VECTOR GROUP LTD
Form 10-K/A
March 22, 2006

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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, 2005

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

| | | |
|---|---|---|
| Delaware | 1-5759 | 65-09495 |
| (State or other jurisdiction of incorporation incorporation or organization) | Commission File Number | (I.R.S. Employer Iden |

| | |
|---|---|
| 100 S.E. Second Street, Miami, Florida | 3313 |
| (Address of principal executive offices) | (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. [X] Yes [ ] 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 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, 2005 was approximately $550 million.

At March 15, 2006, Vector Group Ltd. had 49,914,537 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 2006 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, 2005 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:

| | Page |
|---|---|
| Douglas Elliman Realty, LLC financial statements as of December 31, 2005 and 2004 and for the three years ended December 31, 2005. | 4 |

| | |
|---|---|
| Koa Investors, LLC financial statements as of December 31, 2005 and 2004 and for the three years ended December 31, 2005. | 57 |

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* Incorporated by reference.

(a)(3) Exhibits

| EXHIBIT NO. | DESCRIPTION |
|---|---|
| 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. |



| | |
|---|---|
| 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
(UNAUDITED)
DECEMBER 31, 2005



DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES
INDEX
(UNAUDITED)
DECEMBER 31, 2005

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FINANCIAL STATEMENTS





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

(in thousands of dollars)

| | 2005 |
|---|---|
| ASSETS | |
| 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 |
| LIABILITIES AND MEMBERS' EQUITY | |
| 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 |
| 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.



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

(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.



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

(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.



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

(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 |
| 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 interal part of these consolidated financial statements.



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

(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 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.





(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 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.





(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 $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.





(in thousands of dollars)

5. INTANGIBLE ASSETS

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

| | 2005 |
|---|---|
| Goodwill | $37,924 |
| 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
(UNAUDITED)

(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 |
| 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
(UNAUDITED)

(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 |
| 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.

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

(in thousands of dollars)

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 an 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.

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

(in thousands of dollars)

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 | 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.

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

(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. 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.



DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005
(UNAUDITED)

(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 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.

(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 |
|---|---|---|---|---|---|
| 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
CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2004

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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:

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



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 |
| 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.



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) |
| 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.



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.



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 |
| 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.

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

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.

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

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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.

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

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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.

(DOLLARS IN THOUSANDS)

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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.

| | |
|---|---|
| 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 live. 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.

(DOLLARS IN THOUSANDS)





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 |

(DOLLARS IN THOUSANDS)

========

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.





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) |

(DOLLARS IN THOUSANDS)

| | |
|---|---|
| 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 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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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

(DOLLARS IN THOUSANDS)

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





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.

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, 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.

(DOLLARS IN THOUSANDS)

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.





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 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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12. COMMITMENTS AND CONTINGENCIES

LAWSUITS

(DOLLARS IN THOUSANDS)

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.

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.





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 |



DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2003
(Unaudited)







DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
DECEMBER 31, 2003
(DOLLARS IN THOUSANDS)
(Unaudited)

| | |
|---|---|
| **ASSETS** | |
| Current assets: | |
| Cash and cash equivalents | $ 9,062 |
| Commission receivables | 1,217 |
| Escrow deposits | 312 |
| Due from affiliate | 415 |
| Due from officer | 1,485 |
| Prepaid expenses and other current assets | 2,956 |
| Total current assets | 15,447 |
| Property and equipment, net | 11,310 |
| Goodwill | 34,319 |
| Trademarks | 21,663 |
| Other intangible assets, net | 3,821 |
| Deferred financing charges | 156 |
| Security deposits | 634 |
| Other assets | 58 |
| Total assets | $ 87,408 |
| **LIABILITIES AND MEMBERS' DEFICIENCY** | |
| Current liabilities: | |
| Current portion of notes payable and other obligations | $ 2,400 |
| Current portion of notes payable to related parties | 1,658 |
| Accounts payable and accrued expenses | 7,353 |
| Commissions payable | 2,525 |
| Escrow deposits payable | 312 |
| Other current liabilities | 500 |
| Total current liabilities | 14,748 |
| Notes payable and other obligations, less current portion | 2,250 |
| Notes payable to related parties, less current portion | 70,698 |
| Commitments and contingencies | -- |
| Members' deficiency | (288) |
| Total liabilities and members' deficiency | $ 87,408 |

