

Office Space

How Leo Wells Built Vast Empire Of Towers on Unusual Foundation

His 'Nonlisted REIT' Has Fees Of 14% and Is Hard to Sell; Elderly Like 'Stable' Value Answering a 'Higher Calling'

By DEAN STARKMAN

NORCROSS, Ga.—Leo Wells peppers his talks with learned biblical references and elaborate metaphors about mules plowing rows or men being chased by bears. But he built his fortune on a simple proposition: Middle-class and elderly Americans deserve a safe, 7% annual return on real-estate securities that sell for a price—\$10 each—that doesn't change.

Between 2001 and 2003, more than 100,000 investors got the message, paying \$4.4 billion for shares in Mr. Wells's biggest investment vehicle, Wells Real Estate Investment Trust Inc. By comparison, mutual funds that invest in mainstream publicly traded REITs netted only about \$8.04 billion during the REIT runup of the same period.

Starting from humble beginnings as an Atlanta real-estate broker, Mr. Wells, 60 years old, has quietly built one of the nation's five largest office companies in terms of square footage. Its trophy properties include Chicago's Aon Center, Nestle USA's tube-shaped headquarters in Glendale, Calif., and Philadelphia's soaring 1901 Market Street.

Mr. Wells has skillfully ridden the wave of investor interest in real estate that began in late 2000, when stocks and bonds began to tumble. Most investors placed their bets through public REITs, the stock-market-listed funds that buy up commercial property and pay out 90% of their taxable income through dividends. While share prices in public REITs rise and fall, investors generally can get in and out of the stocks whenever they wish.

Despite a similar-sounding name, Mr. Wells's empire is built on a very different foundation. Called a nonlisted REIT, Mr. Wells's fund also buys up commercial property and pays a dividend based on income from that property. The Wells REIT's articles of incorporation state that it must list on a major stock exchange by 2008, or begin to liquidate and repay investors their initial capital—and perhaps a bonus based on appreciation of the underlying properties.

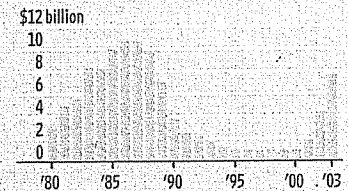
Shares in the Wells REIT aren't traded on any major exchange—so their



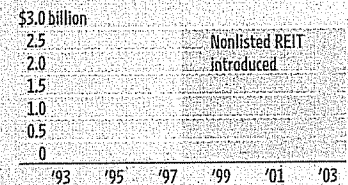
Leo Wells

Buy and Hold

Sales of nontraded real-estate securities, including old-style limited partnerships and new "nonlisted REITs"



Sales of Wells funds, including limited partnerships and first nonlisted REIT



Source: Robert A. Stanger & Co.

value is difficult to determine. Investors pay a total of 14% in commissions and other fees, which effectively dilutes their capital. The REIT's management structure allows other Wells companies to pocket millions of dollars in management and other fees. And despite the goal of listing in 2008, the company could simply begin to liquidate its assets, a process that could take years depending on market conditions. In fact, Mr. Wells has never fully repaid investors in any of his funds over the last 20 years.

Most large brokerage firms—including American Express Co. and Merrill Lynch & Co.—won't handle Wells, despite the hefty commissions. Mutual funds that invest in REITs don't buy Wells or other nonlisted REITs, saying their high fees and illiquidity make them a poor choice for investors. "We don't bother with those," says Steven R. Brown, portfolio manager for Lehman Brothers Inc.'s Neuberger Berman Real Estate Fund. "There's really no way to make those numbers work."

Wells executives argue that the company and other nonlisted REITs provide investors with the income and portfolio diversification of real estate without the gyrations of a public REIT stock. Mr. Wells says elderly investors aren't interested in selling shares and have suffered as interest-rate cuts trimmed returns from savings accounts and bonds. "It just destroyed those people," he says.

