SAFE

Third Quarter 2017 Earnings Call

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C O R P O R A T E P A R T I C I P A N T S

Jason Fooks, *Vice President of Investor Relations and Marketing*

Jay Sugarman, *Chair and Chief Executive Officer*

Geoffrey Jervis, *Chief Operating Officer and Chief Financial Officer*

C O N F E R E N C E C A L L P A R T I C I P A N T S

Richard Anderson, *Mizuho Securities*

Collin Mings, *Raymond James & Associates*

Anthony Paolone, *JP Morgan*

Daniel Donlan, *Ladenburg Thalmann Financial Services, Inc.*

Joshua Dennerlein, *Bank of America Merrill Lynch*

P R E S E N T A T I O N

Operator:

Good day, and welcome to Safety, Income & Growth Third Quarter 2017 Earnings Conference Call. If you should need any assistance during today's call, please press star, zero.

At this time, for opening remarks and introductions, I would like to turn the conference over to Jason Fooks, Vice President of Investor Relations and Marketing. Please go ahead, sir.

Jason Fooks:

Thank you. Good morning, everyone, and thank you for joining us today to review SAFE's Third Quarter 2017 Earnings Report. With me today are Jay Sugarman, Chairman and Chief Executive Officer, and Geoff Jervis, our Chief Operating Officer and Chief Financial Officer.

This morning, we plan to walk through a presentation that details our third quarter results. That presentation can be found on our website at safetyincomegrowth.com, in the Investor Relations section. There'll be a replay of the presentation beginning at 1:00 p.m. Eastern Time today.

Before I turn it over to Jay, let me point you to our forward-looking statements disclaimer on Slide 1. I'd like to remind everyone that statements made on our conference call which are not historical facts may be forward-looking. Today's actual results may differ materially from these forward-looking statements, and the risk factors that could cause these differences are detailed on this slide, as well as in our SEC reports.

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SAFE disclaims any intent or obligation to update these forward-looking statements, except as expressly required by law.

Now, I'd like to turn it over to our Chairman and CEO, Jay Sugarman. Jay?

Jay Sugarman:

Thanks, Jason, and good morning. During the third quarter, we expanded our efforts to get in front of key parts of the real estate transaction world and demonstrate how ground leases can and should be a part of many real estate capital structures. Meetings with top brokerage firms, active developers, and multiple real estate investment firms have supported our belief that we can revolutionize the way ground leases are thought about and employed in providing highly efficient capital to owners, operators, and developers alike. While the pipeline is quite active as the result of our outreach, we are seeing long lead times on getting deals closed due to the education process involved. We definitely expect to see increased investment volumes as our Deal Teams continue to penetrate the top 20 markets throughout the country.

As we've mentioned before, we see two main approaches to building the business: the first involves acquiring existing ground leases in whole or part, with cash or OP units. The second involves creating new ground leases in conjunction with the sale or financing of existing properties, or in conjunction with the development of new properties. While the second quarter was highlighted by the acquisition of a large existing ground lease, what we are seeing now is that the larger opportunity may very well be in phased active creation of ground leases.

The two deals closed since our last call both represent interesting examples of the types of investment we believe will create robust growth going forward; one with an existing relationship and one as part of the new construction project. Both deals benefited from iStar's range of relationships and capabilities and demonstrate pockets of the market we think SAFE should have a significant competitive advantage in going forward. I'll talk more about how we see the business developing in a minute, but let's have Geoff walk through the quarter in more detail first. Geoff?

Geoffrey Jervis:

Thank you, Jay, and good morning everyone. My remarks this morning will refer to slides from our earnings release that was posted to our website earlier this morning. Starting on Slide 3, when we evaluate performance at Safety, we look not only at GAAP net income, but also at non-GAAP financial measures such as funds from operation, or FFO and adjusted funds from operation, or AFFO.

