

View of the Market

Volume XVII/Issue

4/April 2025

2024

Strategy and Insight for the Commercial Real Estate Industry

A Publication of Paramount Capital Corporation

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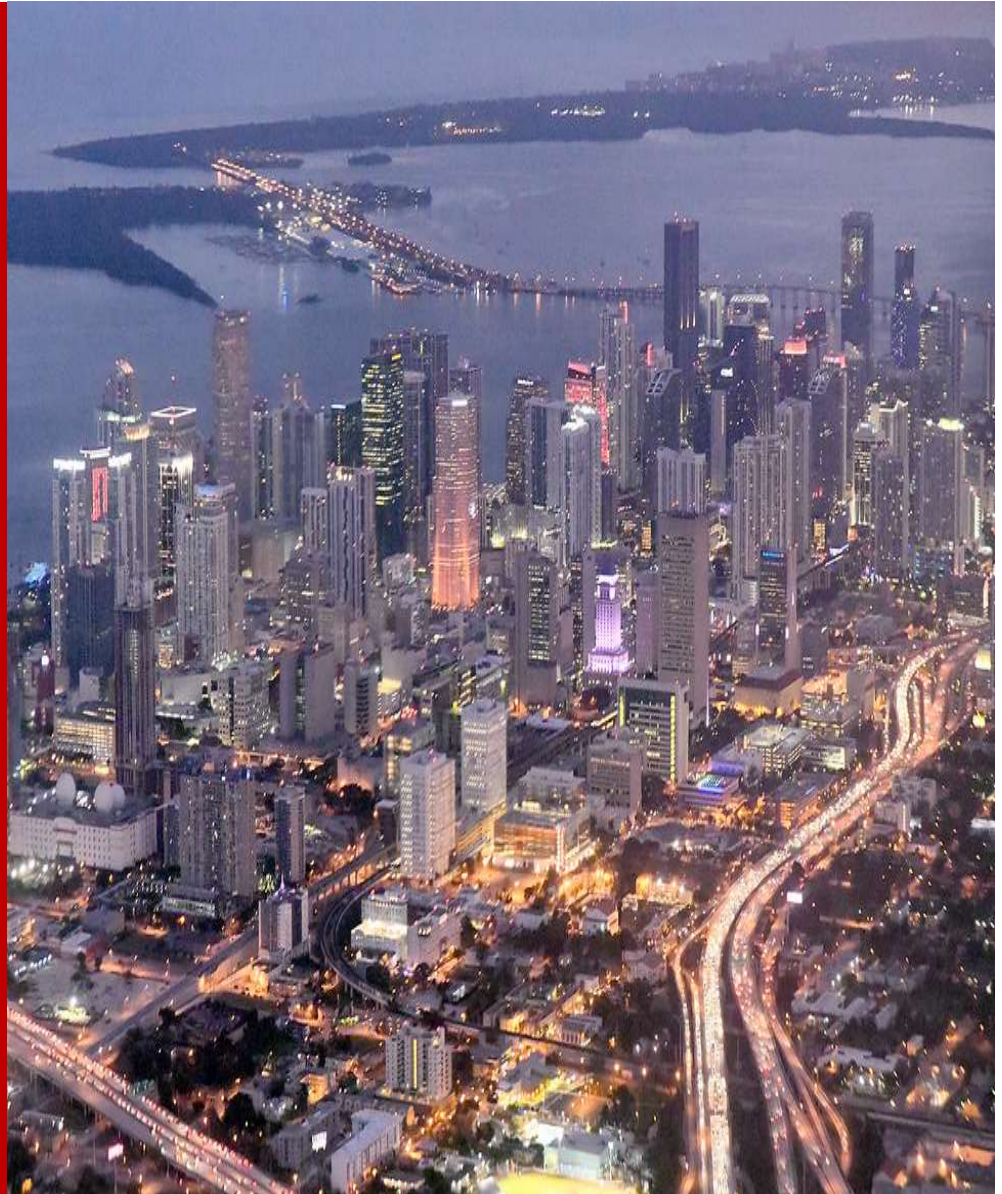
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REAL ESTATE FOCUS

Update on the CRE Debt Market

There's been a lot of chatter over the last year on the CRE debt market and looming defaults of distressed CRE loans. As usual, most of the pundits were wrong and the CRE market did not crash, and there was not a CRE implosion. The amount of distressed and defaulted CRE loans are less than 1.5% of total loans outstanding. Below is a chart from the Mortgage Bankers Association (MBA.org) of the total CRE debt outstanding as of Q4 in 2023 and 2024.

