It’s All Relative

Our NAV-based Pricing Model has served as the backbone of our stock selection process for over twenty years. The model is designed to assess relative valuations; i.e., it identifies the REITs that are most/least attractively valued.

The model combines NAV – a great starting point and high quality estimates are essential – with the factors that impact the premiums at which REITs should trade: franchise value, balance sheet risk, corporate governance, and overhead. The compartmentalized nature of the model forces discipline to consider all relevant valuation issues.

* Past performance (as of 5/30/14) can not be used to predict future performance. Please see recommendation track record disclosure on page 20
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This report is an excerpt from REIT Valuation: Version 3.0 of our Pricing Model
The NAV-based Pricing Model

Executive Summary

Overview
- Our NAV-based pricing model has been a driver of our stock recommendations for over twenty years
- It has played an instrumental role in our successful recommendation track record
- The compartmentalized nature of the model forces discipline to consider all relevant valuation issues

The Basics
- NAV is the starting point - the value of a REIT is a function of the value of the assets it owns
- Warranted share price = NAV plus or minus a premium for future value added by management
- Franchise value, balance sheet risk, corporate governance and G&A impact the size of the premium
- It is a relative valuation model: roughly equal number of Buys and Sells at all times
- Relative approach anchors around average sector premiums at which REITs trade

The Components
- Franchise values are inherently subjective, but objective inputs help
  - Management Value Added (MVA) shines a bright light on performance attributable to mgmt
  - Total returns relative to peers are also important
  - Balance sheet acumen scores give credit for broad financing menus and low debt costs
- Balance sheets are important; less leverage is better
  - REITs with less leverage have delivered far better returns
  - Investors usually ascribe higher NAV premiums to REITs with low leverage
- Corporate Governance scoring system ranks REITs in a systematic fashion
- The impact of G&A is readily quantified and is dealt with apart from the other factors
  - Differences in G&A are large; they warrant large differences in unlevered asset value premiums
Overview: A Disciplined Approach Toward Stock Selection

**A Key Driver of Success:** The Green Street NAV-based pricing model is designed to assess the valuation of any REIT relative to sector-level peers. The discipline and rigor the model embodies have played a pivotal role in the two-decade-long success of our recommendation track record. While the model is designed to be neutral with regard to whether REITs in aggregate are cheap or expensive, investors can employ other Green Street analytic tools to help assess overall valuation and/or sector allocation issues.

**Company Research**

The NAV-based Pricing Model, coupled with heavy analyst input, drives our stock recommendations. The recommendations are always market and sector neutral.

\[
\text{NAV-Based Pricing Model} \\
\text{NAV} + \text{Warranted Premium to NAV} = \text{Warranted Share Price}
\]

**Stock Recommendations**

The NAV-based Pricing Model, coupled with heavy analyst input, drives our stock recommendations. The recommendations are always market and sector neutral.

**20+Yr Annualized Returns of Green Street's Recommendations***

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy</td>
<td>24%</td>
</tr>
<tr>
<td>Universe</td>
<td>11%</td>
</tr>
<tr>
<td>Sell</td>
<td>0%</td>
</tr>
</tbody>
</table>

*Past performance can not be used to predict future performance. Please see recommendation track record disclosure on page 20

**Macro Research**

**Overall REIT Valuation**

The *RMZ Forecast Tool*, published monthly, assesses overall REIT valuation vs. bonds and stocks. Has proven very helpful in identifying periods when REITs are badly mis-priced.

**Property Sector Allocation**

The *Commercial Property Outlook*, published quarterly, addresses sector-level valuation questions with a focus on the long term. It is based on extensive research we’ve published on long-term sector performance and cap-ex requirements.
Overview: Why Use NAV?

**Because We Can:** Most equity investors focus a great deal of attention on P/E multiples and/or yields, so it is fair to question why NAV should be the primary valuation benchmark for REITs. The short answer is that investors elsewhere would use NAV if they could, but the concept doesn’t translate well to companies that are not in the business of owning hard assets. Because the value of a REIT is, first and foremost, a function of the value of the assets it owns, NAV is a great starting point for a valuation analysis.

