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VECTOR GROUP LTD  
Form 10-K/A  
March 21, 2007

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Securities And Exchange Commission  
Washington, D.C. 20549

Form 10-K/A

Amendment No. 1

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For The Fiscal Year Ended December 31, 2006

VECTOR GROUP LTD.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation  
incorporation or organization)

1-5759  
Commission File Number

65-09495  
(I.R.S. Employer Identif

100 S.E. Second Street, Miami, Florida  
(Address of principal executive offices)

3313  
(Zip Co

(305) 579-8000  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
----- Common Stock, par value \$.10 per share	----- New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. [ ] Yes [X] No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.  
[ ] Yes [X] No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  
[X] Yes [ ] No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 Regulation S-K is not contained herein, and will not be contained, to

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the best of the Registrant's knowledge, in definitive proxy or information statement incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. [ ] Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company as defined in Rule 12b-2 of the Exchange Act. [ ] Yes [X] No

The aggregate market value of the common stock held by non-affiliates of Vector Group Ltd. as of June 30, 2006 was approximately \$580 million.

At March 14, 2007, Vector Group Ltd. had 57,068,168 shares of common stock outstanding.

Documents Incorporated by Reference:

Part III (Items 10, 11, 12, 13 and 14) from the definitive Proxy Statement for the 2007 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission no later than 120 days after the end of the Registrant's fiscal year covered by this report.

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EXPLANATORY NOTE

This Annual Report on Form 10-K/A for the year ended December 31, 2006 is being filed to include in Part IV, Item 15, financial statements with respect to Douglas Elliman Realty, LLC and Koa Investors, LLC. In accordance with Rule 3-09 of Regulation S-X, the separate financial statements of these entities (50% or less owned persons) are being filed with the SEC no later than 90 days after the end of our fiscal year covered by this report.

This Amendment No. 1 does not update any other disclosure to reflect developments since the original date of filing.

The following item of the original filing is amended by this Amendment No. 1:

Item 15. Exhibits and Financial Statement Schedules.

Unaffected items have not been repeated in this Amendment No. 1.

(a)(2) List of Financial Statement Schedules

The following is filed as part of this report pursuant to Item 15(c) of Form 10-K:

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Douglas Elliman Realty, LLC financial statements as of December 31, 2006, and for the year ended December 31, 2006.	4

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(a) (3) Exhibits

EXHIBIT NO.	DESCRIPTION
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23.1	Consent of Independent Registered Public Accounting Firm
23.2	Consent of Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer, Pursuant to Exchange Act Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
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31.2	Certification of Chief Financial Officer, Pursuant to Exchange Act Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(c) Financial Statement Schedules

The financial statements with regard to Douglas Elliman Realty, LLC and Koa Investors, LLC are being filed in this report pursuant to Rule 3-09 of Regulation S-X.

DOUGLAS ELLIMAN REALTY, LLC  
AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2006

DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2006

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Notes to Consolidated Financial Statements.....11-19

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Managers and the Members  
of Douglas Elliman Realty, LLC:

In our opinion, the accompanying consolidated statement of financial position and the related consolidated statements of operations, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of Douglas Elliman Realty, LLC and Subsidiaries (the "Company") at December 31, 2006, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

Melville, New York  
March 12, 2007

DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
STATEMENT OF FINANCIAL POSITION  
DECEMBER 31, 2006

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(in thousands of dollars)

### ASSETS

#### Current assets

Cash and cash equivalents	\$ 19,307
Receivables	3,830
Prepaid expenses and other assets	2,388

Total current assets	25,525
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Property and equipment, net	19,538
Goodwill	38,087
Trademarks	21,663
Other intangible assets, net	1,721
Deferred financing charges	245
Security deposits and other non current assets	1,001

Total assets	\$ 107,780
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### LIABILITIES AND MEMBERS' EQUITY

#### Current liabilities

Current portion of notes payable and other obligations	\$ 1,897
Current portion of notes payable to related parties	2,483
Accounts payable and accrued expenses	12,063
Accrued compensation	4,995
Commissions payable	4,448

Total current liabilities	25,886
---------------------------	--------

Notes payable and other obligations, less current portion	405
Notes payable to related parties, less current portion	44,202
Other long-term liabilities	3,513
Accrued royalties	1,691

Total liabilities	75,697
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Commitments and contingencies (Note 9)

Members' equity	32,083
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Total liabilities and members' equity	\$ 107,780
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The accompanying notes are an integral part of these

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consolidated financial statements.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
STATEMENT OF OPERATIONS  
YEAR ENDED DECEMBER 31, 2006

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(in thousands of dollars)

REVENUES

Commission revenues	\$	319,270
Property management fees		23,113
Other revenues		4,861
		-----
Total		347,244

COSTS AND EXPENSES

Commissions and royalties		205,199
Sales administration		11,062
General and administration		62,577
Rent		16,532
Advertising and promotions		19,977
Depreciation		5,138
Amortization of intangible assets		410
		-----

Total costs and expenses 320,895

Operating income 26,349

Other income (expense)

Interest income		433
Interest expense		(6,138)
		-----

Net income before taxes 20,644

Income tax expense 1,140

Net income \$ 19,504

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The accompanying notes are an integral part of these consolidated financial statements.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 STATEMENT OF CHANGES IN MEMBERS' EQUITY  
 YEAR ENDED DECEMBER 31, 2006

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(in thousands of dollars)

BALANCE, JANUARY 1, 2006	\$ 21,462
Net income	19,504
Distributions to members	(8,883)
	-----
BALANCE, DECEMBER 31, 2006	\$ 32,083
	=====

The accompanying notes are an integral part of these consolidated financial statements.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 STATEMENT OF CASH FLOWS  
 YEAR ENDED DECEMBER 31, 2006

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(in thousands of dollars)

CASH FLOWS FROM OPERATING ACTIVITIES	
Net income	\$ 19,504
Adjustments to reconcile net income to net cash provided by operating activities	
Depreciation	5,138
Amortization	410
Interest paid in kind	387
Changes in operating assets and liabilities	



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Receivable	(2,129)
Prepaid expenses and other assets	1,968
Accounts payable and accrued expenses	3,760
Commissions payable	1,437
Other liabilities	(225)
	-----
Net cash provided by operating activities	30,250
	-----
CASH FLOWS FROM INVESTING ACTIVITIES	
Capital expenditures	(6,486)
Contingent purchase price payments	(163)
	-----
Net cash used in investing activities	(6,649)
	-----
CASH FLOWS FROM FINANCING ACTIVITIES	
Payments on notes payable to related parties	(9,895)
Payments on notes payable and other obligations	(900)
Distribution to members	(8,883)
	-----
Net cash used in financing activities	(19,678)
	-----
Net increase in cash and cash equivalents	3,923
CASH AND CASH EQUIVALENTS	
Beginning of period	15,384
	-----
End of period	\$ 19,307
	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION	
Interest paid	\$ 5,289
Income taxes paid	\$ 1,034

The accompanying notes are an integral part of these consolidated financial statements.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 2006

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 (in thousands of dollars)

1. BASIS OF PRESENTATION

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of Douglas Elliman Realty, LLC, formerly Montauk Battery Realty, LLC, a New York limited liability company, and its wholly-owned subsidiaries (the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

NATURE OF OPERATIONS

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The Company is primarily engaged in the real estate brokerage business through its principal subsidiaries, Douglas Elliman, LLC ("Douglas Elliman"), a residential real estate brokerage company based in New York, New York and its Long Island based operations, B&H Associates of New York, LLC and B&H of the Hamptons, LLC, both of which conduct business as Prudential Douglas Elliman Real Estate ("Prudential Douglas Elliman"). The Company is also engaged in property management through its subsidiary, Residential Management Group, LLC, which conducts business as Douglas Elliman Property Management ("DEPM").

### ORGANIZATION

On October 15, 2002, Montauk Battery Realty, LLC was formed to consolidate the ownership of the then Company's operating entities, B&H Associates of New York, LLC and B&H of the Hamptons, LLC, under one company, which was completed on December 19, 2002. On March 14, 2003, the Company acquired Douglas Elliman and DEPM and, on May 19, 2003, Montauk Battery Realty, LLC changed its name to Douglas Elliman Realty, LLC.

In October 2004, upon receipt of required regulatory approvals, the Company purchased all of the interest in Burr Enterprises Ltd., which conducts business as Preferred Empire Mortgage Company ("Preferred"). Preferred is a mortgage broker.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### CASH AND CASH EQUIVALENTS

The Company considers all highly liquid financial instruments with an original maturity of less than three months to be cash equivalents.

### AGENCY ACCOUNTS

DEPM, acting as an agent for its managed properties, manages cash held in separate trust bank accounts in the name of the owners. The cash represents net collections made for the accounts of the owners of managed properties in connection with the services rendered by DEPM. At December 31, 2006, such cash was approximately \$40,000. Since this cash is not an asset of the Company, it is not included in the accompanying statement of financial position.

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(in thousands of dollars)

### PROPERTY AND EQUIPMENT

Property, equipment and leasehold improvements are stated at cost. Maintenance and repairs are charged to expense as incurred; costs of major additions and betterments are capitalized. When property and equipment are sold or otherwise disposed of, the cost and related accumulated depreciation are eliminated from the accounts and any resulting gain or loss is reflected in other income.

Depreciation is provided on the straight line method over the estimated useful lives of the related assets. The cost of leasehold improvements is amortized over the lesser of the length of the related leases or the estimated useful lives of the improvements.

### LONG-LIVED ASSETS

If there is an event or a change in circumstances that indicates the basis of the Company's long-lived assets may not be recoverable, the Company's policy is to assess any impairment in value by making a comparison of the current and projected operating cash flows of the asset over its remaining useful life, on an undiscounted basis and without interest charges, to the carrying value of the asset. Such carrying amounts would be adjusted, if necessary, to reflect an impairment in the value of the assets. There were no such impairment charges in 2006.

### GOODWILL AND TRADEMARKS

In accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), the Company does not amortize goodwill and trademarks, which are deemed to have an indefinite useful life. The Company assesses goodwill and trademarks for impairment using fair value measurement techniques on an annual basis. Based on such annual review, no impairment adjustment is required.

### OTHER INTANGIBLE ASSETS

Other intangible assets consist primarily of management contracts. Amortization of management contracts is being provided over fifteen years.

### DEFERRED FINANCING CHARGES

Deferred financing charges consist primarily of professional fees related to the acquisition of new financing and the restructuring of the Company's debt obligations. These are being amortized over the life of the related debt obligations.

### REVENUE RECOGNITION

Real estate and mortgage commissions earned by the Company's real estate brokerage business are recorded as revenue on a gross basis upon the closing of a real estate transaction (i.e., the purchase or sale of a home). Property management fees earned by DEPM are recorded as revenue when the related services are performed.

### ADVERTISING COSTS

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Advertising costs are expensed as incurred and are included in operating expenses.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2006

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(in thousands of dollars)

### INCOME TAXES

The Company is a limited liability company. The members of a limited liability company are taxed on their proportionate share of the Company's taxable income. Accordingly, no provision or liability for federal income taxes is included in the financial statements, except for Preferred Empire Mortgage which is taxed as a C Corporation. Preferred's income tax expense includes \$517 of current tax expense and \$22 of deferred tax expense, of which \$383 is federal tax expense, and \$156 is state and local tax expense. Taxes for New York City operations of \$601 are included in the financial statements as New York City does not follow federal tax regulations for limited liability companies.

### FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument represents the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. Significant differences can arise between the fair value and carrying amount of financial instruments that are recognized at historical amounts.

The carrying amounts of the Company's cash and cash equivalents, accounts receivable, accounts payable and other current liabilities approximate fair value because of their short maturity. The carrying value of the Company's long-term debt approximates fair value because the underlying instruments are variable interest rate notes. The fair value of the Company's subordinated debt approximates \$21,600 at December 31, 2006.

### 3. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2006 consist of the following:

	2006
Furniture, fixtures and office equipment	\$ 20,184
Computer software	3,441
Leasehold improvements	13,738
Automobiles	109
Construction in progress	1,827

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	----- 39,299 -----
Less, accumulated depreciation and amortization	(19,761) -----
	\$ 19,538 =====

The estimated useful life of furniture, fixtures and office equipment at December 31, 2006 ranges from five to ten years. Computer software has an estimated useful life of three to five years, and automobiles have a life of six years. Leasehold improvements are depreciated based on the lesser of the remaining life of the lease or the useful life of the leasehold improvement. Depreciation expense for the year ended December 31, 2006 was \$5,138. Computer software had a net book value of \$1,711 at December 31, 2006, and the related amortization expense included in the above was \$658 for the year then ended.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2006  
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(in thousands of dollars)

4. INTANGIBLE ASSETS

Intangible assets at December 31, 2006 consist of the following:

	2006
Goodwill	\$ 38,087
Trademarks	21,663
Deferred financing charges	506
Other intangible assets	4,308
	-----
	64,564
Less, accumulated amortization	(2,848)
	-----
	\$ 61,716 =====

In accordance with SFAS No. 142, the Company does not amortize goodwill and trademarks, which have indefinite lives. Amortization expense for

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the year ended December 31, 2006 was \$410. Amortization expense is estimated to be \$344, \$293, \$253, \$218, and \$118 for the five years ended December 31, 2006 through 2011, respectively. Accumulated amortization on deferred financing costs is \$261, and on other intangible assets is \$2,587 at December 31, 2006.

The changes in the carrying amount of goodwill for the year ended December 31, 2006 was as follows:

	REAL ESTATE BROKERAGE	PROPERTY MANAGEMENT	TOTAL
BALANCE AS OF DECEMBER 31, 2005	\$ 37,921	\$ 3	\$ 37,924
Contingent purchase price payments	163	--	163
	-----	-----	-----
BALANCE AS OF DECEMBER 31, 2006	\$ 38,084	\$ 3	\$ 38,087
	=====	=====	=====

### 5. NOTES PAYABLE AND OTHER OBLIGATIONS

Notes payable, capital leases and other obligations at December 31, 2006 consist of:

	2006
Notes payable and other obligations	
Payment obligation - former owner	\$ 262
Term note payable - bank	1,269
Notes payable issued in connection with acquisitions	765
Capital leases payable	6
	-----
Total notes payable, capital leases and other obligations	2,302
Less, current maturities	(1,897)
	-----
Amount due after one year	\$ 405
	=====

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### PAYMENT OBLIGATION -- FORMER OWNER:

In connection with the acquisition of Douglas Elliman, the Company assumed an obligation to make a payment to a former owner of Douglas Elliman in an amount up to \$4,000, due in 2003 and 2004. The first payment was made in 2003. The second liability for the payment was settled in 2005, with a partial payment to the former owner, and a partial assumption of a deferred compensation liability. The remaining liability is payable in 2007, 2011, and 2012.

