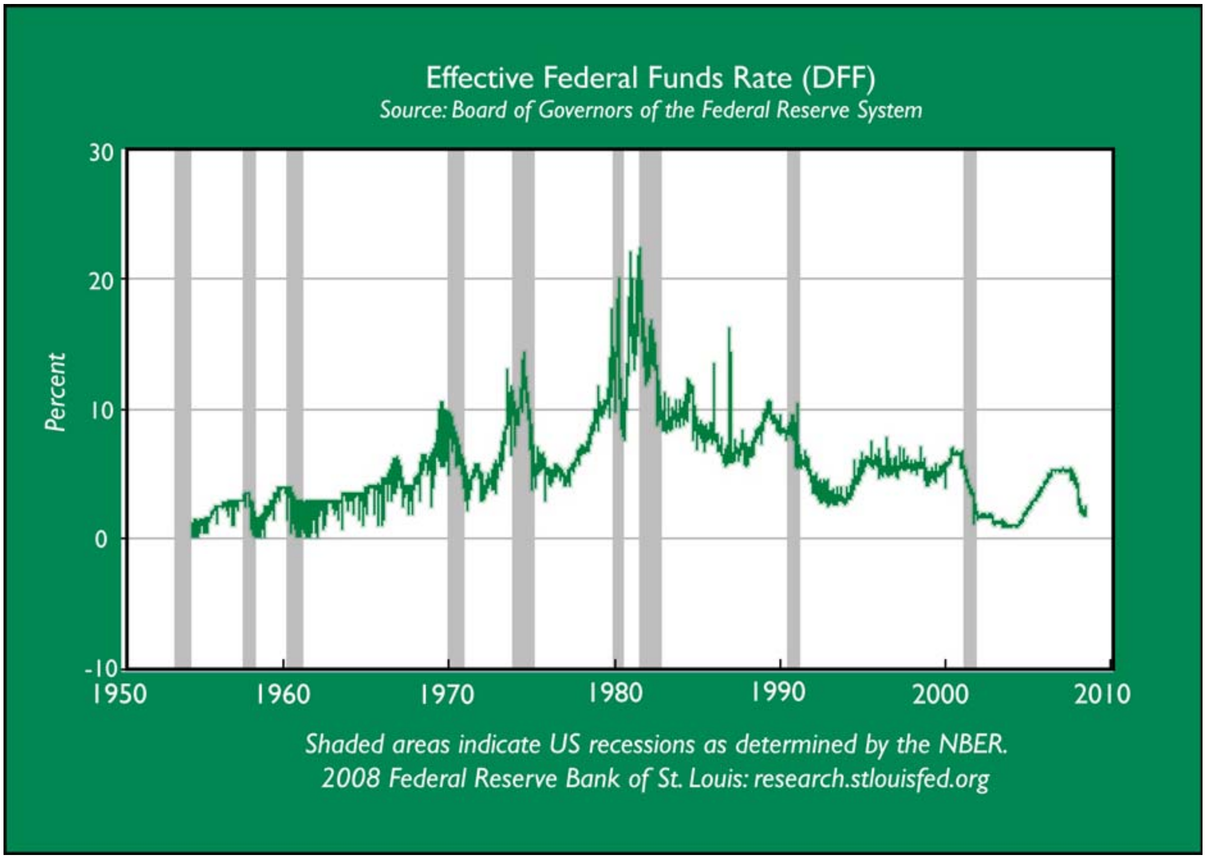
A **The credit markets are still very stressed and there are significant issues that have yet to be resolved**. We are all aware of the subprime debacle and its effect on investment banks. It is very likely that additional losses will have to be absorbed by investment banks before a recovery can begin. **The next issue that will be making headlines will be the woes of the regional and smaller banks which face mounting construction loan problems**. Many have excessive percentages of their total risk based capital in construction loans. Nearly one out of three have more than 100% of their total risk based capital in construction loans, a red flag to regulators. **According to the FDIC, $45.5 billion of the $631.8 billion in construction loans outstanding at the end of the first quarter were delinquent**. It is expected that second quarter results will be more negative. CMBS lenders are effectively out of business and until a new product or new mechanism is created to fill that void, large transaction financings are going to remain very challenging. **Credit markets, in general, may not have seen their worst state**. It could be said that optimists today are under estimating the severity of the credit collapse. In May, total bank credit shrank at a 5.1% annual rate. Household credit has shrunk at a 2.7% annual rate spread between a 3.6% drop in mortgage credit and a 1.5% drop in consumer loans. Business lending has also receded at an 8.2% annual rate. **Interestingly, not a single company backed by venture capitalists went public in the 2nd quarter of 2008, the first time that has happened since 1978**. A sustained reduction in credit demand is not likely to lead to a sustained increase in interest rates. The good news is that if a lender is going to lend anywhere, it will, and should be, on New York City real estate.

