

Introduction

It has been five years since the tragedy of September 11, 2001, nearly crippled New York's economy and shook the confidence of the entire country. The crisis of uncertainty that followed was greater than at any other period in modern history, and yet, just five years later, the city's economy is thriving.

Recent economic and commercial real estate data provides ample support for a very promising outlook for New York's future. For the first time in more than five years, the city's economic growth rate has exceeded the national growth rate. In the first half of 2006, New York's employment growth of 1.3 percent was twice the 0.6 percent growth rate posted nationally. Manhattan's expansion has been broad-based, cutting across all industries and neighborhoods.

Most economists agree that New York's growth is far healthier now than during previous recent expansions because it is widespread and not concentrated in a few industries as it had been during the prior Wall Street and dot-com frenzies. There is no evidence of any bubble in the city's expansion, not even in the housing market, where demand remains strong at a time when the supply of housing has remained relatively fixed.

Also fueling a burst of optimism about prospects for Downtown New York is the fact that real progress is being made in the World Trade Center rebuilding effort. The Port Authority of New York and New Jersey, together with city and state government agencies, has settled on a plan to redevelop the site, and construction at Site 1 is about to begin.

Lower Manhattan's Recent Performance

As recently as 18 months ago, a sharp turnaround in the New York's economy did not seem possible. At that time, the stock market was heading into a significant correction, and the city's employment growth had stagnated. The average Midtown Class A asking rent had stalled in the mid \$50s per square foot while Downtown rents had barely been able to climb above \$30 per square foot.

A positive shift in the market was presaged late in 2004, when Morgan Stanley announced its return to Lower Manhattan with a 447,000 square-foot lease at 1 New York Plaza. This was followed by The Goldman Sachs Group Inc.'s commitment in July 2005 to build its world headquarters Downtown.

These two transactions re-anchored the financial services industry to the area. Morgan Stanley had left Downtown after losing the space it occupied at the World Trade Center on September 11, 2001. With two expansions since then, Morgan Stanley now occupies 750,000 square feet in 1 New York Plaza. Returning to the area underscored the company's confidence in the economy and future of Lower Manhattan. Additionally, Aon Corporation, which had relocated to Midtown following September 11, subsequently returned and recently leased 221,000 square feet at 1 Seaport Plaza.

Prior to this activity, many had foretold the financial services industry's departure not just from Downtown but throughout the city, as jobs moved outside New York. In fact, in the years immediately following 2001, many of the biggest leases signed Downtown included education institutions and nonprofit firms that took advantage of the large blocks of space and low rents.

By the fourth quarter of 2005, confidence in the city had surged, prompted by space users choosing to expand within New York. Companies elected to expand in Manhattan after learning a valuable lesson from earlier growth periods—in order to attract the brightest staff from the outstanding labor pool, it is important to be in the heart of New York, near a transportation hub.

Moreover, Lower Manhattan is not only the center of the New York metropolitan area, it is an internationally recognized market. National and international firms prefer to locate in buildings with recognizable Financial District addresses. Downtown also benefits from the fact that its rents are not only advantageous compared to Midtown, but are at a deep discount to other international cities such as London and Hong Kong.

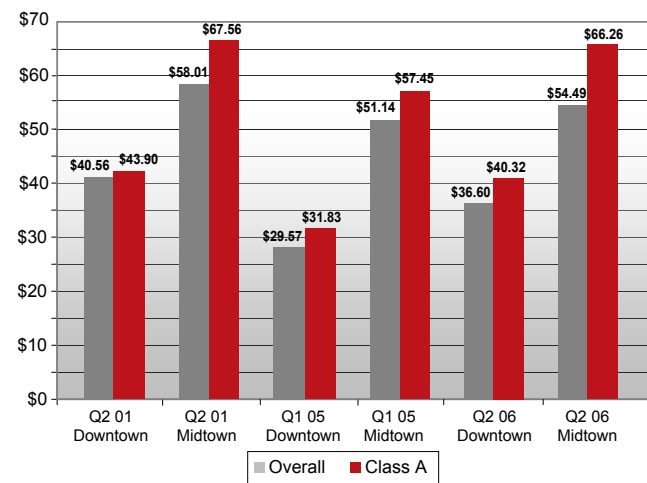
Office Market

Second Quarter 2001

In the second quarter of 2001, about two and a half months prior to the terrorist attacks, Lower Manhattan's office inventory measured 110.9 million square feet of Class A and B space. The area's Class A office market encompassed 72.5 million square feet of space.