<table>
<thead>
<tr>
<th>Too Simplistic</th>
<th>Far Better</th>
<th>There is More to it Than Just NAV</th>
</tr>
</thead>
</table>
| Dividend Yield                 | **Net Asset Value**
   | "NAV"                                                 | Compartmentalized Analysis Looks at Relevant Factors |
| FFO Yield or Multiple          | Good NAV estimates are critical and they require serious resources |
| AFPO Yield or Multiple         | **Discounted Cash Flow**
   | "DCF"                                                 | NAV: The Starting Point |
|                                | We use DCF internally to double-check results        |

**Warranted Premium to NAV**
Warranted premiums are a function of:
- Premiums Ascribed by the Market to Other REITs
- Franchise Value
- Balance Sheet Risk
- Corporate Governance
- Overhead (G&A expenses)

**Warranted Share Price**
Used to compare valuations relative to those of other REITs. It’s fair to call it “relative intrinsic value.”
Overview: What is NAV?

Mark It to Market: An NAV-based valuation methodology is only as good as the underlying estimate of NAV. High-quality estimates of marked-to-market asset value require a great deal of effort and resources, but the estimate can be reasonably precise when done properly. It is also important to mark-to-market the right-hand side of the balance sheet, as the cost of in-place debt can stray substantially from prevailing market. Many market participants skip this important step.

REIT Balance Sheet

Book Value of Assets
- Replace With
- Market Value of Assets

Book Value of Liabilities
- Replace With
- Market Value of Liabilities

Results In...

NAV
The marked-to-market equity value per share

Common Question: Many REIT investors and analysts do not mark debt to market. Is it really necessary?

Imagine: Two identical office buildings, except that one is encumbered by a 60% LTV mortgage carrying a 7% interest rate with another five years to run, while the other has an identical loan at a 5% rate. Which building will command the higher price?

The answer is obvious to any real estate market practitioner. Building prices are profoundly impacted by assumed debt, and a high-cost mortgage negatively impacts pricing. The same holds true when those buildings are held by a REIT and if the debt is unsecured rather than secured. Marking assets to market without doing the same for liabilities yields the wrong answer.
Overview: NAV - A Simplified Example

Calculating NAV - A Simplified Example

Balance Sheet for REIT XYZ (X's $1,000)

<table>
<thead>
<tr>
<th></th>
<th>Book Value</th>
<th>Analyze</th>
<th>Market Value</th>
<th>Replace</th>
<th>Current Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Estate Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Real Estate</td>
<td>$6,000,000</td>
<td>A</td>
<td>$9,350,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction in Progress</td>
<td>$500,000</td>
<td>B</td>
<td>$550,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$200,000</td>
<td></td>
<td>$162,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity in Unconsolidated JVs</td>
<td>$1,000,000</td>
<td></td>
<td>$0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of Fee Businesses</td>
<td>$0</td>
<td>E</td>
<td>$500,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Assets</td>
<td>$100,000</td>
<td>F</td>
<td>$68,625</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td>$7,800,000</td>
<td></td>
<td>$12,880,625</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liabilities</td>
<td>$5,000,000</td>
<td>G</td>
<td>$5,250,000</td>
<td></td>
<td>$1,500,000</td>
</tr>
<tr>
<td>Preferred Stock</td>
<td>$500,000</td>
<td></td>
<td>$500,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders Equity</td>
<td>$2,300,000</td>
<td></td>
<td>$5,630,625</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fully Diluted Shares</td>
<td>200,000</td>
<td>H</td>
<td>204,750</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NAV</td>
<td>$11.50</td>
<td></td>
<td>$27.50</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The Adjustments:

A. Operating Real Estate: The most important part of an NAV analysis, this step involves calculating a 12-month forward estimate of NOI and applying an appropriate cap rate. The quality of the analysis rests on an in-depth knowledge of prevailing cap rates, the quality/location of the real estate, and other required industry- and company-specific adjustments.

B. Construction in Progress: Adjustments to the book value of CIP reflect the extent to which stabilized yields are likely to exceed an appropriately high risk-adjusted return bogey.

