GLOBAL LISTED REAL ESTATE REPORT

MAY 2019

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Our fund benchmark, the FTSE EPRA/NAREIT Developed Net Rental Index, recorded a net total USD return of 0.08% in April. The best performing listed real estate market was Japan, which recorded a total USD return of 5.07% for the month. The UK recorded the lowest total USD return of -6.40%.

A common question we get asked by our clients is how we go about choosing the stocks to include in our fund. More importantly, how do we go about analysing and assessing these companies. Our investment team, led by our founder, Andre Stadler, has developed and sharpened our investment process for the last 18 years. We were the first manager in South Africa to focus purely on listed property investments, and our process for analysing investment opportunities is applied consistently across our local, global and flexible property solutions.

Manufactured housing, up until recently, was a relatively obscure and misunderstood real estate sector, but significant outperformance versus major REIT and broader market indices has caused investors to take note of the industry and start to appreciate the solid investment case for investing in 'trailer-parks'.

An example of our investment process in action is our addition of Sun Communities (SUI) to our Global Fund over three years ago. SUI owns 379 manufactured home communities and recreational vehicle (RV) parks, representing 132,000 sites, predominantly situated across the Sunbelt region of the United States. Many of these communities are river, lake or sea facing and contain some form of recreational facilities. 32% of SUI's portfolio is age restricted and caters to retirees over the ages of 55 years old. RV parks represent around 30% of SUI's portfolio and 60% of these sites are on annual leases. The conversion from transient to permanent RV leases represents a significant growth opportunity for SUI as the conversion to a yearly lease results typically in a 40%-60% increase in revenue.

Source: Catalyst Fund Managers Site Visit

Tenants own their own manufactured home or RV and rent a site in SUI's communities. Despite annual lease contracts and the theoretical mobility of a manufactured home, the cost of moving a home runs into thousands of Dollars and the average tenant stays in a community for 14 years. Most homes are sold in place, with the average home occupying a community for 44 years, maintaining high occupancy and consistent income for the landlord. Annual rent escalations are between 2%-4%. Occupancy of SUI's entire portfolio sits above 96%, which does limit future rent growth through vacancy reduction but illustrates the demand for the asset class and the operational acumen of the company.

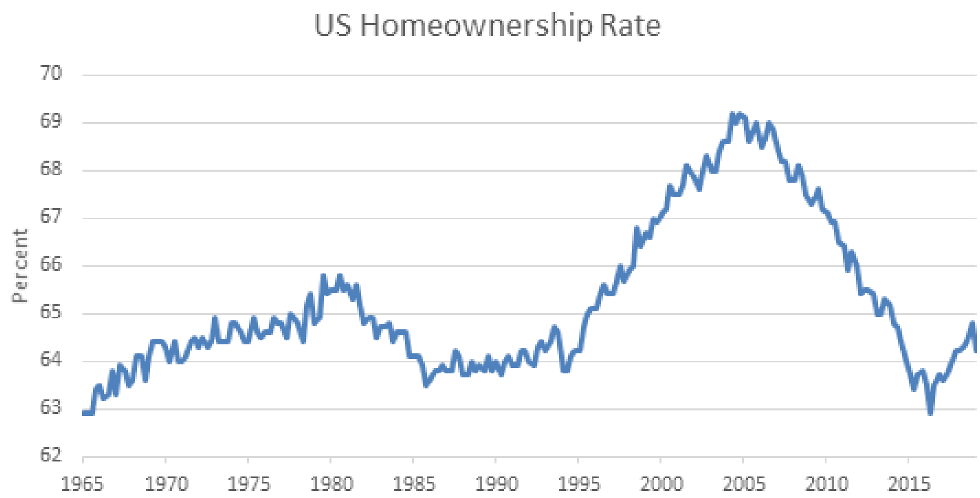
The almost non-existent supply of new manufactured housing communities has become significant as the 'baby boomer' generation ages and seeks retirement areas, and millennials look for affordable housing options. Off a base of approximately 50,000 manufactured housing communities in the US, there have been fewer than 100 communities created in the last decade.

