Strategy and Insight for the Commercial Real Estate Industry

VIEW OF THE MARKET

A PUBLICATION OF PARAMOUNT CAPITAL CORPORATION

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REAL ESTATE FOCUS

Seven CRE Investment Strategies for 2023

1. Sell Industrial Assets in Overpriced Markets

Industrial assets in some of the "hot" markets like the Inland Empire, Orange County, Miami, Phoenix, San Francisco and San Jose, during the last few years, have seen rents increase at least 50% and cap rates compress to 3.0%-4.0%. With supply chains back to normal and less demand for products due to raging inflation, rents may decline in these markets by 20% or more. Industrial assets in these markets should be sold and the proceeds reinvested in more stable and value priced industrial markets in the Midwest, Texas, Tennessee, and the Carolinas.

2. Sell Net Lease Properties

The net lease industry has been very robust during the last few years courtesy of the Fed's zero interest rate policy and abundance of capital. However, with the Federal Funds rate at 4.25% and increasing to 5.0% or more by the first quarter of 2023, net lease assets will decline in value substantially as cap rates increase. The net lease investment business is really a bond spread game, by buying long-term leases at cap rates of 6.0%-8.0% and financing these assets at mortgage rates of 5.0%-7.0%. These investments tend to have long durations of twelve to fifteen years, which may cause large price decreases when rates rise. As with corporate bonds, when rates rise, the value of the net lease assets falls.

3. Increase Allocation to Public REITs and Reduce Allocation to Private CRE

The 2022 total return for public equity REITs as shown by the FTSE NAREIT All Equity REITs Index has declined by 24.95%. Many REITs are trading at or below NAV value and less than comparable private CRE values and should be purchased. The table below is the Four Quadrant CRE Investment Matrix that should be used to create a CRE investment allocation for institutional investors. As stated above, allocations to private commercial real estate equity (see lower right quadrant in box) should be sold and the proceeds reinvested in public REIT stocks (upper right quadrant in box).

	Debt	Equity
Public	CMBS	REITs REOCs (real estate operating companies)
Private	First Mortgages Mezzanine Loans Subordinate Loans Bridge Loans Participating Loans	Direct Acquisitions Joint Ventures Commingled/Special Account Funds Private Equity Real Estate Funds Non-Traded REITs Closed-End Funds

4. Sell CRE Assets in Overpriced Gateway Markets and Reinvest in Suburban and Sunbelt Markets

The majority of CRE investment and development activity pre-covid had been concentrated in the 24-hour Gateway cities that include New York, San Francisco, Chicago, Portland, Atlanta, Oakland, Seattle, and Los Angeles. Many properties in these markets are suffering with large vacancies, low utilization and discounted values due to high crime and homelessness policies in these markets. Investors should sell assets in these markets and reinvest in suburban areas surrounding these Gateway cities and the higher growth and lower tax Sunbelt markets.

5. Sell Overpriced Core Assets and Reinvest in Opportunistic Assets

Institutional investors typically focus on the risk and return characteristics of various CRE investment strategies. The lowest risk is core and core plus investments, which are typically fully leased, institutional quality, Class A properties with little or no leverage. The next riskiest investment strategy is value-added strategies which are higher risk and involve some property redevelopment, tenant adjustment or leasing or with operational problems. The riskiest sector are opportunistic strategies, that involve a high degree of redevelopment, leasing, tenant relocation or change or may be in financial distress. Many core properties are still trading at sub-5 % cap rates and should be old. The proceeds should be reinvested in higher-return opportunistic strategies.

6. Invest in Hotel Assets with Expected Higher Inflation

According to Smith Travel Research, the major lodging markets are forecast to achieve solid gains in RevPAR during 2023. These gains include 8.6% for the 65 largest markets and 9.3% for the 25 largest markets. Driving these returns are robust leisure travel, increasing business travel with a return to normal for the convention business and higher occupancy and average daily rate. Both occupancy and ADR are expected to increase 4.2% to produce the higher RevPAR. By year-end 2023, 53 of the 65 top markets in the STR forecast are expected to have reached, or surpassed, their 2019 RevPAR levels. Leisure-centric markets which are expected to see their 2019 RevPAR levels exceeded by 20% include Savannah, GA, Miami, FL, St. Petersburg, FL and Coachella Valley, CA.

