

# HEARTLAND REAL ESTATE BUSINESS™

VOLUME 4, ISSUE 2

OCTOBER 2005

## FINANCIAL REIT LIKES MIDWEST'S POTENTIAL

*American Financial Realty Trust is finding tremendous growth by focusing on financial institution tenants.*

Nicole Thompson

There is a real estate investment trust (REIT) for almost every aspect of real estate — such as sector-based REITs that focus on a type of property like office projects, or geographically focused REITs that might only own properties in one particular region. But Jenkintown, Pennsylvania-based American Financial Realty Trust (NYSE: AFR) is employing a new model when it comes to REITs by focusing on a single tenant sector. AFR, which was formed as a REIT in May 2002 and had one of the largest domestic IPOs of 2003, has seen astounding asset growth over its history by targeting tenants in the regulated financial services industry and establishing multifunctional relationships with them by leasing, often on a net basis, office buildings, bank branches, operational



centers — any real estate that a financial company requires is AFR's specialty.

The company's assets have grown quickly as AFR acquires more portfolios and deepens its relationships with financial institutions.

"These are very large transactions, with very serious people," says Nicholas Schorsch, the president and CEO of AFR. "These institutions are looking for long-term stability and long-term landlords — they're looking for somebody that is going to be their partner in the future."

In the second quarter alone, AFR had acquired 158 properties comprising an aggregate of approximately 4.2 million square feet with a total purchase price of approximately \$281.1 million, bringing the company's building ownership or leasehold interest to more than 1,000 properties comprising approximately 36.5 million square feet in 38 states and Washington, D.C. AFR has made several acquisitions since

the end of the second quarter.

In July, AFR completed the \$24.5 million acquisition of a 158,000-square-foot credit card operations center in Sioux Falls, North Dakota, that is net-leased to a subsidiary of HSBC through November 2013.

In early August, AFR completed another large acquisition, the national headquarters of the Fireman's Fund Insurance Company in Novato, California, which is a three-building Class A office portfolio with more than 700,000 square feet over 64 acres. The gross purchase price for the property was approximately \$283.5 million. Fireman's Fund will continue to lease 100 percent of the property on a net-lease basis through November 2018.

Two of AFR's large portfolio acquisitions in the second quarter had a strong Midwestern component, which added to AFR's already established presence in the region through its relationship with Bank of America. In June, AFR purchased a 33-property portfolio from Charter One Bank, a subsidiary of Citizens Financial Group, that consisted of bank branches and small office buildings. The company also purchased a 109-property portfolio from Regions Financial Corporation and certain affiliates. The Midwestern properties in these two portfolios are mainly located in Illinois, Indiana and Missouri.

In fact, AFR expects to concentrate on the Midwest over the next 6 to 8 months, and has hired Richard Eisman to further strengthen Midwestern operations. According to Eisman, the managing director of office leasing and sales for the Midwest, many of AFR's Midwestern properties are not in central business districts (CBD), where landlord competition is stiff and tenants hard to come by.

"These assets aren't in CBDs, so it's not like Chicago, where it is pretty tough to be leasing right now," Eisman says. "Our properties are more often in areas like county seats, and suburban markets — what they refer to as a tertiary market. We find that banks stay strong, period. The peaks and valleys are not as dramatic as the CBD markets. A lot of investors and REITs

focus on the CBDs and focus away from the Heartland. And I think that we're a little different in that respect. We embrace the Heartland — I think the core, from all aspects of business, is solid. There are always people who need banks. There is always access, and from a business perspective, it's about ethics, the people, and trust, which is valuable to us."

This rapid acquisition pace has been funded in several different ways, including through public offerings, the most recent in May, which resulted in net proceeds of approximately \$242.6 million. The company watches its leverage and equity ratios, however.

"We wanted to balance our overall balance sheet with a long-term strategy that kept our leverage ratios and our equity ratios in good stead," says Schorsch of the offering. "And with our acquisition pipeline as strong as it was, we basically only raised money for the acquisitions that we were closing, and Fireman's Fund just finishes that whole package off. So it's pretty amazing that in less than 18 weeks, we took down \$250 million and fully deployed all of it — that's the game, that's the whole point of the business. We told the market that we would not raise money that we could not put to work promptly."

AFR is also careful to dispose of non-core assets and preserve the business model. In the first half of 2005, the company sold a total of 67 properties and disposed of four leasehold interests, about 1.4 million square feet total, of which approximately 925,000 square feet was vacant or expected to become vacant in the near term. These dispositions resulted in an approximately \$3.8 million net gain (net of impairments and income tax).

"We're very keen to make sure that we dispose of assets that are not core to us because one, they have large vacancy, or two, they do not have occupancy of a financial institution of greater than 25 to 35 percent of the asset," says Schorsch.

The company has grown by leaps and bounds, growing 600 percent in assets in the past 3 years, and has very extensive relationships with some of the largest banking and other financial institutions in the United States, such as Bank of America, Wachovia, Citibank and State Street.

Schorsch says that the strength of the financial services industry is one of the factors that drove AFR's customer-centric business model.

"We feel that this is certainly a thing of the future," he says. "Ten years ago, you had REITs doing office, retail, and residential, all in the same REIT, and today, you see the development arms of REITs are being spun off, and REITs