LIBERTY REAL ESTATE PORTFOLIO (LREP)

Since the listing of **Liberty Two Degrees (L2D)** and launch of the **Liberty Real Estate Portfolio (LREP)** in December 2016, LREP has been a significant area of concern for clients and advisers alike. Following the recent presentation of L2D's financial results for the year ended 31 December 2017 and subsequent roadshows, below are some of the key points and takeaways.

1 LREP PERFORMANCE

- LREP buys 100% into L2D, therefore LREP's performance is directly linked to the unit price movements of L2D.
- L2D's underlying property portfolio remains robust with unparalleled quality assets. The strong operational performance of the portfolio is evident in the rental income growth achieved, the attraction of new tenants as well as in the Net Asset Value (NAV) which increased from R9.52 at listing (December 2016) to R9.86 (December 2017).

THIS MEANS THAT THE PROPERTY PORTFOLIO IS WELL POSITIONED TO SHOW CONTINUED IMPROVEMENT

Net Asset Value
R9.52 December 2016

Net Asset Value
R9.86 December 2017

- LREP's performance has been significantly negative over the past year as L2D's unit (share) price is lower than the price at launch, and initial expectations.

WHY?

- L2D as a listed company is sound and its fundamentals are strong. However, the L2D unit price is driven by market factors and market sentiment and in this case the market is discounting the value of L2D (placing a lower value on the unit than its intrinsic value i.e. NAV).

Reasons for discounting

Liberty "Evergreen" Put Option

- Liberty, via the Liberty Property Portfolio (LPP), has the right (but not the obligation) to sell properties (from the LPP) to L2D twice a year, at a specified price subject to valuation. This "Put" option has no expiry date and continues indefinitely. L2D has the obligation to buy these properties from Liberty at the specified price when Liberty exercises this Put option. L2D only has a choice in how to finance the purchase of these properties. L2D can use debt (if it isn't too dilutive), sell units (shares) to Liberty or use cash.

Why this is perceived an issue:

- The market's perception is that if L2D pays for these properties with units (shares), Liberty will hold too many units which it will need to offload into the market (sell these units in the market). This may result in an over-supply of units, which may then affect L2D's unit price. This structure has therefore not been well-received by the market.
- This, together with the structure of an external management company managing the assets (L2D) has been identified as the main driver in the unit price being discounted (lower value placed on share than what it's actually worth).
- In June 2017 Liberty exercised the Put option, and L2D used approximately R2.5 bn of cash raised at launch to purchase properties from the Liberty Property Portfolio (LPP). This increased L2D's ownership of the co-owned properties in the LPP portfolio from 22% to 31%. The increase in ownership is a good thing as L2D had always planned to increase its ownership of the LPP property portfolio, as mentioned in its pre-listing statement. Going forward however, if Liberty chooses to exercise this Put option, L2D will either use units or debt to buy the properties put to them by Liberty.

Market factors

Market sentiment on the retail sector in general has had a material impact on the unit price of L2D as can be observed on other listed retail property units. There has however recently been an improvement in consumer confidence in the South African market, which should have a positive impact on the underlying assets.