Lender	Mortgage Debt Q4-2024 (millions)	%	Mortgage Debt Q4-2023 (millions)	%
Bank and Thrift	\$1,800	37.6%	\$1,782	38.6%
Agency and GSE's	\$1,064	22.2%	\$1,002	21.7%
Life Insurance Cos.	\$799	16.3%	\$712	15.4%
CMBS, CDO & ABS	\$625	13.1%	\$593	12.8%
State and Local Government	\$109	2.3%	\$106	2.3%
Nonfinancial Corporate	\$107	2.2%	\$106	2.3%
Federal Government	\$100	2.1%	\$96	2.1%
REITs	\$85	1.8%	\$95	2.1%
Finance Companies	\$34	.7%	\$35	.8%
Nonfarm Corporate	\$34	.7%	\$33	.7%
Other Insurance	\$32	.7%	\$32	.7%
Private Pension Funds	\$10	.2%	\$14	.3%
State/Local Govt. Retirement	\$2	.1%	\$2	.1%
Household Sector	\$1	.05%	\$1	.05%
Total	\$4,789		\$4,617	

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In addition to the \$4.7 trillion of permanent loans in 2024 above, there are also \$703 billion in construction loans and \$669 billion in owner-occupied commercial mortgages, for a total of CRE debt outstanding of \$6.16 trillion. It is estimated that the current value of all investment real estate in the U.S. is approximately \$20 trillion and with \$6.16 trillion in debt, the loan to value ratio is conservative 31%. Per the MBA report, the total delinquency rate is about 1.50% or \$92.4 billion in loans and not a significant amount that can negatively affect the CRE industry or economy. There is also approximately \$2 trillion in CRE loans that will come due by the end of 2026. This will not be a problem for the industry but a welcome big boom for the mortgage brokers, bankers and lenders as interest rates are lowered and a huge refinancing wave occurs.

The CRE CLO Market

Over the last several years, commercial real estate collateralized loan obligations (CLOs) have emerged as a significant source of liquidity for various types of real estate lenders, including Wall Street investment banks, mortgage bankers, debt funds, and small hard money lenders. CLOs are structured finance transactions comprising pools of securities sold to investors and collateralized by below-investment-grade commercial real estate loans. The loans are primarily short-term bridge and transitional loans secured by first mortgage liens on the property. The average term of the loans is three to five years, and the average loan-to-value ratio is 65%-70%. There are typically four or five tranches, with the subordinated tranches being unrated and held by the issuer or sponsor. The subordinated tranches provide subordination for the higher-rated classes. Multifamily properties comprise approximately 70% of the loans contributed. The table below shows CLO issuance from 2015 to Q1-2025.

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Year	CLO Issuance (Billions)
2015	\$4.0
2016	\$2.4
2017	\$8.0
2018	\$15.2
2019	\$18.0
2020	\$8.4
2021	\$45.4
2022	\$30.5
2023	\$6.5
2024	\$8.8
2025 (Q-1)	\$7.4

The CLO market is a subset of the CRE securitization sector and is the smaller cousin of the CMBS market, which will securitize approximately \$150 billion of loans in 2025. However, as shown above, the CLO sector is poised to grow rapidly, and this is primarily due to the popularity of the CRE shadow lending market, which originates most of the CLO securitized loans. The demand and popularity of CLO securities are a function of the demand for yield by investors, tight credit conditions by regulated lenders, and a stable economy and CRE market.

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The Highest and Best Use of CRE

The highest and best use concept in CRE has been around since the early 1900s and is based on the conceptualized idea of maximum productivity for a given parcel of land. In appraising a CRE asset, the appraiser first determines the highest and best use of the land. It then determines how the highest value for the property is arrived at and how it produces the greatest value, regardless of its actual current use.

