CORPORATE PARTICIPANTS

Braden Lyons
Investor Relations

Steve Hodgson
Chief Executive Officer

Michael Sheehan
Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Jonathan Kelcher
TD Securities

Brendon Abrams
Canaccord Genuity

Chris Couprie
CIBC Capital Markets

Matt Kornack
National Bank Financial

Fred Blondeau
iA Securities

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Slate Office REIT Third 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. If you require any further assistance, please press star zero.

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

Braden Lyons, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the Q3 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 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 Q3 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 good morning, everyone.

We are pleased to report strong third quarter results, which reflect the continued stability of our portfolio. Tenant credit quality is fundamental to our investment strategy. Approximately 60% of our income is generated from government and credit-rated tenants and we have very little exposure to retail or the energy sector.

We continue to have strong conviction in the office sector and believe the potential adverse impact the work-from-home experiment could have on office demand is overblown. We share the view of many Fortune 500 office users that ad hoc interaction with colleagues and an overall sense of community is critical to workplace culture. With 85% of our assets in suburban locations in major markets or urban locations in secondary markets, we are encouraged by the number of tenants returning to offices across our portfolio, especially relative to our peers who have assets in downtown locations within major markets.

Now a few comments on our results. The REIT's industry-leading cash rent collections continued in the third quarter. The REIT has now collected between 96% and 98% of rent in each month since April 2020. We expect to substantially collect the residual rent through short-term deferral agreements.

In September and October, the REIT completed C$395.7 million and US$161.1 million of debt refinancing, including our revolving credit facilities and certain term loans, which enhanced the REIT's liquidity and addressed all of 2020 debt maturities and the majority of 2021 debt maturities. As part of these refinancings, 40% of our asset base was externally appraised, which further validates our net asset value.

The REIT also completed 142,000 square feet of leasing in Q3, comprised of approximately 93,000 square feet of renewals and 50,000 square feet of new lease deals. In 2021, only 5.6% of the portfolio is maturing, which we view as a positive in the current environment. The REIT finished the quarter with a well covered payout ratio of 62%.

Looking forward, we expect renewal volumes to be strong for the remainder of the year and into 2021 and new leasing will be constrained by the logistics of touring space with COVID-related restrictions. We view these disruptions as short term in nature and expect occupancy to grow from current levels in 2021.

Slate Office REIT is a compelling total return investment opportunity. We are paying a distribution of over 11% that is well covered with an AFFO payout ratio of 62%. We are also trading at an approximately 60% discount to net asset value, providing unitholders with the potential for significant capital appreciation. We are feeling optimistic about the future of our business and we look forward to finishing the year on a strong note. On behalf of the entire Slate Office REIT team, we wish you good health and thank you for your continued support.

I will now hand it over for Q&A.

QUESTION AND ANSWER SESSION

Operator

At this time we would like to take any questions you may have for us today. To ask a question, please press star followed by the number one on your telephone keypad.

Your first question is from Jonathan Kelcher with TD Securities. Your line is open.

Jonathan Kelcher, TD Securities

Thanks. Good morning. First question is just on office utilization. Can you maybe give us an update? I realize it is an estimate, but I am trying to see if there is much of a difference between what you are seeing in Atlantic Canada versus the rest of the markets that you are in.

Steve Hodgson, Chief Executive Officer

Yeah, it is consistent with prior quarter, around 30% to 40% across the portfolio. I will caveat that, to your point, it is difficult to measure. Atlantic Canada would be on the higher end of that range, Jonathan. And I would suspect it would actually be higher, but some of the tenants that we have out there are national tenants that adhere to the guidelines that are driven out of their Toronto office. So we expect utilization rates will continue to outperform in our portfolio given that we are in secondary markets and we are in suburban locations.

Jonathan Kelcher, TD Securities

Okay. And then just turning to the leasing spreads in the quarter, a little bit lower than the past; was that just a function of the space that was leased or have market rents sort of stepped back a bit?

Steve Hodgson, Chief Executive Officer

No, I do not think it is indicative of any change in market rents. And just to clarify, our overall spread was about 3.5%. On new deals we were over 10% and on renewals we were basically flat. And I think that is consistent with what is going on in the market, because you also have to look at the weighted average lease term on our renewals was about 3.5 years and on new deals was about 7.5 years. And what we are finding is that tenants that are maturing are looking to do short-term renewals on an as-is basis and so what we are doing is we are offering short-term renewals to tenants at a similar rent to what they were paying before.

Jonathan Kelcher, TD Securities

Okay. So if we look at 2021, would you expect the same sort of, and I know there is not a lot of space rolling, but would you expect the same sort of thing on renewals, kind of flattish rents, and then some uplifts on any new leasing that you do?

Steve Hodgson, Chief Executive Officer

Well, the reason that the shorter-term renewals are happening right now is because of the overall uncertainty in the economic environment and tenants, understandably, not wanting to make long-term commitments. I think when that changes, we will revert to a more conventional deal structure that includes longer-term deals with some inducements that will push rents up to close the gap between in-place rents and market rents.

