Debunking the Bear Thesis: The Case for Buying Mall REITs

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VOSS CAPITAL

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EXECUTIVE SUMMARY

- The false narrative surrounding the death of malls has created a buying opportunity in retail REITs.
- A failure to acknowledge the empirical data allows for the ability to purchase public retail REITs at up to 60% discounts to our estimates of private market net asset value per share.
- Retail REIT valuations have bifurcated into extremes between perceived Class-A property owners and Class-B owners.
- Exposure to struggling department stores is declining and manageable. When a Sears or JC Penney leaves a mall it is actually a net positive for the retail landlords.
- Our base case valuation for our top REIT idea CBL yields 60% to 140% upside and has limited downside due to already distressed valuation levels.
- At $7.50/share CBL trades at an implied ~10.6% cap-rate.* The stock has only been cheaper briefly during the trough of the financial crisis, when leverage was much higher and overall asset quality was much lower.

* Using our 2017 NOI estimate of $755 million

CBL OVERVIEW

- Founded in 1978. IPO in 1993.
- CBL is primarily a B-Class mall REIT, with additional retail property types, office buildings, and a third party property management business.
- Their malls are often the #1 shopping destination within their markets. Key markets are Southeast and Mid-Atlantic.
- Green Street Advisors estimates CBL to have a $10 billion gross asset value.
- $1.0 billion in annual revenues.
- Est. $775 million in NOI in 2016.
- $480+ million in adjusted FFO.
- 14.2% dividend yield (~52.5% FFO payout ratio).
- CBL's mall exposure:
  - Tier 1: 41%
  - Tier 2: 49%
  - Tier 3: 10%

Total Properties	123
Malls	66
Outlet Centers	4
Associated Centers	23
Community Centers	9
Office Buildings	5
Properties Managed for 3rd Parties	16

CBL Malls by Gross Leaseable Area		
Square Feet	#	%
> 1,000,000	20	31%
800,001 to 1,000,000	18	28%
400,001 to 800,000	25	39%
200,001 to 400,000	1	2%

Property Type	Year-End 2016 Occupancy	Year-End 2016 Avg. Annual Base Rent PSF
Same-Center Stabilized Malls	94.2%	$32.82
Stabilized Malls	94.1%	$32.96
Non-Stabilized Malls	92.8%	$26.60
Associated Centers	96.9%	$13.90
Community Centers	98.2%	$16.10
Office Buildings		$18.69

Source: CBL SEC filings.

BULL / BASE / BEAR CASE

- **Base Case: 60% to 140% upside**
  - Assumes 6% to 10% decline in NOI y/y
- **Bull Case: 160% to 221% upside**
  - Assumes flat to 3% decline in NOI y/y
- **Bear Case: -6% to -41% downside**
  - Assumes 13% to 16% decline in NOI y/y

CBL Equity Upside Based on Total CBL NOI and Mall Portfolio Cap Rate

Mall Portfolio Cap Rate	**NOI (in $ millions)** $625	$650	$675	$700	$725	$750	$775
7.0%	123%	147%	171%	195%	219%	242%	266%
7.5%	87%	109%	132%	154%	176%	198%	221%
8.0%	55%	76%	97%	118%	139%	160%	181%
8.5%	28%	47%	67%	87%	106%	126%	146%
9.0%	3%	22%	40%	59%	77%	96%	114%
9.5%	-19%	-1%	16%	34%	51%	69%	87%
10.0%	-39%	-22%	-6%	11%	28%	45%	61%
10.5%	-57%	-41%	-25%	-9%	7%	23%	39%
11.0%	-73%	-58%	-43%	-28%	-13%	3%	18%
Implied NOI Δ from 2016	*-19%*	*-16%*	*-13%*	*-10%*	*-6%*	*-3%*	*0%*