A piece of land may be considered to be its highest and best use when it provides the maximum return to its owner or user. The return may be measured in monetary terms, in intangible and social ways, or a combination of such values. However, the value of a piece of land is not static and can change over time. The highest and best use of a property at any point in time is derived from four qualities as follows:

- Is it legally allowable under local laws and regulations?
- Is it physically possible for the use of the subject land?
- Is the return financially feasible and the highest possible for the subject land?
- Does the use provide maximum utility/profitability?

In the CRE bear market of the last few years, the highest and best use concept has been put on steroids, with hundreds of properties around the country changing use. During the last five years, there have been two substantial changes in the use of many properties. The first was the conversion of older urban office buildings into high-rise apartments or condominiums. This is currently popular in many urban markets like New York City, Dallas, TX, Chicago, IL, and other downtown areas. The other highest and best use change has been suburban mall properties converted into industrial, office, hotel, medical, apartment and other special-use properties.

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The major reasons for both of these use changes are property obsolescence, changes in demand, public policy changes and higher rents and returns. The lack of construction of new apartments in many urban cores since the pandemic and the large number of older and obsolete office buildings in these urban areas has created a huge opportunity to convert these buildings from office use to multifamily. Even though there has been record construction of more than 500,000 units of new apartments around the country, most are located in high-growth Sunbelt markets



and not in these urban core markets. Developers are helping meet the demand for multifamily in these urban cores by changing the property's existing use from office to residential.

The other major change in the highest and best use is the conversion of older and obsolete regional malls and shopping centers into industrial, office and other uses. Dozens of zombie malls around the country have and will benefit from a change in use. Many of these malls were built in the 1960s or 1970's, were about 600,000 square feet and featured two or three large anchor tenants. When one or two of the anchor tenants went dark and occupancy decreased, these properties were ripe for a change in use. The new buyers would in many cases, literally cut the mall in half, with one half remaining the retail portion, as there was only demand for half the retail space in the market. The other half was converted to a myriad of new uses as mentioned above. The concept of the highest and best use is a foundation of the CRE investment business. Seeking investments that can be converted into a higher and better use is another way to create value and profits in today's tumultuous real estate environment.

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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 on Kindle, and soft and hardcover from \$8.99 to \$24.99.

