CORPORATE PARTICIPANTS

Brady Welch
Interim Chief Executive Officer

Charles Peach
Outgoing Chief Financial Officer

Robert Armstrong
Incoming Interim Chief Financial Officer

Paul Wolanski
SVP, National Sales and Investor Relations

CONFERENCE CALL PARTICIPANTS

Sairam Srinivas
Cormark Securities

Jonathan Kelcher
TD Securities

Brad Sturges
Raymond James

Gaurav Mathur
IA Capital Markets

Jenny Ma
BMO Capital Markets

Tom Callaghan
RBC Capital Markets

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Slate Office REIT Second Quarter 2023 Financial Results Conference Call.

At this time, all lines are in listen-only mode. Following the presentation, we will conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press star-zero for the operator. This call is being recorded on Wednesday, August 2nd, 2023.

I would now like to turn the conference over to Paul Wolanski, SVP, National Retail Sales and Investor Relations. Please go ahead.

Paul Wolanski, SVP, National Sales & Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the Q2 2023 conference call for Slate Office REIT. Today I am joined by Brady Welch, Interim Chief Executive Officer; Charles Peach, Outgoing Chief Financial Officer; and Robert Armstrong, Incoming Interim 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 disclosures, including our Q2 2023 investor update, which is now available.

I will now hand over the call to Brady Welch for opening remarks.

Brady Welch, Interim Chief Executive Officer

Thank you, Paul. In a challenging operating environment, our team remained focused on positioning the REIT’s portfolio for stability and long-term performance. This quarter, we continued to assess opportunities to strengthen the REITs balance sheet and liquidity.

In April, the Special Committee of the Board completed its review of strategic alternatives and announced a value preservation plan, under which the REIT amended its monthly distribution to retain $24 million of cash annually. The REIT's Board unanimously approved this plan as the most prudent way to preserve value for unitholders in the current macroeconomic environment, while also positioning the REIT for long-term success.

The REIT's leasing activity continues to show improved rental rates for both new leases and renewals. Looking ahead, our team remains focused on leasing vacancies, extending lease terms, increasing occupancy, and growing in-place rental revenue.

Long-term, we continue to look for opportunities to reposition the REIT's portfolio away from capital intensive assets toward stable cash-flowing assets with lower capital requirements. We believe the office plays an essential role in workplace culture, productivity, and innovation, and we continue to evaluate opportunities to align our portfolio with stable tenants, assets, and markets.

I'll now hand it over to Charles for some additional highlights.

Charles Peach, Outgoing Chief Financial Officer

Thank you, Brady. Leasing in the quarter continued to capture increased rental spread, with a weighted average rental rate spread of 12.1%, and the portfolio has a 3.5% weighted average discount to current market rent. The next 12 months' maturing leases have in-place rents 9.1% below market rate, providing the opportunity to further capture this.

Central banks in the REIT's markets of Canada, the United States, and Ireland have continued to raise interest rates over the quarter, which has made financing more expensive, while the market sentiment towards the broader office sector has made credit less available.

The strength of the REIT's rental revenue from its high-quality tenant base continued to assist with the refinancing of the REIT. Following the refinancing of unsecured debt in the first quarter, in the second quarter we completed the refinancing of Commerce West, and progressed three other senior refinancings, all with different finance providers.

I'll now hand over for questions.

Operator

Thank you. Ladies and gentlemen, if you do wish to register for a question, please press the star followed by the one on your touchtone phone. You will hear a three tone prompt acknowledging your request. If you would like to withdraw your request, please press the star followed by the two. Once again, to register for a question, it's star followed by one.

Our first question comes from the line of Sairam Srinivas from Cormark Securities. Please go ahead. Your line is now open.

Sairam Srinivas, Cormark Securities

Thank you, operator. Good morning. Congratulations on the good spreads this quarter, but I see the vacancy has gone up on a quarter-on-quarter basis. Can you give some color on the vacancy you're seeing in Ireland and Atlantic Canada?

Brady Welch, Interim Chief Executive Officer

Yes, good question. We're optimistic on the activity that we're seeing in our buildings. I think it's just a matter of timing. We've got some large potential users that are looking at space right now. We're doing some good leasing in Ireland specifically. We've done a couple of deals in Atlantic Canada. It gives us hope that we can continue along that momentum.