7. Invest in CRE Proptech Businesses

One of the key growth areas of CRE is in data analytics. This business has low capital costs and high returns on equity by selling data to the CRE industry. Data analytics encompasses all aspects of big data for CRE including demographics, ownership data, property data, historical value information, sales/lease data and financial analysis. The data analytics space is very fragmented with a few large companies like CoStar, RealPage, REIS (a unit of Moody's) and Real Capital Analytics and many smaller local and start-up companies. These larger firms have been acquiring smaller competitors to expand their service offerings and customer base. As the industry grows, there will be more consolidation and an opportunity to acquire these smaller private firms and even establish a platform to consolidate these entities or sell them to larger firms. The large CRE software firms are also prime buyers for data analytics companies as they seek to diversify their software business and cross-sell the data analytics products.

The Role of the CRE Acquisition Group

Most of the medium-sized and larger CRE private equity and institutional investors have a dedicated and separate CRE acquisition or deal team within their firms. This team is usually comprised of former brokers and seasoned acquisition and industry investment veterans, whose primary mission is to generate CRE deals for their firms to acquire. They have solid and long-term relationships with brokers, investors, real estate funds, sellers and institutions and scour the U.S. and even international markets for CRE deals to buy. The acquisition program will be a function of the various investment strategies of the firm including core, core-plus, value-added, opportunistic, distressed and development.

CRE acquisition personnel are usually compensated with a base salary and incentive compensation based on the number or volume of properties acquired. The incentive compensation is primarily in the form of a commission on each deal, annual bonus or profit sharing based on the volume of acquisitions that are generated for the firm. Once a property is brought into the firm as a viable deal, it is given preliminary approval by senior management for purchase. At this time a letter of intent will be sent to the seller and broker. The property sourced by the acquisition team is usually analyzed and underwritten by them. The acquisition team will determine the cap rate based on a proforma net operating income and prepare a 5, 7 or 10- year proforma cash flow to equity with internal rates of return unlevered on the net operating income and the cash flow to equity. They will also verify the purchase price by calculating the net present value of the net operating income at an appropriate discount rate. If the price and acquisition terms are acceptable, the deal will then receive final approval or disapproval for purchase by senior management or the acquisition committee of the firm. Quality acquisition teams are vital to the success of CRE investment firms, however, there is a major conflict of interest regarding the typical internal acquisition process as discussed above.

Since the acquisition team brings in the deal and also does the preliminary property underwriting, they are incentivized to "pump up" the numbers to make the deal look better than it probably is and gets the acquisition approved for purchase. As stated above, the acquisition team is compensated based on the volume of deals done and they would like to get as many deals approved and closed as soon as possible. They are also not responsible for the future success of the property and do not get penalized if the operating performance is substantially less than the proforma. There is no "clawback" of the acquisition teams' compensation when a deal they sourced is promoted and purchased, but the deal underperforms and even loses some of the investor equity.

In most firms, there is no internal group to provide a "check and balance" on the financial analysis and deal underwriting of the acquisition team. In smaller firms, which typically manage their own properties, this function is provided by the CEO of the firm and its property managers. In a larger private equity or investment shop that manages its own properties, they may also use the property management group or the CFOs group to also underwrite the new acquisition as a check and balance on the acquisition team proforma. Once an independent financial underwriting is created, both groups, the acquisition team and property management/CFO departments, should meet to review each other's underwiring analysis and reconcile them to produce one approved underwriting proforma for senior management to review and approve.

If the CRE firm is a large private equity fund or an institution, it most likely will not have a separate property management function as that function is usually outsourced to unrelated third parties. However, they can still provide a check and balance on the acquisition team, by using the chief financial officer's group, to provide a competing proforma analysis. The CFOs group should be able to prepare the underwriting analysis to make sure that the deal metrics and proforma analysis as shown to senior management and the acquisition committee is accurate, realistic, and reliable.

The acquisition function of CRE firms is critical for their success, however, astute firms must have a proper check and balance on the internal deal analysis function. CRE investment firms that have a second internal team to prepare a competing proforma underwriting and deal analysis as a check and balance on the acquisitions department, will acquire better properties, increase the firm's financial analysis acumen and be more successful in its real estate investment efforts.