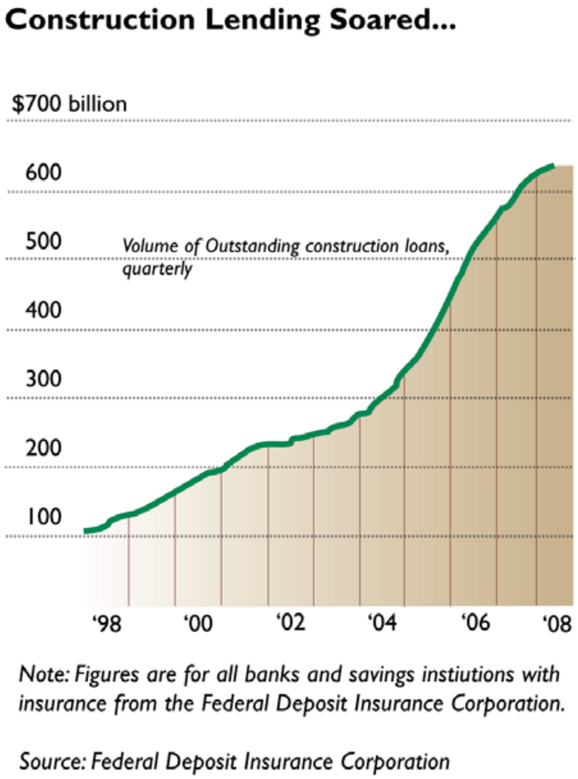
Q What is the "deleveraging" that we hear about?

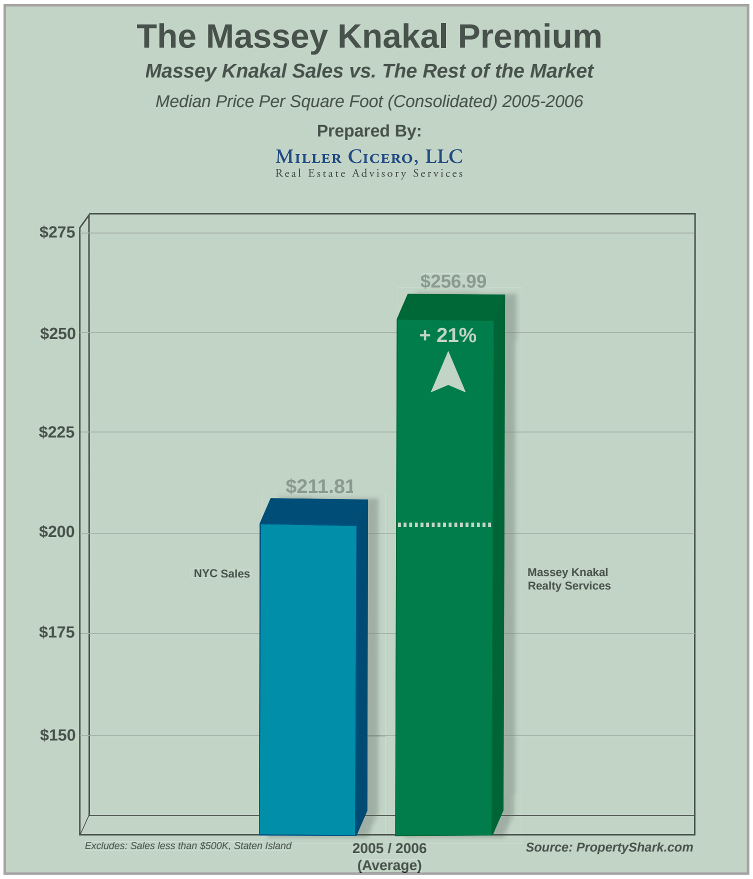
A Deleveraging is a term to address the fact that the amount of leverage available in the past is not available today. To the extent that properties which were financed within the last couple of years, need to be refinanced now, the amount of leverage will be lower so additional equity will be required to effectuate the refinancing. As the amount of leverage is reduced, the market experiences a deleveraging. Essentially, the total amount of leverage tomorrow will be less than the total amount today.