At the time, the office market was already six months past its peak. The overall availability rate for Lower Manhattan office space in the second quarter of 2001 was 7 percent, with Class A space boasting an availability rate of 6 percent. (Even Class B space posted an availability rate lower than 10 percent, an extremely rare occurrence.) Overall asking rental rates in Downtown in the second quarter of 2001 averaged \$40.56 per square foot, with Class A space achieving rents of \$43.90 per square foot.

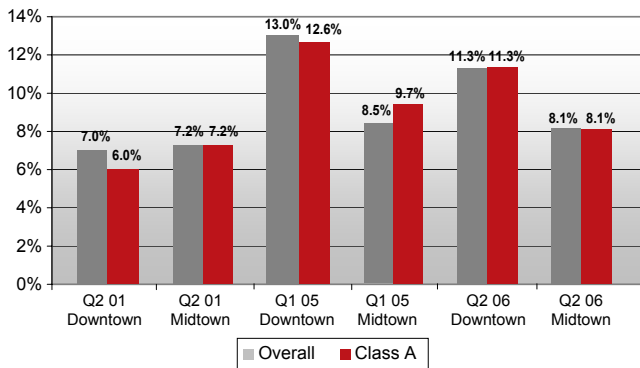
TABLE 1: DOWNTOWN RENTAL RATE COMPARISON



The September 11 terrorist attacks initially destroyed nearly 15 million square feet of Lower Manhattan Class A office buildings. The properties included 1, 2, 4, 5, 6 and 7 World Trade Center, comprising 13.4 million square feet. The six buildings represented approximately 12.1 percent of the entire Downtown office market and 18.5 percent of the area's Class A space.

This does not include several other office buildings that were later set to be demolished due to damage and/or contamination. These properties included the Deutsche Bank building, 130 Liberty Street with 1.4 million square feet; and 4 Albany Street with 131,466 square feet.

TABLE 2: DOWNTOWN AVAILABILITY RATE COMPARISON



Despite the loss of that much office space, Lower Manhattan still ranks as the nation’s fourth largest central business district, surpassed only by Midtown New York, Chicago and Washington, D.C. The amount of office space lost in the terrorist attacks is equal in size to the entire office inventories of cities such as Milwaukee, Wisconsin, with 16.5 million square feet; Baltimore, Maryland, with 16.2 million square feet; and Oakland, California, with 12.9 million square feet.

First Quarter 2005

The Downtown New York office market sank to its lowest point during the first quarter of 2005. Three years after the events of September 11, Lower Manhattan’s office inventory was 94.8 million square feet of space. The Class A office market totaled 57.6 million square feet.

Despite the introduction of commercial office incentives, many tenants continued to eschew taking space in Lower Manhattan. Lackluster leasing activity led to a market that saw an overall availability rate of 13 percent in the first quarter of 2005. Class A office space posted an availability rate of 12.6 percent, a 110 percent increase from the availability rate recorded for that property type in the second quarter of 2001.

Rents also suffered, with Downtown office space recording overall average asking rents of \$29.57 per square foot in the first quarter of 2005, a 27 percent drop compared to rents that building owners achieved in the second quarter of 2001. Class A office space posted average asking rents of \$31.83, a 27.5 percent decrease.

