

# View of the Market

Volume XVI/Issue  
10/October 2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

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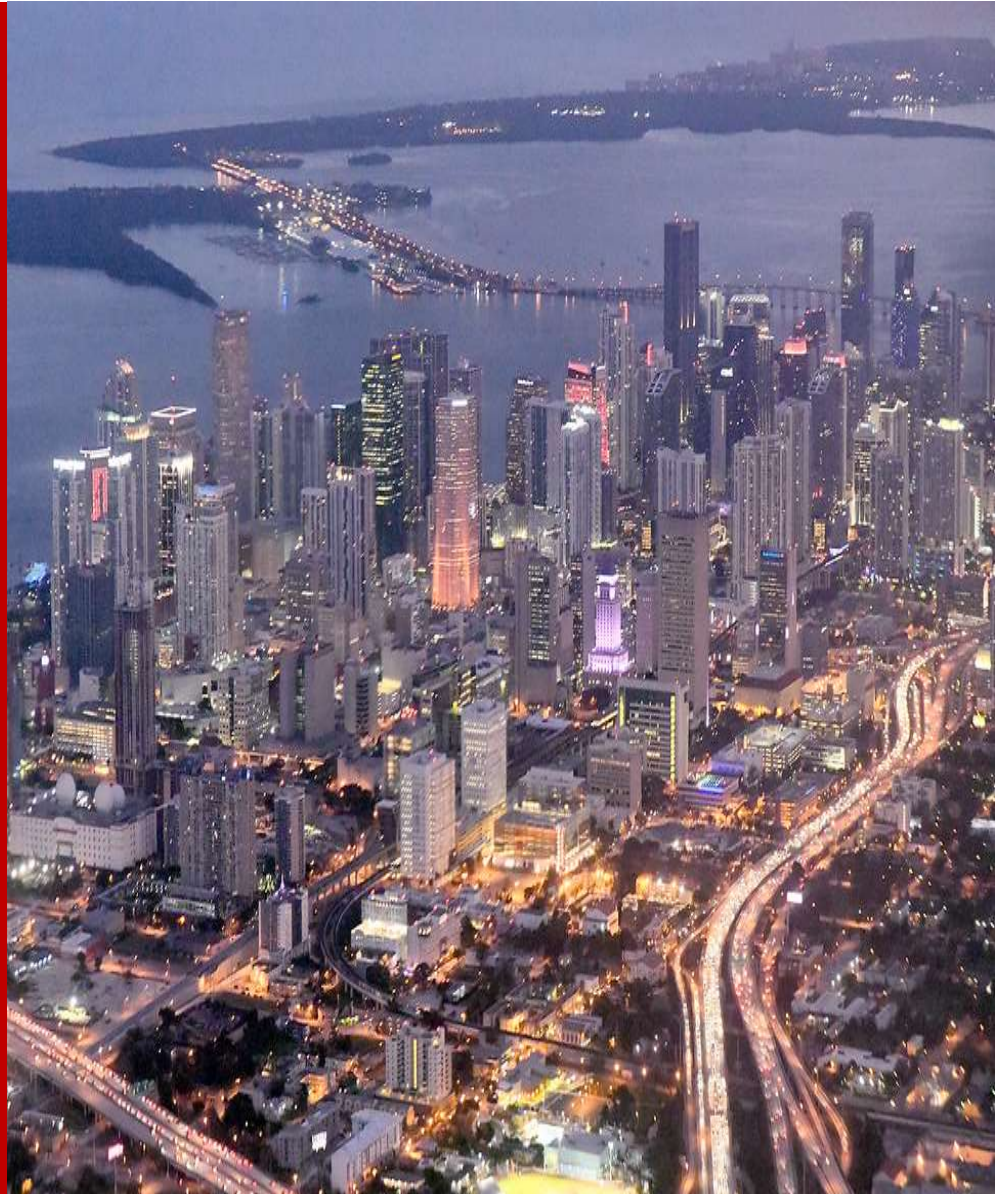
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## **REAL STATE FOCUS**

### **Creating Value in CRE Investment Firms**

There are thousands of real estate investment companies located in the U.S. from behemoths like Blackstone to the local investor that owns 200 apartment units or a small strip shopping center. The key investment objectives of these firms are to earn various fees for management, asset management and brokerage services and a return on the invested equity capital in the real estate properties. If the real estate firm has multiple entities or raises capital in a fund structure, there are four pockets of value in the organization. These are as follows:

- The ownership interest or carried interest of the general partner in each property
- The property management fee of 3.0%-6.0% of effective gross income earned, if the properties are self-managed
- The asset management fee of 1.0% to 2.5% of the equity capital raised or net asset value paid to run the fund or portfolio of properties
- Other fees including brokerage, advisory, financing, construction, and sales commissions which typically range from 1.0% to 6.0%

It is critical that real estate investment firms have the appropriate entities and organizational structures to earn these fees and maximize their corporate enterprise value. In most local and regional CRE firms these fees are scattered throughout each entity limited partnership (LP) or limited liability company(LLC) and do not flow up to a top-tier holding company entity where the full equity and enterprise value can be realized. In many cases, they are not even charged or paid. Even larger national firms do not have a holding company structure to maximize these four pockets of value.

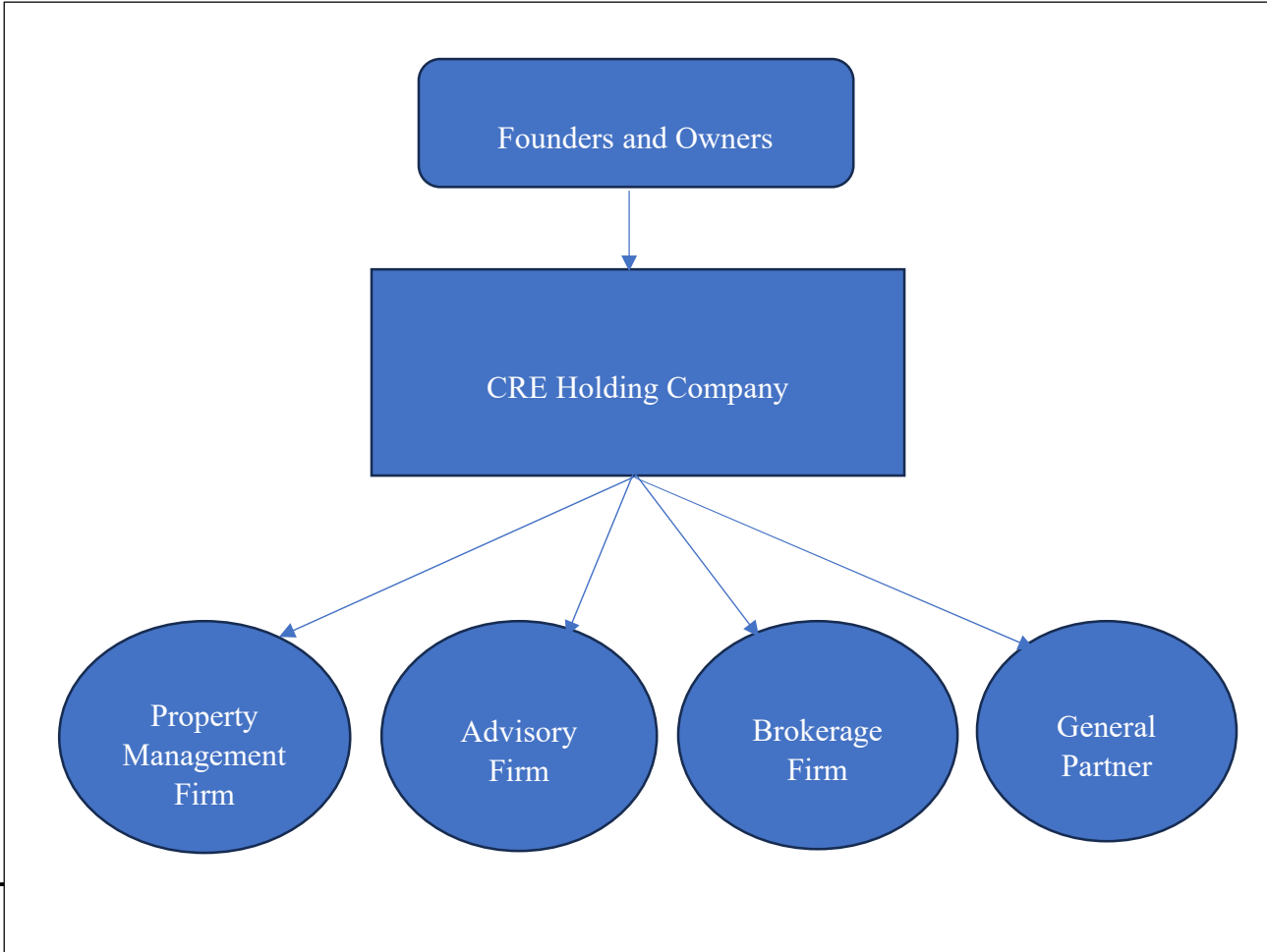
The corporate structure should include a holding company formed as an LLC or LP and subsidiary LLCs or LPs that own the property management company, the general partner, the