C. Land: Land values can be much higher or lower than book.

D. Joint Venture Accounting is a Mess: Because of that, we present a pro-rata allocation of JV assets and liabilities. There is no reliable way to otherwise value JV interests, as leverage within the JV typically renders more simplified approaches useless. A pro-rata allocation also does a much better job of showing leverage that may be embedded, but otherwise hidden, in JV investments.

E. Fee Income: Some REITs generate asset management/property management fees associated with JV structures. This fee income can be lucrative, and the range of appropriate multiples to apply is dependent on the quality of the fee stream. This value is not reflected on GAAP balance sheets.

F. Other Assets: REITs often have a material amount of intangible assets, which are deducted for this exercise.

G. Liabilities: Mark-to-market adjustments are necessary where subsidized financing is present, or market interest rates are materially higher or lower than contract rates on the REIT’s debt.

H. Fully Diluted Shares: All in-the-money options, converts, etc. need to be included in the share count.
### Overview: NAV - More on Operating Real Estate

**Calculating NAV - More on Operating Real Estate**

<table>
<thead>
<tr>
<th>Income Statement for REIT XYZ (X's $1,000)</th>
<th>Three Months Ending XXX</th>
</tr>
</thead>
<tbody>
<tr>
<td>GAAP Net Operating Income (NOI)</td>
<td>$149,500</td>
</tr>
<tr>
<td><strong>Adjustments</strong></td>
<td></td>
</tr>
<tr>
<td>Straight-Line Rent (A)</td>
<td>($1,250)</td>
</tr>
<tr>
<td>NOI of Properties Acquired During Quarter (B)</td>
<td>$1,750</td>
</tr>
<tr>
<td>Quarterly Pace of Net Operating Income</td>
<td>$150,000</td>
</tr>
<tr>
<td>Annual Pace NOI</td>
<td>$600,000</td>
</tr>
<tr>
<td>Estimated Growth Over Next 12 Months</td>
<td>$12,000</td>
</tr>
<tr>
<td>12-Month Look-Forward NOI Estimate</td>
<td>$612,000</td>
</tr>
<tr>
<td>Cap Rate (C)</td>
<td>6.5%</td>
</tr>
<tr>
<td>Value of Operating Real Estate</td>
<td>$9,350,000</td>
</tr>
</tbody>
</table>

**The Adjustments:**

**A. Straight-Line Rent:** GAAP requires that companies report average rental revenue over the term of the lease. For example, GAAP rent for a 10-yr lease with a starting rent of $50/sqft and 2% annual escalators is $55/sqft. Phantom income items like straight-line rent need to be deducted to arrive at "cash" NOI.

**B. Acquisitions:** Properties acquired during the quarter will contribute less to reported NOI than they would have had they been owned the full period. Reported NOI needs to be adjusted upward when this is the case.

**C. Cap Rate:** The convention in the real estate industry is to quote pricing in terms of the first-year yield on investment. This measure is known as the capitalization rate (cap rate). Cap rates are the most critical input in the NAV analysis. An in-depth understanding of the location, age, and general desirability of the real estate portfolio coupled with a good handle on prevailing cap rates is essential to coming up with good estimates. The cap rate for the entire portfolio is shown here, but the analysis is typically done on a market-by-market basis.
Overview: Where Do Green Street NAVs Come From?

**Hard Work:** Green Street takes its NAVs very seriously. We devote a great deal of resources toward deriving the best possible estimates of NAV because it has always been the driver of our valuation conclusions.

- **Kicking the Tires**
  - Extensive property visits
  - Deep market contacts - public & private
  - Lengthy coverage of most REITs
  - Strategic partner: Eastdil Secured

- **A Large Research Team**
  - 25 full-time research professionals in US
  - We take NAV seriously
  - It has always driven our Pricing Model

- **Real Estate Data Sources**
  - Green Street's property databases are extensive
  - We also use other research vendors
  - Local leasing and sales brokers

- **Cap-ex: the 500-Pound Gorilla**
  - Capitalized costs are big and they need to be considered
  - They vary a lot even among REITs in the same sector
  - Cap-ex is broadly misunderstood…we have studied extensively
  - Market participants underestimate cap-ex
  - Cap-ex policies influence the cap rate used
Overview: Warranted Premiums to NAV

**NAV Plus or Minus?** Prospective future total returns for any REIT are a function of how its real estate portfolio is likely to perform, as well as the value that its management team is likely to add or detract. Our Pricing Model provides a systematic assessment of the four key variables - franchise value, corporate governance, balance sheet risk, and overhead - that typically distinguish REITs that deliver "real estate plus" returns from those in the "real estate minus" camp.