New Leases in Lower Manhattan

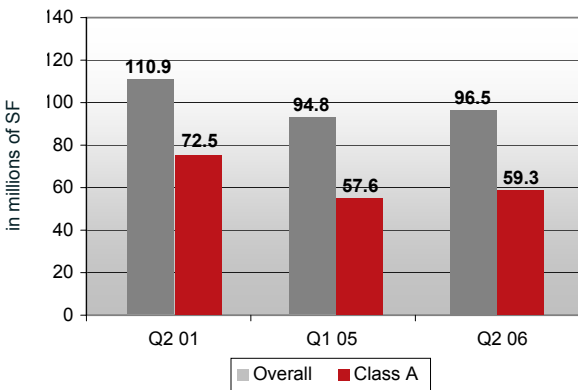
Education/Training	<ul style="list-style-type: none"> Claremont Preparatory School – 100,000 SF at 41 Broad Street Millennium High School – 75,000 SF at 75 Broad Street Kaplan Inc. – 43,000 SF at 1 Liberty Plaza The Learning Tree – 42,000 SF at One New York Plaza CUNY – 42,000 SF at 25 Broadway
Finance/Insurance	<ul style="list-style-type: none"> Morgan Stanley – 447,000 SF, 219,742 SF, 60,000 SF (Total 726,742 SF) at 1 Seaport Plaza Aon Corporation – 221,000 SF at 1 Seaport Plaza
Governmental/City Agencies	<ul style="list-style-type: none"> New York City Department of Transportation – lease out for 500,000 SF at 55 Water
Health Care Firms	<ul style="list-style-type: none"> HIP Health Plan of New York – 300,000 SF at 55 Water Street Beth Israel – 160,000 SF at 160 Water Street
Legal	<ul style="list-style-type: none"> Thatcher, Proffitt & Wood, LLP – 198,000 SF at 2 World Financial Center Morgan & Finnegan, LLP – 104,000 SF at 1 World Financial Center McKee Nelson – 73,000 SF at 1 Battery Park Plaza
Not for Profit	<ul style="list-style-type: none"> National Sports Museum – 87,200 SF at 26 Broadway American Red Cross – 34,000 SF at 7 Hanover Square World Trade Center Memorial Fund – 23,000 SF at One Liberty Plaza YWCA – 22,000 SF at 52 Broadway International Center for Transitional Justice – 19,000 SF at 5 Hanover Square Vocational Foundation Inc. – 17,000 SF at 52 Broadway
Publishing/Media	<ul style="list-style-type: none"> Bowne & Co. Inc. – 190,000 SF at 55 Water Street Cambridge University Press – 62,000 SF at 60 Hudson Street William H. Sadlier Inc. – 60,000 SF at 14 Wall Lifestyle Media Inc. – 42,000 SF at 110 William WOR Radio – 22,152 SF at 111 Broadway

Second Quarter 2006

While Downtown New York has not yet matched the real estate performance it saw prior to the terrorist attacks on September 11, the submarket has surpassed everyone’s expectations. Lower Manhattan looks poised to meet and surpass the fundamentals it once boasted prior to the attacks.

Downtown saw the addition of the rebuilt 7 World Trade Center to the market in the second quarter of 2006, boosting its office inventory to 202 buildings encompassing 96.5 million square feet. Downtown counted 58 Class A buildings containing 59.3 million square feet, representing a bit more than 61 percent of the area’s office market.

TABLE 3: SIZE OF DOWNTOWN OFFICE MARKET



Lower Manhattan posted an overall availability rate of 11.3 percent in the second quarter of 2006. Class A space also recorded an availability rate of 11.3 percent. While these figures do not appear to be much of an improvement over first quarter 2005, they take into account the addition of the 7 World Trade Center’s 1.7 million square feet of space to the submarket’s office inventory.

Average asking rental rates offer a better view of the ongoing strength of Downtown’s office market. The submarket recorded overall average asking rental rates of \$36.60 per square foot in the second quarter of 2006, an increase of \$7.03 per square foot from rents seen in the first quarter of 2005.

Lower Manhattan Class A office space posted an average asking rental rate of \$40.32 per square foot, an increase of \$8.49 per square foot from rates seen in the first quarter of 2005

Commercial Office Incentives

In the months following the terrorist attacks, city, state and federal agencies implemented a number of economic incentive plans to retain existing office and retail tenants in Lower Manhattan and to lure new businesses to relocate there. Approximately \$4 billion in incentives were set aside for the area’s commercial real estate

sector, and a similar amount was made available for the residential sector. The financial benefits ranged from reductions and abatements on a variety of taxes to financial grants and energy cost reductions.

All the initiatives included guidelines that restricted the financial benefits to companies of a certain size, and limited them to businesses that were either already located in or considering relocating to specific locations in Lower Manhattan. Each program also spelled out application deadlines, how long the benefits would apply, and the date ranges during which leases and or acquisitions completed in Lower Manhattan would be eligible for incentives.

In August 2005, with Lower Manhattan still experiencing a lackluster office market, the city and state established a new set of economic inducements very similar to the initial round of incentives. At the time, approximately \$2 billion in funds set aside for commercial incentives remained unallocated, while the entire \$4 billion earmarked for the residential sector was used up.

