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The US Recovery: In 2009, KW pounded the pavement to take advantage of a generational buying opportunity in US real estate. The company raised $110 million in common equity and converted $53 million of preferred stock for a total of $163 million.

Kennedy Wilson Does Europe: After waiting patiently, the distress opportunity in Europe is finally emerging. Lenders are expected to sell €80bn of loans this year. By creating a separate entity for its European investments (KWE), management maintains control without fully consolidating KWE on its balance sheet, while providing investors with the attractive economics of the management agreement.

Catalysts & Continued Deleveraging: We expect real estate loan sales to increase in the EU, prompted by regulatory requirements, retrenching of banks, increased liquidity in the loan market and improved economic data allowing financial institutions the flexibility to make needed write-downs.

KW’s Track Record: So Far, So Good: KW Europe has demonstrated strong sourcing capabilities. As of year-end 2013, it had assets under management in Europe of £2.5 billion.

In Good Company: We expect that KW’s team in Madrid, established through the acquisition of a Spanish real estate and asset management platform, will provide a long runway for future growth.

Net Asset Value: Shares of KW appear well supported at current levels based on the value of KW Investments, even ignoring the recurring and lucrative income generated by KW Services & KWE. Given the growing institutional interest in The European Distress Spigot, the potential for KW to create additional fee-generating investments is significant. Fortunately, investors don’t have to pay up for this opportunity today.
Forever Blowing Bubbles

I'm forever blowing bubbles
Pretty bubbles in the air
They fly so high, nearly reach the sky
Then like my dreams they fade and die

Fortune's always hiding
I've looked everywhere
I'm forever blowing bubbles
Pretty bubbles in the air

"I'm Forever Blowing Bubbles" was a popular American song by John Kellette which debuted in 1918. More than a half century later, in 1973, Dean Martin released *Sittin' on Top of the World* featuring Dino’s own version of *Forever Blowing Bubbles*. Our extensive research on the subject has yet to uncover the link between Dean Martin, The King of Cool, and Alan Greenspan, The Maestro, but the Rat Pack’s influence on the Federal Reserve is irrefutable. Ain’t that a kick in the head?

Bubbles have become an increasingly common feature of the economic landscape over the past three decades. The increasing number and magnitude of crises begs the question of whether central bank policies are fanning the flames of destabilizing speculation. To their credit, this is really a neat trick - market participants demand a lender of last resort to prevent panic from escalating into crisis. And today’s central bankers are happy to play the part of the economic hero who flies in at the very last moment to save the day. But this isn’t Marvel Comics. In the real world, our “heroes” are reluctant to head back to their day job at The Daily Bugle to manage price stability in the newspaper industry. Instead, they hang on to the limelight as long as possible, powering the economy and asset prices ever higher with their super powers of money and credit. This ensures job security for our fearless leaders as the next financial crisis is always born out of the ashes of the previous bust.

![Image](source: MarketWatch)
Our story today begins in 1980s Japan, with a real estate bubble so massive that by the end of the decade, the market value of land under the Imperial Palace in Tokyo was greater than the market value of all of the real estate in California. The bubble in Japan reached its peak in 1989 as banks developed hundred-year mortgages and foreign investors became increasingly concerned about the solvency of Japanese financial institutions.

As capital flowed out of Tokyo, it found a home in *The East Asian Miracle*, where export-led growth shaped a spectacular economic expansion from Thailand to South Korea – a comparable backdrop to earlier Japanese gains. Like Japan, the surge in capital led to rapid increases in real estate and stock prices. And like Japan, when the bubble inevitably burst, the miracle chatter disappeared with it. The sharp depreciation of the Asian currencies that followed led to an equally sharp increase in the US trade deficit and an appreciation of the US dollar, as money followed Moore’s Law into the technology sector and ultimately into the American Dream.

The moral of our story is simple: Bubbles always implode. By definition, a bubble is created by a speculative rise in price that will eventually bust. As such, the management of risk and return depends largely on two factors.

- The first is common sense for those of us who grew up with a curfew – never be the last one at the party. It’s better to head home early even if all your friends are hanging around having fun. Only bad things happen that late anyhow.
- The second factor is more relevant in the investment world than the real world, so kids, please do not try this at home – pay attention to the first swimmer that yells shark. Get your suit ready but be patient. If you jump in too early you can get badly hurt.

The best swimming in the financial markets is when panic breaks loose and the entire crew at the *Jersey Shore* is trampling the crowd to get out of the water. By that time, the damage has been done and those with the courage to dive in head first can find it extremely rewarding.
With that longwinded introduction out of the way, we’d like to introduce you to a very talented swimmer we recently discovered while surveying the investment landscape for sharks. The balance of our story will outline some of the brave and profitable swims they’ve enjoyed over the past decade.

**Who is Kennedy Wilson?**

Founded in 1977, Kennedy Wilson (KW) has grown from a small auction business into a vertically integrated real estate operating company headquartered in Beverly Hills under the leadership of William McMorrow. Starting from a net worth of $50,000, McMorrow paid $1,000,000 for KW in 1988, which has a market capitalization in excess of $2 billion today. The value of his initial investment is now worth $300 million, based upon the chairman’s 15% ownership stake. Insiders, in aggregate, own nearly 20% of the company.

![Kennedy Wilson History Timeline](image)

Kennedy Wilson went public in 2009 and remains underfollowed and misunderstood despite incredible investment success. Management has a demonstrated nose for value and a proven track record of identifying and capitalizing on shark-infested waters.

In other words, they are excellent swimmers with the experience to follow the current of distress across global real estate markets and position the portfolio to benefit from central bank super powers of money and credit. Previous investments have systematically exploited the historical cycle of boom and bust.
Our thesis on KW is straightforward, although the accounting may be somewhat more complex given that investments are held at depreciated cost basis and only marked to market when sold. Simply put, this means that the company’s current earnings power is vastly understated as gains on investments are only recognized at the time of sale. As a result, we believe that shares trade at a healthy discount to current net asset value and expect that gap to close as investments mature and gains are crystallized. More importantly, we see a long runway for growth in European real estate investments as banks have just begun shedding real estate loans and related assets. In other words, we expect significant growth in NAV over our time horizon. KW’s recent investments in Spain could be its most profitable venture yet.

In this report, we review the company’s operating segments, describe the Opportunity in Europe and outline our estimates of Net Asset Value.

A Proven Model for Capital Allocation

Kennedy Wilson’s operations are comprised of two complimentary business segments, which together, create off-market sourcing opportunities and deal-flow from various financial institutions:

- KW Services provides real estate services to property owners and lenders, with a focus on financial institutions. This operating segment has five main lines of business - investment management, property services, research, brokerage, and auction and conventional sales - which generate revenue through recurring fees and commissions. Since inception, KW has sold more than $10 billion of real estate and currently manages 69 million square feet of commercial property and 20,000 multi-family units in the U.S., Europe and Japan. Importantly, KW Services provides management with market insight and creates opportunities for investment.

- KW Investments includes fund management and advisory services for portfolio investments, property acquisitions and note purchases. Since 1999, the company has invested in 371 deals, deploying $16.4 billion of capital. While early investments were often wholly owned, recent growth has been driven by investments in joint ventures, whereas KW is typically the general partner. This arrangement provides exceptional returns on capital as the company benefits from gains on the original investment as well as a promoted interest in the profits beyond its ownership interest.

The following illustration, presented by Chris Mayer of Agora Financial, provides a good overview of the economics behind this business. We think the assumptions here are quite reasonable given the existing opportunity set (which we will discuss in detail) and management’s track record.