Warranted Premium to NAV for a REIT is a Function of...

- **Prevailing Premiums for Sector Peers Based on Prevailing Share Prices**
- **The net value that a management team is likely to add or detract in the future**
- Our Pricing Model tallies up a total score on the variables below and ranks each REIT relative to sector peers

Which is it, NAV or UAV?
The investment world focuses on premiums to NAV, which are impacted by leverage, but the mechanics of our model strip out the distortions leverage can cause by focusing on premiums to **unlevered asset value (UAV)**. Even though the model is UAV-centric, the many references herein to NAV are employed to better speak the language most commonly used in our industry.

Franchise Value
A gauge of management's propensity to add or detract value

Corporate Governance
Our governance scoring system provides an annual review

Balance Sheet Risk
Capital Structure plays a big role in how REITs are valued

Capitalized Value of Unusual G&A
This can be readily quantified and is dealt with apart from the other factors that impact premiums
Overview: The Influence of Property Sectors

**A Normal World**: The starting point in calculating the warranted premium for any REIT is the sector-average premium ascribed by the market at current share prices. An assumption is made that the dispersion of observed premiums for the entirety of our coverage universe serves as a good indicator of how premiums should be dispersed in any given sector. REITs that stack up better in the Pricing Model relative to their sector peers are then ascribed better-than-average warranted premiums, and vice versa.

*Each sector tends to march to its own drummer on average premiums... ...to which the dispersion of premiums for all REITs can be applied*

### Why Sector Premiums Vary

There are three primary reasons:

1) REIT investors often disagree with private-market valuations
2) Some sectors may offer more lucrative growth opportunities.
3) A sector full of "A-students" should trade better

The model is neutral with regard to sector valuations.
Franchise Value: What is it?

An Important Assessment: Franchise value and G&A are the most important drivers of UAV premiums. Franchise value pertains to the value that a management team is likely to create in the future, which is a question best addressed by combining objective tools with subjective input from experienced analysts.

Franchise Value: a Forward-Looking Concept
Franchise value is an estimate of the relative value that a management team is likely to add or detract in coming years. Our analysts determine franchise value based on a wide variety of objective inputs and subjective assessments.

Objective Metrics
- Past Performance
  - Management Value Added (MVA)
  - Total Returns to Shareholders
- Balance Sheet Management
  - Balance Sheet Acumen Score
  - Full Menu of Options is good
  - Cheap debt → UAV Premium

Subjective Factors
- Lessons from REIT History
  - Simplicity is a virtue
  - Activity ≠ Value Added
  - Development is a tough business
  - Capital allocation skills are critical

Other Factors to Consider
- Will past performance recur?
- Has there been a strategy change?
- Has management learned lessons?

Franchise Score
The objective metrics help guide the analyst, but the ultimate score is entirely at his/her discretion.
Balance Sheet Risk: Balance Sheets Matter

**Low Leverage is Better:** Even though property prices have risen more than 50% over the last ten years, REITs that have employed less leverage have delivered far better returns over that time period than REITs with higher leverage. The same statement has held true over the vast majority of ten-year periods since the Modern REIT era commenced in the early-’90s. Not surprisingly, investors are willing to ascribe much higher NAV premiums to REITs with low leverage.

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**Leverage has Impacted Total Returns**
A 10% variance in the lev’g ratio has been associated with a 5% gap in total returns. Every year!

**Leverage & Total Returns (past 10 years*)**

* Charts are from Oct 2, 2012 Heard on the Beach. Left chart uses total returns from Aug ’02 to Aug ’12; right is based on stock pricing as of Sept ’12.