REIT Returns Update

Public REIT stocks had a very tough year in 2022 with the FTSE NAREIT Equity Index down by 24.37% as shown in the chart below. All the key sectors lost by double digits in 2022 due to higher interest rates courtesy of the Federal Reserve. The poor 2022 results were after a boom year in 2021, when there were historical gains in some of the hottest sectors like, industrial up 62.03%, self-storage up a whopping 79.43% and the beleaguered retail sector up 51.91%

Sector	2021	2022	Dividend Yield
FTSE NAREIT Equity REITS	43.24%	-24.37%	4.15%
Industrial	62.03%	-25.58%	2.98%
Retail	51.91%	-13.29%	4.99%
Apartments	63.61%	-31.95%	3.80%
Lodging/Resorts	18.22%	-15.31%	5.46%
Health Care	16.32%	-22.18%	5.46%
Self-Storage	79.43%	-26.73%	3.63%
Data Centers	25.47%	-27.97%	2.85%

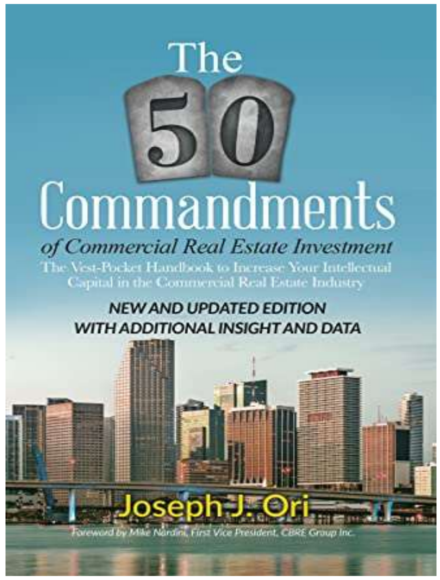
We here at VOM advise that all investors, whether you are an individual or institution, to allocate 15%-20% of their funds into a diversified equity REIT fund. This is especially true now, as REIT stocks are available at a deep discount.

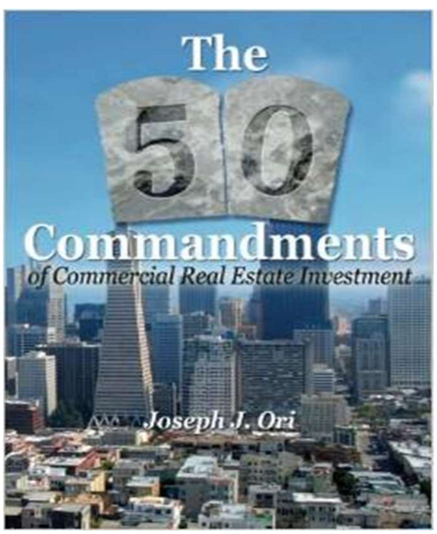
Get Your Copy of Three Great CRE Books by Our Editor, Joseph Ori

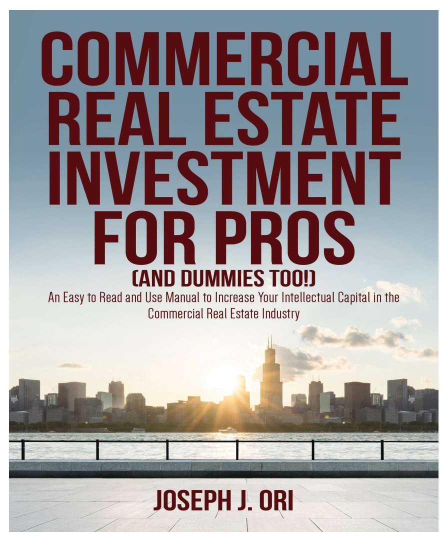
The editor of this newsletter, Joseph Ori, is pleased to offer his three CRE books for sale, "The Fifty Commandments of Commercial Real Estate Investment" Edition I and II and "Commercial Real Estate Investment for Pros (and Dummies Too!)." All books are available on Amazon and other book outlets in 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 35 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.







