CORPORATE PARTICIPANTS

Madeline Sarracini
Investor Relations

Scott Antoniak
Chief Executive Officer

Robert Armstrong
Chief Financial Officer

Steve Hodgson
Chief Operating Officer

CONFERENCE CALL PARTICIPANTS

Jonathan Kelcher
TD Securities

Dawoon Chung
National Bank Financial

Jimmy Shan
GMP Securities

Sairam Srinivas
BMO Capital Markets

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Slate Office REIT Third Quarter 2017 Financial Results Conference Call. As a reminder, this call is being recorded today, Wednesday, November 8, 2017 at 9:00 a.m. Eastern Time. Your host for today's call is Madeline Sarracini, Investor Relations. Please go ahead.

Madeline Sarracini, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the third quarter 2017 conference call for Slate Office REIT. I am joined this morning by Scott Antoniak, Chief Executive Officer; Robert Armstrong, Chief Financial Officer; and Steve Hodgson, Chief Operating Officer of Slate Office REIT.

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 measures, 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 Q3 2017 investor update, which is available now.

We will now allocate the remainder of this call to answering your questions. Thank you.

QUESTION AND ANSWER SESSION

Operator

If you would like to ask a question, please press star then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from the line of Jonathan Kelcher from TD Securities. Please go ahead, your line is open.

Jonathan Kelcher, TD Securities

Thanks. Good morning.

Scott Antoniak, Chief Executive Officer

Hi, Jonathan.

Jonathan Kelcher, TD Securities

Scott, in the letter you mentioned in terms of acquisitions new markets in North America. Would that mean you guys are now looking at the U.S.?

Scott Antoniak, Chief Executive Officer

Yes, we are not at the exception of Canada, Jonathan, or exclusion thereof, but we think the strategy of buying assets below replacement cost with high-quality tenants in markets that we like is transferrable, so we're going to remain consistent with the investment thesis but I think we'd be remiss if we weren't looking at more markets. We will continue to look in places where we have assets and look to tuck in assets that build on the existing portfolio and concentrations in given markets, however, I think the office dynamics from a leasing and operations perspective in the U.S. are fairly compelling right now. It's not dissimilar to how things were here 24 to 30 months ago. So, if we can execute on that basis and find those kinds of assets, that are below replacement cost, in many cases with credit profiles that are as good or better, and given the size of that market, I think it's our best interest to explore that.

Jonathan Kelcher, TD Securities

Okay. I guess you guys have done due diligence and walked away from a number of assets over the last couple of months. Were all of those in existing markets or were any of those in new markets?

Scott Antoniak, Chief Executive Officer

Both in existing and in new markets.

Jonathan Kelcher, TD Securities

Lastly, in terms of operations, I guess you were positive same property NOI versus Q2 but still down year over year. You look ahead to 2018 based on the—you had pretty good leasing activity the last couple of months and into Q4. What are you looking at for same property NOI growth?

Robert Armstrong, Chief Financial Officer

Jonathan, I think from a quarter over quarter, Q3 to Q4, we would expect Q4 to be better. I think for year over year some of the stuff that's rolling off this year will still take some time and Bell Aliant out east will still take some time to re-lease. We've been really excited about the positive leasing we've had to date at rates well above what those are coming off on, but it will take some time. We'd expect that we'd see year-over-year positive NOI growth continue in Q1 of 2018. I think Q4 will be close but we're hopeful for Q1 2018.

Scott Antoniak, Chief Executive Officer

To add to that, I think you're right to point that out but in terms of our 2017 budget our results this quarter over the same quarter last year are ahead of where we were on a plan basis. So, to Bobby's point, we're dealing with some things that we knew were coming down the pipeline even from acquisition and I think we're a little bit ahead of schedule on that. Looking forward into Q1 2018 and beyond as leases come on stream and we have some embedded rental growth, et cetera, I think you'll see that number start to get even better.

Robert Armstrong, Chief Financial Officer

Additionally, the last point I'd make is even outside of the same property, as you're aware, West Metro and Commerce West are still not going to be in the same property until Q3 of 2018, but we'd expect and the momentum we've had in both those buildings is in excess of what we underwrote, so we're quite pleased about that. It won't obviously come up in same property but it will translate into growth in 2018.

Jonathan Kelcher, TD Securities

Okay. Thanks. I'll turn it back.

Robert Armstrong, Chief Financial Officer

Thanks, Jonathan.

