Newsletter
March 2015

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Our hedge fund, The Select Opportunity Fund, returned a + 2.97%* for the month, while our unit trust, the ALTRE BCI Real Return Property Fund, returned + 2.73%*.

"Skyscrapers are the ultimate architecture of capitalism." – Carol Willis

Skyscrapers are being built at an astonishing rate. Ninety-seven buildings that exceed 200 meters (656 feet) in height were constructed in 2014 demolishing the previous record which stood at eighty-one buildings completed in 2011. The total number of skyscrapers in existence now is 935, an increase of 350 percent since the year 2000.

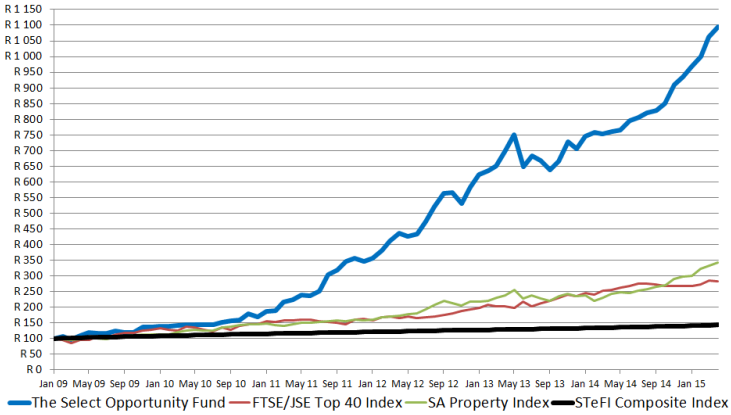
The tallest skyscraper completed in 2014 was One World Trade Center in New York City. Initially dubbed "Freedom Tower" it is the third tallest skyscraper in the world, and the tallest in the western hemisphere, but only if you include the antenna/spire in the building's height. Brookfield Place, in which we hold an investment in the Select Opportunity Fund, is a neighbouring building to One World Trade Centre in New York City.

Today the tallest skyscraper in the world is the Burj Khalifa in Dubai. Estimated by some to have cost the developer, Emaar Properties, approximately $4.6 billion to build, it was completed in October 2009 and opened its doors in January 2010. The Burj Khalifa stands tall at 828 meters with a total rentable area of 4,000,000 m² and boasts the 37-storey Aramani Hotel, which comprises of 403 suites.

In May 2014, construction commenced on a new world record setting skyscraper being constructed in Jeddah, Saudi Arabia – The Kingdom Tower. The Kingdom Tower will eclipse the height of all buildings to date, as it is designed to be over one kilometer in height, or more than eleven football fields and is slated for completion in late 2016 or early 2017. As designed, the Kingdom Tower will exceed the height of the Burj Khalifa by more than 500 feet.

The Select Opportunity Fund

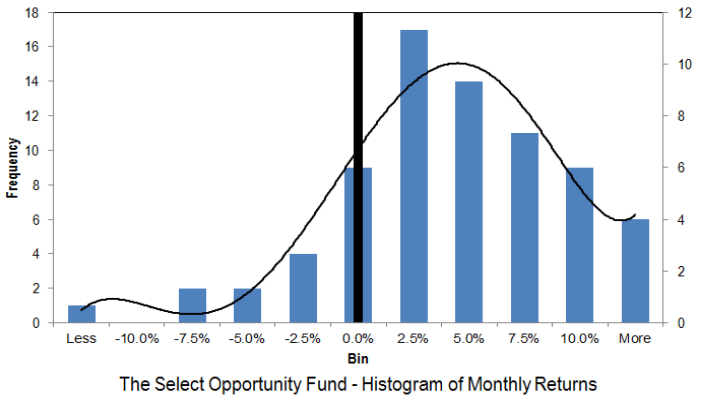
The Select Opportunity Fund is a private partnership hedge fund with the objective to provide investors with a 20% per annualised compound return over a long investment time horizon, through holding investments in Real Estate and Property related companies. The Fund uses a long term value investment approach whilst holding as little fundamental risk as possible.



