THE NEW YORK FAMILY OFFICE

Your Contact in the U.S.

Newsletter: 3rd Quarter 2014

U.S. on Track for Rising Interest Rates in 2015

The U.S. economy continues its story of strong job growth (adding 248,000 jobs in September) and a decreasing unemployment rate. Most indicators – especially consumer and business confidence – are still improving. Sustained job growth is boosting confidence allowing some consumer spending and increasing business investments. In this environment the financial situation of households is improving and housing is expected to strengthen further. In the public sector improved economic conditions are generating more state and local revenue. With decreasing energy costs and other prices remaining relatively stable, inflation does not seem to pose a threat at the moment. If this trend continues economists expect that U.S. growth will be around three percent for the coming months and the U.S. economy will approach full capacity and reach its natural unemployment rate of 5.5 percent in 2015. The continued weakness in wage growth will probably arrive at its turning point in the second half of 2015 when a tightening of the labor market could cause payrolls to rise. Overall, it appears that the world's largest economy is on track for steady expansion and rising interest rates in 2015.

Ford's Bold Strategic Move for Long-Term Survival

The big three U.S. auto makers' (General Motors, Ford and Chrysler) most profitable vehicles are heavy-duty pickup trucks and SUVs. Even though gas prices have stabilized the industry faces challenges as consumers and politicians have increased pressure to improve the gas-guzzlers' mileage. By 2025 all car makers have to meet the U.S. government's target of a fleet averaging 54.5 miles per gallon (approximately 4.3 liters per 100 kilometers), which more than doubles the gas mileage for most of them. Obviously it is harder to reach this goal if your fleet consists mainly of highly profitable but heavy pickup trucks and SUVs. Accordingly, it will require bold moves from U.S. auto makers to significantly reduce the weight of their trucks and SUVs if they do not want to reduce their profitability by selling more small cars.

Ford made a big bet and unveiled the new F-150 pickup truck with an all-aluminum body which will hit the showrooms this year. Aluminum makes the truck about 700 pounds (approximately 320 kilograms) lighter than its 2014 model. This will translate into significantly better mileage per gallon and potentially substantial market-share gains. Today only a few luxury cars like the Audi A8, the Tesla Model S and the Jaguar cars have a body almost entirely of aluminum. However, for the first time an auto maker decided to use aluminum for a high volume vehicle like the F-150 which has been the best-selling vehicle in the U.S. for over 30 years. For comparison, Ford produces as many F-150s per month as all other aluminum-bodied vehicles combined sell in the U.S. per year. According to estimates the F-series accounts for approximately 30 percent of Ford's U.S. sales and for even more percent of its profits.

Ford's move will cause others to follow and according to a study by 2025 about 20 percent of all vehicles will have all-aluminum bodies compared to less than one percent today. The two largest producers of aluminum in the U.S., Alcoa Inc. and Novelis Inc., are already expanding production capacity in order to meet anticipated demand.

Nevada Will be Home to Tesla's Gigafactory

At the beginning of September Tesla Motors Inc. confirmed that its new battery factory will be constructed outside Reno, Nevada to produce powerful lithium-ion batteries that power its electric vehicles. The project called Gigafactory will cost up to $5 billion, create up to 6,500 new jobs and produce up to 500,000 battery packs a year (35 gigawatt hours of battery cells annually). Panasonic Corp. which currently supplies the batteries for Tesla's Model S, will help running the battery cell making operations and contribute 30 to 40 percent of the total cost of the factory. Tesla's management has mentioned it needs its own ten million-square-foot (approximately 929,000 square meters) production facility to lower battery costs and offer a more affordable car.

Nevada is the winner of a competition against Arizona, California, New Mexico and Texas. To land the project, Nevada offered incentives that could total up to $1.2 billion (up to $1 billion in tax abatements and approximately $200 million in tax credits). In exchange the Gigafactory offers the state that was hit disproportionally hard by the recession an opportunity to diversify its economy predominantly built on tourism. Currently, Nevada only has a relatively small manufacturing sector which employs about 3.5 percent of its workforce. In addition, state officials expect that the facility will generate $1.9 billion in tax revenue over a 20 year period.

Obviously Nevada's incentives are important but in the end several other factors had been considered for the final decision:

1. Speed

Probably most important was Nevada's ability to move quickly, allowing Tesla to set up the factory in less than three years. Tesla is under a tight timeline to complete the Gigafactory by 2017 since its produced batteries are critical to Tesla's plan to release and deliver its third vehicle, Model III, in 2017. Model III is an entry-level mass-market electric car starting at $35,000 and with the ability to travel 200 miles (approximately 320 kilometers) on an electric charge. This would be about two times the rate existing electric vehicles at that price can achieve and it is mainly due to cost savings from building the new battery factory.

