2011 Midyear Rental Report

Overview of the Collaboration

This report details the rise in the rental market, documenting the gains and examining the shifts at the low and high ends of the market which substantiate its strength. Also, for the first time, the report compares rental units in condominium buildings to those in rental buildings.

In addition to the quantitative analyses, this report looks qualitatively at continuing shifts in employment trends that we first noted in the 2010 Year End Report. The report also takes an innovative look at a new Renter's Confidence Index charting the ratio of income to rent over the past five years.

To produce this comprehensive overview, Nancy Packes, Inc. has collaborated with StreetEasy.com and On-Site.com. For this report StreetEasy has provided the rental data and On-Site has provided the demographic data. The New York real estate market is one of the most watched, dynamic and valuable markets in the world, with many companies striving for a role in providing services and data. In this tremendously competitive environment, StreetEasy and On-Site have emerged as pre-eminent resources for both consumers and professionals.

StreetEasy.com is a real estate website providing in-depth sales and rental information across all brokerages and offering consumers and professionals the power to search, sort and manage that information effectively, as well as the tools needed to stay on top of the market.

For the insightful qualitative data concerning employment and income, we have collaborated with On-Site.com. Founded in 1999, On-Site has grown to become the gold standard for innovation in the apartment business. On-Site allows apartment operators to maximize occupancy, enhance quality control, maintain compliance and ensure consistent success at all levels of property operations.

Current Rental Levels

The report charts both average and median increases between year-end 2010 and midyear 2011. Coincidentally, for both calculations, the studio-two bedroom portion of the whole market is identical at 5.4%. As expected, the averages are much more volatile with a higher rate of increase in average attended building rents of 9.8%

for the period. The average is even higher in the unattended building sector, as sharply rising rents have increased demand for unattended buildings.

Substantial though these increases are, the effective increase is actually higher. For the year 2010 approximately 25% of all transactions counted a concession equal to approximately one month's rent, or 8% of the annual rent. Today, concessions have practically disappeared. This change adds an effective 2% to rent increases. Please see the chart on page 29 for more information.

Rental Market Strength

From 1990 through the latest peak in 2008, the rental market achieved an average gain of approximately 4% per year in attended lobby buildings. Though this increase is not net of inflation, compared to the stock market where an investment may not see positive returns for decades depending on the point of entry, the rental market, with its shorter and less volatile cycles, has proven to be a powerful magnet for local, national and international financial entities seeking a stable hedge against more volatile businesses and real estate sectors like commercial and retail.

Yet, in the near term, future rental supply in Manhattan remains low. The recent extension of 421-a tax benefits makes some rental developments plausible, but with strong competition from condominium developers the price of land, which has once again approached all time highs, is negating the possibility. The chart on page 30 shows the number of units currently foreseen for rental development in Manhattan compared to the annual average since 1997 of more than 3,200 units per year. At 3,584 units currently foreseen, the annual average for the next few years should be well below trend. The details on these projects are on pages 31 to 34 of the report.

As the outer boroughs (and, to a lesser extent, New Jersey) continue to develop market rate rentals, the new supply from these areas also needs to be considered. To a large extent, these areas benefit from the demand of existing area residents who upgrade their accommodations. But, they also share demand with the Manhattan market. Before the recent surge in development in these areas of Brooklyn and Queens, the difference in rent with the Manhattan market was a substantial 30%. For the past year the difference has been closer to 10%, tracking at the same level as older Manhattan buildings.

This is significant because, despite this effective addition to supply, it has not dampened Manhattan rent growth. As conditions in Manhattan, primarily the price of land, continue to impede rental development, supply will continue to be displaced to the outer boroughs. The available land mass in these areas offers intriguing possibilities for multi-family housing. As this trend takes hold, the impact on supply needs to be mentioned. Through 2013, however, the market seems poised for above average growth that we estimate to be approximately 6%.

Rent Trends

The charts on pages 23 to 28 show the premium between attended and unattended lobby buildings. As rents have surged over the past 18 months, the premium for attended lobby buildings has decreased. For the period between 2010 and midyear 2011 the premium for attended lobby units changed as follows: for studios a decrease of 36%, for one-bedrooms a decrease of 21%, for two-bedrooms a decrease of 18%, and for three-bedrooms a decrease of 19%. The correlation is clear that the more budget-conscious renters were more willing to accept unattended buildings to remain in Manhattan. For the four-bedroom-and-larger renter, the opposite effect manifested with the premium increasing in the period for attended lobby buildings by a whopping 34%.

Part of the demand at four-bedroom-and-larger end of the rental market represents a shift towards renting and away from buying. The quality of high-end rentals has tended to converge with the quality of homes for sale. The durability of this trend remains to be seen.

