

View of the Market

Volume XVI/Issue
8/August 2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

INSIDE THIS ISSUE

Real Estate Focus:

- An Update on REIT Returns
- A Review of the Office Market
- Where are Cap Rates Headed?
- CRE Books by Our Editor, Joseph Ori
- CRE Financing Rates Courtesy of Paramount Capital Corporation

CRE Deal Focus:

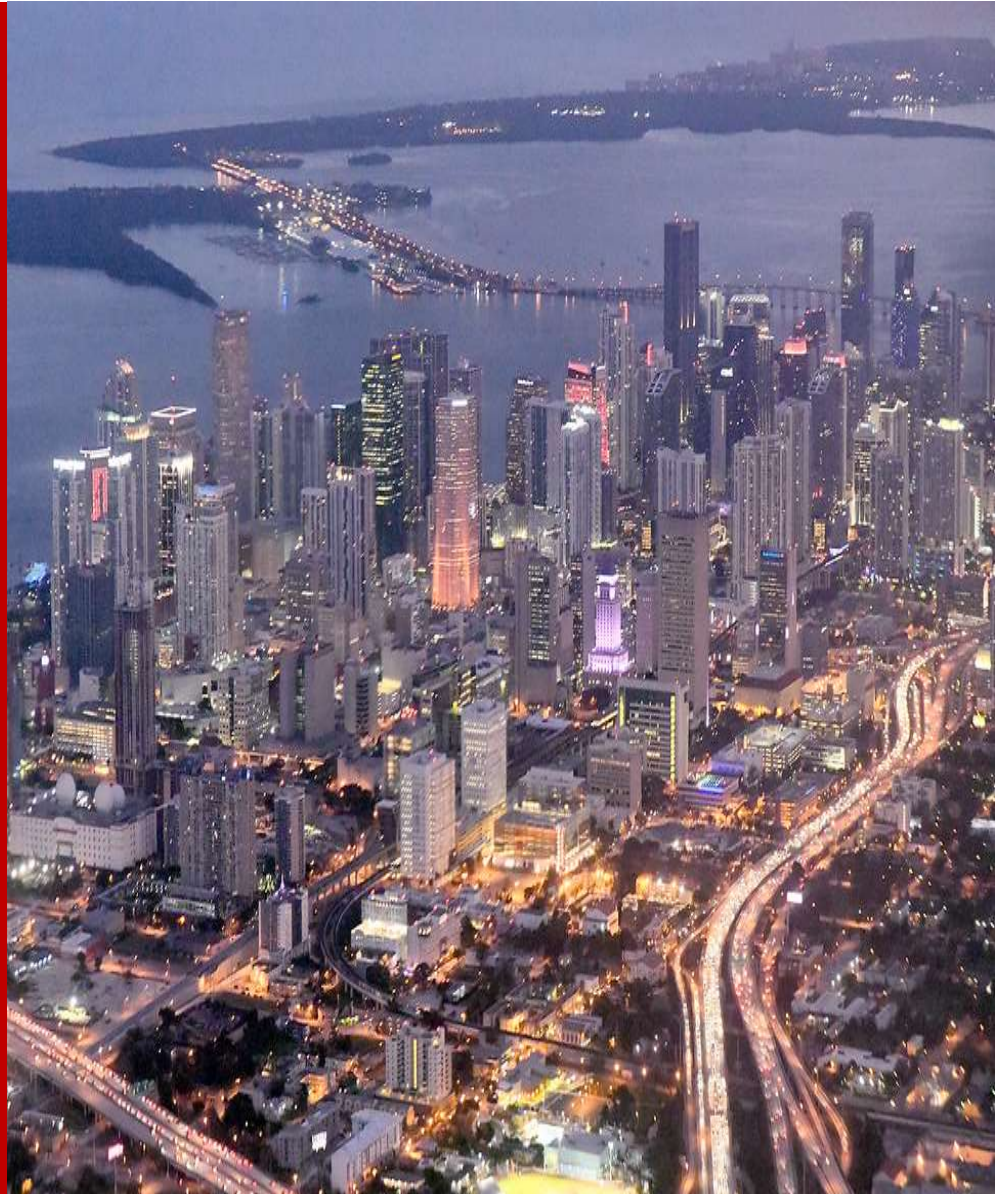
- CRE Deals of the Month

Corporate Finance Focus:

