View of the Market

Volume XVI/Issue 6/June 2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

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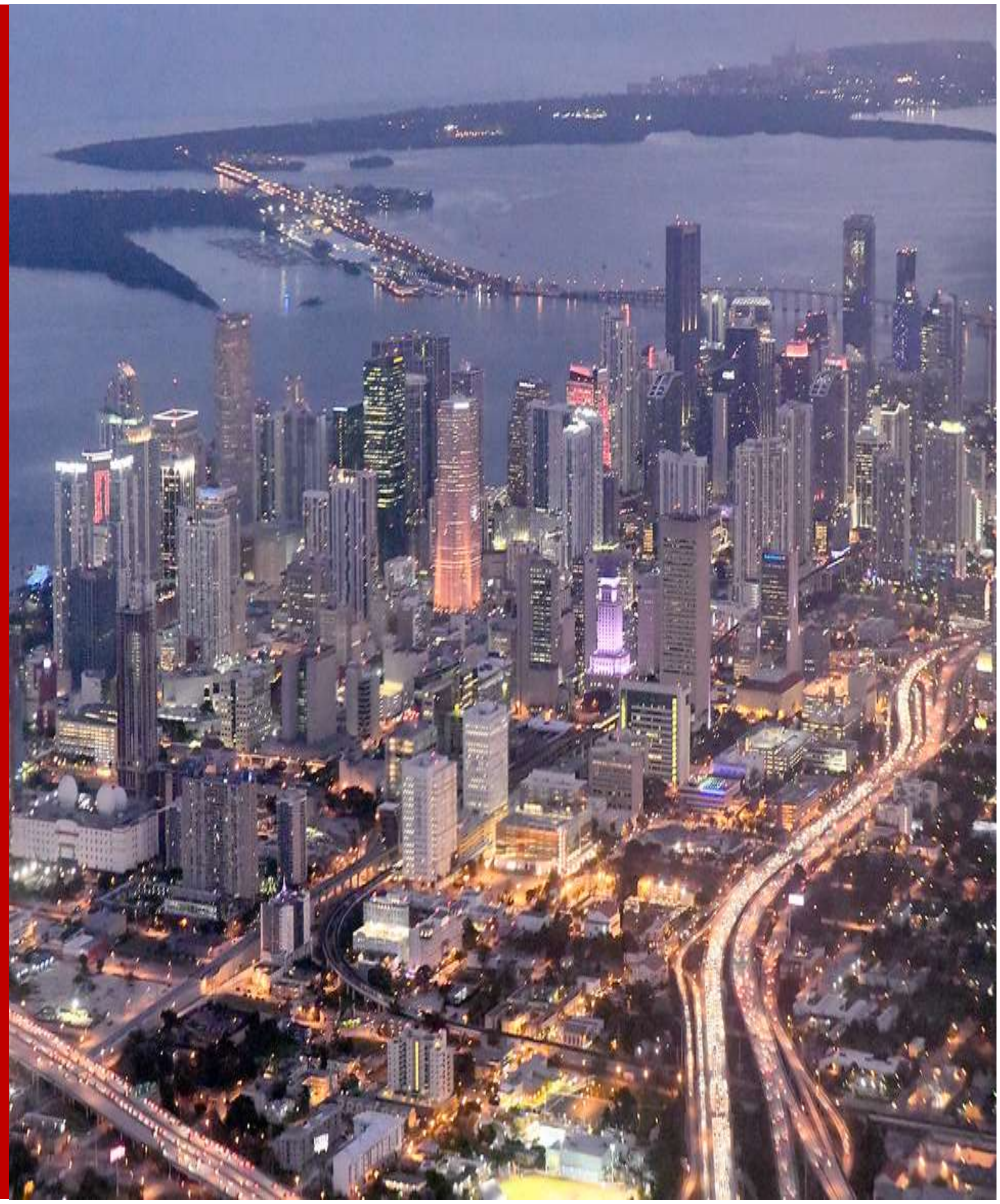

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REAL STATE FOCUS

The Good, the Bad and the Ugly of CRE

It has been a grueling and tumultuous twenty-six months for the CRE industry since the Fed began raising the Federal Funds rate in March of 2022. There has been a lot of pain, fallen incomes, job losses and little exuberance during this period and we here at VOM thought it would be instructive to examine the Good, the Bad and the Ugly of the CRE industry during this turbulent period.

The Good

- The CRE market has not crashed and thrown the economy into the Great Recession II as many pundits have predicted
- There has not been a wave of defaulted CRE loans that would take the commercial banking sector under as many have predicted
- The retail sector has done very well with little new construction and increased consumer demand
- The data center sector is booming with huge demand, tight supplies, and rents up 10%-20%
- The apartment and industrial sectors are doing fine even though rents in some of the “hot” markets are down 5%-10%
- New construction in all sectors except data centers, has slowed which will improve demand in late 2024 and 2025
- Total defaults and foreclosures of CRE have been less than 2% of total loans which is manageable and not a threat to the $17 trillion CRE industry
- Job growth has been stable which is the key demographic for the CRE industry
- Prices have fallen and cap rates expanded for many properties, which will increase deal activity in the next few years
- There is over $150 billion of private real estate capital ready to be deployed in the next few years

