RHIZOME PARTNERS

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Dear Partners,

During the third quarter of 2021, Rhizome Partners generated a net loss of 1.7% versus 0.6% gain for the S&P 500 index and 0.2% gain for the NAREIT index. During the quarter, Clipper Realty contributed roughly 1.5% gains. Howard Hughes and portfolio hedging contributed to roughly 1% loss and 0.5% loss, respectively. Year to date, Rhizome Partners Class B returned 17.0% versus 15.9% for the S&P 500 and 21.6% for the NAREIT index. Since inception, our portfolio had 57% market exposure, 27% cash/SPAC holdings, and 12% market neutral investments.

Time Period	S&P 500[1]	Hypothetical 10% Absolute Return	FTSE NAREIT All Equity REIT Total Return[2]	Rhizome Partners Class B Net Return[3,4]
April 10th thru Dec 31, 2013	18.2%	7.2%	-4.9%	19.50%
Full Year 2014	13.7%	10.0%	28.0%	19.2%
Full Year 2015	1.4%	10.0%	2.8%	-5.8%
Full Year 2016	12.0%	10.0%	8.6%	11.5%
Full Year 2017	21.8%	10.0%	8.7%	5.6%
Full Year 2018	-4.4%	10.0%	-4.0%	-7.2%
Full Year 2019	31.5%	10.0%	28.7%	17.8%
Full Year 2020	18.4%	10.0%	-5.1%	23.7%
Q1 2021	6.2%	2.4%	8.3%	11.5%
Q2 2021	8.5%	2.4%	12.0%	7.0%
Q3 2021	0.6%	2.4%	0.2%	-1.7%
YTD 2021	15.9%	7.4%	21.6%	17.0%
Cumulative Return Since Inception	220.7%	124.4%	110.7%	150.2%
Annualized Return Since Inception	**14.7%**	**10.0%**	**9.2%**	**11.4%**

1. S&P 500 returns include dividend reinvestments and are fully invested
2. FTSE NAREIT All Equity REIT Total Return Starts on 3/31/2013 and includes dividend reinvestments and are fully invested
3. Net return is net of expenses and incentive allocation for Class B. Individual partners may experience returns that are different than the Class B return.
4. Rhizome Partners Class B Net Return is accomplished while holding 27% cash and SPACs while comparable indexes are fully invested.
Class B Net Return also includes 12% of investments that are workouts/special situations/hedged. Total market exposure was only 57% since inception.

General Commentary

In the beginning of the summer, we noticed that the Delta variant was starting to surge in the U.S. and causing "reopening" activities to slow down. We allocated about 1% of the partners' capital to buying a basket of out-of-the money puts on the Russell 2000 indexes, portfolio companies, and comparable companies. This hedging exercise contributed to losses during the quarter. This is the expected outcome in most years. Our objective is to (1) hedge out tail risk (2) generate a cash windfall to redeploy after a significant market move and (3) keep our partners' capital fully allocated during normal markets. Because of our active risk-management strategy, we sleep better at night.

Portfolio Updates

During the quarter, we sold out of Dupont and Corteva because we believe they were trading close to fair value and we found better risk-reward opportunities. We also exited our small position in Nuance upon Microsoft's acquisition. Nuance is a leader in voice recognition software, with dominant market share, and its speech-to-text product is the gold standard in radiology. In addition, by eliminating the need for note taking and allowing doctors to focus on patient care, Nuance could transform the way doctors treat patients. We built a 1% position in Nuance after attending its comprehensive investor day. Our view is that if Nuance can successfully grow its voice-recognition software in doctor's offices, it could be worth multiples of our cost basis. Microsoft's acquisition eliminated the multi-bagger upside but also partially validates the belief that Nuance is a high-quality technology company. We exited Nuance with a 62% gain in less than a year. This example is representative of the slight adjustments we made to our portfolio construction. We will allocate to small bets on technology and high-growth companies that could increase our exposure to "right tail" upside. Rest assured that our focus is still roughly 50% real estate, 30% high-quality companies trading at cheap multiples of free cash flow, and the rest in investments with the potential for growth and higher upside.

