



Valuation and risks

CIO

Valuation

Our target price is based on a 10% discount to our 2-year forward NAV estimate at a 7% cap rate. Our cap rate assumption is based off private market transactions and our assessment of property types, regions, and asset quality. We think this metric is appropriate as we believe REITs should trade near the private market value of their assets. We apply a 10% discount to reflect our view of CIO's elevated risk profile.

Risks

We believe CIO's risk profile is higher than average, largely due to its size. We view portfolio concentration, tenant concentration, leverage, limited trading liquidity, ownership concentration, an elevated dividend payout ratio, and a reliance on external capital to fund growth beyond 2016 as the key downside risks to our Buy-rating.

PGRE

Valuation

With trophy CBD office assets trading in the sub-4% range, we are conservatively applying a 4.5% cap rate to our 2-yr forward NOI estimates to arrive at NAV. To account for the limited visibility on the timing of expected NOI increases and to account for the potential for higher-than-average quarterly earnings volatility due to the size of the portfolio, we are also applying a 5% discount to NAV to arrive at our target price.

Risks

The key risks to PGRE are tied to its small overall portfolio size and limited visibility as to when some of the expected NOI upside will be achieved. With just 12 assets, PGRE's quarter-to-quarter results can be highly influenced by the move-in or move-out of anchor tenants. It also subjects the company to above average concentration risks, with ~76% of its annualized base rent (ABR) generated from the NYC market and 68% of ABR from financial services and legal tenants. As noted above, while we see substantial NOI upside potential in the portfolio, the exact timing of when this upside will be realized is difficult to project on a quarterly basis, which could result in heightened trading volatility around earnings. We also expect heightened tenant improvement and leasing costs over the next few years as vacancy is leased up, something that will likely act as a headwind to FAD until the portfolio reaches a more stabilized level.