For the quarter, net income was a loss of $721,000; FFO was positive $1.5 million; and AFFO was $2 million or $0.11 per share. As we discussed last quarter, our largest asset is the Master Lease with Hilton, covering five properties. Our ground lease not only provides for base-rent but also provides for percentage rent, which was $3 million last year. The entirety of percentage rent is booked in the first quarter of every year when Hilton reports the figure to us, leading to lumpy earnings. If we straight-line 2017's percentage rent over the entire year, this quarter's earnings would have been higher by $750,000 or approximately $0.04 per share. Net income would have been break-even per share, FFO $0.12 per share, and AFFO $0.15 per share.

Staying on income-related topics; as we promised during the IPO road show, this quarter we paid our first dividend of $0.1566 per share. This included $0.0066 per share from the shortened prior quarter, and $0.15 per share for this quarter's regular dividend. We expect to consistently grow the dividend as we continue to invest the proceeds from the IPO.

Turning to Slide 5, this slide shows a reconciliation of GAAP net income to both FFO and AFFO. For Safety, FFO is simply net income of negative -$721,000, adjusted to eliminate $2.3 million of real estate-

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related depreciation and amortization resulting in a million and a half dollars of positive FFO for Q3. AFFO is also an important metric for us; AFFO is a metric we use to assess long-term operating performance, and is used internally when considering operating performance, debt coverage, as well as dividend sustainability and when formulating corporate goals and strategies. As you can see, we have eliminated the $1.4 million benefit from straight-line rent, as well as adding back non-cash and/or non-recurring expenses. As a result, our Q3 AFFO was $2 million, or roughly $0.11 per share based on the 18.2 million shares that were outstanding at September 30. With the aforementioned Hilton adjustment, as I mentioned earlier AFFO would have been $0.15 per share for the quarter.

On to Slide 6, Slide 6 is a simple roll-forward of our portfolio. Starting with the $481 million, 14 asset portfolio at the end of Q2, and adding the period's origination, the $16 million LifeHope Ground Lease.

Turning to Slide 7 for more details; the first transaction we closed, we refer to as LifeHope. This deal represents a repeat ground lease customer for SAFE and involves a fully preleased medical office building in an affluent and growing submarket of Atlanta. The developer is repositioning a former regional headquarters building as part of a larger medical complex, and has secured leases ensuring full occupancy on a long-term basis, prior to settling on a capital structure.

SAFE presented a 33% of cost, 99-year ground lease, and iStar offered a 75% LTV leasehold bridge loan to enable the owner to complete the TI and building improvements prior to accessing permanent leasehold financing. The going-in cap rate on our ground lease was 5.5%, with a 2% annual bump. This is the second deal between SAFE and this developer, and each includes a SAFE ROFO on adjacent developable land.

On to Slide 8, the second deal that we refer to as Great Oaks, closed shortly after the quarter-end. This transaction also represents an innovative approach that can potentially lead to significant future business. SAFE and iStar, again, provided a one-stop capital solution to a top-tier developer of multifamily in Northern California. In this one, iStar had entitled land, and offered a combination of ground lease, and leasehold construction financing to fast-track the purchase and development of 300 units of class-A multifamily by Fairfield Development and its large institutional partner in the rapidly developing south San Jose market.

This 25% of cost ground lease should enjoy greater than five-times coverage upon completion. SAFE will fund its ground lease in 36-months, at the end of the estimated construction period. The cap rate at closing will be 3.75% with 2% annual bumps, and 10-year CPI look-backs beginning in year 20. This transaction and LifeHope are both affiliate transactions, as iStar was the former owner of the Great Oaks site, and is the leasehold lender for both LifeHope and Great Oaks.

We have a well-defined and strict policy for affiliate transactions, including the requirement to have all affiliate transactions approved by the independent members of each of SAFE's and iStar's Boards of Directors. Both of these transactions received approval from both sets of independent Directors.

