CORPORATE PARTICIPANTS

Steve Hodgson
Chief Executive Officer

Michael Sheehan
Chief Financial Officer

Lindsay Stiles
Chief Operating Officer

Braden Lyons
Investor Relations

CONFERENCE CALL PARTICIPANTS

Jonathan Kelcher
TD Securities

Brendon Abrams
Canaccord Genuity

Sairam Srinivas
Cormark Securities

Jenny Ma
BMO Capital Markets

Matt Kornack
National Bank Financial

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Slate Office REIT First Quarter 2021 Financial Results Conference Call. At this time, all participant lines 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 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, Braden Lyons, Investor Relations. Thank you. Please go ahead, sir.

Braden Lyons, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the Q1 2021 conference call for Slate Office REIT. I am joined this morning by Steve Hodgson, Chief Executive Officer; Michael Sheehan, Chief Financial Officer; and Lindsay Stiles, Chief Operating 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 Q1 2021 investor update, which is available now.

I will now hand over the call to Steve Hodgson.

Steve Hodgson, Chief Executive Officer

Thank you, Braden.

I would like to focus my comments on three key areas. One, the durability of our cash flows; two, our current trading discount to net asset value; and three, our scalable platform for growth.

On the durability of our cash flows. 60% of our portfolio is comprised of government or credit rated tenants. We paid investors an annualized distribution of 9.3% in the first quarter, which was well covered with a payout ratio of 79%. We completed over 100,000 square feet of leasing with positive rental spreads.

We have continued to demonstrate organic rental rate growth in our portfolio with average leasing spreads of 13.6% since January 2020. Subsequent to quarter end, we completed a 10-year lease renewal with the province of New Brunswick for over 100,000 square feet, highlighting the improving market fundamentals in Atlantic Canada. Our weighted-average lease term is 5.3 years, with only 2.9% of our portfolio remaining to be renewed in 2021.

On our trading discount to net asset value, there continues to be a disconnect between public and private office real estate values. We are trading at a 49% discount to our net asset value. However, our net asset value is supported by recent comparable transactions, and 74% of the portfolio was externally appraised in 2020.

Finally, on our scalable platform for growth, our best-in-class team and the strength and reach of the Slate Asset Management platform combine to create a tremendous opportunity to grow our business. We intend to focus on larger, more transformative acquisitions in growing markets in the United States, Canada and Europe.

Growth is critical for the REIT's long-term success, as it will further diversify and stabilize our portfolio, attract more institutional investors, reduce our cost of capital and further strengthen our balance sheet.

Given the attractiveness of the investment opportunity and the improving operating fundamentals in our markets, the future is bright. On behalf of the Slate Office REIT team, we thank you for your continued support. And I will now hand it over for Q&A.

QUESTION AND ANSWER SESSION

Operator

Ladies and gentlemen, if you would like to ask a question, please press star then the number one on your telephone keypad. We will pause for just a moment to compile the Q&A roster.

Your first question comes from the line of Jonathan Kelcher with TD Securities.

Jonathan Kelcher, TD Securities

Thanks, good morning. Is Europe a new market for you? I do not think you guys have previously talked about that. And what markets over there would you specifically be looking at?

Steve Hodgson, Chief Executive Officer

Thank you for the question, Jonathan. It is a new market for Slate Office REIT. Slate Asset Management, however, has been investing in Europe since 2016, and we have about 12 people on the ground in Germany, the United Kingdom and Luxembourg.

So, the idea is for a special meeting later today to amend our declaration of trust to include the ability to invest in Europe. And it is really just because we have people on the ground there. There are some interesting deals. Nothing imminent, but there are some interesting deals that we have seen and we wanted to provide the REIT the flexibility to potentially do something exciting and accretive in those markets.

And to your question about which markets specifically, it would be likely the United Kingdom, Germany or France.

Jonathan Kelcher, TD Securities

And your leverage is still fairly elevated. Would you be looking to sell some assets here in order to fund acquisitions going forward?

Steve Hodgson, Chief Executive Officer

No, what we are looking to do from a growth perspective is we have some liquidity, but we do not intend to use all of that liquidity to just buy one or two assets. We would rather use that liquidity to support a more transformative acquisition, whether that is a share deal of some sort or a merger of some sort.

So, we always will continue to recycle capital as we fully value assets and look to redeploy that equity to more accretive opportunities. But it is not about selling from one market to another. It is just about growth.

Jonathan Kelcher, TD Securities

Okay. And just on the government renewal, what sort of uplift did you get on that 100,000 square feet?

Lindsay Stiles, Chief Operating Officer

Hi, Jonathan. As Steve said, we are really pleased that we were able to complete this 10-year extension with the province of New Brunswick in Fredericton. We do not disclose spreads for specific deals, but what I will say is, they have been in place for 10 years so there was an adjustment to bring that rate closer to what we feel is current market. We are happy with their commitment to the location and the market long-term and we are starting to see that from other tenants in the other markets we are operating in as well.