- The Daily Drucker
- A Primer on NOI and EBITDA in CRE

REIT Focus:

- REIT Return Statistics
- REIT Review: Camden Property Trust, an Apartment REIT



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REAL STATE FOCUS

An Update on REIT Returns

Public REIT stocks have been volatile during the last couple of years depending on the sector. The FTSE NAREIT ALL Equity Index is up by 11.36% as shown in the chart below. Through June of 2024, most key sectors are down due to higher interest rates courtesy of the Federal Reserve. The poor 2024 results follow a solid year in 2023, when there were big gains in some of the hottest sectors like data centers up 30.08%, lodging/resorts up a favorable 23.92% and the beleaguered office sector up a minuscule 2.03%. We believe that REIT returns for all of 2024 will be up 15%-18% and 20%+ in 2025 due to much lower interest rates.

Sector	6/2024	2023	Dividend Yield
FTSE NAREIT ALL Equity REITS	11.36%	-2.19%	4.13%
Industrial	-12.82%	19.15%	4.17%
Retail	.22%	10.57%	5.12%
Apartments	3.70%	5.87%	3.70%
Lodging/Resorts	-6.30%	23.92%	4.39%
Health Care	10.27%	13.94%	4.23%
Self-Storage	-2.28%	18.49%	4.25%
Data Centers	1.99%	30.08%	2.64%
Office	-5.56%	2.03%	5.89%

We here at VOM advise that all investors, whether you are an individual or institution, allocate 15%-20% of your funds into a diversified equity REIT fund. This is especially true now, as REIT stocks are available at a deep discount and with an attractive average dividend of 4.13%. Some

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popular REIT ETFs include the Vanguard Real Estate ETF (VNQ) with a current dividend yield of 4.2% and iShares Cohen & Steers REIT ETF (ICF) with a dividend yield of 2.74%.

A Review of the Office Market

The office market has been the worst-performing sector of the CRE market since the beginning of the pandemic in 2000. Most real estate pundits claim the woes of the office market are entirely due to work-at-home policies by companies and workers. However, although these policies have hurt office demand and usage in some markets, the real culprit has been the high crime and outmigration of residents and companies in many urban office markets around the country. These markets include New York, Washington D.C., Chicago, San Francisco, Seattle, Oakland, downtown Los Angeles, and Portland. If the office data for these cities were excluded from the national statistics, the office market would be doing simply fine. These markets have extremely high vacancies like 37% in San Francisco and 24% in Chicago, high crime, and a large number of residents and companies relocating to suburban areas or out of the state. According to Cushman & Wakefield's Officer Marketbeat for Q2-24, average rents for Q2-24 have increased by 1.4% over the same period in 2023 and the current average asking rent is \$37.91 per square foot. New construction for the same period averaged only 44.3 million square feet of space, which is over 50% less than in a normal office market. Cap rates have expanded to 7.0%-10.0%+, and there is a very low demand for office space in the above urban markets.

Key statistics and data on the office market are discussed below.

I. Key Statistics

General statistics for the office market as of Q2-24 per broker, Cushman & Wakefield are as follows:

- Vacancy rate – 20.5%
- Net absorption – (18.2) million square feet

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- Average annual net rent - \$37.91 (up 1.4% YoY)
- Construction starts – 44.3 million square feet

II. Pros and Cons of Office Investment

The office market has become a disaster in many markets, and the pros and cons of office investment include the following:

- Pros
 - Investment type diversity with urban high rise, suburban midrise and corporate campuses
 - Range of values and cap rates available
 - Some trophy buildings in prime locations and with high-credit tenants are still in great demand
 - Property management is fairly simple
 - Newer buildings with high ceilings, modern technology and mechanical systems, On-site amenities and in A locations are in the highest demand
- Cons
 - Difficult to finance in today's market
 - Urban office buildings were regarded by many institutional investors as the top "core" investment
 - Lease structures are varied with gross, triple net, double net, expense stop, and base year type leases
 - Poor demand for space in the high-crime urban markets
 - Tenant improvements and leasing commissions are significant costs
 - Location and market are key to a successful investment
 - Loss of a large credit tenant can be detrimental to the property operations
 - Older buildings have a high obsolescence factor due to floor plates, age, poor design, and lack of amenities

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III. Office Rental Rates and Rent Growth

Since the pandemic, office rental rates have been soft. The chart below shows the average rent and rent change for ten key markets per the Cushman & Wakefield report for Q2 2024.

