Office REIT
SLATE

FINAL TRANSCRIPT

Q4 2015 Investor Call

March 4, 2016 – 8:30a ET

SPEAKERS

Conor McBroom
Vice President, Investor Relations, Slate Asset Management

Scott Antoniak
Chief Executive Officer, Slate Office REIT

Robert Armstrong
Chief Financial Officer, Slate Office REIT

Blair Welch
Partner & Co-Founder, Slate Asset Management

ANALYSTS

Troy MacLean
BMO Capital Markets

Jonathan Kelcher
TD Securities

Mark Rothschild
Canaccord Genuity

Dawoon Chung
National Bank Financial

Rob Sutherland
Euro Pacific Canada

Operator

Good morning. My name is Jessa and I will be your conference operator today. At this time I would like to welcome everyone to the Slate Office REIT Fourth Quarter 2015 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 fourth quarter and 2015 year-end 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 March 2016 investor update, which will be available shortly after today's call.

We'll 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.

During 2015 we made significant improvements in our financial results and we are excited about the platform we've built for the future.

Core FFO for 2015 was $27.6 million or $0.99 per unit. This compares to core FFO for 2014 of $10.7 million or $0.63 per unit. We've been able to increase core FFO by $0.33 per unit year over year. We believe this increase represents significant accretion in earnings per unit and is meaningful to unitholder value. The year-over-year core FFO increase is primarily the result of portfolio growth from the acquisition of the suburban office properties in December 2014 and the Fortis acquisition in June. Core FFO for Q4 was $8.5 million, down slightly from $9.8 million in Q3. This changed as the result of our strategy to dispose of non-core non-office assets. We expect that during 2016 we will be able to recycle the capital raised from non-core asset sales into accretive opportunities. An example of this is our ability to increase our existing interest in the (inaudible) assets through well-located office properties in St. John's and other opportunities.

During 2015 we have also de-risked the stability of distributions being provided to unitholders. Our AFFO payout ratio during the fourth quarter was the second quarter in a row with a fully covered AFFO distribution ratio. The payout ratio was 89 percent, down from 159 percent in Q4 of 2014. Our now fully covered AFFO payout ratio provides a foundation for growth and stability going forward. On an annual basis the REIT's AFFO payout ratio was 95.5 percent as compared to 124 percent for 2014. We believe that our payout ratios in 2016 will average about 90 percent as a result of the dispositions of non-core assets, trending down in the latter half of the year. As a result of the sales we will be in the high 90s in Q1, trending down to the high 80s and low 80s in the back half of the year. However, our longer-term target will be to have our AFFO payout ratio in the mid-80 percent range.

As it relates to our IFRS valuations, we've currently marked our portfolio at a 6.8 percent capitalization rate. We didn't make significant changes from the third quarter. This valuation translates into an approximately $165 per square foot value. Our purchase cost is slightly less than that rate. We believe that with our current occupancy rate, below market in-place leases, and low dollar purchase costs we can creatively attract tenants and compete with higher-cost landlords.

In summary, we believe that 2015 was a very strong year. We were able to execute on our disposition strategy ahead of schedule, meaningfully increase results, and build a platform for the future.

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

Scott Antoniak, Chief Executive Officer

Thank you, Robert.

As I wrote in the unitholder letter and as you can see in our results, 2015 was an important year for Slate Office REIT. Let me touch on a few of the highlights before we open the call to your questions.

First, we transformed Slate Office REIT into a focused national office vehicle comprising a portfolio of well-located quality buildings with strong operating histories in stable markets. Moreover, we own these assets at an average cost basis of $164 per square foot. Not only is this a material discount to both replacement cost and peak value, it also provides for tremendous flexibility on the leasing and operation side. The 215,000 square foot SNC-Lavalin lease in Sheridan Business Park is a prime example of this.

Our tenant roster has a strong mix of corporate and government entities with 42 percent of the REIT space rentals classified as investment-grade. The weighted average lease term of the portfolio is 5.5 years and, most importantly, in-place rents across the portfolio are approximately 7 percent below market. With a steady lease maturity profile in the coming years, Slate Office REIT is well positioned to capitalize on this embedded organic growth.

What was once a predominately Western Canadian portfolio is now nationally diversified with 35 percent of net operating income coming from the GTA, 49 percent from Atlantic Canada, and 16 percent from Western Canada. Furthermore, we have no exposure to the Alberta office market and only 3 percent exposure to the oil and gas sector nationally. Our assets are predominately located in markets with limited new supply.