	Fund	Top 40	Property	Cash
From Inception	995.09%	181.87%	241.53%	42.92%
Annualised Return	46.66%	18.03%	21.72%	5.88%
Current Month	2.97%*	-1.53%	2.64%	0.54%
2015 YTD	13.16%	5.66%	13.70%	1.52%
2014 Return	29.82%	9.17%	26.64%	5.57%
2013 Return	19.70%	22.77%	8.39%	4.68%
2012 Return	74.34%	26.12%	35.88%	5.10%
2011 Return	90.30%	2.20%	8.93%	5.27%
2010 Return	34.72%	17.22%	29.62%	6.26%
2009 Return	39.34%	31.73%	14.07%	8.36%

March 2015 Fact Sheet

Histogram of Returns



The Select Opportunity Fund - Histogram of Monthly Returns

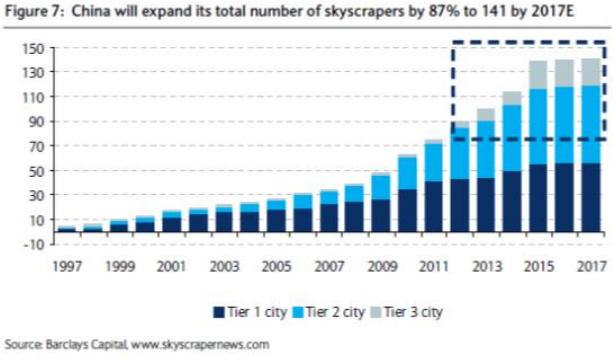
Opening for business in mid-2015, this year China's business capital will welcome the Shanghai Tower, which will be the world's second-tallest building and China's tallest skyscraper. If there is a geographic center to the current skyscraper craze, it is China. Half of the world's 30 tallest buildings are located within its borders. China will complete 53% of the 124 skyscrapers under construction over the next three years, expanding the number of skyscrapers in Chinese cities by a staggering 87%. China's skyscrapers are not only increasing in number – it now has 75 completed skyscrapers above 240m in height - but the average height of the skyscrapers that it is building is also increasing.

Figure 6: China skyscrapers are becoming ever higher

Source: Barclays Capital, www.skyscrapernews.com

In addition, to the increase in size and number of China's skyscrapers, their geographic profile is also changing. Today over 70% of China's skyscrapers are unsurprisingly clustered in the more economically advanced coastal areas of the Pearl River Delta and the Yangtze River Delta. Yet between now and 2017 over 50% of China's skyscrapers will be built inland as China's building boom moves from first-tier cities to second- and third-tier cities. Over 50% of China's skyscrapers are today in tier 1 cities, and based upon current completion plans about 80% of China's new skyscrapers will be built in tier 2 and 3 cities over the next three years.

Figure 7: China will expand its total number of skyscrapers by 87% to 141 by 2017E



Source: Barclays Capital, www.skyscrapernews.com

Various academic and market commentators, have long argued that clusters of buildings assailing new heights is a sure sign of an imminent downturn in an economy and that such times are often followed by periods of financial stress, this condition has come to be known as the "skyscraper curse".

Mr Andrew Lawrence, of Barclays Capital, in a paper in 1999 first identified this phenomenon known as the "skyscraper curse". Mr Lawrence noticed a curious correlation between the construction of the world's tallest buildings and economic crises. The unveiling of the Singer Building and the Metropolitan Life Tower in New York, in 1908 and 1909 respectively, roughly coincided with the financial panic of