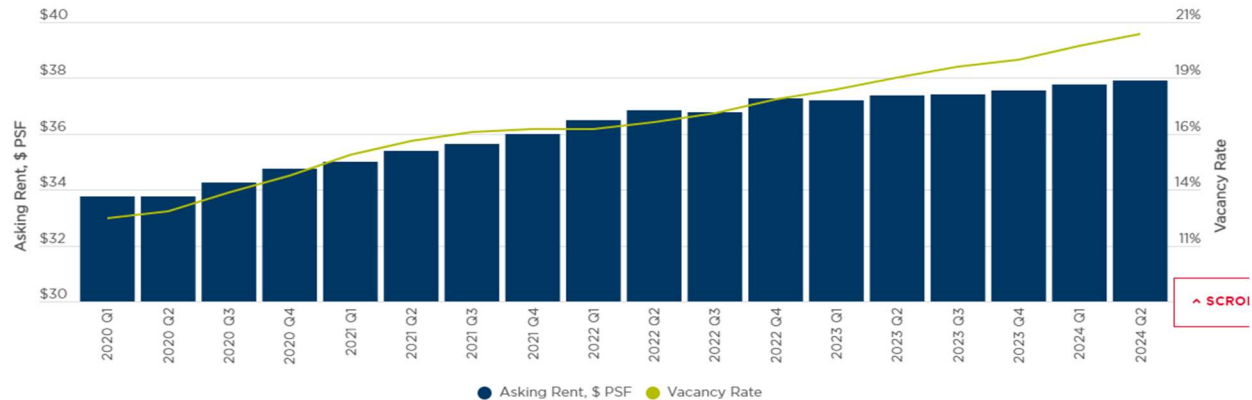
City	Rent PSF	YoY Rent Change
San Francisco, CA	\$67.85	-6.9%
New York, NY	\$78.03	1.2%
Los Angeles, CA	\$44.43	-1.3%
Inland Empire	\$26.94	.14%
Austin, TX	\$47.33	2.0%
Miami	\$54.85	9.5%
Las Vegas	\$27.97	2.6%
Phoenix	\$29.66	2.8%
Dallas	\$30.34	4.8%
Nashville	\$34.18	-3.8%

The chart below per Cushman & Wakefield shows tepid rent growth and much higher vacancies due to less demand for space in the high crime urban markets.

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OVERALL VACANCY AND ASKING RENT



Source: Cushman & Wakefield Research

IV. New Office Construction

The chart below shows new office construction per the Cushman & Wakefield report. This period of new construction has been at historically low rates.

Period	Construction Completions (millions of square feet)
Q2-24	17.6
2023	33.7
2022	47.6
2021	53.1
2020	50.4

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V. Office Returns

The yearly returns, including price change and dividends for the office sector for both NAREIT and NCREIF are shown in the two charts below. The NCREIF returns are not leveraged and since office properties are leveraged at 60%-65+% of value, the levered returns for office would be more than twice the returns shown.

NAREIT	6/24	2023	2022	2021	2020
Annual Returns	-5.56	2.03	-37.62	22.00	-18.44

Data per NAREIT

NCREIF	Q4-22	3 Years	5 Years	10 Years	15 Years
Period Returns	-4.3%	1.4%	3.5%	6.3%	4.4%

Data per NCREIF

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Where are Cap Rates Headed?

One of the key questions from investors in today's tumultuous CRE market is where cap rates are headed. Cap rates have expanded about 2.0% since the Fed began raising the federal funds rate in March 2022, although the transaction volume is down about 70% from normal levels. Many "hot" properties like industrial warehouses in the Inland Empire and Miami and apartments in New York, Tampa and Miami saw cap rates compressed down to the 3.5%-4.5% range from 2019 through 2022. As the economy continues to slow down and the Fed begins lowering interest rates this year and next, cap rates will follow but we don't see them getting back to the lows above.