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

DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS
FOR THE YEAR ENDED DECEMBER 31, 2003
(DOLLARS IN THOUSANDS)
(Unaudited)

| | |
|---|---|
| Revenues: | |
| Commission revenues | $ 157,958 |
| Property management fees | 19,807 |
| Other revenues | 2,088 |
| Total | 179,853 |
| Costs and expenses: | |
| Commissions and royalties | 100,461 |
| Sales administration | 15,099 |
| Administration | 28,480 |
| Rent | 8,677 |
| Advertising and promotions | 11,643 |
| Depreciation | 3,640 |
| Amortization of intangible assets | 5,037 |
| Other costs and expenses | 1,917 |
| Total | 174,954 |
| Operating income | 4,899 |
| Other: | |
| Other income | 67 |
| Interest income | 15 |
| Interest expense | (4,782) |
| Total | (4,700) |
| Net income | $ 199 |

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



DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' DEFICIENCY
FOR THE YEAR ENDED DECEMBER 31, 2003
(DOLLARS IN THOUSANDS)
(Unaudited)

| | |
|---|---|
| Balance, January 1, 2003 | $ (2,541) |
| Net income | 199 |
| Issuance of membership interests | 2,500 |
| Distributions | (446) |
| Balance, December 31, 2003 | $ (288) |

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



DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2003
(DOLLARS IN THOUSANDS)
(Unaudited)

| | |
|---|---|
| Cash flows from operating activities | |
| Net income | $ 199 |
| Adjustments to reconcile net income to net cash provided by operating activities: | |
| Depreciation | 3,640 |
| Amortization | 5,037 |
| Interest paid-in-kind | 308 |
| Changes in operating assets and liabilities, net of acquisitions | |
| Accounts receivable | 655 |
| Prepaid expenses and other assets | (3,686) |
| Accounts payable and accrued expenses | (1,420) |
| Commissions payable | 1,555 |
| Escrow deposits payable and other liabilities | 711 |
| Cash provided by operating activities | 6,999 |
| Cash flows used in investing activities | |
| Capital expenditures | (2,321) |
| Cash acquired in acquisition | 650 |
| Investment in affiliate | (325) |
| Cash used in investing activities | (1,996) |
| Cash flows used in financing activities | |
| Proceeds from notes payable to related parties | 3,322 |
| Repayments of notes payable to related parties | (2,127) |
| Proceeds from notes payable and other obligations | 657 |
| Repayments of notes payable and other obligations | (2,344) |
| Deferred financing charges | (475) |

| | |
|---|---|
| Distributions to members | (446) |
| Cash used in financing activities | (1,413) |
| Net increase in cash and cash equivalents | 3,590 |
| Cash and cash equivalents, beginning of year | 5,472 |
| Cash and cash equivalents, end of year | $ 9,062 |
| Interest paid | $ 4,237 |
| Income taxes paid | 4 |
| Non cash investing and financing activities: | |
| See Note 3 for the acquisition of Douglas Elliman and RMG. | |
| Fixed assets acquired through incurrence of debt | $ 95 |
| The Company recorded an increase of $2,500 to members' equity in connection with the issuance of the subordinated debt. See Note 8 | |

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)
(Unaudited)

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 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 ("RMG").

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 RMG and, on May 19, 2003, Montauk Battery Realty, LLC changed its name to Douglas Elliman Realty, LLC. See Note 3.

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.

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 other intangible assets, primarily trademarks, deemed to have an indefinite useful life. The Company assesses goodwill and certain intangible assets deemed to have an indefinite useful life 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 on a straight line basis over the contractual term, generally three years or less. Amortization of management contracts is being provided on a straight line basis 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 RMG 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 or state income taxes is included in the financial statements.

NEW ACCOUNTING PRONOUNCEMENTS. In December 2003, Financial Accounting Standards Board Interpretation ("FIN") No. 46(R), "Consolidation of Variable Interest Entities (revised December 2003)" was issued. The interpretation revises FIN No. 46, "Consolidation of Variable Interest Entities" to exempt certain entities from the requirements of FIN No. 46. The interpretation requires a company to consolidate a variable interest entity ("VIE"), as defined, when the company will absorb a majority of the VIE's expected losses, receive a majority of the VIE's expected residual returns, or both. FIN No. 46(R) also requires consolidation of existing, non-controlled affiliates if the VIE is unable to finance its operations without investor support, or where the other investors do not have exposure to the significant risks and rewards of ownership. The interpretation applies immediately to a VIE created or acquired after January 31, 2003. For a VIE acquired before February 1, 2003, FIN No. 46(R) applies in the first interim period ending after March 15, 2004. The Company has not completed its assessment of the impact of this interpretation, but does not anticipate a material impact on its consolidated financial statements.