Jonathan Kelcher, TD Securities

Okay. So, we should be able to back into that next quarter though, right? I would assume that is going to be the bulk of your re-leasing spread when you report Q2?

Steve Hodgson, Chief Executive Officer

Yeah. What I will say is, since January 2020, our leasing spreads have averaged 13.6%. And, Q2 is pacing well ahead of that number.

Jonathan Kelcher, TD Securities

Okay, thanks. I will turn it back.

Operator

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

Brendon Abrams, Canaccord Genuity

Hi, good morning, everyone.

I am not sure if it is disclosed in the MD&A; maybe I missed it. But what has been the retention rate within the portfolio over the last few quarters?

Steve Hodgson, Chief Executive Officer

We had some known vacancies hit us in Q4 and Q1, which were really at the end of Q4 that hit the occupancy in Q1. So, over the last couple quarters, those known vacancies in Atlantic Canada did hit us. And so, I would suggest that our retention rate was lower than usual. But we normalize at an 85% retention rate.

Brendon Abrams, Canaccord Genuity

Right, okay. That is helpful. With occupancy where it is currently and projected to be on a stabilized basis being much higher, where do you see the opportunities in the portfolio over the next 12 months to meaningfully move up occupancy? Is there one or two assets where you think you could really drive occupancy higher?

Lindsay Stiles, Chief Operating Officer

Yeah. We are really encouraged by the momentum we have seen across the portfolio in all of the markets this quarter. As we mentioned in Q4, we really viewed Atlantic Canada as a leading indicator for the rest of our markets.

To give you some indication for Q1, the bulk of the leasing activity we completed was specific to the Greater Toronto Area. Certainly, still solid numbers in Atlantic Canada and a few smaller deals in the U.S. and our Western portfolio. But we are really starting to see an uptick in the Greater Toronto Area, and also lots of momentum and paper trading in Chicago as well.

So, I do not think I would pinpoint any specific assets, but the fact that we have 85% of the portfolio located in suburban and secondary markets, we have not seen the same impact of the rising vacancy and sublet space availability that a lot of the downtown core markets are struggling with right now.

Brendon Abrams, Canaccord Genuity

Okay, that is helpful. And just the last one for me before I turn it over. Wondering if you could comment on the tenant incentive environment right now within your submarkets and how that would have compared to a pre-COVID environment?

Steve Hodgson, Chief Executive Officer

Yeah, tenants that are doing deals today are either renewing long-term or they are looking to put the least amount of capital investment into a new deal that they can. So, what we are seeing is that renewals from a tenant incentive perspective are happening pretty much in line with what they were before, because tenants are a little stickier and more apt to stay in place than to move in this market.

And then from a new leasing perspective, there are some additional incentives, more so on the free rent side, to get tenants to make decisions now versus waiting until the conclusion of the pandemic. But otherwise, the tenant incentive packages are pretty similar to what they were before.

And further, it is different because 85% of our assets are not in downtown cores in major markets, we are not seeing the same sublet activity that Lindsay noted. And so, we do not have that competitive pressure from a tenant incentive perspective.

Brendon Abrams, Canaccord Genuity

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

Operator

Your next question comes from Sairam Srinivas with Cormark Securities. Your line is open.

Sairam Srinivas, Cormark Securities

Hey, guys. Good morning. Just broadly on the leasing side, are you seeing more tenants getting into discussions in terms of changing floor plans and requiring you to invest more capital in new properties?

Lindsay Stiles, Chief Operating Officer

That is a great question, Sai. I cannot cite a specific example where we have seen that. I would say as a general rule, a lot of the conversations we are having are just about when tenants are returning. At the moment, it sounds like with the quick vaccine rollout and things picking up, we expect a lot of our larger tenants to come back to the office later in Q2, Q3, and certainly by the end of this year.

Based on corporate direction, some may look to do some reconfiguration of their space. But I think in a lot of instances what is more likely to happen is a select few employees will choose to continue to work from home, and that will allow some additional space for the necessary social distancing requirements to be implemented within existing premises.

Having said that, we have had some discussions with groups who feel that they will need more space in order to accommodate social distancing. So, it is a little early on to know exactly how that is all going to shake out, but I think we will have a better sense in the next couple of quarters.

Sairam Srinivas, Cormark Securities

Thanks for the color, Lindsay. And broadly, the second question is around the weighted average in-place rent. I see it kind of trickled down a bit in Q1, $17.86 versus $17.95 in the last quarter. Any specific reason why the downtrend? Is it because of lower spreads on the renewals?