Looking ahead, we have a strong company that is well positioned to execute on both internal and external growth. Our dedicated and experienced team at Slate Office REIT, which is fully aligned as the REIT's largest unitholder, is excited to continue to build on the success of 2015.

Thank you for calling in today and with that we'll open up the line for your questions.

Q&A

QUESTION AND ANSWER SESSION

Operator

At this time I would like to remind everyone in order to ask a question please press star followed by the number one on your telephone keypad. Your first question comes from the line of Jonathan Kelcher from TD Securities. Please go ahead.

Jonathan Kelcher, TD Securities

Thanks. Good morning. First, a little bit of a dip in occupancy in Q4. Where do you think you can get occupancy going into 2016?

Scott Antoniak, Chief Executive Officer

On a same-store basis, Jonathan, I think it's about 50,000 feet quarter over quarter. A third of that is related to Fortis Properties who, at the time of the underwriting, we knew would be leaving. They stayed a little bit longer because the hotel sale process took a little bit longer but they were always contemplating to be leaving Fortis Building. So that's a third of it, about 17,000 or 18,000 feet. We've got committed leases in place for 62,000 feet for Q1. So I think, you know, I'd say going forward over the course of the year I'd look for probably 2 percent, a 2 percent increase overall.

Jonathan Kelcher, TD Securities

Okay. And then, secondly, just on the seasonality of the hotel, I guess that hit you a little bit from Q3 to Q4. Does that—how much annual NOI does the hotel generate?

Scott Antoniak, Chief Executive Officer

It's about 900,000, Jonathan. And I would say 80-ish percent of that would be in Q2 and Q3.

Operator

Your next question comes from the line of Dawoon Chung from National Bank. Please go ahead.

Dawoon Chung, National Bank Financial

Thank you and good morning. It seems like you have extended the lease with one of your top tenants, the Minacs Group, for an additional five years. Is that the one that you were talking about with regards to 62,000 square feet of committed lease? And, if that's the case, could you provide more colour on this in terms of renewal spread and where that is located?

Scott Antoniak, Chief Executive Officer

That's not the 62,000, Dawoon. Minacs is in the east GTA and that's not part of the 61,000 feet of renewal.

Dawoon Chung, National Bank Financial

Okay. In terms of your balance sheet side of things, leverage ratio kind of crept up slightly in Q4 to 61 percent. And you obviously reiterated your target ratio at 55 percent. From a timing standpoint, when do you expect to achieve this target?

Robert Armstrong, Chief Financial Officer

I think we're expecting that our leverage ratio will drop naturally just through pay-downs of principal and accretion in the portfolio, because we have the below-market rents at about 100 to 150 basis points annually. I'd say that's if we do nothing. So that's a steady case.

Dawoon Chung, National Bank Financial

Okay, great. And, finally, switching gears here a bit, in your outlook you've mentioned that you will selectively sell non-strategic assets and acquire office properties and obviously some of your larger peers are looking at selective non-core asset sales. Do you have a sense what your acquisition pipeline would be this year?

Scott Antoniak, Chief Executive Officer

Some of our peers have announced that they'll be selling assets - we would evaluate those opportunities as we'd evaluate any other office opportunities. I think we would look to grow selectively in markets where we can find the office dynamics that we're looking for so, you know, low placement cost, rents below market, continue to execute on the strategy that we rolled out in 2015.

I do think that one thing—it trailed off when I was answering the previous question. That 61,000 feet is new leasing. The Minacs deal in the eastern GTA is renewal, so it doesn't count as part of that 61,000.

Operator

Your next question comes from the line of Mark Rothschild from Canaccord. Please go ahead.

Mark Rothschild, Canaccord Genuity

Thanks and good morning. A few of my questions have been answered so maybe just in regards to the plan to grow the REIT. If you could talk about what would it be based on your current cost of capital, how you plan to finance growth and, in particular, if a rights offering would be something that would be considered.

Scott Antoniak, Chief Executive Officer

I think we'd evaluate any and all capital raising opportunities. I think we've proven in the past to be creative. Where the unit price will go this year I can't necessarily forecast. I'd love to be able to but I don't think I can at this point. I think we'd watch the capital markets obviously. We'd continue to be creative in terms of raising capital to grow the business.

Mark Rothschild, Canaccord Genuity

So am I to infer that issuing equity in the market, which I guess would be less creative, is something that you wouldn't consider?

