

PARAGON REAL ESTATE EQUITY & INVESTMENT TRUST

Form 10-K

February 15, 2012

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K**

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

“ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2011**

**Commission File Number: 001-15409**

**PARAGON REAL ESTATE EQUITY AND INVESTMENT TRUST**

(Exact name of registrant as specified in its charter)

**Maryland**  
(State or other jurisdiction of

incorporation)

**10011 Valley Forge Drive, Houston, Texas**  
(Address of principal executive offices)

**Registrant's telephone number: 440-283-6319**

**39-6594066**  
(I.R.S. Employer

Identification Number)

**77042**  
(Zip code)

**Securities registered under Section 12(b) of the Act: None**

# Edgar Filing: PARAGON REAL ESTATE EQUITY & INVESTMENT TRUST - Form 10-K

## Securities registered under to Section 12(g) of the Act: Common Shares, \$0.01 par value

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the Registrant is not required to file reports pursuant to section 13 or 15(d) of the exchange act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to the filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☒

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K ☒.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☒

Indicate by check mark whether the Registrant is a shell company (as defined in rule 12b-2 of the Exchange Act.) Yes ☒ No ☐

At February 15, 2012, the Registrant had issued 443,226 common shares of beneficial interest and had 405,096 shares outstanding after deducting 38,130 shares held in treasury. At June 30, 2011, the aggregate market value of the voting common shares held by non-affiliates of the Registrant was approximately \$34,116 based on the closing price of \$0.18 per common share on the over-the-counter bulletin board on that date.

## DOCUMENTS INCORPORATED BY REFERENCE

None

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**PARAGON REAL ESTATE EQUITY AND INVESTMENT TRUST**

**2011 ANNUAL REPORT ON FORM 10-K**

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### **PART I**

#### **Item 1. Business.**

##### **Company Overview**

Paragon Real Estate Equity and Investment Trust (the Company, Paragon, we, our, or us) is a real estate company with its primary focus on keeping its public entity available for value-added real estate opportunities, including land development, retail, office, industrial, hotel, other real estate investment and operating companies, and joint venture investments. In addition in early 2008, the Company began to invest on a temporary basis a portion of its available cash in publicly traded shares of other real estate companies. The investments are available to be liquidated into cash as needed. Presently, the Company is a corporate shell, current in its SEC filings that may be used in the future for real estate transactions or sold to another company.

The Company was formed on March 15, 1994 as a Maryland real estate investment trust ( REIT ). We operated as a traditional real estate investment trust by buying, selling, owning and operating commercial and residential properties through December 31, 1999. In 2000, the Company purchased a software technology company, resulting in the Company not meeting the Internal Revenue Code qualifications to be a REIT for federal tax purposes. In 2002, the Company discontinued the operations of the technology segment. We intend to take advantage of our tax loss carryforwards prior to electing REIT status again.

From 2003 through 2006, we pursued a value-added business plan primarily focused on acquiring well located, under-performing multi-family residential properties, including affordable housing communities, and repositioning them through renovation, leasing, improved management and branding. In 2006, we were unable to complete a \$100 million public offering to fund an acquisition of a portfolio of ten apartment communities comprised of 1,478 units located in Texas and Ohio. Without completing the public offering, the Company was not able to meet the listing requirements of the American Stock Exchange ( Amex ) because its book equity was less than the \$6 million minimum requirement, it had sustained consecutive years of losses from operations and net losses since its inception in 1994, and its common shares had been selling at a low share price for more than a year. In February 2006, Amex delisted Paragon's common shares, which then commenced being quoted on the Over-The-Counter Bulletin Board ( OTC Bulletin Board ) and on the pink sheets with the new symbol PRLE .

Because our unrestricted cash was not sufficient to allow us to continue operations, in the third quarter of 2006, three independent trustees signed subscription agreements to purchase 125,000 Class C Convertible Preferred Shares for an aggregate contribution of \$500,000 to maintain the Company as a corporate shell current in its SEC filings so that it may be used in the future for real estate transactions or sold to another company. There can be no assurance that we will be able to close a transaction or keep the Company currently filed with the SEC. Even if our management is successful in closing a transaction, investors may not value the transaction or the current filing status with the SEC in the same manner as we did, and investors may not value the transaction as they would value other transactions or alternatives. Failure to obtain external sources of capital and complete a transaction will materially and adversely affect the Company's ability to continue operations.

##### **Competition**

We compete for the acquisition of properties with many entities, including, among others, publicly traded REITs, life insurance companies, pension funds, partnerships and individual investors. Many competitors have substantially greater financial resources than we have. In addition, certain competitors may be willing to accept lower returns on their investments. If competitors prevent us from buying properties that may be targeted for acquisition, our capital appreciation and valuation may be impacted. Because we invest on a temporary basis a portion of our available cash in publicly traded shares of other real estate companies, we compete with other investors for these same shares. We are subject to the fluctuations in market prices of these publicly traded securities.

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### **Employees**

The Company has two part-time employees as of February 15, 2012.

### **Item 1A. Risk Factors.**

This annual report contains historical information, as well as forward-looking statements that involve known and unknown risks and relate to future events, our future financial performance, or our expected future operations and actions. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expect, plan, anticipate, believe, estimate, future, intend, could, hope, potential, or continue or the negative of these terms or other similar expressions. These forward-looking statements are only our predictions based upon current information and involve numerous assumptions, risks and uncertainties. Our actual results or actions may differ materially from these forward-looking statements for many reasons. While it is impossible to identify all of these factors, the following could cause actual results to differ materially from those estimated by us:

worsening of national economic conditions, including limited liquidity in the capital markets and stringent lending requirements by financial institutions;

depressed values for commercial real estate properties and companies;

changes in interest rates and in the availability, cost and terms of mortgage funds;

decreases in market prices of the shares of publicly traded real estate companies;

adverse changes in governmental rules and fiscal policies; and

other factors which are beyond our control.

In addition, an investment in the Company involves numerous risks that potential investors should consider carefully, including, without limitation:

we have no operating assets;

our cash resources are limited;

we have a history of losses;

we have not raised funds through a public equity offering;

our trustees control a significant percentage of our voting shares;

shareholders could experience possible future dilution through the issuance of additional shares;

we are dependent on a small number of key senior professionals who are part-time employees; and

we currently do not plan to distribute dividends to the holders of our shares.

**Table of Contents****Item 2. Properties.**

As of December 31, 2011, we did not own any real estate assets.

**Item 3. Legal Proceedings.**

In the normal course of business, we may be involved in legal actions arising from the ownership and administration of real estate. In our opinion, the liabilities, if any, that may ultimately result from such legal actions are not expected to have a materially adverse effect on our consolidated financial position, operations or liquidity. We are not currently involved in any legal actions.

**PART II****Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities.**

Our common shares are quoted on the OTC Bulletin Board and on the pink sheets with the symbol PRLE.

Our Class A Preferred Shares are quoted over-the-counter with the symbol PRGYP. Preferred shareholders have the right to convert each of their shares for 0.046 common shares.

Our Class C Convertible Preferred Shares were issued effective September 29, 2006 to the trustees of the Company who contributed cash and/or services for these shares. The Class C Convertible Preferred Shares are not traded on an exchange.

The following table shows the range of the high and low sale prices for our common shares as reported on the OTC Bulletin Board. The quotations shown represent inter-dealer prices without adjustment for retail markups, markdowns or commissions, and may not reflect actual transactions.

<b>2011</b>	<b>High</b>	<b>Low</b>
4 <sup>th</sup> Quarter	\$ 0.19	\$ 0.18
3 <sup>rd</sup> Quarter	\$ 0.19	\$ 0.12
2 <sup>nd</sup> Quarter	\$ 0.25	\$ 0.09
1 <sup>st</sup> Quarter	\$ 0.11	\$ 0.09
<b>2010</b>	<b>High</b>	<b>Low</b>
4 <sup>th</sup> Quarter	\$ 0.09	\$ 0.09
3 <sup>rd</sup> Quarter	\$ 0.09	\$ 0.08
2 <sup>nd</sup> Quarter	\$ 0.09	\$ 0.08
1 <sup>st</sup> Quarter	\$ 0.10	\$ 0.08

On February 8, 2012, the last reported sales price of our common shares on the OTC Bulletin Board was \$0.20. The number of holders of record of our common shares was 230 as of February 15, 2012 and we estimate we have approximately 1,200 beneficial holders of common interests as of that same date.

**Dividend Policy**

We have not declared or paid dividends on our common shares since 1999, and we do not anticipate paying dividends on our common shares in the foreseeable future. Declaration or payment of dividends, if any, in the future, will be at the discretion of the board of trustees and will depend on our then current financial condition, results of operations, capital requirements and other factors deemed relevant by the board of trustees.

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### **Preferred Share Conversions**

During 2011, no preferred shares were converted to common shares.

### **Issuer Purchases of Equity Securities**

The Company did not purchase any of its equity securities in 2011.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

### **Cautionary Statements Regarding Forward-Looking Statements**

This annual report contains historical information, as well as forward-looking statements that involve known and unknown risks and relate to future events, our future financial performance, or our expected future operations and actions. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expect, plan, anticipate, believe, estimate, future, intend, could, hope, potential, or continue or the negative of these terms or other similar expressions. These forward-looking statements are only our predictions based upon current information and involve numerous assumptions, risks and uncertainties. Our actual results or actions may differ materially from these forward-looking statements for many reasons. While it is impossible to identify all such factors, factors that could cause actual results to differ materially from those estimated by us include:

worsening of national economic conditions, including limited liquidity in the capital markets and stringent lending requirements by financial institutions;

depressed values for commercial real estate properties and companies;

changes in interest rates and in the availability, cost and terms of mortgage funds;

decreases in market prices of the shares of publicly traded real estate companies;

adverse changes in governmental rules and fiscal policies; and

other factors which are beyond our control.

In addition, an investment in the Company involves numerous risks that potential investors should consider carefully, including, without limitation:

we have no operating assets;

our cash resources are limited;

we have a history of losses;



we have not raised funds through a public equity offering;

our trustees control a significant percentage of our voting shares;

shareholders could experience possible future dilution through the issuance of additional shares;

we are dependent on a small number of key senior professionals who are part-time employees; and

we currently do not plan to distribute dividends to the holders of our shares.

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### **Overview**

Paragon Real Estate Equity and Investment Trust (the Company, Paragon, we, our, or us ) is a real estate company with its primary focus on keeping its public entity available for value-added real estate opportunities, including land development, retail, office, industrial, hotel, other real estate investment and operating companies, and joint venture investments. During the fourth quarter of 2008 and continuing through much of 2011, capital markets had limited access for small companies, like Paragon, and financing was difficult to obtain for real estate transactions. Paragon has also been reviewing the possibility of selling the corporate entity or seeking additional investors. In addition in early 2008, the Company began to invest on a temporary basis a portion of its available cash in publicly traded shares of other real estate companies. The investments are available to be liquidated into cash as needed.