The great thing for us is that we own the real estate at a very attractive basis per square foot, and where rental rates are, we're not seeing the softening of rental rates. It's competitive out there to get tenants, and we're doing everything that we can to be competitive.

The vacancy I look at as upside for us to continue to increase our occupancy, and that's how we're going to create more cash flow for the unitholders.

Sairam Srinivas, Cormark Securities

Brady, in terms of the Atlantic Canada portfolio, I know in the last couple of years the strategy was to get those short-term leases in place and fill that in, and then essentially fill the vacancy. Are those the leases that are coming up?

Brady Welch, Interim Chief Executive Officer

We have a small percentage of short-term leases in the portfolio. We always look to put term into any deals that we do. Our 10 largest tenants in the portfolio represent 40% of our cash flow, and we will always look for long-term commitments in our buildings, not shorter-term deals.

We're intentionally looking for good tenants, good covenants, and commitments to our buildings.

Sairam Srinivas, Cormark Securities

To your point on focusing on occupancy, where do you see occupancy trending over the six months?

Brady Welch, Interim Chief Executive Officer

We're hopeful that we can continue to add. We're just around 80%, and it's an asset class where we feel that people are coming back to the office.

If we look at the markets that we operate in, even in the Greater Toronto Area, we don't own any assets in downtown Toronto. We have seen a lot of leasing activity in the suburbs of the Greater Toronto Area where our assets are, and those markets seem to be performing better than downtown.
In Ireland, that market is performing very well; it's a different market than Canada. Ireland has the best GDP in the EU, a lot of foreign direct investment. We have assets that are located in markets where there's a lot of skilled labor and a lot of life sciences tenants. And although vacancy might drop, we're 88% - 89% occupied, and we see some uptick there.

I would say we'll gradually chip away. There are some large potential deals that could make a significant difference for us if we're able to make that happen.

Sairam Srinivas, Cormark Securities

That's good color, Brady. Just finally changing gears to financing, I know this quarter you guys made some progress on refinancing more of the debt coming up. But can you give some color on the upcoming maturities and where you see those things getting refinanced?

Brady Welch, Interim Chief Executive Officer

As Charles mentioned, it is a market right now where access to credit has tightened. That being said, we are in the process of refinancing approximately $130 million on two assets, which we hope to close in the next few days. And we are continuing discussions with our lenders, and we're having constructive conversations with them.

That is our focus right now; liquidity in the company, making sure that we retain cash, and working closely with our lenders in a challenging credit environment for office.

Sairam Srinivas, Cormark Securities

That's awesome. Thanks for the color, Brady. I'll turn it back.

Operator

Thank you. Our next question comes from Jonathan Kelcher from TD Securities. Please go ahead. Your line is open.

Jonathan Kelcher, TD Securities

Thanks. Good morning. Going back to occupancy, it did dip a little in the quarter. How much of that would be non-renewals versus tenants renewing but taking up less space?

Brady Welch, Interim Chief Executive Officer

That's a good question, Jon. I think it's a combination of both. We've seen some tenants renew and contract on the amount of space they're taking, which I think is a broader macro issue for office. And then there were a couple of known vacancies, so it's a combination.

Subsequent to June 30th, we've done some positive leasing on larger deals, both in Atlantic Canada and in Ireland.

Jonathan Kelcher, TD Securities

Okay. So, good progress. You don't have a lot maturing over the next little bit, based on that?

Brady Welch, Interim Chief Executive Officer

Yes.

Jonathan Kelcher, TD Securities

Okay. And more generally speaking, how would you compare renewal rates now versus what they would have been pre-pandemic? Are you getting similar renewals?

Brady Welch, Interim Chief Executive Officer

Yes, we haven't seen slippage in our base rates in the markets where we're operating. That's why I made that comment about downtown Toronto. I don't know whether that's the same case, but all of our leasing spreads, both on new deals and renewals, have been positive.

When we've bought assets, we always focus on what's our per square foot basis, where are rents, and is there organic growth. And in the markets we have, we continue to see the same trends.