- New development of all property types except data centers has been curtailed which will be positive for future demand and rent increases
- The Sunbelt markets especially Arizona, Nevada, Texas, Florida, and Tennessee are seeing high demand for CRE and record in-migration of residents and businesses
- Distressed investing will lead to outsized returns for investors in the next few years
- The CRE software and data analytics sectors are still seeing solid demand for their products and services

The Bad

- Interest rates are still elevated with the Federal Funds rate at 5.25%, but it is expected that the Fed will begin lowering rates in the second half of 2024
- Office valuations in the high-crime urban cities have dropped like a "lead balloon" by 50% or more
- Transaction activity including sales, financings and leases has been down by 70% since the Fed began raising interest rates
- The cost of a collar (buy a cap and sell a floor) and interest rate swaps to reduce interest rate risk from floating rate debt has skyrocketed to 2%-5%+ of the loan amount
- Many small syndicators and leveraged CRE investors will go out of business due to the CRE "bear market"
- Most CRE deals today have "negative leverage," wherein the cap rate is less than the debt constant and the "cash-on-cash" return is less than the cap rate
- Institutional demand from pension funds and sovereign wealth funds for allocations to private CRE have dropped precipitously
- REIT returns, although up 11.36% in 2023 per the FTSE All Equity REITs Index are negative 1.3% through March of 2024
- The data center market is having difficulty finding new development sites with fiber connectivity and most important, access to power
- The excessive cost of debt and tight credit conditions have made CRE investment very challenging

The Ugly

- Interest rate increases by the Federal Reserve have caused considerable pain, loan defaults and foreclosures and steep value declines in CRE assets
- The office markets in the high-crime urban cities of New York, Washington D.C., Chicago, San Francisco, Los Angeles (downtown), Seattle, Oakland and Portland are still in chaos and won't recover until "law and order" is reestablished
- Out-migration in the high-crime urban cities of residents and businesses has been at record levels
- Transaction fees for the brokerage industry have dropped 70%, which will cause many participants to leave the industry
- Job demand in CRE has been at the lowest level since the Great Recession, especially for new graduates

A Review of the Industrial Market

The industrial market has been one of the best-performing sectors of the CRE market until the Federal Reserve began raising interest rates in March 2020. Before this date and since the end of the Great Recession in 2012 the industrial market boomed, with compressed cap rates, high single-digit rent increases in the "hot markets" and construction of more than 400 million square feet of new space each year. Beginning in 2015, cap rates for new industrial warehouses in the Inland Empire, Silicon Valley, Florida, and other high-growth markets compressed from about 5.0%-7.0%+ to 3.5%-5:5%+. Average rents for the same period in the growth markets increased approximately 7.0%-10.0%+ per annum. New construction for the same period averaged over 600 million square feet. However, since the Fed began raising rates, cap rates have expanded to 6.0%-8.0%+, and average national rents have decreased about 5.0% during this period. The industrial market includes distribution warehouses, manufacturing facilities and last-mile warehouses. Last-mile warehouses are typically multi-story properties converted from older manufacturing facilities that are close to urban areas to enhance next day delivery programs. Key statistics and data on the industrial market are discussed below.

I. Key Statistics

General statistics for the industrial market as of Q1 2024 per broker, Cushman & Wakefield are as follows:

- Vacancy rate – 5.8%
- Net absorption – 13.8 million square feet
- Average monthly net rent - $9.73 (up .5% YoY)
- Construction starts – 404.7 million square feet

II. Pros and Cons of Industrial Investment

The industrial market is a favorite for various investor groups and the pros and cons of industrial investment include the following:

- Pros
  - Easy to understand, analyze and underwrite
  - Easy to finance
  - Favorable financing rates and terms
  - Solid demand for space
  - Investment type diversity including Class A, B & C warehouses
  - Range of values and cap rates available
  - Typically, single tenant with triple net leases
  - Fairly easy to develop as most warehouse buildings today are built with tilt-up concrete panels, structural steel, steel truss roofs and 36’-40’ clear heights
  - Not management intensive with single tenant net leases
  - Low tenant turnover

- Cons
  - Older properties with lower ceiling heights (below 24 feet) typically sell at higher cap rates and many need upgrades and renovation
  - Downtime upon lease turnover can be years
  - Cap rates are determined by the credit of the tenant and the lease term. The higher the credit and longer the lease, the lower the cap rate. The lower the credit rating and shorter the lease term, the higher the cap rate

III. Industrial Rental Rates and Rent Growth

Since the end of the Great Recession, industrial rental rates nationally have risen at low single-digit rates. However, in the high-growth Sunbelt and large urban markets rental rates have realized 5.0%-10%+ annual rental rate increases from 2018 to 2022. The chart below shows the average rent and rent change for ten key markets per the Cushman & Wakefield report for Q1 2024.