### TERM NOTE PAYABLE -- BANK:

In December 2002, Prudential Douglas Elliman borrowed \$1,940 from a bank, bearing interest at 7% per annum, due in 2007. Principal is amortized in the amount of \$15 per month during the term of the loan. The loan is collateralized by the assets of Prudential Douglas Elliman to the extent of the unpaid principal and interest.

### NOTES PAYABLE ISSUED IN CONNECTION WITH ACQUISITIONS AND CAPITAL LEASES PAYABLE:

Prudential Douglas Elliman has various other notes issued in connection with acquisitions of real estate brokerage companies and capital leases payable bearing interest at various rates up to 14.5%, which mature through 2009. Assets under capital lease are primarily office equipment and furniture, and have a net book value of \$45 at December 31, 2006.

### SCHEDULED MATURITIES:

Scheduled maturities of notes payable, capital leases and other obligations are as follows:

YEAR ENDING DECEMBER 31	2006
2007	\$ 1,897
2008	102
2009	100
2010	--
2011	146
2012	57
	-----
Total	\$ 2,302
	=====

### 6. NOTES PAYABLE TO RELATED PARTIES

Notes payable to related parties at December 31, 2006 consist of:

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2006

Acquisition term note payable - PREFSA	\$ 25,504
Acquisition subordinated notes payable - PREFSA	8,875
Acquisition subordinated note payable - Vector (fka New Valley)	8,875
Franchise term notes payable - PREA	3,201
Note payable - officer	230
	-----
Total notes payable to related parties	46,685
Less, current maturities	(2,483)
	-----
Amount due after one year	\$ 44,202
	=====

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 2006

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(in thousands of dollars)

ACQUISITION TERM NOTE PAYABLE - PREFSA:

In connection with the acquisition of Douglas Elliman and DEPM, Prudential Real Estate Financial Services of America, Inc. ( PREFSA ) lent the Company \$52,500 of Senior Secured Debt, maturing in 2011 (the "Term Note"). The Term Note bears interest at prime rate (8.25% at December 31, 2006) plus 2% and is collateralized by substantially all the assets of the Company. The Term Note provides for monthly payments of 3% of gross revenues of Douglas Elliman and Prudential Douglas Elliman prior to March 15, 2005 and 4.5% thereafter so long as the Term Note is outstanding. The payments based on gross revenues are applied first to interest and then to outstanding principal. Additional principal payments are due on June 1 of each year in the amount equal to 60% of the Company's Excess Cash Flow, which is defined in the Term Note loan agreement as the prior year's net income plus cash proceeds received from asset sales and depreciation and amortization expense, less cash capital expenditures, principal payments on notes payable and capital leases (excluding the revolving note facility discussed below), and tax distributions made to the Company's members. The Term Note includes covenants that, among other things, require the Company to meet certain financial ratios, limit the Company's ability to incur debt, and limit capital expenditures.

SUBORDINATED NOTES PAYABLE -- PREFSA AND NEW VALLEY:

In connection with the acquisition of Douglas Elliman and DEPM, PREFSA and New Valley each lent the Company \$9,500 of subordinated debt, due 2013 (the "Subordinated Debt"). The Subordinated Debt is subordinate to



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the Term Note and bears interest at 12% per annum, of which 10% is payable in cash and 2% accrues and is added to the principal amount. Interest added to the principal balance in 2006 was \$387. In connection with the issuance of the Subordinated Debt, PREFSA and New Valley each acquired additional membership interests representing a 15% fully-diluted interest in the Company. Based on an appraisal conducted by a third party, the Company valued those membership interests at \$2,500 and recorded this amount as a reduction to the principal amount of the Subordinated Debt. The Company is amortizing the value of these membership interests over the term of the Subordinated Debt. The amount amortized to interest expense for the year ended December 31, 2006 was \$224. Principal payments are due on June 1 of each year in an amount equal to 20% of the Company's Excess Cash Flow computed in the same manner as defined in the Term Note loan agreement.

### FRANCHISE TERM NOTES PAYABLE:

In December 2002, The Prudential Real Estate Affiliates, Inc. ("PREA" or the "Franchiser"), an affiliate of PREFSA, lent Prudential Douglas Elliman \$3,300 bearing interest at 9% per annum and due in annual installments of principal and interest of \$514 through 2012.

In March 2003, PREA lent Douglas Elliman \$1,250 bearing interest at 8% per annum and due in annual installments of principal and interest of \$186 through 2013.

### REVOLVING LOAN FACILITY:

In March 2003, the Company and PREFSA entered into a revolving loan facility for \$5,000, available until September 2006. Borrowings under the facility bore interest at prime rate plus 1.5% and were collateralized by substantially all the assets of the Company. This facility has not been renewed.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2006

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(in thousands of dollars)

### NOTE PAYABLE -- OFFICER:

As of December 31, 2006, the Company was indebted to a member and executive officer of Douglas Elliman Realty, in the amount of \$230 with interest at prime rate plus 1.5% (9.75% at December 31, 2006). The principal amount is due on June 1 of each year in the amount equal to approximately 8.29% of the Company's Excess Cash Flow, which is computed in the same manner as defined in the Term Loan agreements, provided New Valley receives an equal payment and PREFSA receives a proportionate payment, each as a return of capital.

### SCHEDULED MATURITIES:

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Scheduled maturities of debt to related parties are presented below. The table does not include the Company's obligations to make principal payments under the Term Note, the Subordinated Notes, or the note payable to such officer based on percentages of future gross revenues or future Excess Cash Flow.

YEAR ENDING DECEMBER 31	2006
2007	\$ 2,483
2008	459
2009	499
2010	542
2011	24,271
Thereafter	18,431
	-----
Total	\$ 46,685
	=====

### 7. FRANCHISE AGREEMENT AND ROYALTY FEES

Douglas Elliman is party to a franchise agreement with PREA entered into in March 2003. The agreement provides for Douglas Elliman to make monthly payments of royalty fees to PREA based on the level of gross revenue, with a royalty rate ranging from 1.8% to 6.0% of gross revenues earned. Pursuant to the franchise agreement, Douglas Elliman was granted a 25% deferral of applicable royalty fees for 2006, which is payable in monthly installments, beginning in the first month of the fourth year. A balance of \$2,013 was accrued at December 31, 2006 of which \$322 is included in accrued expenses, with the remainder in long-term accrued royalties. The royalty percentage was 1.90% for the year ended December 31, 2006. The agreement also provides for Douglas Elliman to remit advertising and annual franchise fees to PREA, which are based on gross revenues and the number of offices occupied.

Prudential Douglas Elliman is party to a franchise agreement with PREA entered into in December 2002. The Agreement provides for Prudential Douglas Elliman to make monthly payments of royalty fees to PREA based on 2.24% of gross revenues earned for the first five years and on a scale ranging from 1.8% to 6.0% of gross revenues earned thereafter. The agreement also provides for Prudential Douglas Elliman to remit advertising and annual franchise fees, which are based on gross revenues and the number of offices occupied.

For the year ended December 31, 2006, total fees incurred under the franchise agreements amounted to approximately \$5,892.

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(in thousands of dollars)

The Franchiser has significant rights over the use of the franchised service marks and the conduct of the brokerage companies' business. The franchise agreements require the companies to coordinate with the Franchiser on significant matters relating to their operations, including the opening and closing of offices, make substantial royalty payments to the Franchiser and contribute significant amounts to national advertising funds maintained by the Franchiser, indemnify the Franchiser against losses arising out of the operations of their business under the franchise agreements and maintain standards and comply with guidelines relating to their operations which are applicable to all franchisees of the Franchiser's real estate franchise system.

The Franchiser has the right to terminate Douglas Elliman's and Prudential Douglas Elliman's franchises, upon the occurrence of certain events, including a bankruptcy or insolvency event, a change in control, a transfer of rights under the franchise agreement and a failure to promptly pay amounts due under the franchise agreements.

The franchise agreements grant Douglas Elliman and Prudential Douglas Elliman exclusive franchises in New York for the counties of Nassau and Suffolk on Long Island and for Brooklyn, Queens and Manhattan, subject to various exceptions and to meeting certain annual revenue thresholds. If Douglas Elliman or Prudential Douglas Elliman fails to achieve these levels of revenues for two consecutive years or otherwise materially breaches the franchise agreements, the Franchiser would have the right to terminate the applicable brokerage company's exclusivity rights.

A termination of Douglas Elliman's or Prudential Douglas Elliman's franchise agreement could have a material adverse affect on the Company.

### 8. DEFINED CONTRIBUTION PLANS

Douglas Elliman, Prudential Douglas Elliman and DEPM sponsor individual 401(k) plans which allow eligible employees to make pre-tax contributions. Employees who have completed one year of service, as defined, are eligible to participate in the plans. The plans provide for matching employer contributions of 10% of employee contributions up to a maximum annual contribution of \$12 per employee. Participants are immediately vested in their contributions made. Matching contributions for the year ended December 31, 2006 amounted to \$371.

### 9. COMMITMENTS AND CONTINGENCIES

#### LAWSUITS

The Company is involved in litigation through the normal course of business. Certain claims arising before the date of acquisition of Douglas Elliman and DEPM are subject to indemnification agreements with the prior owners. The majority of these claims have been referred to the insurance carrier and related counsel. The Company believes that the resolution of these matters will not have a material adverse effect on the financial position, results of operations or cash flows of the Company.

#### LEASES

The Company and its subsidiaries are obligated under various operating

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lease agreements for office facilities. Certain leases are non-cancelable and expire on various dates through September 2013.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 2006

(in thousands of dollars)

Future minimum rental payments under the operating leases at December 31, 2006 are as follows:

YEAR ENDING DECEMBER 31	2006
2007	\$ 12,951
2008	12,023
2009	8,370
2010	6,922
2011	5,761
Thereafter	33,726
	-----
Total	\$ 79,753
	=====

10. CONCENTRATION OF CREDIT RISK

The Company and its subsidiaries may, from time to time, maintain demand deposits in excess of federally insured limits in the normal course of business. At December 31, 2006, cash balances in excess of insured limits were approximately \$19,038. The Company places its cash and cash equivalents with financial institutions with high credit ratings.

11. BUSINESS SEGMENT INFORMATION

The Company reports using separate business segments, defined by the different services offered. The following table presents certain financial information of the Company's continuing operations as of and for the year ended December 31, 2006. Corporate loss consists solely of the Company's net interest expense.

REAL ESTATE	PROPERTY	MORTGAGE	
BROKERAGE	MANAGEMENT	BROKERAGE	CORPORATE

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Revenues	\$ 308,634	\$ 23,113	\$ 15,497	\$ --
Net income (loss)	25,535	(406)	711	(6,336)
Identifiable assets	99,804	4,625	3,351	--
Depreciation and amortization	4,322	1,100	126	--
Capital expenditures	6,273	135	78	--

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Managers and the Members  
of Douglas Elliman Realty, LLC:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Douglas Elliman Realty, LLC and Subsidiaries (the "Company") at December 31, 2005 and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United

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States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

Melville, New York  
February 23, 2006

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF FINANCIAL POSITION  
DECEMBER 31, 2005

(in thousands of dollars)

	2005
	-----
<b>ASSETS</b>	
Current assets	
Cash and cash equivalents	\$ 15,384
Commission receivables	1,696
Other receivables	3,518
Other current assets	763
	-----
Total current assets	21,361
	-----
Property and equipment, net	17,973
Goodwill	37,924
Trademarks	21,663
Other intangible assets, net	2,072
Deferred financing charges	308
Security deposits and other non current assets	1,271
	-----
Total assets	\$102,572
	=====
<b>LIABILITIES AND MEMBERS' EQUITY</b>	
Current liabilities	
Current portion of notes payable and other obligations	\$ 2,437
Current portion of notes payable to related parties	2,333
Accounts payable and accrued expenses	7,989
Accrued compensation	5,196
Commissions payable	3,292
Other current liabilities	500
	-----
Total current liabilities	21,747

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Notes payable and other obligations, less current portion	765
Notes payable to related parties, less current portion	53,657
Other long-term liabilities	3,047
Accrued royalties	1,894
	-----
Total liabilities	81,110
	-----
Commitments and contingencies (Note 10)	
Members' equity	21,462
	-----
Total liabilities and members' equity	\$102,572
	=====

The accompanying notes are an integral part of these consolidated financial statements.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF OPERATIONS  
YEAR ENDED DECEMBER 31, 2005

(in thousands of dollars)

	2005
	-----
REVENUES	
Commission revenues	\$303,291
Property management fees	22,486
Other revenues	4,298
	-----
Total	330,075
COSTS AND EXPENSES	
Commissions and royalties	195,056
Sales administration	13,290
General and administration	53,858
Rent	14,681
Advertising and promotions	20,588
Depreciation	4,896
Amortization of intangible assets	899
	-----
Total costs and expenses	303,268
Operating income	26,807
Other income (expenses)	
Interest income	299
Interest expense	(6,273)
	-----
Net income before taxes	20,833
Income tax expense	782
	-----
Net income	\$ 20,051

=====

The accompanying notes are an integral part of these consolidated financial statements.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY  
 YEAR ENDED DECEMBER 31, 2005

(in thousands of dollars)

	2005
	-----
BALANCE, JANUARY 1, 2005	\$10,723
Net income	20,051
Distributions to members	(9,312)
	-----
BALANCE, DECEMBER 31, 2005	\$21,462
	=====

The accompanying notes are an integral part of these consolidated financial statements.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 CONSOLIDATED STATEMENT OF CASH FLOWS  
 YEAR ENDED DECEMBER 31, 2005

(in thousands of dollars)

	2005
	-----
CASH FLOWS FROM OPERATING ACTIVITIES	
Net income	\$ 20,051
Adjustments to reconcile net income to net cash provided by operating activities	
Depreciation	4,896
Amortization	899
Interest paid in kind	389
Changes in operating assets and liabilities, net of effects of acquisitions	
Commission receivable	119
Prepaid expenses and other assets	(1,895)
Accounts payable and accrued expenses	1,739



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Commissions payable	(2,228)
Other liabilities	1,016
	-----
Net cash provided by operating activities	24,986
	-----
CASH FLOWS FROM INVESTING ACTIVITIES	
Capital expenditures	(7,347)
Business acquisitions	(680)
	-----
Net cash used in investing activities	(8,027)
	-----
CASH FLOWS FROM FINANCING ACTIVITIES	
Payments on notes payable to related parties	(11,452)
Payments on notes payable and other obligations	(2,186)
Distribution to members	(9,312)
	-----
Net cash used in financing activities	(22,950)
	-----
Net decrease in cash and cash equivalents	(5,991)
CASH AND CASH EQUIVALENTS	
Beginning of period	21,375
	-----
End of period	\$ 15,384
	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION	
Interest paid	\$ 6,273
Income taxes paid	\$ 384

Non-cash investing and financing activities - see Note 3.