Note: The legal environment in California did not provide enough certainty to move quickly, because it is basically impossible to prevent a court somewhere in California from issuing an injunction to stop work on a project if a lawsuit gets filed under some environment or business concern.

2. Proximity to Tesla's Existing Car Plant

Reno is relatively close to Tesla's existing car assembly plant in Fremont, CA. Transportation takes approximately 5 hours by truck plus the Reno site has access to transportation by rail and air.

3. Access to Lithium Supply

Lithium is a key raw material for batteries that power electric cars. Nevada has the only active lithium mine in the U.S. and offers additional access to lithium deposits.

4. Renewable Energy Source

The Gigafactory will require a huge amount of electricity to operate and is supposed to be energy self-sufficient. Tesla plans to use a significant part of the site for a large array of solar panels and wind turbines.

5. Favorable Tax System

Nevada has a favorable tax system with no individual income tax and no corporate income tax. The state finances itself through gaming tax, sales and excise tax as well as property tax.

6. Right-to-Work State

Nevada is a "right-to-work" state. „Right-to-work" laws do not, as the name might suggest, aim to provide a general guarantee of employment to people seeking work, but rather secure the right of employees to decide for themselves whether or not to join or financially support a union. These rules are part of a state constitution or state law regulating contractual agreements between employers and labor unions. The laws prevent union security agreements, arrangements between labor unions and employers that govern the extent to which an established union can require employees to join and pay union dues and fees in order to get or keep a job. According to the U.S. Labor Department there are currently 24 "right-to-work" states* with 12 located in the South.

**The following states are right-to-work states: Alabama, Arizona, Arkansas, Florida, Georgia, Idaho, Indiana, Iowa, Kansas, Louisiana, Michigan, Mississippi, Nebraska, Nevada, North Carolina, North Dakota, Oklahoma, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, and Wyoming.*

7. Relatively Low Wages

It is expected that the average wage at the Gigafactory will be $25 per hour. In selecting Nevada, Tesla is picking a state with relatively low manufacturing pay. Based on industry estimates manufacturing employees in Nevada make about 30 percent less than in California.

Air Rights

When tourists look at Manhattan's skyline it is sometimes puzzling for them that there are different buildings on the same block which can vary significantly in height. How is this possible? Developers purchase unused development rights, so called air rights, which enable them to build taller than they otherwise could have. Essentially these developers are purchasing the air above other existing buildings.

As a rule of thumb, air rights trade for 60 percent of the price for which the land would be sold. In general, development rights refer to the maximum amount of floor area permissible on a zoning lot. When the actual built floor area is less than the maximum permitted floor area, the difference is referred to as unused development rights or air rights. In New York City there are two ways air rights are commonly used for real estate developments: Floor area ratio (FAR) rights in case of a zoning lot merger and the transfer of development rights (TDR) to move rights from one location to another.

1. Zoning Lot Merger

In the first option, floor area ratio (FAR) rights can be transferred between the owners of contiguous properties that have been consolidated into a single zoning lot. The Zoning Resolution of the City of New York defines the FAR as: "... the total floor area on a zoning lot, divided by the lot area of that zoning lot. (For example, a building containing 20,000 square feet of floor area on a zoning lot of 10,000 square feet has a FAR of 2.0.)"

Two or more contiguous lots within the same block, although they are owned by different parties, can be combined into a single zoning lot. The total FAR allowance for the consolidated zoning lot then can be allocated among the various parcels that comprise the zoning lot. Therefore, with the cooperation of several neighboring buildings, a developer can build a new structure based upon the unused FAR rights of the surrounding lots.

2. Transfer of Development Rights (TDR)

The second option allows for the transfer of unused development rights from one zoning lot to another in limited circumstances, usually to promote the preservation of historic build¬ings, open space or unique cultural resources. For such purposes, a TDR may be permitted where the transfer could not be accomplished through a zoning lot merger. In the case of a landmark building, for example, a transfer may be made by City Planning Commission (CPC) special permit from the zoning lot containing the designated landmark to an adjacent zoning lot or one that is directly across the street or, for a corner lot, another corner lot on the same intersection. In 2013 for example Christ Church in NYC sold roughly 70,000 square feet (approximately 6,500 square meters) of air rights at approximately $600 per square foot (around 6,460 USD per square meter) to Zeckendorf Realty, netting the church $42 million.