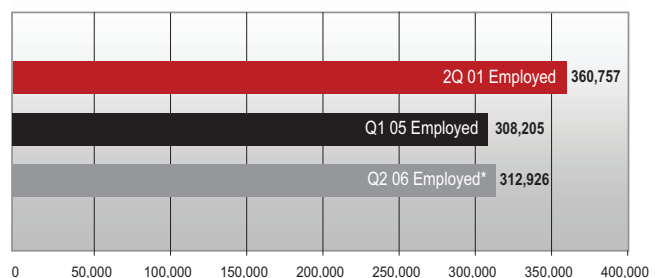
The tax incentive programs have a substantial impact on the bottom line of companies that relocate to Lower Manhattan. A company willing to move Downtown could wind up paying half as much in rent as a business leasing comparable space in Midtown.

For example, average asking rents for Midtown Class A office space reached \$66.26 per square foot in the second quarter of 2006. Asking rents for Downtown Class A office space reached \$40.32 per square foot during the same time period. That created a disparity in average asking rental rates between Midtown and Downtown at more than \$26.00 per square foot. When incentive programs for Lower Manhattan were taken into account, the disparity in overall average rental rates between Midtown and Downtown Class A office buildings rose to around \$36.00 per square feet.

Employment Market/Industry Sectors

According to data from the New York State Department of Labor and estimates from Jones Lang LaSalle, Lower Manhattan employed 313,000 people at midyear 2006. While this is still nearly 50,000 short of the 361,000 people employed prior to the attacks, Downtown is now gaining jobs. The low point in the job market 308,200 people employed—was reached in early 2005.

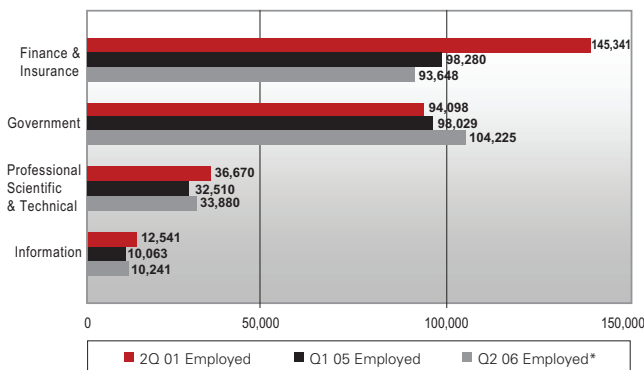
TABLE 4: DOWNTOWN TOTAL EMPLOYMENT



*Estimated by Jones Lang LaSalle based on current occupancy statistics

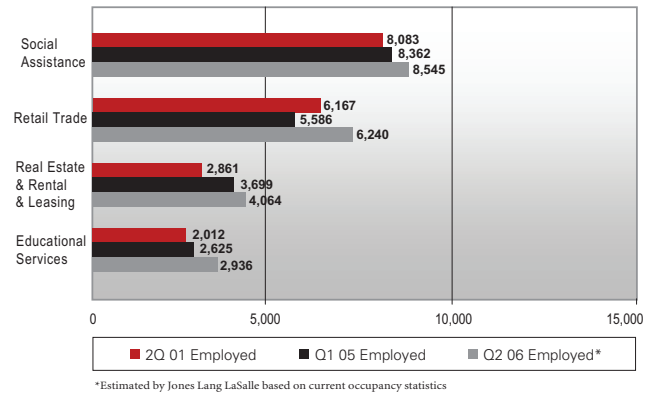
The finance and insurance industries, which suffered the worst losses after September 11, 2001, are now leading the growth Downtown. Approximately 93,650 finance and insurance employees were housed in Lower Manhattan in the second quarter of 2006, an increase from the 92,400 jobs posted at year-end 2005. The finance and insurance sector employed 145,340 people Downtown prior to the attacks.

TABLE 5: DOWNTOWN LARGEST EMPLOYERS BY INDUSTRY



The retail, private education, social services, real estate and government sectors employed as many or more people Downtown at year-end 2005 as they did in the second quarter of 2001. Businesses and organizations in these industries signed the most significant leases during the past five years.

TABLE 6: INDUSTRIES THAT HAVE GROWN DOWNTOWN



Construction

Work on rebuilding the World Trade Center complex was stalled for years due to design considerations and ongoing negotiations between the many players involved in the high-profile project. Construction finally began in earnest after Larry Silverstein of Silverstein Properties Inc., the developer of the complex, reached an agreement with The Port Authority of New York and New Jersey on their respective roles and responsibilities.