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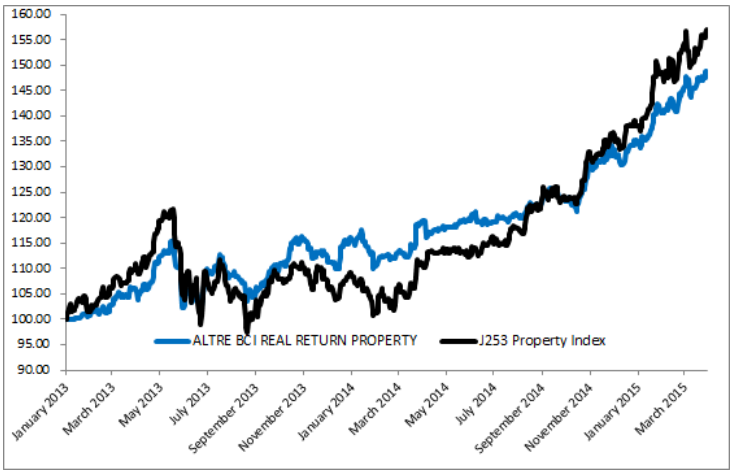


	Fund	Benchmark
Return from Inception	48.41%	56.06%
Annualised Return	19.18%	21.87%
Current Month Return	2.73%*	2.64%
2015 YTD	10.05%	13.70%
2014 Return	16.53%	26.64%
2013 Return	15.73%	8.38%

March 2015 Fund Analysis

Application Form

What we are thinking about…

The Skyscraper Center – The Global Tall Building Database of the CTBUH

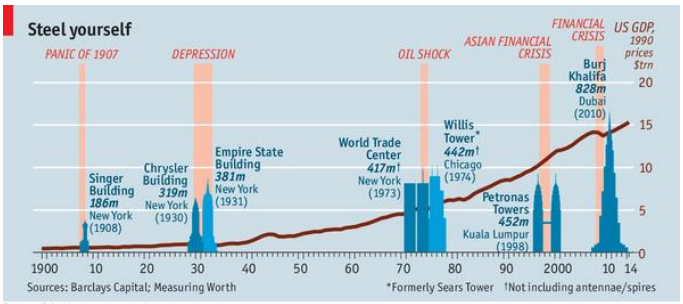
100 Tallest Completed Buildings in the World -CTBUH

One World Trade Center - CTBUH

Disclosure

*Most recent monthly performance is based on Alternative Real Estate's initial "soft" estimates of the fund's value prior to management and performance fees.

1907 and subsequent recession. The Empire State Building opened its doors in 1931, as the Great Depression was beginning - it was soon dubbed the “Empty State Building”.



(Note: The Empire State Building, after being held in a private syndication which was first formed in 1934 by various New York families, was brought to the public markets by the Empire State Realty Trust in October 2013, a REIT listed on the NYSE - interestingly some 40% of the building’s revenue stems from the Observatory which generated record income of $28.2 million and a visitor footfall of 997,000 during the fourth quarter of 2014). Malaysia’s Petronas Towers became the world’s tallest building in 1996, just before the Asian financial crisis. Dubai’s Burj Khalifa, currently the world’s tallest building, opened in 2010 in the middle of a local and global crash.

Skyscrapers can be hugely profitable, since by building upwards developers can rent out more floor space on a given plot of land. But at some point extra storeys are no longer a good deal, since marginal costs—for more lifts and extra steel to stop the building from swaying in the wind, for example—increase faster than marginal revenues (rents or sales).

Carol Willis, an architectural historian, explained the difference between normal times and boom times:

> *In normal times, when costs of land, materials, and construction are predictable, developers use well-tested formulas to estimate the economics of a project. These calculations are based on the concept of the capitalization of net income. This value takes into account the net income for thirty or forty years . . . the conventional market formulas and the concept of economic height were widely known and followed in the industry. Most building was not risky, but reserved in its calculations and highly responsive to market desires.*

All of the normal calculations that help ensure profit and avoid loss are not, however, reliable during the boom phase of the business cycle. As Willis explains further:

> *In booms, the so-called rational basis of land values is disregarded, and the answer to the question “What is the value of land?” becomes “Whatever someone is willing to pay.” Some speculators estimate value on new assumptions of higher rents; others simply plan to turn a property for a quick profit. . . . But due to the cyclical character of the real estate industry, the timing of a project is crucial to its success, and the amount a property reaps in rents or sale depends on when in a cycle it is completed or comes onto the market.*

Willis said that "height is a barometer of boom", "the tallest buildings generally appear before the end of a boom, their height driven up by the speculative fever that affects both developers and lenders", citing cyclically inflated land values as the principal factor for increases in building height.

