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Brookfield Property Partners (BPY)
and
Brookfield Property REIT (BPYU)

The End of the Dividend

And

Negative Equity

THIS IS AN ABBREVIATED VERSION OF A LONGER REPORT

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A Note on Structure:

Brookfield Property Partners is ~64% owned and externally managed by Brookfield Asset Management. Brookfield Property REIT is ~95% owned by Brookfield Property Partners and is externally managed by Brookfield Asset Management.

Brookfield Property Partners and Brookfield Property REIT

Brookfield Property Partners (BPY) and its publicly traded subsidiary Brookfield Property REIT (BPYU), (ex-GGP) and the second largest mall operator in the U.S, are not self-sustaining enterprises. In addition to retail, BPY owns office, hospitality, student housing, multifamily and logistics assets. Embedded incentives in the structure facilitate overleverage and cash extraction through fees and overpayment of distributions by the external manager, Brookfield Asset Management (BAM).

Historical cash deficits at BPY have been filled largely by adding leverage to the properties. The strategy has become unstable in the current environment. **We believe BPY and BPYU will cut their distributions**.

Issues include:

- **Overpayment of distributions** – We estimate that BPY had annual cash flow deficits after distributions of approximately ($1B) before Covid that will grow in 2020.
- **Cash cow no more** – BPYU was the largest source of cash for BPY. In 2019, we estimate that $790M of cash upstreamed from BPYU amounted to 67% of BPY's distributions paid. BPYU's cash distributions to BPY declined to $0 in 1H20.
- **Overstated NOI and operating metrics** – BPYU's steady q/q revenue and soaring accounts receivable in the face of collapsing cash flows suggests reported NOI and EBTIDA are overstated. We use reported figures, but adjusted operating metrics are likely 20% lower at BPYU and 10-15% lower at BPY.
- **Insurmountable debt** – BPY and BPYU both have extremely high levels of debt. Debt/EBTIDA of 15.4x and 14.3x, respectively, are twice the peer group average of 7.4x. Interest expense is 61% and 182% of adjusted cash flow for BPY and BPYU, respectively, compared to 30% for high-quality peers.
- **Debt defaults and consequences –** BPYU is in default on $1.2B of mortgage debt across 12 properties and has approximately $4.9B coming due by the end of 2021. We believe continued debt defaults may lead to a collapsing of the corporate holding structure, putting assets across BPY at risk.
- **Distribution cuts are coming –** All mall REITs (except BPYU) and 36% of all REITs have cut or suspended dividends. BPY's excessive leverage, high exposure to retail, poor cash generation and costly external management make distributions unsustainable. The distribution will have to be scaled down.
- **Bailouts for now –** BAM has engineered bailout programs through various strategies for the organizations, including funding tenants, direct cash infusions and stock buy-backs, using both corporate cash and private equity funds, in what we view as deeply conflicted transactions. BAM committed nearly $2.4B to the entities in 1H20.
- **Watchful investors and lenders -** Will BAM's private equity clients watch while their cash is used to bailout BAM's failing public entities? Will lenders accept ring-fenced, asset specific, defaults where partial and/or implied guarantees exist while the parent, BPY, continues to upstream ~$800M annually in fees and distributions to BAM?
- **The units are worthless –** Using EV/EBITDA metrics from the peer group indicates that BPY's units have negative equity.

The Endgame: Insolvency is Here

- Historical substandard cash flows exacerbated by Covid-19
- BPY's largest source of cash disintegrates
- Revenue recognition policy appears to overstate operating metrics
- Excessive leverage and debt defaults

Brookfield Property Partners (BPY) is not a viable entity as it does not generate enough cash to sustain the enterprise. Further, it has negative real equity after years of asset stripping through a conflict-ridden incentive system by BAM (Brookfield Asset Management). Bankruptcy could be imminent given the defaults of $1.2B of property debt, which could prompt CBMS investors to test the collapse of the SPE structures as happened during GGP's bankruptcy.

Cash flow deficits have plagued BPY since its inception (see below). We are now at the point in the cycle where declining cash flows and asset values are bringing financial mismanagement to the fore. In our analysis, BPY is teetering on the edge of insolvency.