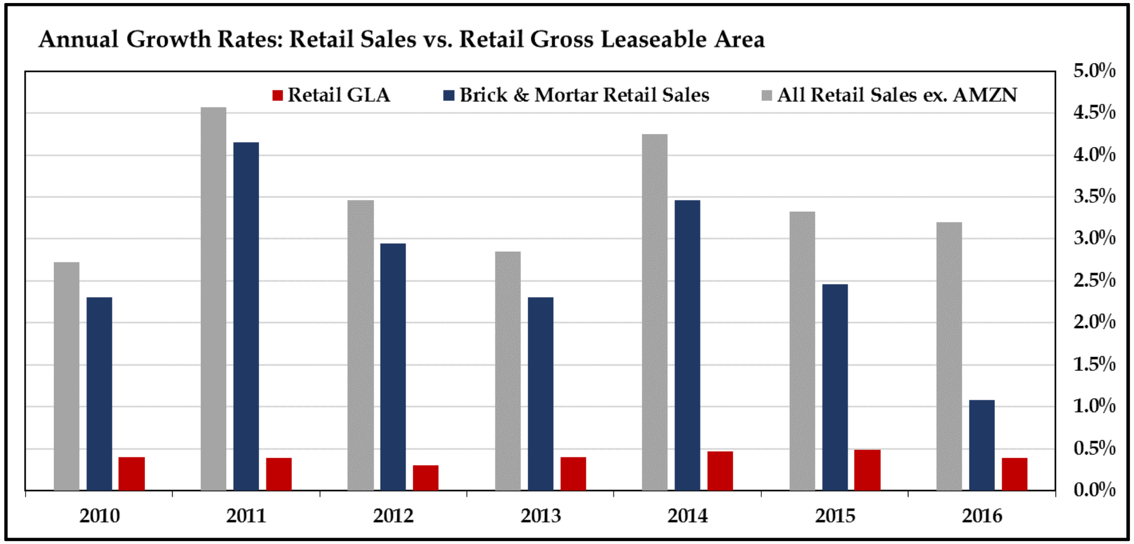
= Bull Case
= Base Case
= Bear Case

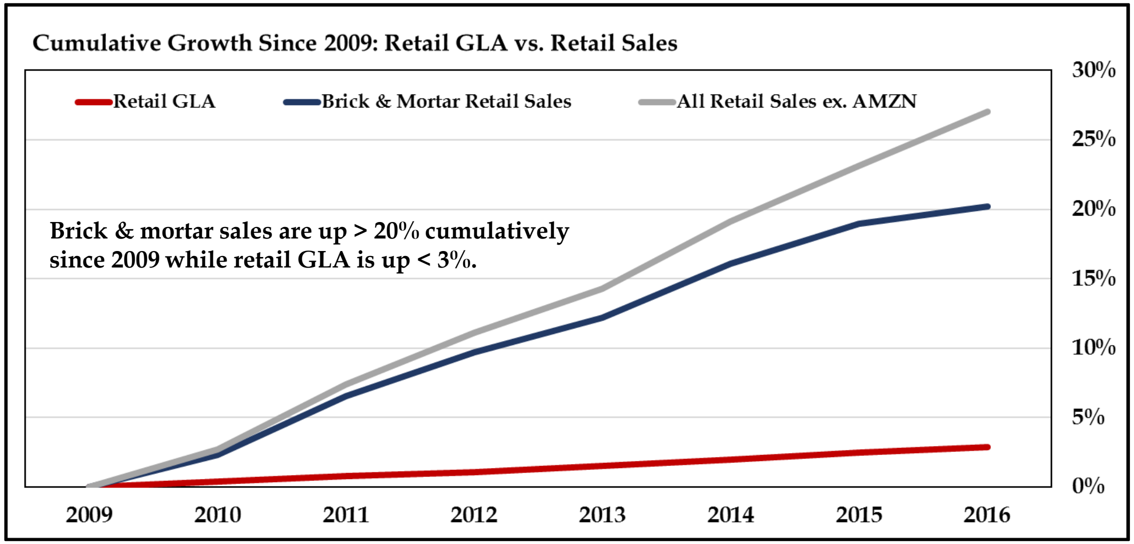
* Estimated returns exclude dividends, assume a starting $7.50 share price and use a 6.9% cap rate on the non-mall portfolio.

MALL MYTHS VS. RETAIL REALITIES

	MYTH	REALITY
Myth 1	eCommerce is killing the need for brick & mortar store fronts.	Sales at B&M stores continue to grow while previously pure eCommerce brands are opening physical stores.
Myth 2	Retailers are closing stores in record numbers.	Recently announced store closures are in-line with historical levels.
Myth 3	Demise of department stores ensures the terminal death of malls.	Department store space has been easily re-tenanted with tenants who increase overall mall traffic.
Myth 4	Rents are collapsing due to declining retailer demand.	Rents are steadily rising at malls, for both renewal leases and new leases.

REALITY: RETAIL SUPPLY & DEMAND IS BALANCING





- Growth of sales is steadily outpacing growth in leasable area, balancing supply & demand.
- New GLA supply at historical lows not seen since 1972.
- Majority of all retail square footage delivered has been concentrated in a few Tier 1 cities.

Source: US government data for retail sales. Amazon SEC fillings for Amazon sales data. ICSC for retail GLA deliveries.
Note: Retail sales numbers exclude autos, auto parts, restaurant sales and gasoline. **GLA includes deliveries for restaurants.**

REALITY: STORE CLOSURES IN-LINE WITH HISTORY

- 2016 had the 2nd lowest number of announced store closures in any year since 2001.
- Store closing announcements are seasonal and weighted almost entirely in Q1. Extrapolating the pace of closure announcements in Q1 2017 is a fundamental analytical mistake.
- In the LTM, there has been 137 million square feet of net absorption across retail real estate in the US.

Retail GLA Supply & Demand	Square Footage Delivered	Net Absorption
Q1 2016	19,888,026	21,358,396
Q2 2016	20,747,328	45,452,991
Q3 2016	22,687,917	43,494,046
Q4 2016	20,856,071	26,910,538
2016 Total	84,179,342	137,215,971

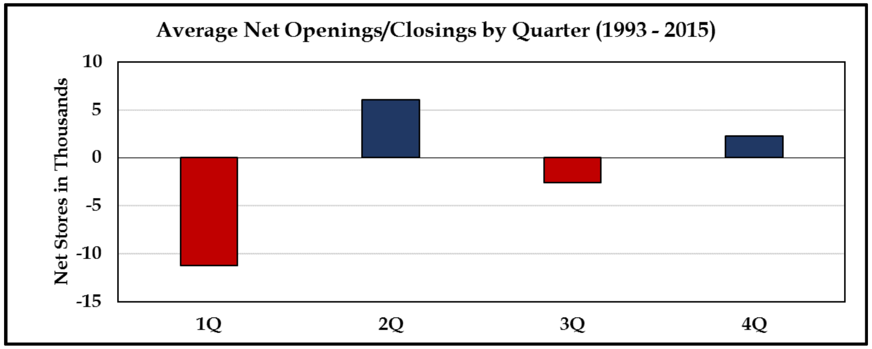
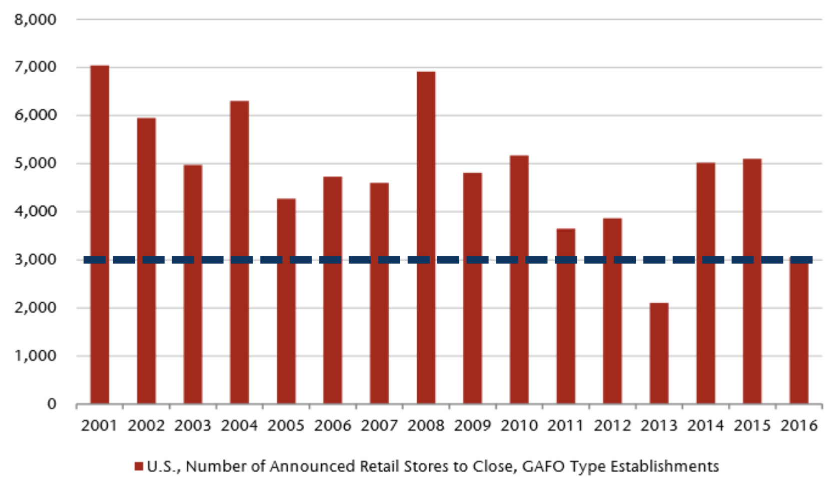


Chart 9: Retail Store Closings Were Down YoY in 2016 by Number of Store Closing Announcements



Source: Jefferies, ICSC

Source: ICSC, CoStar and Jefferies

REALITY: DEPARTMENT STORES CLOSING LESS IN MALLS

- Sears and Macy's are closing stores at the public mall REITs at less than half the rate of their total store base closings.
- JC Penney is closing its stores in mall REITs at 1/10th the rate of its store base closings.