As of December 31, 2011, the Company is a public shell current with its SEC filings. The board of trustees intends to keep the Company currently filed with the SEC as a corporate shell that may be used in the future for real estate deals or sold to another company. There can be no assurance that we will be able to close a transaction or keep the Company currently filed with the SEC. Even if our management is successful in closing a transaction, investors may not value the transaction or the current filing status with the SEC in the same manner as we did, and investors may not value the transaction as they would value other transactions or alternatives. Failure to obtain external sources of capital will materially and adversely affect the Company's ability to continue operations, as well as its liquidity and financial results.

### **Brief History**

Paragon was formed on March 15, 1994 as a Maryland real estate investment trust ( REIT ). We operated as a traditional real estate investment trust by buying, selling, owning and operating commercial and residential properties through December 31, 1999. In 2000, the Company purchased a software technology company, resulting in the Company not meeting the Internal Revenue Code qualifications to be a REIT for federal tax purposes. In 2002, the Company discontinued the operations of the technology segment. We intend to take advantage of our tax loss carryforwards prior to electing REIT status again.

### **Recent Developments and Executive Overview**

During 2011, the Company continued as a public shell current with its SEC filings. The board of trustees approved investing on a temporary basis a portion of the Company's available cash in shares of publicly traded real estate companies, and the Company began doing so in early 2008.

### **Results of Operations**

The following is a discussion of our results of operations for the years ended December 31, 2011 and 2010 and financial condition, including:

Explanation of changes in the results of operations in the Consolidated Statements of Operations for the year ended December 31, 2011 compared to the year ended December 31, 2010.

Our critical accounting policies and estimates that require our subjective judgment and are important to the presentation of our financial condition and results of operations.

Our primary sources and uses of cash for the year ended December 31, 2011, and how we intend to generate cash for long-term capital needs.

Our current income tax status.

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### **Comparison of the years ended December 31, 2011 and 2010**

#### **Revenues from Operations**

Total revenues remained the same at approximately \$8,000 for the years ended December 31, 2010 and December 31, 2011. Interest and dividend income increased from approximately \$6,700 for the year ended December 31, 2010 to approximately \$8,000 for the year ended December 31, 2011, an increase of \$1,300 due to increased dividends and interest paid by real estate companies and by two equity securities in which we were invested. Other income of approximately \$1,300 for the year ended December 31, 2010 decreased to zero for the year ended December 31, 2011. The decrease was the result of the removal of an estimate for accrued liabilities and accounts payable in 2010 that was no longer considered an obligation.

#### **Expenses from Operations**

Total expenses, comprised mostly of general and administrative expenses, increased approximately \$2,000; from approximately \$64,000 for the year ended December 31, 2010 to approximately \$66,000 for the year ended December 31, 2011. This net increase is mostly due to an increase in SEC filing costs to meet the additional XBRL filing requirements.

#### **Loss from operations**

As a result of the above, the loss from operations increased from approximately \$56,000 for the year ended December 31, 2010 to approximately \$58,000 for the year ended December 31, 2011.

#### **Gain on sale of marketable securities**

The gain on sales of marketable securities of approximately \$25,000 for the year ended December 31, 2011 was a result of our sale of 17,675 common shares of publicly traded real estate companies for approximately \$266,000.

The gain on sales of marketable securities of approximately \$49,000 for the year ended December 31, 2010 was a result of our sale of 4,945 common shares of publicly traded real estate companies for approximately \$154,000.

#### **Net loss attributable to Common Shareholders**

Based on the above, the net loss attributable to Common Shareholders increased from approximately \$7,000 for the year ended December 31, 2010 to approximately \$33,000 for the year ended December 31, 2011.

### **Liquidity and Capital Resources**

Cash provided by operations, equity transactions, and borrowings from affiliates and lending institutions have generally provided the primary sources of liquidity to the Company. Historically, the Company has used these sources to fund operating expenses, satisfy its debt service obligations and fund distributions to shareholders. Presently, we are dependent on our existing cash, which was provided by three independent trustees contributing \$500,000 in exchange for Class C Convertible Preferred Shares to maintain the Company as a corporate shell current in its SEC filings so that it may be used in the future for real estate transactions or sold to another company. We have kept the public entity available for value-added real estate opportunities, including land development, retail, office, industrial, hotel, other real estate investment and operating companies, and joint venture investments, as well as reverse merging with another company, selling the corporate entity, and seeking additional investors. In early 2008, the Company began to invest on a temporary basis a portion of its available cash in publicly traded shares of other real estate companies. The investments are available to be liquidated into cash as needed.

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### **Cash Flows**

As of December 31, 2011, our unrestricted cash resources were approximately \$12,000. We are dependent on our existing cash, contributed by three independent trustees in exchange for Class C Convertible Preferred Shares, to meet our liquidity needs because we do not have cash from operations to meet our operating requirements.

During the year ended December 31, 2011, the Company's cash balance decreased by approximately \$20,000 from approximately \$32,000 at December 31, 2010 to approximately \$12,000 at December 31, 2011. During 2011, we invested cash of approximately \$234,000 in the purchase of marketable securities of other publicly traded real estate companies. This was offset by approximately \$266,000 cash received from the sale of some of these marketable securities. Cash of approximately \$52,000 was used in continuing operations.

Cash used for continuing operations included general and administrative costs, primarily for maintaining Paragon as a public shell and to keep it current with its SEC filings so that it may be used in the future for real estate deals or sold to another company.

### **Future Obligations**

Because the Company is a corporate shell that may be used in the future for real estate transactions or sold to another company, we have no cash from operations and have reduced our day-to-day overhead expenses and material future obligations. We have reduced overhead expenses by issuing stock for our CEO's salary and trustee fees, placed our other employee on a part-time unpaid basis, and have not replaced employees who have left. We have eliminated our office space and rent, and reduced the use of outside consultants, negotiating discounts on prices wherever possible, and foregoing other expenses.

### **Long Term Liquidity and Operating Strategies**

We historically have financed our long term capital needs, including acquisitions, as follows:

Borrowings from new loans;

Additional equity issuances of our common and preferred shares; and

Proceeds from the sales of our real estate, a technology segment, and marketable securities.

Because our unrestricted cash is not sufficient to allow us to continue operations, we have been reviewing other alternatives, including selling the corporate entity and seeking additional investors. In 2006 and 2007, the Company received total payments of \$500,000 from three independent trustees for payment of Class C Convertible Preferred Shares. These funds have been and continue to be used to maintain Paragon as a public shell current with its SEC filings while it searches for and reviews other value added real estate opportunities. In addition, the Company began in early 2008 to invest on a temporary basis a portion of the available cash in shares of publicly traded real estate companies that have share prices at discounts to their net asset value. The investments are available to be liquidated into cash as needed.

### **Current Tax Status**

At December 31, 2011, we have net operating loss carryforwards of approximately \$2.3 million. While these losses created a deferred tax asset, a valuation allowance was applied against the asset because of the uncertainty of whether we will be able to use these loss carryforwards, which will expire in varying amounts through the year 2031.

We, and our subsidiary, are also subject to certain state and local income, excise and franchise taxes. The provision for state and local taxes has been reflected in general and administrative expense in the consolidated statements of operations and has not been separately stated due to its insignificance.



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### **Interest Rates and Inflation**

Interest rates fell during 2008 as the Federal Reserve Bank lowered the discount rate and remained low through 2011. While interest rates are at record lows, capital markets were generally not accessible by small real estate companies, like Paragon in 2009 through 2011 and debt financing was only available to larger creditworthy companies. Financial institutions tightened financial covenant tests, decreased loan-to-value ratios, and charged higher fees for loans, which has reduced the number of real estate transactions.

We were not significantly affected by inflation during the periods presented in this report due primarily to the relative low nationwide inflation rates and the Company being a corporate shell with minimal expenses.

### **Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements that have, or are likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

### **Application of Critical Accounting Estimates**

Our Consolidated Financial Statements are prepared in accordance with generally accepted accounting principles, which require us to make certain estimates and assumptions. The following section is a summary of certain estimates that both require our most subjective judgment and are most important to the presentation of our financial condition and results of operations. It is possible that the use of different estimates or assumptions in making these judgments could result in materially different amounts being reported in our Consolidated Financial Statements.

#### **Valuation Allowance of Deferred Tax Asset**

We account for income taxes using the liability method under which deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities using enacted tax rates in effect for the period in which the differences are expected to affect taxable income. At December 31, 2011, we had net operating loss carryforwards totaling approximately \$2.3 million.

While these losses created a deferred tax asset of approximately \$935,000, a valuation allowance of \$935,000 was applied against this asset because of the uncertainty of whether we will be able to use these loss carryforwards, which will expire in varying amounts through the year 2031. Pursuant to Internal Revenue Code regulations, we will be limited to using approximately \$2.3 million of the prior net operating losses of \$11.1 million, and these same regulations also limit the amount of loss used in any one year.

### **Item 8. Financial Statements and Supplementary Data**

The required audited consolidated financial statements of the Company are included herein commencing on page F-1.

### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

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### **Item 9A. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

As of December 31, 2011, we evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934. Based upon this evaluation, our principal executive officer and principal financial officer each concluded that, as of December 31, 2011, our disclosure controls and procedures were effective.

#### **Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining an adequate system of internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles defined in the exchange act.

Our principal executive officer and principal financial officer carried out an evaluation of the effectiveness of our internal control over financial reporting. In making this evaluation, management used the COSO (the Committee of Sponsoring Organizations) framework of the Treadway Commission. Based on the results of our evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2011. Further, there was no change in the fourth fiscal quarter of 2011 in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

#### **Changes in Internal Control over Financial Reporting**

No changes.

### **Item 9B. Other Information.**

None.

**Table of Contents****PART III****Item 10. Directors, Executive Officers and Corporate Governance.**

The names, ages and positions of our trustees and executive officers are as follows:

<b>Name</b>	<b>Age</b>	<b>Position</b>	<b>Expiration of Term <sup>(1)</sup></b>
James C. Mastandrea	68	President, Chief Executive Officer and Chairman of Board of Trustees	2006 <sup>(1)</sup>
John J. Dee	60	Senior Vice President, Chief Financial Officer and Trustee	2007 <sup>(1)</sup>
Daryl J. Carter	56	Trustee	2008 <sup>(1)</sup>
Daniel G. DeVos	53	Trustee	2006 <sup>(1)</sup>
Paul T. Lambert	59	Trustee	2007 <sup>(1)</sup>
Michael T. Oliver	68	Trustee	2008 <sup>(1)</sup>

- (1) Because the trustees own a significant number of the voting shares and the Company is reducing expenses to conserve its limited cash, an annual meeting has not been held since 2006. The trustees will continue to serve until an election of trustees is held, though no election is currently planned.

**Board of Trustees and Executive Officers**

The business experience, principal occupations and employment, as well as the periods of service, of each of our trustees and executive officers during at least the last five years are set forth below.