Q The Fed seems to have indicated a potential tightening of monetary policy based upon inflation concerns. Do you think rates will increase?

A This is a very complicated issue and one that could have a significant impact on our building sales market. It's very clear from the speeches that Fed Chairman Bernanke has made recently that **there is a tangible shift in the perspective of the Fed away from stimulating growth and towards fighting inflation**. In May, increases in CPI, which totaled 0.6%, and inflation running at 4.2% helped tighten expectations of increases in rates which tend to hold down prices. In fact, the price of 2 year T-bills surged as investors believe rates will increase at least half a point by the end of the year. In the past, Fed rate increases have come approximately 12 months after unemployment had hit its peak. With unemployment hitting 5.5% in May, a cyclical high which hasn't been seen since October of 2004, it would appear that interest rate increases in the near term would not be good. It is hoped that the Fed does not make the same pre-emptive policy mistake that triggered the double dip recession in 1981 to 1982 or the one that exacerbated the depression in the early 1930's. **The weak dollar has some benefits to our local real estate market but at some point the Fed will have to take steps to strengthen the dollar. Raising rates will be a necessary component of this initiative**.


Effective Federal Funds Rate (DFF)
Source: Board of Governors of the Federal Reserve System
Percent
30
20
10
0
-10
1950
1960
1970
1980
1990
2000
2010
Shaded areas indicate US recessions as determined by the NBER.
2008 Federal Reserve Bank of St. Louis: research.stlouisfed.org


Construction Lending Soared...
$700 billion
600
500
400
300
200
100
Volume of Outstanding construction loans, quarterly
'98
'00
'02
'04
'06
'08
Note: Figures are for all banks and savings instiutions with insurance from the Federal Deposit Insurance Corporation.
Source: Federal Deposit Insurance Corporation