The accompanying notes are an integral part of these consolidated financial statements.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2005

(in thousands of dollars)

1. BASIS OF PRESENTATION

Principles of Consolidation

The consolidated financial statements include the accounts of Douglas Elliman Realty, LLC, formerly Montauk Battery Realty, LLC, a New York limited liability company, and its wholly-owned subsidiaries (the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

Nature of Operations

The Company is primarily engaged in the real estate brokerage business

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through its principal subsidiaries, Douglas Elliman, LLC ("Douglas Elliman"), a residential real estate brokerage company based in New York, New York and its Long Island based operations, B&H Associates of New York, LLC and B&H of the Hamptons, LLC, both of which conduct business as Prudential Douglas Elliman Real Estate ("Prudential Douglas Elliman"). The Company is also engaged in property management through its subsidiary, Residential Management Group, LLC, which conducts business as Douglas Elliman Property Management ("DEPM").

### Organization

On October 15, 2002, Montauk Battery Realty, LLC was formed to consolidate the ownership of the then Company's operating entities, B&H Associates of New York, LLC and B&H of the Hamptons, LLC, under one company, which was completed on December 19, 2002. On March 14, 2003, the Company acquired Douglas Elliman and DEPM and, on May 19, 2003, Montauk Battery Realty, LLC changed its name to Douglas Elliman Realty, LLC.

In October 2004, upon receipt of required regulatory approvals, the Company purchased all of the interest in Burr Enterprises Ltd., which conducts business as Preferred Empire Mortgage Company ("Preferred"). Preferred is a mortgage broker.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Estimates.** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and Cash Equivalents.** The Company considers all highly liquid financial instruments with an original maturity of less than three months to be cash equivalents.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2005

(in thousands of dollars)

**Property and Equipment.** Property, equipment and leasehold improvements are stated at cost. Maintenance and repairs are charged to expense as incurred; costs of major additions and betterments are capitalized. When property and equipment are sold or otherwise disposed of, the cost and related accumulated depreciation are eliminated from the accounts and any resulting gain or loss is reflected in other revenues.

Depreciation is provided on the straight line method over the estimated useful lives of the related assets. The cost of leasehold improvements is amortized over the lesser of the length of the related leases or the estimated useful lives of the improvements.

**Goodwill and Trademarks.** In accordance with Statement of Financial

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Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), the Company does not amortize goodwill and trademarks, which are deemed to have an indefinite useful life. The Company assesses goodwill and trademarks for impairment using fair value measurement techniques on an annual basis. Based on such annual review, no impairment adjustment is required.

Other intangible assets. Other intangible assets consist primarily of management contracts. Amortization of management contracts is being provided over fifteen years.

Deferred Financing Charges. Deferred financing charges consist primarily of professional fees related to the acquisition of new financing and the restructuring of the Company's debt obligations in March 2003. These are being amortized on a straight-line basis over the life of the related debt obligations which approximates amortization expense under the effective interest method.

Revenue Recognition. Real estate commissions earned by the Company's real estate brokerage business are recorded as revenue on a gross basis upon the closing of a real estate transaction (i.e., the purchase or sale of a home). Property management fees earned by DEPM are recorded as revenue when the related services are performed.

Advertising Costs. Advertising costs are expensed as incurred and are included in operating expenses.

Income Taxes. The Company is a limited liability company. The members of a limited liability company are taxed on their proportionate share of the Company's taxable income. Accordingly, no provision or liability for federal income taxes is included in the financial statements, except for Preferred Empire Mortgage which is taxed as a C Corporation. Taxes for New York City operations are included in the financial statements as New York City does not follow federal tax regulations for limited liability companies.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2005

(in thousands of dollars)

### 3. ACQUISITIONS IN 2005

The Company acquired the interest of several real estate offices in four transactions for an aggregate purchase price of \$1,415. The results of their operations are included in the consolidated financial statements from the dates of acquisition. The Company's acquisition objective was to leverage its position in the real estate brokerage business in the New York metropolitan area.

The acquisitions have been accounted for in accordance with SFAS No. 141, "Business Combinations". The cost of the acquisitions was allocated to the assets acquired and liabilities assumed based on estimates of their respective fair values at the date of acquisition, which approximated their book values. The costs of the acquisitions were allocated to goodwill for

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\$1,248, to fixed assets for \$2, and to listings for \$165. The purchases were primarily funded from the Company's operations, and the Company issued a note for \$733 for one of the real estate transactions. Goodwill acquired is amortizable over 15 years for U.S. income tax purposes. Pro forma information has not been presented because the net impact of the acquisitions would not have been significant to the Company's Consolidated Financial Statements.

#### 4. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2005 consist of the following:

	2005
	-----
Furniture, fixtures and office equipment	\$ 14,742
Computer software	5,416
Leasehold improvements	11,928
Automobiles	80
Construction in progress	430
	-----
Total	32,596
	-----
Less, accumulated depreciation and amortization	(14,623)
	-----
Total	\$ 17,973
	=====

The estimated useful life of furniture, fixtures and office equipment at December 31, 2005 ranges from five to ten years. Computer software has an estimated useful life of three to five years, and automobiles have a life of six years. Leasehold improvements are depreciated based on the lesser of the remaining life of the lease or the useful life of the leasehold improvement. Depreciation expense for the year ended December 31, 2005 was \$4,896. Computer software had a net book value of \$2,915 at December 31, 2005, and the related amortization expense included in the above was \$967 for the year then ended.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 2005

(in thousands of dollars)

#### 5. INTANGIBLE ASSETS

Intangible assets at December 31, 2005 consist of the following:

	2005
	-----
Goodwill	\$37,924

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Trademarks	21,663
Deferred financing charges	506
Other intangible assets	3,926
	-----
Total	64,019
Less, accumulated amortization	(2,052)
	-----
Total	\$61,967
	=====

In accordance with SFAS No. 142, the Company does not amortize goodwill and trademarks, which have indefinite lives. Amortization expense for the year ended December 31, 2005 was \$899, which includes \$165 of amortization of customer-based intangible assets acquired and fully amortized during the year. Amortization expense is estimated to be \$405, \$344, \$293, \$253, and \$218 for the five years ended December 31, 2006 through 2010, respectively. Accumulated amortization on deferred financing costs is \$198, and on other intangible assets is \$1,854 at December 31, 2005.

The changes in the carrying amount of goodwill for the year ended December 31, 2005 was as follows:

	REAL ESTATE BROKERAGE	PROPERTY MANAGEMENT	TOTAL
	-----	-----	-----
Balance as of December 31, 2004	\$36,673	\$ 3	\$36,676
Acquisitions	1,248	--	1,248
	-----	---	-----
Balance as of December 31, 2005	\$37,921	\$ 3	\$37,924
	=====	===	=====

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 2005

(in thousands of dollars)

6. NOTES PAYABLE AND OTHER OBLIGATIONS

Notes payable, capital leases and other obligations at December 31, 2005 consist of:

	2005
	-----
Notes payable and other obligations	
Payment obligation - former owner	\$ 406
Term note payable - bank	1,430
Notes payable issued in connection with acquisitions	1,322

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Capital leases payable	44
	-----
Total notes payable, capital leases and other obligations	3,202
Less, current maturities	(2,437)
	-----
Amount due after one year	\$ 765
	=====

Payment Obligation - Former Owner:

In connection with the acquisition of Douglas Elliman, the Company assumed an obligation to make a payment to a former owner of Douglas Elliman in an amount up to \$4,000, due in 2003 and 2004. The obligation is subject to certain claims and offsets the Company has against this former owner. The 2003 payment of \$2,000 was made. A payment of \$1,594 was paid during 2005, and the Company assumed a liability for the remaining balance.

Term Note Payable - Bank:

In December 2002, Prudential Douglas Elliman borrowed \$1,940 from a bank, bearing interest at 7% per annum, due in January 2006. Principal is amortized in the amount of \$15 per month during the term of the loan. The loan is collateralized by the assets of Prudential Douglas Elliman to the extent of the unpaid principal and interest.

Notes payable issued in connection with acquisitions and capital leases payable:

Prudential Douglas Elliman has various other notes issued in connection with acquisitions of real estate brokerage companies and capital leases payable bearing interest at various rates up to 14.5%, which mature through 2009. Assets under capital lease are primarily office equipment and furniture, and have a net book value of \$110 at December 31, 2005.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 2005

(in thousands of dollars)

Scheduled Maturities:

Scheduled maturities of notes payable, capital leases and other obligations are as follows:

Year ending December 31	2005
-----	-----
2006	\$2,437
2007	564
2008	103
2009	98
	-----

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Total \$3,202  
=====

7. NOTES PAYABLE TO RELATED PARTIES

Notes payable to related parties at December 31, 2005 consist of:

	2005
	-----
Notes payable to related parties	
Acquisition term note payable - PREFSA	\$35,058
Acquisition subordinated notes payable - PREFSA	8,570
Acquisition subordinated notes payable - New Valley	8,570
Franchise term notes payable - PREA	3,583
Note payable - officer	209
	-----
Total notes payable to related parties	55,990
Less, current maturities	(2,333)
	-----
Amount due after one year	\$53,657
	=====

Acquisition Term Note Payable - PREFSA:

In connection with the acquisition of Douglas Elliman and DEPM, Prudential Real Estate Financial Services of America, Inc. ( PREFSA ) lent the Company \$52,500 of Senior Secured Debt, maturing in 2011 (the "Term Note"). The Term Note bears interest at prime rate (7.25% at December 31, 2005) plus 2% and is collateralized by substantially all the assets of the Company. The Term Note provides for monthly payments of 3% of gross revenues of Douglas Elliman and Prudential Douglas Elliman prior to March 15, 2005 and 4.5% thereafter so long as the Term Note is outstanding. The payments based on gross revenues are applied first to interest and then to outstanding principal. Additional principal payments are due on June 1 of each year in the amount equal to 60% of the Company's Excess Cash Flow, which is defined in the Term Note loan agreement as the prior year's net income plus cash proceeds received from asset sales and depreciation and amortization expense, less cash capital expenditures, principal payments on notes payable and capital leases (excluding the revolving note facility discussed below), and tax distributions made to the Company's members. The Term Note includes covenants that, among other things, require the Company to meet certain financial ratios, limit the Company's ability to incur debt, and limit capital expenditures.

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### Subordinated Notes Payable - PREFSA and New Valley:

In connection with the acquisition of Douglas Elliman and DEPM, PREFSA and New Valley each lent the Company \$9,500 of subordinated debt, due 2013 (the "Subordinated Debt"). The Subordinated Debt is subordinate to the Term Note and bears interest at 12% per annum, of which 10% is payable in cash and 2% accrues and is added to the principal amount. Interest added to the principal balance in 2005 was \$389. In connection with the issuance of the Subordinated Debt, PREFSA and New Valley each acquired additional membership interests representing a 15% fully-diluted interest in the Company. Based on an appraisal conducted by a third party, the Company valued those membership interests at \$2,500 and recorded this amount as a reduction to the principal amount of the Subordinated Debt. The Company is amortizing the value of these membership interests over the term of the Subordinated Debt. The amount amortized to interest expense for the year ended December 31, 2005 was \$172. Principal payments are due on June 1 of each year in an amount equal to 20% of the Company's Excess Cash Flow computed in the same manner as defined in the Term Note loan agreement.

### Franchise term notes payable:

In December 2002, The Prudential Real Estate Affiliates, Inc. ("PREA" or the "Franchiser"), an affiliate of PREFSA, lent Prudential Douglas Elliman \$3,300 bearing interest at 9% per annum and due in annual installments of principal and interest of \$514 through 2012.

In March 2003, PREA lent Douglas Elliman \$1,250 bearing interest at 8% per annum and due in annual installments of principal and interest of \$186 through 2013.

### Revolving Loan Facility:

In March 2003, the Company and PREFSA entered into a revolving loan facility for \$5,000, available until March 2006. Borrowings under the facility bear interest at prime rate plus 1.5% and are collateralized by substantially all the assets of the Company. As of December 31, 2005, \$5,000 was available under the facility.

### Note payable - Officer:

As of December 31, 2005, the Company was indebted to a member and executive officer of Douglas Elliman Realty, in the amount of \$209 with interest at prime rate plus 1.5%. The principal amount is due on June 1 of each year in the amount equal to approximately 8.29% of the Company's Excess Cash Flow, which is computed in the same manner as defined in the Term Loan agreements, provided New Valley receives an equal payment and PREFSA receives a proportionate payment, each as a return of capital.



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Scheduled maturities of debt to related parties are presented below. The table does not include the Company's obligations to make principal payments under the Term Note, the Subordinated Notes, or the note payable to such officer based on percentages of future Gross Revenues or future Excess Cash Flow.