Jonathan Kelcher, TD Securities

Okay. And switching to the balance sheet, Charles, your total debt increased a little bit quarter-over-quarter. Was that mostly a function of FX rates?

Charles Peach, Outgoing Chief Financial Officer

No, on our financing on Commerce West, we financed at a slightly higher amount than we had before. So, that shows the ability to up-finance on some of the assets that we may have. We had a slight drawing on the revolver as well.

If I look in totality at the amount of change in debt from the end of December, I think it was just over 1%. It wasn't a significant increase in the amount of debt that we have outstanding at the moment.

Jonathan Kelcher, TD Securities

Okay. Looking ahead on that with the lower distribution level, should we expect the total amount of debt to tick down over the next few quarters?

Charles Peach, Outgoing Chief Financial Officer

I think the amount of debt outstanding is going to be a function of what happens on the operational side of the portfolio. At the moment, there are two things, one of which is, as Brady has mentioned so far, the ability to increase that rental revenue that we have by working on in-place rents, and also by working on occupancy. And that comes in and that supports the quantum of debt we have outstanding.

At the same time, there may be opportunities to release capital from certain assets, by dispositions, for example. And if so, then that's down to the Board and management on the decision of how that might be best applied, whether that might be best applied towards accretive leasing, for example, or in reducing what the debt might be on the company.

Jonathan Kelcher, TD Securities

Okay. That is helpful. That's it for me. I'll turn it back. Thanks.

Operator

Thank you. Once again, to register for a question, please press star followed by the one on your touchtone phone.

Our next question comes from the line of Brad Sturges from Raymond James. Please go ahead. Your line is open.

Brad Sturges, Raymond James

Hi there. Good morning. Just to follow up on the questions on the balance sheet, just for my understanding, in terms of the upcoming maturities that you're working on, at this stage would you be expecting to repay down some debt, or would you be refinancing at similar levels based on your expectations today?

Charles Peach, Outgoing Chief Financial Officer

We have a mixed environment. We have certain times where we’ve had the opportunity to up-finance our assets. And there are other assets which we will look to pay down their debt. We did similarly towards the end of last year on 120 South LaSalle in Chicago with a fairly significant pay down.

It varies across each of our assets, partly because each of our assets are financed (with the exception of our revolving facility) individually, and it’s an opportunity for us to optimize the amount of debt we have against each one.

It’s really an asset-by-asset perspective about whether we’d look to gain further financing on one asset in order to pay down the debt against another asset. So, it’s individually based.

Brad Sturges, Raymond James

Okay. And you have been reviewing your portfolio in a pretty comprehensive fashion and concerning asset sales. Where would you be at that stage? Are we potentially getting close to seeing some assets being listed for sale, or do you think it’s not the time to be doing that quite yet?

Brady Welch, Interim Chief Executive Officer

Good question, Brad. We are always looking at our assets in terms of, have we completed our business plan? Is it the right time to sell? Generally, it’s a tough market out there today to go sell assets, but we will look at the opportunities to sell assets if we feel that we can.

You'll probably see us consider some sales on assets that we feel are not core for us long-term. But we need to do it in a programmatic way and see what's the best for the unitholders, as opposed to selling in a forced market. That's what we weigh.

Brad Sturges, Raymond James

Makes sense. To go back to the leasing occupancy discussion, as you're seeing new activity from new users into your portfolio, are you seeing any further extension on timelines for negotiation or just in terms of touring activity to get a deal done, or has that stabilized to the best of your knowledge right now?

Brady Welch, Interim Chief Executive Officer

We haven't seen that. When we talk to our tenants, they are looking long-term about where they want to be and what type of office space they want to be in. Whether they're only there three or four days a week, they need to have a place, and they're putting in long-term strategies.

We haven't seen reduced time to do deals or make decisions. It's the same. I think they're just considering, how much space do we need? How is our business going to operate? But I haven't seen any delays in making decisions.

Brad Sturges, Raymond James

Got it, and I know there's not that much left to roll this year. Looking into next year, are there more known vacancies that you're aware of at this point where there's either downsizing or a non-renewal, or do you have pretty good visibility on what your retention rate would be at the stage?