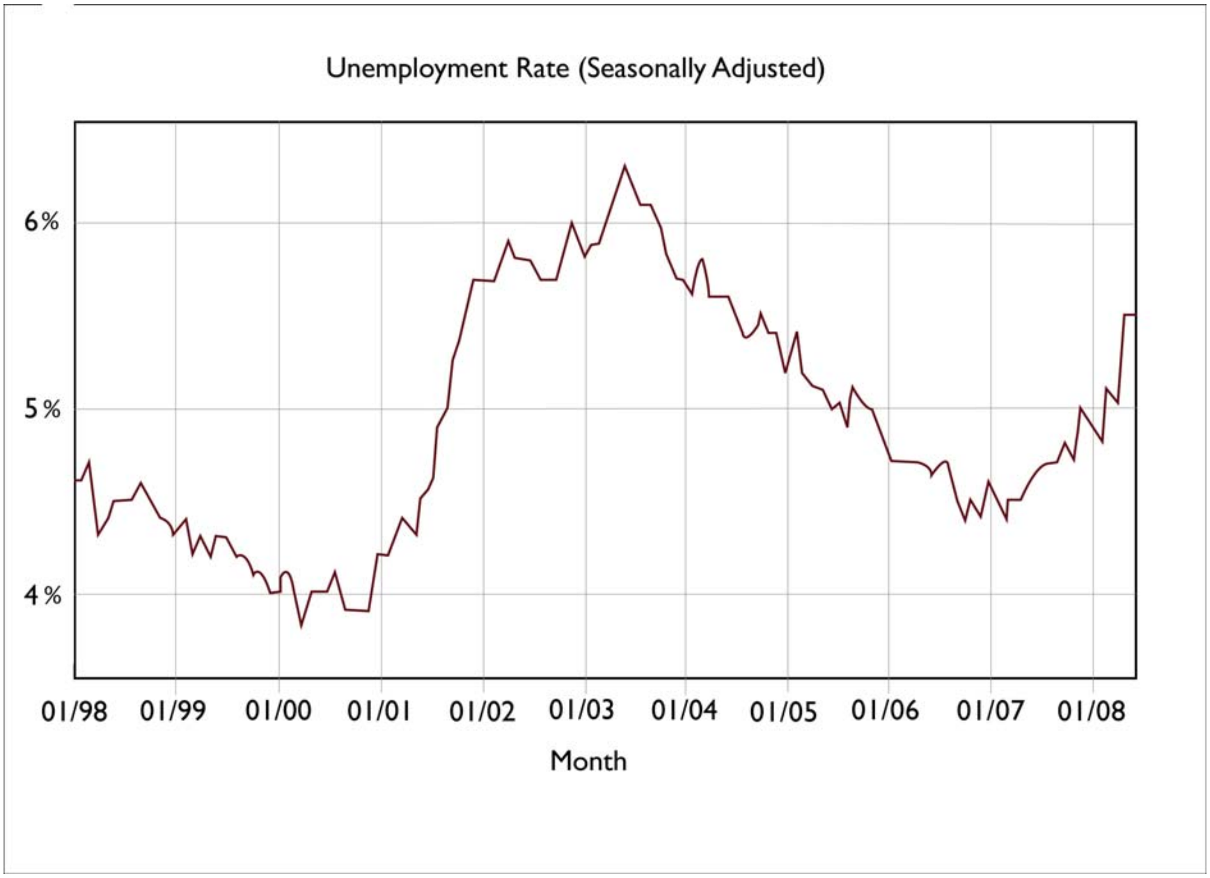

The Massey Knakal Premium
Massey Knakal Sales vs. The Rest of the Market
Median Price Per Square Foot (Consolidated) 2005-2006
Prepared By:
Miller Cicero, LLC
Real Estate Advisory Services
$275
$250
$225
$200
$175
$150
$256.99
+ 21%
$211.81
NYC Sales
Massey Knakal Realty Services
Excludes: Sales less than $500K, Staten Island
2005 / 2006 (Average)
Source: PropertyShark.com

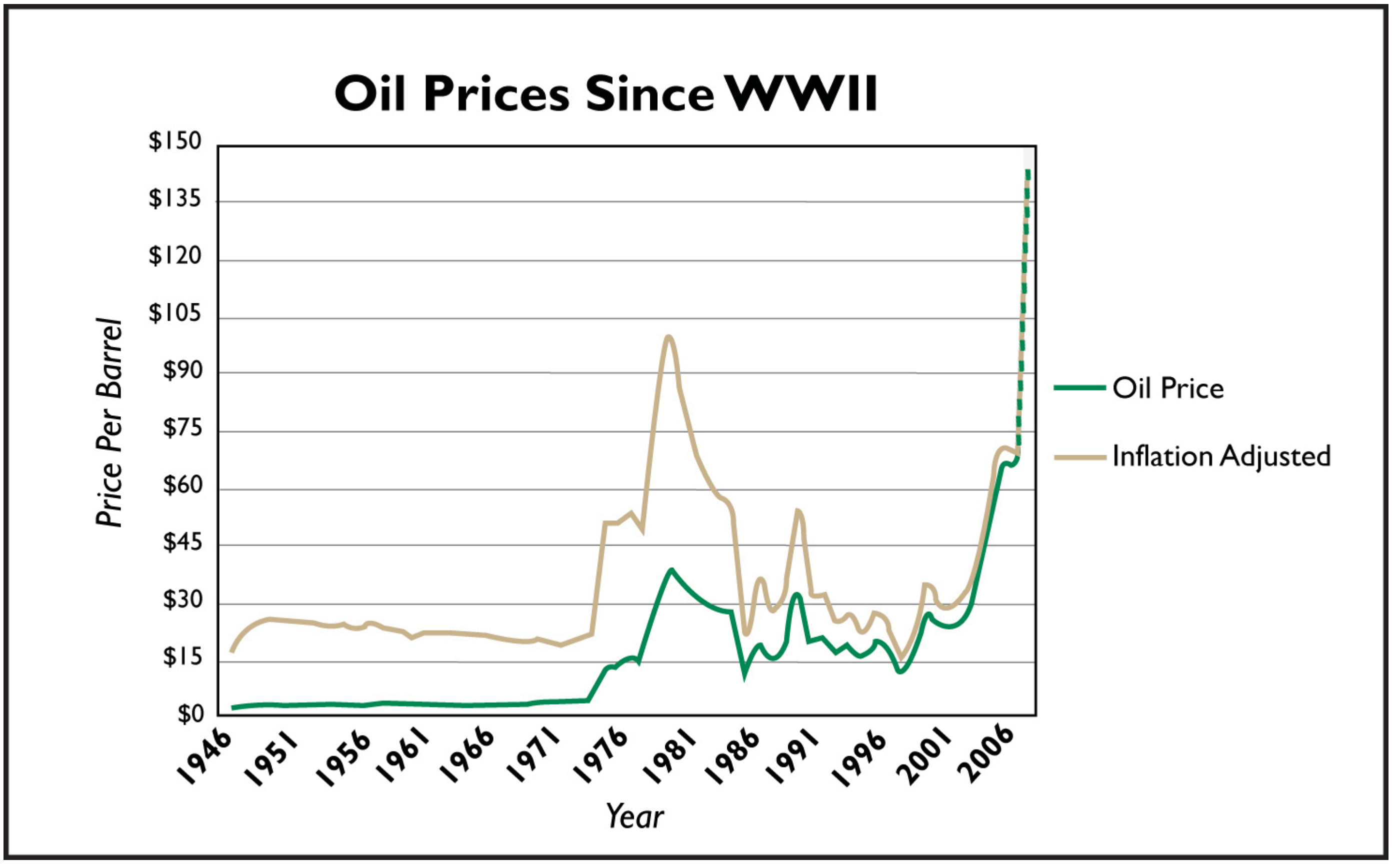
Q In one of your prior interviews, you indicated that unemployment was a key economic indicator to watch and you just mentioned it hit 5.5%. How is this going to affect our building sales market?