Retailers Are Trying to Reinvent Themselves and to Find a Remedy to Combat Online Shopping

Investing in retail is challenging because shopping habits and sales channels are constantly changing, making it difficult for businesses to build and maintain competitive advantages. The U.S. retail industry is going through significant transformation due to the rapid growth of online shopping and an oversupply of retail real estate. Currently the industry is experiencing two major trends: downsizing and attempts to bring back foot traffic.

1. Downsizing: Online Shopping is Changing Retail Space Demand

Big box stores and many other retailers are facing mounting margin pressures from Internet retailers. As a result, stores tend to close or reduce retail space throughout the country.

While all retail companies are faced with changing consumer behavior due to increased internet purchases and declining in-store foot traffic, the shift in consumer habits has hit electronics, appliances and office supplies retailers the most since these items are sold online more frequently than other goods.

For example **Staples Inc.** is planning to close over 200 of its more than 1,800 stores in the U.S. and Canada over the next two years. Even though online sales already account for approximately fifty percent of Staples' annual revenue, the company's management has mentioned that its retail presence is still too big after the announced closures and it is planning to reduce the size of its remaining stores in half. The company expects to improve its bottom-line by cutting rent cost in half and reducing maintenance, wages and other expenses for the smaller stores.

The retailers **J.C. Penney** and **Sears Holdings Corp.**, each with losses of more than $2 billion over the past two years, are racing to close stores, most of them in shopping malls. Since 2010 Sears has closed over 100 of its full-line stores and is planning to close more stores to improve the company's bottom line. Also J.C. Penny has plans to close more than 30 of its stores. Their downsizing will cause a major transformation in U.S. malls since almost half of them have both Sears and J.C. Penney as anchor tenants. 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 1,000 enclosed malls in the U.S. These top-performing malls are trying to reinvent themselves by adding entertainment like indoor golf courses and higher-end restaurants, as well as services such as same-day delivery. For other malls the loss of anchor tenants can create a downward trend, especially in locations that have both J.C. Penney and Sears as tenants. Experience shows that if one of them closes its store, it almost forces the other one to do the same, because the mall will lose too much foot traffic. For stronger malls the exit of a troubled retailer can create an opportunity to find healthier tenants, while for the others a departing anchor can cause other stores to leave or renegotiate their leases, contributing to a spiral of declining traffic and investment.

2. Retailers' Attempts to Bring Back Foot Traffic.

Even many shrewd investors did not anticipate the deep changes that are continuing to shake the U.S. retail landscape. Retailers are potentially facing a permanent drop in traffic as Americans increasingly shop online for everything from diapers to drywall. In 2013 U.S. shoppers made four percent fewer shopping trips than in 2012 according to a market research firm. Another research firm estimates in-store foot traffic has fallen by approximately five percent from a year earlier in every month for the past two years.

For many years the largest retailers would choose a specific category, build huge stores and wipe out less specialized competitors. This strategy is changing since large chains like Best Buy, Home Depot and Staples are expecting that adding consumer basics to their merchandise will increase sales and bring back traffic. The underlying rationale is that while sales of electronics and office supplies have quickly shifted online, soap, paper towels and other necessities sales generally have not, making them

attract foot traffic.

For example **Home Depot Inc.** added toilet paper and detergent to its merchandise and even introduced its own laundry detergent label in spring 2014.

Best Buy Co. has a similar strategy and is trying to use consumables such as Tide, coffee pods and home soda machine supplies to bring back customers who once stopped by every week to buy compact discs, movies and ink cartridges. According to market research data over 30 percent of consumers who buy home soda machines will revisit the same store when they need to refill their CO2 gas or syrup cartridges. These recurring visits are likely to induce shoppers to pick up other items while in the store.

Staples Inc. is trying to reinvent itself and align with changing consumer tastes by adding 1,600 new items to its stores. Most of the items are business-related supplies, however, expanding into deodorants, shaving cream and other goods that have to be replenished regularly is a logical part of its strategy „beyond office supplies." With its new products consisting of a mixture of traffic drivers and convenience goods, Staples is trying to establish new patterns with its customers, who might be shopping those paper towels, deodorants, etc. somewhere else.

Target Corp. tried a different strategy, giving customers 25 percent discounts on certain online purchases if they pick up the merchandise at the store. The retailer's rationale is that customers who visit the store often stock up on other items and increase sales.