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asset management entity, and an entity to collect brokerage, advisory and other fees. Some firms may combine these four value entities into two or three separate firms, but we advise maintaining them as four separate entities to maximize their internal and external sales value. The value of the holding company will be enhanced greatly if it has these three or four subsidiaries, all of which have different value drivers, and that value is consolidated into the parent holding company. If the CRE sector is in a “Bear Market” as during the last few years since the Fed began raising interest rates in March 2022, the four value pockets can be used to provide additional capital to the holding company through sales and financings.

A flow chart of this CRE holding company structure is shown below:



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Once all the entities are consolidated into the holding company, the value of the holding company will increase significantly. This structure also provides the holding company optionality in creating and realizing value in these subsidiary entities. For example, it can sell the property management company at a multiple of earnings before interest, taxes, depreciation, and amortization (EBITDA), it can sell all a portion of the general partner based on its carried interest value and it can sell the brokerage and asset management entities based upon a percentage of assets managed. The owners of the holding company can also take the entire entity public or sell it to a third party. This ownership structure for private CRE organizations will maximize the four pockets of value and create enterprise value in the holding company that is typically not realized in most private real estate investment firms.

### **A Review of the Student Housing Market**

The student housing market has been booming even though total college enrollment has been on the decline. Per the Education Data Initiative, total college enrolment has declined from the peak in 2010 of 21.02 million students to a projected 19.2 million students in 2024 or a drop of 8.6%. The data indicates that more Americans are forgoing college to build savings or seek work in the trades or technology areas of the economy.

However, the large four-year universities, especially in the Southwest and Southeast sections of the country, are seeing high demand and development of new student housing. The national average rent per bed increased to \$897 in May 2024, which is an increase of 5.3% from the year-earlier per Yardi Matrix, a CRE data firm. There are also 45,495 new beds that will be delivered to the largest 200 colleges in 2024, an increase of from 37,576 beds delivered in 2023. Sales of student housing properties have been muted in 2024 compared to prior years. Per Yardi Matrix, there were only 26 properties sold through May 31, 2024, compared to 33 in the year-ago period.

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The price per bed increased to \$87,500 compared to an average of \$80,000 per bed from the 2017-2023 period.

Key statistics and data on the student housing market are discussed below.

### I. Key Statistics

General statistics for the student housing market as of Q1-24 per Yardi Matrix, are as follows:

- Preleasing rate – 80% (10% higher than May 2023)
- Average annual net rent per bed - \$897 (up 5.3% from May 2023)
- Construction starts – 45,495 new beds

### II. Pros and Cons of Student Housing Investment

The student housing market is strong, and the pros and cons of student housing investment include the following:

- Pros
  - High demand in college towns with large universities, especially in the Southwest and Southeast sections of the country
  - Low lease default rates
  - The investment market is extraordinarily strong with an abundance of debt and equity capital available
  - Rental rates are per bed and not per unit as in traditional apartments
- Cons
  - It is difficult to find the land and build on-campus or in college towns with large universities
  - Cap rates have stayed compressed to an average of about 5.0%-6.0%
  - High repair and maintenance costs
  - High summer vacancies as most undergraduates leave for the summer

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### III. Student Housing Rental Rates and Inventory

Since the pandemic, student housing rental rates have soared. The chart below shows the average rent and inventory for key markets per the Yardi Matrix report.

University	Beds Completed	Rent Per Bed
Texas A&M	32,130	\$791
University of Florida	29,998	\$797
Florida State University	27,727	\$845
University of Texas	21,656	\$1,157
University of Central Florida	15,891	\$1,073
University of South Florida	15,906	\$936

### IV. Student Housing Construction

The chart below shows new student housing construction at select universities per the Yardi Matrix report.