BPY Summary Cash Flow

($ millions)	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**1H20**	**Cumulative**
Cash flow from operations	421	483	590	745	639	1,357	624	838	5,697
Total distributions	(1,361)	(1,797)	(1,564)	(1,750)	(3,509)	(3,690)	(4,421)	(1,021)	(19,113)
Cash flow after distributions	**(940)**	**(1,314)**	**(974)**	**(1,005)**	**(2,870)**	**(2,333)**	**(3,797)**	**(183)**	**(13,416)**
CapEx	-	(821)	(2,065)	(1,605)	(1,895)	(2,283)	(2,769)	(1,017)	(12,455)
Free cash flow	(940)	(2,135)	(3,039)	(2,610)	(4,765)	(4,616)	(6,566)	(1,200)	(25,871)
Non-CapEx investment	(1,622)	(4,179)	(1,869)	(1,629)	9	(6,123)	1,158	440	(13,815)
Cash deficit	**(2,562)**	**(6,314)**	**(4,908)**	**(4,239)**	**(4,756)**	**(10,739)**	**(5,408)**	**(760)**	**(39,686)**
Total financing	3,030	6,252	4,742	4,656	4,757	12,563	3,529	880	40,409
Net cash flow	468	(62)	(166)	417	1	1,824	(1,879)	120	723

Source: Company filings and estimates.

We estimate that LP-level cash deficits after distributions were approximately ($1B) pre-Covid-19, filled largely by increasing asset-level debt. Both cash-out refinancings and asset sales are significantly more difficult in the current environment than in the past, limiting deficit-financing options.

BAM took actions to relieve the financial stress at BPY and its subsidiary BPYU in May 2020 with the announcement of Brookfield's 'Retail Revitalization Program'. Since then, assistance has grown to include direct cash infusions and support of stock prices.

Brookfield management pointed out that while it does not specifically target Brookfield tenants with the Retail Revitalization Program, it's an opportunity to "utilize the knowledge, the relationships and the understanding of these tenants that we have in the real estate business through our relationships with these tenants, and bring some capital to bear on this and earn investment returns".

In July 2020, both BPY and BPYU announced substantial issuer bids totaling $1B, though neither entity had the cash. BAM disclosed that the tender offer for BPY would be funded 50% from BAM

capital and 50% from managed accounts from private equity clients. It is unclear whether this is separately raised capital from institutional investors or part of existing private equity funds.

Both the tender offer and the Retail Revitalization Programs use private equity funds in conflicted transactions to support BAM's ailing publicly traded investment vehicles. **BAM is a direct beneficiary as it earns capitalization-based fees and receives distributions on its ownership stake**.

In August 2020, BPY approved certain subsidiaries as borrowers on a $500M credit facility, which is guaranteed by BAM. Additionally, BAM is also providing a liquidity facility of $500M directly to BPY's retail subsidiary BPYU. Altogether, BAM and BAM-managed entities committed approximately $2.4B of support in 2Q20-3Q20.

1. BPYU: Loss of the Key Cash Generator as Malls Disintegrate

BPYU (ex GGP) is the key to the BPY's dividend viability. Between 2013 and August 2018, BPY owned 29-34% of GGP. In that time, GGP's dividends increased significantly and the company was a key source of cash dividends paid to BPY. In 2017, GGP accounted for 65% of all cash upstreamed from equity accounted investments. Purchasing the 66% of GGP BPY did not already own in 2018 allowed it to extract more cash by both relevering and selling assets.

As part of the acquisition, GGP paid a $9.8B dividend prior to the deal's close. It was funded largely with $7B of refinancing debt and $3B in asset sales. However, asset stripping became problematic in 2019 as the retail apocalypse took hold, as shown in BPYU's summary cash flow for 2019.

BPYU

(millions)	**2019**
Cash flow from operations	428
Total distributions	(912)
Cash after distributions	(484)
Cash flow from investments	(1,329)
Total cash deficit	(1,813)
Total financing raised	1,790

Source: Company filings and estimates.

The REIT paid a total of $912M of distributions with only $428M of cash flow. Including investing cash flow, the total cash deficit for the year was $1.8B. **We estimate that BPY received approximately $681M of total distributions paid in 2019.**

BPYU financed the deficit by raising approximately $1.9B in additional mortgage debt.

BPYU has a complex share structure. The publicly traded security is the Class A shares, which receive a distribution equal to BPY's. BPY owns several non-traded share classes, two of which have cumulative dividends. In 1H19, the Class B and Series B preferred shares paid a total of $659M to BPY. As shown in the table below, the figure has collapsed to $0 in 1H20.

BPYU: Unable to Upstream Cash

($ millions)	**1H19**	**1H20**
Estimated distributions to BPY	659	-

Source: Company filings and estimates.

The publicly traded Class A shares pay a distribution identical to BPY's declared distribution as part of the so-called economic equivalency of the entities. Class A distributions were $39.6M in 1H20. Thus, distributions to the outside shareholders have been maintained, but distributions to BPY have been cut to $0. **The key source of cash for the limited partnership appears to have been shut-down.**

BPYU's financial performance was suffering prior to Covid-19; it has gotten a lot worse. The firm's 10-Q states that 2Q20 collections were only 30% of rents, though the collection rate improved going into and subsequent to quarter's end.