CRE Financing Rates

Loan Type	Mortgage Rate	Maximum Amortization	Term (years)	Maximum LTV
Permanent Loans	6.38%-9.00%+	30	10	75%
Conduit-CMBS	6.01%-7.20%+	30	10	75%
Bridge Loans	8.81%-17.81%+	Interest Only	1-3	90%
Construction Loans	8.50%-13.50%+	Interest Only	1-4	75%
Insurance Co. Loans	5.88%-7.89%+	30	10	70%
Fannie Mae/Freddie Mac	5.30%-6.52%+	30	10	80%

Commercial Loan Index Rates	
Prime Rate	7.00%
30 Day LIBOR	4.40%
90 Day LIBOR	4.80%
30 Day SOFR (secured overnight funding rate)	4.22%
1 Year Swap	5.06%
10 Year Swap	3.50%
5 Year Treasury	3.99%
10 Year Treasury	3.88%
Federal Funds Rate	4.25%

Short-term interest rates have still remained elevated with the 30-day SOFR rate up to 4.22%. The 30-day LIBOR rate is also up to 4.40% from .51% in April 2022 and longer-term treasury rates have eased somewhat with the 10-Year treasury rate down to 3.88%. This is due to expectations that the Fed will not be as aggressive with future rate increases, even though they raised the Federal Funds rate by .50% on December 14th. The above financing rates and data are courtesy of Paramount Capital Corporation and feel free to contact Joseph Ori, Executive Managing Director, Paramount Capital Corporation, jjo@paramountcapitalcorp.com, for your real estate capital needs.

CRE Deal Focus

CRE Deals of the Month

Purchaser/ Sponsor	Seller	Property/ Deal	Price	Description
Realty Income	CIM Real Estate Finance	Retail and Industrial Portfolio	$894M	185 single-tenant retail and industrial properties.
Unibail-Rodamco-Westfield	Kroenke Organization	The Village, Los Angeles, CA	$325M	A 600,000 square foot shopping center.
MG Properties and Rockwood Capital	Magnolia Capital	Domain, San Diego, CA	$185M	A 379-unit apartment complex completed in 2012.

Workspace Property Trust	Griffin Realty Trust	Six Suburban Office Properties	$170M	A portfolio of six suburban assets with 1 million square feet.
Hines	Turnbridge Equities and Loan Wharf Capital	Newark Distribution Center, Newark, N.J.	$127M	A 738,000 square foot industrial portfolio.
LaSalle Investment Management	Clarion Partners	Valley Distribution Center, Renton, WA	$120M	A 473,000 square foot industrial building.
Empire Capital Holdings	Invesco	550 West 54th St., New York, NY	$100M	162 apartment units on the top 11 floors.

LP Capital Partners	WPT Capital Advisors	Rider Distribution Center, Perris, CA	$90M	A 354,810-square-foot industrial building completed in 2019.
Signature Acquisitions	Sovereign Partners LLC	Class A Office Building, Parsippany, NJ	$88M	A 400,000 square foot office building.
Limestone Asset Management and Orion Real Estate Group	MetLife Investment Management	Colonial Palms, Miami, FL	$70M	A 188,389 square foot retail center.

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 great 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. Reinvent Yourself

Knowledge people must take responsibility for their own development and placement. In today's society and organizations, people work increasingly with knowledge, rather than skill. Knowledge and skill differ in a fundamental characteristic, skills change very, very slowly. Knowledge, however, changes itself. A knowledge worker becomes obsolescent if he or she does not go back to school every three or four years.

II. Performance: The Test of Management

Achievement rather than knowledge remains both the proof and aim of management. The ultimate test of management is performance. The test of good management is whether it enables the successful performer to do her work. No greater damage could be done to our economy or to our society than to attempt to professionalize management by licensing managers, for instance, or by limiting access to management positions to people with a special academic degree.

III. The Management Revolution

What matters is the productivity of nonmanual workers. But knowledge is now also being applied systematically and purposefully to define what new knowledge is needed, whether it is feasible and what has to done to make knowledge effective. Supplying knowledge to find out how existing knowledge can best be applied to produce results is, in effect, what we mean by management.

IV. The Educated Person

The educated person needs to bring knowledge to bear on the present, not to mention molding the future. Postcapitalist society needs the educated person even more than any earlier society did, and access to the great heritage of the past will have to be an essential element. But liberal education must enable the person to understand reality and master it.

REIT Statistics

Current REIT statistics for October 2022 per NAREIT and NCREIF are included in the table below. Please note the all-equity REIT return over 20 years. REITs have been one of the best-performing asset classes historically.