University	Beds Under Construction
University of Tennessee	3,961
University of Texas	3,170
Purdue University	2,122
Indiana University	1,474
Ohio State University	1,220

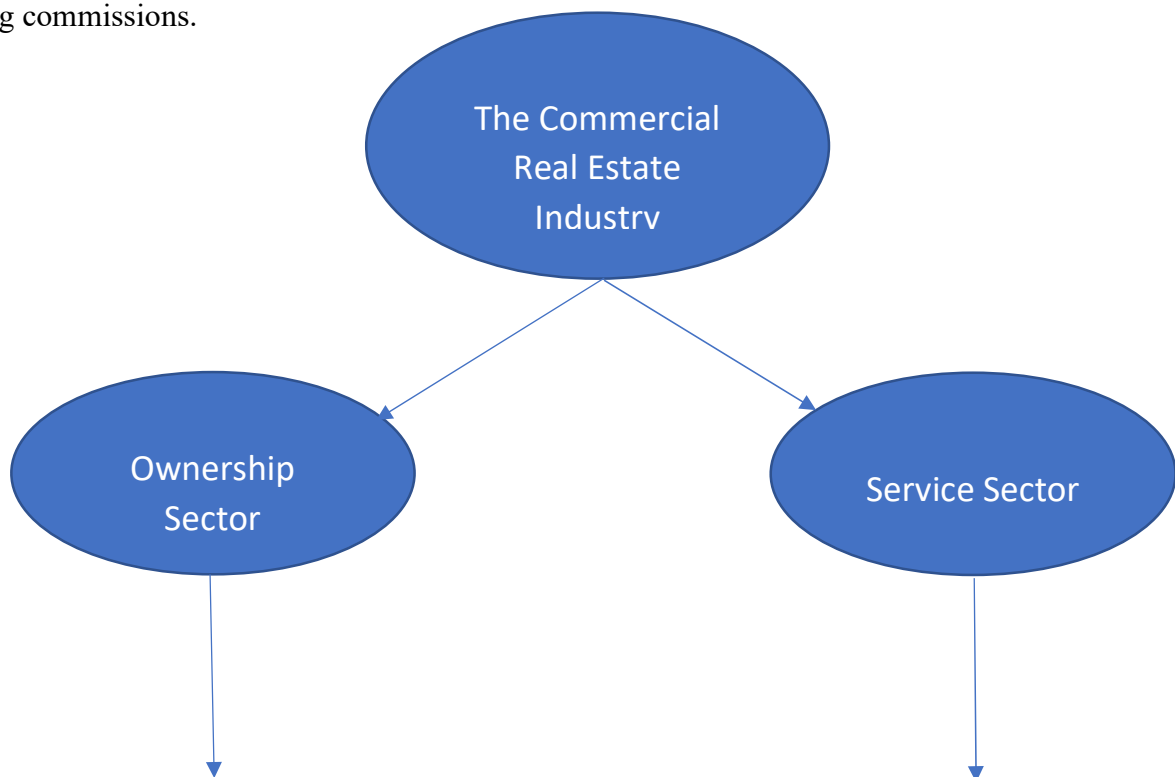
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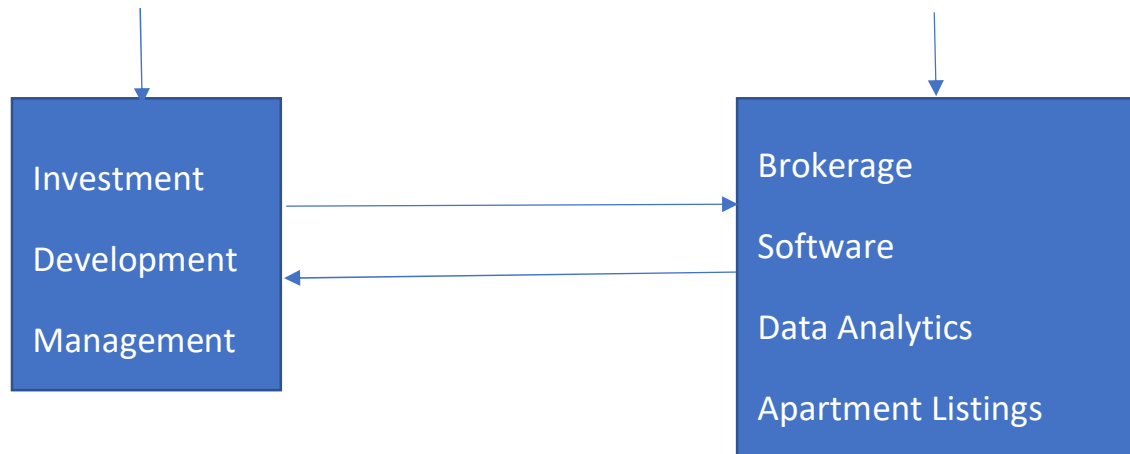
### A Review of the Service Sector of CRE