Year ending December 31 -----	2005 -----
2006	\$ 2,333
2007	415
2008	451
2009	491
2010	534
Thereafter	51,766
	-----
Total	\$55,990 =====

### 8. FRANCHISE AGREEMENT AND ROYALTY FEES

Douglas Elliman is party to a franchise agreement with PREA entered into in March 2003. The agreement provides for Douglas Elliman to make monthly payments of royalty fees to PREA based on the level of gross revenue, with a royalty rate ranging from 1.8% to 6.0% of gross revenues earned. Pursuant to the franchise agreement, Douglas Elliman was granted a 25% deferral of applicable royalty fees for 2005, which is payable in monthly installments beginning in the first month of the fourth year. A balance of \$2,135 was accrued at December 31, 2005 of which \$241 included in accrued expenses. The royalty percentage was 1.90% for the year ended December 31, 2005. The agreement also provides for Douglas Elliman to remit advertising and annual franchise fees to PREA, which are based on gross revenues and the number of offices occupied.

Prudential Douglas Elliman is party to a franchise agreement with PREA entered into in December 2002. The Agreement provides for Prudential Douglas Elliman to make monthly payments of royalty fees to PREA based on 2.24% of gross revenues earned for the first five years and on a scale ranging from 1.8% to 6.0% of gross revenues earned thereafter. The agreement also provides for Prudential Douglas Elliman to remit advertising and annual franchise fees, which are based on gross revenues and the number of offices occupied.

For the year ended December 31, 2005, total royalty fees incurred under the franchise agreements amounted to approximately \$4,798.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 2005

(in thousands of dollars)

The Franchiser has significant rights over the use of the franchised

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service marks and the conduct of the brokerage companies' business. The franchise agreements require the companies to coordinate with the Franchiser on significant matters relating to their operations, including the opening and closing of offices, make substantial royalty payments to the Franchiser and contribute significant amounts to national advertising funds maintained by the Franchiser, indemnify the Franchiser against losses arising out of the operations of their business under the franchise agreements and maintain standards and comply with guidelines relating to their operations which are applicable to all franchisees of the Franchiser's real estate franchise system.

The Franchiser has the right to terminate Douglas Elliman's and Prudential Douglas Elliman's franchises, upon the occurrence of certain events, including a bankruptcy or insolvency event, a change in control, a transfer of rights under the franchise agreement and a failure to promptly pay amounts due under the franchise agreements. A termination of Douglas Elliman's or Prudential Douglas Elliman's franchise agreement could have a material adverse affect on the Company.

The franchise agreements grant Douglas Elliman and Prudential Douglas Elliman exclusive franchises in New York for the counties of Nassau and Suffolk on Long Island and for Brooklyn, Queens and Manhattan, subject to various exceptions and to meeting certain annual revenue thresholds. If Douglas Elliman or Prudential Douglas Elliman fails to achieve these levels of revenues for two consecutive years or otherwise materially breaches the franchise agreements, the Franchiser would have the right to terminate the applicable brokerage company's exclusivity rights. A loss of these rights could have a material adverse affect on the Company.

### 9. DEFINED CONTRIBUTION PLANS

Douglas Elliman, Prudential Douglas Elliman and DEPM sponsor individual 401(k) plans which allow eligible employees to make pre-tax contributions. Employees who have completed one year of service, as defined, are eligible to participate in the plans. The plans provide for matching employer contributions of 10% of employee contributions up to a maximum annual contribution of \$12 per employee. Participants are immediately vested in their contributions made. Matching contributions for the year ended December 31, 2005 amounted to \$305.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2005

(in thousands of dollars)

### 10. COMMITMENTS AND CONTINGENCIES

#### Lawsuits

The Company is involved in litigation through the normal course of business. Certain claims arising before the date of acquisition of Douglas Elliman and DEPM are subject to indemnification agreements with the prior owners. The majority of these claims have been referred to the insurance carrier and related counsel. The Company believes that the resolution of

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these matters will not have a material adverse effect on the financial position, results of operations or cash flows of the Company.

### Leases

The Company and its subsidiaries are obligated under various operating lease agreements for office facilities. Certain leases are non-cancelable and expire on various dates through September 2013.

Future minimum rental payments under the operating leases at December 31, 2005 are as follows:

Year ending December 31	2005
-----	-----
2006	\$13,538
2007	12,490
2008	11,031
2009	7,101
2010	5,577
Thereafter	34,494
	-----
Total	\$84,231
	=====

### 11. CONCENTRATION OF CREDIT RISK

The Company and its subsidiaries may, from time to time, maintain demand deposits in excess of federally insured limits in the normal course of business. At December 31, 2005, cash balances in excess of insured limits were approximately \$13,200.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 2005

(in thousands of dollars)

### 12. BUSINESS SEGMENT INFORMATION

The Company reports using separate business segments, defined by the different services offered. The following table presents certain financial information of the Company's continuing operations as of and for the year ended December 31, 2005. Corporate loss consists solely of the Company's net interest expense.

REAL ESTATE BROKERAGE	PROPERTY MANAGEMENT	MORTGAGE BROKERAGE	CORPORATE	2005 TOTAL
-----	-----	-----	-----	-----

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Revenues	\$295,098	\$22,486	\$12,491	\$ --	\$330,075
Net income (loss)	26,929	(1,017)	525	(6,386)	20,051
Identifiable assets	94,735	5,261	2,576	--	102,572
Depreciation and amortization	4,153	1,484	158	--	5,795
Capital expenditures	6,958	293	96	--	7,347

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Managers and the Members  
of Douglas Elliman Realty, LLC:

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In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Douglas Elliman Realty, LLC and Subsidiaries (the "Company") at December 31, 2004 and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

Melville, New York  
February 18, 2005

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF FINANCIAL POSITION  
(DOLLARS IN THOUSANDS)  
DECEMBER 31, 2004

ASSETS

Current assets

Cash and cash equivalents	\$ 21,375
Commission receivables	1,814
Prepaid expenses and other current assets	2,912

Total current assets	26,101
----------------------	--------

Property and equipment, net	15,520
Goodwill	36,676
Trademarks	21,663
Other intangible assets, net	2,748
Deferred financing charges	370
Security deposits	650
Other assets	92

Total assets	\$103,820
--------------	-----------

LIABILITIES AND MEMBERS' EQUITY

Current liabilities

Current portion of notes payable and other obligations	\$ 2,491
Current portion of notes payable to related parties	2,507
Accounts payable and accrued expenses	7,436
Accrued compensation	4,808
Commissions payable	5,520

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Other current liabilities	500
	-----
Total current liabilities	23,262
	-----
Notes payable and other obligations, less current portion	2,063
Notes payable to related parties, less current portion	64,647
Other long-term liabilities	1,838
Accrued royalties	1,287
	-----
Total liabilities	93,097
	-----
Commitments and contingencies	
Members' equity	10,723
	-----
Total liabilities and members' equity	\$103,820
	=====

The accompanying notes are an integral part of these consolidated financial statements.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF OPERATIONS  
(DOLLARS IN THOUSANDS)  
YEAR ENDED DECEMBER 31, 2004

-----	
REVENUES	
Commission revenues	\$ 258,388
Property management fees	22,939
Other revenues	5,489
	-----
Total	286,816
COSTS AND EXPENSES	
Commissions and royalties	168,164
Sales administration	13,170
General and administration	45,191
Rent	12,137
Advertising and promotions	15,200
Depreciation	4,533
Amortization of intangible assets	968
	-----
Total costs and expenses	259,363
Operating income	27,453
Other income (expenses)	
Interest income	71
Interest expense	(6,279)

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Net income before taxes	21,245
Income tax expense	645
Net income	\$ 20,600

The accompanying notes are an integral part of these consolidated financial statements.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY  
(DOLLARS IN THOUSANDS)  
YEAR ENDED DECEMBER 31, 2004

BALANCE, JANUARY 1, 2004	\$ (288)
Net income	20,600
Distributions to members	(9,589)
BALANCE, DECEMBER 31, 2004	\$ 10,723

The accompanying notes are an integral part of these consolidated financial statements.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(DOLLARS IN THOUSANDS)  
YEAR ENDED DECEMBER 31, 2004

CASH FLOWS FROM OPERATING ACTIVITIES	
Net income	\$ 20,600
Adjustments to reconcile net income to net cash provided by operating activities	
Depreciation	4,533
Amortization	968
Interest paid in kind	392

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Changes in operating assets and liabilities, net of effects of acquisitions	
Accounts receivable	(182)
Prepaid expenses and other assets	1,003
Accounts payable and accrued expenses	4,579
Commissions payable	2,995
Other liabilities	3,125
	-----
Net cash provided by operating activities	38,013
	-----
CASH FLOWS FROM INVESTING ACTIVITIES	
Capital expenditures	(8,413)
Business acquisitions	(3,293)
	-----
Net cash used in investing activities	(11,706)
	-----
CASH FLOWS FROM FINANCING ACTIVITIES	
Payments on notes payable to related parties	(5,594)
Payments on notes payable and other obligations	(396)
Payments on notes receivable	1,585
Distribution to members	(9,589)
	-----
Net cash used in financing activities	(13,994)
	-----
Net increase in cash and cash equivalents	12,313
CASH AND CASH EQUIVALENTS	
Beginning of period	9,062
	-----
End of period	\$ 21,375
	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION	
Interest paid	\$ 6,279
Income taxes paid	\$ 77

Non-cash investing and financing activities -- see Note 4.

The accompanying notes are an integral part of these consolidated financial statements.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (DOLLARS IN THOUSANDS)  
 DECEMBER 31, 2004

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1. BASIS OF PRESENTATION
- PRINCIPLES OF CONSOLIDATION



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The consolidated financial statements include the accounts of Douglas Elliman Realty, LLC, formerly Montauk Battery Realty, LLC, a New York limited liability company, and its wholly-owned subsidiaries (the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

### NATURE OF OPERATIONS

The Company is primarily engaged in the real estate brokerage business through its principal subsidiaries, Douglas Elliman, LLC ("Douglas Elliman"), a residential real estate brokerage company based in New York, New York and its Long Island based operations, B&H Associates of New York, LLC and B&H of the Hamptons, LLC, both of which conduct business as Prudential Douglas Elliman Real Estate ("Prudential Douglas Elliman"). The Company is also engaged in property management through its subsidiary, Residential Management Group, LLC, which conducts business as Douglas Elliman Property Management ("DEPM").

### ORGANIZATION

On October 15, 2002, Montauk Battery Realty, LLC was formed to consolidate the ownership of the then Company's operating entities, B&H Associates of New York, LLC and B&H of the Hamptons, LLC, under one company, which was completed on December 19, 2002. On March 14, 2003, the Company acquired Douglas Elliman and DEPM and, on May 19, 2003, Montauk Battery Realty, LLC changed its name to Douglas Elliman Realty, LLC.

In October 2004, upon receipt of required regulatory approvals, the Company purchased all of the interest in Burr Enterprises Ltd., which conducts business as Preferred Empire Mortgage Company ("Preferred"). Preferred is a mortgage broker, and the seller is a former officer of the Company. See Notes 3 and 4.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**ESTIMATES.** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**CASH AND CASH EQUIVALENTS.** The Company considers all highly liquid financial instruments with an original maturity of less than three months to be cash equivalents.

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PROPERTY AND EQUIPMENT. Property, equipment and leasehold improvements are stated at cost. Maintenance and repairs are charged to expense as incurred; costs of major additions and betterments are capitalized. When property and equipment are sold or otherwise disposed of, the cost and related accumulated depreciation are eliminated from the accounts and any resulting gain or loss is reflected in other income.

Depreciation is provided on the straight line method over the estimated useful lives of the related assets. The cost of leasehold improvements is amortized over the lesser of the length of the related leases or the estimated useful lives of the improvements.

GOODWILL AND TRADEMARKS. In accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), the Company does not amortize goodwill and trademarks, which are deemed to have an indefinite useful life. The Company assesses goodwill and trademarks for impairment using fair value measurement techniques on an annual basis.

OTHER INTANGIBLE ASSETS. Other intangible assets consist primarily of non-compete agreements and management contracts. Amortization of non-compete agreements is being provided over the contractual term, generally three years or less. Amortization of management contracts is being provided over fifteen years.

DEFERRED FINANCING CHARGES. Deferred financing charges consist primarily of professional fees related to the acquisition of new financing and the restructuring of the Company's debt obligations in March 2003. These are being amortized over the life of the related debt obligations.

REVENUE RECOGNITION. Real estate commissions earned by the Company's real estate brokerage business are recorded as revenue on a gross basis upon the closing of a real estate transaction (i.e., the purchase or sale of a home). Property management fees earned by DEPM are recorded as revenue when the related services are performed.

ADVERTISING COSTS. Advertising costs are expensed as incurred and are included in operating expenses.

INCOME TAXES. The Company is a limited liability company. The members of a limited liability company are taxed on their proportionate share of the Company's taxable income. Accordingly, no provision or liability for federal income taxes is included in the financial statements. Taxes for New York City operations are included in the financial statements as New York City does not follow federal tax regulations for limited liability companies.

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### 3. ACQUISITION OF DOUGLAS ELLIMAN AND DEPM

On March 14, 2003, the Company acquired from Insignia Financial Group, Inc. ("Insignia") the operations of Douglas Elliman and DEPM and related trademarks for \$67,250 cash, \$175 in closing costs and the assumption of up to \$4,000 of liabilities. The results of their operations are included in the consolidated financial statements from the date of acquisition. The Company's acquisition objective was to leverage and expand its position in the real estate brokerage business in the New York metropolitan area.

Douglas Elliman was founded in 1911 and is one of Manhattan's leading residential real estate brokers, specializing in the high-end of the sales and rental marketplaces. Douglas Elliman has twelve New York City offices with more than 1,100 real estate brokers. DEPM is a leading manager of rental, co-op and condominium housing in the New York metropolitan area. DEPM provides full service third-party fee management for approximately 250 properties, representing approximately 50,000 units in New York City, Nassau County, Northern New Jersey and Westchester County.

To fund the acquisition, the Company borrowed \$71,500 from two of its members, Prudential Real Estate Financial Services of America, Inc. ("PREFSA") and New Valley Corporation ("New Valley"). PREFSA lent the Company \$52,500 of senior secured debt and PREFSA and New Valley each lent the Company \$9,500 of subordinated debt. In connection with the issuance of the subordinated debt, PREFSA and New Valley each acquired additional membership interests representing a 15% fully diluted interest in the Company. Based on an appraisal conducted by an independent third party, the Company valued these additional membership interests at \$2,500 and recorded this amount as a reduction to the principal amount of the subordinated debt. The Company is amortizing the value of these membership interests over the term of the subordinated debt.