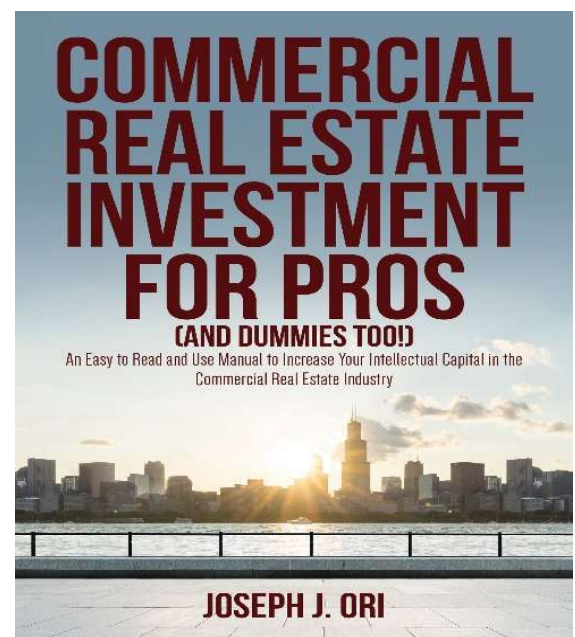
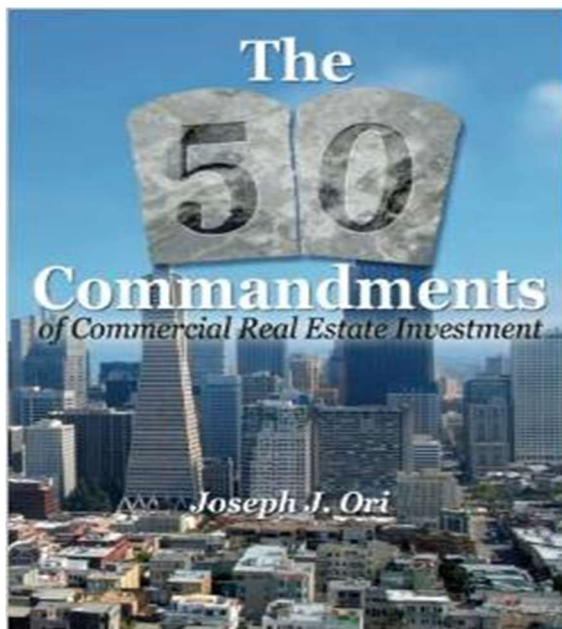
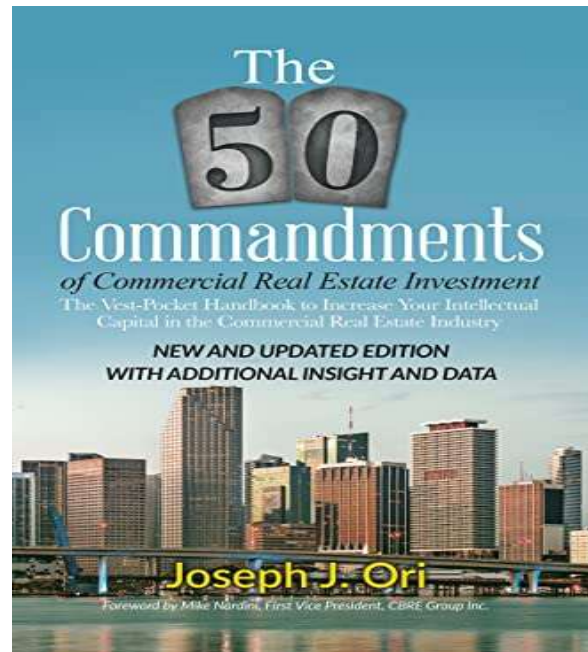
Both editions of The Fifty Commandments of Commercial Real Estate Investment compile the choice pieces of advice Mr. Ori has amassed for over 40 years in the CRE industry. Mr. Ori lists essential dos and don'ts, mistakes, and successful strategies with a mixture of critical analysis and a keen sense 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%-8.88%+	30	10	70%
Conduit-CMBS	5.88%-7.49%+	30	10	70%
Bridge Loans	5.50%-10.50%+	Interest Only	1-3	80%
Construction Loans	6.00%-11.00%+	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	7.50%
30-Day SOFR (secured overnight funding rate)	4.33%
1 Year Swap	3.88%
10 Year Swap	3.66%
5 Year Treasury	3.91%
10 Year Treasury	4.16%
Federal Funds Rate	4.25%



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Interest rates have again eased in the last month, with the 10-year treasury note down to 4.16% due to nervousness from the administration's tariff program. The Federal Reserve's Open Market Committee met on March 18th and 19th and did not lower interest rates, which we believe was a big mistake. 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
Naftali Group	Spitzer Enterprises and Winter Organization	800 Fifth Ave., New York, NY	\$800M	A 208-unit apartment property overlooking Central Park.
Starwood Capital	Goldman Sachs and Dalfen Industrial	Industrial Portfolio, U.S.	\$685M	An industrial portfolio with 38 warehouses and 89% leased.
BDT, MSC Partners and DivcoWest	Fortis Property Group	One Lincoln Tower, Boston, MA	\$400M	A 1.1 million square foot office tower sold at a foreclosure auction to the lenders.
The BlackChamber Group	The Pruitt Corp.	65 Acres, Manassas, VA	\$190M	65 acres of land for a new data center development.

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SV333 Realty LLC	Brookfield Asset Management	333 W. 34 th St., New York, NY	\$150M	A 345,500-square-foot office building originally purchased for \$255 million.
Regency Centers Corp.	Sarofim Realty Advisors	Brentwood Place Shopping Center	\$118.5M	A 320,000-square-foot retail center that is 95% leased.
A&E Real Estate	Soloviev Group	Rivers Bend, New York, NY	\$116.5M	A 179-unit apartment property built in 1963.
Journey Capital Real Estate Partners	Encore Capital Management	The Rise at Plantation Walk, Plantation, FL	\$102M	A 404-unit apartment property.
New York Life Insurance	Western Realco and AEW Capital Management	Birch Commerce Center, Brea, CA	\$92.1M	A 218,600-square-foot industrial property built in 2016.

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Foothill De Anza Community College	Prometheus Real Estate Group	McClellan Terrace, Cupertino, CA	\$66.7M	A 94-unit apartment property built in 1971.
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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. Managing Oneself: How Do I Perform?