Scott Antoniak, Chief Executive Officer

Well, I think as the largest unit holder we're not in a rush to dilute ourselves, or anybody else from that perspective, so we would watch the unit price as closely as anyone else would.

Blair Welch, Partner & Co-Founder

Hey, Mark, it's Blair. I totally agree with Scott. We think we're well positioned. The reason why we created an office company was our view that there could be office trades in portfolios that will come to market and I think, as our peers are showing you, there should be and there is a lot of office product that is out there. I think we're in a unique position to grow the REIT but we're only going to grow wisely. I would say that, you know, doing great deals like the Fortis transaction shows that over the long term that's a huge, huge value creator for this company. And, you know, as the largest shareholder, we're going to be smart about it. But if there are exceptional deals we'll do the right thing for the shareholders, of which we're the largest, and try and grow NAV.

Operator

Your next question comes from the line of Rob Sutherland from Euro Pacific Canada. Please go ahead.

Rob Sutherland, Euro Pacific Canada

Hi, guys. So most of the questions, like everybody else, have been answered, but you can further increase your ownership stake in the St. John's assets? You went up to 30% do you have rights to go further with that if you want to?

Robert Armstrong, Chief Financial Officer

Yes, we've got a right coming due in June to buy another 19 percent and then later in the year we also have the additional right to take our interest to 100.

Rob Sutherland, Euro Pacific Canada

Okay. And then outside of that, you know, obviously you're going to be opportunistic where you're looking but what markets are you expecting to focus on in terms of new acquisitions? Are you going to be looking more at the west? Are you going to be looking, you know, you're pretty heavy now in eastern Canada, are you looking to get into Quebec or, you know, any of those types of things?

Scott Antoniak, Chief Executive Officer

I think it would be as it's been in the past, Rob. I've used this term before - I think we're a little bit market agnostic. I think we would look for opportunities that fit the investment and return dynamics that we've outlined clearly and we've done before. I don't think we necessarily woke up in 2015 thinking we definitely needed to go to Atlantic Canada. That turned out to be a fantastic transaction for us and a way to create great value for the REIT. Part of the benefit of Slate Office REIT is that we can look in any market, we can look in any urban market, we can look in any suburban market and be much more about the specific opportunity and what the building or property offers, what the market looks like. So that's part of the benefit of this is that we're kind of able to look across the country.

Rob Sutherland, Euro Pacific Canada

Would you look at Calgary?

Robert Armstrong, Chief Financial Officer

The story in Calgary is that we're obviously interested but we think the larger dynamic there is that owners of assets in Calgary won't just be sellers in Calgary, they'll be sellers elsewhere, and I think we'll be interested in opportunities that come out elsewhere in Canada from owners of office property in Alberta as well.

Scott Antoniak, Chief Executive Officer

I don't know if there's an intersection point yet in terms of valuation in Calgary but we'd be remiss if we didn't look there. In a previous iteration SLAM had a lot of success investing in the Alberta office market, so I think it would be wrong for us not to look there. I don't know, over time, over the next couple of quarters this year we'll see if there is an intersection point in terms of valuation between buyers and sellers in Alberta and we'd be keen observers of that. So I wouldn't absolutely discount any market. I think it'd be kind of foolish.

Operator

Your next question comes from the line of Troy MacLean from BMO Capital Markets. Please go ahead.

Troy MacLean, BMO Capital Markets

Good morning. Just on the 2016 renewals, you know, the weighted average in-place rent is $13.34. Can you tell us or give us some colour on how that would compare to market?

Scott Antoniak, Chief Executive Officer

Across the portfolio, Troy, our view is that we're a little more than $1 below market, which is about 7 percent. And that's fairly consistent over the rollover profile over the next five years or so. So there's no one particular year that's greatly higher or lower than that. So it'd be somewhere in the range for the 2016 expiries.

Troy MacLean, BMO Capital Markets

And then what's your outlook for tenant retention for the 2016 leases?

Scott Antoniak, Chief Executive Officer

I think it'd be consistent with our historical retention. I think, you know, in that 200 basis points I talked about earlier with Jonathan I think we'd be looking at 85 percent.

Troy MacLean, BMO Capital Markets

Okay. Thank you. Those are my questions.

Operator

There are no further questions at this time. I turn the call back over to the presenters.

Conor McBroom, Vice President, Investor Relations

Thanks, everyone, for making the time today and we'll look forward to providing an update in a few months' time.

*****