Period	*All REITs*	*All Equity REITs*	*NCREIF NPI Levered Index (Q3-22)*	*S&P 500*	*NASDAQ Composite*
10/2022	-25.57%	-25.49%	.35%	**-17.70%**	-29.32%
1-Year	-19.77%	-19.16%	20.19%	**-14.61%**	-28.56%
5-Year	4.30%	4.77%	9.32%	10.44%	**11.32%**
10-Year	7.06%	7.38%	12.56%	12.79%	**15.18%**
20-Year	9.17%	9.67%	11.88%	9.81%	**11.14%**
Market Capitalization	$1.26T	$1.20T	$281B	NA	NA
Dividend Yield	4.27%	3.86%	NA	1.63%	NA

REIT Review

Summary

This REIT valuation is on the STAG Industrial, Inc. ("STAG"), a publicly-traded REIT that is engaged in the acquisition and operation of single-tenant industrial properties throughout the U.S. STAG owns or has interests in 563 industrial buildings in 41 states with approximately 111.6 million square feet. The buildings consist of 488 warehouse/distribution buildings, 73 light manufacturing buildings and 2 flex/office buildings.

Property Information

As of Q3-22, the occupancy rate was 98.9% and the Q3 YoY increase in rental income was 17.6%.

Corporate Data

STAG is traded on the NYSE, is incorporated in Maryland, and is located in Boston, MA. STAG has 179.2 million common shares outstanding and a market capitalization of approximately $6.066 billion. STAG is rated Baa3 by Moody's and BBB by Fitch Ratings. STAG owns a 97.9% managing ownership interest in its UpReit partnership, STAG Industrial Operating Partnership, L.P.

Management

William R. Crooker, 42, CEO and Director

President, Chief Executive Officer, and Director

Mr. Crooker serves as our President, Chief Executive Officer, and Director. Mr. Crooker most recently served as our Chief Financial Officer, Executive Vice President, and Treasurer from January 2016 until May 2021. Mr. Crooker has also served as Chief Accounting Officer and Senior Vice President of Capital Markets. Prior to the formation of our Company, Mr. Crooker served as the Chief Accounting Officer for the Company's predecessor, STAG Capital Partners, LLC, from 2010 to 2011, where he was responsible for the accounting, tax, and financial reporting for the company. From 2002 to 2010, Mr. Crooker worked for KPMG LLP, in its real estate practice focusing primarily on publicly traded real estate investment trusts. He has held various positions with KPMG LLP, including most recently as Senior Manager. Mr. Crooker is a certified public accountant and received his Bachelor of Science degree in accounting from Bentley University.

Ownership

Top Institutional Holders	Shares (000's)	%
Vanguard Group, Inc.	26,016	14.52
Blackrock, Inc.	18,056	10.08

Norges Bank Investment Management	8,607	4.80
State Street Corporation	4,500	2.51
T. Rowe Price Associates, Inc.	4,433	2.47

Ownership Breakdown	
% Of Shares Held by All Insiders and 5% Owners	0.16
% Of Shares Held by Institutional & Mutual Fund Owners	88.78
Number of Institutions Holding Shares	569

All amounts above per Yahoo Finance

Financial Analysis and Valuation

Select financial data for STAG per the Q3-22 10Q and supplemental information.

(In millions where applicable)

Financial Data	Amounts
Real Estate Assets, Gross	$6,954
Total Assets	$6,195
Property Debt (at a weighted average interest rate of 3.29%)	$2,458
Stockholders' Equity	$3,496
Revenue	$487
Net Income (Loss)	$148
Cash Flow from Operations	$297
Unsecured Credit Facility ($1B with $140M used)	$860
Market Capitalization	$6,066
Property Debt to:	

Gross Real Estate Assets	35%
Market Capitalization	40%
Enterprise Value	29%
Dividend and Yield ($1.46/sh.)	4.35%
Shares Sold Short (in millions per Yahoo Finance)	3,230