Operator

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

Dawoon Chung, National Bank Financial

Good morning.

Scott Antoniak, Chief Executive Officer

Good morning.

Dawoon Chung, National Bank Financial

Perhaps a question for Steve: I know this is a relatively small lease deal but regarding the Cogeco lease at West Metro, was there a termination fee with the SNC lease and is there a lift in rent compared to the previous lease?

Steve Hodgson, Chief Operating Officer

Yes, to both. You will recall from our tour of the GTA West a few months ago I had mentioned that SNC-Lavalin had a termination right on three of their floors at 191 West Metro. This represents two of those floors, which our view is that they intended to exercise a termination right that would have been effective the end of 2019. This Cogeco deal pre-lets that space to avoid any downtime and we were also able to collect an early termination fee from SNC. And the rental lift on that deal was 9 percent over existing rent.

Dawoon Chung, National Bank Financial

And to Bobby, it seems like you refinanced a $40 million mortgage at Johnson Building. It's a three-year deal at 325 fixed. What was the rationale for sort of going for a shorter term other than the fact that it had lower rates?

Robert Armstrong, Chief Financial Officer

The rational was, as you know, for the Johnson lease, we renewed them from 2020 through to 2030. Currently they're subletting in that space. The reason we went with 2020 was two factors. One, they still have an option to pull, which we are hopeful and would expect them to pull prior to that point in time. We are also in the process, over the short term, and we'd like to re-lease the basement that's currently out to Bell, doing a lease out to 2020, which would give us optimal financing at that point in time.

Steve Hodgson, Chief Operating Officer

I'd just add to that too. When Johnson commences the rent steps up significantly, as you know, Dawoon, so the debt service coverage ratio metrics improve drastically, which will allow us to extract additional proceeds.

Dawoon Chung, National Bank Financial

Right. Okay. And with regards to the AFFO payout ratio, it exceeded 100 percent for the second time this year. What's your sort of approach on this front?

Robert Armstrong, Chief Financial Officer

I think our approach and what the board considers is laid out within the MD&A and we've been clear on that but, just to reiterate, one, we look at what we believe to be the long-term capital needs of the business. You know, it's always an asset allocation decision as it relates to the distribution. We think the distribution is appropriate at this point in time.

We also think that earnings are growing. We've done a lot of great stuff so far in the REIT. We'd expect the payout ratio to return to below 100 percent rate in the short term. But what I'd add in that respect too is from a liquidity perspective the REIT has never been in a better spot and we've got more dry powder now than we ever had. So, in part, the ratio is, in our view, the implication of having capital that we haven't expended yet. So, once we deploy that capital you're going to see the payout ratio drop back down to low 90s and perhaps even high 80s.

Scott Antoniak, Chief Executive Officer

Yeah, just to finish that thought, I mean we look at this when going through these numbers, so we're very pleased with the liquidity position of the REIT right now and what that affords us the ability to do. What we never want to do is do something in the short term that will compromise valuations over the longer run.

We have been disciplined in the approach. You know that there's a couple deals that we didn't execute on. We want to buy the right assets for the right reasons and I think we're in a position to do that and had we placed even a third of the available liquidity right now we would have been right on top of expectations in terms of AFFO and would have been at or slightly inside of 100. We are very focused on the long term of this and I think it's important to note that whether that capital is deployed immediately or in the near-term future it will be one of those, but we're going to do it in a disciplined manner.

Dawoon Chung, National Bank Financial

Okay, thanks. I'll turn it back.

Scott Antoniak, Chief Executive Officer

Thanks, Dawoon.

Operator

Your next question comes from the line of Jimmy Shan from GMP Securities. Please go ahead, your line is open.

Jimmy Shan, GMP Securities

Thanks. Good morning, guys. I just wanted to follow up on the expanded scope of your acquisition strategy. Can you maybe just talk about what are some of the U.S. markets you'd be looking at and maybe what type of asset you'd be looking at? And then I was just wondering if there was anything specific that resulted in this expanded scope or is it just lack of available products here, the pricing levels here, or is it that you've found some interesting opportunities down there that caused this?