The commercial real estate industry is characterized by two sectors, the property investment, development, ownership, and management (investment sector) sector and the service sector. The investment sector includes all the companies and personnel involved in buying, owning, leasing, and managing CRE assets. The service sector includes all the companies and personnel providing numerous services to the investment sector and the CRE industry in general. This sector is further broken down into four subsectors, brokerage, software, data analytics and apartment listing services. The CRE service sector is especially important for the overall health and growth of the investment sector and the industry. It provides stable fee income in the form of subscriptions with data analytics, software and listing services, asset management and facility management fees and more volatile brokerage fee income in the form of sales, finance, and leasing commissions.



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The Service sector of the CRE industry is very important and the investment sector will not prosper without the services sector. The service sector supports and creates value for the investment sector. The four distinct subsectors are the Brokerage sector, the sale, lease and financing of CRE, the Software sector, the sale and maintenance of CRE accounting, financial analysis, asset management and other software, the Data Analytics sector, the preparation, maintenance and financial analysis of all types of data for the industry and the Apartment Listing sector, the online apartment listings of apartments for rent like apartments.com, Zillow, rent.com and others.

There are many key players in the four service sectors as shown below.

## I. The Brokerage Sector

A. The six large publicly traded brokerage firms:

1. CBRE
2. Jones Lang Lasalle
3. Cushman and Wakefield
4. Colliers International

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5. Newmark Knight Frank

6. Marcus and Millichap

B. There are also several large private national or regional brokerage firms:

1. Avison Young

2. TCN Worldwide

3. Lee and Associates

4. SVN International

5. Berkadia

6. Northmarq

C. There are also hundreds of local and smaller brokerage firms located throughout the country

## II. The Software Sector

A. The four large software firms:

1. Yardi

2. MRI

3. Appfolio

4. RealPage

B. There are dozens of smaller and specialized software firms including:

1. Entrata

2. Skyline

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3. ResMan

4. Argus

### **III. The Data Analytics Sector**

A. The four large data analytics firms:

1. Real Capital Analytics (part of MSCI)

2. CoStar

3. RealPage

4. Moody's (REIS)

B. There are dozens of smaller and specialized data analytics firms including:

1. Trepp

2. Compstak

3. Reonomy

4. Greenstreet

### **IV. The Apartment Listing Firms**

A. The four large apartment listing firms:

1. CoStar (apartments.com)

2. Zillow

3. Rent.com

4. Zumper

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B. There are also a few smaller apartment listing firms