Performance that violates your values corrupts, and it will ultimately sap and destroy your strengths. Just as different people have different strengths and weaknesses, they also work and perform in different ways. For example, some people learn by reading, others by listening. You also have to consider your personal values: are they comparable to or at least compatible with your strengths? If there is any conflict between your values and strengths, always choose values.

II. Managing Oneself: What to Contribute?

Successful careers are not the products of luck or planning; they are built by people who are able to seize those opportunities that match their own strengths. Just as it is important for you to know your own strengths, work styles, and values, it is also important that you learn the strengths, work styles and values of the people around you. Once you have identified your strengths, work style and values, as well as what your contribution should be, you must then consider who else

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needs to know about it. Everyone who depends on you and on whom you depend on needs to know this information about how you work.

III. Managing the Boss

There is nothing quite as conducive to success as a successful and rapidly promoted superior. Almost everybody has at least one boss. And the trend is for knowledge workers to have an increasing number of bosses, an increasing number of people on whose approval and appraisal they depend on, and whose support they need.

IV. Managing Oneself: The Second Half

What to do with the second half of one's life? Knowledge workers are able physically to keep on working into old age, and well beyond any traditional retirement age. But they run a new risk: they may become mentally finished. What's commonly called "burnout." Set goals outside of your current work. Begin to pursue these goals now.

Analyzing Corporate Cash Flow

With fiscal and monetary policy dumping \$9 trillion into the U.S. economy during the last four years, most corporate treasuries are flush with cash. The companies with the biggest cash hoards are the large-cap tech and industrial firms like Apple, Alphabet, Microsoft, Amazon, Meta and Berkshire Hathaway, who combined have over \$858 billion in cash and short-term investments as of their latest quarterly or annual SEC filings. This is a huge amount of excess corporate cash flow and deciding what to do with it can increase or decrease the long-term value of the firm. Generating a lot of free cash flow is the envy of every public and private company in the world and is very positive for the firm's shareholders, employees and third parties like vendors, unions and government entities.

There are only four courses of action a company can take with excess corporate cash as shown below.

1. Reinvest the cash in its core business.

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2. Use the funds to make acquisitions.
3. Return the funds to stockholders and debtholders via dividends and stock and bond buybacks.
4. Nothing, keep it on the balance sheet.

Of the four alternatives above, the best action for the company and its stakeholders is to reinvest the funds in the company's core business. Assuming the core business investments earn a return greater than the company's cost of capital, the company and its shareholders will benefit from a higher stock price and increased wealth. If companies elect to use excess capital to buy back stock or pay down debt instead of reinvesting in their core business, this means the company does not have enough profitable investment opportunities in its core business and therefore elects to return the capital to shareholders.

Another key reason companies elect buybacks over core investments is that it is easier and less risky. Corporate CEOs have three primary tasks: growth, strategy, and capital allocation. Most CEOs are good at growth and strategy but poor at capital allocation and this is where the use of excess capital is important. Finding suitable and profitable core investments takes time and is hard, but buying back one's stock is very easy and can be done every quarter. Returning capital to shareholders in the form of dividends and stock buybacks do provide financial benefits to the shareholders as they have funds to spend, save or reinvest, which increases shareholder wealth. Many companies during the last several years have used their excess cash to buy back stock (number 3 above) and the amount spent on this strategy for 2024 was \$942 billion per S&P Dow Jones Indices. The financial effect on each company of these large buybacks has been to reduce the number of common shares outstanding, which raises earnings per share and in many cases the stock price. However, the only time a company should buy back its stock is if the market price of the stock is less than its intrinsic value. We have discussed here on VOM in many issues, how to calculate a company's intrinsic value, using free cash flow analysis.

However, most corporate buybacks are at prices in excess of the company's intrinsic value and this, in the long run, will erode the company's stock price and shareholder wealth. When a company buys back stock at a price greater than its intrinsic value, the selling shareholders

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benefit at the expense of the non-selling shareholders. When the buyback is for less than the intrinsic value, the non-selling shareholders benefit at the expense of the selling shareholders. Using excess corporate cash to make acquisitions may be beneficial to the company and its shareholders, if the acquisitions are accretive in terms of earning per share, are made at values less than the target's intrinsic value and the return earned on the acquisition is greater than the company's cost of capital. There have been numerous studies over the last 30 years that have concluded that 80% of corporate mergers do not add value to the acquiring company five years after the acquisition's transaction. AOL's merger with Time Warner, ATT's purchase of Time Warner, Dollar Tree's purchase of Family Dollar, Quaker Oats' purchase of Snapple, and the merger of Sears and Kmart are a few glaring examples of overpriced and overhyped failed acquisitions.