*James C. Mastandrea* has been our Chairman, President and Chief Executive Officer since 2003. Mr. Mastandrea has over 35 years of experience in the real estate industry and 17 years serving in high level positions of publicly traded companies. He also serves, since 2006, as the President, Chief Executive Officer and Chairman of the Board of Trustees of Whitestone REIT, a publicly traded REIT listed on the NYSE-Amex focused on Community Centered Properties™, and, since 1978, as the Chief Executive Officer/Founder of MDC Realty Corporation, a privately held residential and commercial real estate development company. From 1994 to 1998, Mr. Mastandrea served as Chairman and Chief Executive Officer of First Union Real Estate Investments, a NYSE-listed real estate investment trust. Mr. Mastandrea also served in the U.S. Army as a Military Police Officer. Mr. Mastandrea currently is a director of Cleveland State University Foundation Board and a member of the investment committee, director of University Circle Inc. Board, Cleveland, Ohio and is a member of the real estate committee, and a director of the Calvin Business Alliance Board at Calvin College, Grand Rapids, Michigan. Mr. Mastandrea regularly lectures to MBA students at the University of Chicago and Rice University and also regularly presents to institutional investors in the U.S. and Europe. Mr. Mastandrea's significant experience and familiarity with the commercial real estate industry and public companies allows him to provide insight into various aspects of the economy and commercial real estate, which is of significant value to our Board.



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*John J. Dee* has served as a trustee, Senior Vice President and Chief Financial Officer since 2003. Since October 2006, Mr. Dee has also been Chief Operating Officer, Executive Vice President, and Director of Finance at Whitestone REIT, a publicly traded REIT listed on NYSE-Amex focused on Community Centered Properties<sup>TM</sup>. Prior to Mr. Dee's joining Paragon, from 2002 to 2003, he was Senior Vice President and Chief Financial Officer of MDC Realty Corporation, Cleveland, Ohio, an affiliate of MDC Realty Corporation, Chicago, Illinois, a privately held residential and commercial real estate development company. From 2000 to 2002, Mr. Dee was Director of Finance and Administration for Frantz Ward, LLP, Cleveland, Ohio, a Cleveland-based law firm. From 1978 to 2000, Mr. Dee held various management positions with First Union Real Estate Investments (NYSE), most recently as Senior Vice President and Chief Accounting Officer from 1996 to 2000. Mr. Dee is licensed as a CPA (non-practicing) in the State of Ohio. Mr. Dee has a significant number of years of experience with publicly listed REITs and his financial and accounting background provides assistance to the Board.

*Daryl J. Carter* has served as a trustee since June 2003. Mr. Carter founded and since 2007 has served as Chairman and CEO of Avanath Capital Partners, LLC, an investment firm focused on urban-themed real estate and mortgage investments. Mr. Carter directs the strategy, investments, and overall operations of the firm. From 2005 to 2007, Mr. Carter was an Executive Managing Director of Centerline Capital Group (Centerline), a subsidiary of Centerline Holding Company (NYSE), and head of the Commercial Real Estate Group. Mr. Carter was responsible for overseeing the Commercial Real Estate Group's national origination platform, investment strategy and new business development. From 2005 to 2007, he was also the President of American Mortgage Acceptance Corporation, a publicly-held, commercial mortgage lender (Amex) that was externally managed by Centerline. Mr. Carter became part of Centerline when his company, Capri Capital Finance (CCF), was acquired by Centerline in 2005 and stayed with Centerline until 2006. Mr. Carter co-founded and served as Co-Chairman of both CCF and Capri Capital Advisors in 1992. He was instrumental in building Capri to a diversified real estate firm with \$8 billion in real estate equity and debt investments under management. Prior to Capri, Mr. Carter was Regional Vice President at Westinghouse Credit Corporation in Irvine and a Second Vice President at Continental Bank in Chicago. Mr. Carter is a Trustee of the Urban Land Institute, Treasurer and Executive Committee Member of the National Multifamily Housing Association, Past Chairman of the Commercial Board of Governors of the Mortgage Bankers Association, and a Trustee of Whitestone REIT, a publicly traded REIT listed on NYSE-Amex. Mr. Carter also serves on the Dean's Advisory Council of the M.I.T. Sloan School of Management. Mr. Carter brings to our Board significant management experience and demonstrated leadership skills with financial and real estate entities.

*Daniel G. DeVos* has served as a trustee since March 2003. Since 1993, Mr. DeVos has served as Chairman of the Board and Chief Executive Officer of DP Fox Ventures, LLC, a diversified management enterprise with investments in real estate, transportation, and sports teams. Since 1999, Mr. DeVos has served as the President and CEO of Fox Motors, based in Grand Rapids, Michigan. He is the majority owner of the Grand Rapids Griffins (AHL), has an ownership interest in the Orlando Magic (NBA) of which he became Chairman in 2011, and is a partner in CWD Real Estate Investment. Mr. DeVos has served as Vice Chairman of the RDV Corporation Board since 1991, and since 1980 has served as a director and currently serves on the Audit Committee of Alticor, Inc., the parent of Amway Corporation, located in Ada, Michigan. Since February 2009, Mr. DeVos has served as a trustee of Whitestone REIT, a publicly traded REIT listed on NYSE-Amex. From 1994 to 1998, Mr. DeVos served as a trustee of First Union Real Estate Investments (NYSE). Mr. DeVos has extensive and diverse business experience within and outside the real estate industry and possesses exceptional leadership skills in business and non-profit management.

*Paul T. Lambert* has served as a trustee since November 1998. Mr. Lambert serves as the Chief Executive Officer of Lambert Capital Corporation. He served on the Board of Directors and was the Chief Operating Officer of First Industrial Realty Trust, Inc. (NYSE) from its initial public offering in October 1994 to the end of 1995. Mr. Lambert was one of the largest contributors to the formation of First Industrial and one of its founding shareholders. Prior to forming First Industrial, Mr. Lambert was

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managing partner for The Shidler Group, a national private real estate investment company. Prior to joining Shidler, Mr. Lambert was a commercial real estate developer with Dillingham Corporation and, prior to that, was a consultant with The Boston Consulting Group. Mr. Lambert is an entrepreneur with significant experience in commercial real estate and financing of development projects.

*Michael T. Oliver* has served as a trustee since March 2003. Mr. Oliver was Director of New Business Development at Concierge Asset Management from December 2005 to April 2010. Mr. Oliver was the State Investment Officer of Real Estate and Private Equity Investments of the Alaska State Pension Board of the Alaska State Pension Fund, Juneau, Alaska, a position he held from August 2000 through September 2005. Mr. Oliver was a consultant from March 1998 to July 2000 to MPAC Capital Markets, Seattle, Washington, and a consultant to several Asian governments concerning laws governing real estate investment trusts. From April 1996 to March 1998, Mr. Oliver was Chairman of RERC Capital Markets, LLC, Chicago, Illinois. From March 1987 to February 1996, he was Chairman of Heitman/PRA Securities Advisors, Inc. and President of its Real Estate Fund. Prior to March 1987 and since 1967, Mr. Oliver held positions at real estate companies raising capital and making direct investments in real estate, and at investment banking firms analyzing real estate companies and raising capital. Mr. Oliver has been involved with REITs, commercial real estate, and capital markets for a significant number of years.

The board of trustees has determined that each of Messrs. Carter, DeVos, Lambert, and Oliver do not have a material relationship with Paragon that would interfere with the exercise of independent judgment and are independent as defined by the applicable rules of the SEC. Mr. Oliver is the chairman of Paragon's audit committee and serves as the committee's financial expert. Mr. Carter is the chairman of the management, organization and compensation committee. All four independent trustees are on the audit committee and the management, organization and compensation committee.

## **Code of Ethics**

On January 14, 2004, our board of trustees adopted a code of conduct and ethics that applies to all officers, trustees and employees of Paragon, including our principal executive officer, principal financial officer and principal accounting officer. The Code of Conduct and Ethics is filed as exhibit 14 to our annual report for the year ended December 31, 2003. Upon written request to the Company, we will provide a copy of our Code of Conduct and Ethics without charge.

## **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's officers, trustees and persons who own more than 10% of our common shares to file reports of ownership and changes in ownership with the SEC. Officers, trustees and greater than 10% shareholders are required by regulation to furnish us with copies of all Section 16(a) forms they file. Based solely on review of the copies of Form 4s filed by trustees reporting grants of restricted shares and options furnished to us, or written representations that no Annual Statements of Beneficial Ownership of Securities on Form 5 were required to be filed, we believe that for the fiscal year ended December 31, 2011, all Section 16(a) filing requirements applicable to our officers, trustees and greater than 10% shareholders were complied with.

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### Item 11. Executive Compensation.

James C. Mastandrea did not receive any compensation for serving as our CEO, president and chairman during the years ended December 31, 2011 and December 31, 2010.

### Outstanding Equity Awards at Fiscal Year End

The following table sets forth the status of equity awards as of December 31, 2011

Name	Option Awards				Stock Awards		Equity Incentive
	Number of Securities Underlying Unexercised Options Exercisable	Number of Securities Underlying Unexercised Options Unexercisable	Option Exercise Price	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested	Market Value of Shares or Units of Stock That Have Not Vested	Plan Awards:
							Number of
							Unearned Shares, Units or Other Rights That Have Not Vested
James C. Mastandrea Chief Executive Officer, President and Chairman					2,000 <sup>(1)</sup>	\$ 380.00	(2)

- (1) Represents restricted common shares issued January 2, 2004. Half of the restricted shares vested on the fifth anniversary of the issuance date. The remaining half will vest when funds from operations has doubled or when Paragon's share price is 50% higher compared to the average trading price for the five days preceding the grant date.
- (2) On June 30, 2003, our shareholders approved the issuance of additional common shares to Paragon Real Estate Development, LLC for James C. Mastandrea, our Chief Executive Officer and President, and John J. Dee, our Chief Financial Officer and Senior Vice President, to encourage them to substantially grow the asset base, net operating income, funds from operations, net value, and share value of Paragon. On September 29, 2006, Paragon amended this agreement to add each of the trustees to the agreement so that if a trustee brings a new transaction to Paragon, he would receive additional common shares of Paragon in accordance with a formula in the agreement. We will issue restricted common shares if they locate and close on our behalf future acquisition, development or re-development transactions. Any of these transactions would be subject to approval by the members of our board of trustees who are not receiving the additional common shares. The maximum number of common shares they may receive under the additional contribution agreement is limited to a total value of \$26 million based on the average closing price of the common shares for 30 calendar days preceding the closing of any acquisition. The common shares will be restricted until we achieve the five-year pro forma income target for the acquisition, as approved by the board of trustees, and an increase of 5% in Paragon's net operating income and funds from operations. The restricted shares would vest immediately upon any shift in ownership, as defined in the agreement.