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**Leverage has a Big Impact on Pricing**
A 10% variance in the lev’g ratio currently equates to a 4% variance in the UAV premiums at which REITs trade

**Leverage & Premiums to Asset Value**

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A 10% variance in the lev’g ratio has been associated with a 5% gap in total returns. Every year!

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This report is an excerpt from REIT Valuation: Version 3.0 of our Pricing Model
Corporate Governance

Green Street’s Governance Scoring System: Our governance ranking system, which is published annually, differs in two key respects from those provided by other evaluators: 1) our familiarity with the companies allows for subjective input; and 2) issues unique to REITs (e.g., the 5 or fewer rule) are ignored by others. Scoring is on a 100-point basis with the key inputs highlighted below. REITs with higher governance scores typically trade at larger premiums to asset value.

<table>
<thead>
<tr>
<th>Category</th>
<th>Max Points</th>
<th>Ideal Structure</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Board Rating:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-staggered Board</td>
<td>20</td>
<td>Yes</td>
</tr>
<tr>
<td>Independent Board</td>
<td>5</td>
<td>80+%</td>
</tr>
<tr>
<td>Investment by Board Members</td>
<td>5</td>
<td>Large Investment by Numerous Members</td>
</tr>
<tr>
<td>Conduct</td>
<td>25</td>
<td>No Blemishes, Fair Comp, Leadership</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>55</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Anti-Takeover Weapons:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State Anti-takeover Provisions</td>
<td>12</td>
<td>Opt out/Shareholders Approve Change</td>
</tr>
<tr>
<td>Ownership Limits from 5/50 Rule</td>
<td>5</td>
<td>Limit Waived for Ownership by other REITs</td>
</tr>
<tr>
<td>Shareholder Rights Plan</td>
<td>10</td>
<td>Shareholders Must Approve Implementation</td>
</tr>
<tr>
<td>Insider Blocking Power</td>
<td>8</td>
<td>No Veto Power</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>35</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Potential Conflicts of Interest:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business Dealings with Mgmt.</td>
<td>6</td>
<td>No Business Dealings</td>
</tr>
<tr>
<td>Divergent Tax Basis of Insiders</td>
<td>4</td>
<td>Basis Near Share Price</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>10</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Perfect Score</strong></td>
<td><strong>100</strong></td>
<td></td>
</tr>
</tbody>
</table>

Anti-Takeover Weapons
There are only a handful of REITs where insiders hold a blocking position, but it’s a big deal where it exists. Because of that, a cap is placed on how many points a REIT where blocking power is present can score on anti-takeover rankings. After all, the anti-takeover provisions don’t matter much if insiders control the vote.
Overhead: A Strong Connection with Size

**Big is Better:** A dollar of cash flow devoted to G&A is worth the same as a dollar of cash flow at the property level, and efficiency differences between REITs can have a profound impact on share valuation. The impact on appropriate unlevered valuations can be calculated by capping those differences at the all-REIT cap rate and adding or subtracting that figure directly as a warranted premium to unlevered asset value. Not surprisingly, big REITs are more efficient when it comes to overhead, and this efficiency should translate into higher relative valuations.

![Company Size and Warranted Premiums Attributable to G&A](chart)

**Warranted Premiums to Asset Value from G&A:**
Extent to which normalized (G&A/Asset Value) is lower or higher than peer average / Avg Cap Rate
Frequently Asked Questions

Answers to Frequently Asked Questions

Q. Net Asset Value (NAV) estimates are far from precise. It’s very common to see NAV estimates for a given REIT spanning a broad range, with some being as much as 30% higher than others. Why base a model on such an imprecise estimate?

A. NAV is admittedly an imprecise estimate of value. It may be best to consider NAV as the midpoint of a reasonable range in which a figure at least 5% higher or lower than the midpoint might be accurate. Reasonable minds can disagree within this range. However, this lack of precision should not be viewed as a serious shortcoming. Every valuation methodology lacks precision, and alternative methodologies are almost certainly less precise than NAV. For instance, where do appropriate Price/Earnings (P/E) multiples come from? EBITDA multiples? An NAV-based approach componentizes the valuation question into discrete pieces and incorporates private-market pricing information, attributes that should yield a higher level of precision than a broad-brush approach to entity valuation. When analyst estimates of NAV fall well outside a reasonable range, this probably reflects the quality of the analysis, as opposed to the metric’s quality. In addition, most analysts only mark-to-market the left-hand side of the balance sheet; Green Street marks-to-market the right-hand side too. NAV calculations require a great deal of time, energy, and expertise to get right; big errors likely occur when shortcuts are taken.