KW has generated an internal rate of return of approximately 40% and a 1.6x equity multiple before promoted interests on 97 realized investments between 1999 and 2012.
Housing the service business and the investment platform under one roof provides KW with significant competitive advantages over other real estate buyers operating stand-alone firms. Rather than participate in a competitive bidding process, the majority of KW’s deals are sourced through the company’s services platform and often provide exclusivity in negotiations.

Management’s local expertise and established reputation in targeted markets have enabled KW to cultivate key relationships with major holders of property inventory. These relationships provide the company with access to deal flow, which in turn, generates highly attractive returns for KW shareholders as illustrated below.

**An Illustration of KW Return on Capital**

![Illustrative asset purchase structure](image)

The services business effectively gets the investment business in the door while providing ongoing market intelligence which is leveraged to allocate the company’s capital. Management has developed a reputation for being able to quickly execute, originate and creatively structure transactions with a hands-on approach to real estate investing and local expertise in regions within its circle of competence.
Around the World with Kennedy Wilson

Kennedy Wilson has a history of being in the right place at the right time. Management has a demonstrated nose for value and a proven track record of identifying and capitalizing on opportunities created as the pendulum swings from greed to fear. With fear comes distress. And with distress, comes opportunity.

Proven Model for Entering New Markets

1. Identify market with attractive growth characteristics
2. Entry into market through services business. Develop financial institution relationships
   - Founded in the U.S. in 1977 as a real estate auction business
   - Purchased in 1988 by current management
3. Launch investment platform
   - Shortly after acquiring Kennedy Wilson, the current management team added a real estate investment platform to the Company's successful auction business

Japan

- Opened Japan office in 1994
- Launched commercial brokerage division in 1994 and hired the group leader from Mitsubishi
- Launched acquisition platform in Japan with purchase of Kawasaki Tech Center for ~£62 million in 1998

Ireland

- Entered Ireland in June 2011 through the acquisition of Bank of Ireland REIM, with £1.3 billion real estate assets under management
- Leveraged BOI relationship to acquire a U.K.-based loan portfolio from Bank of Ireland for £1.1 billion in October 2011
- Assets under management now exceed £3.0 billion

Spain

- Entered Spain in 2012 through auction business
- Exploring acquisitions of additional servicing operations business
- Company will use local market expertise gained from servicing platform acquisition to explore investment opportunities in the Spanish property market

Source: Company Filings

In the pages that follow, we will take a trip Around the World with Kennedy Wilson touching on the Japanese real estate bubble and the US housing crisis, before more closely examining the current opportunity set in Europe. In each case, the team at KW waited patiently with their swimming trunks in hand, and bravely dove into crisis-infested waters creating long term value for shareholders.

First Stop – The Japanese Real Estate Bubble

Godzilla was a 1954 Japanese science fiction monster who ravaged Japan and demolished Tokyo. While the economy recovered and generated tremendous growth for the next three decades, the most recent three decades have been somewhat of a different story.
In 1995, after the bursting of the Japanese real estate bubble, KW invested $590 million of equity through a former wholly-owned subsidiary, later sold at a substantial gain. Since 2005, KW has invested over $230 million of equity in Japan, acquiring 2,410 multifamily units, totaling approximately one million square feet.

The Japanese Bubble

![Graph showing land prices, stock prices, and CPI excluding fresh food from 1989 to 2003.]

Source: BIS, *The Asset Price Bubble in Japan*

In recent years, the Japanese real estate market has experienced an upswing compliments of Abenomics or QE on steroids. Prime Minister Shinzo Abe has clearly stated that his priority is to revitalize the economy, which is changing the way foreign investors look at Japan.

Source: *The Economist*

Real estate has been a prime beneficiary as The Bank of Japan has expanded its purchases of shares in Japanese real-estate investment trusts. With diminishing supply of new inventory due to stricter building regulations imposed in 2007, rents for quality assets remain strong while vacancy rates remain stable. A weaker yen and rising inflation expectations after years of price declines, have prompted Asian investors to go on the hunt for office buildings and condominiums in Tokyo. It doesn't hurt that Tokyo real estate is undervalued relative to its global peers. Over the past year, condo sales have jumped to their highest level in six years, and Japan's REIT index has hit a five-year high.
Next Stop - The US Recovery

Real estate bubbles correct more slowly than stock markets. Lenders are loath to push foreclosures and homeowners are averse to realizing losses. At the bottom, transactions dry up and prices deflate gradually. In general, the higher they go, the harder they fall. Japan experienced the greatest property bubble in history.

After the market peaked in 1990, Japanese land prices fell for more than a decade. They have only recently begun to recover and KW is positioned accordingly. In the US, the bounce off the lows has come more quickly compliments of the Federal Reserve, which acted more swiftly than the BOJ, at least until recently.

“Major corrections create new opportunities that, if seized, can transform companies to even greater heights.” These were the words of KW’s McMorrow in his 2009 letter to shareholders. Fast forward to today, and it’s hard to believe that even Bill wouldn’t be surprised at the heights his company has achieved. Here’s the backdrop from that 2009 letter for additional perspective:

We began 2009 knowing that the real estate capital markets had collapsed, creating illiquidity never before seen in our industry. Several major investment banks had failed overnight and the residential and income property markets were under severe pressure.

Given those events, we made the decision to focus our efforts throughout 2009 on raising more capital for the company to take advantage of what would certainly be one of the greatest buying opportunities of the last 50 years.

It was inevitable, given the lack of global liquidity, that many of the traditional sources of debt and equity we had come to rely on would evaporate. We packed our suitcases and spent most of 2009 visiting potential new partners. It was a daunting task, with the Dow below 7,000 and the subprime debt crisis in the headlines everyday, to tell our story and raise capital for real estate. Despite that resistance, we trekked onward. We had over 1,000 investor meetings, and I am very pleased to report that our efforts paid tremendous dividends for KW’s shareholders.

Over the last 18 months, we raised $1.3 billion of new capital, which includes approximately $350 million of equity and debt for the parent company, and is now allowing us to expand our service business and our investment platform at a time when many real estate operators are, at best, contracting. Additionally, Kennedy Wilson created new business relationships with some of the most well capitalized financial firms in North America that have a desire to invest in our real estate platform.

We know few investors with the courage, the liquidity and the temperament to trust their instincts and dive in head first when everyone around was yelling Shark! Bill McMorrow was one. In 2009, KW pounded the pavement to take advantage of a generational buying opportunity in US real estate. The company raised $110 million in common equity and converted $53 million of preferred stock for a total of $163 million.
In addition to $925 million in outside capital raised to purchase distressed real estate through separate accounts and funds, management formed a relationship with Fairfax Financial in May of 2010 which resulted in a $100 million convertible preferred equity placement, making Prem Watsa the company’s largest outside shareholder. Here’s what Prem had to say about that deal in his 2011 Annual Letter:

I have attended the Berkshire Hathaway shareholders’ meeting since there were only 200 shareholders in attendance about 30 years ago. I still find I learn something each year from Warren and Charlie. At the meeting in 2010, I met Bill McMorrow through Alan Parsow, who is a money manager based in Omaha and a great friend. As a result of this meeting, we invested $100 million in a Kennedy Wilson 6% preferred convertible at $12.41 per share, and later purchased $32.5 million of a 6.45% preferred convertible at $10.70 per share and 400,000 common shares at $10.70 per share. Fully diluted we own 18.5% of the company.