### Employment Agreements

On April 3, 2006, the Board of Trustees of Paragon authorized modifications to the employment agreement of James C. Mastandrea, President and Chief Executive Officer. The modification agreement allows Mr. Mastandrea to devote time to other business and personal investments while performing his duties for Paragon. The original employment agreement with Mr. Mastandrea provides for an annual salary of \$60,000 effective as of March 4, 2003. The initial term of Mr. Mastandrea's employment is for two years and may be extended for terms of one year

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through his 70th birthday. Mr. Mastandrea's base annual salary may be adjusted from time to time, except that the adjustment may not be lower than the preceding year's base salary. The employment agreement provides that Mr. Mastandrea will be entitled to base salary and bonus at the rate in effect before any termination for a period of three years in the event that his employment is terminated without cause by us or for good reason by Mr. Mastandrea. Effective September 29, 2006, in lieu of an annual salary of \$100,000, Mr. Mastandrea received 44,444 Class C Convertible Preferred Shares for his services as an officer of Paragon through September 29, 2008. This agreement was amended to extend the service period and vesting period restriction dates to September 29, 2012, though the shares were fully amortized by the original date in 2008.

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Effective June 30, 2003, we issued 696,078 preferred shares valued at approximately \$2.4 million to Messrs. Mastandrea and Dee pursuant to separate restricted share agreements. On June 30, 2003, 534,668 preferred shares were converted at a factor of 0.305 into 163,116 common shares. Under the restricted share agreement for each of Mr. Mastandrea and Mr. Dee, the restricted shares vest upon the later of the following dates:

the date our gross assets exceed \$50.0 million, or

50% of the restricted shares on March 4, 2004; 25% of the shares on March 4, 2005, and the remaining 25% of the shares on March 4, 2006.

The number of common shares and the conversion factor have been revised to reflect the 1-for-75 reverse split of the common shares that occurred in July 2006.

## **Compensation of Trustees**

During the year ended December 31, 2011, trustees were not paid any compensation.

In lieu of cash payments for trustee fees, effective September 29, 2006, each trustee of the Company received 12,500 restricted Class C Convertible Preferred Shares for service as a trustee until September 29, 2008. The shares are restricted until the latest to occur of: (a) a public offering by the Company sufficient to liquidate the shares, (b) an exchange of the Company's existing shares for new shares, and (c) September 29, 2008. These agreements were amended to extend the service period and vesting period restriction dates to September 29, 2012, though the shares were fully amortized by the original date in 2008.

On June 30, 2003, our shareholders approved the issuance of additional common shares to Paragon Real Estate Development, LLC for James C. Mastandrea, our Chief Executive Officer and President, and John J. Dee, our Chief Financial Officer and Senior Vice President, to encourage them to substantially grow the asset base, net operating income, funds from operations, net value, and share value of Paragon. On September 29, 2006, Paragon amended this agreement to add each of the trustees to the agreement so that if a trustee brings a new transaction to Paragon, he would receive additional common shares of Paragon in accordance with a formula in the agreement. We will issue restricted common shares if they locate and close on our behalf future acquisition, development or re-development transactions. Any of these transactions would be subject to approval by the members of our board of trustees who are not receiving the additional common shares. The maximum number of common shares they may receive under the additional contribution agreement is limited to a total value of \$26 million based on the average closing price of the common shares for 30 calendar days preceding the closing of any acquisition. The common shares will be restricted until we achieve the five-year pro forma income target for the acquisition, as approved by the board of trustees, and an increase of 5% in Paragon's net operating income and funds from operations. The restricted shares would vest immediately upon any shift in ownership, as defined in the agreement.

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### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The following table includes certain information with respect to the beneficial ownership of our shares by: (i) each person known by us to own more than 5% in interest of the outstanding shares; (ii) each of the trustees; (iii) each of our executive officers; and (iv) all of the trustees and executive officers as a group. Except as otherwise noted, the person or entity named has sole voting and investment power over the shares indicated.

The table shows ownership as of February 15, 2012.

Name and Address <sup>(1)</sup>	Common Shares <sup>(2)</sup>		Preferred A Shares <sup>(3)</sup>		Preferred C Shares <sup>(4)</sup>		Total Common Shares and Preferred Shares <sup>(5)</sup>	
	Number	Percent <sup>(6)</sup>	Number	Percent <sup>(6)</sup>	Number	Percent <sup>(6)</sup>	Number	Percent <sup>(6)</sup>
James C. Mastandrea	174,163 <sup>(7)</sup>	43.0%	161,410 <sup>(15)</sup>	62.5%	56,944	23.3%	792,846 <sup>(17)</sup>	77.4%
Paragon Real Estate Development, LLC	163,117 <sup>(8)</sup>	40.3%	161,410 <sup>(15)</sup>	62.5%			212,359 <sup>(18)</sup>	46.7%
Paul T. Lambert	34,448 <sup>(9)</sup>	8.5%			62,500	25.6%	659,448 <sup>(19)</sup>	63.9%
John J. Dee	4,000 <sup>(10)</sup>	1.0%	<sup>(16)</sup>		12,500	5.1%	129,000 <sup>(20)</sup>	24.3%
Daryl J. Carter	3,000 <sup>(11)</sup>	*			37,500	15.3%	378,000 <sup>(21)</sup>	48.4%
Daniel G. DeVos	3,000 <sup>(11)</sup>	*			62,500	25.6%	628,000 <sup>(22)</sup>	60.9%
Michael T. Oliver	1,667 <sup>(12)</sup>	*			12,500	5.1%	126,667 <sup>(23)</sup>	23.9%
All trustees and current executive officers as a group <sup>(13)</sup>	220,278 <sup>(14)</sup>	53.8%	161,410	62.5%	244,444	100.0%	2,713,961 <sup>(24)</sup>	93.5%

\* Indicates less than one percent

- (1) Unless otherwise indicated, the address of all beneficial owners is our corporate address at 10011 Valley Forge Drive, Houston, Texas 77042.
- (2) Percentages based on 405,096 common shares outstanding, not including 38,130 shares held in treasury. For each individual trustee and executive officer, also includes common shares he has the right to acquire through share options that are currently exercisable as of April 15, 2012. The total options for all named persons is 4,667.
- (3) Percentages based on 258,236 preferred A shares outstanding as of February 15, 2012, which convert to 53,694 common shares as follows: 161,410 preferred A shares are each convertible into 0.305 common shares and 96,826 preferred A shares are each convertible into 0.046 common shares.
- (4) Percentages based on 244,444 preferred C shares outstanding as of February 15, 2012, which convert to 2,444,440 common shares. Each preferred C share is convertible into 10 common shares.
- (5) Percentages based on 405,096 common shares outstanding, not including 38,130 shares held in treasury, and 244,444 preferred C shares which convert to 2,444,440 common shares. For each individual trustee and executive officer, also includes common shares he has the right to acquire through share options that are currently exercisable as of April 15, 2012. Mr. Mastandrea's percentage is calculated using a denominator that includes (i) 405,096 common shares, not including 38,130 shares held in treasury; (ii) 56,944 preferred C shares that convert to 569,440 common shares; and (iii) 161,410 preferred A shares, which convert to 49,243 common shares.
- (6) The ownership percents total more than 100% due to more than one person or entity being considered the beneficial owner of the same shares, in accordance with SEC regulations for this table.
- (7) Includes: (i) 6,667 restricted common shares issuable to an independent third party which Mr. Mastandrea has the right to vote; (ii) 163,117 common shares held by Paragon Real Estate Development, LLC, of which Mr. Mastandrea is the managing member; (iii) 2,000 common shares; (iv) 2,000 restricted common shares; and (v) 379 common shares.

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- (8) Mr. Mastandrea is the managing member of Paragon Real Estate Development, LLC and these shares are also included in Mr. Mastandrea's common shares.
- (9) Includes: (i) 1,666 options; (ii) 5,930 common shares held by Lambert Equities II, LLC, of which Mr. Lambert is the controlling majority member and sole manager; and (iii) 26,852 common shares.
- (10) Includes: (i) 2,000 common shares and (ii) 2,000 restricted common shares. Does not include 163,117 common shares held by Paragon Real Estate Development, LLC, of which Mr. Dee is a member.
- (11) Includes: (i) 2,000 common shares and (ii) 1,000 options.
- (12) Includes (i) 667 common shares and (ii) 1,000 options.
- (13) Includes six named persons.
- (14) Includes: (i) 6,667 restricted common shares issuable to an independent third party which Mr. Mastandrea has the right to vote; (ii) 163,117 common shares held by Paragon Real Estate Development, LLC, of which Mr. Mastandrea is the managing member; (iii) 4,000 common shares; (iv) 4,000 restricted common shares; (v) 4,667 options; and (vi) 37,827 common shares.
- (15) Represents shares held by Paragon Real Estate Development, LLC, of which Mr. Mastandrea is the managing member. Each preferred A share is convertible into 0.305 common shares.
- (16) Does not include 161,410 preferred A shares held by Paragon Real Estate Development, LLC, of which Mr. Dee is a member.
- (17) Includes: (i) 6,667 restricted common shares issuable to an independent third party which Mr. Mastandrea has the right to vote; (ii) 163,117 common shares held by Paragon Real Estate Development, LLC, of which Mr. Mastandrea is the managing member; (iii) 2,000 common shares; (iv) 2,000 restricted common shares; (v) 49,243 common shares issuable upon conversion of 161,410 preferred A shares held by Paragon Real Estate Development, LLC; (vi) 569,440 common shares issuable upon conversion of 56,944 preferred C shares; and (vii) 379 common shares.
- (18) Includes (i) 163,116 common shares and (ii) 49,243 common shares issuable upon conversion of 161,410 preferred A shares. These shares are also included in Mr. Mastandrea's total shares.
- (19) Includes: (i) 1,666 options; (ii) 625,000 common shares issuable upon conversion of 62,500 preferred C shares; and (iii) 32,782 common shares.
- (20) Includes: (i) 2,000 common shares (ii) 2,000 restricted common shares; and (iii) 125,000 common shares issuable upon conversion of 12,500 preferred C shares. Does not include 163,117 common shares or 161,410 preferred A shares held by Paragon Real Estate Development, LLC, of which Mr. Dee is a member.
- (21) Includes: (i) 2,000 common shares; (ii) 1,000 options; and (iii) 375,000 common shares issuable upon conversion of 37,500 preferred C shares.
- (22) Includes: (i) 2,000 common shares; (ii) 1,000 options; and (iii) 625,000 common shares issuable upon conversion of 62,500 preferred C shares.
- (23) Includes: (i) 667 common shares; (ii) 1,000 options; and (iii) 125,000 common shares issuable upon conversion of 12,500 preferred C shares.
- (24) Includes: (i) 6,667 restricted common shares issuable to an independent third party which Mr. Mastandrea has the right to vote; (ii) 163,117 common shares held by Paragon Real Estate Development, LLC, of which Mr. Mastandrea is the managing member; (iii) 4,000 common shares; (iv) 4,000 restricted common shares; (v) 4,667 options; (vi) 49,243 common shares issuable upon conversion of 161,410 preferred A shares held by Paragon Real Estate Development, LLC; (vii) 2,444,440 common shares issuable upon conversion of 244,444 preferred C shares; and (viii) 37,827 common shares.

