AMERICAN REALTY ADVISORS
INSTITUTIONAL CAPITAL MANAGEMENT

American Core Realty Fund

Commentary on 2017 Performance and Outlook for 2018

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Commentary on 2017 Performance and Outlook for 2018

The American Core Realty Fund employs a conservative strategy to provide our investors exposure to institutional commercial real estate through a broadly diversified portfolio of high-quality, well-leased, and strongly-positioned assets in major metropolitan areas. We believe our focus on capital preservation, long-term appreciation, low-volatility, durable income, and the best quality assets, markets, and tenants can provide compelling risk-adjusted returns for our investors over a full market cycle. We also strive to "do well by doing good" and build into our portfolio management a focus on environmental and social concerns.

<u>2017 – A Successful Year</u>

At the beginning of 2017, our letter to our investors outlined the strategic decisions that ARA implemented to strengthen the portfolio for immediate and long-term growth in the face of changing market conditions. Throughout 2017 we continued our strategic plan and took advantage of a strong and liquid capital market to reposition the Core Fund for outperformance.

In today's lower return environment, cost control and quality of income and tenancy can boost returns. We sold a number of older and less strategically located assets, averaging 25 years of age, at compelling pricing and redeployed these proceeds into strategic core and, in select cases, non-core or alpha generating investments.

Core acquisitions in 2017 focused on newly-built assets, averaging two years in age, with lower future capital expenditures and greater prospects for net operating income growth. These assets are also larger, which we believe improves operating efficiency and attracts higher quality tenancy. We targeted more urban properties (to take advantage of demographic changes and long-term trends) averaging 95% leasing to a quality tenant base on longer-term leases with contractual rent escalations to minimize downside risk. This was completed while shifting property type allocations away from office and multifamily in the short term, while increasing our overweight to industrial, the top performing property type segment over the last three years. We believe that industrial will continue to outperform.

In 2017 the Core Fund began to realize the benefits of these strategic decisions. <u>As a result, the American Core Realty Fund outperformed the NFI-ODCE peer group by 45 bps in 2017.</u> We delivered this outperformance primarily from property type and market allocation decisions, disciplined asset selection, structured investments, and manage-to-core investments.

<u>Allocation Decisions Add to Outperformance</u>

The Core Fund generated 30 bps of outperformance from property type and market allocation decisions, including tactical moves between property type allocations and urban vs. suburban exposures. Our overweight to industrial and our commitment to the Seattle market, ranked by ULI as the number one market in the U.S. for 2018, positively impacted the return to our investors.

Asset Selection

Core Fund acquisitions made since the end of 2010 have outperformed assets acquired by the NFI-ODCE peer group for the same time-period by an average of 100 bps over each of the last 1, 2, 3, 4, and 5-years, as well as outperforming the overall NFI-ODCE property returns. In particular, investments made in 2015-2016 contributed positively to outperformance in 2017.

Key components to our portfolio re-positioning were strengthening tenant quality and diversification as well as lengthening contractual lease terms. Over the last two years we reduced the number of

Patti McLauchlin
Mar 28, 2018 14:01

tenants in the commercial portfolio from 816 to 533, while simultaneously increasing the average lease size by 35% and the average lease term by 35% to 6.1 years. Tenants added include Google, Amazon, Visa, and IBM, and we estimate that 56% of our commercial rental income is now represented by tenants generating in excess of $1 billion in annual revenue, which we believe substantially improves the cash flow durability of the portfolio. Despite the shift to fewer tenants, we remain focused on minimizing risk exposure and no single tenant represents more than 5% of the Core Fund's total revenue.

Structured Investments/Manage to Core
Structured investments (averaging a 9% income return), together with manage-to-core investments comprised 8% of the fund GAV and added to relative outperformance.

Leverage
The Core Fund's more conservative leverage level in previous years resulted in underperformance to the peer group, but we have moved to a more neutral debt position. Average remaining term on leverage is 6 years and, with 89.3% being fixed interest rate at a blended cost of 3.7%, the portfolio now has one of the strongest debt positions in the core fund universe.

<u>2018 and Going Forward</u>
We expect to achieve attractive risk-adjusted investment performance in both the near and long-term with durable and growing income coupled with moderate value appreciation. In 2018, we anticipate $700-$800 million in acquisitions and a reduced disposition volume of $350-$450 million as our portfolio repositioning is completed. The lease percentage should increase slightly to 94% and we expect same-store net operating income growth of 3.4% ($235-$245 million of total net operating income) resulting in a fund level income return of over 4%.

The American Core Realty Fund is in its fifteenth year of operation and we thank you for your continued confidence in ARA and in the Core Fund Team. We are engaged and working diligently to ensure that your confidence is well placed. We look forward to continuing to serve you and to delivering the stable and compelling risk-adjusted returns necessary to achieve your real estate investment goals and reduce volatility in your portfolio.

Thank you again for the opportunity to work together as part of your investment team.

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