2017 Public Mall REITs

Tenant	Total Closings Announced	% of Total Store Base	# of Closings at Public Retail Mall REITs	Total # of Locations at Public Mall REITs	% Closing as % of Total # at Mall REITs	Ratio of % Closing of Store Base to Mall REITs
JC Penney	138	13.8%	4	285	1.4%	9.9x
Sears	42	6.0%	8	263	3.0%	2.0x
Macy's	68	10.2%	14	322	4.4%	2.3x

Source: SEC filings and company press releases. Public mall REITs used: MAC, SPG, GGP, TCO, WPG, CBL

HISTORICAL RE-DEVELOPMENT

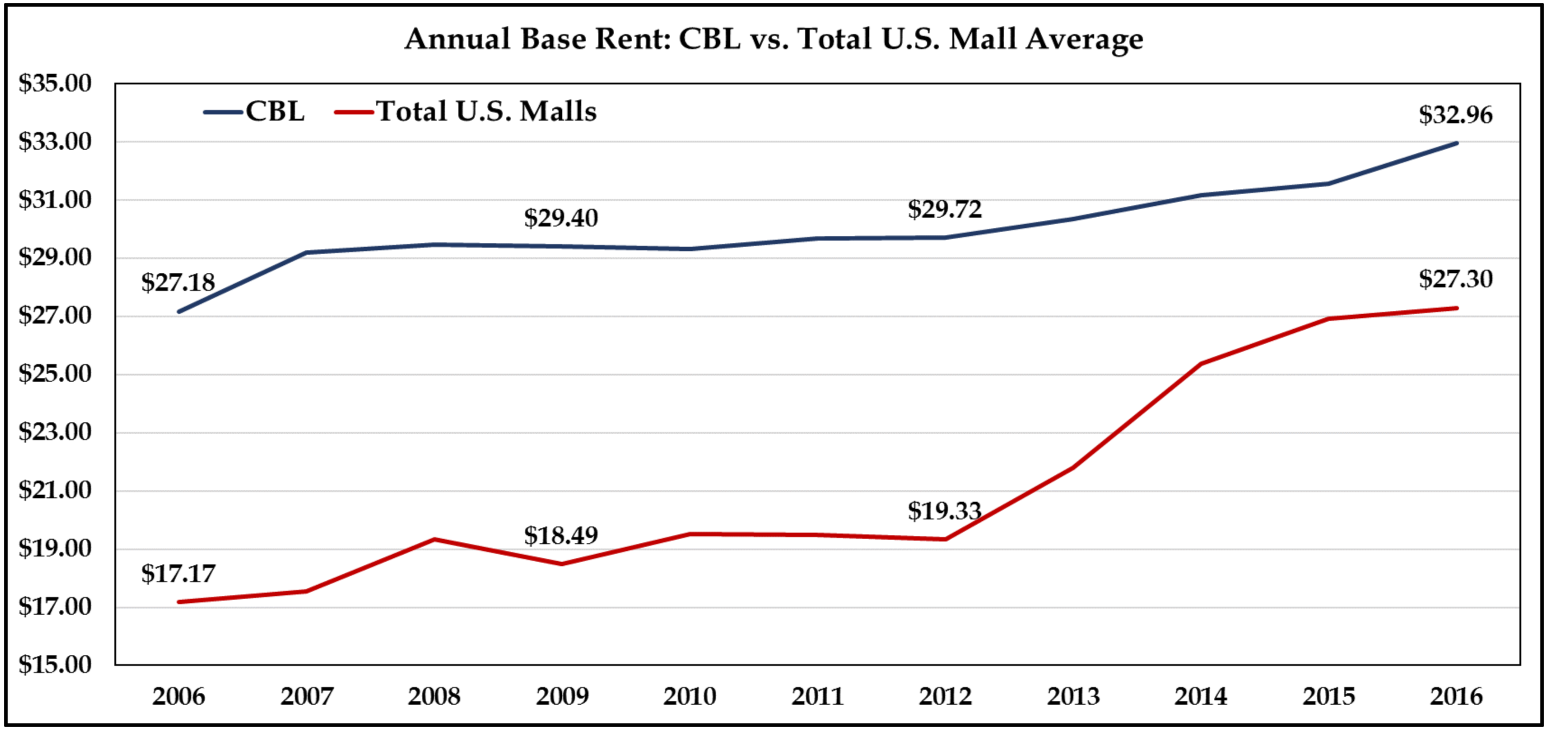
- Weak department stores are hurting the malls; replacing them with higher traffic tenants is a net positive.
- CBL has a long track record of profitably redeveloping department stores (anchor tenants).
- Since 2013, CBL has completed 25 redevelopment projects, deploying a total of $250 million in capital, and achieving an average un-levered return of 8.5%.

Examples of CBL Redevelopments

Metrics	Fayette Mall	Coolsprings Galleria
Redevelopment Spend	$68.5 million	$64.6 million
Pro-forma NOI	$5.55 million	$4.65 million
Unlevered Yield	8.1%	7.2%
Appraiser's Estimated Cap Rate	4.2%	4.9%
Estimated ROI	93%	47%

IKEA takes up space previously occupied by a Macy's and a Sears, ~300k square feet.
http://www.bizjournals.com/triangle/news/2017/02/03/ikea-cary-towne-center-loan-documents.html?ana=yahoo

REALITY: ANNUAL BASE RENTS ARE STEADILY RISING



- Total US Mall average base rent has been rising steadily.
- CBL's base rents are at premium to the US mall average are inflecting higher, especially in the last year.

Source: CBL SEC Filings, ICSC, National Council of Real Estate Investment Fiduciaries

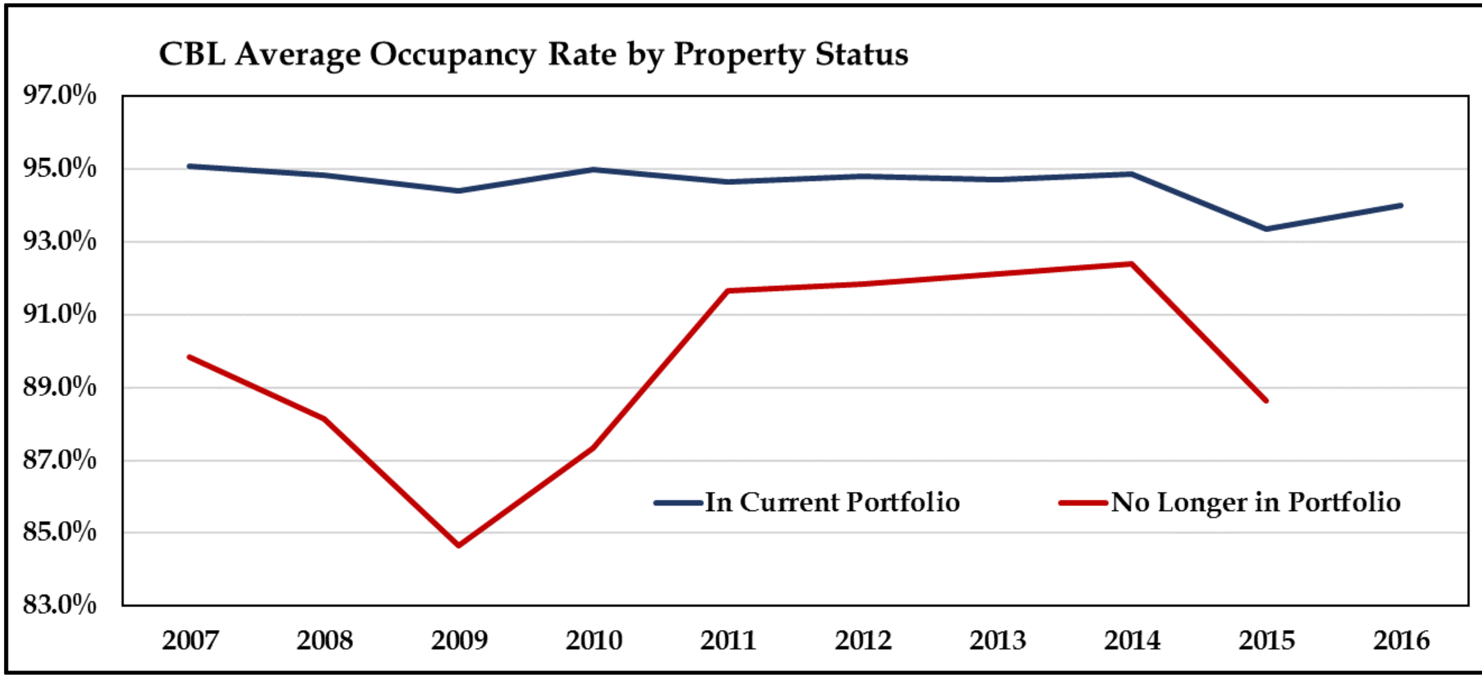
WHY CBL?

