FINAL TRANSCRIPT

Q1 2016 Office REIT Investor Call

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SPEAKERS

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Brady Welch
Chief Financial Officer & Trustee

Blair Welch
Chief Executive Officer

ANALYSTS

Troy Maclean
BMO Capital Markets

Dawoon Chung
National Bank Financial

Jonathan Kelcher
TD Securities

Rob Sutherland
Echelon Wealth Partners

Operator

Good morning. My name is Lindsay and I will be your conference operator today. At this time I would like to welcome everyone to the Slate Office REIT's First Quarter 2016 Financial Results Conference Call.

All lines have been placed on mute to prevent any background noise. After the speakers remarks there will be a question and answer session. If you would like to ask a question during this time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question, please press the pound key.

Thank you. Mr. Conor McBroom, you may begin your conference.

Conor McBroom, Vice President, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the first quarter 2016 conference call for Slate Office REIT. I'm joined today by Scott Antoniak, CEO, and Robert Armstrong, CFO.

Before getting started, I'd like to remind participants that our discussion today may contain forward-looking statements and therefore ask you to familiarize yourself with the disclaimers regarding forward-looking statements as well as non-IFRS financial statements, both of which can be found in management's discussion and analysis. You can visit Slate's website to access all of the REIT's financial disclosure, including our May 2016 investor update, which will be available shortly after today's call.

We're going to devote most of our time to answering questions, first though Robert will provide a financial update and afterwards Scott will touch upon recent business developments and our strategy moving forward.

At this time I'll turn the call over to Robert.

Robert Armstrong, Chief Financial Officer

Thanks, Conor.

First I would like to comment that Scott, myself, and the rest of the team are very pleased with our quarterly results.

2015 was a year of growth and transition to a pure-play office REIT. Accordingly, the first quarter of 2016 was the first full quarter after having achieved that vision. On that premise, same property NOI excluding the REIT's hotel asset, which has seasonal NOI contributions, was up 0.7 percent compared to the fourth quarter of 2015. This increase is primarily from increased rents and expense reimbursement offset by slightly lower occupancy. Overall, NOI was down $0.6 million as a result of the loss of contribution from the retail and industrial assets we sold in the fourth quarter of 2015 offset by the previously announced 20 percent ownership increases in our Places assets in St. John's Newfoundland.

The REIT's core FFO per unit in the first quarter was $0.25, up one penny from the fourth quarter. As a reminder, core FFO adjusts REALpac's definition of FFO to include the lease payments we received from our data centre investment, which is accounted for as a finance lease. On a total basis, core FFO was $8.7 million compared to $8.5 million in the fourth quarter of 2015. This increase is attributable to interest savings offset by a reduction in earnings from the properties we disposed of in Q4 2016. Adjusted FFO in the first quarter was $7.3 million or $0.21 per unit. This is comparable on a per-unit basis to Q4 and Q1 of 2015.

Touching on the REIT's distribution ratio, a key focus of management, we are pleased to report that the AFFO payout ratio in the first quarter was 90.3 percent. this result is 60 basis points above the payout ratio in Q4 2015 but, more importantly, is substantially below the payout ratio of one year ago, which was in excess of 110 percent. De-risking the portfolio and insuring the stability of unitholders distribution continues to be a top priority and we are maintaining a long-term AFFO payout ratio target in the mid-80 percent range.

We're also pleased to announce that subsequent to the end of the first quarter we have agreed with our lender to renew $144 million of mortgages secured by 12 of the REIT's properties. This debt was originally scheduled to expire in January of 2017 but has now been extended for an additional five years to 2021 on favourable terms. In conjunction to this refinancing and this debt structure enhancement, we've also worked with our lender to secure up to $24 million of additional financing to be deployed in connection with our Sheridan Park redevelopment initiative here in the GTA.

With that, I'll turn the call over to Scott.

Scott Antoniak, Chief Executive Officer

Thanks, Robert.

As Robert indicated, we are very pleased with the results that we achieved in the first quarter and remain extremely excited about the opportunities for internal and external growth that lie ahead. I'll speak briefly today about some of the competitive advantages we're working to cultivate in our portfolio before opening the line to your questions.

We spent the vast majority of last year assembling a leading portfolio with diversified high quality Canadian office properties. With this transformation largely in place we're now turning our focus to operations and driving net asset value across the portfolio. The portfolio that we have assembled has two key characteristics that we believe are essential to value creation.

First, we acquired and now own the assets at a cost base that is materially below replacement cost. This allows us to invest in our properties where warranted and where the additional capital will drive enhanced returns. It also provides for a competitive advantage on the leasing side where the low cost base allows us flexibility in our dealings with new and renewal tenants.

Second, on somewhat related, on average in-place rents in the portfolio are significantly below market. This provides for a readily accessible pipeline for internal or organic growth across the portfolio. In fact, we estimate that in-place rents across the portfolio are approximately 6 percent to 7 percent below market.