Fueled by an army of financial planners who sell the products in living rooms and seminars across the country, the nonlisted REIT business is booming. Investors poured more than \$15 billion into a half-dozen nonlisted REITs from 2001 through May, according to Robert A. Stanger & Co., a Shrewsbury, N.J., re-

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search firm. In the past two years, major closely held companies, including Inland Real Estate Group, CNL Financial Group Inc. and Hines Interests L.P., have all rushed to launch private REITs.

Just this week, nonlisted REITs suffered a black eye when CNL abruptly postponed a plan to float a nonlisted hotel-owning REIT, CNL Hotels & Resorts Inc., on the New York Stock Exchange. CNL cited unfavorable "market conditions." Institutional investors balked at the \$19 to \$21 per share initial offering price and would only pay about \$12, according to John Arabia, an analyst at Green Street Advisors Inc., Newport Beach, Calif. CNL had sold the shares in the nonlisted REIT at a split-adjusted fixed price of \$20 to small investors in recent years.

The news points up a big drawback of the nonlisted REITs: Investors who want to sell their shares are often stuck. Mr. Wells's REIT, for instance, buys back 3% of outstanding shares a year on a first-come, first-served basis. The stock has careened around various secondary markets, trading at \$5, \$10.25 and \$8.43 in May and June, the latest data available. At a gathering last year of real-estate executives at a posh private club in New York, Michael Fascitelli, president of Vornado Realty Trust, a giant public REIT, teased Mr. Wells on his stock's illiquidity, comparing it to a "roach motel."

"You can check in, but you can't check out," Mr. Fascitelli joked to raucous laughter, according to a person who was there. Through a spokeswoman, Mr. Fascitelli declined to comment.

Mr. Wells, who was there, brushes off such remarks. "Obviously, he knows more about roach motels than I do, but among non-traded public REITs, Wells has the most investor-friendly redemption policy," he says. He adds that more than two-thirds of Wells investors continue to express confidence in the REIT by reinvesting their dividends each quarter.

Wells officials say shareholder value is protected by top-quality office buildings—geographically dispersed for safety—and leased at an industry-leading 97% occupancy. What's more, they say, the company's low debt levels—about 18% of assets, compared with about 45% for public office REITs—protect against crashes and will keep dividends competitive.

By their nature, Mr. Wells explains, nonlisted REITs are for long-term investors

only. His company fully discloses its risks in bold-face type on the front page of its prospectus, he points out, adding: "We didn't even wait until they flipped the page."

The Wells operation has suffered a few recent setbacks. Last September, the National Association of Securities Dealers suspended Mr. Wells from the organization's broker-dealer arm for a year for far exceeding the value of noncash perks brokers are allowed to dish out to financial planners. The regulator alleged that the Wells organization spent \$425,000 for a 2002 conference in Amelia Island, Fla., that included a "beach bash" and dinner in a Civil War-era fort with fireworks, sky divers, a fife-and-drum corps and actors parading in Civil War dress.

In late 2002, Wells cut the dividend of Wells REIT I to 7% from 7.75%. And when Wells launched a second REIT, Wells REIT II, at a more sustainable 2.5% dividend, sales were slow until the company raised the payout to 5%. The rate is now 6%. Wells officials say the dividends of both of its REITs are based on the financial performance of the funds, not marketing concerns.

In an interview at his office on the company's leafy campus in Norcross, an Atlanta suburb, Mr. Wells peered over wire-rimmed glasses, straightforwardly affirming his belief in prayer as an important part of the company's business practice. He compared his firm's role in investors' lives to that of the patriarch Joseph, who, the Bible says, served as steward to Potiphar, an official in Pharaonic Egypt. "His job was to run things," Mr. Wells says of Joseph. "It really is a higher calling."

Any structural problems in the way his funds are set up are beside the point, he says. Normal corporate structures didn't help investors in Enron Corp. or WorldCom Inc. He compares the different structures to differently shaped bottles, one filled with water, the other with poison. "It's not the bottle that kills you," he says. "It's the contents."

Some investors like Wells just fine. "It has good diversification, a good return," says Ira Miller, 58, of Henderson, Nev., a retired corporate controller who put 5% of his retirement savings in Wells REIT shares in 2001. "I have a hope of some pop when it goes public."