We expect the federal funds rate to drop 1.0%-1.5% this year and 1.5%-2.0% in 2025. This will create a CRE mini-boom in the fourth quarter of 2024 and a big boom in 2025. There is a huge pent-up demand to do CRE deals as the entire market has been in purgatory since 2022. We expect cap rates for high-demand Class A properties, excluding office buildings, in the Sunbelt growth markets to average 5.0%-6.0% and Class B properties in these markets to average 6.0% to 8.0%. Class A/B office buildings in the top markets will average 6.5% to 8.0% and in the high-crime urban markets, 8.0% to 10.0%+. Many office buildings in these high-crime urban markets like San Francisco, are in such distressed states, that they will not trade at a cap rate, but at a price discount of 60%-70% off their 2019 value. For example, a 90,000-square-foot building at 955 Market Street in San Francisco, sold a few months ago for a pittance of \$6.5 million or about 10% of the prior sales price of \$62 million in 2016.

The cap rate on a property can be calculated in two ways. The first is the actual or dollar cap rate determined by dividing the proforma net operating income of a property by the cost or value and the second, is by a cap rate formula. The cap rate formula is the risk-free rate plus a risk premium less the growth rate in rents. The risk-free rate used in the cap rate formula is typically the 10-year Treasury Note which we believe will drop to 2.75% from about 3.9% today by the summer of 2025. The risk premium has historically been between 3.0% to 10.0% and we estimate that it is about 7% today. If the average growth rate in rents is 2.5%, then the cap rate

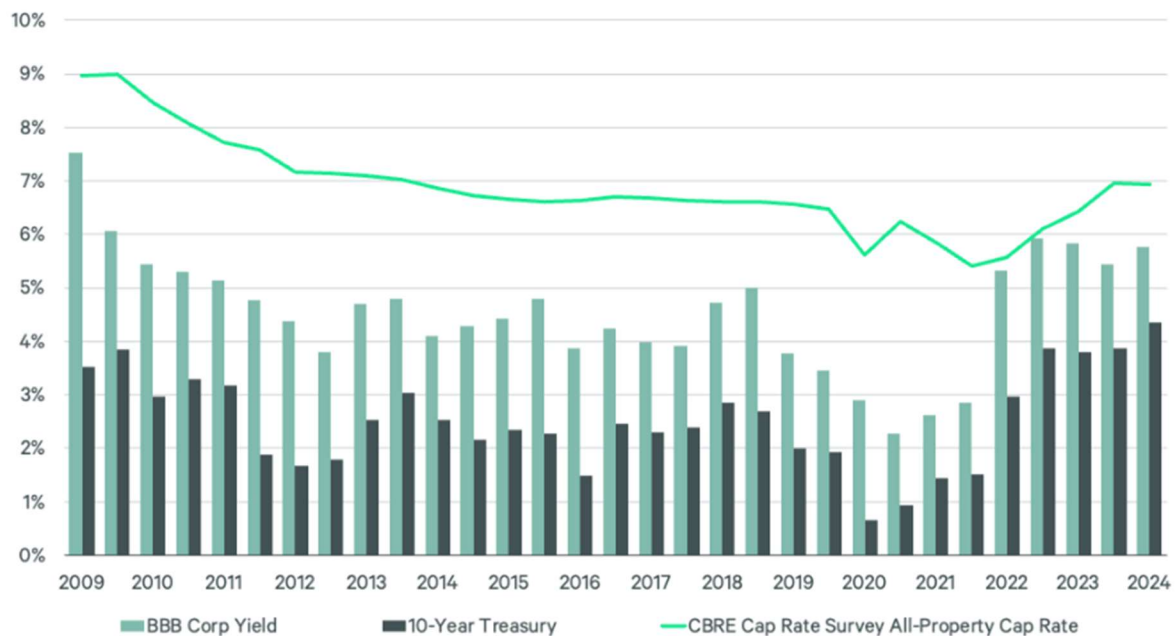
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formula will produce an average cap rate in the summer of 2025 of 7.25% ($2.75\% + 7.0\% - 2.5\% = 7.25\%$). This is an average cap rate and needs to be adjusted further up or down depending on the location and type of property.

There is still over \$200 billion of capital available in CRE private equity funds and lenders will be eager again to increase their loan books with new commercial real estate loans. Foreign investors will also be active; however, they may be constrained by their mostly weak economies and the rise in the value of the dollar. Below is a cap rate and bond yield chart for all properties from CBRE.

Figure 1: Real Estate Cap Rate and Bond Yields, period average (%)



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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 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.