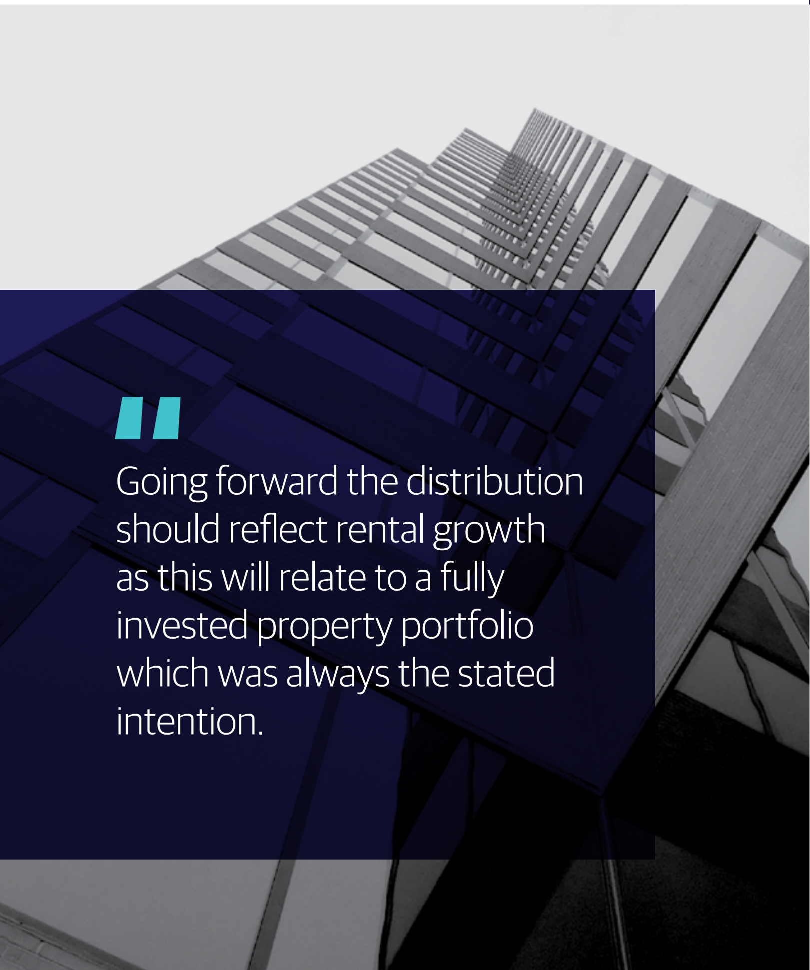
The Solution

L2D and Liberty acknowledge the challenges with the current corporate structure and the negative impact it is having on the unit price. Both entities are committed to finding a resolution that will benefit all stakeholders. Please note that this is a priority for both Liberty and L2D. Once a solution is reached, this will be communicated to market. It is important to note that in the best interest of all stakeholders, Liberty has no intention to offload units into the market at the detriment of Liberty, Liberty policyholders and L2D.

2 DISTRIBUTION

- L2D declares a distribution which is akin to a dividend paid by listed companies, twice a year. The Last Day to Trade (LDT) is the last date on which a person can acquire units in order to qualify for the distribution. It is also the last date **before** the unit trades ex-distribution). On or before the LDT, the price of the L2D unit includes the value of the expected distribution.
- Once the Last Day to Trade has passed (unit trades ex distribution), L2D's unit price will change (decrease) by the amount of the declared distribution as well as **any market movements.**

LIBERTY AS THE UNITHOLDER FOR LREP RECEIVES THE DISTRIBUTION PAID BY L2D. LIBERTY USES THIS TO RE-INVEST INTO LREP.



> Going forward the distribution should reflect rental growth as this will relate to a fully invested property portfolio which was always the stated intention.

- On the day following the LDT, the LREP price will **not be adjusted downwards** in line with the L2D unit price. The reinvestment of the L2D distribution will ensure that the LREP price includes both the income and capital return of the L2D unit **so clients effectively receive the value of the dividend rolled up into the LREP price.** The LREP price thus includes both the capital movement of the L2D unit as well as the distribution declared by the L2D unit, **this means that your clients will not see any change in units on their statements as the effect of the distribution is rolled up in the price. It is essentially on this day (day after LDT) that the client will benefit from the effect of the L2D distribution.**
- L2D declared a final distribution of 29.22c for the year ended 31 December 2017. Given that cash was used for the Put option, the distribution reflects a portion of the cash return as well as a portion of property (capital) growth. Going forward the distribution should reflect rental growth as this will relate to a fully invested property portfolio which was always the stated intention.

Other factors that impacted L2D and the distribution declared...

STUTTAFORDS

Stuttafords closed their stores in July 2017 at Sandton City and Eastgate shopping centre leaving behind 15 000 square metres vacant in Sandton City and Eastgate.

H&M

Dis-Chem PHARMACIES

The Stuttafords vacancy at Sandton City and Eastgate has mostly been let. New tenant deals were concluded in the period and the vacancy will be fully let in the fourth quarter of 2018. While Stuttafords closing their stores was a challenge in the short term, this has provided the opportunity for a new tenant mix such as bringing Dis-Chem to Sandton City and both Dis-Chem and H&M to Eastgate.