Mr. Wells himself has done very well with the private REIT and associated companies. He is the sole owner of Wells Capital, which Wells REIT paid \$122.1 million last year for asset management, ad-

visory and other services. And he is sole owner of Wells Investment Securities, a brokerage firm, which netted \$32 million from the Wells REIT last year. Wells executives say the expenses fund the 600-employee Wells organization that operates the REIT.

A native of Valdosta, Ga., and the son of an air-traffic controller, Mr. Wells started as a real-estate broker in Atlanta in the 1970s before going into the real-estate syndication business—an early attempt to pool investor funds to finance real-estate projects through limited partnerships.

Wells enjoyed modest success; his biggest fund raised around \$35 million. But he built a loyal following among financial planners and broker-dealers, who responded to the company's overtly religious, family-oriented ethos.

Joe Sgroi, a Buffalo, N.Y., planner and Wells booster, puts it this way: "If you're screwing around on your wife, you're not going to get much else right either."

In the late 1980s, a change in tax laws and tumbling commercial real-estate values all but wiped out the syndication business. Millions of investors were left holding virtually worthless "units" in limited partnerships.

Mr. Wells's funds survived the collapse of the syndication business, mostly because they didn't borrow much and avoided the foreclosures that wiped out most syndication deals. While many of Mr. Wells's limited partnerships still pay dividends to investors, not one has made good on their stated goal of liquidating assets and returning principal to investors.

Robert Beneda, a 64-year-old retired engineer in Stone Mountain, Ga., invested in a 1984 Wells limited partnership fund. The fund, Wells Real Estate Fund I-B, has suspended its dividend; its units, which originally sold for \$250, traded at \$105 as of May 30, according to Direct Investments Spectrum, a Dallas-based newsletter. Mr. Beneda says he asked Mr. Wells at an investor presentation several years ago when principal would be returned. "He gave me this thing about 'the corn not being ready to harvest,' or something," Mr. Beneda says.

A Wells spokesman says the company has begun returning principal to investors in early limited-partnership funds, though it doesn't yet know if all original principal will be returned. Wells executives also say that the Wells REIT I is committed to its goal of listing or liquidating by 2008 and has already hired an investment-banking firm to study the matter.

Mr. Wells launched his REIT in 1998. He says the REIT is a different vehicle entirely because it is governed by a board of directors with a majority of independent members, unlike limited partnerships, which are controlled entirely by the general partner.

The REIT took off in 2001, when public REITs began a four-year bull run after the broader stock market and interest rates both tumbled.

Wells and other nonlisted REITs are sold through a network of hundreds of independent broker-dealers that contract with or employ thousands of financial planners. Among them, they split sales commissions of up to 9.5%. The rest of the 14% in upfront fees, or load, as they are known in the industry, goes to Wells-controlled entities for advisory and other services.

According to a Wells newsletter distributed to planners, the top broker-dealers for the month of January were Securities America Inc., Omaha, Neb.; Next Financial Group Inc., Houston; and Cadaret, Grant & Co., Syracuse, N.Y. The leading financial planner seller for the month, Loren Trenholm, of Waikiki, Hawaii, sold \$605,000 of Wells products that month. Mr. Trenholm didn't return telephone calls.

Some financial planners strongly de-

fend nonlisted REITs and Wells in particular for its low leverage, geographic diversity and high-credit tenants. The fixed share price, they say, gives investors peace of mind and is no different from the price of a home, whose precise value is unknown until it is sold. "There's no kid walking around with a sandwich board saying, 'the price of your house just went down 5%,'" says Troy Smith, a Durham, N.C., planner who recommends Wells.

Some planners refuse to sell Wells or any nonlisted REIT because of the fees and illiquidity. Indeed, one of two main financial-planning trade groups says its members mostly shun Wells and other nonlisted REITs. "What does it have? Incredibly high operating costs; lack of liquidity; and what disclosure exists makes me uncomfortable," says Gary H. Schatsky, president of the National Association of Personal Financial Advisors, an Arlington Heights, Ill., trade group of about 1,000 planners, known as fee-only planners because they don't accept commissions. "It doesn't make a lot of sense."