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

Economic Indicators	August 2014	June 2014	August 2013	August 2011	August 2009
Employment	142,000	288,000	169,000	0	(216,000)
Unemployment Rate	6.1%	6.1%	7.3%	9.1%	9.7%
Avg. Weekly Hours (Manuf.)	41.0	41.1	40.8	40.3	39.8
Avg. Overtime Hours (Manuf.)	3.4	3.5	3.4	3.2	2.9
Building Permits	998,000	963,000	918,000	620,000	579,000
Housing Starts	956,000	893,000	891,000	571,000	598,000
Consumer Confidence Index	93.4	86.4	81.8	44.5	54.5
Purchasing Managers Index	59.0	55.3	55.7	53.2	53.5

Other Indicators	August 29, 2014	June 30, 2014	August 30, 2013	August 31, 2011	August 31, 2009
S&P 500 Index	2,003.37	1,960.23	1,632.97	1,218.89	1,020.62
S&P 500 - Trading Volume (in thousands)	2,259,130	3,037,350	2,734,300	5,267,840	5,004,560
VIX (Volatility Index)	12.09	11.57	17.01	31.62	26.01

Real GDP	2014 Q2	2014 Q1	2013	2011	2009
Real GDP	4.0%	(2.9%)	1.9%	1.8%	(2.8%)

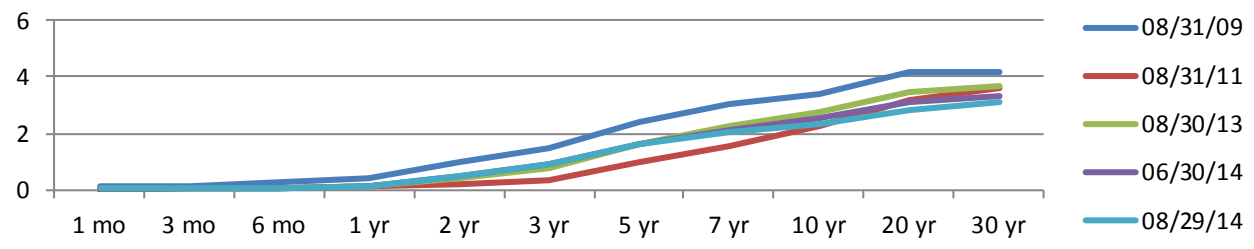
Inflation	August 2014	June 2014	2013	2011	2009
Inflation	1.7%	2.1%	1.5%	3.2%	(0.4%)

Currency Exchange Rates	August 31, 2014	June 30, 2014	August 31, 2013	August 31, 2011	August 31, 2009
EUR / USD	1.3131	1.3645	1.3229	1.4468	1.4298
GBP / USD	1.6596	1.7028	1.5498	1.6349	1.6264
CHF / USD	1.0885	1.1216	1.0743	1.2221	0.9432
CAD / USD	0.9188	0.9371	0.9493	1.0223	0.9157
CNY / USD	0.1625	0.1624	0.1622	0.1567	0.1462
JPY / USD	0.0096	0.0098	0.0102	0.0130	0.0107

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

Interest Rates, Real Estate & Taxes

Treasury Yield Curve (in %)



Base Rates	October 8, 2014	2 Weeks Ago	One Year Ago
30 Day LIBOR	0.15%	0.15%	0.17%
U.S. Treasury			
5 Year	1.63%	1.82%	1.42%
10 Year	2.35%	2.57%	2.67%

10-Year Fixed Rate Ranges by Asset Class	Max. LTV	Class A	Class B/C
Anchored Retail	70-75%	T + 185	T + 195
Strip Center	65-75%	T + 185	T + 195
Multi Family (Non-Agency)	75-80%	T + 160	T + 170
Multi Family (Agency)	75-80%	T + 170	T + 175
Distribution/Warehouse	65-70%	T + 185	T + 195
R&D/Flex/Industrial	65-70%	T + 190	T + 200
Office	65-75%	T + 180	T + 190
Full Service Hotel	55-65%	T + 245	T + 265

Note: T = Interest Rate for 10-Year U.S. Treasury (2.35%)
Source: Cushman & Wakefield (October 8, 2014)

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

Note: * = As of January 1, 2014 higher tax rates apply for individuals earning more than USD 406,750 (and couples earning more than USD 457,600).

THE NEW YORK FAMILY OFFICE

Your Contact in the U.S.

If you have questions or would like to schedule a meeting, please contact us.
We are looking forward to hearing from you.

The New York Family Office
Telephone: +1 (646) 734 - 4056
Facsimile: +1 (646) 355 - 2855
contact@tnyfo.com
www.tnyfo.com