City	Rent PSF	YoY Rent Change
San Francisco, CA	$22.93	-6.9%
New York, NY	$28.56	9.3%
Los Angeles, CA	$18.60	-9.3%
Inland Empire	$15.64	-16.5%
Austin, TX	$11.86	-15.2%
Miami	$16.93	7.3%
Las Vegas	$11.60	-6.4%
Phoenix	$10.95	-23.9%
Dallas	$7.60	1.2%
Nashville	$7.59	-1.3%

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The chart below per Cushman & Wakefield shows slowing rent growth and higher vacancies due to the large number of new square feet being built in most major markets around the country.

IV. New Industrial Construction

The chart below shows new industrial construction per the Cushman & Wakefield report. This period of construction was the largest ever for the industrial sector.

Period	Construction Completions (millions of square feet)
Q1-24	115
2023	609
2022	518
2021	365
2020	363
2019	317

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V. Industrial Returns

The yearly returns, including price change and dividends for the industrial sector for both NAREIT and NCREIF are shown in the two charts below. The NCREIF returns are not leveraged and since industrial properties are leveraged at 65%-70+% of value, the levered returns for industrial would be more than twice the returns shown.

NAREIT	3/24	2023	2022	2021	2020
Annual Returns	-2.51%	19.51%	-28.58%	62.03%	12.17%

Data per NAREIT

NCREIF	Q3-23	3 Years	5 Years	10 Years	20 Years
Period Returns	-0.4%	20.4%	17.0%	15.2%	11.5%

Data per NCREIF

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How to Create Value in Today's Tumultuous CRE Market

The CRE market has been in distress for the last twenty-six months with high interest rates, transaction volume down 70%, valuations down on average about 25%, and high levels of loan defaults and foreclosures. Of the five key CRE property types, retail is doing very well with high demand and very low new construction, data centers are booming with high demand and low supply, apartments are also doing fine, especially in the Sunbelt and Midwest markets, the industrial market is stable, although rents in the "hot markets" have declined 5%-10% from "nose bleed" levels and the office market is in major distress primarily in the high crime urban markets with high vacancies and increased loan defaults and foreclosures.

As a CRE owner and investor today, what strategies can be implemented to increase the net operating income, cash flow and value of the existing portfolio? Each of the five property types, office buildings, shopping centers, industrial properties, apartment complexes and data centers have distinct income, cash flow and physical characteristics that drive their valuation. These properties primarily derive their revenue stream from the tenant leases which are varied and encumber the property, but all have similar operating expenses. To create value in this tough environment, the owner/manager must adopt various policies and strategies such as providing best-in-class management programs, implementing revenue-enhancing capital improvements, altering the ownership and management structure, and/or increasing financial restructuring to realize incremental net operating income and increased value. These value-added strategies to create value for CRE assets are discussed below.

1. Management and Leasing

It is critical to have the best-in-class management and leasing personnel and policies when managing and operating a CRE asset. There is a wide disparity in the industry regarding the quality of leasing and managing agents and hiring the right firm or personnel is critical to creating long-term value. This is especially true with apartments which are the most management-intensive of the five primary property types. The difference in the net operating income of an apartment property between a great and poor manager can be 10% or more, which will substantially affect the property's cash flow and value. Owners need to review their entire ownership and management operation with a focus on the following:

- Operating expenses and tenant billings to see if expenses can be reduced and billings are proper
- Consider centralizing operations and management to achieve lower costs and efficiencies
- Lower utility costs and consumption through energy-efficient investments and third-party energy savings programs
- Use new software and data analytics to lower costs and increase return on investment
- Use more flexible lease structures to keep tenants in place
- Consider cost-segregation studies to increase depreciation deductions and increase cash flow

In most office markets around the country, the landlord is a "price taker," that is the tenant has all the power and can dictate the rental price and lease terms. In the data center market, the tenant is the "price taker" and will accept the lease terms from the landlord. In the retail, apartment and industrial markets, the bargaining position between tenant and landlord is fairly equal, and neither party can dictate the rental terms. These landlord/tenant relationships may help or enhance new management or leasing strategies.

2. Capital Improvements and Repositioning

CRE investors need to consider investing additional funds to improve the physical property above and beyond normal and recurring repairs and maintenance. This is another key strategy to increase and at least maintain the value of a CRE property. Many of these strategies can provide a return on investment of 10% to 20% or more. Renovation of an office building lobby, new appliances for an apartment project and repurposing of an office building to residential apartments or a life science building are all capital improvement and repositioning strategies that can greatly increase value. This is also a suitable time for property owners to add additional revenue-enhancing capital programs to their properties, including parking, storage, signage, and Wi-Fi service and adopt new CRE software and data analytics with AI capabilities to increase productivity, efficiency and further lower operating costs.

3. Owners and Advisors

This relates to a change in the property ownership or advisor relationship. Some firms are simply better owners/asset managers and advisors than others. The owner and advisor of CRE assets must make critical and strategic decisions on how the asset is managed, who will be responsible for the operations, the capital allocation between debt and equity and leasing and capital improvement policies. Many institutional real estate fund owners do not establish the proper operating, investment, and capital strategies and therefore, realize lower returns than their counterparts who are better owners and managers. Many large real estate private equity firms are more concerned with raising capital than operating the properties. Numerous private equity firms are not in the CRE investment business but are large marketing machines that excel at raising billions in capital, but poor at operating, leasing, and managing the real estate assets.