- CBL stands out among retail REITs with the largest discount to NAV, highest dividend yield, highest implied cap rate and lowest P/FFO multiple.

REIT	Stock Price	Consensus Cap Rate	Consensus NAV	Δ Stock/NAV	Div. Yield	P/FFO (NTM)
CBL	**$7.50**	**10.9%**	**$20.18**	**-63%**	**14.2%**	3.5x
WPG	$8.12	9.4%	$14.21	-43%	12.3%	4.5x
DDR	$9.25	7.5%	$16.07	-42%	8.2%	8.1x
TCO	$63.17	5.6%	$95.32	-34%	4.0%	16.1x
KRG	$19.27	7.2%	$28.79	-33%	6.3%	9.0x
KIM	$18.31	6.9%	$25.83	-29%	5.9%	11.6x
RPAI	$12.73	7.1%	$17.58	-28%	5.2%	12.1x
GGP	$23.33	5.6%	$31.95	-27%	3.8%	14.1x
MAC	$59.22	5.5%	$79.23	-25%	4.8%	14.5x
SKT	$26.47	7.3%	$35.40	-25%	5.2%	10.6x
SPG	$159.78	5.8%	$212.78	-25%	4.3%	13.3x
WRI	$30.96	7.4%	$39.33	-21%	5.0%	12.6x
REG	$61.97	5.3%	$72.07	-14%	3.4%	17.2x
SRG	$39.78	5.9%	$36.25	10%	2.5%	19.1x

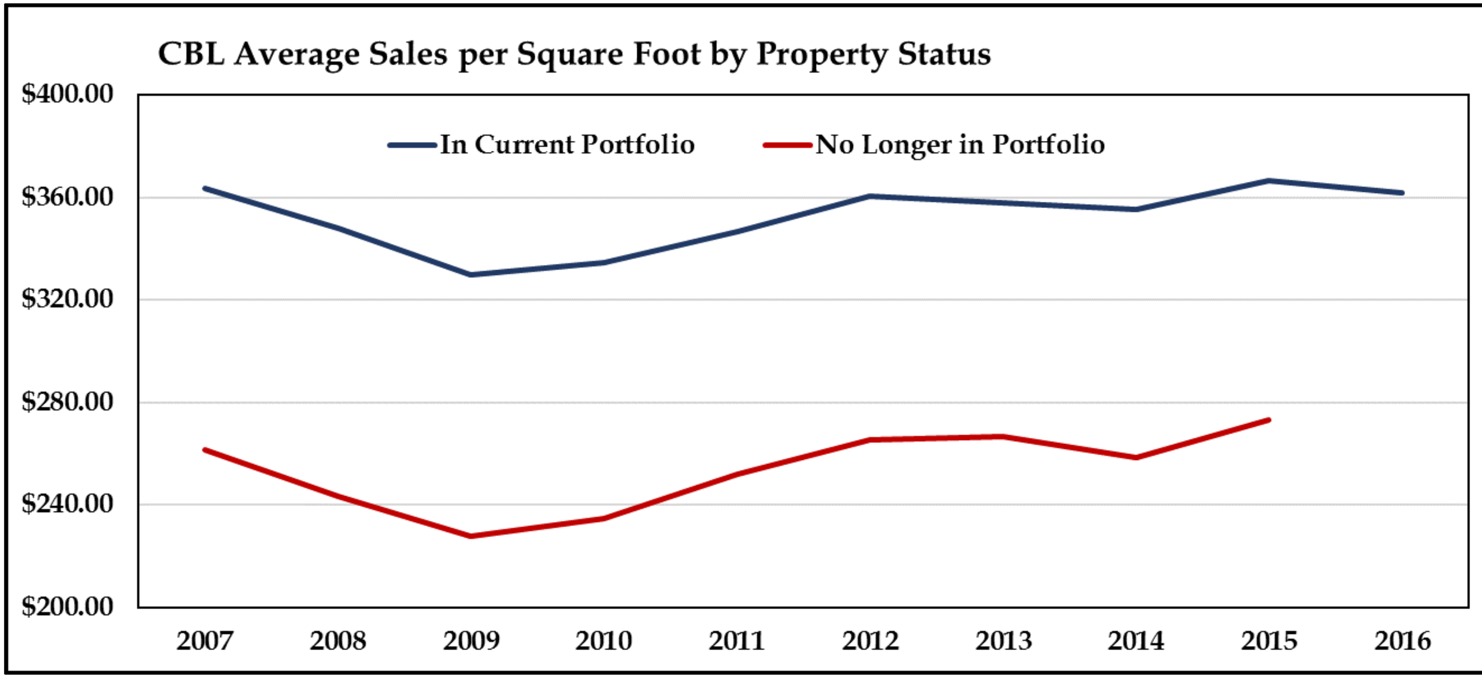
Average	7.0%	-	-28.5%	6.1%	11.9x
Median	7.0%	-	-27.3%	5.1%	12.3x

CBL's Quality Has Substantially Improved



- The blue line isolates CBL's malls that are still currently in their portfolio. The red line represents the 27 malls CBL has disposed of over the past 9 years.
- CBL now holds a higher quality portfolio of properties which held up well in 2008 – 2009.
- On average, **the current portfolio only experienced a 70 bps drop in occupancy rate from 2007 to 2009**, while the malls that have been disposed of experienced a 520 bps drop.