A Well, the question really is how much further will the increases in unemployment go? We've seen, in the last 30 days, significant layoffs from financial institutions and there is a general consensus that the full extent of the pain associated with this credit crisis has not yet been fully absorbed. **Employment has a significant impact on the real estate market and building sales values** because if people are out of work, they are not likely to move to a bigger apartment or may have to relocate to a smaller unit. People who are out of work or fear losing their job are not likely to purchase new condos. Similarly, with companies cutting back the size of their staffs, reductions in workforce reduce the need for office space. We are lucky in New York that our vacancy rates for both residential and commercial space have been relatively low and while commercial vacancy is increasing slightly there is still healthy demand with little new construction due to come on line within the next 3 or 4 years. Of course, there are significant projects in the pipeline such as the World Trade Center and the Hudson Yards redevelopments. But this construction is likely to have an impact only on our next cycle, not the present one. Residential vacancy is miniscule and new units are being absorbed well. Unemployment remains a key economic metric to watch.

Q We all know how gas prices are affecting drivers but how is the price of oil affecting property values?

A Oil is a very complicated subject. In fact, it is one of the big differences between today's market and the market in the early 90's to which so many people are making comparisons. In the early 90's, the price of oil was decreasing. Today we have seen record gains in the price of oil. **Currently, there is about an 85 million barrel per day supply of oil with an 86.4 million barrel demand**. Saudi Arabia recently has increased its production by 300,000 barrels per day and has pledged to increase capacity by an additional 200,000 barrels per day. There will be a significant lag until the infrastructure is created to effectuate this additional capacity. Notwithstanding this increased production, demand will still outweigh supply. Surprisingly, OPEC does not openly acknowledge this dynamic as its president, Chakib Khelil, has stated that any request to increase output is "illogical". **Energy consumption in high growth countries such as China and India has stimulated demand. There is also presently a shortage of capacity worldwide to refine oil into gas and supply is simply not keeping pace with demand**. This voracious appetite for oil will only be abated by either an increase in efficiency or substitution. Some people blame speculators for the tremendous run up in oil prices. Supplies are tight and there is tremendous fear that demand will outpace production growth for years to come. In May, gas prices increased by 5.2% to over $4 per gallon (a 21% increase from one year ago) and barrel prices hit $143.57 this morning amid a bigger than expected drawdown on US oil reserves. It took 5 years to get the price of oil from $5 per barrel to $60 and in 2007 alone the price increased by $60. The current price is nearly13x the price in the early 90's. Right now we are seeing, for the first time since drilling began in the 1850's, prices climbing for 7 consecutive years. When we are underwriting apartment buildings now, we can no longer rely on last year's fuel bills to forecast next year fuel expense. We are underwriting using today's price to account for the significant increases we have seen. Not too long ago fuel was $750 per unit and today it can be as much as $2,000 per unit. Intuitively, these increases should put downward pressure on prices. Remarkably,


Unemployment Rate (Seasonally Adjusted)
6%
5%
4%
01/98
01/99
01/00
01/01
01/02
01/03
01/04
01/05
01/06
01/07
01/08
Month


Oil Prices Since WWII
$150
$135
$120
$105
$90
$75
$60
$45
$30
$15
$0
Price Per Barrel
1946
1951
1956
1961
1966
1971
1976
1981
1986
1991
1996
2001
2006
Year
Oil Price
Inflation Adjusted

prices are holding relatively firm.