BPYU: Comparative Financial Performance

	BPYU		**Simon Property Group (SPG)**		**Taubman Centers (TCO)**	
($ millions)	**1Q20**	**2Q20**	**1Q20**	**2Q20**	**1Q20**	**2Q20**
Accounts receivable, net	242	517	793	1,458	91	169
Rental revenue	352	341	1,262	1,013	143	112
Cash from operations	11	(166)	741	73	44	(33)
Change						
Accounts receivable, net		114%		84%		86%
Rental revenue		-3%		-20%		-21%
Cash from operations		-1609%		-90%		-174%

Source: Company filings and estimates.

BPYU's revenue declined only -3% q/q compared to -20% for peers while accounts receivable increased significantly more than comparable companies. **The discrepancies suggest that BPYU continues to book revenue and accrue it in accounts receivable where peers are writing-off a portion as uncollectable.** Continuing to book revenue in accounts receivable boosts reported NOI, EBITDA and FFO, which makes operating metrics at both BPYU and BPY appear more stable than those of competitors.

The operational metrics make it impossible for BPYU to continue its distributions to BPY at previous levels. Further, the devastating retail environment makes asset sales and debt increases on the asset level a virtual impossibility.

2. The Insurmountable Debt Problem – BPY & BPYU

We show comparative leverage statistics for both BPY and BPYU in the accompanying table.

Comparative Leverage Statistics

Company	Ticker	Debt/EBITDA
Simon Property Group	SPG	6.62x
Vornado Realty Trust	VNO	9.56x
Boston Properties	BXP	5.87x
Average		7.35x
Brookfield Property Partners	BPY	15.42x
Brookfield Property REIT	BPYU	13.85x

Source: Companies, Morningstar and estimates.

Source: Company filings and estimates. We include $1.3B of BPY corporate debt at the BPYU level. BPY EV is calculated on the market capitalization plus proportionate debt.

BPY as a whole and BPYU as the retail subsidiary are both substantially more levered than peers. The table below shows how the leverage flows through to operating statistics.

BPYU: Leverage in the Time of Covid

	1H20			GGP
($ millions)	**BPYU**	**SPG**	**TCO**	**2008**
Cash flow from operations	(155)	814	11	556
Interest expense	343	385	68	1,299
Adjusted cash flow from operations	188	1,199	80	1,856
Interest as a % of adjusted cash flow	182%	32%	86%	70%

Source: Company filings and estimates.

At the BPYU level, interest expenses for 1H20 was 182%, a higher ratio than BPYU's predecessor company's leverage in 2008 just prior to filing bankruptcy, and significantly higher than contemporary peers, particularly the more prudently financed SPG, with whom BPYU's assets are most often compared.

Operating statistics at the BPY level are likewise significantly higher than those of peers.

BPY Comparative Leverage

	IH20		
($ millions)	**BPY**	**SGP**	**BXP**
Cash flow from operations	838	814	554
Interest expense	1,308	385	209
Adjusted cash flow from operations	2,146	1,199	763
Interest as % of cash flow	61%	32%	27%

Source: Company filings and estimates. Comps are Simon Property Group and Boston Properties

The downturn across the real estate industry has caused many REITs to down-size their dividends to reflect the current environment. Recent research by Hoya Capital notes **that all mall REITs with the exception of BPYU and 36% of all REITs have cut dividends**. Of companies noted, SGP and VNO have cut dividends; BXP, the most stable and least levered of the group, has maintained its dividend.

BPY's combination of income mix with 65% of net operating income derived from retail and risky LP investments, and excessive leverage, create an extremely high-risk financial profile. While many other REITs have opted to cut payouts in the face of financial uncertainty, BPY's external management has elected continue with unsustainable payouts. **However, in our view, the bailouts will end and the BPY's distribution will have to be eliminated.**

Collapsing Cash Flow Leads to Debt Default

Unlike BPY's IFRS statements with vague language regarding 'suspension of payment' of debt, BPYU's US GAAP statements speak quite plainly regarding the REIT's debt problems. The 2Q20 10-Q states that "the company stopped making payments on 12 property level mortgages resulting in them being in default." The company has a total of $1.2B of mortgages in default on properties with a carrying value of $1.1B." BPYU's defaults represent 4% of the total debt outstanding. We show the companies consolidated debt along with its proportion of equity accounted debt below.