Q. An NAV analysis is only as good as the cap rate applied to net operating income (NOI). Where does Green Street get its cap rates?

A. The choice of cap rates is the most important input in our model. Our analysts spend a great deal of time talking to market participants (e.g., REIT executives, private real estate participants, brokers, etc.), compiling databases of comparable transactions, reading trade publications, reviewing findings of providers of transaction information, and understanding the extent to which contractual rents are above or below market.

Q. As the REIT industry continues to mature, analysts and investors will inevitably value these stocks the same way the vast majority of other stocks are valued. Approaches based on P/E multiples, EBITDA multiples, or discounted cash flow models will take the place of a REIT-centric concept like NAV. After all, no one tries to figure out the NAV of General Motors or Microsoft, so why bother to do so with REITs?

A. The simple answer to this question is that investors in other sectors would use NAV if they could. However, their inability to do so relegates them to using generally inferior metrics. Thoughtfully applied alternative approaches to valuation should result in similar answers to an NAV-based approach, but these other methods must be used with caution.
Frequently Asked Questions (continued)

Q. REITs are more than just a collection of assets. Management matters a lot, and an NAV-based approach can’t possibly factor that in.

A. Contrary to a widespread misperception, the use of an NAV-based model is consistent with a view that management is important. As long as an NAV-based model provides output with a sizable variance in company-specific warranted premiums/discounts, that model is implicitly acknowledging that management matters significantly. Capital allocation and balance sheet management are by far the key differentiators of management capabilities.

Q. Many REITs own hundreds of properties spread across the U.S., and an asset-by-asset appraisal would take an enormous amount of time. How can an analyst know the value of any given portfolio?

A. A reasonable NAV estimate can be derived if disclosure at the portfolio level is sufficient to allow for a comparison of the characteristics of a given portfolio with the characteristics of properties that have traded hands. No two portfolios are exactly the same, but plenty of pricing benchmarks exist to allow for adjustments based on portfolio location, quality, lease structure, growth prospects, etc.

Q. REITs have broad latitude in how they expense many operating costs. Can an NAV-based approach be fooled if a REIT inflates NOI by moving costs to the General & Administrative (G&A) expense line?

A. Yes. This is why an explicit valuation adjustment for G&A expense is included in our pricing model. It identifies companies that shift expenses in ways that are inconsistent with those of its peers.

Q. An NAV analysis derived from real estate NOI seemingly ignores capital expenditures (cap-ex). How does cap-ex factor into the analysis?

A. One of the easiest ways to make big mistakes in an NAV analysis is to utilize simple rules of thumb with regard to cap-ex. Most rules of thumb undercount the magnitude of cap-ex. In addition, the range of appropriate reserves varies hugely by property sector, property quality, and accounting practices. Each factor needs to be addressed before choosing the cap-ex reserve to utilize for a particular portfolio. The real estate portfolios in any sector that offer the highest quality, best growth, and lowest risk should be accorded the highest valuation multiples (lowest cap rates), and vice versa. Thus, it is important to rank the portfolios relative to each other and to then ensure “economic” cap rates (based on NOI less a cap-ex reserve) line up in this manner. An analysis that does not back out cap-ex costs, and is instead based off of nominal cap rates, will generate misleading relative conclusions.
Frequently Asked Questions (continued)

Q. NAV is a backward looking metric.

A. Real estate markets are active and liquid, and when buyers and sellers agree on deal terms (e.g., cap rates, price/square foot, etc.), those terms reflect their views of future prospects. When prevailing cap rates are applied to a REIT's forward-looking NOI estimate, the result is an estimate of value that is as forward looking as any other approach toward valuing stocks.
This report is an excerpt from REIT Valuation: Version 3.0 of our Pricing Model

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