It's not clear that Wells shareholders always understand the fine print. Ron Mertz, a 64-year-old retired oil-company executive in Seven Lakes West, N.C., put about 12% of his retirement savings into Wells REIT in 2000. He was fuzzy on how long he must wait to get his money back after he decides to cash in. "I think it's 30 or 60 days," he says. In fact, because the Wells redemption limit of 3% of shares has already been hit for this year, he must wait until next year before he can attempt to get his money back.

The Wells REIT's massive growth since 2001 took even Mr. Wells by surprise, ballooning his closely held companies to more than 600 employees, from fewer than 200 in 2001. A heady atmosphere took hold at headquarters as sales poured in, say people familiar with the Wells organization. With employee bonuses tied to share sales, an office ritual developed around using a company intranet site to calculate how a day's sales boosted individual bonuses.

But the rush to add employees also brought problems. Earlier this year, for instance, a candidate for an executive-level job sued the Wells organization, alleging that during job interviews Wells executives pressed for information about his "spiritual background" and made "very direct inquiries" about his religious practices. In the suit, pending in Atlanta federal court, L. James Richards, a Minnesota resident, alleges that his response—that he and his wife had been raised Baptists but had stopped attending church—cost him the job.

Mr. Wells, in an interview, denies the allegations in the suit and says the company hires people of all faiths.

Critics and rivals were handed ammunition last fall, when the NASD sanctioned Mr. Wells and his organization for providing improper perks for financial planners. The "beach bash" and Civil War-themed weekend cost \$933 per person, far in excess of NASD limits of \$100 a year for non-cash compensation to financial planners. The Wells organization, which didn't admit or deny the allegations, says its conferences now comply with all NASD rules.

Sales of the new REIT launched earlier this year, Wells REIT II, initially lagged behind rivals. But after addressing concerns from broker dealers and planners about service problems dealing with paperwork, the fund has started to do better, Wells officials say. The new fund, which has also raised its dividend, carries an ambitious goal: raising \$7.7 billion.

Mr. Wells says setting audacious goals has been a key to the company's success. "We need a goal that everybody knew that without God's help we couldn't accomplish it," he says.

CORRECTIONS & AMPLIFICATIONS

Readers can alert THE WALL STREET JOURNAL to any errors in news articles by e-mailing wsjcontact@wsj.com or by calling 888-410-2067

THE MILITARY POLICE Company featured in a page-one article yesterday was the 211th Military Police Company of the North Carolina National Guard. A headline in some editions yesterday incorrectly referred to the unit as the 110th.

THE ELECTRICITY PRICES in a Tuesday article and accompanying chart about Italian utility Enel SpA were in megawatt hours. The article and chart incorrectly referred to the measurements as being in kilowatt hours in some editions.

MICROSOFT Corp.'s Redmond, Wash., campus is located partially in U.S. Rep. Jay Inslee's district and partially in the Eighth Congressional District, whose representative is Jennifer Dunn. An item in last Thursday's Digits column said that Mr. Inslee's district includes the company's headquarters.

THE AMERICAN ACADEMY of Pediatric Dentistry seal appeared on promotional material for Dannon fluoridated wa-

ter, which is distributed by Coca-Cola Co. in the U.S. A July 20 Marketplace article incorrectly identified the brand of water as Dasani, which is owned by Coca-Cola. The article also included a statement from a March 2003 memo to members of the AAPD from Paul A. Reggiardo, who was president-elect at that time and is now a past president. The article incorrectly implied that he is still president-elect.

T-MOBILE and Danger Inc. plan to charge an unspecified amount for a new synchronization program that can be used with the Sidekick II smart phone. Yesterday's Mossberg Solution column in Personal Journal incorrectly said the program would be free.

TEMASEK HOLDINGS PTE. Ltd. offered to pay \$1.6 billion for the portion of Neptune Orient Lines Ltd. that it doesn't already own. A headline in some editions yesterday incorrectly said Temasek had bid \$2.35 billion for the rest of Neptune. The \$2.35 billion is the implied value of the whole company based on Temasek's bid.