Silverstein will develop three office towers—2, 3 and 4 World Trade Center—and the Port Authority will develop Site 1 and Site 5. The agreement covers 8.8 million square feet of total development on the site, including the 2.6 million-square-foot Site 1, the 2.4 million-square-foot 2 World Trade Center, the 2 million-square-foot 3 World Trade Center and the 1.8 million-square-foot 4 World Trade Center. Construction at Site 1 began in April 2006, with groundbreaking expected for Tower 3 and Tower 4 in late 2007. The majority of the office space is scheduled for completion by 2012.

While this may seem like a great deal of space in a market still dealing with relatively high availability rates, the outlook for Downtown is very positive. In the past five years, approximately 12 million square feet of the submarket's obsolete or low-quality office space has been converted to residential space and entirely removed from the office inventory. This has had the affect of constricting the supply of office space at a time when leasing remains very active.

With the Midtown office market nearly out of available space, and average asking rents there climbing past the \$60 per square foot mark, and pushing past \$100 per square foot for trophy-quality buildings, tenants are increasingly eyeing Downtown office space. The area's real estate fundamentals continue to improve, and it is conceivable the market will be very tight by the time the first of the new buildings is completed in 2010.

Residential Market

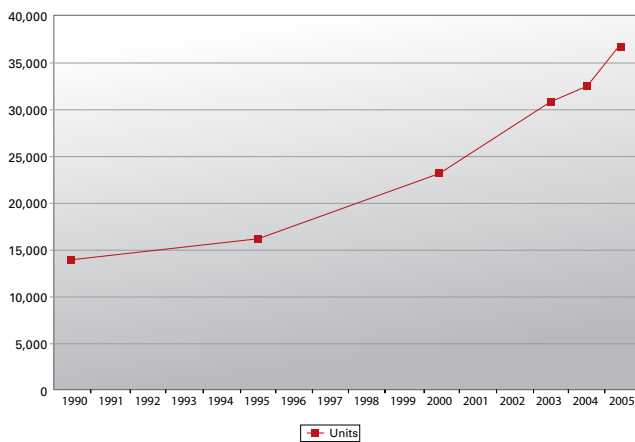
Residential Population Growth

The residential population of Lower Manhattan has been on the rise for more than a decade, the result of public and private initiatives to create a 24-hour community and a steadily advancing residential real estate market.

Since 1990, Downtown’s residential population has more than doubled from 14,000 to approximately 36,000, according to the Alliance for Downtown New York Inc. Given the ongoing development of residential projects throughout Lower Manhattan, the Alliance estimates there may be 42,000 residents by 2007 and that the population could continue to rise further.

After the terrorist attacks, Lower Manhattan residents were forced to leave their homes, and many did not return. To lure people back, city, state and federal agencies offered financial incentives to existing residents to remain in Lower Manhattan and to people willing to relocate to the area. (The incentives took the form of rent subsidies offering a total of up to \$12,000 to eligible participants.) The incentive program, now expired, was extraordinarily successful and the neighborhood’s population remained robust throughout the crisis and rebuilding period.

TABLE 7: DOWNTOWN RESIDENTIAL POPULATION GROWTH



Residential Development

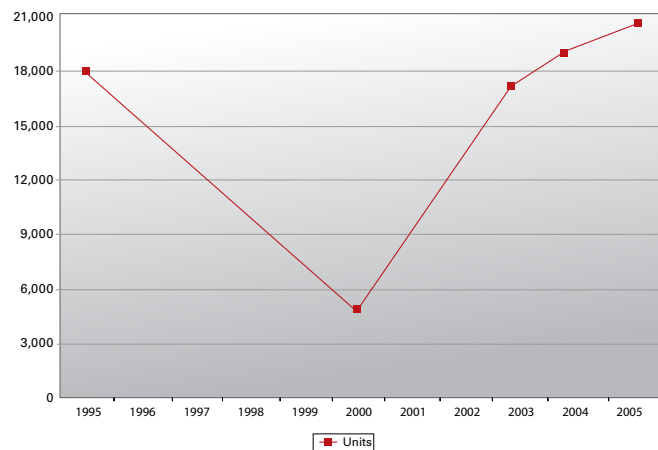
Much of the increase in residential property in Lower Manhattan has come from a wave of conversions of Class B and Class C commercial buildings into condominiums. Approximately 12 million square feet of aging office space has been taken off the market in the past five years. Thousands of additional residential units are slated for construction in Lower Manhattan in the next few years.

Most market experts believe the ongoing expansion of Downtown New York’s residential population has tremendous benefits. Culling functionally obsolete office buildings out of the market improves the overall quality of office inventory. Meanwhile, an

increasing residential population is expected to prompt growth in retail services.

