<u>City Office REIT Summary</u> (*Holding*)

Date of Report: Nov. 5, 2020 | P/E Ratio for CIO: - 72.34

Stock: City Office REIT (CIO) | EPS for CIO: - 0.09

Sector: Real Estate | Current Price: $8.75 | Price Target: $13.67

<u>Recommendation</u>: **Hold**

Company Summary:

City Office REIT, Inc. ("CIO") is an internally managed real estate company focused on acquiring, owning and operating high-quality office properties located in metropolitan areas in the Southern and Western United States. Our senior management team has extensive industry relationships and a proven track record in executing this strategy, which we believe provides a competitive advantage to our shareholders. We currently own 65 office buildings with a total of approximately 5.8 million square feet of net rentable area ("NRA") in the metropolitan areas of Dallas, Denver, Orlando, Phoenix, Portland, San Diego, Seattle and Tampa.

Industry Outlook Summary:

With some extensive research through IBISWorld, we gathered that the four major external drivers in the REIT industry are *revenue*, *rental vacancy rates*, *per capita disposable income* and *corporate profit*. Beginning with rental vacancy rates, these rates reflect the percentage of US rental properties that are without tenants. The vacancy rate is indicative of rental demand, as higher vacancy rates generally indicate that demand for rentals is low, while demand for housing is high. Rental vacancy rates are anticipated to increase in 2020, posing a potential threat to the industry. Secondly, per capita disposable income is defined as personal income minus current personal taxes. Consumer confidence and disposable income levels largely determine retail spending trends. As disposable income declines, consumers cut back on retail spending. A decline in retail spending decreases demand for retail space as companies cut costs or exit their respective industries. Per capita disposable income is expected to decrease in 2020. Lastly, another major factor contributing to the industries outlook for REIT's is corporate profit. Corporate profit influences businesses' demand for rental space. Contracts for office rental space and other commercial purposes normally span many years and depend on the performance of the businesses seeking to rent space. As corporate profit increases, demand for rental space rises. Corporate profit is expected to decline in 2020. *(source: IBISWorld)*

Industry Outlook COVID – 19 Summary:

The sharp decline in consumer activity among retail, lodging and other properties due to the COVID-19 (coronavirus) pandemic has caused severe rent shortfalls for REITs. According to the

National Association of REITS (NAREIT), retail REITs surveyed in April 2020 noted only collecting 70.0% of rents due. Moreover, the continuing severity of the crisis threatens to worsen commercial rent collection throughout 2020. Conversely, the industry mostly performed well prior to 2020. Rising capital markets, low interest rates and robust property values have been major contributors to the industry's growth during the period. Nevertheless, the shock of the coronavirus pandemic is expected to drag down the industry's growth. As a result, industry revenue has declined at an annualized rate of 2.7% to $181.8 billion over the five years to 2020, including a decline of 15.1% in 2020 alone as REITs struggle to collect rent amongst struggling businesses. Moreover, the industry average profit margin, measured as earnings before interest and taxes, has declined during the period, accounting for 20.8% of revenue in 2020. *(source: IBISWorld)*

Cash Flow History and Forecast:

We project dividends per share to increase back to $.94 starting in 2021 due to a swift recovery in the economy as the real estate sector closely follows the market. With the trend of recovery due to news of a vaccine, the real estate sector should immediately start to recover.