Steve Hodgson, Chief Executive Officer

No. So the weighted average in-place rent would be exactly that, a weighted average based on the buildings and the various rents. So, it is likely that where we had some vacancy arrive or some new leasing arrive, either moved up or down that weighted average. But from a building-by-building perspective, we are not seeing a decline in weighted average rent.

Sairam Srinivas, Cormark Securities

Perfect. That is it for me. I will turn it back.

Operator

Okay. Again, to ask a question, please press star then the number 1 on your telephone keypad. Your next question comes from Jenny Ma with BMO Capital Markets. Your line is open.

Jenny Ma, BMO Capital Markets

Thank you, and good morning. Just back on the topic of the potential opportunities in Europe. Given where the liquidity is at and your desire to not sell properties to fund it, would you consider doing any joint ventures with Slate Asset Management to pursue these deals?

Steve Hodgson, Chief Executive Officer

We would consider joint ventures, not necessarily with Slate Asset Management though. If there was a compelling opportunity and that is the way we had to structure it, then it is a possibility, but it is certainly not part of our going-in investment thesis.

Jenny Ma, BMO Capital Markets

Okay. And would you be looking for a managing partner on the ground, or would you have the desire to actually take up the management with the team that you have there already?

Steve Hodgson, Chief Executive Officer

No, we would be looking for a management team on the ground to support us, in addition to the team that we have from an oversight perspective.

Jenny Ma, BMO Capital Markets

Okay. And I am just wondering, I am sure it is early days and you have not gotten the declaration change yet, but are you starting to kick any tires there, or how far along are you on that process of exploring potential expansion in Europe?

Steve Hodgson, Chief Executive Officer

Yeah, we have been investing in Europe since 2016 and well in advance of that had started kicking tires in Europe. So, the team is very well versed. As you may know, Brady Welch now lives in London, and he is a founding partner of Slate and has a team with him there that are sourcing opportunities for the entirety of the platform.

As you may know, the way that we originate deals is Slate Asset Management looks at all kinds of real estate transactions that fit our profile of buying below replacement cost and being able to leverage our platform to create value.

Some of those will fit more opportunistic type funds. Some will fit more core type funds and some might fit the core plus type returns and profile that the office REIT is looking for. So, in that event, Slate Office REIT would like to participate.

And again, this is not about we have a deal and we are going to talk about it in the next few weeks. This is about positioning ourselves to have more opportunities in the future.

Jenny Ma, BMO Capital Markets

Okay. What I am trying to drill down to is whether or not you have seen anything in the office space that was compelling. I know the asset management group has looked at a variety of asset classes. But is there anything that is really emerging that fits into the Slate Office bucket, which I presume would be primarily office properties?

Steve Hodgson, Chief Executive Officer

Yeah, there are deals, and that is definitely why we are interested in exploring it further. Nothing imminent at the moment that we are acting on, but there are deals that are coming in the pipeline or that we have seen transact that we think could be interesting and fit our profile.

Jenny Ma, BMO Capital Markets

Okay, great. My next question is about the discussion about the U.S. London Interbank Offered Rate (“LIBOR”) transition. I am wondering if you can give us more color around that. What rate are you paying now? And what is the risk around the transition? When you are talking about transitioning away, are you able to get another lender in place or go into fixed rate debt? How should we think about this?

Michael Sheehan, Chief Financial Officer

Yeah. Quite honestly, there is not going to be a material impact to the business, so that is the expectation at this point in time. Our counterparties on those transactions are Canadian banks and we have had numerous discussions with them. There is fallback protocol which you may be aware of that basically outlines at what point in time the event is triggered that you transition away from LIBOR. And for U.S. LIBOR, it is actually 2023 for the one-month LIBOR. That is the expected timing at this point.

And based on discussions with our counterparts on all those transactions, we are expecting to be economically equivalent in terms of a benchmark rate, once that transition does happen.

Jenny Ma, BMO Capital Markets

Okay. And how much term do you have left on those pieces of debt from the U.S. properties?

Michael Sheehan, Chief Financial Officer

There is one that is up this year and then the other one is next year.

Steve Hodgson, Chief Executive Officer

The one that is up this year is 120 South LaSalle. And as a reminder, it is almost 90% occupied and growing and the lead tenant is CIBC with nine years left of lease term. So, from a refinancing perspective, it is very stable and we are comfortable.

Jenny Ma, BMO Capital Markets

Okay. And given that the maturities are fairly short-term, would you be looking to fix these pieces of debt and eliminate this U.S. LIBOR discussion, not so much on the economics?

Michael Sheehan, Chief Financial Officer

Yeah, it is a possibility, certainly an option on the table. But what everyone is doing now is continuing to run their businesses and have provisions by which you would transition from LIBOR to the Secured Overnight Financing Rate ("SOFR") rate, which is the expected replacement rate for the LIBOR loans currently.