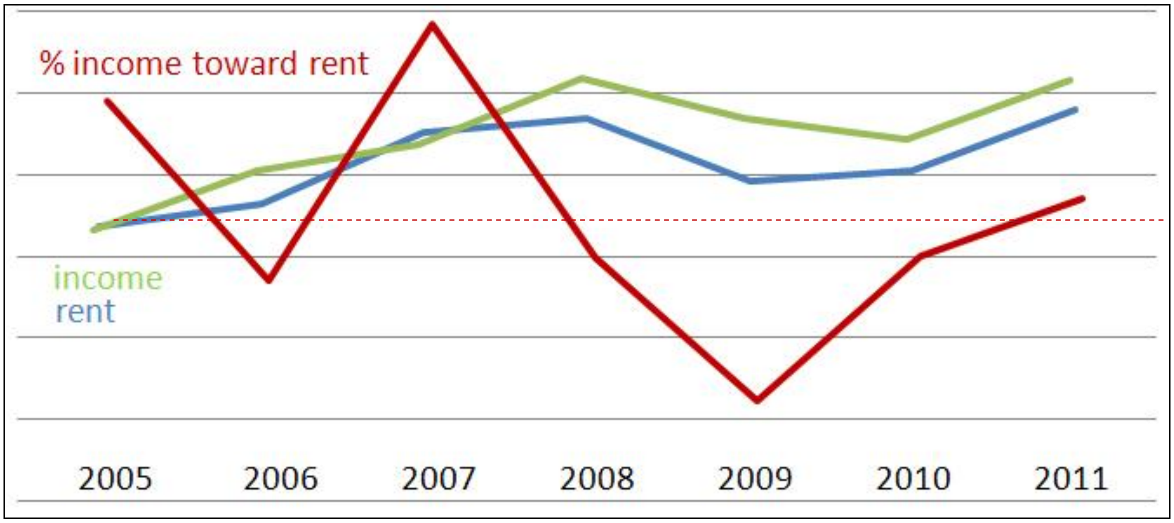
Premiums for Condominium vs. Rental Units

As expected, the comparison between condominium rentals and units in rental buildings shows a demonstrable premium which increases with home size. The premium is also most pronounced in more valuable neighborhoods. It will be interesting to observe how this premium changes as the rental housing stock looks more like the condominium housing stock in terms of furnishings, amenities and architecture.

The Demographics of the Market

Jake Harrington, Chief Revenue Officer at On-Site has provided the following comments:

Renter's Confidence Index



SOURCE: ON-SITE.COM

We studied a five-year trend by plotting the rent/income percentage of rental lease applications alongside income and rental rates. The study uses gross income and effective rents for nearly one million transactions.

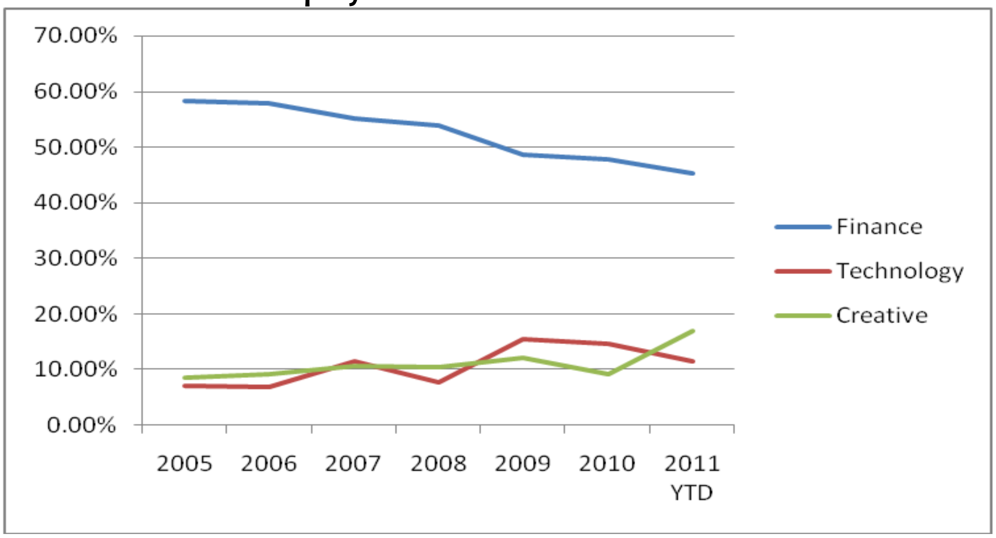
Naturally, incomes and rental rates correlate. As incomes steadily increased from 2005 to a peak in 2008, rents showed a steady increase. And as incomes began to recover last year, rental rates followed course.

We view the opportunity to look at the rent/income ratio to measure the marketplace's capacity to absorb rent increases. As the ratio increases, a household is spending a larger percentage of income on housing.

While measuring income may be a good gauge of a renter's ability to pay rent, the rent/income ratio represents the willingness to do so – a sort of barometer on consumer confidence. The first quarter of 2007 represents a high water mark for this figure, before it swung over 20% lower over the next 24 months.

How does the current measure compare to the previous period of sustained rent increases? Comparing the rent/income percentage during the period of rental rate increase from 2005-2008 to today suggests that today's Manhattan market still has capacity to absorb rent increases. The ratio is currently at its five-year average. In the previous run-up in rents, the ratio was below this average for only two quarters out of 14 that began in 2005 and continued until the Wall Street meltdown.

Manhattan Renter Employment Trend



SOURCE: ON-SITE.COM

One notable trend we observe in the types of employment for Manhattan renters is a continuing slide in investment banking and other Finance jobs. In 2005, there were eight Finance industry jobs for every one Technology job; today that ratio is four to one.

The last 18 months has shown a boost in the number of Creative jobs such as media and fashion. Its contribution has doubled in size since last year, and the number of employers hiring in the Creative category is 70% higher than its five-year average.

Conclusion

The decline in financial sector employment taken alone would have resulted in a weakening of rental demand and lowered rents. The expansion in New York City population as reported by the U.S. Census Bureau at over 160,000 people in the period from 2000 to 2010 and the increase in these alternative employment sectors is simply testament to the extraordinary magnetic attraction that New York offers to dynamic businesses. These trends, and others yet to be foreseen, are implicit in the shift away from Finance and towards other activities as the true and continuing source of New York City's strength.

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