

Are BPY units a good exchange for GGP shareholders? Or should it be an all cash deal?

Brookfield Property Partners LP's (NASDAQ: BPY) \$14.8 billion initial offer to buy out the remainder of Class A mall REIT GGP Inc. is comprised of half cash and half equity. The equity is in limited partnership units of Brookfield Asset Management's commercial real estate spin off, Brookfield Property Partners. BPY is a publicly-listed Bermudan limited partnership.¹ A pressing question should be whether BPY limited partnership units are a good swap for GGP (NYSE: GGP) shareholders, or whether you would be better served not only with a higher offer, but one that is all cash.

Brookfield Control

Canadian global asset manager Brookfield Asset Management (NYSE: BAM) formed BPY in 2013 to hold its commercial real estate.² BAM currently controls 69% of the economic interests in BPY³, which is projected to drop to 48% if GGP shareholders take the half cash/half equity offer.⁴ BAM is also the sole shareholder of BPY's general partner; "controls the appointment and removal of the BPY General Partner's directors..."⁵ with the exception of one director who can be designated by a Preferred Unit Holder; can sell or transfer its general partnership interest in BPY to a third party "without the consent of unitholders"⁶; and "has sole authority to determine whether our company will make distributions and the amount and timing of these distributions."⁷ Moreover, BPY limited partnership unit holders have little say in the commercial real estate company. Unit holders have no management or control and cannot vote on matters relating to the company, but are entitled to consent to certain matters delineated in the limited partnership agreement.⁸

Brookfield's Fees

GGP shareholders contemplating BPY units should pay close attention to the fees BAM extracts out of BPY. Under a Master Services Agreement, BPY pays BAM affiliates a base management fee of 0.5% of its total capitalization that is subject to an annual minimum of \$50 million plus an annual inflation adjustment of 0.5%.⁹ A BAM subsidiary, Brookfield Property Special LP, receives a quarterly equity enhancement distribution of 0.3125% of the amount by which BPY's total capitalization exceeds its post-spinoff capitalization and could receive other incentive distributions.¹⁰ Together, these fees have been substantial:

Management and Other Fees BPY Pays to BAM

	Base Management Fee ¹¹	Equity Enhancement Distribution ¹²	Annual Total
2014	\$50.0 million	\$50.0 million	\$100.0 million
2015	\$76.1 million	\$59.9 million	\$136.0 million
2016	\$104.4 million	\$25.1 million	\$129.5 million
		3-year Total	\$365.5 million

In addition to the fees Brookfield Asset Management collects from Brookfield Property Partners, the general partner of BPY, which is controlled by BAM, receives 0.2% of BPY's total distributions. Brookfield Property Special LP, BAM again, receives 1% of the total distributions.¹³

There are substantial other related party transactions between BPY and Brookfield Asset affiliates outlined in BPY's 2016 20-F.

Brookfield Management Agreement "Continues in Perpetuity" and Cannot Be Terminated for Poor or Under-Performance

GGP shareholders should also take note that the Master Services Agreement, under which BAM collects the 0.5% fee of BPY's total capitalization, "continues in perpetuity" and can only be terminated by the BAM-controlled BPY General Partner if the BAM affiliates providing services under the agreement do any of the following:

- default in the performance or observance of any material term, condition or covenant contained in the agreement in a manner that results in material harm that continues unremedied for 60 days;
- engage in any act of fraud, misappropriation of funds or embezzlement against any Service Recipient that results in material harm to the Service Recipients;
- are grossly negligent in the performance of their obligations under the agreement and such gross negligence results in material harm to the Service Recipients; or
- certain events relating to the bankruptcy or insolvency of each of the Service Providers.

The agreement "expressly provides" that it "may not be terminated by the BPY General Partner due solely to the poor performance or the underperformance of any of our operations."¹⁴

Brookfield can Compete with BPY

GGP shareholders should also factor into their consideration of the BPY equity offer that Brookfield Asset Management is not restricted from competing with BPY. Pursuant to a

relationship agreement between BAM and BPY summarized in BPY's 2016 20-F filing, "Brookfield may pursue other business activities and provide services to third parties that compete directly or indirectly with us."¹⁵

Nothing in the Relationship Agreement limits or restricts Brookfield from establishing or advising these or similar entities or limits or restricts any such entities from carrying out any investment. Brookfield Asset Management has agreed that it will offer our company the opportunity to take up Brookfield's share of any investment through these consortium arrangements or by one of these entities that involves the acquisition of commercial property that is suitable for us, subject to certain limitations.¹⁶

BPY is one of many investment vehicles managed by BAM, and the potential for conflicts of interest affecting BPY unitholders is detailed throughout BPY's 20-F.