4. Financial Restructuring

This involves altering the structure of the property capital stack including the amount, percentage, and cost of the first mortgage, mezzanine debt, subordinated debt, preferred equity, owner equity and securitization opportunities. Aggressive financial restructuring is required in today’s market, because of the elevated levels of defaults and foreclosures and value destruction. Owners should consider obtaining a PACE (property accessed clean energy) loan to pay down a portion of the existing debt and fund energy and other building improvements, which are paid back through a special real estate tax assessment on the property. Owners should also consider participating loan structures and preferred equity positions to enhance the capital stack. If a property owner needs to repay a portion of the first mortgage on the property to halt a potential default or foreclosure, where do the funds come from? In this tight credit market and with the high cost of equity, the general partner of the property owner should be able to borrow funds from its own bank credit line and relend those funds to the partnership.

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The editor of this newsletter, Joseph Ori, is pleased to offer his three CRE books for sale, “The Fifty Commandments of Commercial Real Estate Investment” Edition I and II and “Commercial Real Estate Investment for Pros (and Dummies Too!).” All books are available on Amazon and other book outlets in Kindle, and soft and hardcover from $8.99 to $24.99.

Both editions of The Fifty Commandments of Commercial Real Estate Investment compile the choice pieces of advice Mr. Ori has amassed over 40 years in the CRE industry. Mr. Ori lists essential dos and don’ts, mistakes, and successful strategies with a mixture of critical analysis and a keen sense of satirical humor, reinforced by his encyclopedic knowledge of the commercial real estate environment. Mr. Ori covers all areas of the industry. Commercial real estate investment, finance, development, capital markets, and management tactics are all given his full attention, as are leasing, financial analysis, and institutional investments. He applies his commandments to all property types, including apartments, office buildings, shopping centers, industrial warehouses, lodging properties, and senior housing.

Commercial Real Estate Investment for Pros (and Dummies Too!) discusses the history, the various financial players, legal and financial structures, property types, modern portfolio theory and the financial metrics of commercial real estate investment and the commercial real estate industry. The book includes numerous charts and analyses of the industry and a step-by-step breakdown of the commercial real estate analysis and investment process. The book is perfect reading for the experienced real estate pro and also understandable to the real estate novice or someone new to the industry.

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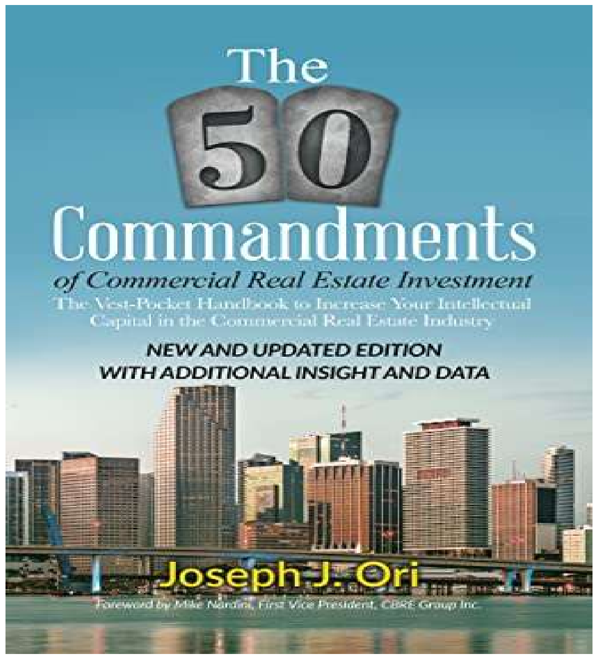

