CORPORATE PARTICIPANTS

Braden Lyons
Investor Relations

Steve Hodgson
Chief Executive Officer

Michael Sheehan
Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Jonathan Kelcher
TD Securities

Chris Couprie
CIBC World Markets

Matt Kornack
National Bank Financial

Jenny Ma
BMO Capital Markets

Brendon Abrams
Canaccord Genuity

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Slate Office REIT Second Quarter 2020 Financial Results Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. To ask a question during the session, you will need to press star one on your telephone.

Please be advised that today's conference is being recorded. If you require any further assistance, please press star zero.

I would now like to hand the conference over to your speaker today, Mr. Braden Lyons, Investor Relations. Thank you. Please go ahead, sir.

Braden Lyons, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the Q2 2020 conference call for Slate Office REIT. I am joined this morning by Steve Hodgson, Chief Executive Officer, and Michael Sheehan, Chief Financial Officer.

Before getting started, I would like to remind participants that our discussion today may contain forward-looking statements and therefore we ask you to review the disclaimers regarding forward-looking statements as well as non-IFRS financial measures, both of which can be found in management's discussion and analysis. You can visit Slate Office REIT's website to access all of the REIT's financial disclosure, including our Q2 2020 investor update, which is available now. I will now hand over the call to Steve Hodgson.

Steve Hodgson, Chief Executive Officer

Thank you, Braden, and thank you to everyone for joining the call this morning.

The COVID-19 pandemic has required us all to adapt to a substantial behavioural and cultural shift in the way we interact with one another. The experiment of working from home has been met with mixed reviews and many have concerns about the impacts it could have on company culture and employee engagement. For many companies, Slate included, culture is a key competitive advantage. Our view is that companies will not risk their ability to attract and retain the best people just to save money on office space.

The REIT collected 96% to 97% of rent in cash within each month of the second quarter and we expect to substantially collect the residual rent through short-term deferral agreements. Our industry-leading rent collections are a function of both the quality of our tenant base and the strength of our team. Approximately 61% of our income is generated from government and credit-rated tenancies with limited concentration to non-essential retail and the energy sector.

Now a few comments on the second quarter: The REIT completed over 100,000 square feet of leasing in Q2 at an average rent increase of 14%. The most notable renewal was approximately 29,000 square feet with a national accounting firm at Gateway Centre in Markham for a 10-year term. Our weighted average remaining lease term is 5.4 years with in-place rents on average 9% below market. The REIT's financial performance continued to improve in the second quarter, highlighted by a 5% increase in adjusted funds from operations, further strengthening our payout ratio to 61.9%. Our loan-to-value ratio finished the quarter at 58.3%. The REIT has ample liquidity to fund ongoing operations, especially considering the strength of our rent collections and our prudent management of operating and capital spend.

The last few months have presented us with a unique set of challenges; however, we assembled our portfolio to be resilient in times like these and we continue to be pleased with the stability of the REIT's cash flows and operating performance during the COVID-19 pandemic. We are feeling very optimistic about the future and we remain committed to working hard to further build on the quality of our portfolio. On behalf of the entire Slate Office REIT team, we wish you good health and we thank you for your continued support.

I will now hand it over for Q&A.

QUESTION AND ANSWER SESSION

Operator

As a reminder, to ask a question you will need to press star one on your telephone keypad. Two withdraw your question press the pound sign or the hash key. Please stand by while we compile the Q&A roster.

Your first question is from Jonathan Kelcher with TD Securities.

Jonathan Kelcher, TD Securities

Thanks. Good morning.

Steve Hodgson, Chief Executive Officer

Good morning.

Jonathan Kelcher, TD Securities

First question: As you look across the portfolio, how is the repopulating of your space going to the extent that you guys know?

Steve Hodgson, Chief Executive Officer

Yeah, it is a great question, Jonathan. It is a very difficult stat to measure perfectly, but anecdotally, and through our property management partners, we have seen the utilization rates about 30% to 40% across the portfolio, we are not privy to our peers that have downtown assets, but anecdotally we believe that to be higher than what we are seeing downtown just given the suburban nature of our properties and the ability of existing tenants that drive to those buildings, not have to use elevators, and have a less dense environment within their workspace. And further in the secondary markets that we are in, such as Atlantic Canada, things are really opening up there a lot sooner than we have seen in the GTA or some of the more major concentrated markets.