Position: Holdings						
City Office REIT (CIO) Valuation November 17, 2020	**12 Months Ended [Historical]**			Forecast		
dollars in thousands	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2019	Dec. 31, 2020	Dec. 31, 2021	Dec. 31, 2022
Income Statement [Abstract]						
Rental and other revenues	$ 106,487	$ 129,484	$ 156,297	$ 159,722	$ 176,759	$ 195,613
Operating expenses:						
Property operating expenses	42,886	49,872	57,316	57,560	61,955	66,685
General and administrative	6,792	8,137	11,066	11,122	12,581	14,232
Total operating expenses	91,272	113,858	127,541	128,470	139,933	152,418
Operating income	15,215	15,626	28,756	31,252	37,413	44,789
Net income	**9,158**	**38,669**	**2,442**	**6,801**	**6,314**	**5,861**
Changes in non-cash working capital:						
Rents receivable, net	(1,647)	(1,602)	(1,061)	(1,437)	(1,367)	(1,288)
Other assets	349	(353)	(330)	(111)	(265)	(235)
Net Cash Provided By Operating Activities	36,553	42,187	49,499	42,746	44,811	45,685
Cash Flows to Investing Activities:						
Deferred leasing costs	(4,289)	(4,048)	(3,926)	(4,088)	(4,021)	(4,011)
CapEx	(257,488)	(197,309)	(81,922)	(178,906)	(152,712)	(137,847)
Debt	489,509	645,354	607,250	580,704	611,103	599,686
Proceeds from borrowings	(3,202)	(2,963)	(1,008)	(2,391)	(2,121)	(1,840)
Repayment of borrowings	392,340	398,749	154,750	315,280	289,593	253,208
Change in WC	351	(3,503)	(6,497)	(3,216)	(4,405)	(4,706)
Dividends Per Share	$ 0.94	$ 0.94	$ 0.94	$ 0.60	$ 0.94	$ 0.94
			PV of DPS	0.56	0.81	0.76

Valuation and Sensitivity Analysis:

Analysts are projecting 12-month price forecasts for City Office REIT Inc to have a median target of 10.50, with a high estimate of 13.00 and a low estimate of 8.00. Our forecast predicts a median target of 21.18 (Short-term PV) and a median target of 13.90 (PV of FCFE) with each discount rate forecasting the stock price to be under-valued.

Calculations											
Net Income		9,158		38,669		2,442		6,801		6,314	5,861
CapEx		(257,488)		0		0		0		0	0
Change in WC		351		(3,503)		(6,497)		(6,497)		(4,405)	(4,706)
Net New Debt		389,138		395,786		153,742		312,889		287,472	251,368
FCFE	**$**	**140,457**	**$**	**437,958**	**$**	**162,681**	**$**	**326,187**	**$**	**298,191**	**$ 261,935**

Discount Rate Scenerios

Stock Price	$8.75
Discount Rate	7.50%
Under Valued	$ 12.96
Stock Price	$8.75
Discount Rate	8.50%
Under Valued	$ 12.42
Stock Price	$8.75
Discount Rate	9.50%
Under Valued	$ 11.90

PV of FCFE Scenerios

PV of FCFE Per Share at $4.80			
FCFE Target Price - DR 7.5%	$14.15	$5.40	Under
FCFE Target Price - DR 8.5%	$13.90	$5.15	Under
FCFE Target Price - DR 9.5%	$13.67	$4.92	Under

Growth Rate	3.50%	Growth Rate	3.50%	Growth Rate	3.50%
Discount Rate	7.50%	Discount Rate	8.50%	Discount Rate	9.50%
Sum of CF	$ 772,312	Sum of CF	$ 759,005	Sum of CF	$ 746,086
Shares Outstanding	54,591,047	Shares Outstanding	54,591,047	Shares Outstanding	54,591,047
Short-term PV	$2.13	Short-term PV	$2.13	Short-term PV	$2.13
FCFE	$ 4.80	FCFE	$ 4.80	FCFE	$ 4.80
Target Price	$ 21.71	Target Price	$ 21.17	Target Price	$ 20.65
Terminal Value	24.3225	Terminal Value	19.4580	Terminal Value	16.2150

PV of CF	$ 303,430	$ 258,035	$ 210,847	DR = 7.50%
	$ 300,633	$ 253,300	$ 205,071	DR = 8.50%
	$ 297,888	$ 248,695	$ 199,504	DR = 9.50%

Conclusion:

Both methods of sensitivity analysis through short-term present value of dividends per share and present value of FCFE per share, show our valuations for CIO to be under valued with each discount rate. With PV of FCFE being the most accurate analysis compared to other analysts, CIO is projected to be under valued by $5.15 in the year 2023, with a sector average discount rate of 8.5%. We will continue to hold our position.