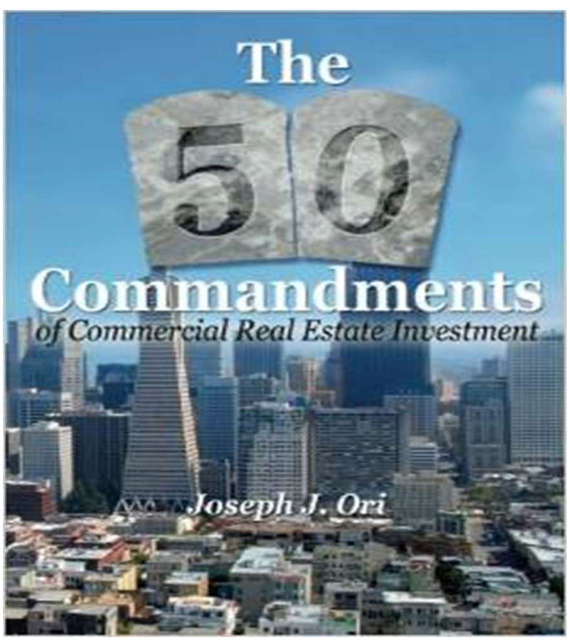

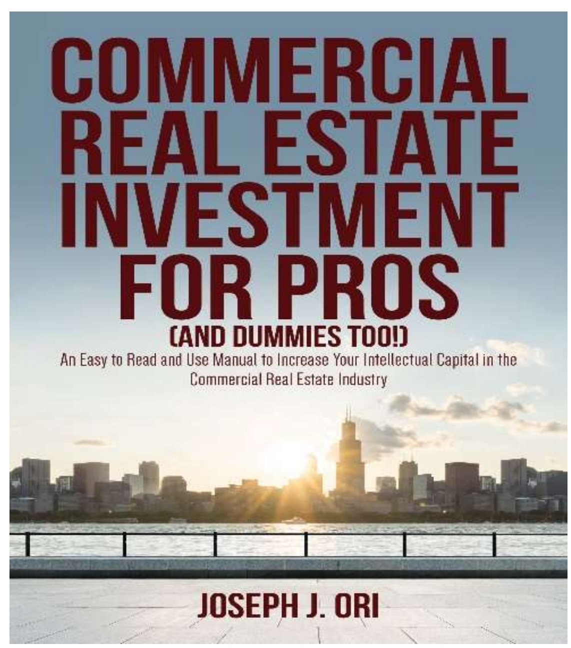

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CRE Financing Rates

Loan Type	Mortgage Rate	Maximum Amortization	Term (years)	Maximum LTV
Permanent Loans	5.87%-10.50%+	30	10	70%
Conduit-CMBS	5.88%-7.49%+	30	10	70%
Bridge Loans	6.50%-14.50%+	Interest Only	1-3	80%
Construction Loans	10.00%-15.00%+	Interest Only	1-4	70%
Insurance Co. Loans	5.38%-7.89%+	30	10	70%
Fannie Mae/Freddie Mac	4.98%-5.79%+	30	10	80%

Commercial Loan Index Rates	
Prime Rate	8.50%
30-Day SOFR (secured overnight funding rate)	5.33%
1 Year Swap	5.10%
10 Year Swap	4.28%
5 Year Treasury	4.42%
10 Year Treasury	4.41%
Federal Funds Rate	5.25%

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Short-term interest rates have remained stable with the 30-day SOFR rate at 5.33%, however, the ten-year treasury rate has declined to 4.41%. The Federal Reserve met on June 11th to 12th and as expected they kept the funds rate the same. We still believe that the Fed will begin to lower rates in the second half of 2024, which will create a mini-boom in CRE. The above financing rates and data are courtesy of Paramount Capital Corporation and feel free to contact Joseph Ori, Founder and CEO, Paramount Capital Corporation, jjo@paramountcapitalcorp.com, for your real estate capital needs.

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CRE Deal Focus

CRE Deals of the Month

Purchaser/ Sponsor	Seller	Property/ Deal	Price	Description
Hendersen Park	Blackstone Real Estate	The Arizona Biltmore, Scottsdale, AZ	$705M	A 705-room luxury hotel that opened in 1929.
Nvidia	Preylock Holdings	2688 San Tomas Expressway, Santa Clara, CA	$374M	Nvidia purchased its headquarters complex.
Terreno Realty REIT	Not Available	Portfolio of Industrial Assets	$365M	A portfolio of industrial assets with 28 buildings and 1.2 million square feet.
TZ Capital	Thor Equities	680 Madison Ave., New York, NY	$180M	A 34,000 square foot retail property.

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Nome Capital Partners	UBS Realty Investors	Pleasanton Corporate Commons, Pleasanton, CA	$152M	A 600,000-square-foot office complex.
Stockbridge	Principal Asset Management	Industrial Portfolio, Inland Empire, CA	$142M	Two industrial properties with 540,478 square feet and fully leased.
Essex Property Trust	Greystar	Elan Mountain View, San Mateo, CA	$101M	A 164-unit apartment complex built in 2018.
Rexford Industrial Realty	American Realty Advisors	Industrial Property, Fullerton, CA	$94M	A 279,000-square-foot industrial building that is fully leased.
Publix	Apollo Global Management	Ramblewood Square, Coral Springs, FL	$58M	A 157,914 square foot shopping center.

Black Lion	Clarion Partners	Lincoln Office/Retail Building, Miami Beach, FL	$62M	A 118,658-square foot office/retail building.

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CORPORATE FINANCE FOCUS

The Daily Drucker

One of the most popular corporate thinkers and management consultants in the last hundred years is Peter Drucker. He passed away in 2005 at 92 years old, but during his illustrious career, published over thirty-five books, and his corporate and management ideas have had a profound impact on shaping the modern corporation and management science. For the next twenty-four issues of VOM, we will highlight some of his insights and motivations in corporate management, personnel, and the knowledge worker from one of his last books, The Daily Drucker.

I. New Knowledge

The theory and practice of innovation and entrepreneurship, the bright-idea innovation belongs in the appendix. New knowledge is not the most reliable of most predictable sources of successful innovations. Knowledge-based innovation has the longest lead time of any innovation. The introduction of innovation creates excitement and attracts a host of competitors, meaning the innovators have to be right the first time. Are you and your organization inventors or imitators? If the former, remember to predict the competition that your successful invention might inspire and plan on responding to competition.