The acquisition of Douglas Elliman and DEPM has been accounted for in accordance with SFAS No. 141, "Business Combinations". The cost of acquisition was allocated to the assets acquired and liabilities assumed based on estimates of their respective fair values at the date of acquisition. Fair values were determined by an independent third-party appraisal.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
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The following table summarizes the final purchase price allocation of Douglas Elliman's and DEPM's assets acquired and liabilities assumed at the date of acquisition.

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ASSETS	
Cash	\$ 650
Receivables	2,860
Other assets	462
Property and equipment	10,864
Customer-based intangible assets	4,057
Management contract intangible assets	2,734
Trademarks	21,663
Goodwill	33,617
	-----
Total	\$76,907
	-----
LIABILITIES	
Accounts payable and accrued expenses	\$ 6,407
Other obligations	4,000
Acquisition financing from related parties	66,500
	-----
Total	\$76,907
	-----

The Company assesses intangible assets for impairment using fair value measurement techniques on an annual basis. In accordance with SFAS No. 142, the Company does not amortize goodwill and trademarks, which are deemed to have an indefinite useful life. Douglas Elliman amortized the entire amount of the acquired customer-based intangible assets of \$4,057 in the year ended December 31, 2003. DEPM is amortizing management contracts over 15 years. This represents the expected period of benefit from such assets. For U.S. income tax purposes, the Company and Insignia elected to treat the acquisition of Douglas Elliman, DEPM and the related trademarks as an asset acquisition. As a result, the entire amount of intangible assets is amortizable over 15 years for U.S. income tax purposes.

#### 4. ACQUISITIONS IN 2004

The Company acquired the interest of Preferred for a purchase price of \$2,363, and the interest of several real estate offices in four transactions for an aggregate purchase price of \$1,230. The results of their operations are included in the consolidated financial statements from the dates of acquisition. The Company's acquisition objective was to leverage its position in the real estate brokerage business in the New York metropolitan area.

The acquisitions have been accounted for in accordance with SFAS No. 141, "Business Combinations". The cost of the acquisitions was allocated to the assets acquired and liabilities assumed based on estimates of their respective fair values at the date of acquisition, which approximated their book values. The costs of the acquisitions were allocated to goodwill for \$2,357, to fixed assets for \$330, and to other assets for \$906. The purchases were primarily funded from the Company's operations, and the Company issued a note for \$300 for one of the real estate transactions. Goodwill acquired is amortizable over 15 years for U.S. income tax purposes.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
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### 5. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2004 consist of the following:

Furniture, fixtures and office equipment	\$ 12,803
Internally developed software	6,030
Leasehold improvements	8,319
Automobiles	80
Construction in progress	415
	-----
Total	27,647
	-----
Less, accumulated depreciation and amortization	(12,127)
	-----
Total	\$ 15,520
	=====

The estimated useful life of furniture, fixtures and office equipment at December 31, 2004 ranges from five to ten years. Internally developed software has an estimated useful life of three to five years, and automobiles have a life of six years. Leasehold improvements are depreciated based on the lesser of the remaining life of the lease or the useful life of the leasehold improvement. Depreciation expense for the year ended December 31, 2004 was \$4,533. Computer software had a net book value of \$3,818 at December 31, 2004, and the related amortization expense included in depreciation expense was \$1,091 for the year then ended.

### 6. INTANGIBLE ASSETS

Intangible assets at December 31, 2004 consist of the following:

Goodwill	\$ 36,676
Trademarks	21,663
Deferred financing charges	506
Other intangible assets	3,764
	-----
Total	62,609
Less, accumulated amortization	(1,153)
	-----
Total	\$ 61,456
	=====

In accordance with SFAS No. 142, the Company does not amortize goodwill and trademarks, which have indefinite lives. Amortization expense for the year ended December 31, 2004 was \$968, which includes \$78 of amortization of customer-based intangible assets acquired and fully amortized during the year. Amortization expense is estimated to be \$729, \$405, \$344, \$293, and \$251 for the five years ended December 31, 2005 through 2009, respectively.

DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
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The changes in the carrying amount of goodwill for the year ended December 31, 2004 were as follows:

	REAL ESTATE BROKERAGE	PROPERTY MANAGEMENT	TOTAL
	-----	-----	-----
Balance as of December 31, 2003	\$34,316	\$ 3	\$34,319
Acquisitions	2,357	--	2,357
	-----	-----	-----
Balance as of December 31, 2004	\$36,673	\$ 3	\$36,676
	=====	=====	=====

7. DUE FROM RELATED PARTIES

A former officer of the Company used the proceeds he received from the sale of Preferred to repay \$1,585 due from that officer.

8. NOTES PAYABLE AND OTHER OBLIGATIONS

Notes payable, capital leases and other obligations at December 31, 2004 consist of:

	2004
	-----
Notes payable and other obligations	
Payment obligation - former owner	\$ 2,000
Term note payable - bank	1,605
Notes payable issued in connection with acquisitions	830
Capital leases payable	119
	-----
Total notes payable, capital leases and other obligations	4,554
Less, current maturities	(2,491)
	-----
Amount due after one year	\$ 2,063
	=====

In connection with the acquisition of Douglas Elliman, the Company assumed an obligation to make a payment to a former owner of Douglas Elliman in an amount up to \$4,000, due in 2003 and 2004. The obligation is subject to certain claims and offsets the Company has against this former owner. The 2003 payment of \$2,000 was made. The remaining balance of \$2,000 was due in August 2004, but is the subject to final negotiation.

TERM NOTE PAYABLE - BANK:

In December 2002, Prudential Douglas Elliman borrowed \$1,940 from a

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bank, bearing interest at 7% per annum, due in January 2006. Principal is amortized in the amount of \$15 per month during the term of the loan. The loan is collateralized by the assets of Prudential Douglas Elliman to the extent of the unpaid principal and interest.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
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NOTES PAYABLE ISSUED IN CONNECTION WITH ACQUISITIONS AND CAPITAL LEASES PAYABLE:

Prudential Douglas Elliman has various other notes issued in connection with acquisitions of real estate brokerage companies and capital leases payable bearing interest at various rates up to 14.5%, which mature through 2009. Assets under capital lease are primarily office equipment and furniture, and have a net book value of \$167 at December 31, 2004.

SCHEDULED MATURITIES:

Scheduled maturities of notes payable, capital leases and other obligations are as follows:

Year ending December 31	2004
2005	\$ 2,491
2006	1,658
2007	203
2008	103
2009	99
Total	\$ 4,554

9. NOTES PAYABLE TO RELATED PARTIES

Notes payable to related parties at December 31, 2004 consist of:

	2004
Notes payable to related parties	
Acquisition term note payable - PREFSA	\$ 45,530
Acquisition subordinated notes payable - PREFSA	8,621
Acquisition subordinated notes payable - New Valley	8,621
Franchise term notes payable - PREA	3,939
Note payable - officer	443
Total notes payable to related parties	67,154

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Less, current maturities	(2,507)
	-----
Amount due after one year	\$ 64,647
	=====

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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ACQUISITION TERM NOTE PAYABLE - PREFSA:

In connection with the acquisition of Douglas Elliman and DEPM, PREFSA lent the Company \$52,500 of Senior Secured Debt, maturing in 2011 (the "Term Note"). The Term Note bears interest at prime rate plus 2% and is collateralized by substantially all the assets of the Company. The Term Note provides for monthly payments of 3% of gross revenues of Douglas Elliman and Prudential Douglas Elliman prior to March 15, 2005 and 4.5% thereafter so long as the Term Note is outstanding. The payments based on gross revenues are applied first to interest and then to outstanding principal. Additional principal payments are due on June 1 of each year in the amount equal to 60% of the Company's Excess Cash Flow, which is defined in the Term Note loan agreement as the prior year's net income plus cash proceeds received from asset sales and depreciation and amortization expense, less cash capital expenditures, principal payments on notes payable and capital leases (excluding the revolving note facility discussed below), and tax distributions made to the Company's members. The Term Note includes covenants that, among other things, require the Company to meet certain financial ratios, limit the Company's ability to incur debt, and limit capital expenditures.

SUBORDINATED NOTES PAYABLE - PREFSA AND NEW VALLEY:

In connection with the acquisition of Douglas Elliman and DEPM, PREFSA and New Valley each lent the Company \$9,500 of subordinated debt, due 2013 (the "Subordinated Debt"). The Subordinated Debt is subordinate to the Term Note and bears interest at 12% per annum, of which 10% is payable in cash and 2% accrues and is added to the principal amount. Interest added to the principal balance in 2004 was \$392. In connection with the issuance of the Subordinated Debt, PREFSA and New Valley each acquired additional membership interests representing a 15% fully-diluted interest in the Company. Based on an appraisal conducted by an independent third party, the Company valued those membership interests at \$2,500 and recorded this amount as a reduction to the principal amount of the Subordinated Debt. The Company is amortizing the value of these membership interests over the term of the Subordinated Debt. The amount amortized to interest expense for the year ended December 31, 2004 was \$172. Principal payments are due on June 1 of each year in an amount equal to 20% of the Company's Excess Cash Flow computed in the same manner as defined in the Term Note loan agreement.



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### FRANCHISE TERM NOTES PAYABLE:

In December 2002, The Prudential Real Estate Affiliates, Inc. ("PREA" or the "Franchiser"), an affiliate of PREFSA, lent Prudential Douglas Elliman \$3,300 bearing interest at 9% per annum and due in annual installments of principal and interest of \$514 through 2012.

In March 2003, PREA lent Douglas Elliman \$1,250 bearing interest at 8% per annum and due in annual installments of principal and interest of \$186 through 2013.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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### REVOLVING LOAN FACILITY:

In March 2003, the Company and PREFSA entered into a revolving loan facility for \$5,000, available until March 2006. Borrowings under the facility bear interest at prime rate plus 1.5% and are collateralized by substantially all the assets of the Company. As of December 31, 2004, \$5,000 was available under the facility.

### NOTE PAYABLE - OFFICER:

As of December 31, 2004, the Company was indebted to a member and executive officer of Realty, in the amount of \$443 with interest at prime rate plus 1.5%. The principal amount is due on June 1 of each year in the amount equal to approximately 8.29% of the Company's Excess Cash Flow, which is computed in the same manner as defined in the Term Loan agreements, provided New Valley receives an equal payment and PREFSA receives a proportionate payment, each as a return of capital.

### SCHEDULED MATURITIES:

Scheduled maturities of debt to related parties are presented below. The table does not include the Company's obligations to make principal payments under the Term Note, the Subordinated Notes, or the note payable to such officer based on percentages of future Gross Revenues or future Excess Cash Flow.

Year ending December 31	2004
2005	\$ 2,507
2006	574
2007	424
2008	461
2009	501
Thereafter	62,687

Total

-----  
 \$ 67,154  
 =====

10. FRANCHISE AGREEMENT AND ROYALTY FEES

Douglas Elliman is party to a franchise agreement with PREA entered into in March 2003. The agreement provides for Douglas Elliman to make monthly payments of royalty fees to PREA based on the level of gross revenue, with a royalty rate ranging from 1.8% to 6.0% of gross revenues earned. Pursuant to the franchise agreement, Douglas Elliman was granted a 50% deferral of applicable royalty fees for 2004, which is payable in monthly installments beginning in the first month of the fourth year. A balance of \$1,394 was accrued at December 31, 2004. The royalty percentage was 2.07% for the year ended December 31, 2004. The agreement also provides for Douglas Elliman to remit advertising and annual franchise fees to PREA, which are based on gross revenues and the number of offices occupied.

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Prudential Douglas Elliman is party to a franchise agreement with PREA entered into in December 2002. The Agreement provides for Prudential Douglas Elliman to make monthly payments of royalty fees to PREA based on 2.24% of gross revenues earned for the first five years and on a scale ranging from 1.8% to 6.0% of gross revenues earned thereafter. The agreement also provides for Prudential Douglas Elliman to remit advertising and annual franchise fees, which are based on gross revenues and the number of offices occupied.

For the year ended December 31, 2004, total fees incurred under the franchise agreements amounted to approximately \$4,515.

The Franchiser has significant rights over the use of the franchised service marks and the conduct of the brokerage companies' business. The franchise agreements require the companies to coordinate with the Franchiser on significant matters relating to their operations, including the opening and closing of offices, make substantial royalty payments to the Franchiser and contribute significant amounts to national advertising funds maintained by the Franchiser, indemnify the Franchiser against losses arising out of the operations of their business under the franchise agreements and maintain standards and comply with guidelines relating to their operations which are applicable to all franchisees of the Franchiser's real estate franchise system.

The Franchiser has the right to terminate Douglas Elliman's and Prudential Douglas Elliman's franchises, upon the occurrence of certain

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events, including a bankruptcy or insolvency event, a change in control, a transfer of rights under the franchise agreement and a failure to promptly pay amounts due under the franchise agreements. A termination of Douglas Elliman's or Prudential Douglas Elliman's franchise agreement could have a material adverse affect on the Company.

The franchise agreements grant Douglas Elliman and Prudential Douglas Elliman exclusive franchises in New York for the counties of Nassau and Suffolk on Long Island and for Brooklyn, Queens and Manhattan, subject to various exceptions and to meeting certain annual revenue thresholds. If Douglas Elliman or Prudential Douglas Elliman fails to achieve these levels of revenues for two consecutive years or otherwise materially breaches the franchise agreements, the Franchiser would have the right to terminate the applicable brokerage company's exclusivity rights. A loss of these rights could have a material adverse affect on the Company.

### 11. DEFINED CONTRIBUTION PLANS

Douglas Elliman, Prudential Douglas Elliman and DEPM sponsor individual 401(k) plans which allow eligible employees to make pre-tax contributions. Employees who have completed one year of service, as defined, are eligible to participate in the plans. The plans provide for matching employer contributions of 10% of employee contributions up to a maximum annual contribution of \$12 per employee. Participants are immediately vested in their contributions made. Matching contributions for the years ended December 31, 2004 amounted to \$252.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(DOLLARS IN THOUSANDS)  
DECEMBER 31, 2004

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### 12. COMMITMENTS AND CONTINGENCIES

#### LAWSUITS

The Company is involved in litigation through the normal course of business. Certain claims arising before the date of acquisition of Douglas Elliman and DEPM are subject to indemnification agreements with the prior owners. The majority of these claims have been referred to the insurance carrier and related counsel. The Company believes that the resolution of these matters will not have a material adverse effect on the financial position, results of operations or cash flows of the Company.