Moving to Slides 9 and 10, as we grow, we will endeavor to design a portfolio that is well-diversified by what we believe to be the most important characteristic of a ground lease; location. As you can see on the map, our largest exposure is to the Los Angeles MSA and we expect this map to be heavily concentrated in top markets of the United States, going forward.

Slide 10 includes five additional portfolio metrics that we believe are important: property type, lease duration, exposure to combined property value, rent escalators, and cash flow coverage. For all of these metrics, we believe that all of the current statistics are in line with our expectations.

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Moving to Slide 11, Slide 11 gives a snapshot of our pipeline of potential new investments that Tim Doherty, our Head of Ground Lease Investments and his team are pursuing. As you can see, our pipeline stands at $1.1 billion, with $278 million in active negotiations. The majority of these transactions involve creating new ground leases, an avenue we continue to find rich in opportunity. From a location standpoint, the pipeline is mostly in the top MSAs in the country, and office and multifamily dominate the property type.

On to Slide 12, on Slide 12 we have expanded our Value Bank disclosure. As we introduced last quarter, Value Bank represents a meaningful component of value embedded in our ground leases. It stems from our right as the landlord to gain control of the building at the end of the term of the ground lease. We calculate Value Bank simply as the combined property value or fee-simple value, less our historical costs in the ground lease. In the past, we provided our own estimate of Value Bank, but as promised, we engaged CBRE to provide expertised, third-party appraisals for the combined property value of each of the assets in our portfolio.

In total, CBRE appraised the combined property value of our portfolio at $1.5 billion. Taking that value and subtracting our ground lease--basis, results in a Value Bank of $993 million, or $54.56 per share. Of course this Value Bank is just a spot-price as of today, who knows what Value Bank will be worth when the leases expire. For some assets, it will go up, and for others it will go down; however, we believe that a diversified portfolio of real estate, over a long period, will track or exceed inflation. If we are right, the Value Bank will provide exceptional inflation indexed capital appreciation.

When you put it all together, we believe that the combination of the SAFE growing and mispriced cash flows of a ground lease, plus the land value, and the appreciation of the land, plus the Value Bank and the appreciation of the Value Bank will equate to extraordinary relative value for our shareholders.

Flipping to Slide 13, that shows our credit metrics. The left-hand table shows that we continue to be conservatively levered at 0.6x debt-to-equity at the corporate level and our debt represents only 15.2% of the combined property value of the portfolio. The table on the right shows our fixed charge coverage ratio, which stood at 2.1x and on a look-through basis to the underlying properties at 9.5x.

Slide 14 lays out our existing debt and hedge positions. Our debt is very straightforward, a $300 million undrawn revolver, plus a fully-funded $227 million 10-year secured non-recourse financing, on an initial portfolio—on our initial portfolio of assets.

As we move forward, we intend to develop a well-laddered, long-term financing model for our long-duration assets. Our interest rate hedging strategy seeks to provide us with short and medium-term protection from rising interest rates. In the long-run, we believe that our rental bumps will exceed inflation, and therefore, we focus on short/medium-term protection. Specifically, we have a policy of entering into 13-year hedges against any debt we incur, or expect to incur on any assets we acquire.

Lastly, as we mentioned on the IPO road show, as well as last quarter in the earnings call, we encourage shareholders to let us know if they would like any additional information in our disclosures as we have committed to providing best in class transparent disclosures to the market.

With that, I will turn it back to Jay.

Jay Sugarman:

Thanks, Geoff. I mentioned our education efforts to start the call, and it's worth spending a minute on how we are going to go about that.

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Education for us is on many fronts; on the deal front, it means making sure all owners and intermediaries involved in the sale of existing ground leases, know to make us one of their first calls. I think we've done a good job on this front. It means making sure all brokers in major markets know how ground leases can be used to create a highly efficient capital structure for their clients looking to finance their properties, or acquire new properties. We are well into this effort, and it means working with developers in the top markets to show them how ground leases can provide both attractive development capital, and be an attractive long-term component of their capital structure. Repeat business will be the reward for the effort we are putting in here.