Jonathan Kelcher, TD Securities

Okay. So maybe for the beginning of the year, similar dynamics, and then hopefully, as it starts to open up in the middle or back half of next year, more normal environment?

Steve Hodgson, Chief Executive Officer

Yes, I think that is fair.

Jonathan Kelcher, TD Securities

Okay. Thanks. I will turn it back.

Operator

Your next question is from Brendon Abrams with Canaccord. Your line is open.

Brendon Abrams, Canaccord Genuity

Hi. Good morning.

Steve Hodgson, Chief Executive Officer

Good morning.

Brendon Abrams, Canaccord Genuity

Just taking a look at note five and I think you referenced the appraisals for the quarter for IFRS purposes. You got appraisals for 16 properties for almost $700 million. Can you just maybe elaborate a little bit on those appraisals in terms of cap rates and where the bulk of the properties were that were underwritten? And, sorry, and how that would maybe compare to pre-COVID valuations.

Steve Hodgson, Chief Executive Officer

So I will start, Brendon, and Mike can jump in. Just a bit of context on our IFRS values, in Q1 of this year we took a hard look at what the impact of the pandemic would do to our new leasing activity and we took a small write-down in our IFRS values reflecting the current leasing environment and our expectation that new leasing would be lower than a typical year. And then, through the refinancings that we just completed, we had externally appraised about 40% of the investment value of our portfolio. Those are the assets that are part of the credit facility as well as the assets that we just recently did term financing on. A bulk of them are in Atlantic Canada and a number of them are in Toronto and I think the view of the external appraisers was that we appropriately reflected the value based on the amendments we made in Q1.

Brendon Abrams, Canaccord Genuity

Okay. And—sorry, go ahead.

Michael Sheehan, Chief Financial Officer

No, just for further context or clarity, 11 of those 16 assets that were appraised were in Atlantic Canada. And then the rest, as Steve has pointed out, have been GTA. There is one in Chicago and out west would make up the balance.

Steve Hodgson, Chief Executive Officer

Correct.

Brendon Abrams, Canaccord Genuity

Okay. That is helpful. And then just one other follow-up from me. I saw you disposed of the small asset in Yellowknife. Just wondering if any other dispositions are targeted or anything else you would deem non-core to dispose it going forward or you feel that the bulk of the dispositions have been already completed?

Steve Hodgson, Chief Executive Officer

Well, both. Absolutely, the bulk of dispositions have already been completed. The property in Yellowknife was a retail property with a Tim Hortons and a Marks and we recently renewed both tenants on a long-term basis, so both it was not strategic to the office REIT long term and it was an opportunistic time to sell given the leasing we had done there. We sold that property at a roughly 8% cap rate, $400 a foot, and generated a 16% IRR, so we are quite pleased with that outcome. There are a couple of other non-office assets within our portfolio that are pretty de minimis to overall value, but we will look to dispose of at the appropriate time.

Brendon Abrams, Canaccord Genuity

Right. Okay, that is helpful. I will turn it over. Thanks.

Operator

Your next question comes from Chris Couprie with CIBC. Your line is open.

Chris Couprie, CIBC Capital Markets

Good morning. Maybe turning from the disposition to acquisitions, just wanted to see if you have had any update in terms of how investment volumes are looking for you and how active you think you might be over the next six months or so.

Steve Hodgson, Chief Executive Officer

I think, similar to last quarter, we are still seeing a lot of deal activity in the broader pipeline that Slate Asset Management is looking at. Most of the volume that we are seeing is outside of Canada. There are some deals in Canada and just recently there has been a few more put on the market that would be comparable to some of our GTA suburban assets.

We have an abundance of liquidity right now, but we think it is still very prudent to preserve cash. It is difficult to price risk in this environment. There are not a lot of trades happening, both on the leasing side, which speaks to the fundamentals of the assets and what that looks like from a cash flow perspective going forward, and then cap rates I think will be more resilient because the interest rate environment is still low. But it is still early days and our view on this is still consistent with last quarter.

Chris Couprie, CIBC Capital Markets

Okay. Gotcha. And any update at all on Speakman?

Steve Hodgson, Chief Executive Officer

We are fortunate in Q2 having completed the deal with the Government of Canada to bring the committed occupancy to 52%. The balance of the building is one floor, 60,000 square foot floor plate, which lends itself to a larger tenant user. In this current leasing environment, large tenant users are not very active. We think there will be a build-up of demand for that type of space in a post-COVID world. And so we are optimistic that it will be leased up, but our horizon for that is pushed out.

Chris Couprie, CIBC Capital Markets

Right. So if you look at occupancy in the near term, kind of we have slid throughout the year here, part of it we knew about. Is there anything on the horizon, any known departures that we should be aware of?

