THE NEW YORK FAMILY OFFICE

Your Contact in the U.S.

Newsletter: 1st Quarter 2013

U.S. Private Sector Has to Absorb a Combination of Higher Taxes and Government Spending Cuts

The first quarter of 2013 presented two major challenges: The absorption of a combination of higher taxes and government spending cuts. As of January 1, 2013 taxes have risen as a result of the expiration of payroll tax cuts (from 4.2% back to 6.2%) and increased tax rates. It is estimated that the additional revenue from these initiatives will be approximately $165-210 billion for 2013. Because of the tax increases consumer confidence turned more negative as many workers have to digest the shock of less net pay. Nevertheless, consumer spending has remained relatively robust. Household's net worth continued to recover, fueled by strong stock market gains and rise in home prices. In addition, job growth was solid and income growth had a slight uptick. As of March 1, 2013 the sequester, automatic across the board spending cuts, reduces government expenditures by $85 billion over the balance of the year. There is concern that these measures will weaken economic growth and some economists have reduced their 2013 forecasts of GDP growth to approximately 1.5% from earlier estimates of approximately 2.5%. A major criticism of what many observers perceive as ill-timed sequester cuts is that they do nothing to deal with the long-term entitlement spending issues such as Medicare and the pension and disability program, which present the most serious challenges for long-term U.S. debt.

Despite political struggles in Washington, the Fed seems to be determined to continue supporting the economy through monetary policy. Based on a press release dated March 20, 2013 the Federal Open Market Committee (FOMC) decided to continue its third round of Quantitative Easing (QE3) by purchasing $40-45 billion of agency mortgage-backed securities and longer-term Treasury securities per month. In addition, FOMC members anticipate that the low federal funds rate will be suitable as long as a) the unemployment rate remains above 6.5% and b) expectations of annual inflation over the next two years do not exceed the FOMC's 2% longer-term goal by more than 0.5%.

Overall, the expectation is that the Fed will continue QE3 throughout 2013 and hopefully economic growth will increase over the year as consumers adjust to the combination of tax increases and reduced government spending. Increased investments by U.S. corporations in capital spending plus additional hiring would significantly aid the recovery. However, confidence in government is crucial and requires efforts from both political parties.

German Firms Bullish on 2013 U.S. Market despite Fiscal Uncertainties in the U.S. and Eurozone Crisis

The German American Chambers of Commerce (GACCs), the Representative of German Industry and Trade (RGIT), and Roland Berger Strategy Consultants conducted a survey at the end of 2012 to gauge the state of German-owned subsidiaries in the U.S. The key findings of the "German American Business Outlook 2013" are:

- German-American firms have had a positive year in terms of business activity and growth in 2012. Respondents expect to continue this trend of outperforming the U.S. economy in 2013.

- ✓ Firms experienced strong top-line growth as sales volumes have continued to increase and price levels have recovered.

- ✓ However, as the market has shown signs of recovery, both labor and non-labor costs continue to exhibit a mild inflationary trend.

- ✓ In response to top-line growth, companies increased their workforces and 76% expect further headcount growth for 2013.

- ✓ In 2013, respondents expect the U.S. market to continue to improve and are confident in the growth prospects for their own firms.

- ✓ Based on this confidence, firms continue to focus on growth-oriented initiatives and invest in new product development and optimization that will impact their U.S. operations in 2013

- In uncertain landscape, respondents expect more negative impact by the Euro-debt crisis and further EUR depreciation in 2013.

  - ✓ Majority of respondents believe that Eurozone instability will continue in 2013 and has an increased negative impact on their U.S. operations.

  - ✓ Further EUR depreciation is expected in 2013. German-American firms have experienced capital constraints from traditional European sources and have reacted by increasing use and reliance on USD.

- The U.S. Administration and Congress are expected to focus on economic improvement in 2013. Government commitment to domestic manufacturing and small and medium sized enterprises (SMEs) inspires confidence among respondents.

  - ✓ German-American firms believe that long-term economic value can be created through investing in education.

  - ✓ Addressing U.S. fiscal concerns and tax reform are believed to help restore market confidence and improve long-run economic growth potential.

Sources: www.rgit-usa.com, www.gaccny.com, www.rolandberger.us

Are there Signs that Abundant Late Stage Private Equity Funding Changes IPO Dynamics?

According to some investors the relatively poor performance of some initial public offerings (IPOs) particularly in the tech sector is not only bad timing but primarily due to different sources of financing for growth-stage companies. Because of abundant late stage private equity funding, today more and more companies become public much later. By the time, management considers an IPO, the companies sometimes are no longer in a growth stage, but rather stable and solid. In this case, the IPO offers founders and private equity investors an exit to cash out. Food for thought.