#### LEASES

The Company and its subsidiaries are obligated under various operating lease agreements for office facilities. Certain leases are non-cancelable and expire on various dates through September 2013.

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Future minimum rental payments under the operating leases at December 31, 2004 are as follows:

Year ending December 31	2004
2005	\$ 10,465
2006	9,775
2007	8,752
2008	7,670
2009	4,190
Thereafter	31,408
	-----
Total	\$ 72,260
	=====

### 13. CONCENTRATION OF CREDIT RISK

The Company and its subsidiaries may, from time to time, maintain demand deposits in excess of federally insured limits in the normal course of business. At December 31, 2004, cash balances in excess of insured limits were approximately \$24,384.

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (DOLLARS IN THOUSANDS)  
 DECEMBER 31, 2004

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### 14. BUSINESS SEGMENT INFORMATION

The Company reports using separate business segments, defined by the different services offered. The following table presents certain financial information of the Company's continuing operations as of and for the year ended December 31, 2004. Corporate loss consists solely of the Company's net interest expense.

	REAL ESTATE BROKERAGE	PROPERTY MANAGEMENT	CORPORATE	TOTAL
	-----	-----	-----	-----
Revenues	\$263,877	\$ 22,939	\$ --	\$286,816
Net income (loss)	27,126	(244)	(6,282)	20,600
Identifiable assets	96,960	6,860	--	103,820
Depreciation and amortization	3,992	1,509	--	5,501
Capital expenditures	7,909	504	--	8,413

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KOA INVESTORS,  
LLC AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)  
DECEMBER 31, 2006

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KOA INVESTORS, LLC AND SUBSIDIARIES  
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(UNAUDITED)  
DECEMBER 31, 2006

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KOA INVESTORS, LLC AND SUBSIDIARIES  
 CONSOLIDATED BALANCE SHEETS  
 December 31, 2006  
 (UNAUDITED)

-----

ASSETS

	2006
	-----
Current Assets	
Cash and cash equivalents	\$ 1,264,211
Accounts receivable, net of allowance of \$23,459	1,644,667
Inventories	94,117
Prepaid expenses and other current assets	291,085
	-----
Total current assets	3,294,080
	-----
Leasehold interest, Improvements and Personal Property	
Leasehold interest and improvements	61,300,290
Furnishings and equipment	17,781,538
	-----
	79,681,828
Less accumulated depreciation	11,192,325
	-----
	67,889,503
	-----
Deferred Financing Costs, net of accumulated amortization of \$1,082,334	1,297,222
Restricted Cash	3,279,507
	-----
	\$ 75,760,312
	=====

LIABILITIES AND MEMBERS' DEFICIT

Liabilities	
Accounts payable and accrued expenses	\$ 4,490,796
Due to affiliates	241,950
Loan payable to affiliate	1,189,000
	-----
Total current liabilities	5,921,746
Mortgage Note Payable	82,000,000
Deferred Ground Rent Payable	5,661,551
	-----
	93,583,297

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Commitments and Contingencies

Members' Deficit	(17,822,985)
	-----
	\$ 75,760,312
	=====

The accompanying notes are an integral part of these consolidated financial statements.

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KOA INVESTORS, LLC AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
YEAR ENDED DECEMBER 31, 2006  
(UNAUDITED)

	2006
	-----
Revenues	
Rooms	\$ 19,358,700
Food and beverage	8,477,871
Other operating revenue	1,603,544
	-----
Interest income	29,440,115
	-----
Costs and Expenses	
Cost of sales and other operating expenses	20,303,907
Selling, general and administrative	4,738,314
Management fees	697,208
Ground rent	1,165,700
Interest expense	6,616,163
Depreciation and amortization	5,988,706
	-----
	39,509,998
	-----
Interest income	41,541
	-----
Net loss	\$ (10,028,342)
	=====

The accompanying notes are an integral part of these consolidated financial statements.

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KOA INVESTORS, LLC AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY (DEFICIT)  
YEAR ENDED DECEMBER 31, 2006

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(UNAUDITED)

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Balance, December 31, 2005	\$ (9,631,383)
Contributions	1,836,740
Distributions	--
Net loss	(10,028,342)
	-----
Balance, December 31, 2006	\$ (17,822,985)
	=====

The accompanying notes are an integral part of these consolidated financial statements.

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KOA INVESTORS, LLC AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
YEAR ENDED DECEMBER 31, 2006  
(UNAUDITED)

---

	2006
	-----
Cash Flows Used In Operating Activities:	
Net loss	\$ (10,028,342)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	5,988,706
Bad debts	36,921
Accounts receivable	(447,128)
Inventories	(4,476)
Prepaid and other current assets	102,973
Restricted cash	106,138
Accounts payable and accrued expenses	535,708
Deferred ground rent	1,152,158
	-----
Net cash used in operating activities	(2,557,342)
	-----
Cash Flows Used In Investing Activities:	
Additions to leasehold interest, improvements and personal property	(268,347)
Restricted cash	(250,436)



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Net cash used in investing activities	(518,783)
Cash Flows From Financing Activities:	
Proceeds from mortgage notes and loans	--
Payments on mortgages and loans	--
Proceeds from loan from affiliate	3,357,000
Payments on loan from affiliate	(2,168,000)
Deferred financing costs	(60,881)
Repayment of capital lease obligations	--
Members' contributions	1,836,740
Members' distributions	--
Net cash provided by financing activities	2,964,859
Net change in cash and cash equivalents	(111,266)
Cash and cash equivalents at beginning of year	1,375,477
Cash and cash equivalents at end of year	\$ 1,264,211
Supplemental Disclosures of Cash flow Information:	
Cash paid during the year ended for:	
Interest	\$ 6,419,012

The accompanying notes are an integral part of these consolidated financial statements.

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KOA INVESTORS, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2006  
(UNAUDITED)

1. PURPOSE AND ORGANIZATION

a. Formation

KOA Investors, LLC and Subsidiaries (the "Company") was formed as a Delaware limited liability company on November 17, 1999. The Company was formed to acquire a mortgage note and foreclose on the note for the purpose of owning, developing and operating a hotel resort in Keauhou, Hawaii (the "Hotel").

The Hotel contains 521 guest rooms, cabana style dining services, and a multi-level pool with a poolside grill and bar. The Hotel renovation was completed in January 2005. The Company has engaged Starwood Hotels & Resorts Worldwide, Inc. ("Starwood") as its exclusive managing agent to operate the Hotel.

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Pursuant to the operating agreement, the Company will continue in existence until the earlier of December 31, 2051 or upon the decision of the Decision Members, as defined, to terminate the Company.

b. Contributions

The operating agreement (the "Agreement") provides for contributions generally based upon each member's ownership interest. In 2006, \$1,850,000 of capital was called by the Company, \$1,836,740 of the capital call was received in 2006 and \$13,260 was received in January 2007.

c. Distributions

Cash available for distribution, as defined in the Agreement, is distributed in accordance with the contributions made until the members have received a 12% return on their contributions and have been returned all contributions; thereafter incentive distributions may be earned by some of the members subject to achievement of certain returns, as defined, in the Agreement. As of December 31, 2006 unpaid returns were approximately \$3,988,000.

d. Income and Losses

Generally, income and losses are allocated in such a manner as to cause each member's capital account to equal the cash distribution each would receive based upon a hypothetical liquidation at the Company's book basis.

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KOA INVESTORS, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2006  
(UNAUDITED)

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Consolidation

The consolidated financial statements of KOA Investors, LLC include the accounts of KOA Hotel Member, LLC a wholly owned subsidiary formed on August 1, 2005 as a Delaware limited liability company which is the mezzanine loan borrower and KOA Hotel, LLC, a wholly owned subsidiary formed on May 2, 2001 as a Delaware limited liability company which is the mortgage borrower. All significant intercompany transactions have been eliminated.

b. Cash and Cash Equivalents

Cash and cash equivalents include cash in banks and overnight

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investments that at various times during the year exceed Federally insured limits. Cash and cash equivalents exceeded Federally insured limits by \$1,225,046 at December 31, 2006. The Company believes it mitigates this risk by banking with high credit institutions.

c. Accounts Receivable

Accounts receivable consists of the receivables for guest for guest rooms and other services. Accounts receivable does not bear interest and is evaluated periodically by collectibility. The Company establishes an allowance for doubtful accounts, based on a percentage of the aged accounts receivable throughout the year.

d. Inventories

Inventories, comprised primarily of food, beverage and hotel operating supplies, are stated at the lower cost or market. Cost is determined by the first-in, first-out method.

e. Leasehold Interest, Improvements and Personal Property

Leasehold interest, improvements and personal property are stated at cost. Buildings, improvements and furnishings and equipment are depreciated using the straight-line method over their estimated useful lives. Significant improvements and betterments are capitalized. Maintenance and repairs are charged to expense as incurred.

The estimated useful lives are as follows:

Buildings and improvements	39 years
Land improvements	15 years
Furnishings and equipment	5 years

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KOA INVESTORS, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2006  
(UNAUDITED)

---

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

e. Leasehold Interest, Improvements and Personal Property  
(continued)

On a periodic basis, management assesses whether there are any indicators that the value of the real estate and personal property may be impaired. The value is impaired only if management's estimate of the aggregate future cash flows (undiscounted and without interest charges) generated by the Hotel is less than the carrying value of the assets. Any impairment losses would be measured primarily by comparing management's analysis of estimated future cash flows generated

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by the Hotel discounted at an appropriate rate, to the carrying value of the asset. Management does not believe that the value of any of its real estate and personal property is impaired.

f. Deferred Financing Costs

Costs incurred in obtaining financing or interest cap agreements are amortized over the term of the related debt.

g. Deferred Ground Rent

Base rental expense on the Company's ground lease is recognized ratably over its non-cancelable term. The difference between the ground rent recognized using the straight-line method and the ground rent in accordance with the lease is reflected as deferred ground rent payable on the balance sheets.

h. Revenue Recognition

Revenues are recognized when services are rendered. The Company receives deposits for events and rooms. Such deposits are deferred and included in accounts payable and accrued expenses in the accompanying balance sheets. The amounts are charged to income when the specific event takes place.

i. Income Taxes

No provision or benefit for income taxes has been included in the financial statements because as a limited liability company, the Company is generally not subject to Federal or state income taxes. The effects of the Company's activities accrue directly to the members.

j. Advertising

Advertising and marketing costs are expensed as incurred.

k. Use of Estimates

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America ("GAAP"), requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

3. ACCOUNTS RECEIVABLE

Approximately 13% of accounts receivable at December 31, 2006 were from one customer.

4. MORTGAGE NOTES

The Company entered into a loan agreement with Lehman Brothers Bank, FSB, pursuant to an 82,000,000 mortgage note payable (the "Note") dated August 1, 2005. The Note bears interest only at the LIBOR rate plus 2.65% (LIBOR was 5.32% at December 31, 2006). The note matures on August 9, 2008 and has two 1-year extension options under terms defined in the loan agreement. The note is secured by the Company's property.

On August 10, 2006 the Lehman Brothers Bank, FSB bifurcated the original note by reducing it by \$26,000,000 and creating a second note (the "Mezz Note"). The Mezz Note bears interest only at the LIBOR rate plus 3.149% (LIBOR was 5.32% at December 31, 2006). The note matures on August 9, 2008 and has two 1-year extension options under terms defined in the loan agreement. The note is secured by the Company's property.

The Notes required the Company to purchase an interest cap agreement on the entire outstanding principal to mitigate its interest risk. The agreement caps the LIBOR rate at 5.5% per annum. On August 10, 2006, in connection with the bifurcation of the Note, the interest cap agreement was amended to cover both notes under the same terms. The cap agreement was deemed to have a nominal value at December 31, 2006.

The Company entered into a cash management agreement that specifies the priority of application of cash receipts. In addition, the Company was required to fund certain escrows for the ground lease, insurance, property taxes and a reserve for replacements.

The Notes also provide for the maintenance of minimum debt service coverage ratios beginning in March 2007.

The Note provides for prepayment penalties ranging from 1.5% if prepaid before February 9, 2007 and to 1% if prepaid before February 9, 2008; thereafter there is no fee.

The Mezz Note provides for prepayment penalties ranging from 1% if prepaid before February 9, 2007; thereafter there is no fee.

5. GROUND LEASE

In connection with the acquisition of the property, the Company assumed two ground leases. On December 20, 2002, the Company entered into a lease escrow agreement, which modified and combined the provisions of the ground lease.

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KOA INVESTORS, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2006  
(UNAUDITED)

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5. GROUND LEASE (continued)

As of December 31, 2006, the minimum amounts payable under the terms of the ground lease for the next five years and in the aggregate thereafter, are as follows:

2007	\$	12,000
2008		12,000
2009		12,000
2010		12,000
2011		12,000
Thereafter		76,733,110
		-----
		\$ 76,793,110
		=====

Subsequent to December 31, 2037, minimum payments are to be agreed upon at a later date in accordance with the lease escrow agreement, but in no event will be less than \$1,537,000. The ground lease expires on April 30, 2069.

The Company is also obligated to pay to the ground lessor percentage rent, as stipulated in the original ground lease agreement, once the Hotel begins operations. As of December 31, 2006, no percentage rent has been paid or accrued.

The Company incurred ground rent expense of approximately \$1,141,000 in 2006.

6. RELATED PARTY TRANSACTIONS

Due to Affiliates

Due to affiliates represents advances from affiliates of the Company through common control to finance short-term cash flow requirements of the Company. The advance is non-interest bearing and due on demand.

Loan Payable to Affiliate

During 2006, approximately \$3,357,000 was loaned to the Company by an affiliate of the Company in order to pay for operating expenses. The balance will be repaid when cash flow permits. The loan bears interest at prime as published in the Wall Street Journal (8.25% at December 31, 2006). Total interest incurred on this loan was approximately \$57,527 in 2006.

Asset Management Fees

Upon completion of the renovation of the Hotel, the asset management fee was reduced, by amendment, to \$120,000 per annum.