Q It seems everyone is concerned with inflation today. Do you think that concern is valid?

A Based on May's numbers, headline inflation was running at 4.2% above May 2007. That's the number that people mainly focus on. However, more importantly is core inflation. **Core inflation strips out food and energy prices and core inflation is running only at 2.1%. This is only 0.1% above the Fed's comfort zone of 1-2% for inflation**. Therefore, we are hopeful that the Fed will not raise rates to stave off inflation. That being said as we discussed, oil prices and food prices have been escalating creating stresses on the American consumer.

Q What's happening with consumer spending?

A Consumer spending in May and June was significantly better than expected. It is believed that is a direct result of the economic stimulus plan that the government put into effect. Notwithstanding this, **consumer confidence is at extremely low levels**. So low, in fact, that they are at levels last seen in 1980 when the economy was really a mess and interest rates were 18%. Moreover, **for the first time in at least 40 years a majority of households expect their income to contract**. The average American can't be too happy today. The decline in housing prices has accelerated, the news on mortgage credit losses has continued to worsen and the unemployment rate has surged causing consumer confidence to plummet to these multi decade lows. With reductions in consumer confidence and subsequent reductions in consumer spending, it will undoubtly have an effect on real estate. Businesses need to keep making money to keep renting space and retain employees which keep square footage occupied. As I stated before, we must keep a watchful eye on unemployment data.

Q How have building sales prices been affected by current economic conditions?

A Once again, it is very important to segment the market. **The value of properties under $50 million has seen a lot of inertia. Rental rates have stabilized and while there is some upward pressure on cap rates, prices per square foot remained stable as rental increases in the past have increased property cash flows**. That being said, we believe that prices have been buoyed by the fact that demand for property continues to outpace supply by a large margin. **The reduction in sales volume is mainly due to supply constraint dynamics, not a reduction in demand**. We believe that potential sellers are reading and hearing so much negativity about the market that they are not putting their properties up for sale. This is creating a short supply of availability which is creating the volume reductions. There are many factors placing downward pressure on prices but this lack of supply is keeping upward pressure on pricing.

Q Some people have predicted a downturn in the hotel market. What are your thoughts?

A The health of the hotel market in the city is directly related to the volume of tourism, both domestic and international. The airline industry is having its problems based upon the run up in fuel prices. Across the United States flights have been cut and now the industry has a capacity that is as low as it was in 2002, just after 9/11. Additional reductions in capacity are expected next year. Additionally, those flights that are scheduled are significantly more costly to the consumer. Therefore, we expect this to have a tangible effect on hotel occupancy. **According to New York City reports, the average room rate is now $288 per night, up 8.6% from March of 2007. Occupancy levels are up to 86.2% and the number of international travelers**

visiting the city is increasing sharply. There is still a tremendous benefit that the hotel market gets from the weak U.S. dollar. Foreign travelers will continue to come to New York in record numbers and domestic travelers are continually coming to New York as overseas travel is cost prohibitive. A number of planned hotels have been converted to alternative uses so the increase in supply will not be as significant as predicted. **We expect room rates to remain at healthy levels and occupancy rates to hover around cyclical highs, notwithstanding the state of the airline industry**.

Q To follow up on your remark about the benefit of the weak dollar, what are the pros and cons?

A In the short term, there are multiple benefits. The main benefits are that the weak dollar has provided the boost to tourism I mentioned before. International travelers find it a bargain to come to New York and fill our hotel rooms and stimulate our local economy. Domestic travelers do not want to break their bank to travel overseas so they are coming to the City also. **The weak dollar has also stimulated massive amounts of foreign capital to be deployed into our real estate market**. New York has benefited greatly from the globalization of real estate dynamics. In the long run, however, the weak dollar is not good for us. Low interest rates and immense budget deficits are keeping the dollar weak which has driven investors to commodities exerting further upward pressure on oil prices. Additionally, the weak dollar has caused the stock market to officially hit "bear" status as last week it fell 20% below its high from October. **The Fed will have to tighten monetary policy; it is just a question of when**.