In 2010 and 2011, we also invested $290 million in several real estate deals with Kennedy Wilson in California, Japan and the U.K. – deals at significant discounts to replacement cost and with excellent unlevered cash on cash returns, in which Kennedy Wilson is the managing partner and a minority investor. We are thrilled to be partners with Bill and his team, who always focus on the downside and have the expertise to manage these investments and finally harvest them.

While US real estate markets have been on the steady road to recovery in recent years, looming debt maturities remain a source of opportunity as longer term leveraged paper issued in 2005-2007 has yet to mature and improving earnings at domestic banks provide a cushion to sell legacy assets at losses.
Meanwhile, a strengthening domestic economy should allow KW to harvest the seeds sown in the aftermath of crisis. Recent exits demonstrate the potential for further value creation.

<table>
<thead>
<tr>
<th>Date Acquired</th>
<th>Purchase Price ($ millions)</th>
<th>Partners Equity ($ millions)</th>
<th>KW Equity ($ millions)</th>
<th>Property Name</th>
<th>Sales Proceeds</th>
<th>KW Gains</th>
<th>KW Multiplier</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct-08</td>
<td>$88.5</td>
<td>$27.8</td>
<td>$3.2(3)</td>
<td>Saybrook Pointe, 324-unit apartment building, San Jose, California</td>
<td>$140.8</td>
<td>$2.2</td>
<td>1.7x</td>
</tr>
<tr>
<td>Jun-09</td>
<td>$33.5</td>
<td>$5.8</td>
<td>$5.9(3)</td>
<td>The Mercury, LA condominiums</td>
<td>$52.2</td>
<td>$9.4</td>
<td>2.6x</td>
</tr>
<tr>
<td>Sep-09</td>
<td>$210.4</td>
<td>$54.7</td>
<td>$17.5(3)</td>
<td>Four multifamily properties in Western US</td>
<td>$243.0</td>
<td>$7.9</td>
<td>1.5x</td>
</tr>
<tr>
<td>Dec-09</td>
<td>$218.0</td>
<td>$32.2</td>
<td>$44.3(3)</td>
<td>6 multifamily properties in Western US</td>
<td>$251.7</td>
<td>$19.5</td>
<td>1.4x</td>
</tr>
<tr>
<td>Jun-10</td>
<td>$56.6(3)</td>
<td>9.6(2)</td>
<td>$6.4</td>
<td>NoHo, 180 unit apartment building; 11,000 sq. ft retail space; increased NOI from $2.3 to $3.1 million</td>
<td>$74.0</td>
<td>$7.2</td>
<td>2.1x</td>
</tr>
</tbody>
</table>

(1) Calculated using 4.1% cap rate at sale and $2.1 million of NOI before acquisition
(2) Assume 40% participation in partnerships based on company filings
(3) Assume 1.85x Leverage where information is unavailable

The sharks are no longer circling but pockets of value still exit in US real estate markets for smart allocators of capital. Of course, there is a much greater source of opportunity across the pond, as we discuss in detail, next.

**Last Stop? The European Distress Spigot**

At Broyhill, investments are sourced through multiple channels. Sometimes our best ideas are found among the lonely shares trading on the 52 week low list. More often than not, they are sourced from our universe of high quality businesses when one encounters the occasional hiccup. And of course we always enjoy the intermittent opportunities provided by corporate actions. But KW just sort of fell in our lap . . . after years of diligence. We just didn’t know we were looking for it.

In 2009, we published our first letter on the [European Sovereign Debt Crisis](#). Since then, we have been waiting for the right opportunity to capitalize on distressed deals from forced sellers in the region. Unfortunately, banks in the region have been slow to unload assets because of accounting rules, political pressure and to avoid selling at steep discounts.

It’s been a long waiting game, while the banks provision more and more each quarter, until they can afford to sell loans at discounted levels. As a result, the disorderly liquidation we’ve been waiting for has been more like a slow drip. The more time that passes, the more capital accumulates on the sidelines. The longer the wait, the more impatient investors become. Of course, the more impatient they become the higher price they are willing to pay. Consequently, the amount of money looking for a home in the region is eye-popping.
There are about 40 distressed debt specialists targeting Europe. They include Apollo, Strategic Value Partners, Cerberus, Angelo Gordon, Avenue Capital as well as Fortress, Lone Star and Oaktree Capital. Private equity groups such as Blackstone and KKR are also active. Blackstone raised more than $4 billion in 2009 to buy European property anticipating that cash-strapped banks would be forced to sell. It sat idle for two years. This year, private equity has raised $1.7 billion for European distressed funds, while hedge funds focused on European distressed debt manage a total of $57.2 billion of assets, according to data from Preqin.

![Annual Europe-Focused Fundraising by Regional Focus, 2008-2013](image)

Source: Preqin

After years of waiting - while European banks “pretend and extend” - the distress opportunity in Europe is finally emerging. European lenders are expected to sell loans with €80bn of combined face value this year, after disposing of about €60bn last year, according to data compiled by PwC. This compares with €46bn in 2012 and €36bn in 2011. The ECB’s asset quality review and stress tests should act as an important catalyst for future sales. We’re five years into the crisis, but the investment opportunity is just beginning.

Our own diligence naturally started with the most prominent managers in the industry, all of which have announced major deals in European assets. But long term allocators of capital should recognize that the longer the lock-up, the greater the odds that a manager overbids the competition. Particularly when those managers have been sitting on the sidelines for five years! Consequently, our attention quickly shifted towards niche, lesser-known firms with boots on the ground in Europe. These deals rarely make the headlines, but by focusing on smaller tickets, which don’t move the needle for most institutions, they are in the sweet spot and should be compensated accordingly. Which brings us back to Kennedy Wilson.
We continued to purchase commercial real estate investments with Bill McMorrow and his team at Kennedy Wilson. For example, we purchased, 50/50 with Kennedy Wilson, perhaps the finest office building in Dublin, built in 2009 and 100% leased to State Street Bank for 25 years, for one-third of its construction cost with an unleveraged yield of approximately 8.5%. We also own, with Kennedy Wilson, some of the finest apartment buildings in Dublin with similar return characteristics. Rest assured we return Bill’s calls very promptly!

As I mentioned to you last year, one such call from Bill in 2011 led to our investment (along with W.L. Ross, Fidelity and Capital Research) in Bank of Ireland – the first significant investment in Ireland by foreign investors since the financial market collapse. Only one year later, Ireland and its economy have made significant strides towards recovery. Irish government bond rates have dropped from mid-teens to approximately 4% today and the €1 billion contingent capital note that the Irish government invested in Bank of Ireland was entirely sold to the financial markets at a premium. More recently, the Irish government has announced the removal of the Eligible Liabilities Guarantee and money is flowing strongly back into Ireland.

The Bank of Ireland has been one of our most successful investments because of the outstanding performance of Richie and his management team. We continue to be strong supporters of Richie and the Bank of Ireland. We continued to invest with Bill McMorrow from Kennedy Wilson in 2013. We invested in the Clancy Quay apartments and some well-leased office buildings in Dublin and we also invested in a U.K. loan pool. We have invested a net cumulative $305 million in real estate deals with Kennedy Wilson in California, Japan, the U.K. and Ireland – deals at significant discounts to replacement costs and with excellent unlevered cash on cash returns, in which Kennedy Wilson is the managing partner and an investor. Also, we continue to own a fully diluted 10.9% interest in Kennedy Wilson.