BPYU Debt Maturity

($ millions)	**Consolidated**	**Unconsolidated**	**Total**
2020	895	275	1,170
2021	2,653	1,106	3,759
After 2021	13,259	9,190	22,449
Total	16,806	10,571	27,377

Source: Company filings and estimates.

The company has a substantial amount of debt maturities on the horizon with $4.9B coming due by the end of 2021. On September 1, 2020, Brookfield failed to pay $282M due on the CMBS for Tysons Galleria. The loan was moved to a servicer for imminent default, though Brookfield stated they "do not expect to default". A hopeful extension, if obtained, might be challenged by the operating advisor.

Much of Brookfield's funding strategy relies on the concept that debt only has recourse to the specific asset it finances. However, the use of special purpose vehicles to insulate owners from the claims of lenders has been pierced in the past.

The bankruptcy remoteness of the SPE structures used by GGP was challenged by the courts that ultimately collapsed the cashflows into a single debt-servicing pool. Furthermore, the courts ruled that looming balloon payments, albeit in the future, could be seen as current financial distress. Given that directors of the SPE structures were found to owe fiduciary duty not to the creditors but to the shareholders and with partial guarantees, we believe it is probable that the current defaults on property-level debt will trigger repayment requirements the BPYU and BPY levels.

Breach of Covenants and the End of Dividends

Subsequent to quarter's end, BPYU appealed to its creditors for covenants relief through the quarter ending June 2021. The company put out a press release on July 30, 2020 announcing the waver of covenants and amendment to the credit agreement. In it, we believe that management was misleading when they stated: **"Nothing in the amendment will prevent BPYU from operating its business as planned including servicing its indebtedness and maintaining payment of dividends to shareholders looking forward".**

In our read of the documents, Brookfield's statement is incorrect.

The amendment provides covenant relief as well as restrictions including:

- Brookfield Asset Management was made to provide a $500M liquidity facility
- Match funding – When drawing on the credit facility, funds must be matched by the Brookfield facility or equity interests.
- Restricted payments – Dividends may not exceed Cumulative Net Income and asset sales.

BPYU may not be restricted so long as it makes money and is able to sell assets. While the credit agreement has its own definition of net income, it seems unlikely that BPYU will be profitable in 2020. **Perhaps BPYU can maintain the annualized $80M of distributions to Class A holders, but the much more critical payments of $700-800M to BPY seem out of the question given current financial stress and covenants.**

BPYU is currently in a financial straight jacket. Cash flows have collapsed, excessive leverage is consuming whatever cash is generated, and the firm has to meet development expenses, that even at reduced levels, amounted to $159.5M for 1H20.

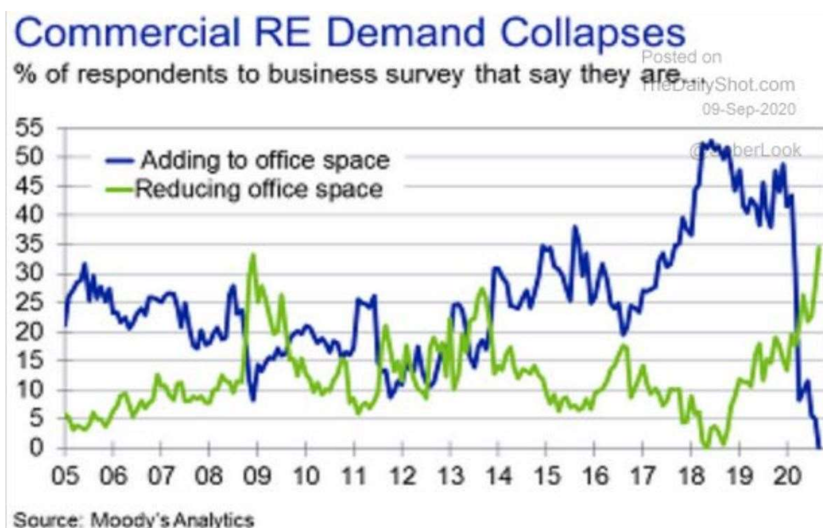
Further, the company might be considered in default of its amended agreement due to cross defaults exceeding $250M save for a provision for Specified Properties that excludes properties with net equity value less than $1B. The total GAAP equity of BPYU is $3B, including non-controlling interests.

3. Willful Suspension of Disbelief: Carrying Values Divorced from Reality

Brookfield's reaction to Covid-19 induced problems in both the retail and office markets have been perplexing. Brian Kingston, BPY CEO, discussed retail in an interview with The Read Deal in June 2020, noting that while some retail real estate will disappear, Brookfield's will survive. Of office, Mr. Kingston said he "just laughs" when people suggest that remote working will result in less demand for office space.