The rest of our portfolio hummed along nicely during the quarter. Fundamentals are generally strong. Howard Hughes Corporation is benefiting from net migration to Texas and Nevada. Higher energy prices help as well. INDUS Realty is executing well and gaining more buy-side awareness. The pace of its deal making has accelerated. Warehouse rent and occupancy rates have exceeded our expectations. FRP Holdings hosted a great investor day. We upped our year-end 2023 NAV estimates upon the announcement of additional projects. We were impressed by the quality of their development projects in Washington, D.C. and the leasing velocity. There were lots of little things that the development team did well, such as locating the Immersive Van Gogh Exhibit next to the Bryant Street project, which turned the empty retail box next to the Bryant Street project into a lively art exhibit that's garnered social media engagement. At $39.90 for adult tickets, the exhibit also attracts a clientele that fits the perfect demographic for the Bryant Street apartments. The choice of location, in turn, lowers the customer-acquisition cost, improves leasing velocity, and elevates the branding of the Bryant Street apartments.

Berry Global does what Berry Global does well. It generates a good chunk of cash flow. Building on our Berry Global experience, we built a 3% position in the SPAC warrants of Gores Holdings V. The company purchased the aluminum-packaging business of Ardagh and now trades as Ardagh Metal Packaging. Unlike most SPACs, Gores has a track record of achieving its EBITDA forecast. Ardagh Metal trades at a significant discount to Ball Corporation and has more exposure to higher-margin specialty cans. We believe the SPAC warrants have 3-4x upside and the common stock has the potential to double. The company may force us to exchange the warrants for common shares at a premium. In that case, our upside will be capped at about a triple.

Clipper Realty–a Deep Value Play on New York City Recovery

In 2020, we started accumulating a position in Clipper Realty, which owns about 2.6 million square feet of multifamily housing in Manhattan and Brooklyn, 500 thousand square feet of office space in Downtown Brooklyn, and 114 thousand square feet of ground floor retail space in its multifamily buildings. My family was in the Chinese restaurant business on Long Island, New York, and despite working for almost a decade, we built very little wealth in the 1990s. In the early 2000s, my parents took out a home-equity loan and used it as a down payment toward a 50/50 investment with one of our relatives. We have since parlayed that equity into about a dozen properties in Queens, New York. Clipper Realty's New York City residential real estate is certainly within my circle of competence. Over

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the years, I have personally listed apartments, interviewed tenants, fixed broken boilers during snowstorms, and debated with my family on the acquisition of new buildings.

Unique New York City Characteristics

Warren Buffet often talks about investing in companies with moats. New York City is flanked by the East River and the Hudson River, which empty out to the Atlantic Ocean. The city literally has deep physical moats that prevent new supply from being built. New construction is hindered by existing housing stock, fierce NIMBYism, long construction lead time, and the threat of litigation from neighbors. Large, contiguous empty lots are rare, forcing developers to buy low-rise homes or warehouses to knock down and redevelop. The developers must deal with environmental remediations, demolition, and a lengthy approval process for permits. The time between lot purchase, demolition, construction, and apartment leasing can run up to five years. Litigation can further delay the process. Existing residential buildings tend to trade at very low capitalization rates, in the 3-4% range. This low cap rate (high multiples of cash flow) compensates for the high risk, long lead time, and regulatory uncertainty of development in New York City. Despite boasting a population of 8 million, New York City delivered only 10,000 to 30,000 units of housing a year from 2000-2020, restricting population growth to 0.3% to 1.0% per year. Hence, the city has a chronic housing shortage.