Jonathan Kelcher, TD Securities

Okay. Would it be higher in the Maritimes than the 30% to 40%?

Steve Hodgson, Chief Executive Officer

Correct.

Jonathan Kelcher, TD Securities

And what about Chicago?

Steve Hodgson, Chief Executive Officer

Yeah, Chicago initially had a similar timeline to the GTA in terms of returning to work. Most of our major tenants, banks and law firms, had been messaging in September. I think some of them, given the recent spike in the US, are now revisiting that and pushing their expectations out to early next year.

Jonathan Kelcher, TD Securities

Okay. And then secondly, are you seeing any pickup in tours? And I am thinking more of your suburban, like the bigger cities where you are in, more in the suburbs. Are you seeing any more inquiries there than you typically would?

Steve Hodgson, Chief Executive Officer

Yeah, we have continued to have inquiries and tours, but it has been primarily, Jonathan, on the smaller size, 5,000 square feet and less. The larger tenants are still, where they have opportunities to, are still renewing in place, either in our portfolio or competitors' portfolios, so we are not seeing a lot of new leasing velocity at this point on a larger scale.

Jonathan Kelcher, TD Securities

Okay. And then just lastly, it was small but you did take a small IFRS write down. Can you give us just a little bit of colour on that?

Michael Sheehan, Chief Financial Officer

Yeah, some of that is FX and then there is just revised timing of certain leasing assumptions.

Steve Hodgson, Chief Executive Officer

Yeah, Jonathan, the write down that we took that was related to actual property fundamentals was in Q1 when we revised our leasing expectations on new leasing for the balance of the year in light of the pandemic. The adjustment that you saw in Q2 was entirely driven by FX.

Jonathan Kelcher, TD Securities

Okay. Fair enough. I will turn it back. Thanks.

Steve Hodgson, Chief Executive Officer

Thanks.

Operator

Your next question comes from Chris Couprie from CIBC.

Chris Couprie, CIBC World Markets

Good morning. A couple questions. On the data centre, it looks like the income went up a touch sequentially. Was that contractual and is that kind of the new run rate?

Michael Sheehan, Chief Financial Officer

Yes, that is right. There are built in steps in that agreement.

Chris Couprie, CIBC World Markets

Okay. And then just with regards to that data centre, is Equinix going to be the tenant at that property following the completion of that transaction and were there any negotiations with respect to that property when Equinix was making that deal with Bell?

Steve Hodgson, Chief Executive Officer

No, we were not privy to the negotiations, Chris. We are obviously aware of the transaction and there has been a request for an assignment of the lease to Equinix. At this point in time I cannot tell you the exact outcome of that but, from our perspective, we are going to continue to have Bell on the covenant and, further, we will have Equinix, which is, as you know, an over $1 billion company. So, we think it just strengthens the overall covenant from Slate Office REIT's perspective.

Chris Couprie, CIBC World Markets

Okay. And then maybe just on the hotel, obviously a tough quarter, not surprising. Any commentary on how you think that might be trending since lockdown measures have been eased?

Steve Hodgson, Chief Executive Officer

Yeah, that is right, Chris. The hotel, for obvious reasons, has had a tough quarter and the balance of the year will be difficult as well relative to the prior year. So, year to date, we are down about $900,000 in income at the hotel versus the prior year. And the balance of the year will be another $900,000 versus the prior year, roughly. However, the distribution of that throughout the year, we are starting to see returning to profitability starting in July. We are starting to see the Atlantic bubble drive some leisure demand. We have also been fortunate enough to secure some groups, critical workers and companies that have a need for quarantine space. So, we have been very fortunate in that regard. So, the balance of the year will be profitable but it just will not be at the same levels that we had seen in prior years.

Chris Couprie, CIBC World Markets

Okay. Got it. And then just maybe lastly, with respect to overall occupancy, I think your commentary alluded to a belief in good renewal activity but maybe a moderation in new leasing activity. What are your thoughts on overall portfolio occupancy? I know it is probably challenging to pin it down, but any colour on where you think that might be trending. Are there any planned move-outs that you are aware of for the balance of the year?