## **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.

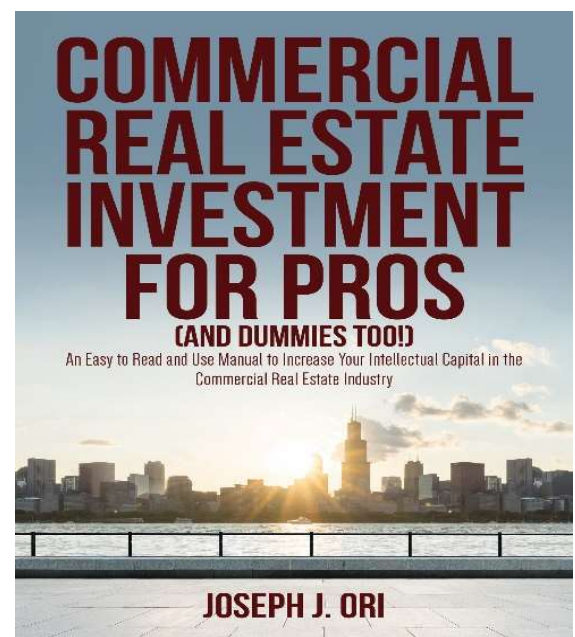
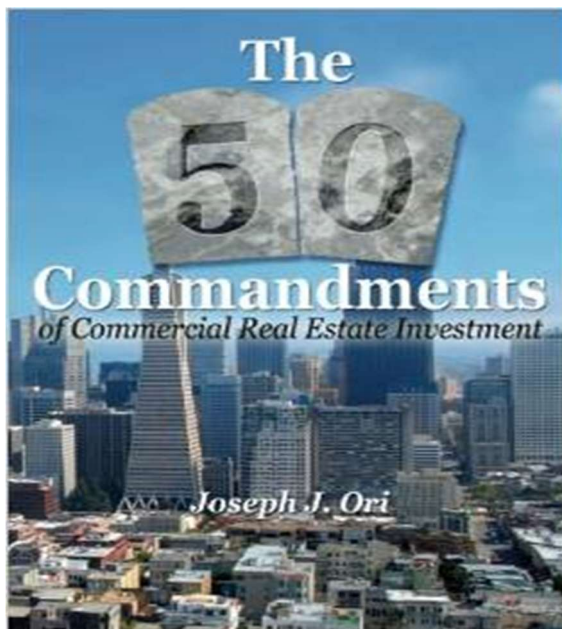
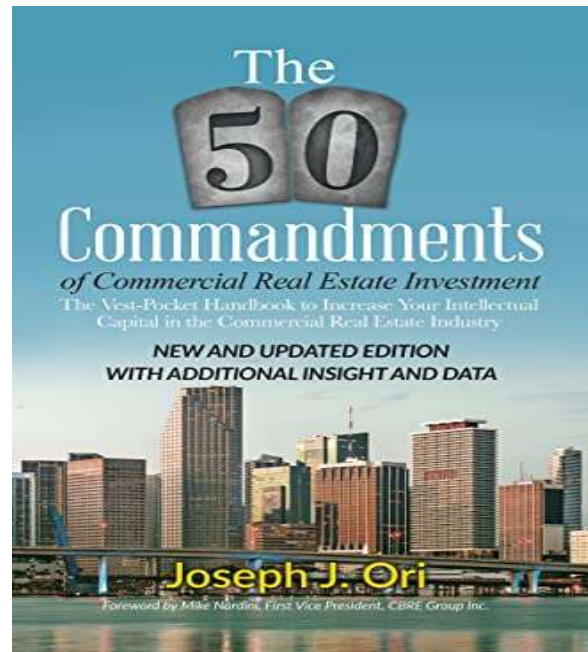
Commercial Real Estate Investment for Pros (and Dummies Too!) discusses the history, the various financial players, legal and financial structures, property types, modern portfolio theory and the financial metrics of commercial real estate investment and the commercial real estate industry. The book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

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## CRE Financing Rates

Loan Type	Mortgage Rate	Maximum Amortization	Term (years)	Maximum LTV
Permanent Loans	5.87%-10.00%+	30	10	70%
Conduit-CMBS	5.88%-7.49%+	30	10	70%
Bridge Loans	6.00%-14.00%+	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	8.00%
30-Day SOFR (secured overnight funding rate)	4.83%
1 Year Swap	3.84%
10 Year Swap	3.33%
5 Year Treasury	3.62%
10 Year Treasury	3.84%
Federal Funds Rate	4.75%



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Short-term interest rates have risen about .30% since the Federal Reserve lowered the federal funds rate on September 19, 2024, due to a stronger jobs report for the month of September. We believe the Fed will lower the funds rate by an additional .50% to 1.0% by the end of this year. 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](mailto:jjo@paramountcapitalcorp.com), for your real estate capital needs.

### **CRE Deal Focus**

#### **CRE Deals of the Month**

<b>Purchaser/ Sponsor</b>	<b>Seller</b>	<b>Property/ Deal</b>	<b>Price</b>	<b>Description</b>
Fowler Property Acquisition	Harbor Group International	Gardencrest Apartments, Waltham, MA	\$221M	A 696-unit apartment property.
Weidner Apartment Homes	Clarion Partners	Desert Club, Phoenix, AZ	\$187M	A 497-unit apartment built in 2004.
Waterton	Brookfield Properties	L Seven, San Francisco, CA	\$177M	A 410-unit apartment property built in 2007.

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TIAA	Criterion Development Partners	Velo Apartments, Boston, MA	\$102M	A 250-unit apartment property built in 2020.
Pantzer Properties	Alliance Residential Co.	Point at Waltham, Waltham, MA	\$91M	A 195-unit apartment property.
LBX Investments and Broadwill	JBG Smith	Fort Totten Square, Washington, D.C.	\$86M	A 345-unit apartment property built in 2015.
GID	Capital Land of Singapore	Heronfield, Kirkland, WA	\$73M	A 202-unit apartment property built in 1990.
Island Capital	TA Realty	One Park Square, Doral, FL	\$71M	A 687,304-square foot office building built in 2009.