II. Optimal Market Standing

A major decision underlying marketing objectives is market standing. One common approach is to say, "We want to be the leader." The other one is to say, "We don't care what share of the market we have as long as sales go up." Both sound plausible, but both are wrong. It does not do much good for a company's sales to go up if it loses market share, that is, if the market expands much faster than the company's sales do. The market standing to aim at is not the maximum but the optimum. This requires careful analysis of customers, of products or services, of market segments and of distribution channels. It requires a market strategy, and it requires a decision of high risk.

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III. Worship of High-Profit Margins

High profit margin holds and umbrella over the competitor. Most businesspeople are aware that profit is not the same as profit margin. Why is the worship of high-profit margin likely to damage, if not destroy, the business? It not only holds an umbrella over the competitor, but it also makes competing practically risk-free and virtually guarantees that the competitor will take over the market.

IV. Four Lessons in Marketing

Of the top marketing lessons for the highly competitive twenty-first century, the most crucial one is that buying customers doesn't work. How to define the market is the second lesson, the lesson of what was both a marketing success and a marketing fiasco, the conquest of the American market by the fax machine. The next lesson is that marketing starts with all customers in the market rather than with our customers. The final lesson is that of the success of the new "pastoral" churches by exploiting demographic changes as a marketing opportunity.

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How to Value REITs

Understanding REIT valuation is a very important function for any CRE Investor. There are three financial methods or models used to value REITs. These are the funds from operations (FFO) multiple approach, the dividend discount model approach, and the net asset value (NAV) capitalization rate approach. Each model will generate different valuations, however, they should all be fairly close in value. Since we here at VOM are highly experienced in commercial real estate, we use the cap rate approach and believe this is the most accurate valuation technique.

The FFO Multiple Approach

FFO is defined as funds from operations and is calculated as the net income of a REIT, adding back depreciation and amortization and plus or minus gains and losses on property sales. This valuation metric is primarily used by Wall Street analysts and sell-side investors to value REITs. The market capitalization of a REIT is divided by the FFO and the FFO multiple is the result. The entire equity REIT market today trades at an FFO multiple of approximately 13 times. The FFO multiple approach determines the value of a REIT by applying the FFO multiple of comparable REITs to a specific REIT. For example, if the average FFO multiple for apartment REITs is 13 times, then ABC Apartment REIT should be valued at 13x its FFO.

The FFO can be adjusted up or down for the quality of ABC's real estate portfolio, its growth trajectory, dividend, and management. The FFO multiple is called relative value analysis and is somewhat flawed because the other REITs in the sample trading at 13x, may be overvalued and therefore if the same valuation is applied to ABC REIT, it will be overvalued. This is no different than saying tech company A is trading at 25 times earnings per share, but peers are at 30 times, therefore, company A is undervalued, and the stock should be bought. The FFO multiple has been volatile over time and by the real estate sector. For example, the FFO of the beleaguered office sector is currently 7.83 times while the strong industrial sector is a solid 17.75 times.

Dividend (Gordon) Discount (DDM) Model Approach

The second approach to REIT valuation uses the dividend discount model. Since REITs pay a constant quarterly dividend, the DDM can be used to value a REIT. This model assumes that the value of a stock is equal to the present value of its future dividends according to the following formula:

Value = Dividend (next year)/R – G

R = expected return on the stock per the CAPM (capital asset pricing model)

The CAPM is a model that calculates the expected return on a stock and the formula is as follows:

CAPM = R = Rrf + B(Rm-Rrf)

Rrf = risk free rate and the 10-Year Treasury note is typically used

Rm = expected market return and the expected return on the S&P 500 Index is typically used

B = Beta or the volatility of the stock as compared to the market

G = growth rate of the dividend

NAV/Capitalization Rate Approach

The third approach to REIT stock valuation is the venerable NAV and capitalization rate. The NAV and capitalization rate approach applies an average cap rate to a REITs proforma net operating income (NOI). See a complete valuation analysis as shown in the REIT Review section of this newsletter on Eastgroup Properties, Inc. The cap rate is typically derived from comparable properties purchased in the market, cap rate surveys or the cap rate formula, which is the risk-free rate (typically the 10-Year Treasury Rate) plus a risk premium and less the growth rate in the property's income. However, just because a property trades at a 4% or 5% cap rate doesn't mean that is the appropriate cap rate to use in valuation. Since March 2022 when the Federal Reserve began raising interest rates, cap rates have expanded to much higher levels with an average of 6%-8%, depending on the property type and location.

Valuation Example

A valuation example for ABC Apartment REIT will show its valuation under the above three approaches. ABC REIT expects in the next year a net income of $8/share, including a deduction of $2/share for depreciation. ABC has no gains or losses from real estate sales. It owns apartments and you believe that apartments are currently selling at an average cap rate of 8%. ABC has 1,000,000 shares outstanding; its balance sheet shows mortgage liabilities of $40,000,000 and has a proforma NOI of $12,000,000. Comparable apartment REITs are valued at an FFO of 10 times. ABC expects to pay a dividend during the next year of $6/share and to increase the dividend at 5.5% per year into the future. Investors in REITs like ABC expect a total return of 12%. What is the value of ABC using the three methods above?