Education also relates to the investment community; we believe SAFE's unique combination of safety of principle, growing income and yield, and sizable capital appreciation potential should be a perfect fit in both institutional and retail investor portfolios. We have continued our efforts to highlight what makes this investment class a new and natural part of investor's portfolios, and we will continue to work to expand our reach on this front.

Based on our own convictions, iStar, Geoff, and I purchased $25 million of SAFE's stock during the quarter, and will work to make sure others understand the compelling valuation of SAFE's shares as the business grows.

With that, let's go ahead and open it up for questions. Operator?

Operator:

Certainly. At this time, I'd like to inform everyone, in order to ask a question, please press star, then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Our first question comes from Rich Anderson with Mizuho Securities. Please go ahead, your line is open.

Richard Anderson:

Thanks, good morning. On the $25 million stock purchases you mentioned at the close there, that exhausts your allotment. Is there any discussion about expanding that further into the future?

Jay Sugarman:

Yes, we continue to look at ways to deploy capital at iStar, and certainly we think this is one of the most attractive investments out there, so that'll be a dialogue once we come out of blackout.

Richard Anderson:

Okay. Second question, in terms of the pipeline, I'm curious what your appetite is for distressed situations? Meaning, a property owner having some difficulty and uses a ground lease as a way to monetize and recover to some degree. Do you see that type of opportunity out there? If so, to what degree do you think it will be a part of the game plan going forward?

Jay Sugarman:

Well, I guess I'd start with where we are in the curve; they're not many high-quality assets in distress so it's not been a big part of the pipeline as we see it today. I think when you think about what we're trying to achieve, if we find good real estate and a bad capital structure, iStar is pretty good at figuring out how to solve those problems for borrowers. I'd start with the premise of good real estate, good sponsorship; bad capital structure is something that we could probably find a good solution for.

Richard Anderson:

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Okay, and as far as meeting your sort of growth hurdles for this year, would it be typical for deals get announced late in the year, as sellers sort of punt prior to year-end? Is that a typical way of the business transacting in a given year?

Jay Sugarman:

You know I think it is true in almost all parts of the market. This is our first year to have the full resources of the Company focused on ground leases. We'll see if that dynamic exists here as well. I would say the pipeline's pretty active, none of the players we're involved with seem to have a hard deadline of year-end, so I wouldn't say we're seeing a lot of people make that part of the conversation. But, it is a natural goal to get a lot deals in under the fiscal year for a lot of people, so we do expect to have some significant activity in these next two months.

Richard Anderson:

Great, and then on the escalators; Geoff, you mentioned 2.8 or showed 2.8 on your Slide 10 as sort of the average right now. We went in thinking 1.5% as a kind of long-term run-rate; are we short on that? Should we be thinking something greater or as percentage rent, sort of declines as a piece of the pie that maybe 1.5% is the—a reasonable number to be thinking about?

Geoffrey Jervis:

We see 1.5% to 2% as sort of the "sweet-spot" in the market, so I think our original IPO models had about 1.75% so we think that still is the long-term reality.

Richard Anderson:

Okay, and my last question is I see in the AFFO calculation, you have the $1.2 million sort of add-back, management fee, non-cash. My understanding was that there would be a zero management fee for the first year; can you just explain that to me? Why there's a cost there, even though its non-cash?

Geoffrey Jervis:

Absolutely, so you're absolutely right. That fee is waived for the first year. GAAP however, requires us to show it, and the adjustments are made in equity. It is non-cash, it will always be non-cash, and that when we do start to pay a management fee in the third quarter of next year, it'll be paid in stock as you recall. But between now and then, you'll see the entry, but there will be no cash, stock, or other expenses associated with it because the Manager has agreed to waive it for the first year of operations.

Richard Anderson:

Okay, so next quarter should we have—maybe, I just blanked out on that. Should we add that number in there, if we're calculating AFFO, sort of through the beginning part of next year?