Valuation Methodology	
Q3-22 Real Estate Revenue	$487
Q3-22 Real Estate Operating Expenses (excluding depreciation, amortization, interest expense, impairment charges plus G&A expenses)	128
Q3-22 Net Operating Income	$359
Annualized Proforma Net Operating Income at 103%	$493
Projected Average Cap Rate	6.0%
Projected Value of Real Estate Assets	$8,217
Add: Net Operating Working Capital (at book value and excluding goodwill)	172
Total Projected Value of the Assets of the Company	$8,389
Less: Total Debt Per Above	(2,567)
Projected Net Asset Value of the Company	$5,822
Common Shares Outstanding, 179.2M	
Projected NAV Per Share	**$32**
Market Price Per Share on 1/15/23	**$33**
Premium (Discount) to NAV	**3%**

Financial Metrics

The gross real estate assets, property debt, revenues, net income, funds from operations, return on invested capital, dividend coverage, and dividends per share for STAG for the years 2017 through Q3-22 are shown in the table below:

(Millions except dividend and per share amounts)	2017	2018	2019	2020	2021	Q3-22
Gross Real Estate Assets	$3,096	$3,553	$4,626	$5,278	$6,513	$6,954
Property Debt	$1,173	$1,324	$1,643	$1,702	$2,216	$2,458
Revenues	$301	$350	$405	$483	$562	$487
Net Income (Loss)	$21	$82	$43	$202	$192	$148
Funds from Operations (FFO)	$149	$186	$232	$285	$332	$301
Return on Invested Capital (1)	8.0%	13.3%	7.1%	6.82%	7.11%	NA
Dividend Coverage (2)	1.05	1.18	1.22	1.27	1.35	1.50
Dividends Paid Per Share	$1.405	$1.418	$1.43	$1.44	$1.4496	$1.460(3)

(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 is currently $.1217 per month.

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

STAG Total Return	10/22	1-Yr	3-yr	5-Yr
	-38.83%	-24.66%	3.17%	5.53%

As shown above, our net asset value per share for STAG is $32/sh., compared to a market price of $33/sh. Current average cap rates for industrial properties per our industry experience and CBRE's Cap Rate Survey are in the 4.0% to 7.0% range, depending on the location and tenancy of the properties and lease term of the tenants. We have used an average cap rate of 6.0% due to STAG's diversified portfolio of industrial assets.

Valuation Analysis

STAG's strengths, concerns and recommendations are as follows:

Strengths:

- An attractive dividend yield of 4.35%.
- A low debt-to-enterprise value of 29%.
- An investment grade credit rating.
- STAG has a diversified national portfolio of industrial assets.

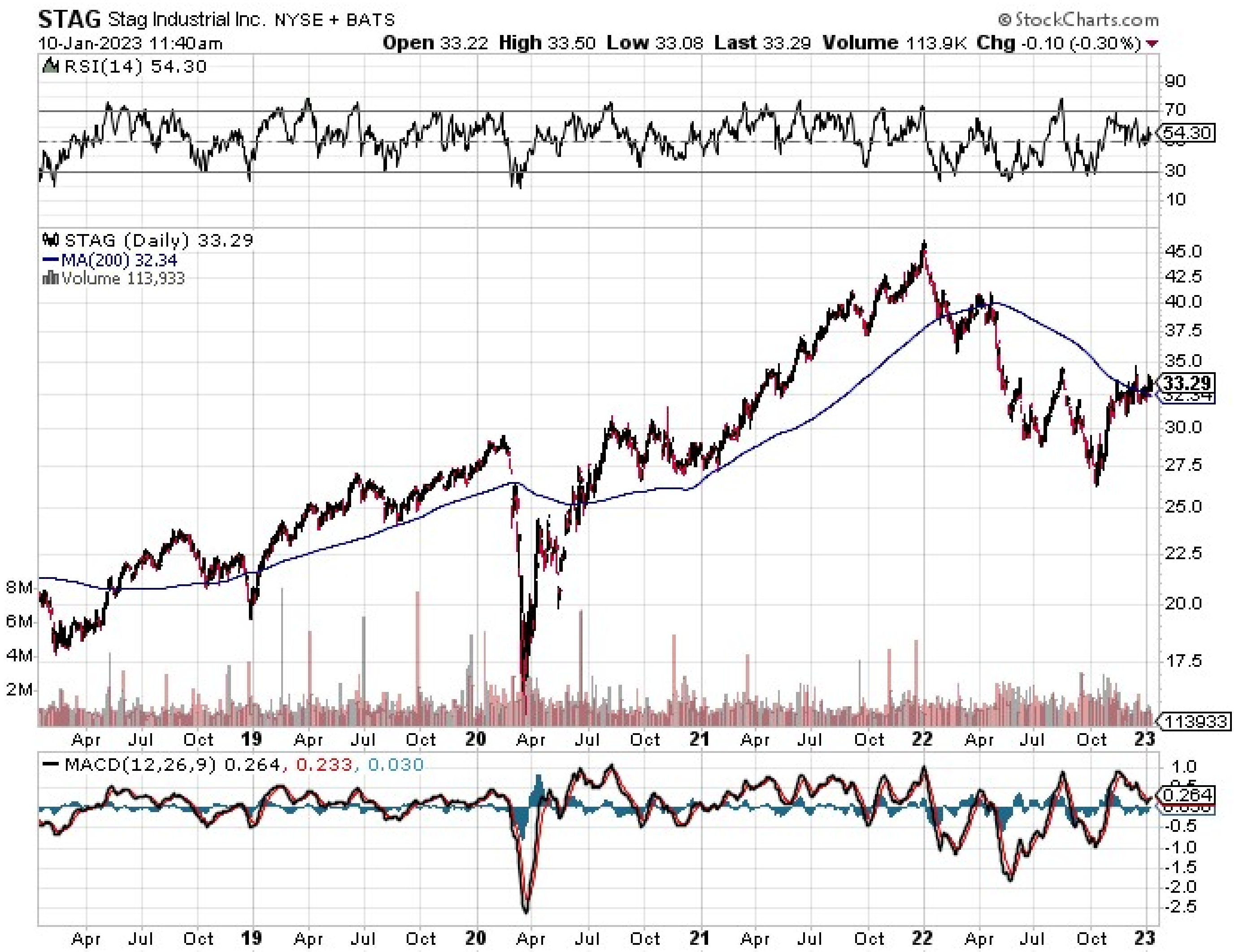
Concerns:

- REIT prices will decline if interest rates increase.
- STAG is trading at a small premium to our NAV.

Recommendation:

STAG is trading at a 1% premium to our NAV; however, we are recommending the purchase of the stock.

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



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

1. WP Carey, November 15, 2020
2. Equity Residential, December 15, 2020
3. Douglas Emmett, Inc., January 15, 2021
4. Boston Properties, Inc., February 15, 2021
5. Spirit Realty Capital, Inc., March 15, 2021
6. Duke Realty Corporation, April 15, 2021
7. Essex Property Trust, Inc., May 15, 2021
8. AvalonBay Communities, Inc., June 15, 2021
9. Brixmor Property Group, Inc., July 15, 2021

10. Cousins Properties, Inc., August 15, 2021
11. Mid-America Apartments, Inc., September 15, 2021
12. VEREIT, Inc., October 15, 2021
13. Spirit Realty Capital, Inc, November 15, 2021
14. First Industrial Realty Trust, Inc., December 15, 2021
15. Camden Property Trust, Inc., January 15, 2022
16. Healthcare Trust of America, Inc., February 15, 2022
18. Simon Property Group, Inc., March 15, 2022
19. Brandywine Realty Trust, April 15, 2022
21. Rexford Industrial Realty, Inc., May 15, 2022
22. Host Hotels & Resorts, June 15, 2022
23. The Macerich Company, July 15, 2022
24. Hudson Pacific Properties, Inc., August 15, 2022
25. Kilroy Realty Corporation, September 15, 2022
26. Realty Income Corporation, October 15, 2022

27. Federal Realty Trust, November 15, 2022
28. Equity Residential, December 15, 2022

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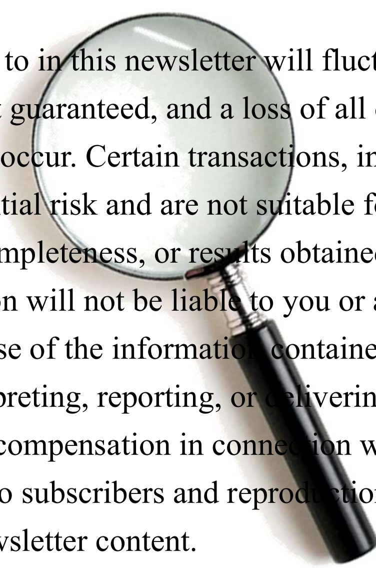

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