So, we have flexibility there, and it is being contemplated by a number of counterparties in the market. So, fixed rate is always an option. The floating rate is an option as well with transition provisions when SOFR is a viable option as an alternative rate.

Jenny Ma, BMO Capital Markets

Okay, great. And then lastly, I am not sure if I missed it, but did you disclose your Q1 rent collection or bad debt provisions?

Michael Sheehan, Chief Financial Officer

We did not, but I can tell you it is consistent with prior quarters. So, 96-98% each month in cash rent collections. Bad debt is disclosed as part of G&A, so we only wrote off $20,000 in Q1.

Jenny Ma, BMO Capital Markets

Perfect. Thank you very much. I will turn it back.

Operator

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

Matt Kornack, National Bank Financial

Apologies if I missed this, but did you disclose whether there was any free rent period associated with the lease extension in New Brunswick post quarter?

Steve Hodgson, Chief Executive Officer

There was free rent. It is staggered over the term. And we would account for that when we do our rental spread calculations, of course. But that is typical for the government deals where they do not request tenant incentives and you provide free rent in lieu. But from an overall inducement perspective, it is relatively low because it was a renewal and the government did not have much of a need for dollars to invest into the space.

Matt Kornack, National Bank Financial

Okay, fair enough. So, from an accounting standpoint, we should expect that there is no cash impact to the straight-line rent. It is amortized, essentially?

Michael Sheehan, Chief Financial Officer

Yes.

Matt Kornack, National Bank Financial

Okay, fair enough. And then just more broadly, you guys have a platform that operates globally. Canada, we are a little bit behind here. You have assets in the U.S. where things are a bit ahead, but can you speak to the leasing dynamics that you are seeing either in underwriting new assets abroad or in your own assets in places where the vaccine rollout has been escalated? Just want to get a sense. Our Canadian context here is a little bit lagging, but interested in what you are seeing elsewhere.

Steve Hodgson, Chief Executive Officer

Sure, and there is a report that Cushman & Wakefield just put out that I can direct you to as well subsequent to the call that is a pretty fulsome answer to your question. But Lindsay, maybe you could speak to the return to work in the U.S. versus Canada, and then I can touch on the investment part of that question.

Lindsay Stiles, Chief Operating Officer

Sure. Yeah, so as you noted, absolutely the rollout of the vaccine has been a lot faster in the U.S., and our experience is specific to Chicago there. From a leasing perspective, we have seen activity pick up significantly in Q2. There is a lot of paper trading. There are a lot of tours happening. People are eager to get back to the office.

We have done a survey of our tenants on their back-to-work plans, and a lot of the larger well-known corporate groups that you would be familiar with are planning to start to return later in Q2, with a full return to pre-pandemic occupancy levels by the end of Q3.

So, they are pretty much full steam ahead. It is getting very close and we expect business as usual towards the end of the year. So, it is really encouraging, and we expect our other markets to follow.

Steve Hodgson, Chief Executive Officer

Yeah, and from an investment perspective, what we are seeing in general is that institutional capital has been more focused on residential, industrial and other sectors. But the private markets have still been doing a lot of office transactions and supporting the values. But that is limited in deal size with private capital.

So, in Toronto, for example, there are still single asset suburban Toronto deals happening at or above values they were pre-pandemic because there is still liquidity and attractive debt financing available.

That is consistent in the U.S., too. It is just that in the U.S., I would suggest there is a little bit more dislocation, competitiveness and oversupply. If you think of Toronto, 70% of the downtown inventory is owned by five landlords, and they are all large institutions that can weather the storm. In markets like New York or San Francisco, it is a little bit more bifurcated and as a result, more competitiveness and more debt on those assets, with the need to be more competitive.

So, the fundamentals are not quite as strong as Canada right now, and so we need to be mindful of that when we review opportunities. But opportunities will come, and it is just right now, the bid/ask spreads are too wide because of that uncertainty. But once things become more certain, we think that gap will close. We are being patient and we think there will be lots of opportunities.

Matt Kornack, National Bank Financial

From what you said, it does not appear that there is any distress at this point in Canada. But are there pockets of distress in the U.S. that would be good from an opportunistic deployment of capital standpoint, or are things holding up pretty well on that front as well?

Steve Hodgson, Chief Executive Officer

Yeah, I think there will be. We are not necessarily targeting pure opportunistic type real estate. We are looking for assets with an element of stability, but still some upside for us to leverage our platform and team and create value. And so those types of deals are still in pretty high demand. So, there is not a lot of distress.

Matt Kornack, National Bank Financial

Okay, fair enough. Thanks, guys. Appreciate it.

Operator

Okay, and I'll now turn the call over to Braden Lyons for closing remarks.

Braden Lyons, Investor Relations

Thank you, everyone, for joining the Q1 2021 conference call for Slate Office REIT. Have a great day.

Operator

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