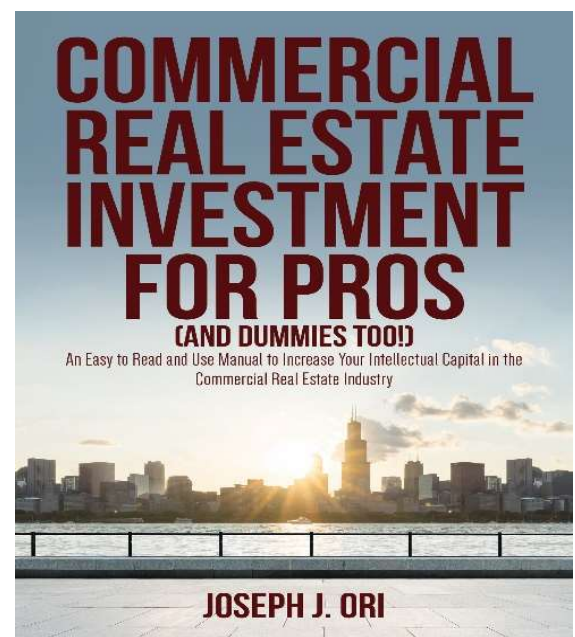
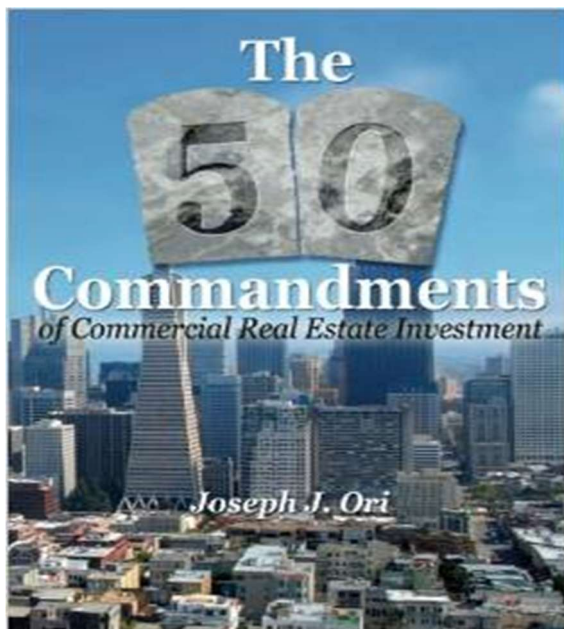
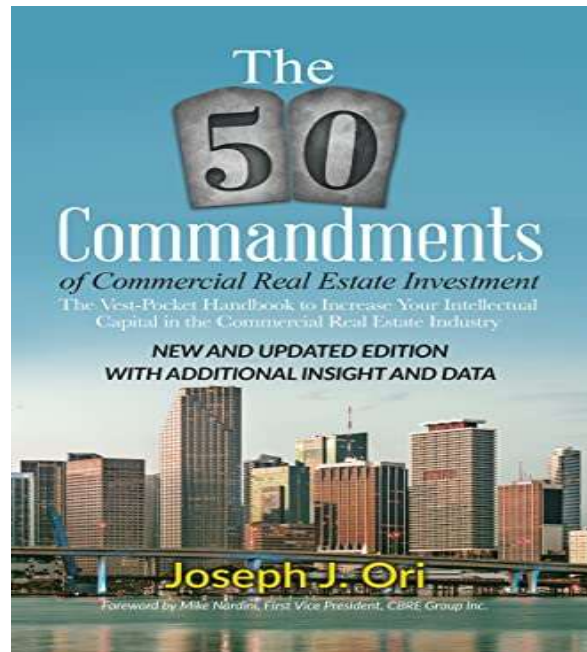
Commercial Real Estate Investment for Pros (and Dummies Too!) discusses the history, the various financial players, legal and financial structures, property types, modern portfolio theory and the financial metrics of commercial real estate investment and the commercial real estate industry. The book 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.

View of the Market

Volume XVI/Issue
8/August 2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation



View of the Market

Volume XVI/Issue
8/August 2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

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)	5.34%
1 Year Swap	4.26%
10 Year Swap	3.40%
5 Year Treasury	3.73%
10 Year Treasury	3.88%
Federal Funds Rate	5.25%



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Short-term interest rates have remained stable with the 30-day SOFR rate at 5.34%, however, the ten-year treasury rate has declined to 3.88%. 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.