Real Estate Co-Investment with U.S. Single Family Office

Currently, The New York Family Office is working on a real estate co-investment with a U.S. single family office (SFO) which has many years of experience in real estate and an outstanding track record. Its special expertise is redeveloping office and industrial buildings in eastern U.S. markets. The investments are opportunistic with target returns of a minimum of 20% IRR and an equity multiple of at least 1.5x. Over the next five years, the SFO plans to invest in 5-7 properties per year and is seeking partners to co-invest a total of $20 million in equity per year. The U.S. SFO contributes 50% of the capital and all capital investors participate as limited partners ("investment on eye level"). The financial results are shared among the limited partners pari passu based on capital contributions. We are planning to give several families and family offices from Austria, Germany, and Switzerland the opportunity to participate in a club deal.

Transformation of the Retail Real Estate Landscape

The rapid growth of online shopping and an oversupply of retail real estate continue to position the retail sector for significant transformation in how and where people shop. Investors should be cautious before investing and diligently differentiate between three sub-sectors: Shopping malls, necessity retail, and high-street retail.

Retail shopping malls are essentially divided into two groups: Top-quality malls and others. Investors tend to favor the strongest mall companies (REITS like Simon Property Group Inc.) which own the highest quality malls and have the most clout with retailers. Their top malls typically average annual sales of at least $500 per square foot ($5,400 per square meter) and account for only about a quarter of the approximately 1,100 enclosed malls in the U.S. Most redevelopments are taking place at these top-performing malls as landlords determine how to best compete against e-commerce and renovate to address retailers' changing strategies which integrate their online sales into bricks-and-mortar. The future is mall shoppers who use smartphone apps which alert them when new products arrive, what is on sale, where to get discounts and where to find discount coupons. These shoppers often want to experience and touch products in the store before they shop online. Therefore, malls will adjust to smaller stores with less storage, but with more showroom and promotion space. In addition, mall owners will add more restaurants, upscale movie theaters, entertainment features, supermarkets, and other tenants that offer goods and experiences that cannot be found online. Nationwide, the number of subpar malls which are generating sales of less than $300 per square foot ($3,200 per square meter) is rapidly increasing to about a third of all malls. The sluggish economy, shifts in consumer habits and chain-store closings will make it hard for them to survive.

Necessity retail overall is continuing to do well. Urban retail development has a lot of potential and multifamily developers accommodate necessity retail components like supermarkets, drug stores and cleaners into infill projects.

High-street or high-end retail is bifurcated into stores that do extremely well economically and stores that focus on marketing/branding where the economics might

be rough. However, for investors the high-street retail real estate market remains strong despite the weakness of the broader economy. For example, along Fifth Avenue in New York, the cost of high-end retail real estate and store rents is at a record high. On Fifth Avenue's prime blocks from 49th to 59th streets, prices exceed $15,000 per square foot ($160,000 per square meter) and rents are as high as $3,000 per square foot ($32,300 per square meter). Even with average ground-floor rents of $700-$800 per square foot ($7,500-$8,600 per square meter) between 42nd and 49th streets, stores need to generate large sales to become profitable. However, some Fifth Avenue stores are very profitable with annual sales of more than $15,000 per square foot ($160,000 per square meter). At the same time, Fifth Avenue has transformed from mostly luxury brands to a mixture of medium and luxury brands. Today you can find discount clothing chains like H&M or Zara on the same block as Cartier.

U.S. Widens Offshore Tax Evasion Probes

On August 19, 2009 the United States and the Swiss Confederation entered into an agreement, in which they agreed on an information exchange mechanism that effectively ended the status quo of the Swiss banking secrecy. This agreement allowed UBS AG to avoid criminal charges in the U.S. for conspiracy in tax evasion by paying $780 million and turning over the names of approximately 4,500 U.S. taxpayers with accounts maintained in Switzerland. Since then, defense lawyers estimate that federal prosecutors have been conducting at least 100 criminal investigations against suspected tax evaders and the U.S. government has already won approximately 50 criminal cases. In addition, to encourage more taxpayers to come forward, the Internal Revenue Service (IRS) has offered three limited amnesty programs allowing holders of undeclared accounts to confess. Taxpayers accepted into these amnesty programs often owe significant penalties but they escape criminal prosecution. They also must cooperate and provide detailed information for the IRS's use in future enforcement efforts. According to the IRS so far over 38,000 holders of undeclared offshore accounts have stepped forward and paid in excess of $5.5 billion in back taxes, interest and penalties. An additional $5 billion is estimated to be collected from ongoing cases in connection with offshore bank accounts and the number of confessions is expected to rise significantly.