FFO multiple approach:
FFO = $8/sh. (net income) + $2/sh. (depreciation) = $10 per share

FFO x FFO Multiple = $10/sh. x 10 times = ***$100 per share***

Dividend discount model approach:
$6 (dividend) / (12% (expected return) - 5.5% (dividend growth rate) = ***$92 per share***

Cap rate approach:
$12,000,000 (NOI) / 8% (cap rate) = $150,000,000 = value of the REITs assets
$150,000,000 - $40,000,000 (debt) = $110,000,000 = net asset value of the REIT
$110,000,000 of NAV / 1,000,000 (shares outstanding) = ***$110 net asset value per share***

As shown above, the three values per share of ABC are $100, $92, and $110, or an average value of $100 per share. Which one of the valuation methods is best or preferred? It depends on the valuer; however, we believe that the capitalization rate is the most accurate. This is because it's based on the actual revenues and expenses of the REIT and cap rates which are fairly easy to calculate over time.

The advantages and disadvantages of each valuation method are as follows:

FFO multiple approach:

Advantages:
- Easy to calculate and use

Disadvantages:
- The multiple can volatile over time and by the real estate sector
- The amount of leverage affects the valuation
- Its faulty relative value analysis

Dividend discount model approach:

Advantages:
- Easy to calculate and use

Disadvantages:
- The calculation of "R" or expected return can vary substantially
- The amount/growth of the dividend may affect the valuation

NAV/Cap rate approach:

Advantages:
- Most accurate
- Based on actual net operating income before debt

Disadvantages:
- Must have significant CRE experience to apply correctly
- Calculation of the net operating income and cap rate may vary

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REIT Statistics

Current REIT statistics for 3/31/24 per NAREIT are included in the table below. Please note that the all-equity REIT return over 20 years includes three CRE downturns, the Great Recession, the retail and store closure meltdown and the current higher interest rate regime.

Period	*All REITs*	*All Equity REITs*	*S&P 500*	*NASDAQ Composite*
3/2024	-1.28%	-1.30%	**10.56%**	9.31%
1-Year	8.44%	8.02%	29.88%	**35.08%**
5-Year	3.56%	3.96%	15.05%	**17.19%**

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10-Year	6.67%	6.93%	12.96%	**15.73%**
20-Year	7.02%	7.60%	10.15%	**11.10%**
Market Capitalization	$1.34T	$1.28T	$43.7T	$19.0T
Dividend Yield	4.39%	4.06%	1.30%	1.46%

REIT Review

Summary

This REIT valuation is for Eastgroup Properties, Inc., ("EGP"), a publicly-traded REIT that is engaged in the development, acquisition, and operation of industrial properties in major Sunbelt markets in the U.S. EGPs properties are primarily located in Florida, Texas, Arizona, California, and North Carolina. EGP owns 51.668 million square feet of industrial space that is 97.5% leased. The three largest tenants are; Amazon (1.8% of annualized base rent), REPET, Inc. (.8% of annualized base rent) and Starship Logistics, LLC (.8% of annualized base rent). The same store net operating income growth for Q1-24 YoY was 11.7%.

Property Developments

As of Q1-24, EGP was developing thirteen properties with 3 million square feet at a total cost of $433.4 million with $245 million incurred through the first quarter.

Corporate Data

EGP is traded on the NYSE, is incorporated in Maryland, and is located in Ridgeland. MS. EGP has 48 million common shares outstanding and a market capitalization of approximately $7,993 billion. EGP is rated Baa2 by Moody's Investors Services.

Management

Marshall A. Loeb, 61, President and CEO

Marshall A. Loeb rejoined the Company as President and Chief Operating Officer in March 2015 and was named Chief Executive Officer and a director in January 2016. He served as President and Chief Operating Officer of Glimcher Realty Trust, a former retail REIT, from 2005 to 2015, when it was acquired by Washington Prime Group Inc. From 2000 to 2005, he served as Chief Financial Officer of Parkway Properties, Inc., a former office REIT. Mr. Loeb was previously employed by the Company from 1991 to 2000, beginning as an asset manager and rising to senior vice president after having a variety of responsibilities with the Company. Mr. Loeb has over 30 years of experience with publicly held REITs and brings real estate industry, finance, operations, development, and executive leadership expertise to the Board. He serves on the Board of Directors and Audit Committee of Lamar Advertising Company, one of the largest outdoor advertising companies in the world specializing in billboard, interstate logo, transit, and airport advertising formats. He serves as a member of the NAREIT 2024 Advisory Board of Governors, the advisory body to the NAREIT executive board, and as chairman of NAREIT's Audit and Investment Committee. He received a BS in Accounting and a Master of Tax Accounting degree from the University of Alabama, then earned an MBA from the Harvard Graduate School of Business.

Ownership

Top Institutional Holders	Shares (000's)	%
The Vanguard Group, Inc.	6,860	14.26
Blackrock Inc.	5,480	11.39
State Street Corporation	2,390	4.96
T. Rowe Price Investment Management, Inc.	1,850	3.84
Morgan Stanley	1,590	3.31

Ownership Breakdown	
% Of Shares Held by All Insiders and 5% Owners	1.0
% Of Shares Held by Institutional & Mutual Fund Owners	93.52
Number of Institutions Holding Shares	602

All amounts above per Yahoo Finance

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Financial Analysis and Valuation

Select financial data for EGP per the 2024 Q1 10Q and supplemental information.