Geoffrey Jervis:

There will be no management fee in AFFO for the first year. We'll back it out for the first year because it's waived.

Richard Anderson:

Right.

Geoffrey Jervis:

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There's no payment due to the Manager. After that, the payment will be made 100% in stock, and it will continue to be added back to AFFO.

Richard Anderson:

I guess, maybe take this offline but will that one—because the GAAP require you to show it today despite the fact that there was no payment? I just want to make sure we have the modeling right.

Geoffrey Jervis:

Correct.

Richard Anderson:

We should not—that number should be zero the next couple of quarters until you start getting paid in stock, is that right?

Geoffrey Jervis:

It'll be zero—yes, it will be zero in AFFO next year.

Richard Anderson:

Okay, that's all I need.

Jay Sugarman:

Rich, just to clarify, from the GAAP perspective; it will show up in the GAAP financials but it's trued up on the equity account, so it gets kind of refunded on the equity account.

Richard Anderson:

Understood, thanks for clarifying. Thank you very much.

Operator:

Our next question comes from Collin Mings from Raymond James. Please go ahead.

Collin Mings:

Hey, good morning.

Jay Sugarman:

Good morning.

Collin Mings:

To start, can you just maybe talk a little bit more about if you expect additional forward commitment transactions, as you look at the deals in your pipeline? Or, was this really a unique deal as far as the forward commitment aspect of it?

Jay Sugarman:

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Yes, it was a pretty unique one. The piece of land is actually part of a much larger master-planned community and so the infrastructure, some of the improvements; you can't really separate this project out from those until it's completed. The way we did it was to create a forward, iStar will continue to work with the developer on all the different parcels in the community to build the infrastructure, to do some of the commitments. We have guarantees from iStar on some of these completion items, and then when that's all settled and done, it makes a clean transaction for SAFE. I think that's a pretty unusual one, pretty unique one, I wouldn't expect to use that structure going-forward very often.

Wherever possible, we want SAFE to have the ground lease as soon as it's created, and we'll use the forward structure only in those circumstances where it makes it very difficult for them to do that. In this case, they just literally, physically couldn't deliver on the obligation needed.

Collin Mings:

Okay, and then, especially given the goal of doubling the initial portfolio by year-end, can you maybe just give us a little bit more color on the composition of that bucket that you're under active negotiations on? That $278 million? Appreciate all the detail about the overall pipeline, but just maybe a little bit more color on this specific, what appears to be near-term opportunities? Is it a lot of smaller deals? Is there one large deal that's making up that $278 million? What are the cap rate ranges? Just additional color there would be helpful.

Jay Sugarman:

Yes, look I think we're trying to give as much transparency as we can. I think your question is, it's multiple deals, in fact there's a lot of small deals and some we're trying to aggregate into portfolios as opposed to just doing them one-off. They could combine, be a reasonably large deal, but no, it's not one deal. It's a bunch of deals, and then of course, we're always pursuing some relatively large transactions but the composition of that active negotiation pile is relatively diversified.

Collin Mings:

Then, in terms of pricing, should we think again, maybe something consistent with somewhere in the mid-3's to mid-5's? Something like that?

Jay Sugarman:

Yes. Look, I think we've shown a grid, depending on where coverage is, and depending on quality of the geographic location. We think the highest quality stuff is going to be in that 3.5 to 4 range. We think the—slightly less quality markets, probably deserve a 50 basis points premium so you'll see that 4 to 4.5 maybe. Then, if it's got a development aspect, or particularly complicated structure, we're going to be in the higher ranges, so that's how we kind of break it down.

I think for the majority of the stuff we see in the multifamily and office, good markets, certainly that 3.5 to 4.5 range is going to cover the vast majority of the deals we're going to look at.

Collin Mings:

Okay, that's helpful. One last one for me and I'll turn it over. Beyond the formal pipeline, are you seeing or making any progress towards any sort of larger deals or opportunities where it would make sense to involve GIC?