Kennedy Wilson Does Europe

After scooping up distressed assets in the wake of the US housing crisis, KW made their first trip to Dublin in 2010, amidst a highly distressed European banking system, and subsequently purchased the Bank of Ireland’s real estate investment management division, with £1.3 billion of real estate assets under management at the time of acquisition. One year later, KW raised $1.5 billion to recapitalize the Bank of Ireland and purchased $2.2 billion of performing real estate secured loans for $1.8 billion. Once again, Bill had some good company. Here’s what Prem had to say in his 2012 and 2013 Annual Letters:

The Bank of Ireland deal set the stage for Kennedy Wilson Europe established in 2011 and led by CEO Mary Ricks, with offices in Dublin, London and Madrid, today. As of December 2013, KW Europe had grown to approximately 50 investment professionals across London, Dublin and Madrid.

KW Europe has demonstrated strong sourcing capabilities and since its inception in 2011, it has acquired assets directly from 11 financial institutions across the UK and Ireland in 14 transactions and as of December 2013, it had assets under management in Europe with a value of £2.5 billion. The portfolio has grown through a series of strategic investments illustrated on the following page.
On February 28, 2014, KW announced the closing of its initial public offering of Kennedy Wilson Europe Real Estate, raising approximately £1 billion in gross proceeds. The strategy appears similar to the model successfully employed by Bruce Flatt at Brookfield Asset Management and creates a strong platform for growth at KW. By creating a separate entity for its European investments, management maintains control without fully consolidating KWE on its balance sheet, while providing investors with the attractive economics of the management agreement (more on this later).

The filing provides a tremendous amount of detail on the European real estate market, which we outline in greater detail in the appendix. What follows, is a brief overview of the European opportunity set and a discussion of recent KW investments in the region, before concluding with our estimate of Net Asset Value.

Catalysts & Continued Deleveraging

The years leading up to the global financial crisis were characterized by the easy availability of credit and loose underwriting standards across Europe. In the years that followed, real estate values declined significantly and many of the loans underwritten in 2005-2008 breached covenants as underwriting standards had become much more stringent. Following the subprime and sovereign debt crises, banks were unable or unwilling to enforce on a large proportion of these NPLs, which largely remain on their balance sheets today.
European banks have been slow to take their medicine. But European real estate markets appear to be at or past their cyclical trough. Against a backdrop of improving market sentiment and positive signals from leading indicators, commercial real estate investment activity has continued to increase, driven by strong cross-regional capital flows and improved availability of debt. In KW’s target markets of the UK, Ireland and Spain, commercial real estate valuations appear to have hit bottom and are in the early stages of recovery, as illustrated in the table below.

<table>
<thead>
<tr>
<th></th>
<th>UK</th>
<th>Ireland</th>
<th>Spain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trough (% below peak)</td>
<td>-42</td>
<td>-67</td>
<td>-47</td>
</tr>
<tr>
<td>Current (% below peak)</td>
<td>-30</td>
<td>-66</td>
<td>-44</td>
</tr>
</tbody>
</table>

*Source: Company Filings*

We expect that the level of real estate loan sales will rise, prompted by regulatory requirements, retrenching of banks back to their core markets, increased liquidity in the loan market and improved economic data allowing financial institutions the flexibility to make needed write-downs.

This should provide KW with a significant opportunity for investments sourced through strong relationships with major financial institutions in the UK, Ireland and Spain. Management’s sourcing ability, strong servicing platforms and execution capabilities make it well-placed to acquire assets through off-market transactions.

The key driver for banks to start or continue with the process of deleveraging is the level of provisioning they have taken and their loss absorption capacity. This however is not the only driver and other factors have played a major part in escalating the deleveraging process.

- **Regulations such as Basel III make it capital intensive for banks to hold NPLs.** Across Europe, the Asset Quality Review being undertaken on behalf of the European Central Bank, to assess the loan book quality of Eurozone banks is expected to require a significant increase in banks’ regulatory capital. One likely outcome of this would be that banks look to move NPLs off of their books to free up capital and hence start their deleveraging exercise.

- **Retrenching of banks back to their core markets has also occurred.** For example, Postbank sold performing loans to GE Capital in order to focus on their core markets. Another example is LBG, which is in the process of extracting itself from the Irish lending market.

- **Liquidity in the loan sale market has increased,** and there has been significant competitive tension in recent loan sale processes, with substantial capital raised by various private equity funds.

- **Loan-on-loan financing, whereby lenders provide loans to investors purchasing loans, has increased in the UK** and is now available to a wide group of borrowers from an increasing number of lenders with increased leverage, lower pricing and reduced equity leakage.
In aggregate, these effects are likely to increase the pressure on banks to continue the process of deleveraging, with the result being significant ongoing NPL portfolio sales.

**KW’s Track Record: So Far, So Good**

Based on KW’s estimate of fair value, as of 30 September 2013, KW had approximately $13.7 billion of real estate and related assets under management, totaling approximately 68.8 million square feet of properties in the United States, Europe and Japan. This total includes ownership interests in 16,511 multifamily apartment units and 9.6 million square feet of commercial properties in such jurisdictions.

In the period between 1999 and 30 September 2013, KW and its partners have invested in over 360 deals, deploying $16.2 billion of capital. From January 2012 to November 2013, KWE was one of the most active buyers of real estate assets in Ireland.

Kennedy Wilson’s full European track record, since first acquiring the Bank of Ireland’s real estate investment platform, is illustrated in the following table. In aggregate, management has sourced deals from nearly a dozen different financial institutions across Europe.

**KW’s European Deal Sheet**

<table>
<thead>
<tr>
<th>Year</th>
<th>Area</th>
<th>Investment</th>
<th>Purchase price</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>UK (£1.1bn)</td>
<td>BOI Loan</td>
<td>£1,100</td>
<td>Loan portfolio, secured against 173 properties across United Kingdom</td>
</tr>
<tr>
<td>2012</td>
<td>£371</td>
<td>UK Loan Pool</td>
<td>£371</td>
<td>Loan portfolio, secured against 114 properties across England and Scotland</td>
</tr>
<tr>
<td></td>
<td>Ireland</td>
<td>Irish Loan Pool</td>
<td>£50</td>
<td>Loan portfolio, secured against 102 properties throughout Ireland</td>
</tr>
<tr>
<td></td>
<td>(£209)</td>
<td>The Alliance</td>
<td>£34</td>
<td>Multifamily asset, consisting of 210 prime luxury units, located in Dublin 4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Brooklawn House</td>
<td>£13</td>
<td>Office property, 5-story property located close to Dublin CBD</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sandford Lodge</td>
<td>£23</td>
<td>Multifamily asset, consisting of 119 prime luxury units, located in Ranelag</td>
</tr>
<tr>
<td></td>
<td></td>
<td>State Street Loan</td>
<td>£89</td>
<td>Office property, 7-story prime office building located within Dublin CBD + 3.5 acre site</td>
</tr>
<tr>
<td>2013</td>
<td>UK (£416)</td>
<td>UK Portfolio</td>
<td>£63</td>
<td>Mixed portfolio of 29 properties located across UK, majority office assets</td>
</tr>
<tr>
<td></td>
<td></td>
<td>UK Loan Pool</td>
<td>£79</td>
<td>Loan portfolio, secured against 52 assets across Northern Ireland, England and Scotland</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Single Loan</td>
<td>£24</td>
<td>Single loan, collateralized by a 93-unit shopping center located in Fareham</td>
</tr>
<tr>
<td></td>
<td></td>
<td>UK Shopping Center Portfolio</td>
<td>£250</td>
<td>Shopping Center Portfolio, 7 secondary assets across the UK</td>
</tr>
<tr>
<td></td>
<td>Ireland</td>
<td>Clancy Quay</td>
<td>£69</td>
<td>Multifamily asset, consisting of 420 prime units within Dublin 8 + 8 acres development site</td>
</tr>
<tr>
<td></td>
<td>(£326)</td>
<td>Irish Property Portfolio</td>
<td>£257</td>
<td>Mixed portfolio of 14 properties, located around Dublin including BOI &amp; KPMG headquarters</td>
</tr>
</tbody>
</table>

*Source: Company Filings*
In Good Company

The majority of KW’s investments in Europe have historically been sourced directly through extensive relationships with financial institutions in the UK and Ireland. Going forward, we expect that KW’s team in Madrid, established through the acquisition of a Spanish real estate and asset management platform, will provide a long runway for future growth.