As I outlined in the unit holder letter, we're very pleased with the REIT's operational results in the first quarter, beginning with our leasing program, which continued its strong momentum from last year. In the first quarter we completed over 200,000 square feet of leasing, including the five-year renewal of the Minacs Group in Oshawa at 100,000 square feet, one of the portfolio's largest tenants. Of the 15 percent of leasable area originally scheduled to mature in 2016, the team has proactively renewed over 460,000 square feet to date, effectively reducing our remaining 2016 maturities to 4.6 percent of the portfolio. In so doing we've dramatically reduced leasing exposure for the balance of the year and can increasingly turn our attention to expiries in 2017 and beyond as well as lease-up opportunities within the portfolio.

I also want to congratulate the entire asset management team for successfully winning Office Lease of the Year at the recent REX Awards for excellence in Canadian commercial real estate. This accolade was in connection with the previously announced deal with SNC-Lavalin Nuclear, under which Slate Office has partnered with SNC to revitalize and re-imagine the tenant's global research and development headquarters at the Sheridan Park in Mississauga.

Shifting our discussion to external growth opportunities, we believe that the REIT is very well positioned to capitalize on the numerous acquisition opportunities across the country. Uncertainty in the energy sector and its impact on office markets in Calgary and Edmonton has owner of assets in these markets seeking liquidity elsewhere in their portfolios, creating opportunities for Slate Office REIT. Furthermore, the REIT has no exposure to these markets and our overall exposure to the energy sector remains below 3 percent. From this advantageous position we will continue to monitor opportunities for attractive entry into these markets and other opportunities that come about as a result of overall dislocation in the Canadian office market.

We thank you for calling in today and with that we'll open the line to your questions.

Q&A

QUESTION AND ANSWER SESSION

Operator

At this time, ladies and gentlemen, if you would like to ask a question please press star followed by the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster. And our first question comes from the line of Troy MacLean from BMO. Your line is open.

Troy MacLean, BMO Capital Markets

Good morning. On the refinancing that you completed, the early refinancing, was there any change in the interest rate?

Robert Armstrong, Chief Financial Officer

No, there was no change in interest rate. It's still 25 basis points over SEDAR (sp.).

Troy MacLean, BMO Capital Markets

Okay. And then, Scott, you mentioned the opportunities eventually presenting themselves; are you seeing much more listed for sale at like prices that you find attractive?

Scott Antoniak, Chief Executive Officer

Are you speaking specifically about Alberta, Troy, or just generally?

Troy MacLean, BMO Capital Markets

Just the market in general.

Scott Antoniak, Chief Executive Officer

Marketed and un-marketed, there's a number of opportunities. In some markets pricing is more in line with expectations, in others there's still a bit of a disconnect between where vendors and sellers are, but there's a fairly robust pipeline nationally. That's how I'd characterize it.

Troy MacLean, BMO Capital Markets

And then on the Nova Scotia renewal at the Maritime Centre, I think it was for two years and it was an early renewal. Why that length of term? Is there anything in particular with that lease that you have to add?

Scott Antoniak, Chief Executive Officer

It was just the standard government position that they took, in order to avoid an RFP process they did shorter duration deals, and it's consistent with what they've done historically.

Troy MacLean, BMO Capital Markets

Okay. So you'd expect to renew them—

Scott Antoniak, Chief Executive Officer

On a perpetual kind of two-year rolling basis would be the way we'd look at it, Troy.

Troy MacLean, BMO Capital Markets

Okay, perfect. And then just wondering if you have an occupancy target for the non-development portfolio where you kind of see the end of the year, the occupancy target for the end of the year.

Scott Antoniak, Chief Executive Officer

Consistent with what we said last quarter, we're just a shade under 90 right now. We'd like to move a percentage point or two into the low 90s overall for the year.

Troy MacLean, BMO Capital Markets

Okay. Thank you. I'll turn it back.

Operator

Our next question comes from the line of Dawoon Chung from National Bank. Your line is now open.

Dawoon Chung, National Bank Financial

Thank you, guys, and good morning. With regards to the, um, just to follow up on Troy's question with regards to the mortgage renewal, was there any up financing portion to it?

Robert Armstrong, Chief Financial Officer

Yes, there was a piece for $25 million where we can draw on that amount as we rolled out our Sheridan Park redevelopment. So we'd expect to draw that over the next 18 months or so.

Dawoon Chung, National Bank Financial

Right, but excluding the Sheridan portion do you have an additional portion?

Robert Armstrong, Chief Financial Officer

No. Just the Sheridan portion was the only additional.

Dawoon Chung, National Bank Financial

Okay, great. With regards to your renewal spread, which dipped slightly below zero, and obviously it's partly due to the large renewals with one of your biggest tenants. What's your sort of outlook for 2016 on the renewal spread?

Scott Antoniak, Chief Executive Officer

2016 would be reflective of the next five years, Dawoon. I think we're between 6 percent and 8 percent, so we'd be consistently there. It's worth noting if you took the Minacs piece out of the renewals that we did in Q1, that number is 11 percent, so that would be even a little bit higher than we had originally messaged. So it'll fluctuate in there.

And on the Minacs side, it was originally a sale leaseback, so we renewed them at market and you can estimate that there would have been probably $2 or $3 amortization in that original lease still just by the nature of it being a sale leaseback.