CRE Deal Focus

CRE Deals of the Month

Purchaser/ Sponsor	Seller	Property/ Deal	Price	Description
Brookfield Asset Management	DRA Advisors	Industrial Portfolio	\$1.3B	A 128-property industrial portfolio with 14.6 million square feet.
Worthe Real Estate Group, QuadReal Property Group and Stockbridge Capital Group	Warner Bros. Discovery	The Burbank Studios, Los Angeles, CA	\$375M	A 685,000-square-foot studio and office campus.
KKR	Artis REIT	Park 8Ninety, Missouri City, TX	\$234M	A 12-building industrial complex with 1.82 million square feet.

View of the Market

Volume XVI/Issue
8/August 2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

Hines	JP Morgan Asset Management	Lenox and Quinn, Jersey City, NJ	\$221M	Two apartment properties with 408 units.
GID Real Estate Investment	The Dinerstein Cos.	Millennium PQ, San Diego, CA	\$167M	A 331-unit apartment property.
JRK Property	Braemar Hotels & Resorts	Hilton La Jolla Hotel, Torey Pines, CA	\$165M	A 394-room hotel built in 1989.
Bell Partners	Realty Center Management	Silverado Apartment Homes, Murrieta, CA	\$146M	A 492-unit apartment complex.
Spear Street Capital	Tishman Speyer	2000 K St., Washington, D.C.	\$140M	A 234,301 square foot office building built in 1986.

View of the Market

Volume XVI/Issue
8/August 2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

Blackrock	CRG	The Cubes at Glendale, Glendale, AZ	\$128M	A 1.2 million square foot industrial building.
Bridge Investments	HCW Development	Glen 91, Glendale, AZ	\$76M	A 296-unit apartment complex.

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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. Making Cost Control Permanent

Cost control is not a matter of cost cutting but of cost prevention. What really matters is not the method. It is the realization that the cost-effectiveness of an activity depends on the way it is being structured. This process also ensures that the entire workforce embraces and accepts cost control. It should actually see it as an opportunity and not a threat. But if cost control is seen and practiced as cost prevention, then the workforce will actually see it as an opportunity.

II. Being the Wrong Size

A business that is the wrong size is a business that does not have the right niche to survive and prosper. Being the wrong size is curable in the majority of cases. But the cure is neither easy nor pleasant. The most rewarding strategy to come to grips with the problem is to attempt to change the character of the business. Are you too small to compete in the business? If so, develop a profitable niche within which you can compete effectively.

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III. Growth

Growth that results only in volume and does not produce higher overall productivities is fat-it should be sweated. Management needs to think through the minimum of growth that its company requires. A company needs a viable market standing. Otherwise, it soon becomes marginal. Any growth that, within a short period of time, results in an overall increase in the total productivities of the enterprise's resources is healthy growth. It should be fed and supported.

IV. Managing the New Venture

Every new project is an infant and infants belong in the nursery. Innovating organizations spend neither time nor resources on defending yesterday. Systematic abandonment of yesterday alone can free the resources and especially the scariest resources of them all, capable people, for work on the new. Cannibalize your own products before your competitor does.



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A Primer on NOI and EBITDA in CRE

The net operating income (NOI) of a CRE asset is the property's effective gross income less operating expenses. The effective gross income is the annual rent from all signed leases, plus vacant space at the market rent, plus other income, and less vacancy. Operating expenses typically include salaries and wages, utilities, real estate taxes, administration, marketing/advertising, repairs and maintenance, management fee, landscaping, and insurance. At the property level, these revenues and expenses are cash items and depreciation, and interest expense are not included in operating expenses. The NOI is a key metric in CRE analysis and valuation by dividing it by an appropriate cap rate to obtain a property's value. For example, if the NOI is \$1,000,000 and the cap rate is 6.0%, the property value is \$16,666,667 (\$1M/6%).

EBITDA is a term used in corporate finance and mergers and acquisitions and is the earnings before interest, taxes, depreciation, and amortization. It is a cash flow metric that is used by Wall Street to value companies for acquisition or analysis. Most companies that are sold trade at an EBITDA multiple of 8 to 12 times. The EBITDA multiple is the enterprise value of a company divided by the EBITDA. The enterprise value of a company is the market capitalization of the common stock, plus the market value of the preferred stock plus the market value of the long-term debt less excess cash on the balance sheet. If a firm's enterprise value is \$500 million and the EBITDA is \$45 million, the EBITDA multiple is 11.1 times (\$500M/\$45M).