In line with KW’s time tested business model, management dusted off the Irish playbook and launched its operations in Spain in 2012 through the real estate auction business followed by a major strategic acquisition last year. Here’s the summary from Banco Popular’s Annual Report:

On December 27, 2013, Banco Popular, S.A sold the real-estate management business unit and some of the Bank’s debt related to the property sector to a newly incorporated company, with a majority shareholding by Värde Partners, Inc. and Kennedy Wilson. The sale includes the transfer of all resources required to independently carry out the real-estate management business. This business had been carried out by the group with the objective of maximizing the sale price of property assets and maximizing the recovery of debt related to the real estate sector. This will allow the Bank to benefit from its partner’s broad management experience with these types of assets with the objective of attaining the maximum yield from the management of this business.

We believe that KW Europe’s position in this servicing platform will contribute to the company’s deal sourcing capabilities in Spain, just as SAREB ramps up sales with €1.5 billion of assets in the pipeline this year. It’s worth noting that the smart money has taken notice:

- Axa Real Estate Investment Managers, the largest European property manager, bought Barcelona office buildings from the government for €172M, only its second purchase in the country in 5 years.
- George Soros and John Paulson have each taken up a €92M stake in Hispanic Activos Inmobiliarios, a Spanish real estate investment trust
- The prospect of a turnaround in Spain’s economy led Bill Gates and George Soros to buy stakes of 3% and 6% respectively in Spanish construction group Fomento de Construcciones y Contratas
- Baupost Group participated in a consortium purchase of Spanish shopping centers and a retail park from European retail property fund Vastned.

Investors in KW Europe Real Estate (KWE) also appear to be in good company as Cornerstone Investors have committed to £540 million worth of shares. KWE seems to be in strong hands with 74% of the float accounted for by Cornerstone Investors and KW’s 12.5 million shares. Liquidity is limited given the reduced free float and KWE currently trades at a premium to NAV (predominantly cash) but investors in the fund do have some protection as the company has the ability to acquire up to 15% of shares annually at a discount to NAV.
We are going to keep an eye on KWE as illiquidity can often create great buying opportunities, but for now, we think KW represents a more attractive investment given the diversity of the asset base and the economics of the general partnership.

<table>
<thead>
<tr>
<th>Cornerstone Investor</th>
<th>Ordinary Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marketfield</td>
<td>11,250,000</td>
</tr>
<tr>
<td>Quantum</td>
<td>11,250,000</td>
</tr>
<tr>
<td>Wellington Management</td>
<td>10,500,000</td>
</tr>
<tr>
<td>Janus</td>
<td>5,378,700</td>
</tr>
<tr>
<td>Moore Capital</td>
<td>4,540,900</td>
</tr>
<tr>
<td>Franklin</td>
<td>4,000,000</td>
</tr>
<tr>
<td>FMR</td>
<td>2,952,500</td>
</tr>
<tr>
<td>Fairfax</td>
<td>2,000,000</td>
</tr>
<tr>
<td>Seawold</td>
<td>650,000</td>
</tr>
<tr>
<td>Elkhorn</td>
<td>520,000</td>
</tr>
<tr>
<td>ACK</td>
<td>500,000</td>
</tr>
<tr>
<td>LeFrak</td>
<td>500,000</td>
</tr>
</tbody>
</table>

Source: Company Filings

**Net Asset Value**

“It seems very hard to try to beat the market consistently by trying to beat the market. Rather it seems to us a more rational approach is to be value conscious rather than outlook conscious.”

- Martin J. Whitman, Modern Security Analysis

Net asset value (NAV), unlike accounting earnings, plays a small role in influencing day-to-day stock prices. In the analysis of most companies, Graham and Dodd place NAV in a supporting role to earnings and dividends as the primary measure of value. Accounting Principles state that, “The information presented in an income statement is usually considered the most important information provided by financial accounting.”

While we are intimately familiar with Graham and Dodd, and often look to the income statement to value the stream of “owner earnings” generated by high-quality compounders, we are forever flexible in our approach to markets. We also strive for balance across investments and aim to complement the high quality core of the portfolio with various special situations. In that regard, we think KW is pretty special.

Changes in earnings can be fast and furious. Changes in price can further amplify these fluctuations. By definition, changes in NAV are more gradual. And for the astute investor, growth in NAV can provide a valuable source of profit.
Even in cases when growth fails to materialize, buying at a discount from readily ascertainable NAV provides a meaningful margin of safety.

In *Modern Security Analysis*, Whitman suggests that readily ascertainable asset values exist where corporate assets consist of cash, marketable securities, performing loans, income-producing real estate and other income-producing assets. We submit below, KW assets as presented by the company’s Consolidated Balance Sheet.

<table>
<thead>
<tr>
<th>Assets</th>
<th>December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>178.2 $</td>
</tr>
<tr>
<td>Short term investments</td>
<td>-</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>5.2</td>
</tr>
<tr>
<td>Accounts receivable - related parties</td>
<td>11.4</td>
</tr>
<tr>
<td>Notes receivable</td>
<td>52.7</td>
</tr>
<tr>
<td>Notes receivable - related parties</td>
<td>4.1</td>
</tr>
<tr>
<td>Real estate, net of accumulated depreciation of $15.8 and $7.4 at December 31, 2013 and 2012</td>
<td>668.8</td>
</tr>
<tr>
<td>Investments in joint ventures ($79.0 and $68.4 carried at fair value as of December 31, 2013 and 2012)</td>
<td>751.4</td>
</tr>
<tr>
<td>Investments in loan pool participations</td>
<td>34.7</td>
</tr>
<tr>
<td>Other assets</td>
<td>68.4</td>
</tr>
<tr>
<td>Goodwill</td>
<td>23.9</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>1,798.8 $</strong></td>
</tr>
</tbody>
</table>

*Source: Company Filings*

While some might consider book value a decent surrogate for NAV, investors in KW need to look beyond book which is vastly understated on their balance sheet. KW reports the great majority of investments at historical cost – often 50% of replacement value – and depreciates investments over time even as economic value is increasing.

This accounting treatment also results in understated earnings, particularly when considered in conjunction with the treatment of gains, which are only crystalized on the financial statements upon the sale of investments. As a result, dedicated Graham and Dodders are unlikely to express any interest in the talented team at KW. We think they are missing out.

