

Dear Investors and Friends:

The U.S. economy is now nineteen months into the economic downturn with no real quarter over quarter data points to suggest recovery is on the horizon. Policy makers talk about “green shoots” starting to take hold based on several government-led stimulus packages; however, the empirical data does not support it at this point. Gross Domestic Product (GDP) fell at a 6.1% annualized rate in the first quarter of 2009, the unemployment rate is nearing 10%, oil is still relatively expensive and consumer confidence is around 50%. These indicators continue to hinder any sustainable business growth or economic recovery in the near future. The one sector that appears to have hit bottom is the residential housing re-sale market. In mid-2007, residential housing was one of the first asset classes to decline in value with home prices falling 25-50% in markets across the country. Over the past two quarters, several markets which had experienced large declines, are now seeing transaction volume improve, albeit at lower prices with buyers providing more equity.

What does this all mean for Commercial Real Estate? Demand for space and rents will continue to soften until businesses start to expand and jobs are added back to the economy. Nationally, it has been reported that real estate values are down 25-30% from mid-2007 as net operating income has decreased and capitalization rates have increased. The first sectors to be directly impacted by weaker demand and lower rents were hotels and apartments, due primarily to the short-term nature of their leases. Office, industrial and retail assets are lagging as their leases have longer terms, which means that unless a tenant defaults, it will take some time before buildings completely roll to new lower market rents. Higher rents from in-place leases are a major factor as to why a greater number of foreclosures have not yet taken place on the commercial front. Additionally, many institutions holding commercial mortgages have been willing to modify loan terms with good borrowers to avoid the more expensive process of foreclosure. Restructuring existing loans with borrowers with productive properties also allows lenders to avoid tougher regulatory requirements.

Whether or not institutions will continue this strategy in 2010 is difficult to predict as over one trillion in collateralized mortgage loans written by Wall Street banks will begin to mature, most with somewhat inflexible documents and managed by thinly capitalized special servicers. It is our belief that most loans made from 2000 through mid-year 2008 which mature in the next few years are unlikely to be re-financed at the maturing balance and face the prospect of a discounted payoff or foreclosure, given the current economic and lending environment. We expect institutions that hold CMBS securities and/or commercial loans on their balance sheet that had a 70% loan-to-value or higher when originated, will likely face a work-out, discounted payoff or foreclosure on or before maturity.

With respect to the markets we invest in, we are experiencing the same economic forces and real estate challenges as the national trends. Office vacancy rates continue to climb each quarter in northern NJ; Westchester County, NY; Fairfield County, CT; and Boston, MA as the financial service sector (our primary space driver) continues to contract. Rents have decreased on average 25% the past year and absorption of space has been negative the past several quarters as more firms either vacate entirely or look to sublet all or a portion of their space. Additionally, concessions such as free rent and greater tenant improvement allowances are essential to getting new leases completed. Any tenant looking for space in today's market will have multiple options and greater negotiating power with landlords. The compounding effect of lower rents and higher tenant concessions requires that a larger percentage of property cash flow go toward servicing the mortgage and paying such leasing costs resulting in less free cash with which to make distributions.

While the cycle is not favorable at this time, this too shall pass. The winners ahead will be those who get back to the basic real estate fundamentals of investing in good locations, providing strong management and promoting good tenant relations. Abbey Road continues to aggressively lease vacant space and renew existing tenants. To date, in 2009 we have leased 28,800 SF (2.6%) and renewed 58,400 SF (5.4%) across our portfolio. Our overall portfolio occupancy currently stands at 84%. We are also actively managing all controllable expenses and are seeing material savings in energy costs for our buildings in Westchester and Fairfield County. Our main goal is to preserve investor equity during the current downturn by finding ways to further increase cash flow in order to meet all expenses; ultimately, positioning the assets to achieve maximum value upon a market recovery. Situations may arise over the course of the next two years which require capital calls to cover the timing of certain expenses like leasing commissions and tenant improvements, but this will only take place to the extent we believe the requested capital is creating additional long-term value.

Many economists are predicting that the economy will hit bottom by September 2009, given that the government stimulus programs may be starting to take effect; while growth in GDP is expected to begin in the second half of 2010. Historically, with the exception of the Great Depression, most recessions (i.e., contraction in GDP) last 18-24 months. If these predictions hold true, we expect many good new investment opportunities will appear soon. The big "X" factors that could dampen any recovery are rising interest rates and inflation. It is very likely interest rates and inflation will rise significantly for a period of time given their recent decline and with our ever growing national deficit. Real estate tends to be a hedge against inflation, as inflation can lead to greater growth in rents. Real estate is however, capital intensive and higher interest rates increase costs of ownership. Nevertheless, through all phases of the cycle, Abbey Road will continue to look at new opportunities that offer attractive risk-adjusted returns to our investors.

All Abbey Road quarterly asset investment reports were mailed out to investors earlier this month. The reports contain more specific commentary on the asset itself and the local market. We will continue to keep you updated on individual assets quarterly or sooner if a material event takes place. If you have any questions, please feel free to contact us anytime at 203-227-9798. We remain fully committed to the long term benefits of real estate ownership and being a leader in our markets.

Enjoy the rest of the summer!

Mark Keeney Alan Bates Jim Digney
John McCarthy Steve Siegel