Jay Sugarman:

We have, we have had that dialogue. I think the—those are the deals I think the lead times have proven to be quite long. What I can say is we've not lost any deals where we've bid on a ground lease so it's

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more the deals that we're creating from scratch, have a lot of moving parts, and particularly when they're quite large they're going to take time to get done. That's where we'll bring the sovereign wealth partner into the equation, to give ourselves the most flexibility to design what our customer or our property owner needs and we think they're going to be a great partner for that.

Collin Mings:

Okay, I appreciate the color. I'll turn it over, thanks.

Operator:

Your next question comes from Anthony Paolone with JP Morgan. Please go ahead.

Anthony Paolone:

Thanks, good morning. Just want to start following up on Rich's G&A questions. Was under the understanding that just putting aside the management fee that kicks in next year; just your G&A for now, is going to run about $900,000 a quarter, or thereabouts. What is that number currently running or what is it going to be?

Geoffrey Jervis:

G&A exclusive of the management fee? Is that what you're asking?

Anthony Paolone:

Yes.

Geoffrey Jervis:

G&A this quarter, exclusive of the management fee, was around $700,000, $700,000 to $800,000. I think that we're in the range.

Anthony Paolone:

Is that like a cash number or a GAAP number? Is there any difference there for that piece of it?

Geoffrey Jervis:

Only $350,000 of that is cash, so that's the accrual of the accounting fees, legal fees, corporate insurance, all of our—the costs associated with being a public company, stock exchange fees, etc. Some of those are paid in a single period and amortized over the entire year, which is why there's a disconnect between cash and GAAP.

Anthony Paolone:

Okay and would you actually add back the non-cash piece of that, even though it's just an accrual timing matter for AFFO?

Geoffrey Jervis:

No.

Anthony Paolone:

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Okay.

Geoffrey Jervis:

Really the big thing, the big adjustment in AFFO is straight-line.

Anthony Paolone:

Right, and so on a go-forward basis, this $700,000 to $800,000 has that been a trend up to what the thinking was around the IPO, closer to $900,000 thereabouts or is it going to be at a lower level?

Geoffrey Jervis:

I don't think we've changed our expectation from IPO.

Anthony Paolone:

Okay, and then in terms of just to understand this GAAP accounting and the add-back and what you intend to do going forward. The add-back, is it going to—is it just going to be the non-cash accounting stuff that is going to be added back for AFFO? Or, if you just pay that bill with stock, you're going to add that back as well? Is there a difference there?

Geoffrey Jervis:

You're right, there will be—looking at the major components, obviously, depreciation, amortization is coming out of FFO and then, in the AFFO line it's straight-line but the other major item will be the management fee because the management fee will be paid in stock and therefore, it's not a cash expense so right now, we're not charging a management fee. But GAAP requires us to show one. Going-forward, we will charge a management fee, GAAP will require us to show the management fee, but because it's paid in cash, it will not—in stock, it will not show up in AFFO. It'll be an add-back to AFFO.

Anthony Paolone:

Okay. All right, understand then. In the fourth quarter, I understand it's the sort of implicit volume guidance for deals, (inaudible) double the initial portfolio of $340 million. Does that include the $34 million forward in that thinking?

Jay Sugarman:

Look, I think the team worked really hard on that deal. We certainly included it as part of the pipeline that is closed, it's a $30-plus million deal so it's not really going to change our calculus. We want to get to around $700 million of assets invested by the end of the year. We certainly have a pipeline that suggests we're going to get there, whether it all gets there in December or January, I'm a little less worried about. What we're happy about right now is it looks like the pipeline is growing every day, as the team goes out there and penetrates these markets, meets with brokers, meets with owners.

We're trying to change the paradigm a little so it's taking a long time to get all these pieces moving in the same direction. But, we do feel very strongly that what we've seen so far suggests there's a big opportunity here, and putting on an additional $150 million to $200 million of assets over the next couple of months, certainly is well within reason. If it slips by a month, so be it, but what we're seeing suggests we can certainly double this portfolio and then focus on doubling it again.