**A Simplified Approach to Valuation**

KW does an excellent job of providing investors with transparency into its operations. The *Supplemental Information* published with each earnings release offers additional detail on the company’s investment account, including square footage, occupancy, rental revenues and acquisitions. We’ve analyzed the portfolio from the bottom up, looking at individual properties and past transactions, but for the sake of this exercise, we aim to simplify our analysis and share the results. In doing so, we assume that if you’ve made it this far, we’ve at least convinced you that KW’s savvy management team is capable of generating superior performance through well-timed investments aided by proprietary deal flow.
Current investments are carried on the books at $1.1 billion as illustrated below.

**Investment Account Detail at December 31, 2013**

<table>
<thead>
<tr>
<th></th>
<th>Commercial</th>
<th>Multifamily</th>
<th>Loans Secured by Real Estate</th>
<th>Residential, Hotel, and Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Western U.S.</td>
<td>$212.8</td>
<td>$221.9</td>
<td>$112.5</td>
<td>$182.8</td>
<td>$730.0</td>
</tr>
<tr>
<td>Other U.S.</td>
<td>$3.4</td>
<td>$0.2</td>
<td>-</td>
<td>$7.8</td>
<td>$11.4</td>
</tr>
<tr>
<td>Japan</td>
<td>$4.1</td>
<td>$68.8</td>
<td>-</td>
<td>$0.4</td>
<td>$73.3</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>$104.5</td>
<td>-</td>
<td>$27.3</td>
<td>-</td>
<td>$131.8</td>
</tr>
<tr>
<td>Ireland</td>
<td>$97.3</td>
<td>$48.2</td>
<td>$8.3</td>
<td>-</td>
<td>$153.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$422.1</strong></td>
<td><strong>$339.1</strong></td>
<td><strong>$148.1</strong></td>
<td><strong>$191.0</strong></td>
<td><strong>$1,100.3</strong></td>
</tr>
</tbody>
</table>

Source: Company Filings

The company’s return on its investments is generated from three sources: (i) fees paid by limited partners (i.e. acquisition fees, asset management fees and property management fees); (ii) cash flows generated by investments (i.e. rental income); and (iii) appreciation.

Since 1999, KW has generated an internal rate of return of approximately 40% and a 1.6x equity multiple on 97 realized investments before promoted interests. That last part is important. The nice thing about investment companies that manage external capital is that if they are good at what they do, they benefit from both the appreciation of their own capital and from sharing in the profits generated for its limited partners. This last part can be substantial, particularly when one considers KW’s 40% average ownership interest across all investments.

Given the company’s track record and timing of investments at home and across the pond, we think a 1.8x multiple (including promoted interest), on the current book is conservative. Based upon the total shares outstanding at year-end, this values KW Investments at $24. Adding $3 in short term investments, netted against $7 in total liabilities gets us to a current net asset value of $20 and within spitting distance of the stock’s recent low.

In our view, the stock appears to be well supported near current trading levels based on the value of KW Investments, and ignoring the recurring, albeit lumpy nature, of lucrative incentive income. But what about KW Services? The two operating segments are closely integrated and the bulk of the value in KW Services is clearly in the market intelligence that it provides to source deals. Still, this operating segment has various business lines which generate revenue through recurring fees and commissions.
Last year, KW Services produced $27.4 million in EBITDA for the company. We value the business at 8x or roughly $3 per share, which puts KW at $23 based upon the company’s year-end reported financials. This is a good point to ask what has transpired since year-end.

**Recent Developments: The European Bonus**

Great question. On February 28, 2014, KW KWE announced the closing of its initial public offering of Kennedy Wilson Europe Real Estate Plc (LSE: KWE), raising approximately £1 billion. KW subscribed for a total of £122.0 million of ordinary shares in the offering. Immediately following the closing, KW’s investment represented approximately 12.2% of KWE’s total capital. More importantly, KW is acting as KWE’s external manager, in which capacity it is entitled to receive certain management and performance fees.

As of January 31, 2014 KWE’s NAV stood at £889 million. After its recent purchase of a property portfolio in England and Scotland for £144 million, the fund is roughly 25% invested with a robust pipeline. Given the increase in activity year-to-date, our contacts expect the remaining capital to be put to work inside of nine months, with the majority allocated across the UK and Ireland up front.

That being said, we would not be surprised to see KW come back to the market in the future as our due diligence has indicated the potential for much larger transactions in Spain, where institutions are ready to sell and putting some big blocks out to bid. While this appears to be a more competitive space, relative to management’s entry into Ireland a few years back, we believe KW is extremely well positioned given the recent Banco Popular deal. If KW were to Get Lucky we could see a much larger percentage of capital allocated to Spain given the ticket sizes.

Considering the growing institutional interest in The European Distress Spigot, the potential for KW to create additional fee-generating investments is significant. Fortunately, investors don’t have to pay up for this opportunity today. The current asset base at KWE should generate $15 million in management fees once fully invested. If we assume that KWE generates returns for investors in line with previous investments (we think the potential in Europe is greater), KW should generate $26 million in annualized incentive fees calculated at 20% over a 10% hurdle using a three year horizon.

Assuming 40% incremental margins to KW and capitalizing sticky management fees at a market multiple while valuing incentive income at a 50% discount to the market, we estimate earnings from KWE are worth an additional $2 per share, before considering appreciation in KW’s equity interest in the fund. Adding it all up, produces the following result.

![Source: Broyhill Asset Management Estimates](source-image-url)
Investing in the common stocks of well-financed companies selling at discounts from readily attainable NAV’s offers investors a comfortable margin of safety. And by restricting such investments to companies able to grow those NAVs over time, our margin of safety expands even further.

On our numbers, KW would seem to fit the bill. And assuming 10% annual growth in NAV over the next few years, the probability of losing money over our time horizon seems minimal. Particularly, with Super Mario on our side.
**Risks**

**Leverage:** A discussion of any investment is not complete without a proper analysis of the balance sheet. We discussed the asset side at length in this report, but liabilities deserve at least as much (if not more attention). KW’s maturity schedule is presented below. As shown, the majority of its mortgage debt matures after 2018.

![The aggregate maturities of mortgage loans and notes payable subsequent to December 31, 2013 are as follows:](image)

Note that as of yearend, KW had debt, both corporate and mortgage debt, of $857 million and assets of $1.8 billion. Leverage ratios calculated at market would be significantly lower.

**Deflation:** There is a certain market contingent that believes Europe is the next Japan. If this is correct, and a major deflation is at hand in the EU, we will likely be wrong on KW as deflation would put downward pressure on the value of the company’s property. Given the ECB’s actions to date, we are willing to take the other side of this trade.

**EU Crisis:** Europe is recovering but is by no means out of the woods yet. Another flare up of the EU sovereign debt crisis would have negative impacts on both currency and bond markets. Higher rates would increase the cost of capital and reduce cash flow to shareholders. KW had $408 million in mortgage debt as of year-end, of which 14% is variable rate at a 3.5% average interest rate – 50% of which have interest rate caps.

**Geopolitical Events:** Recent events in Ukraine have raised questions about Vladimir Putin’s global ambitions. If Putin were to continue his aggression elsewhere in the old Soviet bloc, Europe would probably be acutely impacted. CEO McMorrow expressed a desire to continue to invest in Europe at a recent conference, and we would expect him to see any weakness as a buying opportunity.

**Liquidity:** KW is clearly dependent on the kindness of capital markets for funding, and management has not been shy about issuing shares in the past. That said, we believe the team’s interest is aligned with our own given the degree of insider ownership. In other words, with the benefit of hindsight, it is clear that the capital raised from prior sales has been put to very good use.
Appendix

Today, there is a significant opportunity to acquire high quality real estate assets from distressed sellers and financial institutions seeking to deleverage by divesting such assets. As of November 2013, there was a gross refinancing gap of approximately £85 billion across Europe, of which the UK, Ireland and Spain in aggregate constituted 37%.