For the year ended December 31, 2006, the Company incurred asset

management fees in the amount of \$120,000.

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KOA INVESTORS, LLC AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2006  
(UNAUDITED)

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7. COMMITMENTS AND CONTINGENCIES

Management Fees

On December 20, 2002, the Company entered into a management agreement (the "Management Agreement") with Sheraton Operating Corporation ("Starwood"), which requires Starwood to provide managerial and promotional services for the Hotel. The Management Agreement has an operating term of two (2) periods of five (5) years each, as more fully described in the Management Agreement.

Starwood has the option to renew the Management Agreement for two successive terms of five years each. The Management Agreement consists of a base management fee equal to 2% of the gross operating revenue of the Hotel, as defined for the first 12 months after the Hotel opens, 2.5% for the subsequent 12 months and 3% thereafter. In addition, the Management Agreement provides for an incentive fee equal to 15% of operating income in excess of a threshold, as defined. Management fees in the amount of \$577,208 and \$484,980 were incurred for the year ended December 31, 2006.

In accordance with the terms of the Management Agreement, the Company also reimburses Starwood for services including payroll and benefits, insurance, marketing, advertising, promotion, sales, reservation services and other charges. Management fees and other Starwood services payable at December 31, 2006 was approximately \$577,673.

In 2006 Starwood agreed to defer payment of management fees until cash flow permits which is expected to be in 2007. Deferred management fees at December 31, 2006 were \$415,940.

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KOA INVESTORS, LLC  
(A Limited Liability Company)

FINANCIAL STATEMENTS

DECEMBER 31, 2005

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KOA INVESTORS, LLC  
(A Limited Liability Company)  
FINANCIAL STATEMENTS

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KOA INVESTORS, LLC  
BALANCE SHEET  
DECEMBER 31, 2005  
(UNAUDITED)



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2005

ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	\$ 1,375,477
Accounts receivable, net of allowance of \$41,183	1,234,460
Inventories	89,641
Prepaid and other current assets	219,058
	-----
TOTAL CURRENT ASSETS	2,918,636
	-----
LEASEHOLD INTEREST, IMPROVEMENTS AND PERSONAL PROPERTY	
Leasehold interest and improvements	61,284,564
Furnishings and equipment	17,528,917
	-----
	78,813,481
Less accumulated depreciation	5,977,097
	-----
	72,836,384
	-----
DEFERRED FINANCING COSTS, NET OF ACCUMULATED AMORTIZATION OF \$301,053 IN 2005	
	2,017,622
RESTRICTED CASH	3,135,209
	-----
	\$80,907,851
	=====
LIABILITIES AND MEMBERS' DEFICIT	
LIABILITIES	
Accounts payable and accrued expenses	\$ 3,962,891
Due to affiliates	66,950
	-----
TOTAL CURRENT LIABILITIES	4,029,841
MORTGAGE NOTE PAYABLE	82,000,000
DEFERRED GROUND RENT PAYABLE	4,509,393
	-----
	90,539,234
COMMITMENTS AND CONTINGENCIES	
MEMBERS' DEFICIT	(9,631,383)
	-----
	\$80,907,851
	=====

The accompanying notes are an integral part of these financial statements.

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	2005
	-----
REVENUES	
Rooms	\$ 15,920,758
Food and beverage	6,677,341
Other operating revenue	1,653,424
	-----
	24,251,523
	-----
COSTS AND EXPENSES	
Cost of sales	13,907,174
Other operating expenses	5,092,453
Selling, general and administrative	4,927,758
Management fees	604,980
Ground rent	1,062,747
Interest expense	6,724,527
Depreciation and amortization	7,401,288
	-----
	39,720,927
	-----
Interest income	38,130
	-----
NET LOSS	\$ (15,431,274)
	=====

The accompanying notes are an integral part of these financial statements.

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KOA INVESTORS, LLC  
STATEMENT OF CHANGES IN MEMBERS' EQUITY (DEFICIT)  
YEARS ENDED DECEMBER 31, 2005

BALANCE, JANUARY 1, 2005	\$ 14,799,913
Contributions	2,000,000
Distributions	(11,000,022)
Net loss	(15,431,274)
	-----
BALANCE, DECEMBER 31, 2005	\$ (9,631,383)
	=====

The accompanying notes are an integral part of these financial statements.

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KOA INVESTORS, LLC

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## STATEMENT OF CASH FLOWS YEAR ENDED DECEMBER 31, 2005 (UNAUDITED)

	2005
	-----
CASH FLOWS USED IN OPERATING ACTIVITIES:	
Net loss	\$ (15,431,274)
ADJUSTMENTS TO RECONCILE NET LOSS	
TO NET CASH USED IN OPERATING ACTIVITIES:	
Depreciation and amortization	7,401,288
Bad debts	41,183
Accounts receivable	(768,632)
Inventories	(11,691)
Prepaid and other current assets	183,604
Accounts payable and accrued expenses	3,962,891
Deferred ground rent	1,050,248
	-----
NET CASH USED IN OPERATING ACTIVITIES	(3,572,383)
	-----
CASH FLOWS USED IN INVESTING ACTIVITIES:	
Additions to leasehold interest, improvements and personal property	(4,304,935)
Restricted cash	(3,135,209)
	-----
NET CASH USED IN INVESTING ACTIVITIES	(7,440,144)
	-----
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from mortgage notes	82,000,000
Payments on mortgages and loans	(57,000,000)
Deferred financing costs	(2,318,675)
Repayment of capital obligations	(3,355,616)
Members' contributions	2,000,000
Distributions to members	(11,000,022)
	-----
NET CASH PROVIDED BY FINANCING ACTIVITIES	10,325,687
	-----
NET CHANGE IN CASH AND CASH EQUIVALENTS	(686,840)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	2,062,317
	-----
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 1,375,477
	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:	
Cash paid during the year ended for:	
Interest	\$ 5,994,885
	=====

The accompanying notes are an integral part of these financial statements.

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KOA INVESTORS, LLC  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2005  
(UNAUDITED)

### 1. PURPOSE AND ORGANIZATION

#### A. FORMATION

Koa Investors, LLC (the "Company") was formed as a Delaware limited liability company on November 17, 1999. The Company was formed to acquire a mortgage note and foreclose on the note for the purpose of owning, developing and operating a hotel resort in Keauhou, Hawaii (the "Hotel").

The Hotel contains 521 guest rooms, cabana style dining services, and a multi-level pool with a poolside grill and bar. The Hotel renovation was completed in January 2005. The Company has engaged Starwood Hotels & Resorts Worldwide, Inc. ("Starwood") as its exclusive managing agent to operate the Hotel.

Pursuant to the operating agreement, the Company will continue in existence until the earlier of December 31, 2051 or upon the decision of the Decision Members, as defined, to terminate the Company.

#### B. CONTRIBUTIONS

The operating agreement (the "Agreement") provides for contributions generally based upon each member's ownership interest.

#### C. DISTRIBUTIONS

Cash available for distribution, as defined in the Agreement, is distributed in accordance with the contributions made until the members have received a 12% return on their contributions and have been returned all contributions; thereafter incentive distributions may be earned by some of the members subject to achievement of certain returns, as defined, in the Agreement. As of December 31, 2005 unpaid returns were approximately \$1,289,553.

#### D. INCOME AND LOSSES

Generally, income and losses are allocated in such a manner as to cause each member's capital account to equal the cash distribution each would receive based upon a hypothetical liquidation at the Company's book basis.

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KOA INVESTORS, LLC  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2005  
(UNAUDITED)

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### A. CASH AND CASH EQUIVALENTS

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Cash and cash equivalents include cash in banks and overnight investments that at various times during the year exceed Federally insured limits. The Company believes it mitigates this risk by banking with high credit institutions.

### B. ACCOUNTS RECEIVABLE

Accounts receivable consists of the receivables for guest rooms and other services. Accounts receivable does not bear interest and is evaluated periodically by collectibility. The Company establishes an allowance for doubtful accounts, based on a percentage of the aged accounts receivable throughout the year.

### C. INVENTORIES

Inventories, comprised primarily of food, beverage and hotel operating supplies, are stated at the lower cost or market. Cost is determined by the first-in, first-out method.

### D. RESTRICTED ASSETS

Restricted assets at December 31, 2005 consisted primarily of amounts held in escrow related to interest, insurance and property taxes.

### E. REAL ESTATE UNDER DEVELOPMENT

All costs incurred in connection with the acquisition, development and construction of the Hotel were capitalized. The Hotel was completed in January 2005.

### F. LEASEHOLD INTEREST, IMPROVEMENTS AND PERSONAL PROPERTY

Leasehold interest, improvements and personal property are stated at cost. Buildings, improvements and furnishings and equipment are depreciated using the straight-line method over their estimated useful lives. Significant improvements and betterments are capitalized. Maintenance and repairs are charged to expense as incurred.

The estimated useful lives are as follows:

Buildings and improvements	39 years
Land improvements	15 years
Furnishings and equipment	5 years

On a periodic basis, management assesses whether there are any indicators that the value of the real estate and personal property may be impaired. The value is impaired only if management's estimate of the aggregate future cash flows (undiscounted and without interest charges) generated by the Hotel is less than the carrying value of the assets. Any impairment losses would be measured primarily by comparing management's analysis of estimated future cash flows generated by the Hotel discounted at an appropriate rate, to the carrying value of the asset. Management does not believe that the value of any of its real estate and personal property is impaired.

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KOA INVESTORS, LLC  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2005  
(UNAUDITED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. DEFERRED FINANCING COSTS

Costs incurred in obtaining financing or interest cap agreements are amortized over the term of the related debt.

H. DEFERRED GROUND RENT

Base rental expense on the Company's ground lease is recognized ratably over its non-cancelable term. The difference between the ground rent recognized using the straight-line method and the ground rent in accordance with the lease is reflected as deferred ground rent payable on the balance sheets.

I. REVENUE RECOGNITION

Revenues are recognized when services are rendered. The Company receives deposits for events and rooms. Such deposits, which were \$474,802 at December 31, 2005, are deferred and included in accounts payable and accrued expenses in the accompanying balance sheet. The amounts are charged to income when the specific event takes place.

J. INCOME TAXES

No provision or benefit for income taxes has been included in the financial statements because as a limited liability company, the Company is generally not subject to Federal or state income taxes. The effects of the Company's activities accrue directly to the members.

K. ADVERTISING

Advertising and marketing costs, which were \$578,586 for the year ended December 31, 2005, are expensed as incurred.

L. USE OF ESTIMATES

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America ("GAAP"), requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

3. LEASEHOLD INTEREST, IMPROVEMENTS AND PERSONAL PROPERTY AND MORTGAGE NOTE PAYABLE

The components of the Company's Leasehold Interest, Improvements and Personal Property and the related mortgage note payable at December 31, 2005 are as follows:

Leasehold interest and improvements .....	\$ 61,284,564
Furnishings and equipment .....	17,528,917

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Total .....	78,813,481
Less accumulated depreciation .....	(5,977,097)
Net investment in real estate .....	\$ 72,836,384
Mortgage note payable .....	\$ 82,000,000
Current portion of mortgage note payable .....	--
Mortgage note payable - long-term portion .....	\$ 82,000,000

MORTGAGE NOTES

The Company entered into a loan agreement with Lehman Brothers Bank, FSB, pursuant to an \$82,000,000 mortgage note payable (the "Note") dated August 1, 2005. The Note bears interest at the LIBOR rate plus 2.65% (LIBOR was 4.12% at December 31, 2005). The note matures on August 8, 2008 and has two 1-year extension options under terms defined in the loan agreement. The note is secured by the Company's property.

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KOA INVESTORS, LLC  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2005  
(UNAUDITED)

The loan agreement required the Company to purchase an interest cap agreement on the entire outstanding principal to mitigate its interest risk. The agreement caps the LIBOR rate at 5.5% per annum. The cap agreement was deemed to have a nominal value at December 31, 2005.

The Company entered into a cash management agreement that specifies the priority of application of cash receipts. In addition, the Company was required to fund certain escrows for the ground lease, insurance, property taxes and a reserve for replacements.

The loan agreement also provides for the maintenance of minimum debt service coverage ratios beginning in March 2007. The note provides for prepayment penalties ranging from 2% of the outstanding principal if the note is prepaid before February 9, 2006 and decreasing to 1.5% if prepaid before February 9, 2007 and to 1% if prepaid before February 9, 2008; thereafter there is no fee.

Prior to the refinancing in 2005, the Company was obligated pursuant to a \$57,000,000 mortgage note payable dated April 15, 2004. The note required payments of interest only at 10% per annum. In connection with the early repayment of the note, the Company incurred prepayment penalties of approximately \$852,000 which is included in interest expense.

4. CAPITAL LEASE OBLIGATIONS

In June 2004, the Company entered into a capital lease agreement to acquire up to \$5,000,000 of furniture and equipment through GMAC Commercial Mortgage Corporation ("GMAC"). Monthly payments commenced in May 2005. In

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connection with the refinancing in August, 2005, the capital lease was repaid.

### 5. GROUND LEASE

In connection with the acquisition of the property, the Company assumed two ground leases. On December 20, 2002, the Company entered into a Lease Escrow Agreement, which modified and combined the provisions of the ground lease.

As of December 31, 2005, the minimum amounts payable under the terms of the ground lease for the next five years and in the aggregate thereafter, are as follows:

2006	\$	12,000
2007		12,000
2008		12,000
2009		12,000
2010		12,000
Thereafter		76,745,110
		-----
		\$76,805,110
		=====

Subsequent to December 31, 2037, minimum payments are to be agreed upon at a later date in accordance with the Lease Escrow Agreement, but in no event will be less than \$1,537,000. The ground lease expires on April 30, 2069.

The Company is also obligated to pay to the ground lessor percentage rent, as stipulated in the original ground lease agreement, once the Hotel begins operations. As of December 31, 2005, no percentage rent has been paid or accrued.

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KOA INVESTORS, LLC  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2005  
(UNAUDITED)

### 5. GROUND LEASE (CONTINUED)

The Company incurred ground rent expense of approximately \$1,141,000 for 2005.

### 6. RELATED PARTY TRANSACTIONS

#### DUE TO AFFILIATES

Due to affiliates represents advances from affiliates of the Company through common control to finance short-term cash flow requirements of the Company. The advance is non-interest bearing and due on demand.