**Table of Contents****Equity Compensation Plan Information**

Equity Compensation Plans		Number of securities to be issued upon exercise of outstanding options, warrants and rights		Weighted - average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Approved/ Not Approved by Security Holders		(a)	(b)		(c)
Equity compensation plans approved by security holders					
2004 Share Option Plan					
Restricted common shares		17,333	\$		
Options for common shares		4,667	\$	16.39	
		22,000	\$	3.48	24,666
Equity compensation plans not approved by security holders					
Common shares		6,667	\$		
		6,667	\$		
Total all plans Common shares		28,667	\$	2.67	24,666

In addition to the above plans, we entered into an agreement dated March 4, 2003 and approved by the shareholders on June 30, 2003 with Mr. Mastandrea, Mr. Dee and Paragon Real Estate Development, LLC of which Mr. Mastandrea is the managing member, and Mr. Dee is a member. Pursuant to this agreement, we may issue up to \$26.0 million in our common shares to Paragon Real Estate Development, LLC in exchange for it and its members procuring future acquisition, development and re-development real estate transactions for Paragon's benefit. On September 29, 2006, Paragon amended this agreement to add each of the trustees to the agreement so that if a trustee brings a new transaction to Paragon, he would receive additional common shares of Paragon in accordance with the formula in the agreement. This agreement is intended to serve as incentive for the trustees and officers of Paragon to increase our assets and net operating income in the future. The exact number of common shares that would be issued will be calculated in accordance with a formula based on the type of transaction that they present to us. The formula for a particular real estate transaction would be calculated by dividing (i) estimated net operating income to be generated from the real estate transaction for the first year following its consummation by (ii) the capitalization rate used in the real estate transaction, less the applicable basis point factor. The applicable basis point factor is defined as: 75 basis points for the acquisition of an existing operating property, 87.5 basis points for the acquisition of a re-development property, and 100 basis points for the acquisition of a development property. We would issue our common shares only upon the closing of the real estate transaction. For any transaction brought to Paragon by Messrs. Mastandrea and Dee, Mr. Mastandrea would be allocated half of the common shares and Mr. Dee would be allocated the other half, and all of their common shares would be held by Paragon Real Estate Development, LLC for the benefit of its owners.

**Item 13. Certain Relationships and Related Transactions, and Director Independence****Relationships and Related Transactions**

None.





**Table of Contents****Trustee Independence**

Our Board has affirmatively determined that four of our six trustees are independent under the NASDAQ listing standards, applicable SEC rules and the standards prescribed by our declaration of trust. These trustees are Daryl J. Carter, Daniel G. DeVos, Paul T. Lambert, and Michael T. Oliver. Messrs. Mastandrea and Dee, our other two trustees, are also executive officers of the Company, and therefore are not considered to be independent according to these standards.

**Item 14. Principal Accountant Fees and Services.**

The aggregate fees billed by the principal independent registered public accounting firm (Boulay, Heutmaker, Zibell & Co., P.L.L.P.) to the Company for the fiscal years ended December 31, 2011 and 2010 are as follows:

Category	Year	Fees	% Approved by Audit Committee
Audit Fees <sup>(1)</sup>	2011	\$ 26,250	100%
	2010	\$ 26,550	100%
Audit-Related Fees	2011	\$	
	2010	\$	
Tax Fees <sup>(2)</sup>	2011	\$ 1,425	100%
	2010	\$ 1,440	100%
All Other Fees	2011	\$	
	2010	\$	

(1) Audit fees include audits and reviews of required SEC filings.

(2) Tax fees include the preparation of the Federal tax return.

**Policy for Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors**

Before the independent auditors are engaged by the Company to render audit or non-audit services, the Audit Committee approves the engagement.

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**PART IV**

**Item 15. Exhibits, Financial Statement Schedules.**

**Exhibit**

<b>Number</b>	<b>Exhibit Description</b>
2.1	Additional Contribution Agreement between the Company and Paragon Real Estate Development, LLC (filed as Exhibit 2.7 with the Company's Current Report on Form 8-K filed on March 5, 2003 and incorporated herein by reference)
2.2	Amendment to Additional Contribution Agreement between the Company, the Board of Trustees and each Trustee individually dated September 29, 2006. (filed as Exhibit 2.1 with the Company's Current Report on Form 8-K filed on October 3, 2006 and incorporated herein by reference)
2.3	Modification Agreement between the Company and Paragon Real Estate Development, LLC (filed as Exhibit 2.8 with the Company's Current Report on Form 8-K filed on March 5, 2003 and incorporated herein by reference)
3.1	Articles of Amendment and Restatement of the Declaration of Trust of the Company (filed as Exhibit 3.1 with the Company's Registration Statement on Form SB-2/A filed on October 14, 1999 and incorporated herein by reference)
3.2	Articles of Amendment of Declaration of Trust of the Company (filed as Exhibit 2.3 with the Company's Current Report on Form 8-K filed on July 15, 2003 and incorporated herein by reference)
3.3	Articles Supplementary to the Declaration of Trust of the Company (filed as Exhibit 3.1 with the Company's Current Report on Form 8-K filed on July 23, 2004 and incorporated herein by reference)
3.4	Articles of Amendment of Declaration of Trust of the Company (filed as Exhibit 3.1 with the Company's Current Report on Form 8-K filed on July 17, 2006 and incorporated herein by reference)
3.5	Articles Supplementary to the Declaration of Trust of the Company (filed as Exhibit 3.1 with the Company's Current Report on Form 8-K filed on October 3, 2006 and incorporated herein by reference)
3.6	Amended and Restated Bylaws of the Company (filed as Exhibit 3.2 with the Company's Registration Statement on Form SB-2/A filed on October 14, 1999 and incorporated herein by reference)
3.7	Amendment No. 1 to the Amended and Restated Bylaws of the Company (filed as Exhibit 3.4 with the Company's Quarterly Report on Form 10-QSB for the quarter ended June 30, 2003 and incorporated herein by reference)
3.8	Amendment No. 2 to the Amended and Restated Bylaws of the Company (filed as Exhibit 3.2 with the Company's Current Report on Form 8-K filed on October 19, 2005 and incorporated herein by reference)

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<b>Exhibit</b>	
<b>Number</b>	<b>Exhibit Description</b>
4.1	Voting and Stock Restriction Agreement among the Company, Steven B. Hoyt, Duane H. Lund, Paul T. Lambert, John J. Dee, James C. Mastandrea, and Paragon Real Estate Development, LLC (filed as Exhibit 2.2 with the Company's Current Report on Form 8-K filed on March 5, 2003 and incorporated herein by reference)
10.1	Employment Agreement of James C. Mastandrea (filed as Exhibit 2.3 with the Company's Current Report on Form 8-K filed on March 5, 2003 and incorporated herein by reference) <sup>(1)</sup>
10.2	Employment Agreement of John J. Dee (filed as Exhibit 2.4 with the Company's Current Report on Form 8-K filed on March 5, 2003 and incorporated herein by reference) <sup>(1)</sup>
10.3	Restricted Share Agreement of James C. Mastandrea (filed as Exhibit 2.5 with the Company's Current Report on Form 8-K filed on March 5, 2003 and incorporated herein by reference) <sup>(1)</sup>
10.4	Restricted Share Agreement of John J. Dee (filed as Exhibit 2.6 with the Company's Current Report on Form 8-K filed on March 5, 2003 and incorporated herein by reference) <sup>(1)</sup>
10.5	Form of Restricted Share Agreement for Trustees dated September 26, 2006 (filed as Exhibit 10.3 with the Company's Current Report on Form 8-K filed on October 3, 2006 and incorporated herein by reference) <sup>(1)</sup>
10.6	Agreement of Limited Partnership of Paragon Real Estate, L.P. (filed as Exhibit 2.2 with the Company's Current Report on Form 8-K filed on July 15, 2003 and incorporated herein by reference)
10.7	2004 Share Option Plan of the Company (filed as Exhibit 4.1 with the Company's Registration Statement on Form S-8 filed on July 23, 2004 and incorporated herein by reference)
10.8	Stock Subscription Agreement between James C. Mastandrea and the Company dated as of September 29, 2006 (filed as Exhibit 10.2 with the Company's Current Report on Form 8-K filed on October 3, 2006 and incorporated herein by reference)
10.9	Form of Stock Subscription Agreement between Investors and the Company dated as of September 29, 2006 (filed as Exhibit 10.1 with the Company's Current Report on Form 8-K filed on October 3, 2006 and incorporated herein by reference)
10.10	Modification Agreement between the Company and John J. Dee dated April 3, 2006 (filed as Exhibit 10.2 with the Company's Current Report on Form 8-K filed on April 6, 2006 and incorporated herein by reference)
10.11	Modification Agreement between the Company and James C. Mastandrea dated April 3, 2006 (filed as Exhibit 10.1 with the Company's Current Report on Form 8-K filed on April 6, 2006 and incorporated herein by reference)
10.12	Form of First Amendment to Restricted Share Agreement for Trustees dated September 25, 2008 (filed as Exhibit 10.1 with the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 and incorporated herein by reference)

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**Exhibit**

<b>Number</b>	<b>Exhibit Description</b>
10.13	First Amendment to Stock Subscription Agreement between James C. Mastandrea and the Company dated September 25, 2008 (filed as Exhibit 10.2 with the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 and incorporated herein by reference)
10.14	Form of Second Amendment to Restricted Share Agreement for Trustees dated September 21, 2009 (filed as Exhibit 10.1 with the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009 and incorporated herein by reference)
10.15	Second Amendment to Stock Subscription Agreement between James C. Mastandrea and the Company dated September 21, 2009 (filed as Exhibit 10.2 with the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009 and incorporated herein by reference)
10.16	Form of Third Amendment to Restricted Share Agreement for Trustees dated September 28, 2010 (filed as Exhibit 10.1 with the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2010 and incorporated herein by reference)
10.17	Third Amendment to Stock Subscription Agreement between James C. Mastandrea and the Company dated September 28, 2010 (filed as Exhibit 10.2 with the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2010 and incorporated herein by reference)
10.18	Form of Fourth Amendment to Restricted Share Agreement for Trustees dated September 29, 2011 (filed as Exhibit 10.1 with the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 and incorporated herein by reference)
10.19	Fourth Amendment to Stock Subscription Agreement between James C. Mastandrea and the Company dated September 29, 2010 (filed as Exhibit 10.2 with the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 and incorporated herein by reference)
14	Code of Conduct and Ethics (filed as Exhibit 14 with the Company's Annual Report on Form 10-KSB for the year ended December 31, 2003 and incorporated herein by reference)
31.1	Section 302 Certification pursuant to the Sarbanes-Oxley Act of 2002 Chief Executive Officer <sup>(2)</sup>
31.2	Section 302 Certification pursuant to the Sarbanes-Oxley Act of 2002 Chief Financial Officer <sup>(2)</sup>
32.1	CEO/CFO Certification under Section 906 of Sarbanes-Oxley Act of 2002 <sup>(2)</sup>
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document

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<b>Exhibit Number</b>	<b>Exhibit Description</b>
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document

\* The following financial information of the Registrant for the years ended December 31, 2011 and 2010, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements.