This funding gap is driving the need to divest non-performing loans and real estate, providing a compelling investment opportunity as banks and government entities accelerate efforts to strengthen their finances. In 2012, the UK, Ireland and Spain were three of the top four countries with the largest NPL balances in Europe. The following table sets forth the balances for each of Germany, UK, Ireland and Spain as at 31 December 2012:

<table>
<thead>
<tr>
<th>Country</th>
<th>2012 NPLs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>€179 billion</td>
</tr>
<tr>
<td>UK</td>
<td>€164 billion</td>
</tr>
<tr>
<td>Ireland</td>
<td>€135 billion</td>
</tr>
<tr>
<td>Spain</td>
<td>€167 billion</td>
</tr>
</tbody>
</table>

Source: PwC Market Update: European Portfolio Advisory Group (October 2013)

Non-Performing Loan Sales: Just Getting Started

In recent years banks are slowly beginning to deal with these NPLs, and taking action to crystallize losses. This has been mainly through enforcement on and sale of underlying real estate assets, or increasingly through sales of NPL portfolios. This process has occurred at different rates across Europe.

The UK and Ireland have active NPL markets focused on commercial real estate (CRE) loans, while Spain, being somewhat further behind in the recovery cycle, has yet to bring a significant volume of CRE loans to market. Since the crisis, banks across Europe have been strengthening their balance sheets through equity capital raising, issuance of convertible securities and through asset sales. In many cases, these actions have been in replacement of or to support state guarantees.
Lenders have employed various strategies to deal with managing the deleveraging process including loan extensions, loan sales, discount payoffs, enforcements, consensual sales, refinancings, maturity extensions and debt for equity swaps.

Loan sales have been the method of choice for many institutions intending to reduce or completely exit their loan books. Loan sales represent an efficient way to move loans in bulk, as well as providing political sanctuary, as it is the purchaser who eventually enforces if the loans are in distress rather than the state-owned bank. Loan sales managed by banks have predominantly consisted of non-core assets.

This strategy is reliant on a legal system that allows for a timely and cost effective process to enforce, which is the case in the UK and Ireland. However across Europe and dependent on country, the process may take 9 to 18 months from appointment of administrators to ownership of the underlying asset. With a possible year-long hold cost based on a cost of capital typical of a loan book purchaser, the difference between vendors’ and purchasers’ views on value may be significant. The beginning of 2014 has seen a continuation of the sale process, with a number of institutions putting loan books onto the market across Spain, the UK and Ireland.

**An Overview of European Real Estate**

There is a strong pipeline of real estate assets in the UK, Ireland and Spain, where KW is initially seeking to make investments. On the most recent earnings call, management pointed to approximately $500 million of deals under contract. KW is specifically targeting assets with the following features: prime high quality properties in good locations; scope for short and medium-term rental and capital growth through active asset management; properties which are undermanaged and undercapitalized, with immediate opportunities to add value; and properties in locations expected to benefit from foreign direct investment in Europe.

**United Kingdom**

A key feature of the UK market over the last four years has been the polarization between prime and secondary locations. Although the fall in prices immediately following the crisis was relatively uniform in its effects, the recovery has had a differentiated effect. In terms of both pricing and levels of activity, this polarization has favored London offices and prime property across the rest of the country. However, since mid-2013 the broader UK recovery has become more established and the pattern of activity has changed as investors are prepared to move up the risk curve. The pricing differential between London and the rest of the UK is significant, implying the potential for substantial returns for taking even moderate additional risk.

As the charts below show, UK CRE capital values fell by just over 40% after the crisis. While there has been an almost 50% recovery in the value of London offices, UK property values as a whole, have levelled off and it is only since the middle of 2013 that there have been signs of further recovery.
The UK NPL market is a large and liquid market, and CRE loan portfolios remain one of the most actively traded classes of NPL assets in the UK, with a face value of €15 billion traded from January 2011 to August 2013. A number of the UK’s largest banks continue to have very significant property exposure. For example, Lloyds Banking Group and the Royal Bank of Scotland were estimated to have a combined CRE NPL portfolio with a face value of €65.2 billion, and have been the largest sellers of NPL portfolios, although other sellers are expected to be active as well. As at June 2013, LBG’s combined non-core UK and Irish property loan books was £16.6 billion. RBS’s internal ‘bad’ bank is reported to have loans with a face value of £38 billion as at November 2013, of which 70% is expected to be sold between 2014 and 2015 and the rest in 2016.

**Opportunities to source equity investments will arise from a variety of sources:** the sale of real estate assets from receivers and administrators following loan enforcement by banks, consensual sales by borrowers triggered by breach of lending covenants, unwinding of commercial mortgage-backed securities and the winding-up of institutional and third party managed funds which were leveraged and have suffered from poor performance and inability to raise further capital.

**Ireland**

In Ireland, there has been a significant fall in values across all real estate types, which has only recently shown signs of reversing. However, the extent of the crash should be viewed relative to prices at the peak of the market which were not supported by fundamentals. Prime office yields reached a low of 3.75% and prime retail yields hit a low of 2.5% - at the market peak, the Irish market was almost entirely domestic, with foreign buyers priced out, and highly debt-driven, with standard LTVs of 80% or more.

Irish GDP reached a low in Q4-09 and has since increased by about 3% although it has not been a smooth return to growth. Other indicators also show some improvement: unemployment is trending down and the yield on Irish government bonds is now below four per cent. Activity levels recovered somewhat during 2013, indicating improved confidence in the market, and prices for the best quality properties are improving.
As the chart above shows, capital values for both CRE and residential property fell by a significant amount, dropping by about 60% of their pre-crisis levels, before stabilizing somewhat in early 2012. CRE yields have only recently begun to tighten. In other words, there is plenty of scope for further improvement.

The variation in investment transaction volumes over the last decade has been more extreme in Ireland than in any other part of Europe. 2006 was the peak year for transactions, with €3.2 billion of CRE transactions by volume. By contrast, over the four years from the second half of 2008 to the first half of 2012 there was just €780 million of CRE transactions recorded.

Activity has picked up since the second half of 2012, but despite the improvement, there is no sign of a return to development activity in Dublin, with no completions expected in 2014. If the residential boom is any indication, investors would be well served not to hold their breath.
Established in 2009, the National Asset Management Agency (NAMA) acquired real estate loans from Irish banks with a nominal value of €74 billion. NAMA’s current activities are focused on management of property assets, and on maximizing the proceeds from its loan portfolio. Since inception, NAMA has overseen the sale of €10.6 billion worth of loans and property, including the sale of over 10,000 individual properties mainly across Ireland and the UK. Over €2 billion worth of Irish assets are currently for sale through debtors, receivers and loan sales, including a number of significant property and loan portfolio sales recently brought to the market in response to interest from large institutional investors.

In aggregate, there were €15 billion of NPL sales by Irish institutions from 2011 to 2013. IBRC is currently in the process of receiving bids for its €12.9 billion real estate loan portfolio, with NAMA acting as the reserve buyer. Sales are reported to be in progress and the process is expected to be completed by the end of Q1-14, with NAMA expected to purchase any unsold assets. NAMA itself expects to wind down its portfolio of loans over the next few years and aims to repay all its senior bonds by 2020.