The lack of supply is due to several reasons;

- NIMBYism ('not in my back yard') - unfortunately, manufactured housing still attracts a negative stigma, and most residents would prefer an apartment complex to be constructed in their neighbourhood instead of a mobile home or RV park community
- Land use restrictions and local planning environments have made it challenging to get zoning for parks
- High alternative use value - Potential manufactured housing land sites, especially those with water frontage are highly desirable for alternative uses such as hotels
- Funding requirements – although the quantum of investment required is less than some other forms of real estate, it remains a challenge to most developers/owners to source funding for a manufactured housing development which has day one revenue of $0 , as it takes several years to get occupancy to stabilised levels, versus an office development, for example, with a signed master lease

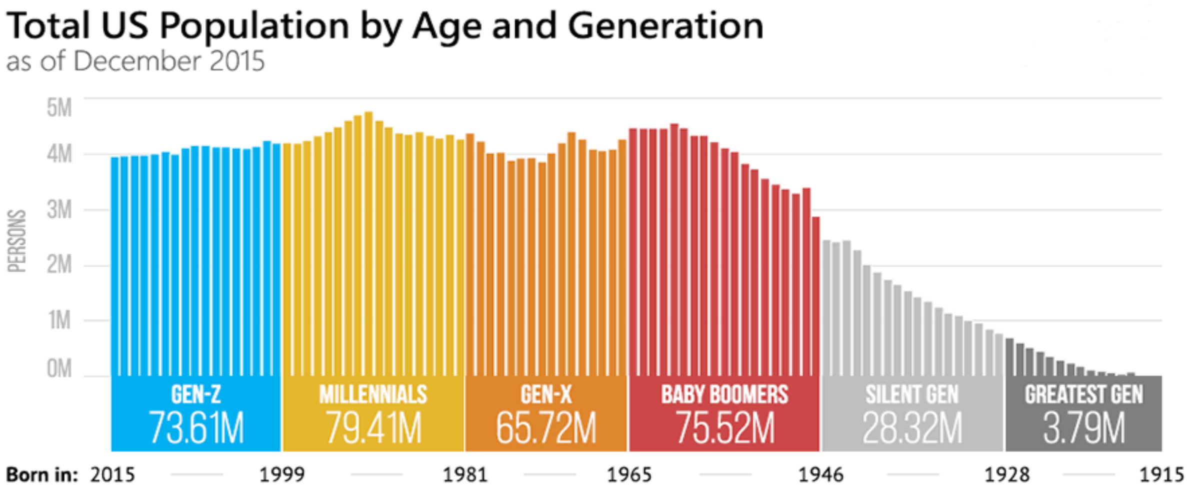
During the previous recession, manufactured housing held up relatively well versus other real estate sectors which can be attributed to the relative affordability of the accommodation offered. SUI's average site is rented out for $550 per month but this amount varies based on the location and standard of community. A typical manufactured home costs around $70,000 and can be financed using a chattel mortgage, a form of financing which uses a movable asset (the manufactured home) as security for a loan. The all-in costs to rent a site and finance a mobile home thus add up to around $1,300 per month, which compared to renting a similar size apartment or a single-family home is considerably cheaper.

Another demand driver for manufactured housing is the demographic tailwind supporting both all-age and restricted-age communities. According to research by the US Census Bureau, millennials (individuals born between 1981 and 1999, aged 20 to 38 in 2019) are expected to overtake Baby Boomers in 2019 as the largest population demographic. As these millennials look to partner up and start families, they require greater housing space. US homeownership levels have not bounced back to previous highs experienced before the recession in 2008 & 2009, and many millennials have since shied away from owning their own homes. Homeownership levels in the US currently hover around the 64% level, coming off an all-time low of 62.99% in Q2 2016, but still far below the peak of 69.2% experienced in Q2 2004.



Source: Federal Reserve bank of St.Louis Economic Research

Roughly 10,000 baby boomers will turn 65 years old every day till 2030 (individuals born between 1946 and 1964, aged 55 to 73 in 2019) and the population of people aged 55 and older is expected to increase by 19% between 2019 & 2034, providing a significant boost to age-restricted communities. 'Snowbirds' the affectionate North American term for mainly retired individuals who migrate from the northern regions of the US and Canada during winter to the warmer sunbelt region are a large user of restricted-age manufactured housing communities, generally buying their manufactured homes for cash and only visiting during the winter months.



Source: Knoema and US Census Bureau

Source: Catalyst Fund Managers Site Visit

Our earnings modelling focuses on calculating the free cash flow generated by SUI each year, adjusting for once-off expenses as well as our estimate of an annual functional capital expenditure reserve. Investors often underappreciate the long-term capital expenditure required to keep real estate assets in their current form.

Capital expenditure requirements across real estate sectors can range anywhere from 5% to 35% of net operating income on an annual basis. One of the defining characteristics of the manufactured housing sector is the low capital expenditure requirements to maintain a community because the most significant depreciating assets in a community are the homes which the tenants own and are responsible for. SUI, as the landlord of the communities it owns is merely responsible for the general upkeep in respect of the roads, verges and shared facilities and has the option not to renew the leases of owners who do not maintain their properties to an acceptable standard.