- (1) Indicates a management contract or compensatory plan or arrangement
- (2) Filed or furnished herewith

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**SIGNATURES**

In accordance with the requirements of the Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PARAGON REAL ESTATE EQUITY AND INVESTMENT TRUST

Date: February 15, 2012

By: /s/ James C. Mastandrea  
James C. Mastandrea

*Chief Executive Officer*

(principal executive officer)

PARAGON REAL ESTATE EQUITY AND INVESTMENT TRUST

Date: February 15, 2012

By: /s/ John J. Dee  
John J. Dee

*Chief Financial Officer*

(principal financial officer)

KNOW ALL PERSON BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints John J. Dee, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorney-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

In accordance with Section 13 or 15(d) of the Securities Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**PARAGON REAL ESTATE EQUITY AND INVESTMENT TRUST**

<b>Signature</b>	<b>Title</b>	<b>Date</b>
<u>/s/ James C. Mastandrea</u>	Trustee, Chief Executive Officer and President	February 15, 2012
James C. Mastandrea		
<u>/s/ John J. Dee</u>	Trustee, Senior Vice President and	February 15, 2012
John J. Dee	Chief Financial Officer	
<u>/s/ Daryl J. Carter</u>		February 15, 2012
Daryl J. Carter	Trustee	
<u>/s/ Daniel G. DeVos</u>		February 15, 2012
Daniel G. DeVos	Trustee	

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/s/ Paul T. Lambert

February 15, 2012

Paul T. Lambert

Trustee

/s/ Michael T. Oliver

February 15, 2012

Michael T. Oliver

Trustee



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**PARAGON REAL ESTATE EQUITY AND INVESTMENT TRUST AND SUBSIDIARY**

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Trustees and Shareholders

of Paragon Real Estate Equity and Investment Trust and Subsidiaries

We have audited the accompanying consolidated balance sheets of Paragon Estate Equity and Investment and Subsidiary as of December 31, 2011 and 2010, and the related consolidated statements of operations and comprehensive income, stockholders' equity, and cash flows for each of the years ended December 31, 2011 and 2010. Paragon Real Estate Equity and Investment Trust and Subsidiaries (the Company) management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Paragon Estate Equity and Investment and Subsidiary as of December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the years ended December 31, 2011 and 2010 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the lack of revenue generating operations, the Company's net losses, negative cash flow from operations and accumulated deficit raise substantial doubt about the Company's ability to continue as a going concern. The consolidated statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Boulay, Heutmaker, Zibell & Co. P.L.L.P.

Certified Public Accountants

Minneapolis, Minnesota

February 15, 2012

**Table of Contents****Paragon Real Estate Equity and Investment Trust and Subsidiary****Consolidated Balance Sheets****December 31, 2011 and December 31, 2010**

	<b>December 31, 2011</b>	<b>December 31, 2010</b>
<b>Assets</b>		
Investments in equipment:		
Furniture, fixtures and equipment	\$ 5,370	\$ 5,370
Accumulated depreciation	(5,370)	(5,370)
Net investments in equipment		
Cash	11,532	31,717
Marketable securities	174,425	225,682
Other assets	8,113	8,644
<b>Total Assets</b>	<b>\$ 194,070</b>	<b>\$ 266,043</b>
<b>Liabilities and Shareholders' Equity</b>		
Liabilities:		
Accounts payable and accrued expenses	\$ 5,376	\$ 500
<b>Total liabilities</b>	<b>5,376</b>	<b>500</b>
<b>Commitments and Contingencies</b>		
Shareholders' equity:		
Preferred A Shares \$0.01 par value, 10,000,000 authorized: 258,236 Class A cumulative convertible shares issued and outstanding, \$10.00 per share liquidation preference	2,583	2,583
Preferred C Shares \$0.01 par value, 300,000 authorized: 244,444 Class C cumulative convertible shares issued and outstanding, \$10.00 per share liquidation preference	2,444	2,444
Common Shares \$0.01 par value, 100,000,000 authorized: 443,226 shares issued and 405,096 outstanding.	4,051	4,051
Additional paid-in capital	28,146,971	28,146,971
Accumulated deficit	(27,148,068)	(27,114,887)
Accumulated other comprehensive income, net unrealized gain (loss) on marketable securities	(18,552)	25,116
Treasury stock, at cost, 38,130 shares	(800,735)	(800,735)
<b>Total shareholders' equity</b>	<b>188,694</b>	<b>265,543</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 194,070</b>	<b>\$ 266,043</b>

The accompanying notes are an integral part of the consolidated financial statements.

**Table of Contents****Paragon Real Estate Equity and Investment Trust and Subsidiary****Consolidated Statements of Operations and Comprehensive Income**

	<b>For the year ended December 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Revenues</b>		
Interest/dividend income	\$ 8,010	\$ 6,737
Other income		1,297
Total revenues	8,010	8,034
<b>Expenses</b>		
Depreciation and amortization		153
General and administrative	65,715	63,691
Total expenses	65,715	63,844
Income (loss) from operations	(57,705)	(55,810)
Gain (loss) on sale of marketable securities	24,525	48,926
Net income (loss) attributable to Common Shareholders	(33,180)	(6,884)
Net income (loss) attributable to Common Shareholders per Common Share: Basic and Diluted	\$ (0.08)	\$ (0.02)
Weighted average number of Common Shares outstanding: Basic and Diluted	405,096	405,096
<b>Comprehensive income (loss):</b>		
Net income (loss)	\$ (33,180)	\$ (6,884)
Other comprehensive income (loss):		
Unrealized gain (loss) on marketable securities, net	(43,669)	(9,511)
Comprehensive income (loss)	\$ (76,849)	\$ (16,395)

The accompanying notes are an integral part of the consolidated financial statements.

**Table of Contents****Paragon Real Estate Equity and Investment Trust****Consolidated Statements of Shareholders' Equity****For the years ended December 31, 2011 and 2010**

	Class A Preferred Shares	Class C Preferred Shares	Common Shares	Additional Paid -in Capital	Accumulated other comprehensive income, net unrealized gain (loss) on marketable securities	Accumulated Deficit	Cost of Shares held in Treasury	Total
<b>Balance at December 31, 2009</b>	<b>\$ 2,583</b>	<b>\$ 2,444</b>	<b>\$ 4,432</b>	<b>\$ 28,146,590</b>	<b>\$ 34,627</b>	<b>(\$ 27,108,003)</b>	<b>(\$ 800,735)</b>	<b>\$ 281,938</b>
Unrealized gain (loss) on Marketable Securities					(9,511)			(9,511)
Adjust for treasury shares			(381)	381				
Net income (loss)						(6,884)		(6,884)
<b>Balance at December 31, 2010</b>	<b>\$ 2,583</b>	<b>\$ 2,444</b>	<b>\$ 4,051</b>	<b>\$ 28,146,971</b>	<b>\$ 25,116</b>	<b>(\$ 27,114,887)</b>	<b>(\$ 800,735)</b>	<b>\$ 265,543</b>
Unrealized gain (loss) on Marketable Securities					(43,669)			(43,669)
Net income (loss)						(33,180)		(33,180)
<b>Balance at December 31, 2011</b>	<b>\$ 2,583</b>	<b>\$ 2,444</b>	<b>\$ 4,051</b>	<b>\$ 28,146,971</b>	<b>(\$ 18,552)</b>	<b>(\$ 27,148,068)</b>	<b>(\$ 800,735)</b>	<b>\$ 188,694</b>

The accompanying notes are an integral part of the consolidated financial statements.

**Table of Contents****Paragon Real Estate Equity and Investment Trust and Subsidiary****Consolidated Statements of Cash Flows**

	<b>For the year ended December 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (33,180)	\$ (6,884)
Adjustments to reconcile net income (loss) to net cash used in continuing operations:		
Depreciation		153
Removal of non cash estimated liabilities		(1,045)
(Gain) loss on sale of marketable securities	(24,525)	(48,926)
Net change in assets and liabilities:		
Other assets	531	2,017
Accounts payable and accrued expenses	4,876	(50)
Net cash from (used in) continuing operations	(52,298)	(54,735)
<b>Cash flows from investing activities:</b>		
Cash used for the purchase of marketable securities	(233,800)	(161,693)
Proceeds from the sale of marketable securities	265,913	153,947
Net cash from (used for) investing activities	32,113	(7,746)
<b>Cash flows from financing activities:</b>		
Net cash from (used for) financing activities		
Net increase (decrease) in cash	(20,185)	(62,481)
Cash		
Beginning of period	31,717	94,198
End of period	\$ 11,532	\$ 31,717

The accompanying notes are an integral part of the consolidated financial statements.

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**Paragon Real Estate Equity and Investment Trust and Subsidiaries**

**Notes to Consolidated Financial Statements**

**December 31, 2011**

**Note 1 Organization**

Paragon Real Estate Equity and Investment Trust (the Company, Paragon, we, our, or us ) is a real estate company with its primary focus on keeping the public entity available for value-added real estate opportunities, including land development, retail, office, industrial, hotel, other real estate investment and operating companies, and joint venture investments. In addition in early 2008, the Company began to invest on a temporary basis a portion of its available cash in publicly traded shares of other real estate companies. The investments are available to be liquidated into cash as needed. Presently, the Company is a corporate shell, current in its SEC filings that may be used in the future for real estate transactions or sold to another company.

The Company presents its financial statements on a consolidated basis because it combines its accounts with a wholly-owned subsidiary that discontinued operations in 2002. All significant inter-company balances are eliminated in the consolidated financial statements.

**Note 2 Basis of Presentation**

**Going Concern**

The financial statements have been prepared assuming the Company will continue as a going concern, which contemplates the continued operations as a public company and paying liabilities in the normal course of business. The Company has received \$500,000 from three trustees for payment of Class C Convertible Preferred Shares, which is to be used to maintain Paragon as a public shell current in its SEC filings. No other amounts are due from the trustees for these Convertible Preferred Shares. The Company has continued to incur net losses and at December 31, 2011 had unrestricted cash of approximately \$12,000. The net decrease in cash during the year ended December 31, 2011 was approximately \$20,000, of which \$32,000 was net cash from investing in marketable securities and \$52,000 was cash used to maintain the Company as a corporate shell reporting with the SEC. Our ability to continue as a going concern will be dependent upon acquiring assets to generate cash flow because we have no revenue generating assets other than marketable securities.

Paragon continues to keep its public entity available for value-added real estate opportunities, including land development, retail, office, industrial, hotel, other real estate investment and operating companies, and joint venture investments. In addition, because our unrestricted cash is not sufficient to allow us to continue operations, we have reviewed other alternatives, including selling the corporate entity and seeking additional investors. There can be no assurance that we will be able to close a transaction or keep the Company currently filed with the SEC. Even if our management is successful in closing a transaction, investors may not value the transaction or the current filing status with the SEC in the same manner as we did, and investors may not value the transaction as they would value other transactions or alternatives. Failure to obtain external sources of capital and complete a transaction will materially and adversely affect the Company's ability to continue operations. Three independent trustees contributed an aggregate of \$500,000 to maintain the Company as a corporate shell current in its SEC filings so that it may be used in the future for real estate transactions or sold to another company.