Steve Hodgson, Chief Executive Officer

Yes, that is right, and we had some known vacates, as you know, that we have messaged in the past, primarily in Atlantic Canada that are going to put a slight headwind for us in the balance of the year from an occupancy perspective. Those predated COVID. So, to be clear, they are not COVID related and we do not expect any incremental known vacates as a result of COVID. In fact, we probably expect more renewal activity for the balance of the tenants.

With respect to occupancy guidance for the balance of the year, as we messaged in the last quarter, we have reduced our expectation of new leasing and that is reflective in our IFRS values as well. I think the current level we are at right now, our goal is to maintain that current level, but it is probably more likely that we would reduce occupancy slightly by the end of the year than increase it. But looking forward to 2021, we had a strong pipeline prior to the pandemic of some larger transactions in Atlantic Canada in particular and I think those will start to pick up steam again in 2021. They have not gone away; they have just been put on hold.

Chris Couprie, CIBC World Markets

Right. And I noticed you expanded a tenant at Speakman and it looks like conversations are still ongoing for the balance of the space. Is that accurate?

Steve Hodgson, Chief Executive Officer

That is correct. Yes. The government tenant that we had done a 40,000-square-foot lease deal with and messaged in Q1 has expanded by an incremental 7,000 square feet and so that brings our committed occupancy of that building to 52%. And the second floor of the building we are actively trying to lease. It will be, by its nature and physical layout, it will be larger tenant space, so I think in this environment it may take some time to backfill that.

Chris Couprie, CIBC World Markets

Thanks. I will turn it back.

Operator

Your next question comes from Matt Kornack from National Bank Financial.

Matt Kornack, National Bank Financial

Good morning, guys. With regards to the mortgage debt that you have renewing, you did quite well on Maritime Centre, but just your thoughts with regards to spreads and financeability of assets for this year and maybe looking forward as well.

Michael Sheehan, Chief Financial Officer

So, the two assets that we have coming up in 2020 are high-quality tenancies and longer weighted average lease terms, so we expect to renew on similar terms for those assets.

Going forward, we have a plan in place. Those maturities that are coming up are mostly our credit facilities. We have strong relationships with those banks and we do have a plan in place, but it is a bit early to really comment too much further on what we have there. But we are confident that we will get something done that is aligned with the terms we are expecting.

Matt Kornack, National Bank Financial

Okay. So, with regards to the mortgage maturities, it sounds like the spreads would have increased but all-in rates are fairly steady with what is maturing. Is that fair? Or will you see actually a decrease in interest rates?

Michael Sheehan, Chief Financial Officer

I would say substantially consistent at this point.

Matt Kornack, National Bank Financial

And on CECRA — I know your collections were very good, but did you take any adjustments for CECRA or bad debt assumptions on the non-collected portion, although it is small?

Steve Hodgson, Chief Executive Officer

Yeah. So, as a reminder, the CECRA program requires the landlord to abate 25% of the rent for those tenants that are eligible. We have had very little applicability across our tenant profile, so the amount of abated rent for each month in Q2 was $37,000.

Matt Kornack, National Bank Financial

Okay. And then occupancy ticked up a bit in one of your Chicago assets. Was that previously leased space or was that something that happened incremental in this quarter?

Steve Hodgson, Chief Executive Officer

We messaged this deal in Q1. It was a large new deal with a financial services tenant at 120 South LaSalle. Their lease just commenced and came into occupancy this quarter.

Matt Kornack, National Bank Financial

And would that have been in straight line rent in this quarter or was it fully cash paying this quarter?

Michael Sheehan, Chief Financial Officer

It would have been in straight line rent, yes.

Matt Kornack, National Bank Financial

Okay, perfect. Thanks, guys.

Operator

Your next question comes from Jenny Ma with BMO Capital Markets.

Jenny Ma, BMO Capital Markets

Thanks. Good morning. With regards to the renewal in Markham, I was just wondering if it is coming off a previous 10-year lease and if you can comment on the lift you got on renewal.

Steve Hodgson, Chief Executive Officer

So, it is not coming off a previous 10-year lease. The tenant had been expanding over time, so there had been a lot of blend and extends over a period of time, so not technically coming off a 10-year lease. But yeah, this was a tenant that had strong conviction in the amount of space that they required and they were willing to commit to it long term.

We did receive about an 18% increase in rents. And we do think that this tenant has a desire to continue to expand within the building, but their existing footprint was the baseline that they felt comfortable committing to long term.