So, from that perspective, it's a little bit not apples to apples when you compare that one, but the rest of it, as I said, was over 10 percent.

Dawoon Chung, National Bank Financial

Great. Thank you. I'll turn it back.

Operator

Our next question comes from the line of Jonathan Kelcher from TD Securities. Your line is now open.

Jonathan Kelcher, TD Securities

Thanks. Good morning. Just to start off, just to clarify something for me, and I apologize if I should have got this, but the 460,000 square feet of leasing you've already done on the original 15 percent that's maturing this year, a good chunk of that was done prior to the beginning of this year, is that correct?

Scott Antoniak, Chief Executive Officer

That's the number kind of over time up to the end of Q1.

Jonathan Kelcher, TD Securities

Okay. So you still have the full 300,000 in your MD&A that you still have to do over the balance of this year. I think it's 300,000 square feet?

Scott Antoniak, Chief Executive Officer

No, it'd be less than, so it's about 250 that's left.

Robert Armstrong, Chief Financial Officer

And the remainder in 2016 at March 31st was 304 and then subsequent to the quarter end we've additionally leased, so the number is in the 200s.

Jonathan Kelcher, TD Securities

Okay. And just going along on that, what sort of renewal rate are you hoping to achieve on the balance of your leasing this year? And do you have any, are any of those leases larger tenants?

Scott Antoniak, Chief Executive Officer

We'd be consistent with that 6 percent to 8 percent guidance on the portfolio basis. This year is in addition to kind of 17 and beyond.

Jonathan Kelcher, TD Securities

No, I'm not talking about rates. I'm talking about actually renewing tenants.

Scott Antoniak, Chief Executive Officer

What's the probability?

Jonathan Kelcher, TD Securities

Yeah. Like do you know of any tenants that are leaving, that are not renewing?

Scott Antoniak, Chief Executive Officer

Yeah, we've got one large expiry at the end of kind of mid-Q4 this year, which is the 3M Group at Promontory.

Jonathan Kelcher, TD Securities

Okay. And the rest is smaller stuff that you should renew, say, 80 percent, 85 percent?

Scott Antoniak, Chief Executive Officer

I would hope at least that, yeah.

Robert Armstrong, Chief Financial Officer

Jon, just to clarify on the leasing question, at March 31st we had 304,000 square feet outstanding to lease for the remainder of 2016. We did renew the province, which was about 100,000, subsequent to the quarter, so that leaves about 200,000 for the rest of the year.

Jonathan Kelcher, TD Securities

Okay. And how big is the 3M lease that is not renewing?

Scott Antoniak, Chief Executive Officer

I think it's about 60,000 feet, 59,000, 60,000 feet.

Jonathan Kelcher, TD Securities

Okay. And then just you have two redevelopment properties in St. John so could you maybe give us a little bit of colour on where that market is right now?

Scott Antoniak, Chief Executive Officer

We've seen some positive activity in Q1. There's some new leasing in the market or at least RFPs at this point in the market from some smaller and a couple slightly more sizeable tenants. Working through the budget and what the government has had to say about it I, a lot of that was predicated on a more dire situation with respect to oil. A lot of that deficit math was done at oil at $37 a barrel for 2016. We're already about $10 higher than that so I think economically things aren't as troublesome as maybe the government had originally indicated.

Just on the leasing side, there is activity in there. It's not a high velocity market at any time really and we're encouraged by what we've seen with that. And specifically on the redevelopment assets, our view is that the longer term for Water Street and Fortis Building together, would be something to revitalize that given its tremendous location. And we look is as development (inaudible). For the near to mid-term future, two or three years, we'd expect that we could lease up those properties on a shorter-term basis and wait for when we get a further recovery in oil and more interest from some of those larger groups where we can get either a full size or a larger size tenant to start off the redevelopment process on that entire piece.

Jonathan Kelcher, TD Securities

Okay. Thanks and I'll turn it back.

Operator

Our next question comes from the line of Rob Sutherland from Echelon Wealth Partners. Your line is now open.

Rob Sutherland, Echelon Wealth Partners

Good morning, guys. Just kind of going back over the debt, just so I've got it clear, so the five-year same terms for the $144 million plus another $24 million that you're going to take, you're going to draw over the next 18 months. So is that going to be a line as opposed to just a single slug of mortgage you're going to be pulling down? Or is that...?

Robert Armstrong, Chief Financial Officer

Yeah, basically as we spend capital or continue to spend capital on the development we'll draw on it, at 50 percent.

Rob Sutherland, Echelon Wealth Partners

And it's the same term, same five-year term as well, so by the time it's fully drawn down you'll have two and a half, three years type of thing?

Robert Armstrong, Chief Financial Officer

Yes, that's correct.

Rob Sutherland, Echelon Wealth Partners

Okay. Perfect. That's all I needed to know. Thank you.

Operator

There are no further questions at this time. I'll turn the call over to Mr. McBroom for closing comments.

Conor McBroom, Vice President, Investor Relations

Thanks, operator. We appreciate everyone taking the time to call in today and we look forward to providing our next update in August. Have a good morning.

Operator

This concludes today's conference call. You may now disconnect.

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