Steve Hodgson, Chief Executive Officer

So, you saw the bulk of it in Q3 with the vacancies we incurred in Atlantic Canada. And those decisions by the tenants predated COVID. I think you will see in Q4 another small tick down in occupancy and in 2021 we will see it ramp up.

Chris Couprie, CIBC Capital Markets

Okay. That is it for me. Thanks.

Operator

Your next question is from Matt Kornack with National Bank. Your line is open.

Matt Kornack, National Bank Financial

Good morning, guys. Just a quick follow-up on that last point that you made with regards to the ramp up in 2021. Is that based on contractual leasing that has already been done?

Steve Hodgson, Chief Executive Officer

No, not yet. It is based on the pipeline that we are seeing and the backfill strategy for some of these vacancies that we have known of for quite some time now.

Matt Kornack, National Bank Financial

Okay. That makes sense. It seemed like there was some lease termination income in this quarter. What would that have related to and is that space under negotiation? Or what has happened there?

Steve Hodgson, Chief Executive Officer

Yeah, so the lease termination income, and I am glad you asked the question because we did want to clarify, this was related to decisions tenants made prior to COVID. And the bulk of it is Exxon.

Matt Kornack, National Bank Financial

Okay. And there was one comment of $400,000, one was $1.3 million in the same-property figures, sequential versus year over year, and I wasn't sure what the actual number was.

Michael Sheehan, Chief Financial Officer

Yeah. So $1.3 million is the total for the quarter. That other number you referred to is the non-Exxon, which is just forward the vacancies, but again, to Steve's point, those were decisions that were made pre-COVID.

Matt Kornack, National Bank Financial

Okay. That is perfect. And then lastly, with regards to capital allocation, how are you thinking about CapEx that you have discussed, acquisitions and you will be patient and see where things go on that front, but is there an opportunity to spend less? I mean if you are doing these leases at prior rent levels, are you putting any CapEx into the deals? Or are they non-CapEx leases at this point?

Steve Hodgson, Chief Executive Officer

No. And to clarify on those renewals that are happening at similar rents to prior, I think that is a short-term dynamic, because there is no CapEx in those deals. When tenants are looking to commit longer term there will be CapEx and there will be increases in rent.

Overall, our capital allocation strategy, we have been very prudent. Really, the bulk of the CapEx that we are spending in our portfolio is: one, on Maritime Centre; two, on a parking garage redevelopment in Toronto, that is a life safety project; and the third is really just leasing capital. In 2021, we do intend to ramp up our occupancy, so there will be leasing costs in parallel with that.

Matt Kornack, National Bank Financial

Right. And I take it no sense of doing unit buybacks at this point even with the liquidity that you have available?

Steve Hodgson, Chief Executive Officer

Yeah, we have the ability to do so. We believe that there is still some uncertainty in the overall economic climate and the most prudent capital allocation strategy for us, and our board agrees, is to maintain a cash position.

Matt Kornack, National Bank Financial

Sure. That makes sense. Thanks, guys.

Operator

As a reminder, if you would like to ask a question, please press star followed by the number one on your telephone keypad.

Our next question comes from Fred Blondeau with iA Securities. Your line is open.

Fred Blondeau, iA Securities

Thank you and good morning. One quick question from me. Just in terms of the same-property NOI, what would be the contribution from the Chicago properties, in USD if possible, and what are your views, generally speaking, on the Chicago market today? Thank you.

Michael Sheehan, Chief Financial Officer

Yeah, so the Chicago properties, they are usually about 15% of our total contribution on a somewhat run rate basis, so you can kind of attribute it to that in terms of same property.

Steve Hodgson, Chief Executive Officer

And tough question to answer exactly. We would have to dig into that, Fred. But what I can say is that both buildings we bought at 84% occupied. 20 South Clark is now at 87% occupancy and 120 South LaSalle is at 90% occupancy. And both have higher weighted average rents than they did when we acquired them. So if that is kind of the nature of the question, we have seen an increase in same property NOI from those two properties.

Fred Blondeau, iA Securities

Okay. So you did see an increase in same property?

Steve Hodgson, Chief Executive Officer

I cannot speak to the exact numbers for this quarter, but I was just trying to give you an overall trend of where we bought them to what we have achieved to date.

Fred Blondeau, iA Securities

Okay. Great. And what would be your expectations for the next 6 to 12 months?

Steve Hodgson, Chief Executive Officer

Well, so at 120 South LaSalle, last quarter we had completed a 40,000 square foot new deal that has not yet started paying rent, so I think, overall, the US portfolio will see positive same-property NOI growth.

Fred Blondeau, iA Securities

That is great. Thank you.

Steve Hodgson, Chief Executive Officer

Thanks.

Operator

We have no further questions at this time. I turn the call back to presenters for closing remarks.

Braden Lyons, Investor Relations

Thank you, everyone, for joining the Q3 2020 conference call for Slate Office REIT. Have a great day.

Operator

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