BAM CEO Bruce Flatt was aggressive in his assertion that office would survive, even thrive post-Covid-19. An article from June 24, 2020 from Bloomberg quotes Mr. Flatt as saying the firm is actually seeing higher demand for real estate as offices reopen.

In contrast to what Brookfield management is telling investors and the press, Moody's Analytics sees a collapse in demand, as shown below.



IFRS 'fair value' accounting is heavily reliant on management's judgement. Therefore, if management *believes* the current dislocation is temporary, IFRS permits them to value assets accordingly.

Bryan Davis, BPY's CFO noted on the 2Q20 conference call that "On balance, we did not adjust discount rates unless specifically warranted. And on balance, we did not adjust terminal rates unless we -- as we continue to take the view that the markets will stabilize by the terminal year". The discount rates are key input variables in Brookfield's valuation models. Keeping them steady, on balance, stabilizes reported valuations.

The table below shows the valuation of key equity accounted assets over the course of 2020, which appear to reflect the views of Messrs. Flatt, Kingston, and Davis that the current market dislocation will soon end and pre-Covid business conditions will return.

Key Asset Carrying Values

(millions)	**2019**	**1Q20**	**2Q20**
Canary Wharf	3,578	3,294	3,204
Manhattan West	1,918	1,973	1,956
Ala Moana Center, Hawaii	1,946	1,929	1,873
% Change			
Canary Wharf		-8%	-3%
Manhattan West		3%	-1%
Ala Moana Center, Hawaii		-1%	-3%

Source: Company filings and estimates.

While BPY has held fast on mark-to-model valuations, publicly traded London and US office REITs such as RDI REIT and Boston Properties and Vornado Realty were down -33% to -40% with premier Class A mall REIT Simon Properties is down -55% through 2Q20.

BPY: Implied Equity Valuation

Investors may be tempted to view BPY's discount to its IFRS book value as a 'margin of safety'. That would be a mistake. A better way to determine BPY's equity value is to compare it with peers. This shows the units to be grossly overvalued as showed below.

Comparative Valuation

Company	Ticker	EV/EBITDA
Simon Property Group	SPG	10.71x
Vornado Realty Trust	VNO	16.20x
Boston Properties	BXP	11.00x
Average		12.64x
Brookfield Property Partners	BPY	19.19x
Brookfield Property REIT	BPYU	21.79x

Source: Companies, Morningstar and estimates.

BPY trades at almost twice the valuation of peers. In the table below, we apply the average EV/EBITDA multiple to BPY and back-out the value of the equity. In doing so, we use BPY's reported EBITDA. Given the high probability of revenue inflation, we believe an adjusted EBTIDA would likely be significantly lower.

BPY Valuation

($ millions)	Implied Valuation	Implied IFRS Multiple
TTM EBITDA	3,199	3,199
EV/EBITDA Multiple	12.64x	***23.91x***
Enterprise Value	40,429	76,496
Proportional Debt	(49,336)	(49,336)
Value of Equity	(8,907)	27,160
BVPU	($8.86)	$27.01

Source: Company filings and estimates.

BPY's equity has a negative value of ($8.86) per share using the peer average of 12.64x. A multiple of 24x is required to arrive at Brookfield's mark-to-model IFRS valuation of $27.01 per share.

Our analysis shows BPY's units are worthless.

The End Game

In a 1992 New York Times article on the Edper Group, BAM's predecessor company, current BAM board member and architect of the group structure, Jack Cockwell, spoke of the "cascading effect of leverage", the ability of the pyramid structure to deliver a cascade of profits and shareholder value. We are now witnessing the effect in reverse as cash flows and asset values decline in tandem.

Bailouts have kept the entities going on life support. Over the last several months, BAM-funded share buybacks of BPY and BPYU have driven the stocks of the financially weak to materially outperform more financially sound peers. That is unlikely to continue.

It is unclear how many billions BAM can commit on a continuing basis to prop them up. It is likewise unclear how long private equity investors and asset-level lenders are willing to tolerate their capital being put at risk and suffering default-driven losses while financial mismanagement of the entities delivers ~$800M annually to BAM.

BPY announced a $2B refinancing of an office development in Manhattan as the tender offer expired. The timing of the announcement seemed intended to support the unit price after the expiry of the tender, as if it were a point of pride to show that Brookfield could still access debt in this environment.

We estimate the cash-out refinancing could provide roughly $175M of much needed cash to BPY. That is certainly a welcome a short-term benefit, but next quarter proportional debt will increase and trailing 12-month EBITDA will continue to sink, driving leverage metrics yet higher.