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Venterra Realty	Terwilliger Brothers and the Caryle Group	Trevesta Place, Palmetto, FL	\$55M	A 256-unit apartment property.
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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. Management Team for the New Venture**

Key activities are not to be found in books. They emerge from analysis of the specific enterprise. Whenever the objective economic indicators of a new venture indicate that the business may double within three years, then it is the duty of the founder or founders to build the management team the new venture will soon require. First of all, the founders, together with other key people in the firm, will have to think through the key activities of their business. Examine a successful new venture either inside or outside of your enterprise. Was the innovator successful in defining key activities and assigning those to people of proven competence?

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### **II. Unrealized Business Potential**

Opportunity is where you find it, not where it finds you. Luck, chance, and catastrophe affect business as they do all human endeavors. But luck never built a business. Prosperity and growth come only to the business that systematically finds and exploits its potential. No matter how successfully a business organizes itself for the challenges and opportunities of the present, it will still be far below its optimum performance. Its potential is always greater than its realized actuality.

### **III. Finding Opportunities in Vulnerabilities**

Finding and realizing the potential of a business is psychologically difficult. It will always be opposed from within because it means breaking with old, established habits. It often means giving up the very skill people are proudest of. To fight the threat, to manage an imbalance, and above all to make a process efficient despite its inherent weaknesses, requires great effort. Conver the vulnerabilities of your enterprise into opportunities.

### **IV. Exploring Innovative Ideas**

Creativity is sexy, but the real problem is the shockingly high mortality rate of healthy new products or services. There usually are more good ideas in even the stodgiest organization that can possibly be exploited. There are four specifically entrepreneurial strategies aiming at market leadership, being: “Fustest with the Mostest;” “Hitting Them Where They Ain’t;” finding and occupying a specialized “Ecological Niche;” and changing the economic characteristics of a product, a market, or an industry. Be systematic in exploiting innovative ideas, remembering these four strategies for success.

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## The Buffett Indicator

The greatest investor of all time is Warren Buffett and one of his favorite indicators regarding the value of the stock market is the value of the entire stock market or the Wilshire 5000 Index versus nominal GDP. The chart below shows this value from 1950 to August 2024. Many market pundits have been saying that we are in another bubble and the stock market is slated for a correction of 10% to 30% or more. The chart below shows that the Wilshire/GDP ratio has exceeded the high in 2021 and is well in excess of the bubble highs in the dot-com boom from 1999-2000.

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## REIT Statistics

Current REIT statistics for 8/31/24 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.

<i>Period</i>	<i>All REITs</i>	<i>All Equity REITs</i>	<i>S&amp;P 500</i>	<i>NASDAQ Composite</i>
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<i>8/2024</i>	10.39%	10.73%	<b>19.53%</b>	18.57%
<i>1-Year</i>	20.82%	21.44%	27.14%	<b>27.15%</b>
<i>5-Year</i>	4.50%	4.82%	15.92%	<b>18.29%</b>
<i>10-Year</i>	6.81%	7.08%	12.98%	<b>15.60%</b>
<i>20-Year</i>	7.58%	8.11%	10.65%	<b>11.99%</b>
<i>Market</i>				
<i>Capitalization</i>	\$1.51T	\$1.43T	\$45.8T	\$22.4T
<i>Dividend Yield</i>	3.94%	3.67%	1.24%	1.27%

## REIT Review

### Summary

This REIT valuation is on Kilroy Realty Corporation, (“KRC”), a publicly-traded REIT that is engaged in the acquisition, ownership, development, and management of premiere office, life science and mixed-use property types. KRCs properties are primarily located in Los Angeles, San Diego, the San Francisco Bay Area, Seattle, and Austin. KRC directly owns 121 properties with a total of 17 million square feet. KRCs occupancy rate is 83.7% and same-store net operating income growth for Q2-24 YoY was -6.3%. The three largest tenants are Global Technology Company (5.6% of annual base rent), Cruise LLC (4.4% of annual base rent) and Stripe Inc. (4.1% of annual base rent).

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### Property Developments

As of Q2-24, KRC was developing three properties with 975,000 square feet at a total cost of \$1.08 billion with \$748 million incurred to date.

### Corporate Data

KRC is traded on the New York Stock Exchange, is incorporated in Maryland, and is located in Los Angeles, CA. KRC has 117 million common shares outstanding and a market capitalization of approximately \$4,461 billion. KRC owns a 100% interest and controls its UpReit partnership, Kilroy Realty L.P. KRC's credit rating is BBB from Standard and Poor's.