Since the UBS case the U.S. government has been sending two clear messages: One to U.S. taxpayers who evaded federal taxes through offshore accounts and one to foreign institutions.

The message to U.S. taxpayers is that the government is aggressively pursuing those who violate U.S. tax laws. For example, the press reported extensively about a 79-year old widow who pleaded guilty on January 8, 2013 to criminal charges of filing false tax returns and evading almost $670,000 in federal taxes on approximately $42 million her deceased husband left her in a secret Swiss bank account at UBS. According to a statement of the U.S. Justice Department, her accounts used foundations in Liechtenstein and Panama to conceal money and she failed to include those accounts in her federal tax returns. She agreed to pay over $21 million in civil penalties representing 50% of the high balance in the account for failure to file Form TD F 90-22.1 ("FBAR"). In addition, she owes the above mentioned federal taxes plus penalties and interest, and faces up to six years in prison.

The message the U.S. government has been sending to foreign offshore institutions is that it is willing to pursue alleged wrongdoers even if they have no offices in the U.S. Switzerland's oldest private bank, Wegelin AG, pleaded guilty on January 3, 2013 to conspiracy to evade more than $1.2 billion in U.S. taxes and agreed on March 4, 2013 to pay $74 million in restitution, penalties and forfeitures for violating U.S. tax laws.

As a next step, the U.S. government is widening its probes to other banks in Switzerland and elsewhere. On January 28, 2013, a federal judge in New York approved an IRS summons demanding more records from UBS AG. According to court filings, the focus is now on U.S. taxpayers with accounts at smaller Swiss banks without U.S. branches that served customers through a UBS account in Stamford, Connecticut. Thanks to leads gathered from interviews with confessed tax evaders, the U.S. government saw the money moving out of UBS AG into Wegelin AG. Now the government is looking where else money is being transferred and is starting to go after undeclared accounts in Hong Kong, India, Israel, Singapore, and elsewhere.

Approach to Protect Tax Revenue in the U.S.

In the beginning foreign investors are often surprised by the United States' strict due dates for filing tax returns, tight control mechanisms with various interests and penalties, and the clear message of the Internal Revenue Service (IRS) to "follow the rules." What kind of welcome for sought-after foreign investors is that? Upon closer look this approach with its high deterrent effect is more understandable, even though it is debatable whether it is optimal.

Unlike countries like Germany, where the tax authorities assess income tax returns and prepare a formal tax assessment statement, the key principle in the U.S. is self-assessment of taxes by taxpayers. Similar to how taxpayers determine the Value Added Tax (VAT) in Germany, all U.S. individual and corporate taxpayers have to evaluate their tax bases and calculate their taxes due. Filed tax returns will be checked by the IRS primarily regarding arithmetic correctness and obvious implausibility. This work is done in central service centers which cover many states. The concept of tax assessment with a substantive examination in a local tax office, where CPAs personally know the responsible tax agents, does not exist. Only a relatively small number of tax returns are subject to further examination regarding factual examination. Depending on scope and complexity of these cases, enhanced examinations will be undertaken through office audits or field audits. According to annually published statistics, on average approximately 1% of roughly 140 million individual income tax returns are audited. However, it has to be considered that the IRS uses its limited economic resources efficiently and focuses on individuals with higher income because they get much more additional tax revenues from going after these taxpayers. In 2011, for example, the audit rate increased to 12.5% for individuals with income of more than $1 million.

In summary, the U.S. has chosen a system to protect tax revenue with limited examination upfront but which provides tax authorities, in comparison to other countries, with extensive penalties. Practical experience shows that it is key in the U.S. to avoid problems upfront and take care of tax issues, since it can become time intensive and costly to fix them later.