At the REIT level, NOI and EBITDA are equivalent. The NOI is the effective gross income less operating expenses and the EBITDA is net income adding back interest expenses, depreciation, taxes, and amortization, all the items excluded in the real estate operating statement to derive the NOI. Many REITs will discuss and publish their NOI for property analysis purposes and also the EBITDA for debt covenants and other non-GAAP financial measures.

View of the Market

Volume XVI/Issue
8/August 2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

REIT Statistics

Current REIT statistics for 6/30/24 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.

<i>Period</i>	<i>All REITs</i>	<i>All Equity REITs</i>	<i>S&P 500</i>	<i>NASDAQ Composite</i>
<i>6/2024</i>	-2.20%	-2.19%	15.29%	18.57%
<i>1-Year</i>	5.73%	5.78%	24.56%	29.61%
<i>5-Year</i>	3.00%	3.40%	15.05%	18.21%
<i>10-Year</i>	5.85%	6.11%	12.86%	16.07%
<i>20-Year</i>	7.34%	7.87%	10.29%	11.40%
<i>Market Capitalization</i>	\$1.32T	\$1.27T	\$45.7T	\$24.5T
<i>Dividend Yield</i>	4.48%	4.113%	1.26%	1.46%

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REIT Review

Summary

This REIT valuation is for Camden Property Trust, (“CPT”), a publicly-traded REIT that is engaged in the ownership, management, development, repositioning, redevelopment, acquisition, and construction of multifamily apartment communities. CPTs properties are located throughout the U.S., in 177 communities and with 59,996 units. CPTs occupancy rate is 95.2% and same-store net operating income growth for Q2-24 YoY was .2%.

Property Developments

As of Q2-24, CPT was developing four apartment communities with 1,166 units at a total cost of \$438 million with \$97 million remaining to complete.

Corporate Data

CPT is traded on the NYSE, is incorporated in Texas, and is located in Houston, TX. CPT has 108.6 million common shares outstanding and a market capitalization of approximately \$12,784 billion. CPT’s credit rating is A- from Fitch Ratings, A3 from Moody’s, and A- from Standard & Poor’s.

Management

Ric Campo, 69, CEO and Chairman of the Board

Ric Campo has been Camden's Chief Executive Officer since the Company's initial public offering in 1993. Under Ric's leadership, Camden has grown from a Texas-based real estate firm with assets valued at \$200 million in 1993 to an industry leader with a national footprint and assets valued at more than \$16 billion. After working for a private Houston real estate company, Ric co-founded Camden's predecessor companies in 1982 with Keith Oden and has spent 40 years (and counting) building a successful organization known for management proficiency, development, construction capabilities, technology, training, and marketing savvy. Ric currently serves as Chairman of the Port Commission of the Port of Houston Authority, and he is on the Board of Directors of several organizations that focus on Houston's economic development and

View of the Market

Volume XVI/Issue
8/August 2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

quality of life. Ric is a member of the American Institute of Certified Public Accountants (AICPA) and graduated from Oregon State University.

Top Institutional Holders	Shares (000's)	%
The Vanguard Group, Inc.	17,290	16.22
Blackrock Inc.	11,950	11.21
State Street Corporation	7,270	6.82
Cohen & Steers, Inc.	5,970	5.60
Victory Capital Management	4,310	4.05

Ownership Breakdown	
% Of Shares Held by All Insiders and 5% Owners	1.47
% Of Shares Held by Institutional & Mutual Fund Owners	97.63
Number of Institutions Holding Shares	809

All amounts above per Yahoo Finance

View of the Market

Volume XVI/Issue
8/August 2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

Financial Analysis and Valuation

Select financial data for CPT per the 2024 Q2 10Q and supplemental information.