**Correction of Immaterial Error**

The financial statements for the first two quarters of 2011 and for the year 2010 showed 443,226 common shares issued and outstanding, which included 38,130 shares held in treasury. The total number of common shares outstanding was corrected in the quarter ended September 30, 2011 to show the reduction for the 38,130 common shares held in treasury, or 405,096 common shares outstanding. In addition, the earnings per share for 2010 is calculated using the corrected number of common shares outstanding, which did not change the loss per share for the year ended December 31, 2010, though it increased the loss per share by \$0.01 for the quarter and nine months ended September 30, 2010, and had an immaterial effect to the overall consolidated financial statements.

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### **Note 3 Summary of Significant Accounting Policies**

#### **Use of Estimates in the Preparation of Financial Statements**

In order to conform with generally accepted accounting principles, management, in preparation of our consolidated financial statements, is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of December 31, 2011 and December 31, 2010, and the reported amounts of revenues and expenses for the years ended December 31, 2011 and 2010. Actual results could differ from those estimates. Significant estimates include deferred taxes and the related valuation allowance for deferred taxes, and these significant estimates, as well as other estimates and assumptions, may change in the near term.

#### **Investments in Equipment**

Our investments in equipment assets are reported at cost.

Depreciation expense is computed using the straight-line method based on the following useful lives:

	<b>Years</b>
Furniture, fixtures and equipment	3-7
There was no depreciation expense for the year ended December 31, 2011 because the equipment assets are fully depreciated.	

#### **Cash**

We maintain our cash in bank accounts in amounts that may exceed federally insured limits at times.

#### **Other Assets**

As of December 31, 2011, other assets of approximately \$8,100 are approximately \$400 dividends receivable on marketable securities and approximately \$7,700 prepaid expenses for director and officer liability insurance.

As of December 31, 2010, other assets of approximately \$8,600 are approximately \$200 dividends receivable on marketable securities and approximately \$8,400 prepaid expenses for director and officer liability insurance.

#### **Revenue Recognition**

Revenues include interest and dividends earned on cash balances and marketable securities.

In 2010 we recorded other income of approximately \$300 from the receipt of an Ohio Workers Compensation deposit that had previously been expensed and approximately \$1,000 from the removal of an accounts payable that was no longer considered an obligation.

#### **Stock-Based Compensation**

The Company accounts for stock-based compensation in accordance with Accounting Standards Codification 718 ( ASC 718 ), Compensation Stock Compensation, which addresses the accounting for stock-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. ASC 718 generally requires that these transactions be accounted for using a fair-value-based method. The Company uses the Black-Scholes option-pricing model to determine the fair-value of stock-based awards.



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### **Income Taxes**

Because we have not elected to be taxed as a Real Estate Investment Trust ( REIT ) for federal income tax purposes, we account for income taxes using the liability method under which deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities using enacted tax rates in effect for the period in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. We intend to take advantage of our tax loss carryforwards prior to electing REIT status again.

The Company evaluates potential uncertain tax positions on an annual basis in conjunction with the Board of Trustees and its tax accountants. Authoritative literature provides a two-step approach to recognize and measure tax benefits when realization of the benefits is uncertain. The first step is to determine whether the benefit meets the more-likely-than-not condition for recognition and the second step is to determine the amount to be recognized based on the cumulative probability that exceeds 50%. The Company has no uncertain tax positions that required adjustments to our financial statements in 2011 or 2010.

At December 31, 2011, we have net operating losses totaling approximately \$2.3 million. While these losses created a deferred tax asset, a valuation allowance was applied against the asset because of the uncertainty of whether we will be able to use these loss carryforwards, which will expire in varying amounts through the year 2031. Pursuant to Internal Revenue Code regulations, Paragon will be limited to using approximately \$1.4 million of the prior net operating losses of \$11.1 million. These same regulations also limit the amount of loss used in any one year.

We are also subject to certain state and local income, excise and franchise taxes. The provision for state and local taxes has been reflected in general and administrative expense in the consolidated statements of operations and has not been separately stated due to its insignificance.

The Company is no longer subject to U.S. federal income tax examinations for the years before 2008 and, with few exceptions, is no longer subject to state and local or non-U.S. income tax examinations by tax authorities for years before 2008.

### **Fair Value of Financial Instruments**

We adopted Accounting Standards Codification 820 ( ASC 820 ), Fair Value Measurements and Disclosures, as it applies to our financial instruments Accounting Standards Codification 825 ( ASC 825 ), Financial Instruments. ASC 820 defines fair value, outlines a framework for measuring fair value, and details the required disclosures about fair value measurements. ASC 825 permits companies to irrevocably choose to measure certain financial instruments and other items at fair value. ASC 825 also establishes presentation and disclosure requirements designed to facilitate comparison between entities that choose different measurement attributes for similar types of assets and liabilities.

Under ASC 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market. ASC 820 establishes a hierarchy in determining the fair value of an asset or liability. The fair value hierarchy has three levels of inputs, both observable and unobservable. ASC 820 requires the utilization of the lowest possible level of input to determine fair value. Level 1 inputs include quoted market prices in an active market for identical assets or liabilities. Level 2 inputs are market data, other than Level 1, that are observable either directly or indirectly. Level 2 inputs include quoted market prices for similar assets or liabilities, quoted market prices in an inactive market, and other observable information that can be corroborated by market data. Level 3 inputs are unobservable and corroborated by little or no market data.

Except for those assets and liabilities which are required by authoritative accounting guidance to be recorded at fair value in our Consolidated Balance Sheets, we have elected not to record any other assets or liabilities at fair value, as permitted by ASC 825. No events occurred during 2011 which would require adjustment to the recognized balances of assets or liabilities which are recorded at fair value on a nonrecurring basis.

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The following table provides information on those assets and liabilities measured at fair value on a recurring basis.

	Carrying Amount in Consolidated Balance Sheet	Fair Value	Fair Value Measurement Using		
			Level 1	Level 2	Level 3
<b>Marketable Securities</b>					
December 31, 2011	\$ 174,425	\$ 174,425	\$ 174,425	\$	\$
December 31, 2010	\$ 225,682	\$ 225,682	\$ 225,682	\$	\$

The fair value of the marketable securities is based on quoted market prices in an active market.

**Recent Accounting Pronouncements**

Management has reviewed recently issued accounting pronouncements and does not expect the implementation of these pronouncements to have a significant effect on the Company's consolidated financial statements.

**Note 4 Marketable Securities**

Our investments in marketable securities are classified as available-for-sale, as of December 31, 2011 and 2010, and represent common shares of publicly traded real estate investment trusts.

We recognize gain or loss on the sale of marketable securities based upon the first-in-first-out method. The gain on sales of marketable securities of approximately \$24,500 for the year ended December 31, 2011 was a result of our sale of 17,675 common shares of publicly traded real estate companies for approximately \$265,900.

As of December 31, 2011, our marketable securities had a fair market value of approximately \$174,400, including marketable securities at market value of approximately \$104,200 and a money market account of approximately \$70,200. We recorded an unrealized loss on marketable securities during 2011 of approximately \$43,700. As of December 31, 2010 we had an unrealized gain of approximately \$25,100, and as of December 31, 2011 we have an unrealized loss of approximately \$18,600, which is shown in shareholders' equity as net unrealized loss on marketable securities.

As of December 31, 2010, our marketable securities had a fair market value of approximately \$225,700, including marketable securities at market value of approximately \$131,400 and a money market account of approximately \$94,300. We recorded an unrealized loss on marketable securities during 2010 of approximately \$9,500. As of December 31, 2009 we had an unrealized gain of approximately \$34,600, and as of December 31, 2010 we had an unrealized gain of approximately \$25,100, which is shown in shareholders' equity as net unrealized gain on marketable securities.

**Note 5 Shareholders' Equity****Preferred Shares**

The Company has outstanding 96,826 Class A Cumulative Convertible Preferred Shares ( "Class A Preferred Shares" ) that were issued to the public. The Class A Preferred Shares bear a liquidation value of \$10.00 per share. The Class A Preferred Shares are convertible into 0.046 common shares subject to certain formulas. We have the right to redeem the Class A Preferred Shares.

Effective June 30, 2003, we issued 696,078 Class A Preferred Shares valued at approximately \$2.4 million to Messrs. Mastandrea and Dee pursuant to separate restricted share agreements. Under each restricted share agreement, the restricted shares vest upon the later of the following dates:

the date our gross assets exceed \$50.0 million, or

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50% of the restricted shares on March 4, 2004; 25% of the shares on March 4, 2005 and the remaining 25% of the shares on March 4, 2006.

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In conjunction with a one-time incentive exchange offer for Class A preferred shareholders, Messrs. Mastandrea and Dee exchanged 534,668 of these restricted Class A Preferred Shares into 163,116 restricted common shares. The restrictions described above are also applicable to their common shares. The remaining 161,410 restricted Class A preferred shares held by Messrs. Mastandrea and Dee can each be converted into 0.305 restricted common shares.

During 2011, no Class A Preferred Shares were converted to common shares.

Effective September 29, 2006, Paragon filed articles supplementary to its declaration of trust, as amended, restated and supplemented with the State Department of Assessment and Taxation of Maryland designating 300,000 Class C Convertible Preferred Shares ( Class C Preferred Shares ). The Class C Preferred Shares have voting rights equal to the number of common shares into which they are convertible. Each Class C Preferred Share is convertible into common shares by dividing by the sum of \$10.00 and any accrued but unpaid dividends on the Class C Preferred Shares by the conversion price of \$1.00. The Class C Preferred Shares have a liquidation preference of \$10.00 per share, plus any accrued but unpaid dividends, and can be redeemed by the board of trustees at any time, with notice, at the same price per share.

Effective September 29, 2006, three independent trustees of Paragon signed subscription agreements to purchase 125,000 Class C Preferred Shares for an aggregate contribution of \$500,000 to maintain Paragon as a corporate shell current in its SEC filings.

In addition, on September 29, 2006, James C. Mastandrea, President, Chief Executive Officer, and Chairman of the Board of Trustees of Paragon, signed a subscription agreement to purchase 44,444 restricted shares of Class C Convertible Preferred Shares. The consideration for the purchase was Mr. Mastandrea's services as an officer of Paragon for the period beginning September 29, 2006 and ending September 29, 2008. The Class C Convertible Preferred Shares are subject to forfeiture and are restricted from being sold by Mr. Mastandrea until the latest to occur of a public offering by Paragon sufficient to liquidate the Class C Convertible Preferred Shares, an exchange of Paragon's existing shares for new shares, or September 29, 2008. This agreement was amended to extend the service period and vesting period restriction dates to September 29, 2012.

Each of the trustees of Paragon, namely Daryl J. Carter, John J. Dee, Daniel G. DeVos, Paul T. Lambert, James C. Mastandrea and Michael T. Oliver, signed a restricted share agreement with Paragon, dated September 29, 2006, to receive a total of 12,500 restricted Class C Convertible Preferred Shares in lieu of receiving fees in cash for service as a trustee for the two years ending September 29, 2008. The restrictions on the Class C Convertible Preferred Shares were to be removed upon the latest to occur of a public offering by Paragon sufficient to liquidate the Class C Convertible Preferred Shares, an exchange of Paragon's existing shares for new shares, or September 29, 2008. These agreements were amended to extend the service period and vesting period restriction dates to September 29, 2012. No compensation expense was recognized due to the modification as it did not increase the value of the original grant.