Economic Indicators & U.S. Dollar Foreign-Exchange Rates

Economic Indicators	February 2013	December 2012	December 2011	December 2009	December 2007
Employment	236,000	155,000	200,000	(85,000)	18,000
Unemployment Rate	7.7%	7.8%	8.5%	10.0%	5.0%
Avg. Weekly Hours (Manuf.)	40.9	40.7	40.5	40.4	41.1
Avg. Overtime Hours (Manuf.)	3.4	3.3	3.2	3.4	3.9
Building Permits	946,000	909,000	671,000	653,000	1,080,000
Housing Starts	917,000	973,000	689,000	575,000	1,004,000
Consumer Confidence Index	69.6	64.6	64.8	53.6	90.6
Purchasing Managers Index	54.2	50.2	52.9	55.3	49.0

Other Indicators	Feb. 28, 2013	Dec. 31, 2012	Dec. 30, 2011	Dec. 31, 2009	Dec. 31, 2007
S&P 500 Index	1,514.68	1,426.19	1,257.60	1,115.10	1,468.36
S&P 500 - Trading Volume (in thousands)	3,912,320	3,204,330	2,271,850	2,076,990	2,440,880
VIX (Volatility Index)	15.51	18.02	23.40	21.68	22.50

Real GDP	2012 Q4	2012 Q3	2011	2009	2007
Real GDP	0.4%	3.1%	1.7%	(3.5%)	1.9%

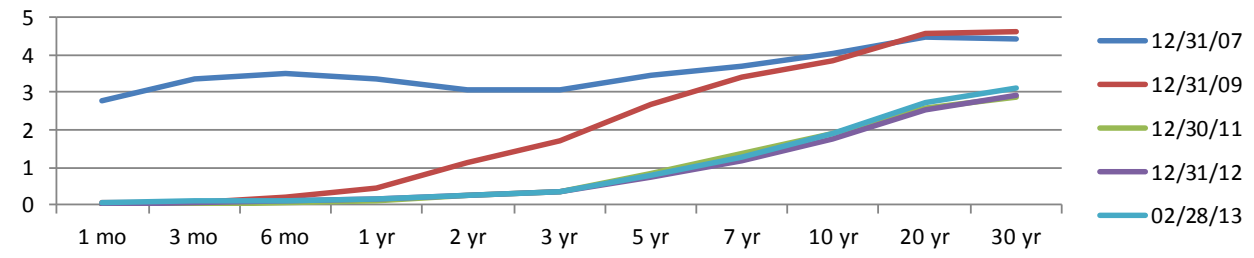
Inflation	February 2013	December 2012	2011	2009	2007
Inflation	2.0%	1.7%	3.2%	(0.4%)	2.8%

Currency Exchange Rates	Feb. 28, 2013	Dec. 31, 2012	Dec. 31, 2011	Dec. 31, 2009	Dec. 31, 2007
EUR / USD	1.3082	1.3215	1.2949	1.4332	1.4719
GBP / USD	1.5127	1.6153	1.5453	1.5926	1.9963
CHF / USD	1.0734	1.0942	1.0640	0.9634	0.8876
CAD / USD	0.9747	1.0031	0.9804	0.9529	1.0183
CNY / USD	0.1590	0.1583	0.1571	0.1463	0.1367
JPY / USD	0.0109	0.0116	0.0129	0.0108	0.0089

Note: Some Numbers May Be Updated Due to Revisions of Official Statistics.

Interest Rates, Real Estate & Taxes

Treasury Yield Curve (in %)



Base Rates	April 1, 2013	2 Weeks Ago	One Year Ago
30 Day LIBOR	0.20%	0.20%	0.24%
U.S. Treasury			
5 Year	0.76%	0.81%	1.05%
10 Year	1.85%	1.96%	2.23%

10-Year Fixed Rate Ranges by Asset Class	Max. LTV	Class A	Class B/C
Anchored Retail	70-75%	T + 200	T + 210
Strip Center	65-70%	T + 220	T + 230
Multi Family (Non-Agency)	70-75%	T + 175	T + 180
Multi Family (Agency)	75-80%	T + 175	T + 180
Distribution/Warehouse	65-70%	T + 205	T + 215
R&D/Flex/Industrial	65-70%	T + 220	T + 235
Office	65-75%	T + 190	T + 205
Full Service Hotel	55-65%	T + 255	T + 280

Note: T = Interest Rate for 10-Year U.S. Treasury (1.85%)
Source: Cushman & Wakefield (April 1, 2013)

Simplified Presentation of the Most Important U.S. Federal Tax Rates:	
Income Tax	10-35% / 10-39.6%*
Long-Term Capital Gains (LTCG)	15% / 20%*
"Qualified" Dividends	15% / 20%*
Corporate Tax	15-35%
Gift and Estate Tax	18-35% / 18-40%*

Note: * = As of January 1, 2013 higher tax rates apply for individuals earning more than $400,000 (and couples earning more than $450,000).

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For questions or scheduling meetings, please contact us.
We are looking forward to hearing from you.

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