#### ASSET MANAGEMENT FEES



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In accordance with the terms of the operating agreement, the managing member provides asset management services to the Company for an annual fee equal to the greater of \$500,000 or 2% of the gross asset value, at cost, of the assets owned by the Company and prior to depreciation. Upon completion of the renovation of the Hotel, the asset management fee was reduced, by amendment, to \$120,000 per annum.

For the year ended December 31, 2005 the Company incurred asset management fees in the amount of \$120,000.

### 7. COMMITMENTS AND CONTINGENCIES

#### MANAGEMENT FEES

On December 20, 2002, the Company entered into a management agreement (the "Management Agreement") with Sheraton Operating Corporation ("Starwood"), which requires Starwood to provide managerial and promotional services for the Project. The Management Agreement has an operating term of two (2) periods of five (5) years each, as more fully described in the Management Agreement.

Starwood has the option to renew the Management Agreement for two successive terms of five years each. The Management Agreement consists of a base management fee equal to 2% of the Gross Operating Revenue of the Project, as defined for the first 12 months after the Hotel opens, 2.5% for the subsequent 12 months and 3% thereafter. In addition, the Management Agreement provides for an incentive fee equal to 15% of operating income in excess of a threshold, as defined. Management fees in the amount of \$484,980 were incurred in 2005.

In accordance with the terms of the Management Agreement, the Company also reimburses Starwood for services including payroll and benefits, insurance, marketing, advertising, promotion, sales, reservation services and other charges.

KOA INVESTORS, LLC  
(A Limited Liability Company)

FINANCIAL STATEMENTS

DECEMBER 31, 2004

KOA INVESTORS, LLC  
(A Limited Liability Company)  
FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Members  
of KOA Investors, LLC  
(A Limited Liability Company)

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of KOA Investors, LLC (a Delaware limited liability company) at December 31, 2004 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to

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obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ Weiser LLP

New York, New York  
February 7, 2005

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KOA INVESTORS, LLC  
(A Limited Liability Company)  
BALANCE SHEET  
DECEMBER 31, 2004

### ASSETS

Real estate under development  
Fixed assets, at cost, net of accumulated depreciation of \$634,141  
Cash and cash equivalents  
Cash - restricted  
Accounts receivable  
Prepaid expenses and other assets  
Deferred financing costs, net of accumulated amortization of \$847,854

### LIABILITIES AND MEMBERS' EQUITY

Mortgage note payable  
Capital lease obligation  
Construction costs and accounts payable  
Due to affiliates  
Deferred ground rent payable

Commitments, contingencies, and other matters

Members' equity

See notes to financial statements.

KOA INVESTORS, LLC  
(A Limited Liability Company)  
STATEMENT OF OPERATIONS  
FOR THE YEAR ENDED DECEMBER 31, 2004

Revenue  
Costs and expenses  
  
Gross Profit  
  
Operating expenses:  
  General and administrative  
  Repairs and maintenance  
  Marketing  
  Utilities  
  Ground rent  
  Management fees  
  Real estate taxes  
  Insurance  
  Depreciation  
  Amortization  
  
    Total operating expenses  
  
Operating loss  
  
Other expenses:  
  
Interest expense  
  
    Total other expenses  
  
Net loss

See notes to financial statements.

KOA INVESTORS, LLC  
(A Limited Liability Company)  
STATEMENT OF CHANGES IN MEMBERS' EQUITY  
FOR THE YEAR ENDED DECEMBER 31, 2004

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Balance - January 1, 2004	\$ 12,459,794
Contributions	7,000,900
Net loss	(3,228,781)
Balance - December 31, 2004	----- \$ 16,231,913 =====

See notes to financial statements.

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KOA INVESTORS, LLC  
(A Limited Liability Company)  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2004

Cash flows from operating activities:

Net loss  
Adjustment to reconcile net loss to net cash used  
in operating activities:  
  Depreciation  
  Amortization  
  Ground rent  
Changes in assets:  
  Increase in accounts receivable  
  Increase in prepaid expenses and other assets

Net cash used in operating activities

Cash flows from investing activities:

Real estate under development

Net cash used in investing activities

Cash flows from financing activities:

Proceeds from mortgage note payable  
Loan payoff  
Restricted cash deposits  
Capital lease obligation  
Members' contributions  
Deferred financing costs

Net cash provided by financing activities

Net increase in cash and cash equivalents

Cash and cash equivalents - beginning of year

Cash and cash equivalents - end of year

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Supplemental disclosure of cash flow information:

Cash paid during the year for interest, net of amounts capitalized

Supplemental disclosure of non-cash financing activities:

Deferred ground rent payable

See notes to financial statements.

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KOA INVESTORS, LLC  
(A Limited Liability Company)  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004

Note 1 - Organization

KOA Investors, LLC (the "Company"), was formed as a limited liability company under the laws of the State of Delaware in November 1999. The Company was formed to acquire a mortgage note (see Note 3) and foreclose on the note for the purpose of owning, developing and operating a hotel resort in Keauhou, Hawaii (the "Project").

The Project contains 521 guest rooms, cabana style dining services, and a multilevel pool with a poolside grill and bar. Management projects the renovation of the hotel will be completed by the beginning of 2005. The Company has engaged Starwood Hotels & Resorts Worldwide, Inc. ("Starwood") as its exclusive managing agent to operate the Project.

Pursuant to the operating agreement, the Company will continue in existence until the earlier of December 31, 2051 or upon the decision of the Decision Members, as defined, to terminate the Company.

Note 2 - Summary of Significant Accounting Policies

a) Basis of Accounting

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

b) Real Estate Under Development

Costs for the acquisition, development and construction of the Project are charged to real estate under development. Capitalized costs include deferred ground rent and interest expenditures incurred during the acquisition, development and construction of the Project.

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### c) Cash and Cash Equivalents

Cash and cash equivalents include cash in banks and overnight investments that at various times during the year have exceeded the Federally insured limits. The Company believes it mitigates its risk by banking with major financial institutions.

### d) Accounts Receivable

Accounts receivable consists of the receivables from guests for guest room revenue. Accounts receivable does not bear interest and is periodically evaluated for collectibility. At December 31, 2004, the Company considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts is required. The Company generally does not require collateral for accounts receivable.

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KOA INVESTORS, LLC  
(A Limited Liability Company)  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004

## Note 2 - Summary of Significant Accounting Policies (continued)

### e) Inventories

Inventories are comprised primarily of hotel operating supplies and are valued at the lower of cost or market. Cost is determined by the first-in, first-out method.

### f) Revenue Recognition

Revenues are primarily derived from hotel and resort revenues at the Sheraton Keauhou Bay Resort & Spa in Kailua-Kona, Hawaii and the Company recognizes revenues when services are rendered.

### g) Deferred Financing Costs

Costs incurred in obtaining financing are amortized over the term of the related financing instrument. Amortization of such costs from inception through completion of construction is capitalized as a cost of the Project and is amortized on a straight-line basis over the life of the related debt, which approximates amortization expense under the effective interest method.

### h) Property and Equipment Under Capital Lease

Property and equipment under capital lease represents property and equipment, which have been leased and have been capitalized by the Company. The property and equipment are recorded at cost and are depreciated on the straight-line basis over the term of the lease.

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### i) Leasehold Improvements and Equipment

Leasehold improvements and furniture, fixtures and equipment are carried at cost and depreciated on the straight-line basis over their estimated useful lives.

Expenditures for maintenance and repairs are charged to operations as incurred. Significant renovations or betterments, which extend the useful life of the assets, are capitalized.

### j) Deferred Ground Rent Payable

Base rental expense on the ground lease is recognized ratably over its non-cancelable term. The difference between the ground rent expense recognized using the straight-line method and the ground rent in accordance with the lease is shown as deferred ground rent payable on the balance sheet.

### k) Income Taxes

No provision or benefit for income taxes has been included in the financial statements because such taxable income or loss passes through to, and is reportable by, the members.

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KOA INVESTORS, LLC  
(A Limited Liability Company)  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004

### Note 2 - Summary of Significant Accounting Policies (continued)

#### 1) Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

### Note 3 - Fixed Assets and Real Estate Under Development

#### FIXED ASSETS

As of December 31, 2004, fixed assets consists of the following:

Building and leasehold interest	\$ 32,287,529
Land improvements	2,937,572
Furniture and equipment	10,123,055
	-----
	45,338,156
Less: accumulated depreciation	634,141
	-----
Total	\$ 44,714,014



=====

Depreciation expense for the year ended December 31, 2004 amounted to \$634,141.

REAL ESTATE UNDER DEVELOPMENT

The Company purchased a non-performing note, collateralized by a leasehold interest in a hotel resort in Hawaii, for approximately \$7,300,000. The Company foreclosed on the note and took possession of the leasehold for renovation and operation of the hotel. During 2004, the Company began to phase-in operations at the Project. At December 31, 2004, real estate under development of \$32,625,132 represents the portion of the Project that has yet to be placed in service, including approximately \$1,399,000 of capitalized deferred ground rent and \$936,632 of capitalized interest.

Note 4 - Mortgage Note Payable

On August 18, 2002, the Company entered into a pre-development loan agreement (the "Loan") with Far East National Bank in an amount up to \$5,000,000. The Loan bore interest at the Prime Rate (as defined in the Loan) plus 2.00% per annum. Interest only payments were required on the first day of every month in arrears. All principal and all accrued and unpaid interest were due and payable at the Loan's maturity date, February 28, 2004. Far East National Bank funded additional loan proceeds in the amount of \$1,500,000 to the Company in January 2004, at which time the Loan's maturity date was extended to May 31, 2004. The Loan was collateralized by the Company's real estate under development. Interest expense relating to the Loan amounted to approximately \$269,000, all of which was capitalized as a cost of the Project.

The Company entered into a loan agreement ("New Loan Agreement") with Canpartners Realty Holding Company IV, LLC (the "Lender") in the amount of \$57,000,000 (the "New Loan") on April 15th 2004. Proceeds of the New Loan included amounts to payoff the principal and interest of the Loan, \$6,500,000 and \$22,750, respectively.

The New Loan bears interest at 10% per annum and calculated on 360-day year. Principal and interest payments are due on the first day of the month beginning May 1, 2004 through January 31, 2007, the maturity date. For the year ending December 31, 2004 the Company incurred interest pf \$2,935,043, of which \$2,223,563 was capitalized as a costs of the Project and \$709,480 was expensed.

Note 5 - Cash - Restricted

Cash - restricted represents unused funds from the proceeds of the New Loan. Cash - restricted is disbursed upon requisition of project

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expenditures in agreement with the funding schedule and approved budget in accordance with the New Loan Agreement. Unused funds available from the New Loan as of December 31, 2004 amounted to \$5,538,372.

Note 6 - Deferred Ground Rent Payable

In conjunction with the purchase of the hotel mortgage note the Company assumed two ground leases for the leasehold. On December 20, 2002, the Company entered into a Lease Escrow Agreement, which modified the provisions of the two ground leases.

As of December 31, 2004, the minimum amounts payable under the terms of the ground lease for the next five years and in the aggregate thereafter are approximately as follows:

Year Ending December 31, -----	Amount -----
2005	\$ 12,000
2006	12,000
2007	12,000
2008	12,000
2009	12,000
Thereafter	76,729,110
	-----
	\$ 76,789,110
	=====

Subsequent to December 31, 2037 minimum payments are to be agreed upon at a later date in accordance with the Lease Escrow Agreement, but in no event will be less than \$1,537,000. The ground lease expires on December 31, 2067.

The Company is also obligated to pay to the ground lessor percentage rent, as stipulated in the original ground lease agreement, once the hotel begins operations.

For the year ended December 31, 2004 the Company incurred ground rent expense of approximately \$1,165,000, of which approximately \$1,025,000 capitalized as a cost of the Project.

KOA INVESTORS, LLC  
(A Limited Liability Company)  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004

Note 7 - Capital Lease Obligations

The Company has entered into a lease agreement with GMAC Commercial Mortgage Corporation ("GMAC") on November 11, 2004, whereby the

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Company may receive advances in the amount of \$5,000,000 for furniture, fixtures and equipment for the Project. Monthly payments will be determined upon commencement of the lease in May 2005. The lease terminates on May 5, 2012 at which time the Company has the option to purchase the leased equipment for \$1, unless terminated earlier in accordance with the lease agreement. Accordingly, the Company's leasehold interest has been recorded as an asset and the capital lease is recorded as a liability in the accompanying balance sheet as capital lease obligation at the lower of the present value of the minimum lease payments or the fair market value of the asset. At December 31, 2004 the Company has drawn \$3,355,516 of advances from GMAC.

### Note 8 - Related Party Transactions

#### Due to Affiliates

Due to affiliates represents advances from affiliates of the Company through common control to finance short-term cash flow requirements of the Company. The advance is non-interest bearing and due on demand.

#### Management Fees

In accordance with the terms of the operating agreement, the managing member shall provide asset management services to the Company for an annual fee equal to the greater of \$500,000 or 2% of the gross asset value, at cost, of the assets owned by the Company and the project entities, prior to depreciation. For the year ended December 31, 2004 the Company incurred management fees in the amount of \$500,000, of which \$439,803 have been capitalized as costs of the Project.

### Note 9 - Commitments, Contingencies and Other Matters

#### a) Management Agreement - Starwood

On December 20 of 2002, the Company entered into a management agreement (the "Management Agreement") with Sheraton Operating Corporation ("Starwood"), which requires Starwood to provide managerial and promotional services for the Project. The Management Agreement has an operating term of two (2) periods of five (5) years each, as more fully described in the Management Agreement.

Starwood has the option to renew the Management Agreement for two successive terms of five years each. The Management Agreement provides for a base management fee equal to 2% of the Gross Operating Revenue of the Project, as defined in the Management Agreement. Management fees in the amount of \$56,200 were incurred for the year ending December 31, 2004.

b) A Leasehold Mortgage and Security Agreement secure the New Loan. Individuals that are affiliates of the Company are the guarantors of the New Loan.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

VECTOR GROUP LTD.  
(Registrant)

By: /s/ J Bryant Kirkland III

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J Bryant Kirkland III  
Vice President, Chief Financial Officer and  
Treasurer

Date: March 21, 2007