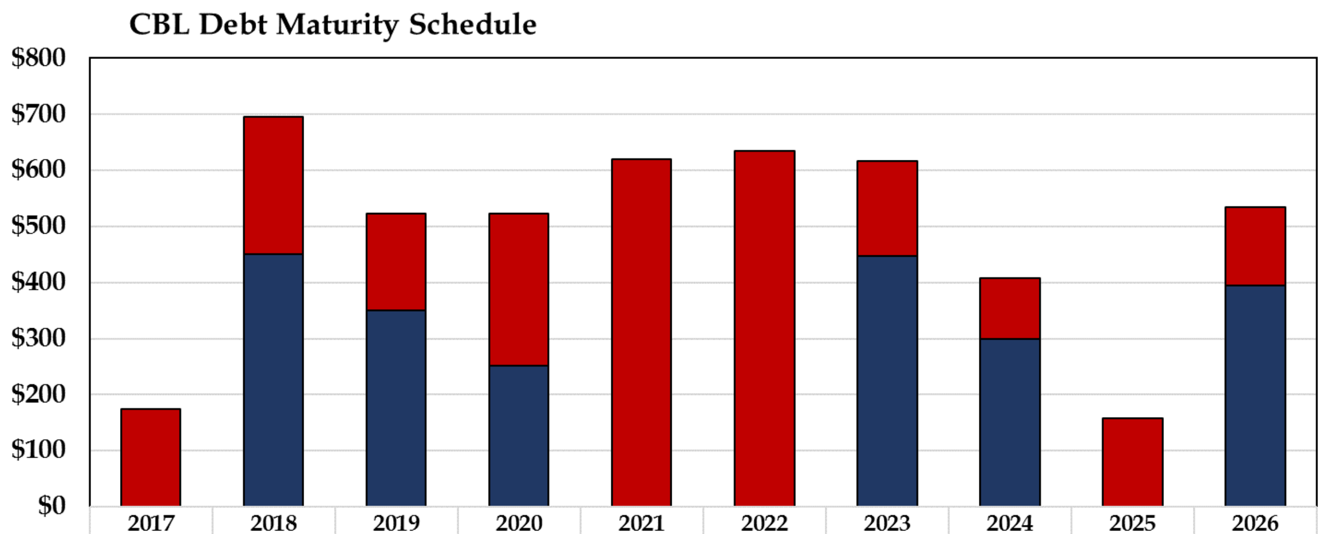
AVERAGE TENANT SALES PSF BY PROPERTY STATUS



- The blue line isolates CBL's malls that are still currently in their portfolio. The red line represents the 27 malls CBL has disposed of over the past 9 years.
- Since 2007, the average sales per square foot of CBL's current mall portfolio is $98 higher than the average of the 27 malls they have disposed of.

CBL Debt

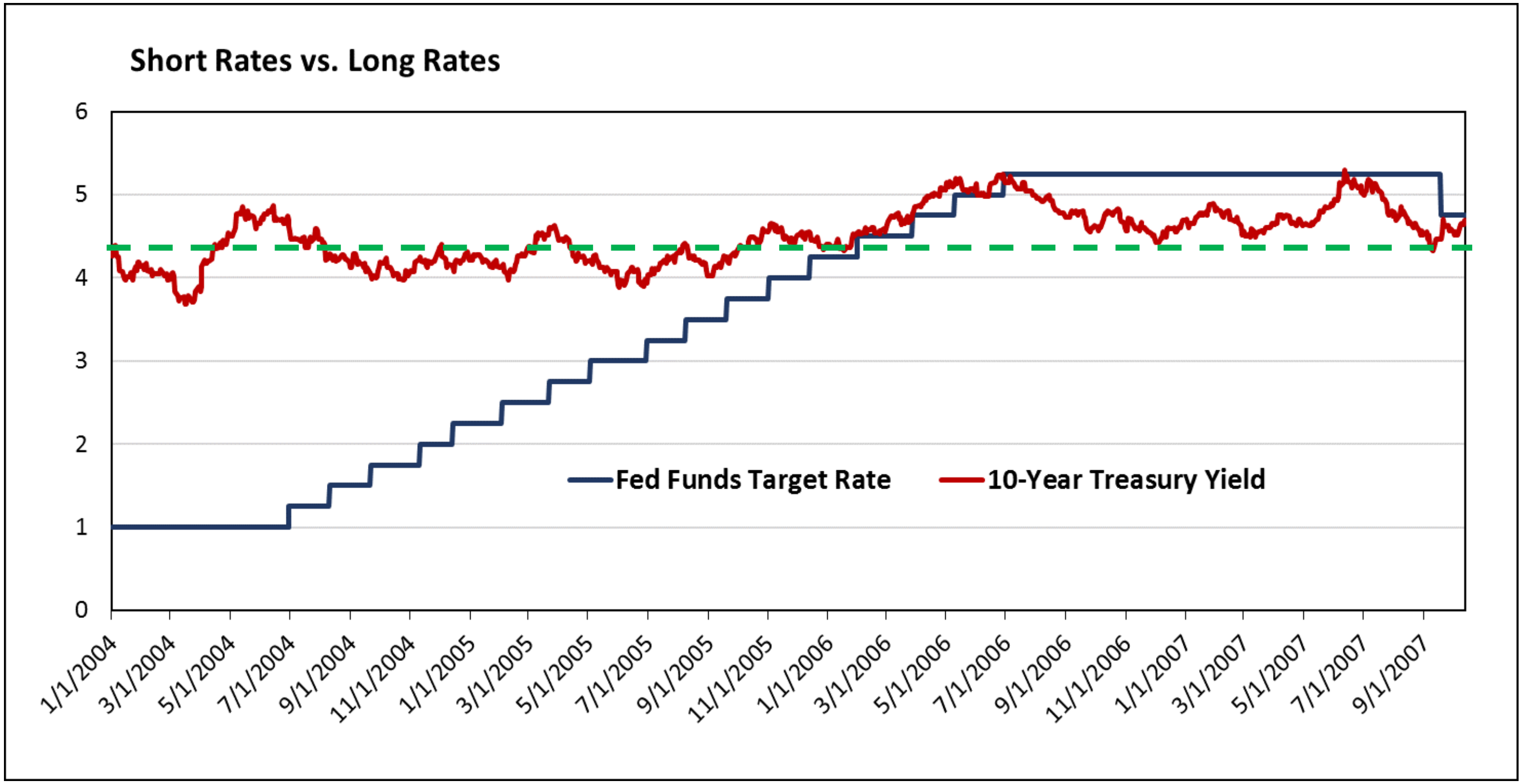
- 56% of CBL's debt is mortgage debt with approximately half of it not maturing until 2021 and 2022.
- While not overly levered relative to its peers, we believe CBL could sell just a few select properties and easily reduce its debt by over $900 million.