The worst alternative above for excess capital and one that many of the technology companies are guilty of is to do nothing with their excess corporate cash. Berkshire Hathaway is the poster child for this complacency as it currently has \$334 billion in excess cash parked on its balance sheet.



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REIT Statistics

Current REIT statistics for 2/28/25 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>2/2025</i>	5.40%	5.23%	1.44%	-2.31%
<i>1-Year</i>	13.52%	13.86%	18.41%	17.93%
<i>5-Year</i>	5.11%	5.61%	16.85%	17.99%
<i>10-Year</i>	5.83%	6.06%	12.98%	15.36%
<i>20-Year</i>	7.13%	7.65%	10.46%	11.73%
<i>Market Capitalization</i>	\$1.49T	\$1.43T	\$51.1T	\$32T
<i>Dividend Yield</i>	4.09%	3.79%	1.22%	1.17%

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REIT Review

Summary

This REIT valuation is on Broadstone Net Lease, Inc. (“BNL”), a publicly traded REIT that is engaged in investing in income-producing, single-tenant net-leased commercial properties. BNL owns 765 properties with 39.4 million square feet and located in 44 states. Occupancy as of 12/31/24 was 99.1%. The same-store net operating income growth for 2024 YoY was -.7%. The three largest tenants are Roskam Foods (4.1% of annualized base rent), UNFI (3.5% of annualized base rent) and AHF Products (2.4% of annualized base rent).

Property Developments

BNL has three build-to-suit projects in process at a total cost of \$227 million with \$26 million funded as of 12/31/24 and at an average capitalization rate of 7.6%.

Corporate Data

BNL is traded on the New York Stock Exchange, is incorporated in Maryland, and is located in Victor, NY. BNL has 188.6 million common shares outstanding and a market capitalization of approximately \$3.06 billion. BNL owns a 95.6% interest and controls its UpReit limited liability company, Broadstone Net Lease, LLC and is rated BBB by Standard and Poor’s and Baa2 by Moody’s.

Management

John D. Moragne, 42, CEO

Mr. Moragne has served as our Chief Executive Officer and as a member of our Board of Directors since March 2023. Mr. Moragne previously served in various roles of the Company, including as our Executive Vice President and Chief Operating Officer from 2018 to 2023, our General Counsel and Chief Compliance Officer from 2016 through 2018, and as the Company’s Secretary from 2016 to 2021. Prior to joining the Company, Mr. Moragne was a corporate, securities and M&A attorney from 2007 to 2016. Mr. Moragne holds a B.A. from SUNY Geneseo and a J.D. from The George Washington University Law School. We believe that Mr.

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Moragne's familiarity with our operations and investment and corporate strategies, having worked with or for the Company since its inception, as well as his management and leadership skills, uniquely qualify him to serve on our Board of Directors and provides the Board of Directors with invaluable insight into our operations.

Top Institutional Holders	Shares (millions)	%
The Vanguard Group, Inc.	27,450	14.54
Blackrock Inc.	19,820	10.50
Principal Financial Group, Inc.	14,280	7.56
State Street Corporation	8,250	4.37
Geode Capital Management, LLC	4,860	2.57

Ownership Breakdown	
% Of Shares Held by All Insiders and 5% Owners	.94
% Of Shares Held by Institutional & Mutual Fund Owners	87.29
Number of Institutions Holding Shares	430

All amounts above per Yahoo Finance

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Financial Analysis and Valuation

Select financial data for BNL per the 2024 10K, and supplemental information.