The disposal of real estate assets held by debtors of NAMA and receivers acting on behalf of NAMA should be a continued source of investment opportunities for KW. Disposals of Irish property assets by domestic banks should be a further source of opportunities. For example, Bank of Ireland Group and Allied Irish Banks still hold large Irish property loan books that were not transferred to NAMA, and are expected to sell these through a number of portfolio sales.

Spain

The value of Spanish commercial and residential properties saw falls almost as large as those recorded in Ireland during the crisis. A key feature of the Spanish property market is the extent to which it is focused on the residential sector. In the mid-2000s, Spain experienced a significant expansion in the housing stock for owner-occupation, fuelled by an extended period of negative real interest rates. There remains a significant over-supply of residential property today.
The Spanish recovery lags that of the UK and Ireland. There are only limited signs that occupier demand is improving. However, CRE investment transaction volumes sharply increased over the second half of 2013, signaling investors’ increased risk appetite, and this has had a consequent effect on yields.

Post crisis, CRE capital values fell sharply, declining to 60% of their peak in 2009. The sovereign debt crisis in 2011 caused a further decline in values. Despite a slight increase in the second half of 2013, prime office capital values remained at 54% below their pre-crisis peak at the fourth quarter of 2007. The decline in house prices in Spain has been less acute, falling nationally by an average of 37% and still in decline.

Spain was Europe’s sixth largest CRE investment market in 2007, with total turnover of over €10 billion. By 2010-2011 investment activity had fallen back to just over €2 billion per annum. However, since the start of 2013, investor interest and activity have increased with total CRE investment in 2013 of €5.0 billion.

Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria (SAREB) was established in November 2012 to aid the restructuring of the Spanish financial sector. In December 2012 and February 2013, 200,000 loans worth approximately €50 billion were transferred to SAREB at significant discounts to book value; the average discounts for loans secured by completed properties and real estate development loans were 54% and 46% respectively. The discounted prices at which these loans were transferred represents the minimum price for which SAREB will be allowed to sell the loans.

SAREB has a fifteen year business plan to maximize its returns from these assets, and has targeted a reduction of 44% in the first five years. SAREB began its divestment program in Q2-13, and realized approximately €2 billion of revenues in its first year.

There were approximately €4 billion of NPL sales in Spain from 2011 to 2013. However there have been limited sales of NPLs related to CRE for three main reasons: SAREB was only created in 2012; much of the Spanish real estate lending was done at the corporate level rather than secured directly on assets at an SPV level; and the process of enforcing in Spain is more time-consuming than in the UK or Ireland.
Capitalizing on European Real Estate

KW has identified the UK, Ireland and Spain as markets with attractive growth characteristics and has established a European investment platform with strong sourcing capabilities and a proven track record in Europe. Sourcing success is primarily attributable to KW’s tested model of entering new markets and establishing relationships through the services platform, and also to extensive relationships that KW has in the European real estate market.

These relationships create substantial access to proprietary deal flow and exclusivity in negotiations, as reflected by the significant majority of the deals being sourced directly from KW Europe’s extensive relationships with financial institutions in Europe. A few examples are highlighted below.

BOI Loan Acquisition

After the acquisition of the real estate investment management platform of Bank of Ireland in June 2011, and as a result of its relationship with Bank of Ireland, KW Europe acquired a UK based loan portfolio from Bank of Ireland through direct negotiations for £1.1 billion in October 2011. The transaction was executed in a short time frame.

The UK based loan portfolio originally consisted of 24 connections of 173 underlying assets, consisting of performing and non-performing loans. The loan collateral consisted primarily of office, retail, multifamily and industrial assets, with a LTV ratio of 78% at the time of acquisition. KW Europe sold the loans of six connections in December 2011 resulting in a gain on such sale. A variety of asset management strategies have been utilized by KW Europe to sell, restructure or otherwise resolve the majority of the connections ahead of schedule and for a higher return than originally anticipated and as of January 2014, KW Europe had resolved the loans of 23 of the 24 connections.

The Alliance Acquisition

KW Europe’s strong sourcing ability has enabled it to acquire its current European portfolio at steep discounts to peak values of as much as 80 per cent and often significantly below replacement cost. In addition, most properties have significant asset management opportunities to which KW has brought its extensive asset management experience.
The purchase by KW Europe in June 2012 of a 210 unit, 9-story luxury apartment complex in Dublin, Ireland out of receivership for £33 million was made at a significant discount to its peak value. As part of its asset management strategy, KW Europe has successfully refurbished 96 units at an average cost of £7,900 per unit and intends to renovate the remaining units over the next four years. Since the acquisition of the property by KW Europe, net effective rents have increased by 21%.

### UK Portfolio Acquisition

Similarly, KWE’s acquisition in January 2013 of a portfolio of 29 predominantly multi-tenant assets across the UK for a purchase price of £63 million from a real estate agent acting as administrator to a commercial mortgage backed securities pool was made at a substantial discount to the previous valuation (highlights below). KWE intends to enhance the value of these properties through capital expenditure and consider alternative uses such as residential conversion where appropriate. As at 17 January 2014, KW Europe and its partners had received approximately £42.8 million from the sale of 15 of the 29 properties and three further properties have exchanged sale contracts with a combined value of approximately £7.75 million.
Broyhill Asset Management, LLC

Broyhill Asset Management is a private investment management boutique. We believe that capital preservation coupled with consistent, compounded returns is the key to long term wealth generation. We are conservative investors for our partners and for ourselves. Our objective is quite simple - superior risk-adjusted performance.

Since the sale of Broyhill Furniture in 1980, the Broyhill family wealth has been managed as a single family office. Today, we are privileged to be able to offer the same level of expertise developed and refined over a quarter century within the Broyhill Family Office, to additional families and investors. We have the highest respect for the trust our investment partners have awarded us, and pledge to always treat non-family investments as if they were our own.

Our Services

The philosophies and strategies we endorse for our investors are only those we have developed and deployed for ourselves. We currently offer investors three different investment strategies, each of which is fundamentally driven by the same objective – income generation and capital preservation. Each is consistent with our own goals and leverages our expertise in asset allocation, in equity research and in credit analysis.

The Broyhill Portfolio is a diversified, multi-asset class investment strategy. Macroeconomic fundamentals and long term investment themes drive the portfolio construction process which is routed in a strict valuation discipline. Embedded in our approach is a relentless focus on the preservation of capital and the belief that risk management begins with portfolio construction. The objective is simply maximum total return, commensurate with the given risk profile of global capital markets and best suited for investors with a long term time horizon.

The Broyhill Opportunistic Fixed Income Portfolio is a separately-managed individual bond portfolio focused on short duration, high-yielding fixed income securities. The portfolio aims to combine a high probability of the safe return of principal with a current return superior to a portfolio of US Treasury securities. A rigorous research process drives the selection of only those securities that meet our requirements based upon an independent assessment of each issuer’s fundamental strength. The result is a cash-generating portfolio focused only on our highest conviction ideas.

The Broyhill High Quality Dividend Portfolio is a concentrated equity strategy invested in a select group of exceptional businesses judged to be competitively entrenched market leaders, trading at reasonable prices. Our research seeks to identify outstanding companies with sustainable competitive advantages, rather than speculate on mediocre businesses with uncertain futures. The result is a portfolio of profitable businesses which offer the potential for full participation in up markets while mitigating the brunt of down markets, delivered to investors in the form of attractive dividends and consistent earnings growth.

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