Scott Antoniak, Chief Executive Officer

I think it's a combination of those things, Jimmy. Part of the benefit of the broader Slate platform is that we are active in markets, not only in North America but around the world, so we're always looking at real estate deals all over. Our view is that, particularly in the GTA, that for the assets we've been historically looking at it's, on a relative basis, getting expensive, which is also a positive for us given the assets that we currently hold. We strongly believe that the strategy itself and the way we execute on acquisitions is transferrable, so to the extent we can find deals that are similar to deals that we've done historically but in new markets, that's a positive. I think anyone would look at it—the U.S. market is bigger than ten times the size of Canada. In many cases the deals that we can find or that we've looked at have an even better credit profile, a deeper discount to replacement cost with upside. So that's it strategically and I think that's evolved over a couple of quarters, that thinking, and as we started to look a little bit more closely or became of the view that there was a significant pipeline of assets that fit that bill.

In terms of specific markets, we think that Chicago has a lot of similar characteristics to Toronto, both downtown and in the suburbs, so we've looked at assets there. Additionally, given Slate Retail REIT's activities in the U.S. and the kind of markets where they are, we have obvious relationships with the brokerage community, with the lending community, and with asset owners in markets like that, so I think some of the markets in the southeast are of interest as well, in the Carolinas, in Atlanta, and places like that. I think for the most suburban markets particularly there are very high-quality assets with very good rent rolls that are, again, available at deep discounts to replacement costs and have a history of performance that are of interesting. Our view is, ultimately if we execute on this strategy, that scale will be important, just as it is here. I think it wouldn't be just a one-off pick and choose. Like we're looking to roll something out kind of strategically, as long as those valuations continue to make sense.

Jimmy Shan, GMP Securities

It sounds like it'd be fair to assume that the next acquisition, and I think you've got still a decent amount of liquidity, that that'll be, it'll be somewhere in those markets in the U.S. Would that be fair?

Robert Armstrong, Chief Financial Officer

I think we'll continue to look at both markets, Canada and the U.S. I think for us, like we've always said, we're somewhat market agnostic. If there are compelling opportunities in Canada in the markets we've had or even new markets in Canada, we are pursuing those and that could be as well. I wouldn't want to suppose that it would have to be the U.S. at this point in time, although we're continuing to look down there actively.

Jimmy Shan, GMP Securities

Okay. Okay, thanks, guys.

Scott Antoniak, Chief Executive Officer

Thanks.

Operator

Again, if you would like to ask a question, please press star then the number one on your telephone keypad. Your next question comes from the line of Sairam Srinivas from BMO Capital Markets. Please go ahead, your line is open.

Sairam Srinivas, BMO Capital Markets

Thank you. Good morning.

Scott Antoniak, Chief Executive Officer

Good morning.

Sairam Srinivas, BMO Capital Markets

You just mentioned about scale, so I just was wondering as to how large a portfolio do you need to actually enter a new market.

Robert Armstrong, Chief Financial Officer

I think what we're finding is the Canadian market at this point in time, and it's very well recognized, is that some of the pricing dynamics that have been in the more downtown markets have been pushed into the suburban markets. We're seeing that both just from a rent perspective but also from an investment dynamic and some of that's crept into our valuations with the increase we took this year on certain of our properties. I think the strategy we have is very simple in that we can buy at replacement cost with great credit on good buildings that have a risk-return profile in excess of, say, core markets, and that dynamic expands to the U.S. very nicely. Chicago, for an example, it's an hour-and-a-half flight, which is closer than Atlantic Canada, so there's a lot of compelling reasons for that.

I think importantly as well is Slate, we believe, is well positioned to execute on that strategy given our deep history and expertise down there with both our own operations as well as people in this office having 20-plus years experience working in the U.S. and doing deals in the U.S. So, we feel quite comfortable. This isn't necessarily new for us. We're already down there in other ways. It is really just a natural expansion of our existing strategy we've had some success with.

Sairam Srinivas, BMO Capital Markets

Great. And a follow-up on that, like are there any tenants with a lease majority in Q4 2017 or 2018 that you would not be renewing?

Steve Hodgson, Chief Operating Officer

There are no major tenants that I'd point to. There's probably about 13,000 square feet of known vacancies in Q4, which has already been, ah, but we've got 28,000 square feet of new leasing done that'll commence in Q4. We're expecting an increase in occupancy by the end of the year.

Sairam Srinivas, BMO Capital Markets

Great. That will be all for me. Thanks.

Robert Armstrong, Chief Financial Officer

Thank you very much.

Operator

We currently have no questions in the queue at this time.

Madeline Sarracini, Investor Relations

Okay. Thanks, everyone, for joining the third quarter 2017 conference call. Have a great day.

Scott Antoniak, Chief Executive Officer

Thank you.

Operator

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