Brady Welch, Interim Chief Executive Officer

We do have pretty good visibility on that. There are no known large vacancies expected right now.

Brad Sturges, Raymond James

Okay. Thanks. I'll turn it back.

Operator

Thank you. Our next question comes from Gaurav Mathur from IA Capital Markets. Please go ahead. Your line is open.

Gaurav Mathur, IA Capital Markets

Thank you, and good morning, everyone. Just on your MD&A, you mentioned that you've explored various capital reallocation strategies that you'll execute on when the markets become more favorable. Would you be able to provide some color on what that looks like and how investors should think about the rate over the next 12 to 24 months?

Brady Welch, Interim Chief Executive Officer

Right now, it's a challenging market. We're being defensive. We're retaining cash. We're focused on making sure we have liquidity for the REIT. We will sell assets when we believe we can at a price that we feel is an appropriate price.

Today, it's not about growth. It's about managing our assets, leasing our assets, and making sure that we have liquidity in the REIT. That's our focus right now.

Gaurav Mathur, IA Capital Markets

Okay, great. And then switching gears to your tenant profile, are there any tenants, or is there a subset of tenants, that are causing concern as you look at the vacancies in the portfolio?

Brady Welch, Interim Chief Executive Officer

No. There are no tenants that we are concerned with in terms of credit. When we look at our rent roll, most of our tenants are strong covenant. We do have some government tenants. But we have a lot of triple A corporate covenants within the portfolio. We're not seeing any weakness in terms of payment of rents within our portfolio.

Gaurav Mathur, IA Capital Markets

Okay, great. And lastly, when you're having discussions on new leases, is there an implication that you'd see your leasing costs rise as well, given the state of the office market currently?

Brady Welch, Interim Chief Executive Officer

In the markets where we operate and own assets, we look to provide incentives if we feel the covenant is there and the tenant's going to commit long-term. And it would be either a combination of some free rent and some cash. With the environment we're in, we're trying to do some more free rent, and some creative deals where we can spread free rent across. Those are the type of things we're seeing.

We haven't seen significant increases in total leasing costs in the markets where we are. I know that in downtown markets, you're seeing incentives and TIs increasing significantly. But in the markets where we are, we haven't seen that.

Gaurav Mathur, IA Capital Markets

Okay, great. Thank you for the color. I'll turn it back to the operator.

Operator

Thank you. Our next question comes from Jenny Ma from BMO Capital Markets. Please go ahead. Your line is open.

Jenny Ma, BMO Capital Markets

Thank you. Good morning, everyone. I wanted to ask about the hotel asset. It looks like the NOI was down year-over-year. Can you give some commentary on the performance of the asset. Is it a revenue decline or is the operating cost going up, and how do you see the third quarter shaping up given that it's the busiest quarter of the year for hotels?

Charles Peach, Outgoing Chief Financial Officer

As opposed to an underperformance in this period, I think we had an outperformance in the prior period due to specific conferences and certain block bookings that there were within the hotel. I don't think we're looking at any particular weakness in that asset, and that asset is, from our perspective, a strong cash flowing one which we're pleased to have.

Jenny Ma, BMO Capital Markets

Okay. It looks like Q3 '22 was a fairly strong quarter as well. So, was that mostly regular business, or is there some conference revenue in that quarter as well?

Charles Peach, Outgoing Chief Financial Officer

My comparison here is quarter-on-quarter from '22 and '23. There was a stronger performance on the conference and the business side and those block bookings that we had in that period. But I think that was an outperformance in that period as opposed to an underperformance.

Brady Welch, Interim Chief Executive Officer

I believe the Memorial Cup was out there, so that hotel experienced outperformance because of the activity there.

Jenny Ma, BMO Capital Markets

Okay. So, would we expect Q3 to come down a little bit year-over-year then? I was just wondering how much exposure there was.

Charles Peach, Outgoing Chief Financial Officer

We think it will be flat.

Jenny Ma, BMO Capital Markets

Okay, that's helpful. Turning to the credit loss that was booked in G&A related to the VTB loan, could you remind us, what property that was related to and how much it was?
I think it's flowed through a few quarters. How should we think about it going forward?