(In millions where applicable)

Financial Data	Amounts
Real Estate Assets, Gross	\$12,864
Total Assets	\$9,079
Property Debt (at weighted average interest rates of approximately 4.2%)	\$3,552
Stockholders' Equity	\$4,926
Revenue	\$784
Net Income (Loss)	\$126
Cash Flow from Operations	\$360
Unsecured Credit Facility (\$1.2B with \$0 used)	\$1,200
Market Capitalization	\$12,784
Property Debt to:	
Gross Real Estate Assets	27%
Market Capitalization	28%
Enterprise Value	22%
Dividend and Yield (\$4.12/sh.)	3.45%
Shares Sold Short (in millions per Yahoo Finance)	2,160

View of the Market

Volume XVI/Issue
8/August 2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

Valuation Methodology	
Q2-24 Real Estate Revenue	\$784
Q2-24 Real Estate Operating Expenses (excluding depreciation, amortization, interest expense, impairment charges plus G&A expenses)	<u>\$336</u>
Q2-24 Net Operating Income	\$448
Proforma Annualized Net Operating Income at 102%	\$914
Projected Average Cap Rate	<u>6.0%</u>
Projected Value of Real Estate Assets	\$15,233
Add: Net Operating Working Capital (at book value)	(\$243)
Properties Under Development (at book value)	<u>\$439</u>
Total Projected Value of the Assets of the Company	\$15,429
Less: Total Debt per Above	<u>(\$3,552)</u>
Projected Net Asset Value of the Company	<u>\$11,877</u>
Common Shares Outstanding, 108.6M	
Projected NAV Per Share	\$109
Market Price Per Share on 8/15/24	\$119
Premium (Discount) to NAV	9%

View of the Market

Volume XVI/Issue
8/August 2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

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 CPT for the years 2019 through Q2-24 are shown in the table below.

(Millions except dividend and per share amounts)	2019	2020	2021	2022	2023	Q2-24
Gross Real Estate Assets	\$8,603	\$8,988	\$9,974	\$12,390	\$7,253	\$12,864
Property Debt	\$2,524	\$2,166	\$3,170	\$3,679	\$2,622	\$3,552
Revenue	\$1,028	\$1,043	\$1,169	\$1,430	\$707	\$784
Net Income (Loss)	\$219	\$123	\$303	\$653	\$192	\$126
Funds from Operations (FFO)	\$505	\$495	\$485	\$628	\$654	\$323
Return on Invested Capital (1)	10.2%	9.12%	9.1%	9.8%	10.5%	NA
Dividend Coverage (2)	1.59	1.49	1.41	1.58	1.51	1.45
Dividends Paid Per Share	\$3.20	\$3.24	\$3.32	\$3.76	\$4.00	\$4.12

- (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 \$1.03 per quarter.

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

CPT Total Return	6/2024	1-Yr	3-yr	5-Yr
	12.1%	4.34%	-3.21%	4.23%

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

As shown above, our net asset value per share for CPT is \$109/sh., compared to a market price of \$119/sh. Current average cap rates for apartment properties per our industry experience and CBRE's Cap Rate Survey are in the 5.0% to 8.0% range, depending on the location, age, and condition of the property. We have used an average cap rate of 6.0% due to CPTs diversified portfolio of mostly high-quality apartment properties.

Strengths:

- A low debt-to-enterprise value of 22%.
- A high-quality portfolio of apartment properties.
- An attractive dividend yield of 3.45%.
- The dividend has increased by 28.75% since 2019.

Concerns:

- REIT prices will decline if interest rates increase.
- The stock is trading at a 7% premium to our NAV.

Recommendation:

CPT is trading at a 9% premium to our NAV per share, and we are not recommending the purchase of the stock.

View of the Market

Volume XVI/Issue
8/August 2024

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



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REIT FOCUS REVIEWS IN PRIOR ISSCPTS 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. CPT 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

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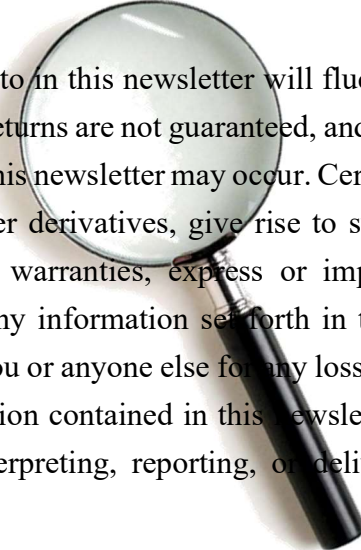
16. Kite Realty Group Trust, November 2023
17. Alexandria Real Estate Equities, Inc., December 2023
18. Agree Realty Corporation, January 2024
19. WP Carey, February 2024
20. Essex Property Trust, March 2024
21. Brandywine Realty Trust, April 2024
22. Urban Edge Properties, May 2024
23. Eastgroup Properties,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

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