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BRE Properties: Now is The Time to Sell the Company — 45% Upside

- *Now is the time for CEO Connie Moore to put BRE Properties (NYSE: BRE) up for sale to the highest bidder. If the Trustees of Lehman Brothers saw it as more profitable to sell Archstone than take it public, then BRE's board should follow Lehman's lead as BRE is worth more in a private sale given the steep discount it trades at today.*
- *45% plus upside to the private market value of BRE's apartments confirmed by the valuation (21x NOI) Lehman Brothers sold Archstone to Equity Residential (NYSE: EQR) and AvalonBay (NYSE: AVB).*
- *BRE has no poison pill, no staggered board and little ownership by management. The board is stacked with REIT executives whose companies have been sold in the past, including Bud Lyons, Dennis Singleton and Connie Moore, currently the CEO.*
- *\$68 private market value reflects the high multiples for BRE's California apartment portfolio (over 80% of company) which is expected to generate the strongest apartment growth in the country.*

Time for Strategic Alternatives Is Now

Since October, when we highlighted BRE as an M&A candidate in our report [“Profit from Housing Shortage: Buy Coastal Apartment REITs Aimco and BRE for 50%+ Upside”](#), several developments occurred that reinforce the urgency for BRE management to take action:

- First, Essex Property Trust (NYSE: ESS) disclosed a “strategic” stake in a company believed to be BRE.
- Second, Lehman Brothers saw more value in Archstone in the private markets than the public markets.
- Third, BRE's apartment portfolio showed an acceleration of growth and third parties highlighted a continuation of robust fundamentals in 2013 and beyond.

Essex Sees Value in BRE

In November 2012, Essex Property Trust (NYSE: ESS), a fellow west coast apartment owner and BRE's most comparable peer, disclosed a stake in a competitor which is “strategic” in nature and widely believed to be BRE Properties. Essex is well-known as an investment sharpshooter, capital allocation all-star and is a

logical acquirer of BRE given the revenue and expense synergies to be achieved given the overlap of the portfolios.

Archstone Chooses the Private Market

The Trustees of Lehman Brothers concluded that an outright sale of Archstone offered better value than an IPO. Similarly, CEO Connie Moore and the board should form a committee to seek strategic alternatives to maximize value for shareholders.

The Archstone portfolio was concentrated in large coastal cities across the United States, while BRE has a greater concentration than Archstone in the more highly priced and more highly sought after California market, suggesting valuations in excess of those achieved in the Archstone transaction. BRE’s markets are expected to have the strongest growth in 2013 (as well as 2014 – 2016), outpacing Archstone and the apartment REIT sector.

BRE’s Fundamentals To Be Best In Class

BRE’s year-over-year same-store NOI accelerated to 6.6% in the third quarter from 5.6% in the second quarter and is expected to grow 7%–8% in 2013 and 6%–8% annually over the next several years.

With growth decelerating at many peers companies, BRE is uniquely positioned to offer an acquirer superior growth. BRE is nearly 100% exposed to west coast markets that are in the early stages of recovery compared to the east coast and Sunbelt markets.

According to Axiometrics forecasts, BRE is concentrated in all of the top 9 rental growth markets 2013–2016. California is only in the second year of a recovery that typically extends 4–7 years, so there remains ample runway for continued above trend growth. The company’s newly rolled-out revenue management system should further add to growth.

Figure 1. BRE's Markets Showing Strong Growth

Top Projected Rent Growth Markets			
Rank	MSA	2013 - 2016 Cumulative Growth	BRE Markets
1	Los Angeles, CA	20.8%	✓
2	San Francisco, CA	20.0%	✓
3	Phoenix, AZ	19.6%	✓
4	Oakland, CA	19.4%	✓
5	Santa Ana-Irvine, CA	19.3%	✓
6	San Jose-Santa Clara, CA	18.7%	✓
7	Riverside, CA	18.3%	✓
8	Denver, CO	18.2%	✓
9	San Diego, CA	18.0%	✓

Source: LANDandBUILDINGS, Axiometrics, Company reports

BRE Takeover Has Few Hurdles

BRE has a non-staggered, largely independent board, little ownership by management, no poison pill and ranks very highly across corporate governance metrics. The board is stacked with senior REIT executives whose companies have been sold or merged, including Bud Lyons, Dennis Singleton and Connie Moore, currently the CEO. In numerous discussions with the BRE management, they have indicated openness to strategic alternatives, described themselves as “not entrenched” and claimed they are “for sale every day.” This is a management team and board that will sell the company when the time is right...and that time is now.

Figure 2. BRE Trading At a Steep Discount to NAV

Fair Value	\$68
<i>Current Price</i>	\$48
Total Return Potential	45%
<i>Property NOI after Prop 13 Impact*</i>	\$280,238
<i>Applied Cap Rate</i>	4.5%
Private Market Value of Properties	\$6,186,269
<i>Share of JV Property NOI</i>	\$3,867
<i>Applied Cap Rate</i>	6.00%
Private Market Value of JVs	\$64,448
Cash	\$66,563
Construction in Progress/Land	\$459,700
Development Value Creation	\$216,771
Other Assets	\$109,167
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Total Assets	\$7,102,918
Debt**	(\$1,732,251)
Other Liabilities	(\$67,063)
Perpetual Preferred Stock	(\$53,993)
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Total Liabilities	(\$1,853,307)
Net Asset Value	\$5,249,611
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Common Shares/OP Units Outstanding	77,144

*BRE has stated the company's annual Prop 13 impact is \$20 - \$24 million, however we suspect BRE is overstating the liability to discourage potential acquirers and thus have assumed \$15M

**Debt mark to market not contemplated as it is unremarkable; Archstone's exit cap rate in the 4s both in 2007 & 2012 shows pricing for Class A apartment assets not solely dependent on debt costs

Source: LANDandBUILDINGS, Company reports

Notes: Total return figure includes dividend; Estimated NOI in 12 months; Balance sheet data as of third quarter 2012; Cash balance includes retained cash flow in excess of dividend; Development value creation reflects discounted development profit on active and identified projects; All numbers in thousands except per share and percentage figures

Pricing as of 12/17/2012

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