(In millions where applicable)

Financial Data	Amounts
Real Estate Assets, Gross	\$4,967
Total Assets	\$5,216
Property Debt (at weighted average interest rates of approximately 4.79%)	\$1,912
Stockholders' Equity	\$3,141
Revenue	\$431
Net Income (Loss)	\$162
Cash Flow from Operations	\$276
Unsecured Credit Facility	\$807
Market Capitalization	\$3,060
Property Debt to:	
Gross Real Estate Assets	38%
Market Capitalization	62%
Enterprise Value	38%
Dividend and Yield (\$1.16sh.)	7.17%
Shares Sold Short (in millions per Yahoo Finance)	4,980

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Valuation Methodology	
2024 Real Estate Revenue	\$431
2024 Real Estate Operating Expenses (excluding depreciation, amortization, interest expense, impairment charges plus G&A expenses)	<u>\$55</u>
2024 Net Operating Income	\$376
Proforma Annualized Net Operating Income at 102%	\$383
Projected Average Cap Rate	<u>7.0%</u>
Projected Value of Real Estate Assets	\$5,471
Add: Net Operating Working Capital (at book value and less intangibles)	\$156
Property Under Development (at book value)	<u>\$18</u>
Total Projected Value of the Assets of the Company	\$5,645
Less: Total Debt per Above	<u>(\$1,912)</u>
Projected Net Asset Value of the Company	<u>\$3,733</u>
Common Shares Outstanding, 188.6M Common Shares	
Projected NAV Per Share	\$19
Market Price Per Share on 4/15/25	\$15
Premium (Discount) to NAV	(21%)

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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 BNL for the years 2019 through 2024 are shown in the table below.

(Millions except dividend and per share amounts)	2019	2020	2021	2022	2023	2024
Gross Real Estate Assets	\$3,457	\$3,704	\$4,205	\$5,008	\$4,888	\$4,967
Property Debt	\$2,004	\$1,612	\$1,714	\$2,021	\$1,909	\$1,912
Revenue	\$298	\$321	\$382	\$407	\$442	\$431
Net Income (Loss)	\$79	\$51	\$102	\$122	\$155	\$162
Funds from Operations (FFO)	\$167	\$192	\$256	\$273	\$298	\$300
Return on Invested Capital (1)	5.7%	6.2%	6.9%	6.3%	6.8%	6.4%
Dividend Coverage (2)	NA	2.46	1.55	1.42	1.52	1.35
Dividends Paid Per Share	NA	\$3.85	\$1.025	\$1.08	\$1.12	\$1.16(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 2025 is \$.29 per quarter.

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

BNL Total Return	2/2025	1-Yr	3-yr	5-Yr
	6.24%	21.17%	-1.73%	NA

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As shown above, our net asset value per share for BNL is \$19/sh., compared to a market price of \$15/sh. Current average cap rates for net lease properties per our industry experience and CBRE's Cap Rate Survey are in the 6.0% to 8%+ range, depending on the tenant's credit and lease term. We have used an average cap rate of 7.0% due to BNL's portfolio of diversified net lease assets.

Strengths:

- An attractive dividend yield of 7.17%.
- A low debt-to-enterprise value of 38%.
- The dividend has increased by 201% since 2020.
- BNL is trading at a discount to our NAV of 21%.

Concerns:

- REIT prices will decline if interest rates increase.

Recommendation:

BNL is trading at a 21% discount to our NAV per share, however we do not recommend the purchase of the stock.

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



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



1. Spirit Realty Capital, Inc., May 2023
2. Cousins Properties, Inc., June 2023
3. Tanger Factory Outlet Centers, Inc., July 2023
4. Paramount Group, Inc., August 2023
5. Broadstone Net Lease, Inc., September 2023
6. Apartment Income REIT Corp., October 2023
7. Kite Realty Group Trust, November 2023
8. Alexandria Real Estate Equities, Inc., December 2023
9. Agree Realty Corporation, January 2024
10. WP Carey, February 2024
11. Essex Property Trust, March 2024
12. Brandywine Realty Trust, April 2024
13. Urban Edge Properties, May 2024
14. Eastgroup Properties, June 2024
15. Stag Industrial, Inc., July 2024
16. Camden Property Trust, August 2024

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17. Regency Centers Corporation, September 2024
18. Kilroy Realty Corporation, October 2024
19. BXP, Inc., November 2024
20. Realty Income Corp., December 2024
21. Equity Residential, January 2025
22. Douglas Emmett, Inc., February 2025
23. Rexford Industrial Realty, Inc., March 2025

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