	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Wgt-Avg. Interest Rate	6.0%	3.8%	3.2%	4.0%	5.3%	4.7%	4.9%	4.5%	4.1%	5.5%
% of Total Debt	3.5%	13.8%	10.4%	10.4%	12.3%	12.6%	12.3%	8.1%	3.1%	10.6%
Mortgage Debt	$174	$246	$174	$271	$619	$634	$170	$108	$157	$140
Non-Mortgage Debt	$0	$450	$350	$252	$0	$0	$447	$300	$0	$394

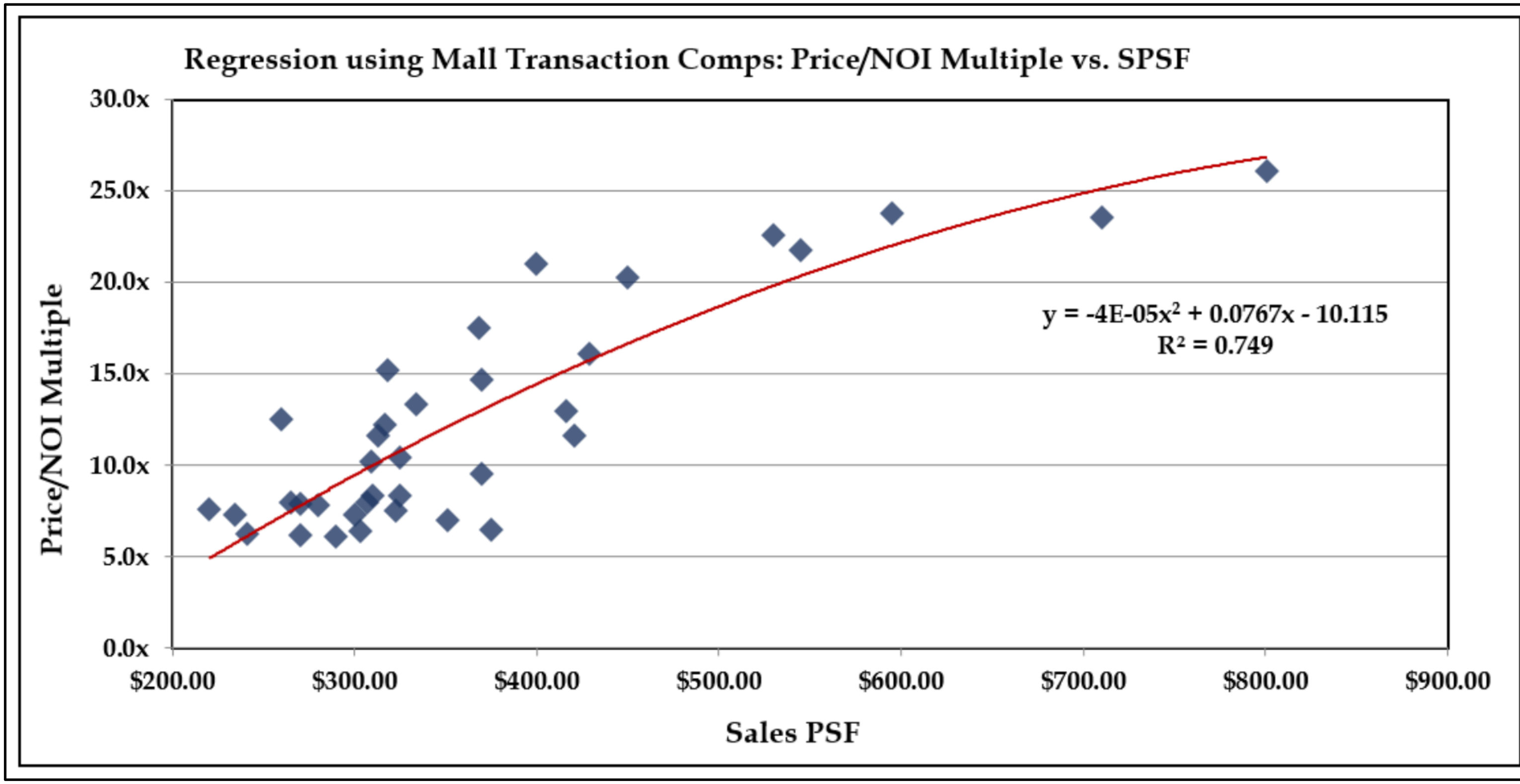
CBL: Interest Rate Risk

- Short term rates rising does not mean long term rates will automatically sky-rocket higher.
- In 2004, the 10-year rate was ~70 bps lower a year after the initial Fed rate hike.
- Commercial real estate cap rates are priced off of 10-year yields. Cap rates compressed materially during this rate hike cycle from 2004 – 2006.