BPY Values GGP higher than its \$23 bid

Lastly, CFO Bryan Davis valued BPY's GGP shares at \$30 on BPY's November 2, 2017 earnings call.¹⁷

BPY has indicated over time that the markets are not recognizing the value of GGP's Class A mall assets¹⁸ despite management "doing a great job focusing on the business" according to BPY CEO Brian Kingston in a fourth quarter 2015 earnings call¹⁹. Then-CEO Ric Clark in a fourth quarter 2014 earnings call hailed General Growth Properties as "a phenomenal investment for us, the assets are world-class, there are not many portfolios that are near as high quality as that and the management team is exceptional, they've done a great job for all investors including Brookfield."²⁰

Brookfield Asset Management CEO Bruce Flatt opined earlier this year on retail real estate and said of Brookfield's retail properties owned through investments in GGP and Rouse that "Most of these assets are very high quality and are in the best of the best retail locations." He later added, "Bottom line, we do not believe the old adage has changed, which is the [sic] great real estate always wins."²¹

The question for GGP shareholders is: Why exactly would the markets start recognizing the value of those assets under the BPY flag if not under the GGP banner? BPY has offered to buy your GGP shares at a 23% discount to its own valuation. Will your new BPY shares appreciate by that amount?

Moreover, while GGP's assets will become part of a larger property company, BPY's value could be hindered by its externally advised structure, the myriad related party transactions with BAM, and BAM's control of the property company.

BPY's Stock Price Is Volatile

Lastly, the stock of BPY traded down 5% on November 13, 2017, the day it announced its GGP bid, and trading remains there. BPY reached its 1-year high just one month earlier on October 13, 2017, closing at \$24.80, nine percent higher than its trading price Monday.²²

To avoid any vulnerability that could be associated with BPY's structure, GGP shareholders should consider requiring an all-cash offer, in addition to seeking an increase in the value of the bid to better reflect Brookfield's internal assessment of GGP's assets.

Endnotes

- 1 Brookfield Asset Management 2016 Form 20-F filed 3/10/17, cover page. <https://www.sec.gov/Archives/edgar/data/1545772/000154577217000005/bpy201620-f.htm>
- 2 Ibid, p. 69.
- 3 Ibid, p. 25.
- 4 Pro forma equity projection: Brookfield Property Partners L.P., "Proposal to Acquire GGP Inc.," 11/13/17, slide 3. https://bpy.brookfield.com/~/_/media/Files/B/Brookfield-BPY-IR/events/BPY%20Proposal%20to%20Acquire%20GGP%20111317%20Final.pdf
- 5 Brookfield Asset Management 2016 Form 20-F filed 3/10/17, p. 25, p. 109. <https://www.sec.gov/Archives/edgar/data/1545772/000154577217000005/bpy201620-f.htm>
- 6 Ibid, p. 26.
- 7 Ibid, p. 27.
- 8 Ibid, p. 131.
- 9 Ibid, p. 122.
- 10 Ibid, p. 116.
- 11 Ibid, p. 90.
- 12 Ibid, p. 90.
- 13 Ibid, p. 117.
- 14 Ibid, p. 25.
- 15 Ibid, p. 114.
- 16 Ibid, p. 114.
- 17 <https://seekingalpha.com/article/4119803-brookfield-property-partners-bpy-ceo-brian-kingston-q3-2017-results-earnings-call-transcript?part=single> Nov 2, 2017 3Q earnings transcript
- 18 Brookfield Property Partners' (BPY) CEO Brian Kingston on Q1 2017 Results - Earnings Call Transcript 5/5/17 <https://seekingalpha.com/article/4069792-brookfield-property-partners-bpy-ceo-brian-kingston-q1-2017-results-earnings-call-transcript?part=single>; Brookfield Property Partners' (BPY) CEO Brian Kingston on Q4 2015 Results - Earnings Call Transcript 2/5/16 <https://seekingalpha.com/article/3870846-brookfield-property-partners-bpy-ceo-brian-kingston-q4-2015-results-earnings-call-transcript?part=single>
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- 21 Brookfield Asset Management's (BAM) CEO Bruce Flatt on Q1 2017 Results - Earnings Call Transcript 5/11/17 <https://seekingalpha.com/article/4072374-brookfield-asset-managements-bam-ceo-bruce-flatt-q1-2017-results-earnings-call-transcript?part=single>
- 22 Yahoo Finance, accessed 11/27/17. 11/10/17 close at \$23.68. 11/13/07 close at \$22.50. 11/27/07 close at \$22.56.