Q What are your thoughts about the multi-family market?

A While the rent guidelines adopted by the Rent Guidelines Board seem decent, it is still difficult for a landlord to have its cash flow keep pace with the increase in expenses. Fuel has more than doubled, water and sewer has gone up 14%, real estate taxes will increase and squeezing every cash flow dollar out of a property is becoming more challenging. **Multi-family properties, however, remain in highest demand given their artificially below market rent levels due to rent regulation. They are also the easiest to finance**. Notwithstanding the numerous sources of debt for the multifamily sector, it is still difficult to get a loan for more than 50-60% of cost based upon the sustained high prices of this product type. **The biggest question for this sector is how legislation is going to affect regulation**. The political horizon is likely to change fundamentally in November and these changes will undoubtedly make things more challenging for landlords.

Q How long do you think this credit crisis will last?

A People do not agree about the extent of the severity of the credit collapse. The economy is still weak and the financial markets are fragile. While the Fed has switched its primary concern from stimulating growth and addressing financial strains back to its natural habitat of curbing inflation, there is a policy move about to strengthen the dollar. **During stresses in the credit markets there has been a huge run up in commodity prices and at the same time an enormous collapse in lending and asset prices, particularly equities and residential real estate**. The question is will we see inflation or deflation? **Until each institution comes fully to terms with the extent of their losses, it will be difficult to get the markets back on track**. I've heard some people say that the lending markets are forever changed. That lenders were too aggressive, underwriting standards were not stringent enough and this time lenders have learned their lesson. People said the same thing in the early 90's yet, 15 years later, the same excesses that exacerbated the problems of the early 90's came back around. **I think we are in the 3rd inning of the game until the credit markets truly normalize**. Additional pain must be experienced and opportunities will present themselves. I believe that the Fed has taken proactive steps to stabilize the financial markets. What they did relative to Bear Stearns was an effective implementation of the Fed's power and kept the markets clear of systemic trouble that could

During Mr. Knakal's 24-year career, he has sold over 974 buildings having an aggregate market value of over $5.6 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 1990, 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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have resulted in a financial meltdown. **The credit markets will eventually normalize and, yes, lending excesses will someday return. Until then, we should all "Have faith in Ben (Bernanke) until 2010"**.

New York City Commercial Property Sales
Top Brokerage Firms 2007
Based on # of Transactions (All Sales)

	#Transactions 2007	Total $ Volume 2007
Massey Knakal Realty Services	405	$2,019,142,322
Capin & Associates	87	$716,127,069
Marcus & Millichap	86	$259,724,587
Eastern Consolidated	77	$2,271,602,757
Besen & Associates Inc.	76	$568,941,127
GFI Realty Services, Inc.	73	$918,657,315
Cushman & Wakefield, Inc.	41	$7,356,512,915
Newmark Knight Frank	35	$670,128,540
Itzhaki Properties	34	$301,621,636
CB Richard Ellis	33	$6,101,055,050
Prudential Douglas Elliman	26	$148,483,222
Swig Equities, LLC.	20	$103,720,000
Greiner-Maltz Company, Inc.	19	$138,440,100
The Corcoran Group	17	$73,813,521
Corporate Offices	17	$43,349,000
Grubb & Ellis	14	$71,487,992
Leslie J. Garfield & Company	12	$50,013,000
RMB Properties, LLC	12	$592,651,768
Georgia Malone & Company, Inc.	11	$62,920,000
Kalmon Dolgin Affiliates, Inc.	10	$34,475,000
Studley	10	$1,041,362,053
The Moshe Group	10	$42,920,000
Wells Fargo & Co	10	$4,332,026,000
Sholom & Zuckerbrot Realty Corp.	9	$53,795,000
NAI Global	8	$37,300,000
Total Dollar Volume - (Brokers on Chart)	1,152	$28,010,269,974
Total Dollar Volume - (All transactions tracked by CoStar Comps in 2007)	1,706	$36,971,204,170

Massey Knakal Realty Services