## **Common Shares**

Effective July 27, 2006, the board of trustees approved a reverse share split of 1-for-75 for the outstanding common shares. Shareholders approved a proposal at the June 3, 2005 annual meeting authorizing the Board, at its discretion, to determine the timing of the reverse share split and declare the split at one of four ratios.

## **Shares Held in Treasury**

On October 1, 2003 we completed the sale of our 92.9% general partnership interest in our four commercial properties. A portion of the proceeds from the sale was paid in 38,130 of our common shares at an average closing price for the 30 calendar days prior to June 27, 2003 of \$21.00 or approximately \$801,000. These shares are recorded at cost in the accompanying consolidated balance sheet under treasury shares.

**Table of Contents****Restricted Common Shares**

The following table summarizes the activity of our unvested restricted common shares for the years ended December 31, 2011 and 2010:

	<b>Unvested Restricted Common Shares</b>	
	Number of Shares	Weighted-Average Grant-Date Fair Value
Unvested at January 1, 2010	163,116	\$ 11.33
Vested		
Unvested at December 31, 2010	163,116	\$ 11.33
Vested		
Unvested at December 31, 2011	163,116	\$ 11.33

The above restricted shares vest upon meeting performance goals as discussed under Preferred Shares. Since the grant date, we have determined that meeting these performance goals is not probable and no compensation expense has been recognized related to this grant. The grant date fair value of \$1,847,000 would be recognized upon meeting the performance goals.

On June 30, 2003, our shareholders approved the issuance of additional common shares to Paragon Real Estate Development, LLC for James C. Mastandrea, our Chief Executive Officer and President, and John J. Dee, our Chief Financial Officer and Senior Vice President, to encourage them to substantially grow the asset base, net operating income, funds from operations, net value, and share value of Paragon. On September 29, 2006, Paragon amended this agreement to add each of the trustees to the agreement so that if a trustee brings a new transaction to Paragon, he would receive additional common shares of Paragon in accordance with a formula in the agreement. We will issue restricted common shares if they locate and close on our behalf future acquisition, development or re-development transactions. Any of these transactions would be subject to approval by the members of our board of trustees who are not receiving the additional common shares. The maximum number of common shares they may receive under the additional contribution agreement is limited to a total value of \$26 million based on the average closing price of the common shares for 30 calendar days preceding the closing of any acquisition. The common shares will be restricted until we achieve the five-year pro forma income target for the acquisition, as approved by the board of trustees, and an increase of 5% in Paragon's net operating income and funds from operations. The restricted shares would vest immediately upon any shift in ownership, as defined in the agreement.

**Options**

On November 16, 1998, we adopted the 1998 Share Option Plan. In 2004 the board of trustees unanimously recommended and the shareholders approved amendments to our 1998 Share Option Plan to increase the number of shares available for grant from 42,222 to 46,666 and to conform with current tax regulations ( 2004 Plan ). The 2004 Plan provides for the grant of incentive stock options, as defined under Section 422(b) of the tax code, options that are not qualified under the tax code (referred to in this annual report as non-statutory options ), share appreciation rights ( SARs ) and restricted share grants and performance share awards and dividend equivalents. The 2004 Plan is administered by our management, organization and compensation committee of the board. The committee has the authority, subject to approval by our board, to determine the terms of each award, to interpret the provisions of the 2004 plan and to make all other determinations for the administration of the 2004 Plan.

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The 2004 Plan provides for the granting of share options to officers, trustees and employees at a price determined by a formula in the 2004 Plan agreement. The options are to be exercisable over a period of time determined by the 2004 Plan committee, but no longer than ten years after the grant date. Compensation resulting from the share options is initially measured at the grant date based on fair market value of the shares.

The assumptions made in estimating the fair value of the options on the grant date are based upon the Black-Scholes option-pricing model. There were no option grants during 2010 and 2011.

The following table summarizes the activity for outstanding stock options:

	Number of Shares	Options Outstanding Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (1)
Balance at January 1, 2010	4,666	\$ 16.39	4.0	
Granted				
Exercised				
Balance at December 31, 2010	4,666	\$ 16.39	3.4	
Granted				
Exercised				
Canceled/forfeited/expired				
Balance at December 31, 2011	4,666	\$ 16.39	2.4	\$ 0.00
Vested and exercisable as of December 31, 2011	4,666	\$ 16.39	2.4	\$ 0.00
Vested and expected to vest as of December 31, 2011	4,666	\$ 16.39	2.4	\$ 0.00

(1) The aggregate intrinsic value is calculated as approximately the difference between the weighted average exercise price of the underlying awards and the Company's estimated current fair market value at December 31, 2011. Because the weighted average exercise price exceeds fair market value at December 31, 2011, there is no aggregate intrinsic value for the options.

The Company did not recognize any stock-based compensation expense during the years ending December 31, 2011 and 2010. As of December 31, 2011 and December 31, 2010, there was no remaining unrecognized cost related to stock options. To the extent the forfeiture rate is different than we have anticipated, stock-based compensation related to these awards will be different from our expectations.

## Warrants

Effective September 23, 2005, we issued to our legal counsel 11,667 warrants for our common shares at an exercise price of \$7.50 per warrant representing the average closing price of our common shares for the preceding ten days. This warrant expired on September 23, 2010.

## Note 6 Loss Per Share

The Company has adopted Accounting Standards Codification 260 (ASC 260), Earnings Per Share (EPS) for all periods presented herein. Net loss per weighted average common share outstanding—basic and diluted—are computed based on the weighted average number of common shares outstanding for the period. The weighted average number of common shares outstanding for the years ended December 31, 2011 and 2010 was 405,096. Common share equivalents of approximately 2,498,000 as of December 31, 2011 and December 31, 2010 include outstanding convertible preferred shares, warrants through their expiration date of September 2010, and stock options, and are not included in net loss per weighted average common share outstanding—diluted as they would be anti-dilutive.



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	<b>For the year ended December 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Numerator</b>		
Net loss attributable to Common Shareholders	\$ (33,180)	\$ (6,884)
<b>Denominator</b>		
Weighted average Common Shares outstanding at December 31, 2011 and December 31, 2010 Basic and Diluted	405,096	405,096
<b>Basic and Diluted EPS</b>		
Net loss attributable to Common Shareholders Basic and Diluted	\$ (0.08)	\$ (0.02)

**Note 7 Dividends/Distributions**

No cash distributions were declared during 2011 and 2010 with respect to the common or preferred shares.

**Note 8 Income taxes**

There was no income tax provision for the years ended December 31, 2011 and 2010.

	<b>For the year ended December 31,</b>	
	<b>2011</b>	<b>2010</b>
Current	\$	\$
Deferred tax benefit	(15,000)	(20,000)
Change in valuation allowance	15,000	20,000
Total tax provision	\$	\$

The tax provision differs from the expense that would result from applying Federal statutory rates as follows:

	<b>For the year ended December 31,</b>	
	<b>2011</b>	<b>2010</b>
Tax / (Benefit) at Federal statutory rate	\$ (11,000)	\$ (2,500)
State income tax / (benefit), net of Federal tax effect	(2,000)	(500)
Adjustment to net operating and capital loss carryforwards	(2,000)	(17,000)
Change in valuation allowance	15,000	20,000
Tax provision	\$	\$

Deferred tax assets and liabilities consist of the following:

	<b>At December 31,</b>	
	<b>2011</b>	<b>2010</b>
Deferred tax assets:		
Net operating loss carryforwards	\$ 935,000	\$ 920,000



Valuation allowance	(935,000)	(920,000)
Net deferred tax assets	\$	\$

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Realization of deferred tax assets is dependent upon generation of sufficient future taxable income and the effects of other loss utilization provisions. Management has determined that sufficient uncertainty exists regarding the realizability of a significant portion of the net deferred tax assets and has provided a valuation allowance of \$935,000 and \$920,000, against the net deferred tax assets of the Company as of December 31, 2011 and 2010, respectively. A valuation allowance is considered to be a significant estimate that may change in the near term.

At December 31, 2011, the Company had net operating loss carryforwards of approximately \$2.3 million available to be carried to future periods. Net operating loss carryforwards of \$887,000 are available for Paragon to use without any limitation or restriction imposed by tax regulations. Changes in the ownership of Paragon's shares that occurred in 2001, 2003 and 2006 have limited the amount of net operating losses to be used to approximately \$72,500 per year for another 15 years, or a total of approximately \$1,448,000. Prior net loss carryforwards of approximately \$11,100,000 cannot be used due to the limitations imposed by Section 382 of the Internal Revenue Code related to the 2001, 2003 and 2006 changes of share ownership. The loss carryforwards expire as follows:

<b>Year Expiring</b>	<b>Net Operating Loss</b>
2026	\$ 1,551,000
2027	364,000
2028	248,000
2029	81,000
2030	52,000
2031	39,000
<b>Total loss carryforwards</b>	<b>\$ 2,335,000</b>

**Note 9 Commitments and Contingencies****Employment Agreements**

On April 3, 2006, the Board of Trustees of Paragon authorized modifications to the employment agreement of James C. Mastandrea, President and Chief Executive Officer. The modification agreement allows Mr. Mastandrea to devote time to other business and personal investments while performing his duties for Paragon. The original employment agreement with Mr. Mastandrea provides for an annual salary of \$60,000 effective as of March 4, 2003. The initial term of Mr. Mastandrea's employment is for two years and may be extended for terms of one year through his 70th birthday. Mr. Mastandrea's base annual salary may be adjusted from time to time, except that the adjustment may not be lower than the preceding year's base salary. The employment agreement provides that Mr. Mastandrea will be entitled to base salary and bonus at the rate in effect before any termination for a period of three years in the event that his employment is terminated without cause by us or for good reason by Mr. Mastandrea. Effective September 29, 2006, in lieu of an annual salary of \$100,000 and to conserve cash, Mr. Mastandrea agreed to receive 44,444 Class C Convertible Preferred Shares for his services as an officer of Paragon through September 29, 2008. This agreement was amended to extend the service period and vesting period restriction dates to September 29, 2012, though the shares were fully amortized by the original date in 2008.

The employment agreement with John J. Dee was also modified on April 3, 2006 in a similar way to Mr. Mastandrea's employment agreement as explained above, except his compensation is based on a rate of \$125 per hour to a maximum of \$5,000 per month. Mr. Dee's base annual salary may be adjusted from time to time, except that the adjustment may not be lower than the preceding year's base salary. The employment agreement provides that Mr. Dee will be entitled to base salary and bonus at the rate in effect before any termination for a period of three years in the event that his employment is terminated without cause by us or for good reason by Mr. Dee. To conserve cash, Mr. Dee agreed to receive no cash compensation since the inception of this agreement.