With a 4% capitalization rate, how does one grow wealthy from owning New York City residential buildings? I joke that there are two kinds of investors who understand the attraction of being a landlord in New York City. The first group is drawn from people like my relatives, who speak very little English. They simply understand that rent goes up 3-5% during a normal year and people want to live in the city. The second group understands that New York has physical moats that make it very difficult to add supply. It is also a robust, two-sided marketplace for dating and employment. The city also lays claim to the best collection of world-class museums, Michelin-starred restaurants, events, nightlife and an endless pool of intelligent and interesting people to meet. The best and the brightest college graduates flock to New York City, and the most prestigious employers have offices here. This becomes a positive feedback loop.

Most importantly, New York City commands a hefty “Tinder Premium.” One can certainly rent a much bigger house in the suburbs for the same price as a shoebox apartment in New York, but the apartment in the city plugs one into a deep and seemingly endless dating pool. Jeff Bezos famously said, “In our retail business, we know that customers want low prices, and I know that’s going to be true ten years from now. They want fast delivery; they want vast selection.” We are willing to bet that people in their twenties will like the option of being able to date someone new every night of the week. In contrast, a young bachelor or bachelorette can quickly deplete the dating pool in a smaller city like Kansas City. We are convinced that people will continue to pay the Tinder Premium to live in New York City decades from now.

During Covid, families with kids packed up and fled to the suburbs. Columnists and financial pundits declared that New York City was dead. This is the third time I have heard this narrative. The first time was when the Twin Towers fell on September 11. The second time was when all the major Wall Street banks were on the brink of collapse during the financial crisis of 2008/2009. The third time was during

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the Covid crisis, before we had an effective vaccine. We started building a position in Clipper in the $4 range and gradually increased our position as Clipper refinanced its buildings and added cash to the balance sheet. The company even bought back $10 million worth of stock at $5.70 per share in late 2020. We kept quiet with our Clipper thesis and kept an open mind while paying close attention to vaccine effectiveness, apartment rent, vacancy, and leasing velocity. We learned from our Calumet mistake, when we were too vocal and too public. Our candor affected our behavior and made it difficult for us to change our mind. Therefore you have heard very little about Clipper Realty from us until now.

Early in 2021, landlords gave away two to three months of rent concessions and paid for broker fees. Young renters responded in droves. For the first time in a few years, young people could afford to live in New York City. Demand for New York apartments was clearly elastic. As pricing decreased, the renters snapped up once-in-a-decade bargains and moved into the city in droves. As the available inventory started to deplete, desirable neighborhoods started to run low on available apartments. Many people who had moved away and wanted to come back suddenly found themselves competing fiercely for apartments. By the early summer, we were starting to hear about bidding wars for rental apartments. Twitter abounds with disgruntled renters complaining about how difficult it is to rent an apartment. By late Q3, anecdotes became common, describing how market rent exceeded pre-Covid levels in desirable neighborhoods like Tribeca and the Village. As we saw these significant improvements in market rent and occupancy, we started to add to our Clipper position. We believe that Clipper's financials will inflect starting in Q3 and will exceed pre-Covid levels in the next four quarters. We increased the Clipper allocation to about 13% of the fund and added an additional 2% via the March 2022 calls, with a $7.50 strike price. At the end of the Q3, our Clipper position is up roughly 31% including dividends received.

Stress Test During Covid

Clipper was thoroughly stress-tested during Covid. On the private side, Covid has had more severe effects than did September 11 or the Great Financial Crisis. Covid was worse because it took away the most attractive attributes of living in New York City—restaurants, dating, arts, and spontaneous meetings and collaborations. Clipper managed to survive Covid and none of its assets were permanently impaired. The management team even completed two cash-out refinances and increased its cash balance to roughly $98 million as of this writing. This represents about 35% of the market capitalization implied by our cost basis. Clipper's buildings are financed with long-term, fixed-rate, non-recourse mortgages. This means that if a particular building suffers impairment, Clipper can hand the keys back to the bank. One should think of the aggregate debt as a maximum figure with the potential to decline through strategic default if needed. None of that happened during 2020 or 2021. We believe Clipper has passed the most stringent stress test. The next maturity of significance is in 2027, a full six years from today.