### Management

#### *Angela M. Aman, 44, CEO*

Chief Executive Officer and as a member of the Board of Directors since January 2024. Prior to joining the Company, Ms. Aman served as President, Chief Financial Officer, and Treasurer at Brixmor Property Group from September 2023 to January 2024 and as Executive Vice President, Chief Financial Officer, and Treasurer from May 2016 until her promotion in September 2023. Prior to joining Brixmor, Ms. Aman held Chief Financial Officer roles at Starwood Retail Partners from 2015 to 2016 and Retail Properties of America, Inc. from 2011 to 2015. From 2005 to 2011, she was a member of the RREEF real estate securities team, serving as an investment analyst and later as a Portfolio Manager and from 2001 to 2005, she was a member of real estate investment banking group at Deutsche Bank Securities, Inc. Ms. Aman is a member of Nareit, Zell/Lurie Real Estate Center at The Wharton School, UCLA Anderson Board of Advisors and serves on the Board of Trustees of Equity Residential, where she is Chair of the Audit Committee. She received a Bachelor of Science degree in Economics from The Wharton School, University of Pennsylvania.

Top Institutional Holders	Shares (000's)	%
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The Vanguard Group, Inc.	16.92	14.41
Blackrock Inc.	16.11	13.72
Norges Bank Investment Management	9.06	7.72
State Street Corporation	5.68	4.84
Apg Asset Management US Inc.	5.38	4.58

Ownership Breakdown	
% Of Shares Held by All Insiders and 5% Owners	2.25
% Of Shares Held by Institutional & Mutual Fund Owners	109.11
Number of Institutions Holding Shares	468

All amounts above per Yahoo Finance

## Financial Analysis and Valuation

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

(In millions where applicable)

Financial Data	Amounts
Real Estate Assets, Gross	\$12,452
Total Assets	\$11,543
Property Debt (at weighted average interest rates of approximately 4.19%)	\$5,119
Stockholders' Equity	\$5,634
Revenue	\$559
Net Income (Loss)	\$99
Cash Flow from Operations	\$256
Unsecured Credit Facility (\$1.1B with \$0 used)	\$1,100
Market Capitalization	\$4,461
<b>Property Debt to:</b>	
Gross Real Estate Assets	41%

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Market Capitalization	115%
Enterprise Value	53%
Dividend and Yield (\$2.16/sh.)	5.75%
Shares Sold Short (in millions per Yahoo Finance)	5,850

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<b>Valuation Methodology</b>	
Q2-24 Real Estate Revenue	\$559
Q2-24 Real Estate Operating Expenses (excluding depreciation, amortization, interest expense, impairment charges plus G&A expenses)	<u>\$219</u>
Q2-24 Net Operating Income	\$340
Proforma Annualized Net Operating Income	\$680
Projected Average Cap Rate	<u>10.0%</u>
Projected Value of Real Estate Assets	\$6,800
Add: Net Operating Working Capital (at book value)	\$972
Undeveloped Land and CIP (at book value)	<u>\$2,207</u>
Total Projected Value of the Assets of the Company	\$9,979
Less: Total Debt per Above	<u>(\$5,119)</u>
Projected Net Asset Value of the Company	<u>\$4,860</u>
Common Shares Outstanding, 117M	
Projected NAV Per Share	<b>\$41</b>
Market Price Per Share on 10/15/24	<b>\$37</b>
Premium (Discount) to NAV	<b>(9.7%)</b>

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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 KRC 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	\$9,628	\$10,190	\$11,292	\$11,732	\$12,241	\$12,452
Property Debt	\$3,552	\$3,923	\$4,068	\$4,262	\$4,928	\$5,119
Revenue	\$837	\$898	\$955	\$1,096	\$1,129	\$559
Net Income (Loss)	\$195	\$187	\$628	(\$65)	(\$91)	\$110
Funds from Operations (FFO)	\$418	\$433	\$462	\$556	\$551	\$266
Return on Invested Capital (1)	5.3%	5.7%	6.1%	6.8%	6.8%	NA
Dividend Coverage (2)	2.13	1.81	1.75	1.96	1.93	1.52
Dividends Paid Per Share	\$1.90	\$1.96	\$2.04	\$2.12	\$2.16	\$2.16(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 in 2024 is \$.54 per quarter.

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

KRC Total Return	8/2024	1-Yr	3-yr	5-Yr
	-6.00%	4.46%	-13.59%	-10.37%