(In millions where applicable)

Financial Data	Amounts
Real Estate Assets, Gross	$5,598
Total Assets	$4,577
Property Debt (at weighted average interest rates of approximately 3.37%)	$1,675
Stockholders' Equity	$2,659
Revenue	$154
Net Income (Loss)	$58
Cash Flow from Operations	$116
Unsecured Credit Facility ($675M with $0M used)	$675
Market Capitalization	$7,993
Property Debt to:	
Gross Real Estate Assets	30%
Market Capitalization	21%
Enterprise Value	17%
Dividend and Yield ($5.08/sh.)	3.06%
Shares Sold Short (in millions per Yahoo Finance)	.894

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Valuation Methodology	
Q1-24 Real Estate Revenue	$154
Q1-24 Real Estate Operating Expenses (excluding depreciation, amortization, interest expense, impairment charges plus G&A expenses)	$49
Q1-24 Net Operating Income	$105
Proforma Annualized Net Operating Income at 103%	$433
Projected Average Cap Rate	6.0%
Projected Value of Real Estate Assets	$7,217
Add: Net Operating Working Capital (at book value)	$137
Development and Value-Add Properties (at book value)	$670
Unconsolidated Investment (at book value)	$7
Total Projected Value of the Assets of the Company	$8,031
Less: Total Debt per Above	($1,675)
Projected Net Asset Value of the Company	$6,356
Common Shares Outstanding, 40M	
Projected NAV Per Share	**$159**
Market Price Per Share on 6/15/24	**$166**
Premium (Discount) to NAV	**4%**

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Financial Metrics

The gross real estate assets, property debt, revenue, net income, funds from operations, return on invested capital, dividend coverage, and dividends per share for EGP for the years 2019 through Q1-24 are shown in the table below.

(Millions except dividend and per share amounts)	2019	2020	2021	2022	2023	Q1-24
Gross Real Estate Assets	$2,844	$3,159	$3,546	$4,395	$4,853	$5,598
Property Debt	$1,182	$1,309	$1,271	$1,861	$1,675	$1,675
Revenue	$331	$363	$409	$487	$570	$154
Net Income (Loss)	$117	$94	$157	$186	$200	$58
Funds from Operations (FFO)	$186	$211	$245	$298	$349	$94
Return on Invested Capital (1)	9.6%	8.9%	10.1%	9.3%	8.9%	NA
Dividend Coverage (2)	1.72	1.77	187	1.54	1.55	1.54
Dividends Paid Per Share	$2.94	$3.08	$3.58	$4.55	$5.02	$5.08

(1) This ratio is cash provided by operations plus interest expense divided by stockholder's equity plus property debt and measures the return the REIT is earning on its invested capital.

(2) This ratio is funds from operations divided by common and preferred stock dividends and distributions to noncontrolling interests.

(3) The dividend in 2024 is $1.27 per quarter.

The total return of EGP year to date and through five years are shown in the chart below per NAREIT:

EGP Total Return	3/2024	1-Yr	3-yr	5-Yr
	-1.36%	11.93%	10.83%	12.89%

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As shown above, our net asset value per share for EGP is $159/sh., compared to a market price of $166/sh. Current average cap rates for industrial properties per our industry experience and CBRE's Cap Rate Survey are in the 8.0% to 8.0% range, depending on the location, age and tenancy of the property. We have used an average cap rate of 6.0% due to EGPs diversified portfolio industrial of properties.

Strengths:

- A low debt-to-enterprise value of 17%.
- A high-quality portfolio of industrial properties.
- The dividend has increased 73% since 2019.

Concerns:

- REIT prices will decline if interest rates increase.
- A low dividend yield of 3.06%.
- The stock is trading at a 4% premium to our NAV.

Recommendation:

EGP is trading at a premium of 4% to our NAV per share and we are not recommending the purchase of the stock.

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A five-year price chart for EGP is shown below:

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REIT FOCUS REVIEWS IN PRIOR ISSEGPS OF VOM ARE AS FOLLOWS:

1. Hudson Pacific Properties, Inc., August 2022
2. Kilroy Realty Corporation, September 2022
3. Realty Income Corporation, October 2022
4. Federal Realty Trust, November 2022
5. Equity Residential, December 2022
6. STAG Industrial, January 2023
7. Brixmor Property Group, Inc., February 2023
8. Mid-America Apartment Communities, March 2023
9. Office Properties, Trust, April 2023
10. Spirit Realty Capital, Inc., May 2023
11. Cousins Properties, Inc., June 2023
12. Tanger Factory Outlet Centers, Inc., July 2023
13. Paramount Group, Inc., August 2023
14. Broadstone Net Lease, Inc., September 2023
15. Apartment Income REIT Corp., October 2023

16. Kite Realty Group Trust, November 2023
17. Alexandria Real Estate Equities, Inc., December 2023
18. Agree Realty Corporation, January 2024
19. WP Carey, February 2024
20. Essex Property Trust, March 2024
21. Brandywine Realty Trust, April 2024
22. Urban Edge Properties, May 2024

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