We forecast and model our expectation of SUI's external activity - acquisitions, disposals, development and redevelopment and decide on possible financing options based on the company's balance sheet and cost of capital. We assess debt by looking at SUI's debt sources and funding spreads, the amount of its secured vs unsecured debt (debt that is secured to a specific asset versus debt with full recourse to the corporate entity) and the maturity profile of the debt. While leverage can enhance equity returns it also adds risk, which we account for in our company-specific required rate of return.

It is no secret that manufactured housing has caught the attention of family wealth offices and private equity funds. This has increased the bid price for communities and makes external growth harder to achieve for SUI going forward. SUI has responded by pivoting towards expansion opportunities by constructing new sites on vacant land at existing communities. The company has identified over 11,000 expansion sites available for development with very attractive yields in the low to mid-teens. These expansions carry significantly less risk than greenfield developments, which typically take around five years to stabilise and carry lease-up risk.

As Theodore alluded to last month in our monthly report, we believe management is vitally important. When assessing management teams, we look at several factors such as the company's performance versus its peers, the level of management ownership in the business (which creates alignment between shareholders and management) and management's track record of capital allocation. Over the last few years, the management team of SUI have proven themselves to be astute capital allocators by raising equity when SUI's share price was trading at a premium to its underlying real estate value and using the proceeds to pay down debt, acquire new communities and fund development and redevelopment opportunities. Since 2016, SUI has increased its portfolio size by close on 50% while at the same time reducing financial leverage risk, taking its loan to value ratio down from 43% to 27%.

The assessment of management is an ongoing process, and we monitor quarterly earnings reporting, annual reports and earnings calls and interrogate broker notes and research. Last year we toured a manufactured housing community in Florida with SUI and met both operational and senior staff at the facility. We attend global real estate conferences throughout the year and can test our assumptions directly with management during face-to-face meetings.

We encourage you to engage directly with us to discuss the listed real estate market and more exciting investment opportunities like Sun Communities.

Overall, real estate fundamentals remain healthy, mainly due to manageable supply levels relative to demand. The estimated forward FAD (Funds Available for Distribution) yield for the sector is 4.75%, and medium-term growth prospects are decent. Listed real estate has performed strongly this year and, on the whole, appears to be fairly priced given our USD real return requirement of 4.90% and current global bond yields. Within the real estate universe, more attractively priced opportunities exist in specific real estate sectors and stocks.

JONATHAN KINNEAR
INVESTMENT ANALYST

GLOBAL LISTED PROPERTY REVIEW

Country	Market Cap USD Million	10 Year Govt Bond Yield	Current Dividend Historical Yield	Debt % Local Currency
US	873 005	2.13%	3.81%	29.24%
Canada	47 377	1.49%	4.04%	43.10%
Total North America	920 382	2.10%	3.83%	29.93%
UK	71 928	0.89%	4.00%	27.98%
Continental Europe	242 773	0.04%	4.10%	33.26%
Total Europe	314 702	0.28%	4.07%	36.37%
Japan	144 960	-0.09%	2.76%	36.76%
Australia	44 349	1.51%	5.20%	29.99%
Hong Kong	83 165	1.42%	3.34%	14.41%
Singapore	39 354	2.09%	4.80%	35.33%
Total Asia	311 828	0.73%	3.54%	31.13%
Total	1 546 912	1.53%	3.82%	31.32%

Region	MAY 2019 Return % (USD)	MAY 2019 Return % (Rand)	YTD Return % (USD)	YTD Return % (Rand)
Global Investors Index (NTR)	0.08%	2.02%	13.24%	14.98%
North America	-0.05%	1.89%	15.40%	17.17%
Europe	-0.90%	1.02%	10.00%	11.69%
Asia ex Australia	2.74%	4.73%	12.97%	14.71%
Australia	-0.93%	0.99%	4.33%	5.93%
SA Listed Property Index	-2.80%	-0.87%	2.17%	3.76%

INFORMATION SOURCE AND METHODOLOGY

Data:	Bloomberg unless stated otherwise
Calculations:	Catalyst Fund Managers
Clean Price:	Adjusts the closing price for distribution accrued since last distribution date
Rolled yield:	Time weighted current 12 month historic distribution divided by the clean price
Debt %:	These are loan to value numbers.
Date:	All data taken on 3 June 2019
Universe:	Companies included are only those companies that form part of the Catalyst core universe

CATALYST
FUND MANAGERS

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