Charles Peach, Outgoing Chief Financial Officer

This is an asset that was sold by the REIT in September 2018, so five years ago, and there was a five-year VTB which was provided against that.

If we think about the VTB itself, it was a small amount of the sale price. The sale price of that asset was $17 million, and the VTB provided was $2.7 million. What you'll see is the bad debt we have within the G&A in this period relating to that VTB was $950,000. So, if I think about it from the sale price, it's $1 million out of $17 million in initial amount.

Jenny Ma, BMO Capital Markets

Okay. Why is the VTB credit loss being written down in steps as opposed to a one-time write down?

Charles Peach, Outgoing Chief Financial Officer

In September we didn't have repayment of principal, but we continued to have some repayment of interest, and our expectation at that point was that we would be able to receive close to full payment, if not full payment, but we took a certain amount of cost on that, due to expected legal costs we might have in recovery.

Since then, in looking further into it, we realized the only way we would be able to recover was through the sale of the security that was there. We sold the security and received $1.4 million on that amount, and we expect that to be the end of the matter.

Jenny Ma, BMO Capital Markets

Okay. So, if I'm hearing correctly, there's $1.4 million to come, in terms of credit loss?

Charles Peach, Outgoing Chief Financial Officer

$1.4 million has been received in July in cash and is with us.

Jenny Ma, BMO Capital Markets

Okay. So, is there any more credit loss to be booked in coming quarters?

Charles Peach, Outgoing Chief Financial Officer

There is no more credit loss to be booked beyond what was booked when we initially said there would be certain legal costs and similar and the $950,000 taken within G&A in Q2.

Jenny Ma, BMO Capital Markets

Okay, that's very helpful. So, I presume there's no more associated interest income that you've received related to this VTB loan. Is that correct?

Charles Peach, Outgoing Chief Financial Officer

We don't expect to. If there were to be, there might be a bit of a further upside, but I wouldn't be reliant on that.

Jenny Ma, BMO Capital Markets

Okay, that's very helpful. Thanks for the color.

Operator

Thank you. Our next question comes from Tom Callaghan from RBC. Please go ahead. Your line is now open.

Tom Callaghan, RBC Capital Markets

Thanks. Good morning, guys. First question is just on physical occupancy or utilization rates across your portfolio. I know in the past you guys had talked about Ireland and Atlantic Canada as leaders, but just curious on any updated thoughts you're seeing here across the portfolio. And are some of the other regions starting to close that gap?

Brady Welch, Interim Chief Executive Officer

Each market operates a little bit differently, and I think it's the result of coming out of COVID and just human behavior. We do see generally a trend of more activity in people coming into the office. It used to be two or three days, and now they're coming in four days. So, the utilization of space is trending positively.

And in Ireland, it's more different than Toronto, but that's just human behavior and where the assets are located. I would say we see more return to the office space in general.

Tom Callaghan, RBC Capital Markets

Okay. And switching gears with respect to the IFRS values, you took your terminal cap rates up this quarter. Maybe just some commentary on what went into this.

And are you starting to see a little bit more activity in the market between willing buyers or sellers, or is it still pretty sparse at this point?

Brady Welch, Interim Chief Executive Officer

We have a methodology and a process for evaluation, which we do each quarter, and we do it on an asset-by-asset level. We look at all the data and inputs in terms of reports from the market and all the data points. And that's how we take a look at terminal cap rates.

Then, we take a look at 10-year Treasuries in each of the markets that we own assets and apply a spread over that to discount things, and then we look at trades. But it is pretty sparse, there are not a lot of trades in office right now. But that's how we do our valuations.

Callaghan, RBC Capital Markets

Okay, thanks. I'll turn it back.

Operator

Thank you. There appear to be no further questions. I'll return the conference to Paul Wolanski for closing remarks.

Paul Wolanski, SVP, National Sales & Investor Relations

Thank you, everyone, for joining the Q2 2023 conference call for Slate Office REIT. Have a great day.

Operator

Thank you. This does conclude today's conference call. Thank you all for attending. You may now disconnect your lines.