Valuation

At our purchase price, we bought Clipper's portfolio at a 5.0% capitalization rate, using trough Covid net operating income figures. We estimate that the normalized capitalization rate is over 6%, which is a steal in New York City, where cap rates are in the 3-4% range. We also get some development projects and air rights for free, including a new project near Barclays Center in Brooklyn, which will increase NOI by 9% upon stabilization. Clipper also owns air rights on 65th Street, by Central Park, and the rights to develop 500 thousand to 1.5 million square feet of housing in the eastern part of Brooklyn. The dividend yield of Clipper was 5.9% at our cost basis. Upon Covid recovery and stabilization of the new 1010 Pacific project, the dividend yield could be as high as 10.8% at our cost basis. On an unlevered basis, we bought Clipper at under $1.3 billion valuation. We estimate that the private market value is about $1.8-$2.0 billion. On a levered basis, we believe we bought the equity at about 32% of private market value.

Another approach to understanding the undervaluation is by examining the replacement cost of the portfolio. We estimate the Clipper portfolio to be worth $600 per square foot, and we paid roughly $400 per square foot. The new construction cost of this portfolio is likely about $800 per square foot. Ground-up development sites can easily cost $200 per square foot. Hard construction cost will come to at least $300 per square foot. Soft cost, financing cost, and developer profits can easily bring the replacement cost to the $800 range for buildings in Queens and Brooklyn. Two of Clipper's buildings—Tribeca House and Clover House—have replacement cost of roughly $1,500 per square foot. Buying at 50 cents of replacement cost in a densely populated location often confers a large margin of safety. It is also important to note that replacement cost is not static. In New York City, replacement cost tends to increase 4-5% a year. The land appreciates over time and the cost to create the foundation, structures, and exterior walls tends to grow much faster than inflation. Because of the siloed nature of Clipper's non-recourse mortgages, our cost basis implies that we paid for the cash balance and the equity in Tribeca House alone. We received all the other buildings and air rights for free.

Inflection/Catalyst

Clipper should report its results shortly. It will likely take four quarters for Clipper to pass through the rent increases. Most important, the narrative of "New York City is dead" can now be put to rest, eliminating terminal risk to the investment. The current environment sets up Clipper to grow its AFFO by double digits for the next 1-3 years. Clipper suffered from being subscale during its IPO in 2017. New supply was also being delivered in 2017-2020, after years of rapid rent increases following the Great Recession, when projects got mothballed. Clipper bought some "value-added" projects that took a couple years to stabilize. When the projects were finally ready to be consolidated in late 2019, Covid hit and dominated the narrative. Clipper never had an opportunity to fully demonstrate its earnings power of $80 million of NOI. We believe Clipper can achieve $80 million of NOI in the next 1-2 years and grow to $90 million of NOI with some additional rent increases. This would imply a P/AFFO multiple of 7x to 10x in the next 1-3 years at our cost basis.

Management Team

Clipper's management team owns more than 50% of the shares outstanding. They tend to think and behave like long-term family owner/operators. But this also introduces an element of control risk. We have spoken with them a couple times during the NAREIT conference in New York. We also chatted with the former CFO closely during 2020. Our assessment is that they are competent operators and

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savvy in structuring building-level debt. We conducted due diligence with a former long-term shareholder and were assured that minority shareholders were treated fairly. The dividend receipts of the insiders alone are multiples of their annual compensation. This coupled with their large ownership stake translates into alignment of interest. We wish that they could allocate more time and effort to investor relationships. But every investment tends to have a bit of a flaw that creates mispricing. We believe that the dividend is a mechanism for minority shareholders to participate in the upside. Some of the negatives—lack of investor outreach and illiquid trading, for example—are more than offset by the degree of undervaluation.

Please feel free to reach out to us if you have any questions.

Sincerely,

Chong Tong Chen

Chong Tong "Bill" Chen

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