Jenny Ma, BMO Capital Markets

Okay, great. And Steve, in your letter you had mentioned that we are starting to see signs of a migration towards the suburbs amongst US millennials, so I am just wondering, in the context of that comment, is it indicative of some of the growth plans you might have to expand into the suburbs in the US or is that a commentary regarding how it might look for Canadian office as well or maybe a little bit of both?

Steve Hodgson, Chief Executive Officer

Yes. It is definitely a bit of both, and thank you for reading the letter, Jenny. Our view is that suburban office will benefit in times like this.

As I mentioned to Jonathan earlier, we have seen the utilization rates higher in the suburbs and we do have a macro view that as larger portions of the workforce, i.e., millennials and the talent pool, move out of the densely populated cities, we will start to see companies want to follow them. And it will not benefit all suburban office, but suburban office like we own, which is well located with strong amenities and good access to transit and parking, will benefit from this longer-term trend.

Jenny Ma, BMO Capital Markets

And maybe it is a little early, but are you starting to see any sort of deals come across your desk in the US or in Canada right now?

Steve Hodgson, Chief Executive Officer

Yeah, we are seeing deals and the Slate Asset Management broader pipeline is quite large, mostly in the US as it relates to office and some deals in Canada, but we do think it is a little early. We have an abundance of liquidity right now, but we think it is a prudent strategy to preserve our cash at this point in time. It is difficult to price risk in this market on new acquisitions, so our strategy is to be patient.

Jenny Ma, BMO Capital Markets

So, what would you need to see to start getting a little bit more active on the deal pipeline? Like I presume, a lot of others have said the bid-ask spread is probably pretty wide, so what are the data points you are looking for before you start really looking at these seriously?

Steve Hodgson, Chief Executive Officer

Yeah, I think it is the bid-ask spread. I mean in the US, we continue to think the fundamentals are strong in the office sector. We think that there is likely some capital structure distress that will happen with certain ownership groups and we think that needs to play out before there is less of a wide bid-ask spread and something that we can be opportunistic on and transact on.

Jenny Ma, BMO Capital Markets

Okay, great. That is all for me. Thank you.

Steve Hodgson, Chief Executive Officer

Thank you.

Operator

Again, if you would like to ask a question, please press star one on your telephone.
Your next question comes from Brendon Abrams from Canaccord Genuity.

Brendon Abrams, Canaccord Genuity

Hi. Good morning.

Steve Hodgson, Chief Executive Officer

Good morning.

Brendon Abrams, Canaccord Genuity

Just taking a look at your tenant profile and the REIT has a decent exposure to government tenants, it looks like about one million square feet or 13.5% of rent. Just wondering if you could comment on your conversations with some of your government tenants and whether or not these would be materially different than conversations you have had with tenants in the private sector.

Steve Hodgson, Chief Executive Officer

It is a good question. We have conversations with our government tenants. It is difficult to get to the decision-maker in those conversations sometimes, as you may imagine. If the question is about whether they have a different view on working from the office in the long term versus work from home, I do not think it is materially different. I see them returning to the office just as I see the private sector returning to the office.

Brendon Abrams, Canaccord Genuity

Okay. Yeah, that is helpful. And just a quick one also on the leasing for me: just in terms of your portfolio, have you had any requests from tenants looking to either break leases early or sublet space? Maybe you could just provide some colour on those items as it relates to your portfolio.

Steve Hodgson, Chief Executive Officer

No, we have not. And I view that as a positive. I have heard other landlords suggest they have had more tenants asking for incremental space versus wanting to shed any space. I can tell you with our portfolio we have not had really requests one way or the other. I do not know if that is just the nature of suburban versus downtown or secondary markets versus primary markets, but any tenants that we have that are maturing in the short term are looking for some flexibility in terms of how long they are willing to commit on their renewal. And that is a trend that we are seeing across the industry. But it is not coming with a request to downsize or a request to increase space at this point.

Brendon Abrams, Canaccord Genuity

Okay. That is great. I will turn it over. Thank you.

Operator

We have no further questions at this time over the phone.

Braden Lyons, Investor Relations

Thank you, everyone, for joining the Q2 2020 conference call for Slate Office REIT. Have a great day.

Operator

Ladies and gentlemen, this does conclude today's telephone conference. Thank you for participating. You may now disconnect.
