

THE EMPIRE STRIKES BACK



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The Empire State Building, almost 90 years old, seems to be getting better with age. We explain how going public as a REIT had a lot to do with this revitalisation.

While people would generally be able to rattle off the names of global listed equity companies quite easily, they might struggle to come up with more than 1 or 2 global listed property companies – it's just not an area that people are overly familiar with.

At the annual Nedgroup Investments' summit earlier this year, we shared our thoughts on a company that is held in our global property funds – Empire State Realty Trust. As the name suggests, the company owns an asset that has an iconic brand name: the Empire State Building.

The Empire State Building – a remarkable story

Located in mid-town Manhattan and standing approximately 440 metres tall with 102 levels crowned by an observation deck, the Empire State Building was the world's tallest building for 40 years after its completion in 1931¹. To put it in perspective it is twice the height of South Africa's tallest building – the Carlton Centre.

Its history is littered with fascinating stories: the fact that it (remarkably) took less than 14 months to build – today buildings of this size would take around 2 years to build; how it was hit by a US B-25 Bomber in 1945 and how it was once again New York's tallest building for a decade after the events of 9-11¹.


The building has been around for almost 90 years but it seems to be getting better with age and going public, as a REIT, has had a lot to do with this revitalisation.

While its history is fascinating, until relatively recently its financial performance wasn't fantastic. You see it was a victim of its birth and dysfunctional ownership structure.

Finished in the depths of the Great Depression, it struggled to lease and sat with a considerable amount of vacant space, so much so that it was nicknamed the Empty State Building.

For many years, the owners simply filled space with whomever would take it, to the point where most of its floors became a rabbit warren of small tenants including lawyers, jewellers, accountants and other small businesses. Some floors had over 40 tenants, which made it very hard to manage the building in an efficient fashion. Consequently, over time the tenant fit-outs, buildings services and infrastructure gradually deteriorated.

¹ <http://www.esbnyc.com/explore>



For a long period ownership of the building was split among three parties who did not have the capital nor shared vision on how to reposition the building. Consequently, it suffered from chronic under-investment and hence was unable to attract tenants except by effectively giving away the space in return for keeping the lights on and paying city taxes.

A second lease on life

All of that changed around 10 to 15 years ago when the ownership was consolidated and ultimately the property listed on the New York Stock Exchange (NYSE) in 2013 as the key asset of Empire State Realty Trust (ESRT). This dedicated structure provided access to capital to accelerate the refurbishment and repositioning of the building.

Under an extensive modernisation program, the new management team added amenities such as a gym, restaurants and conference facilities while lobby and lifts were upgraded, lighting, and power replaced².

They did such a good job that, in spite of its vintage, the Empire State Building is now in the top 15% of the most energy efficient buildings in the US. The Empire was moving from an Empty State to a 'Tower of Power' - and is only getting better with age. The Empire was striking back!

And tenants get it. Occupancy has increased from 78% in 2013 to 92.5% today – that's better than the average premium grade New York office building. At the same time rents have grown from around US\$40 in 2013 to on average over US\$52 per sq ft today with most recent deals at over US\$60 a sq ft. Tenants now include high profile larger names such as LinkedIn, JC Decaux and Shutterstock. It is a phenomenal turnaround in perception and reality in terms of commercial outcomes.

I still haven't got to the jewel in the crown, the observation deck. Today it attracts more than 4 million visitors per annum² and generates US\$100m of income per annum. In the past 20 years other decks have been launched including, Rockefeller's Top of the Rock and the One World Observatory but, almost everyone wants to go to the Empire State Building. Since 2001 (the worst year in terms of income from the observation deck) and through the Global Financial Crisis (GFC), the observation deck saw a drop in income of less than 1%. It's been an incredibly resilient cash cow for this property.

Why Resolution Capital invested in it

Resolution Capital is a global real estate securities manager, with over a 10-year track record in analysing and investing in global listed property markets. We believe that listed property provides an excellent means of gaining an efficient exposure, to the returns of some of the world's highest quality real estate assets.

In 2013, when the IPO for the Empire State Building was launched, the general perception was that it was a novelty, if not a tired old building and not a serious investment. It is fair to say that there was reasonable but not overwhelming demand for the stock. Nevertheless, for us, it had the bones of a good building, an improving location and the character was consistent with what an increasing number of tech and media tenants were drawn to. We saw the enormous potential of a well-run building, with a better balance sheet to be able to extract returns. It reminds us of The Tea Building in London's Shoreditch – a century old tea warehouse that retains a number of its raw features and has a waiting list of tenants.

The Empire State Realty Trust listed at US\$ 13 per share and the stock now trades at US\$ 20 per share. Along the way, it has paid a good and increasing dividend, with earnings expected to grow at 7% pa in the decade after its IPO. Better still, last year the company did a placement of 10% of its issued capital at US\$ 21 per share and using the proceeds to significantly deliver what was already a solid balance sheet. Now the loan to value (LTV) across the consolidated portfolio is less than 15%.

So this is why we get excited about selective listed global real estate opportunities. They give you the ability to gain access to great real estate, with management that is focused and strong balance sheets, which allow this value to be unlocked.

Access to an exceptional strategy through Nedgroup

The interesting investment case study provided in the narrative above is just one example of the real estate companies held within the Nedgroup Investments Global Property Fund. The Resolution Capital team invests in a select and diverse group (no more than 55 stocks) of real estate companies capable of generating superior risk adjusted returns for investors.

The stringent filtering process focuses on identifying and exploiting three key attributes:


1. High barrier property markets where landlords have pricing power; and
2. Strong balance sheets, which can successfully withstand and exploit market cycles; and
3. Management teams with skill, discipline and alignment.

The Nedgroup Global Property Fund is a mirror of the Resolution Capital flagship Global Property Securities Strategy, which boasts a stellar 10-year track record of out-performance.

Nedgroup Investments provides access to this strategy via two FSB approved access points:

- Nedgroup Investments Global Property Fund (USD - domiciled in Ireland)
- Nedgroup Investments Global Property Feeder Fund (ZAR - domiciled in South Africa). ■

² https://www.esbnyc.com/sites/default/files/esb_fact_sheet_4_9_14_4.pdf



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