Eastgate Rates Increase

June 2017
R3BN

December 2017
R8BN

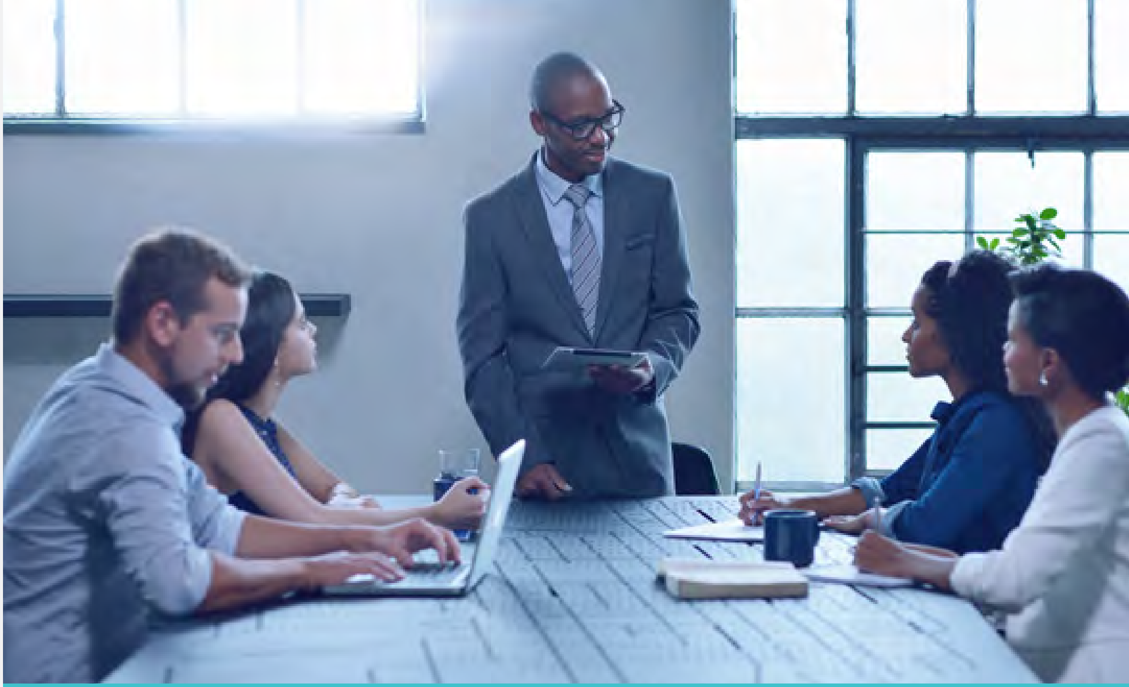
In the line with many Johannesburg properties, the municipal valuation of the Eastgate shopping centre increased from 3bn at June 2017 to 8bn as at December 2017.

100%

This increase in the value of the property had an impact on the municipal rates charged. The municipal rates on this property increased by more than 100% in December 2017. This in turn affected the asset value of this property given the increase in liabilities due to rate hike.

L2D is currently appealing this with the municipality. However, this process could take between 6-12 months.

Other questions raised



Office Vacancy rates

Office vacancies, particularly in the Sandton area, have been on the rise given the recent over-supply of space in the area and the number of companies who have built their own office buildings. While L2D is monitoring this, they are not prepared to offer premium office space at lower rentals just to fill the spaces - this would distort the market and cause issues with remaining tenants and is thus not an approach they will consider. The office component of the overall portfolio is not significant and as such the strategy will always be to maintain the value the portfolio and keep an eye out for the right leasing opportunities.

Africa Strategy

L2D's pre-listing statement (PLS) outlined expansion into Africa as part of the overall investment strategy in the long term. This strategic direction will however only be followed should a favourable opportunity arise that is line with L2D's investment guiding principles. Consideration would be made to the quality of assets, corporate and shareholder structure considerations and general market conditions. Currently and in the past year, management has not encountered any opportunities or come across any assets that match the quality of L2D's assets. This is not anticipated to be executed in the short or medium term.

Gearing
(addition of debt into the portfolio)

L2D's balance sheet is well positioned to take on gearing. It is management's strategic intent to use this capacity to fund future quality acquisitions in line with their strategy when it is beneficial to do so. In other words, the current cost of debt (9.25% as at end 2017) is significantly higher than net property income currently available.

Therefore, the use of debt in the current environment is inefficient and may be too dilutive, but will be considered for the right transaction and to make the balance sheet more efficient.

Online shopping as a growing trend

Although online shopping has become popular in more recent years, bricks-and-mortar still remains an important part of a client's experience. L2D however remains cognisant of online shopping as a growing trend in the retail sphere and is finding ways to integrate this platform into its assets. L2D has geared its focus to creating environments that remain industry leading for its clients at the various centres. The aim is for clients to have more than a day out shopping but rather an experience that provides more satisfaction than a click and collect online retail experience.

In Summary

- L2D's portfolio remains robust and is well positioned for growth. L2D management is managing the assets in a responsible and strategic manner with a focus to enhance value and create environments that remain industry leading.
- Investments in LREP carry a Moderately Aggressive risk profile, and as such it is a long term investment proposition with significant volatility - as with exposure to any single share/ listed stock.
- Projected net property income growth of between 7 and 9% from 2019 onwards is a solid growth for investors.
- Unforeseen events like Stuttafords closures and the rise in Eastgate Municipal values (and therefore rates) have been addressed with the utmost urgency and efficiency and where possible used as an opportunity for change (introducing Dis-Chem following Stuttafords closures).
- L2D remains committed to "sticking to their strengths" and investing in a way that they believe will grow the value of the assets rather than following fleeting industry trends.

Most importantly

Liberty and L2D acknowledge the unit price performance and the impact on client returns. While L2D continues to manage the properties to grow its value, if the market continues to discount the value of the L2D units based on negative sentiment then the unit price will suffer and LREP will be impacted. L2D and Liberty have proactively sought out answers as to why the market may not be reflecting the true value of the unit in the unit price and is committed to addressing the issues so that in time the true value of this investment will be realised.