CBL Valuation

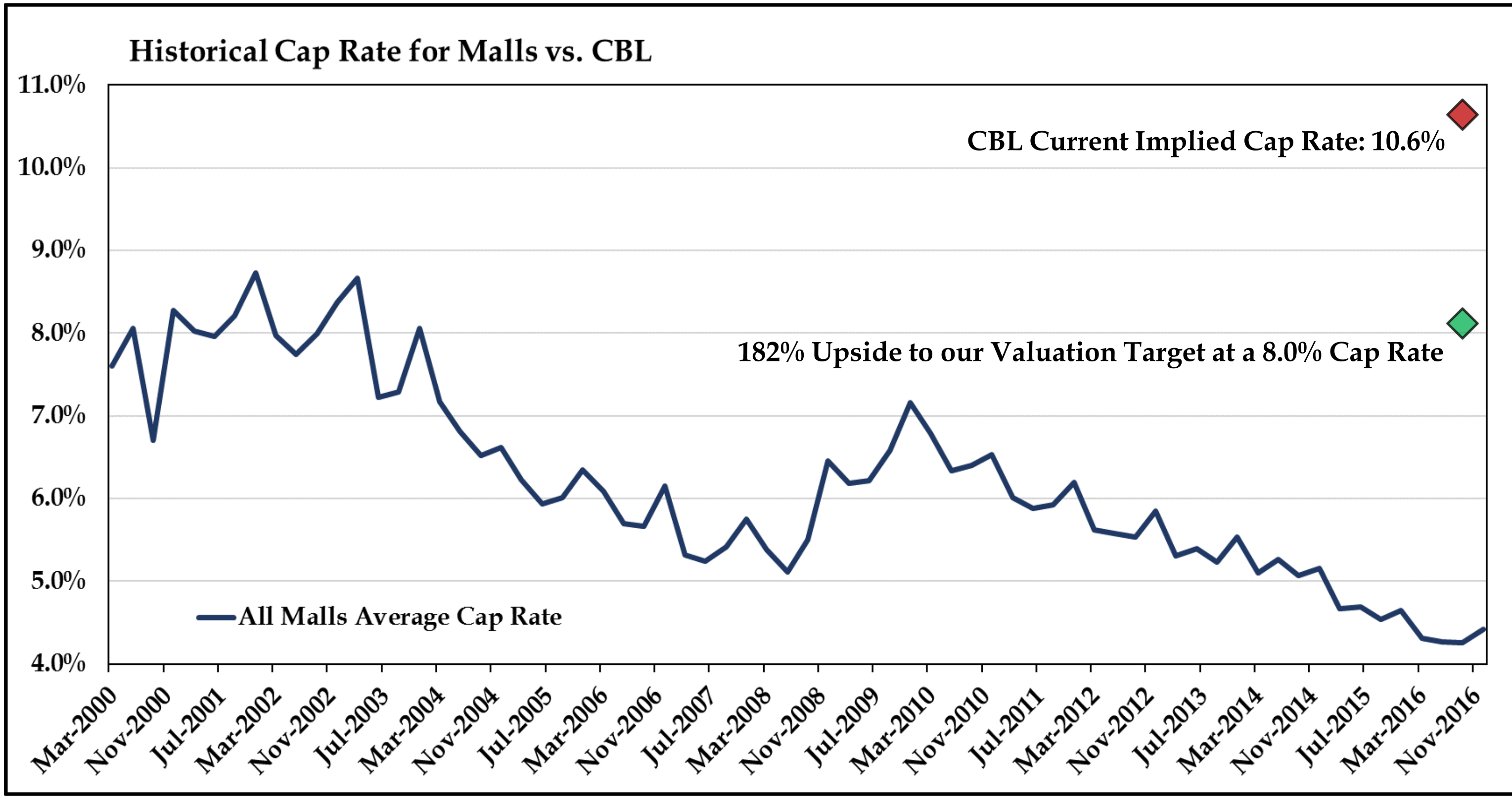
MALL TRANSACTION COMPS REGRESSION



- We ran a regression using 36 transaction comps from 2016 – 2017 to derive cap-rate estimates for each CBL mall based on its tenant sales psf.
- Using this transaction comp regression gives CBL's mall portfolio an 8.0% weighted-average cap rate.

Source: Mall transaction comp data from CBRE and Cushman Wakefield.

HISTORICAL MALL CAP RATE VS. CBL



- CBL's current implied cap rate is 10.6%, 260 bps above our regression-derived cap rate for CBL's mall portfolio of 8.0%.
- CBL's cap rate is ~ 200 bps higher than the 2002 valuation low for malls when rates were > 6%.
- Reverting back near malls' all-time high cap rates of 8.8% gives CBL 112% upside before dividends.

Source: ICSC for historical mall cap-rate data.

CBL NAVPS ESTIMATES

- Using estimated 2017 NOI of $755.6 million and 199.4 million shares outstanding, below is an equity return sensitivity table using a starting stock price of $7.50:

			Total Return With Dividends			IRR		
	Target	Total	Holding Period					
Cap Rate	Stock Px	Px Return	1-Year	2-Year	3-Year	1-Year	2-Year	3-Year
11.5%	$4.83	-35.6%	-21.8%	-7.9%	6.0%	-21.8%	-4.3%	2.3%
11.0%	$6.33	-15.7%	-1.8%	12.1%	25.9%	-1.8%	6.3%	9.1%
10.5%	$7.97	6.2%	20.1%	33.9%	47.8%	20.1%	16.7%	15.6%
10.0%	$9.77	30.3%	44.1%	58.0%	71.9%	44.1%	27.2%	22.0%
9.5%	$11.77	56.9%	70.7%	84.6%	98.5%	70.7%	37.8%	28.3%
9.0%	$13.98	86.4%	100.3%	114.2%	128.0%	100.3%	48.6%	34.6%
8.5%	$16.46	119.4%	133.3%	147.2%	161.0%	133.3%	59.8%	41.0%
8.0%	$19.25	156.6%	170.5%	184.3%	198.2%	170.5%	71.5%	47.5%
7.5%	$22.40	198.7%	212.6%	226.4%	240.3%	212.6%	83.9%	54.2%
7.0%	$26.01	246.8%	260.7%	274.6%	288.4%	260.7%	97.0%	61.2%

- We believe a 8.0% - 8.9% is a fair cap rate for CBL. That is higher than almost any private market transactions for Class-C retail real estate in 3rd tier cities.
- If re-attaining an 8.5% cap rate takes two years, the total return to shareholders would be 147%, a 60% IRR when accounting for dividends.

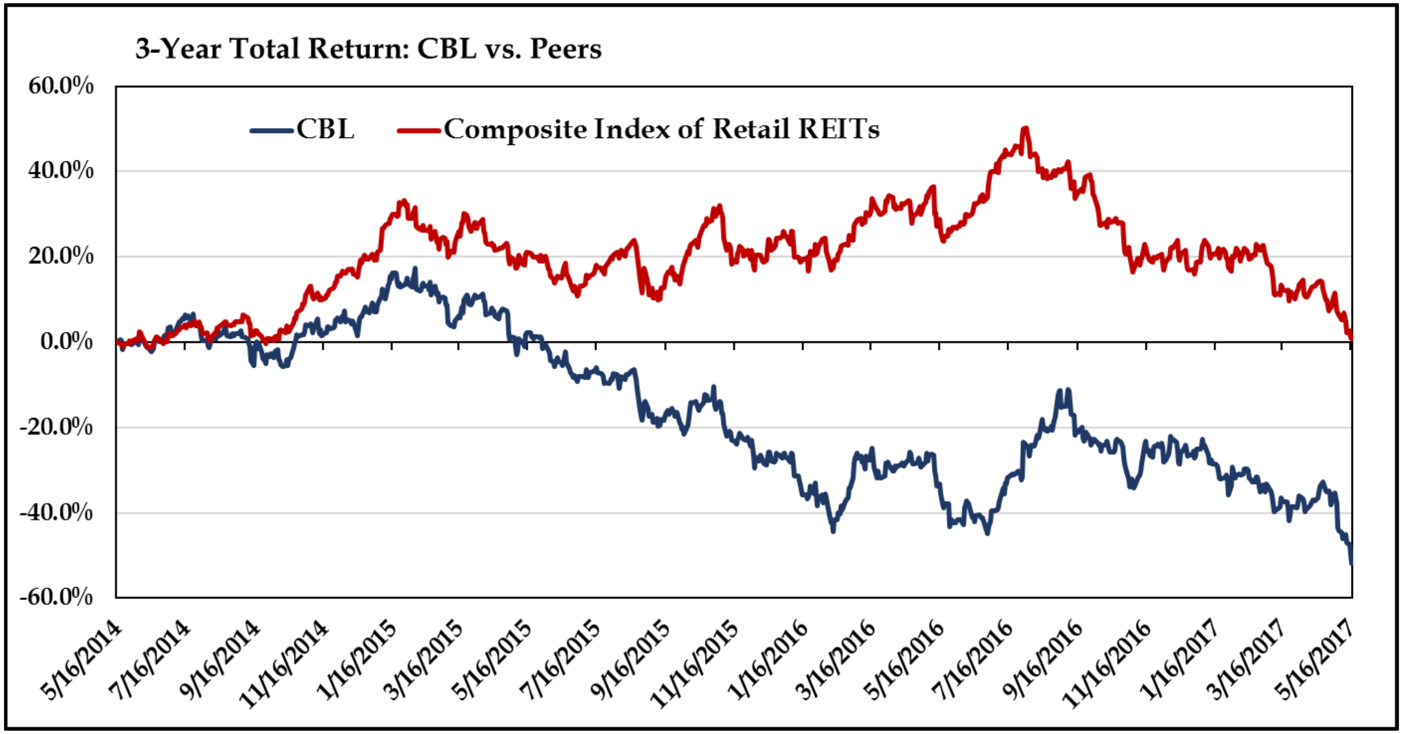
ROUSE BUYOUT EVALUATION

- Rouse was spun-off from GGP in January of 2012.
- Brookfield Asset Management paid an implied 7.9% cap-rate for Rouse in July 2016.
- Rouse had a lower quality portfolio overall than CBL as measured by standard industry metrics.
- Rouse had zero NOI from open-air lifestyle centers/associated centers.