Anthony Paolone:

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Got it, just thinking through the math, trying to understand whether it hits in December or January or whatever, it seems like about $150 million you think of the pipeline is kind of where you're getting pretty close?

Jay Sugarman:

Yes.

Anthony Paolone:

Okay and then, you may have touched on this, I could have missed it. But you had some deals around the time of the IPO that were kicking around, are those still in the pipeline? Or, did those drop out, (inaudible), and a couple of other things in the mix, some retail?

Jay Sugarman:

Yes, some of those are still kicking around, and we've actually made quite a bit of progress on them. But one deal that I think we called out was underneath an Apple campus in Sunnyvale, and it looks like a neighboring strategic is likely going to be the acquirer, which means we won't have a ground lease opportunity underneath that one. But, the deals that we have been pursuing, for the most part, are still active. We've probably backed off a little bit on the retail pieces just because of what we've seen in the market environment, just couldn't get comfortable with, but overall, we're still seeing traction on most of the stuff we started down the road on.

Anthony Paolone:

Okay, and then in terms of the competitive landscape, it seems like the debt markets for commercial real estate have opened up in the last few months. Have you seen that as increased competition for this product?

Jay Sugarman:

Interesting question; I mean, the one thing I would say is, as we develop and educate the market, we're also doing the same on the leasehold financing side. I think there are big opportunities to work within the existing financing world, to help people understand why one-plus-one can be better than two for all parties involved and that includes the ground lease owner, the leasehold lender, and the property owner. The market has become a little more fluid in terms of thinking about risk and reward, that's good for us. At the same time, if the market gets too heated, yes, you're right, it could impact the number situation where we are the best, most highly efficient provider of capital. I haven't seen that be a driving dynamic just yet, but obviously, we're watching it closely. I don't think a couple of basis points here or there really changes the calculus.

Anthony Paolone:

Okay, and then just a last question on the forward; how do you think about what, if any, premium the cap rate reflects for doing a forward versus maybe a spot deal? I think it's the 3.75 like you said; any translation there as to if you were able to put the money out today?

Jay Sugarman:

Yes, we actually look at the forward curve, and try to equilibrate owning it three-year from now versus owning it today. We do put a forward hedge in place on those forwards so that we know what the base rate for the financing that we will put in place three-years from now will be. We're really looking at the spread based on today's marketplace and then adding the forward curve premium that we're going to have to incur to put on a three-year forward, ten-year financing hedge. That's the science behind the delta

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of picking what it's worth today, obviously, it takes into account the market, the product type, we think that Northern California multifamily cap rates on the equity are in the low-4's range, up to around 5, so we think a 3.75 cap rate's quite attractive.

Anthony Paolone:

Okay, got it. Thank you.

Operator:

Your next question comes from Dan Donlan from Ladenburg Thalmann. Please go ahead.

Daniel Donlan:

Yes, most of the questions have been answered. Was just curious though, the composition of the pipeline, it looks like the transactions that you're originating looks kind of the 80% of the pipeline from the 60% range. Was just kind of curious if that's kind of an area you think it's going to stay at? Is that going to oscillate up and down, depending upon the pipeline? Just curious in general, the Alpharetta (phon) deal you've done, the Hollywood deal; Alpharetta, it seems like there is a change in the assets composition and the Hollywood deal, it's still being developed. Is that kind of when you guys have—is that the "sweet spot" for you guys when you do originate these deals? Is it kind of in and around development and/or redevelopment?

Jay Sugarman:

Yes, I think as I said in the beginning, the two main vectors here are buy something that exists. That market is unpredictable. We saw the Hollywood deal, we jumped on it, we've had a couple of other things come to market that actually just haven't traded, for whatever reason, so we can't really control that flow. But it will almost certainly be sporadic, there's not 10 of these coming to market every quarter, so on that one, we'll just take them as they come.