In April 2003, SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" was issued. SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133.





SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The adoption of this statement did not have an impact on the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for how companies classify and measure certain financial instruments with characteristics of both liabilities and equity. It requires companies to classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). SFAS No. 150 is effective immediately for financial instruments entered into or modified after May 15, 2003 and in the first interim period after June 15, 2003 for all other financial instruments. The adoption of this statement did not have an impact on the Company's consolidated financial statements.

3. ACQUISITION OF DOUGLAS ELLIMAN AND RMG

On March 14, 2003, the Company acquired from Insignia Financial Group, Inc. ("Insignia") the operations of Douglas Elliman and RMG 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 nine New York City offices with more than 900 real estate brokers. RMG is a leading manager of rental, co-op and condominium housing in the New York metropolitan area. RMG 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 RMG 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
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (continued)
(DOLLARS IN THOUSANDS)
(Unaudited)

The following table summarizes the final purchase price allocation of Douglas Elliman's and RMG's assets acquired and liabilities assumed at the date of acquisition.

| | |
|---|---|
| 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 live. Douglas Elliman amortized the entire amount of the acquired customer-based intangible assets of $4,057 in the year ended December 31, 2003. RMG is amortizing management contracts using the straight line method over 15 years. This represents the expected period of benefit from such assets and will result in future annual amortization expense of $181. For U.S. income tax purposes, the Company and Insignia elected to treat the acquisition of Douglas Elliman, RMG 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. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2003 consist of the following:

| | |
|---|---|
| Furniture, fixtures and office equipment................ | $ 9,773 |
| Internally developed software........................... | 4,362 |
| Leasehold improvements.................................. | 4,394 |
| Automobiles............................................. | 49 |
| Total............................................... | 18,578 |
| Less: Accumulated depreciation and amortization......... | (7,268) |
| Total............................................... | $ 11,310 |

The estimated useful life of the property and equipment, excluding leasehold improvements, at December 31, 2003 ranges from one to seven years. Leasehold improvements are depreciated based on the lesser of the

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DOUGLAS ELLIMAN REALTY, LLC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (continued)
(DOLLARS IN THOUSANDS)
(Unaudited)

remaining life of the lease or the useful life of the leasehold improvement. Depreciation expense for the year ended December 31, 2003 was $3,640.

5. INTANGIBLE ASSETS

Intangible assets at December 31, 2003 consist of the following:

| | |
|---|---|
| Goodwill | $ 34,329 |
| Trademarks | 21,663 |
| Deferred financing charges | 505 |
| Other intangible assets | 4,084 |
| Total | 60,581 |
| Less: Accumulated amortization | (622) |
| Total | $ 59,959 |

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, 2003 was $5,037, which includes $4,057 of amortization of customer-based intangible assets acquired and fully amortized during the year.

The changes in the carrying amount of goodwill for the year ended December 31, 2003 were as follows:

| | Real Estate Brokerage | Property Management |
|---|---|---|
| Balance as of December 31, 2002 | $ 387 | $ -- |
| Acquisition of Douglas Elliman (Note 3) | 33,614 | -- |
| Acquisition of RMG (Note 3) | -- | 3 |
| Other acquisitions | 325 | -- |
| Balance as of December 31, 2003 | $ 34,326 | $ 3 |

6. DUE FROM RELATED PARTIES

As of December 31, 2003, the Company had a receivable of $415 due from Burr Enterprises, Ltd., doing business as Preferred Empire Mortgage Company ("Preferred Empire Mortgage"), for advances made during 2002, and for allocation of expenses in 2003. The balances are payable on demand and bear interest at the prime rate (4.00% at December 31, 2003) plus 1.5% per annum compounded monthly.

In December 2002, the Company advanced $300 to an officer in connection with the purchase by the Company of the officer's stock ownership interest in Preferred Empire Mortgage. In January 2003, the Company lent $1,150 to the officer to finance the officer's purchase of additional stock in Preferred Empire Mortgage. The loan bears interest at prime plus 1.5%, and is due in January 2005. Upon receipt of the required regulatory approvals, the Company has agreed to purchase this officer's shares at a price of $1,150.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (continued)
(DOLLARS IN THOUSANDS)
(Unaudited)

7. NOTES PAYABLE AND OTHER OBLIGATIONS

Notes payable, capital leases and other obligations at December 31, 2003 consist of:

Payment obligation - former owner...........