A Perspective on Equity Commonwealth

by Nolan Anderson

Equity Commonwealth ("EQC") is a real estate investment trust (REIT) focused exclusively on the ownership of office properties located in the U.S. Founded in 1986, the company spent most of its life as an externally managed REIT with poorly crafted management incentives, weak corporate governance and an unfocused real estate strategy. Unsurprisingly, the long term result for shareholders was below average returns. The status quo changed in 2013 when two activist investors amassed a 10% stake in the company and led a successful takeover campaign. In 2014, an experienced and highly respected management team led by Sam Zell took over the company. As part of the takeover, Sam and the senior leadership team agreed to purchase approximately $100mm of stock (roughly 3% of shares outstanding) from the activist shareholders. Over the past 25 years, Mr. Zell has built three of the largest U.S. property REITs including Equity Office Properties, Equity Residential and Equity LifeStyle Properties, while generating above average shareholder returns. Under Sam's leadership, EQC has appointed a new board of directors, internalized management, overhauled corporate governance and created a management incentive framework that is focused on creating long term shareholder value.

Good Defense (Credit Improvement) Leads to Good Offense (Equity Upside)

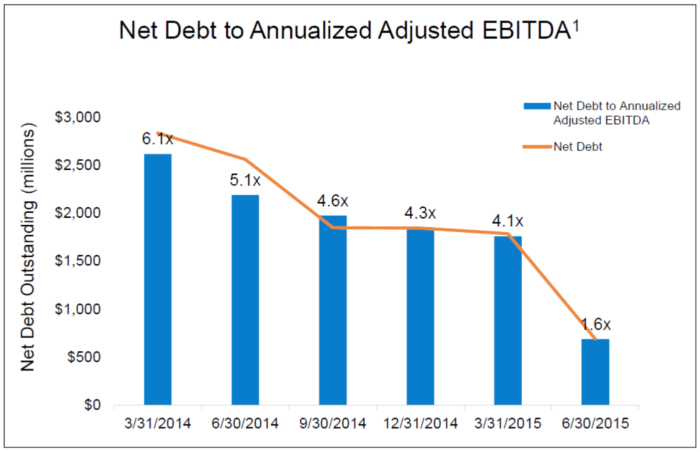
With U.S. commercial real estate prices near all-time highs and REIT stocks in general fairly valued (primarily as a result of low interest rates), why focus on REIT stocks? In short, we believe EQC is a unique story with strong leadership and an undervalued asset base. In what is an inherently cyclical business, Mr. Zell is known as a shrewd, contrarian real estate investor. This reputation is most exemplified by the $39 billion sale of Equity Office Properties to Blackstone, the largest ever U.S. real estate buyout, at the peak of the real estate boom in 2007. Fast forward to today, most office REITs are still looking to grow, despite frothy conditions. EQC is doing the opposite. In February, the company announced a $2-3 billion disposition program to be completed over the following 2-3 years. The strategy was simple: create a significantly smaller, higher-quality office portfolio focused on core markets while improving the corporate balance sheet and liquidity profile. While the market yawned, we took a hard look at the company's debt structure and liquidity profile. We then began an intensive bottom-up analysis of the company's 150+ assets. Our research process concluded with a view that EQC had both ample liquidity and an undervalued asset base using reasonably conservative assumptions. Why didn't the market take notice? First, there was execution and timing risk. Market conditions can change rapidly, the company owned some lower-quality assets in secondary and tertiary markets, and 2-3 years is too long of a time frame for many investors. Second, there was uncertainty about what assets would be kept and sold. With a large and disparate portfolio, this made analyzing future earnings difficult. Third, and potentially most important to traditional REIT investors, the company eliminated the dividend and would not provide certainty of reinstatement.

Lucky and Smart

Over the past six months, good timing and hard work have paid off. Since February, the company has sold 82 properties comprised of over 16 million square feet for total cash proceeds of $1.7 billion. The total number of properties has declined by over 50%, while overall portfolio square footage has decreased approximately 40%. Management is aiming for an additional $1.3 billion of asset sales bringing total cash proceeds to $3 billion. In our view, the real estate portfolio has been significantly de-risked with the majority of the company's secondary and tertiary assets having been sold. Currently, the 30 largest properties in the portfolio generate over 80% of annualized rental revenue and, in our opinion, more than 100% of EQC's current market value. The majority of revenue is now generated from strong office markets including Austin, Boston, Chicago, Denver, Seattle-Bellevue, Philadelphia and Washington, DC.

Cash Rich, Debt Poor = Uniquely Positioned

Today EQC is uniquely positioned in the REIT world. With a current cash balance of approximately $1.6 billion, EQC sits in an enviable position of having significant liquidity and peer leading leverage metrics. As illustrated below, management has significantly deleveraged the balance sheet since taking over in 2014. According to Wells Fargo Securities, in the second quarter of 2015, the largest 80 U.S. REITs had an average of 5.9x Net Debt to Annualized EBITDA (defined as total debt, less cash on hand, divided by "earnings before interest, taxes, depreciation and amortization"). Going forward, the continual process of converting a geographically dispersed portfolio of secondary and tertiary office buildings into cash will make the company easier to analyze and the discount to our estimated $33 per share of net asset value (NAV) more clear. However, this valuation framework assigns no earnings power to the current cash position. The company has significant flexibility to repurchase stock or repay high coupon debt, some of which we also own in our bond funds. Given the longevity of the current economic recovery, frothy real estate market conditions and the prospects for higher interest rates, we believe EQC is well positioned and properly incentivized to take advantage of potential market weakness and increase NAV per share over the long term.



Source: Equity Commonwealth September 2015 Investor Presentation
www. Eqcre.com

***Nolan Anderson**, Research Analyst and Co-Portfolio Manager of the Core Plus Income Strategy (Core Plus Income Fund), joined Weitz in 2011. While Nolan spends the majority of his time focusing on fixed income, Equity Commonwealth is a good demonstration of the collaborative nature of our research team. Nolan holds both a BSBA and an MBA from the University of Nebraska Omaha. Prior to joining Weitz, he performed financial modeling and due diligence on leveraged buyout transactions for Wells Fargo in San Francisco and was a commercial real estate research analyst for Woodmen of the World Life Insurance Society.*

As of September 30, 2015: Equity Commonwealth represented 5.1%, 2.2%, 2.2%, 2.2% and 0.8% of the Core Plus Income Fund, Hickory Fund, Short-Intermediate Income Fund, Balanced Fund and Partners III Opportunity Funds' net assets, respectively.