The loss of outdated office buildings will be offset by the addition of millions of square feet of newly constructed Class A office property in the next five to 10 years. Site 1 alone will add 2.6 million square feet of Class A space to the market.

TABLE 8: DOWNTOWN RESIDENTIAL INVENTORY



Retail Market

The Lower Manhattan retail market suffered a terrible blow on September 11. Slightly more than 12 percent of Downtown New York retail space was destroyed when the World Trade Center buildings collapsed.

Lower Manhattan had approximately 3.5 million square feet of retail space prior to the attacks. This figure included the 427,000-square-foot, high-end indoor mall located beneath the World Trade Center complex. It was one of the highest producing retail spaces in the United States, recording annual sales volume greater than \$900 per square foot.

Five years after the terrorist attacks, Lower Manhattan still has about 3 million square feet of retail space. Virtually all available economic and demographic data indicates that this is just not enough retail space to meet the needs of Downtown shoppers. According to the Alliance for Downtown New York Inc., out of a total demand for retail goods and services of \$2.3 billion annually, about \$1.4 billion has remained unmet since September 11.

Much of that demand may be met by the redevelopment of the World Trade Center retail space. Approximately 500,000 square feet of new retail space is planned for the site. The actual size and composition of the new space has yet to be determined as negotiations continue between players involved in the retail component of the project.

The growing size of Lower Manhattan’s residential market and, in particular, the demographic of its population has already begun to attract some of the nation’s high-end retailers. Lured by the promise of affluent residents, Tiffany & Co., Hermès, BMW, Hickey Freeman,

and Sephora have all recently announced plans to open stores Downtown. According to the Alliance for Downtown New York Inc., the median household income Downtown was \$87,000 per year—roughly twice the average for the entire city. Lower Manhattan residents tend to have more disposable income because 81 percent of them do not have children.

Retailers have begun to vie for prime spaces, pushing up retail rents. According to the Real Estate Board of New York, in 2005, average asking rents for Lower Manhattan retail space jumped to \$85 per square foot from \$73 per square foot, an increase of 16 percent compared to the 5 percent growth seen citywide. Premium retail spaces Downtown are fetching rents that would not seem out of place in Midtown. Building owners of well-located retail sites have achieved rents surpassing \$200 per square foot.

Conclusion/Outlook

The outlook for Lower Manhattan's economy, which was bleak at best five years ago, has never looked better. The city's expanding economy has fueled a surge in office leasing in Lower Manhattan. Net absorption of Downtown office space for the first half of 2006 has already surpassed net absorption for all of 2005. Furthermore, as Midtown's only two new office projects are already 83 percent leased and activity within the remaining space remains high, there are few choices left in Midtown to meet the needs of space users already combing the submarket for space.

The office market citywide is expected to become even tighter in the next 18 months. New York has already added more than 20,000 office jobs this year and will likely add at least 15,000 more, with another 20,000 office jobs expected for 2007. Using a rule-of-thumb average of 250 square feet per employee, the amount of office space needed just to house these additional office employees is 8.8 million square feet, exactly equal to the projected square footage of the entire World Trade Center site, including Site 1. This data has mollified concerns that all this planned construction will oversaturate the market.

Downtown's outlook is analogous to Times Square in the mid-1990s when developers and other large tenants considered the area the next frontier in Manhattan. At that time, numerous development sites along 42nd Street were available, and city and state officials were offering generous incentives to lure businesses to the famous area. Their efforts went somewhat unrewarded until 1994, when The Durst Organization signed Condé Nast Publications and Skadden, Arps, Slate, Meagher & Flom LLP to fill 4 Times Square. Other developers saw these deals as an endorsement of the neighborhood's turnaround and quickly snatched the remaining sites.

In Lower Manhattan, 7 World Trade Center has signed letters of intent to lease more than 600,000 square feet. The combined effect of businesses taking space at the newly constructed office tower adjacent to Ground Zero, current market conditions, favorable rents, and government incentives will likely drive more tenants to the area.

The Authors

Jones Lang LaSalle provides comprehensive real estate advisory services to The Port Authority of New York and New Jersey, focusing on the redevelopment of the World Trade Center complex. A leader in the commercial real estate industry, Jones Lang LaSalle delivers a wide range of services that include leasing, management, project management and capital markets to real estate owners, occupiers and investors through its Downtown and Midtown offices.



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