Metric	Rouse	CBL	Difference	Upside for CBL at RSE's Takeout Value
Tenant Sales PSF	$357	$376	+$19/+5.3%	n/a
Physical Occupancy	89.3%	94.1%	+4.8%	n/a
TTM SS NOI Growth	0.8%	2.8%	+2.0%	n/a
EV/EBITDA	16.1x	9.3x	-6.8x	353%
Cap Rate	7.9%	10.9%	+3.0%	164%
EV-to-Gross PP&E value	109.3%	73%	-36.3%	200%
P/TTM FFO	12.5x	3.4x	9.1x	345%

CBL's Performance vs. Peers

	CBL Total Return Performance vs. Peers						
Period	**KRG**	**KIM**	**PEI**	**GGP**	**MAC**	**SPG**	**WPG**
YTD	-13.4%	-7.9%	8.8%	-23.7%	-17.1%	-23.2%	-8.1%
1-Year	4.8%	7.8%	25.0%	-9.1%	-5.1%	-6.2%	-6.4%
3-Year	-32.4%	-40.3%	-16.9%	-53.6%	-52.2%	-53.7%	2.4%
5-Year	-52.7%	-63.0%	-41.6%	-93.4%	-67.8%	-71.9%	-



Plan of Action

- We believe there are 7 malls CBL can sell to generate after-debt, after-tax, net proceeds equivalent to ~89% of its current market cap. We estimate these properties make up 14% of CBL's total NOI.

Mall	Est. Cap Rate	NOI Estimate	Mortgage	Net Proceeds to CBL	% of MCAP	% of Total CBL NOI	Proceeds/NOI Ratio
Fayette Mall	5.1%	27,359,723	$161,051,000	$301,341,437	20.2%	3.6%	5.6x
Mall del Norte	5.7%	17,407,399		$273,392,233	18.3%	2.3%	7.9x
West Towne Mall	5.3%	13,647,493		$222,576,396	14.9%	1.8%	8.2x
Mayfaire Town Center	7.0%	11,526,021		$156,345,154	10.5%	1.5%	6.9x
South County Center	7.9%	11,423,976		$144,471,485	9.7%	1.5%	6.4x
St. Clair Square	7.7%	11,207,845		$130,186,445	8.7%	1.5%	5.9x
Cross Creek Mall	5.5%	14,079,535	$122,451,000	$104,737,024	7.0%	1.9%	3.8x
	Total	**106,651,991**	**$283,502,000**	**$1,333,050,174**	**89.1%**	**14.1%**	**6.3x**

Proceeds to CBL	**$1,333,050,174**
- Pay Off Line of Credit	$252,100,000
- Pay Off Other Debt	$400,000,000
Remaining Cash	$680,950,174
Special Div./Share	**$3.42**
Div. Yield	*46%*
Total Debt Reduction	$935,602,000
in %	-19%

- The sale could reduce CBL's debt by 19% and leave enough cash for a > $3.00/share special dividend.
- Assuming the stock price doesn't move, CBL would still be trading at an implied cap rate of 10.5%, leaving ~ 100% upside to reach our pro forma cap rate estimate of 8.3%

Current	
CBL Units	199,386,000
Unit Price	$7.50
Market Cap	$1,495,395,000
- Cash	$27,553,000
+ Debt	$5,025,750,000
+ Pfd. Stock	$626,250,000
- Mortgage & Notes Rec.	$16,347,000
EV	**$7,103,495,000**
Total Est. CBL NOI	$755,625,000
Implied Cap Rate	**10.6%**

Pro Forma		
CBL Units	199,386,000	Change
Unit Price	$7.50	
Market Cap	$1,495,395,000	
- Cash	$27,553,000	
+ Debt	$4,090,148,000	($935,602,000)
+ Pfd. Stock	$626,250,000	
- Mortgage & Notes Rec.	$16,347,000	
EV	**$6,167,893,000**	
Total Est. CBL NOI	$648,973,009	(106,651,991)
Implied Cap Rate	**10.5%**	

COMMENTS FROM RETAIL REITS AFTER Q1 2017

- "Our leasing volume is the highest in 10 plus years… While retailer weakness is dominating the media, many retailers, a majority of them our tenants, are thriving. For example, TJX, Ross and Burlington in aggregate have announced expansion plans in excess of 300 stores." – KIM

- "The narrative or rhetoric is clearly a little worse than what we're actually seeing… What has happened in Q1 in terms of tenant closings isn't really that different for us than it has been in Q1 of every year... There's a big discrepancy right now between what cap rates actually are and what stocks trade for." - KRG

- "The Internet and changing consumer patterns will undoubtedly cause some weak retailers to fall into distress. But there's still a healthy list of high-quality replacement anchors including the TJX brands, Ulta Beauty, DICK'S, Aldi, Ross, Five Below and Burlington." – DDR

- "When we look at our five Sports Authority leases that we backfilled this quarter, there were five different tenants that took the spaces. So that just shows the diversity of demand that we are dealing with." – KIM

- "In 2015, we had basically the same amount of bankruptcies [as in Q1 2017] and we got that occupancy back over a 24-month period." – CBL

- "Looking back over the past couple of years for perspective, in early 2015, there were also a number of tenant bankruptcies, and the portfolio was 95.8% leased compared to 96.2% leased in the first quarter of 2014. By the end of 2015, the portfolio recovered to 96.9% leased. We anticipate a similar recovery this year given our leasing progress." - GGP

- "I don't think there's more or less than in years past [retailer bankruptcies]… Keep in mind, our portfolio is over 96% occupied. The only way some of these new, vibrant tenants can gain access is for some other tenants go out. So, it's a process that's been going on for the 35, 36 years we've been in business, so nothing new." - SKT

- "Disruption is undeniably fixating and coupled with the images of drone delivery and a cyclical spike in tenant bankruptcies, it's just our time out of the sun." – RPAI

- "To paraphrase Mark Twain, reports of the death of retail real estate have been greatly exaggerated." - KIM

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