Record-breaking skyscrapers could therefore be seen as an indication that gung-ho investors are overestimating the probable future returns from new construction. Indeed, developers may be building record-breaking towers, even such behavior by developers has resulted in the consensus thinking that (a) the most severe forms of height competition occur near the business cycle peaks and (b) that extreme heights are examples of developers “gone wild.” The implications of these beliefs are that skyscraper height can be used to predict the business cycle (i.e., height is a leading indicator), and that over time, height and output (GDP growth) should deviate because height competition causes builders to build taller than their rivals, rather than what is profit maximizing.

Until recently, however, there had been no formal analysis of the skyscraper curse. A new paper by Mr Barr, Bruce Mizrach and Kusum Mundra (all of Rutgers) investigates Mr Lawrence’s musings in detail. At first they looked at the building of 14 world-record-breaking skyscrapers, from New York’s Pulitzer (which opened in 1890) to the Burj Khalifa, and compare them to American GDP growth.

If, as the skyscraper curse suggests, the decision to build the biggest towers happens near the peak of the business cycle, then you could use record-breaking projects to predict the future path of GDP. However, the range of months between the announcement of the towers and the business-cycle peak is large, varying from zero to 45 months. Seven of the 14 opened during a downward phase of the business cycle. “We first looked at the announcement and completion dates of record-breaking skyscrapers and found that there was very little correlation with the peaks or toughs of the cycles”, say the Rutgers team. In other words, you cannot accurately forecast a recession or financial panic by looking at either the announcement or the completion of the world’s tallest building.

With such a small sample, it is tricky to draw firm conclusions. However the paper expands the sample to 311 projects by looking at the tallest building completed each year in four countries (America, Canada, China and Hong Kong). The authors then compare building height to GDP per person. They find that in all countries GDP per person and skyscraper height are “cointegrated”, and that height does not cause output (GDP growth), but that output (GDP growth) causes height. These results are robust at the international level.

In other words, developers tend to be profit-maximisers, responding rationally to rising incomes (and thus increased demand for office space) by making buildings taller.

“While we don’t deny that height competition and ego-based construction are present in the skyscraper market, they do not appear to be a systematic part of the market. The fact that heights rise over the business cycle indicates that height is a response, on average, to rising incomes rather than increased competition or other factors”, say Messrs. Barr, Mizrach et. al.

Willis correctly identified that "easy financing underlie all booms," but this does not answer her conundrum because easy financing and low interest rates are also at the heart of genuine economic growth (which was the case pre- 2005). The entrepreneur's problem is that profit calculations cannot show for certain whether interest rates will remain low and that projects will succeed (economic growth) or interest rates will rise and projects will fail (business cycle).

Economists of the Austrian School have a theory of the business cycle based on capital theory where the structure of production is distorted by artificial changes in the interest rate. Economic activity is based on "fundamentals," but the fundamentals themselves can be distorted and induce bad investments (hysteria and speculation) that ultimately are revealed to be bad investments during economic contraction. (Mark Thornton)

Obviously this does not suggest that building heights should be used as a guide to fiscal and monetary policy or that skyscraper heights should be limited to prevent economic crises. It does however lend additional standing to the Austrian theory of the business cycle. Furthermore, it does suggest that both the cause of skyscrapers reaching new heights and severe business cycles are related to instability in debt financing and that the institutions that regulate debt financing should be re-evaluated, if not replaced with more efficient and stabilizing institutions. (Mark Thornton)

In our view, investors are well advised to watch for signs of over-heated development. Foremost amongst these signs is a tightening of liquidity conditions, which is often accompanied by changes in regulatory capital requirements and the subsequent withdrawal of lenders of financing from development projects. The tightening of financing conditions and the withdrawal of available liquidity is most often the trigger point.

Regards

Alternative Real Estate Team

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