On the create side, any time there's a transaction, we can put our foot in the door. That can be a sale of a property, it can be a financing of a property, it can be buying a partner out, it can be trying to access capital on a long-term, fixed rate basis, as opposed to taking on floater. It can happen when there's new development or repositioning, so transactions are a critical entry point for us because we can put something creative and perhaps better on the table, when a borrower/customer/owner/developer is just in the process of trying to figure out what is the right strategy. Once we know what their real business plan is, we're pretty good at crafting some sort of custom-tailored set of variables that work for them.

Yes, you're going to see us work in those places where transactions are taking place. That can be an existing property, or it can be a development repositioned property, but it's that moment of truth where we can walk in and compare apples-to-apples, what we think ground leases can do for them versus their other alternatives. In more and more cases, we think the ground lease combination with a leasehold financing is the better structure for folks, and the more opportunities we get to tell that story, we think the more that message is going to get out there.

Daniel Donlan:

Okay, and then, you talked a little bit about education. What is do you think the biggest hurdle or maybe the largest misconception that you found that potential sellers or people that are maybe looking to originate these things, have that you think they just can't seem to get past?

Jay Sugarman:

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Okay. Look, it's a range of things. But, if I had to just give you a quick summary, I'd say people in the real estate business all have a horror story, from 30-years ago about a ground lease that didn't work out right. We've tried to be really clear that ground leases that are inappropriately structured, ground leases that represent too big a piece of the capital structure, ground leases that are not thought of as long-term components of the capital structure but are used for the wrong reasons, that's not what we do at SAFE.

That's not how you create a giant business and change the paradigm, so we have to show that whatever, 20-years, 30-years, 15-years ago, created this negative impression has nothing really to do with what we're talking about. There are lots of "ground leases" that we don't really consider anywhere close to what we're doing, they're either too high in the capital structure, they have provisions in them that really don't work for the owner/operators or the leasehold lenders, and you just have to strip all of that baggage away and say, well, let's look at what we're really talking about. Then, you start to get into get a much more interesting conversation because people do see the validity, they do see the benefits, they do see why it can create real value for them as owners and operators and developers. But, you have to get past that first step of "oh, I had a friend" or "I knew somebody who had one and it didn't work out".

Daniel Donlan:

Okay, thanks. That's very, very helpful, appreciate it.

Operator:

Your next question comes from Joshua Dennerlein from Bank of America Merrill Lynch. Please go ahead.

Joshua Dennerlein:

Good morning, guys. Most of my questions have been answered, just curious on the old note and Parkway acquisition; it was a cap rate of 5.5 (inaudible) in year two. It seems high just given kind of the framework you laid out. Anything special on that deal that got the cap rate higher than was expected given the (inaudible)?

Jay Sugarman:

Yes. Look, a big part of our business has always been repeat customers and this is somebody who was very comfortable that we could move at the speed and certainty they needed. We had documents off-the-shelf because we had done a prior transaction. I think they see an opportunity to do more deals with us, so there wasn't a lot of quibbling about the specific terms, the borrower expects to make a lot of money here. We provided a capital solution for them that allows them to move forward on the timeframe necessary to have all these leases be—stay in place, so it's kind of a perfect example of—what we try to do is create win-win solutions for our customers, meet their business needs. We're not talking about who can provide the last basis points savings; we're trying to help them earn very significant returns on their capital. We can charge a little bit of a premium there, if we do our jobs well.

Joshua Dennerlein:

Okay, thanks.

Operator:

Mr. Fooks, we have no further questions.

Jason Fooks:

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Thank you and thanks everyone for joining us this morning. If you should have any additional questions on today's earnings release, please feel free to contact me directly. Would you please give the conference call replay instructions once again? Thank you.

Operator:

Certainly, if you would like to listen to the replay, please dial (855) 859-2056 or (404) 537-3406, and reference conference ID# 93767388. The replay will be available at 1:00 p.m. You may now disconnect.

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