CORPORATE PARTICIPANTS

Madeline Sarracini
Investor Relations

Scott Antoniak
Chief Executive Officer

Robert Armstrong
Chief Financial Officer

Steve Hodgson
Chief Operating Officer

CONFERENCE CALL PARTICIPANTS

Stéphane Boire
Echelon Wealth Partners

Jonathan Kelcher
TD Securities

Matt Kornack
National Bank Financial

Chris Couprie
CIBC World Markets

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Slate Office REIT Fourth Quarter 2017 Financial Results Conference Call. As a reminder, this call is being recorded today, March 1, 2018, at 9:00 a.m. Eastern Time. I would now like to turn the call over to Madeline Sarracini. Please go ahead, ma'am.

Madeline Sarracini, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the fourth 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 Q4 2017 investor update, which is available now.

I will now hand over the call to Mr. Antoniak for some short comments.

Scott Antoniak, Chief Executive Officer

Good morning, everyone. Thanks for joining the call. Just a few brief comments before we turn it over to Q&A.

First, on the operations side, we completed 358,000 square feet of leasing across the portfolio in Q4 at an average positive leasing spread of 7.7% over expiring rents. That means for the year the REIT completed just shy of a million square feet of leasing at average spreads of 13.5% over expiring rents and increased the weighted average lease term for the entire portfolio to 5.8 years, up from 5.4 years.

On the acquisition side, post quarter the REIT acquired 20 South Clark Street in Chicago's central business district, closing February 2nd, making this the first acquisition in our US expansion strategy. We believe the Chicago market provides ample opportunity for future growth and is indicative of the type of opportunities available to us in the US. Additionally, the REIT is currently under contract to acquire a portfolio of assets from Cominar REIT located in the Greater Toronto Area and Atlantic Canada, deepening our existing presence in both markets.

Finally, just a quick comment on total returns. So, the impact of our strategy is being translated into value through meaningful returns to the REIT's unitholders. We've measured the total return to unitholders as 9.6% and 11.9% for 2017 and 2016 respectively. Please refer to the total return to unitholders section of the MD&A. Importantly, a large part of this total return to unitholders is provided by way of distributions. For 2017 and 2016, 100% and 90.2% respectively of the distributions received by unitholders were treated as return of capital for taxation purposes, resulting in a meaningful deferral of the taxation of returns being provided.

Thanks for your participation and I'll now turn it over to you for questions.

QUESTION AND ANSWER SESSION

Operator

Thank you. As a reminder, if you would like to ask a question at this time, please press star followed by the number one on your telephone keypad. Once again, that's star then one if you would like to ask a question. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from the line of Stéphane Boire with Echelon Wealth Partners. Please go ahead, your line is open.

Stéphane Boire, Echelon Wealth Partners

Hi. Good morning, everyone. I've got a couple of questions for you. Could you tell us what was the implied cap rate of your acquisition in Chicago and does it compare to acquisitions you would be looking at in the GTA market?

Scott Antoniak, Chief Executive Officer

It was a mid-five cap rate on a building that is about 84% occupied. We think it stabilizes over the next 12 to 18 months more in the range of into the sevens. We think for comparable assets in the GTA with similar characteristics it would be on a stabilized basis a higher cap rate on the Chicago investment. Which is really the whole part of the strategy, Stéphane. We can see kind of outsized returns on a comparable risk-related profile. When you compare that on a per square foot basis to the deals we're seeing in downtown Toronto, we bought that asset at about a third of replacement costs and we're seeing a similar type of quality and product in the GTA at 10% to 15% over replacement cost. So, again, right in line with our strategy and we're excited about it.

Stéphane Boire, Echelon Wealth Partners

Okay. That's good. Could you give us an idea of the same property NOI growth you expect this year?

Robert Armstrong, Chief Financial Officer

Sure. I think a couple things. For 2018 it's a mix of what's going to be in the same store. So, just as a reminder, Commerce West and West Metro won't go into same store until Q3 and Q4 given they were acquired in Q2 of 2017. That's where we're seeing a lot of success, so we'll see that pop into those quarters and we're expecting to have modest positive numbers in that respect. I would think on the smaller portfolio for Q1 and Q2, you know, will be positive to flat same store. But in part, and I think this is important, throughout the portfolio we've done quite a bit of leasing, as you can see, over the last year and we're either in fixturing periods right now or rent hasn't yet commenced.

Steve Hodgson, Chief Operating Officer

Yeah. Stéphane, it's Steve. In 2017 we did 157,000 square feet of leasing that commences in 2018.

Stéphane Boire, Echelon Wealth Partners

Okay.

Robert Armstrong, Chief Financial Officer

The final point I'd make is you can see some of that same theme show up in this quarter's same store. So, while we're down a couple percent on same store, I think the headwinds that we've faced and that we've addressed and that we've known since underwriting, primarily with Bell Aliant leaving Brunswick Square and Maritime and MMM leaving the Sheridan Exchange, those three buildings for those two tenants accounted for about $800,000 worth of NOI that we did have in 2016 that we did not have in 2017. Additionally, as we disclosed in our MD&A, 2285 Speakman, our tenant there is in the fixturing period, which is about $700,000 in rent we otherwise would have that will start to kick in in 2018. If you adjust even just for Speakman, you know, we're at 2% positive, which I think is a great story given where we come from. And, that being said, we still have square footage to lease that has more upside potential going forward.

Stéphane Boire, Echelon Wealth Partners

Okay. And speaking of Speakman, 2599, given that it's reclassified as a redevelopment property, will it remain in the same property?

Robert Armstrong, Chief Financial Officer

It will.

Stéphane Boire, Echelon Wealth Partners

Okay. Also, I believe it was mentioned in previous calls that the AFFO payout ratio target was approximately mid 80%, low 90%, if my memory is correct. Could you tell us what is your short-term AFFO payout ratio target, say, at the end of 2018?

Robert Armstrong, Chief Financial Officer

I think our target hasn't changed. I think that's where we think a good range is for this business. What I would say is throughout 2018, you know, factoring into account the acquisition of South Clark, which is a great quality asset and right on strategy, and then the closing of the assets from Cominar, when you loop all that in with the recent equity offering we'd expect that in 2018, in the later half of the year, we'd get down to a high 90, low, possibly above 100%. But I think it'll be dependent on a number of things so I don't want to provide too much certainty around that. But, regardless, we're really happy with how NOI is trending in that direction and the progress that business is being made and we still have a lot of upside from an occupancy and rent perspective. But it won't be in this year that we'll see numbers back down to the 85s.

Stéphane Boire, Echelon Wealth Partners

Okay, that's good. Also, in previous calls there were some discussions in regards to acquisitions in the US and Canada and I was wondering if you have some sort of target in terms of percentage of NOI that you would like to come from each country. Or is it simply, are you simply looking at this from an opportunistic standpoint without necessarily having a target in mind?

Scott Antoniak, Chief Executive Officer

Yes, it's the latter, Stéphane. I mean part of the benefit of the strategy is that it's transferrable, so that's what we like, you know, including the US piece of this. We started to talk about that mid last year. So, in terms of future acquisitions, we'll go where we can achieve the investment characteristics that we're looking for. We can do deals like 20 South Clark that are materially below replacement cost with a little bit of upside on the occupancy, et cetera, in markets that we like. Those are the deals we'll do. And if they're in the Greater Toronto Area or in the Maritimes or Chicago or other places, we're less fussed about that, because we think that we can pick up that strategy and move it. So, as opposed to, you know, it's a long-winded answer, but less a specific asset split or mix across the border, more just where we can be opportunistic with the capital.

Stéphane Boire, Echelon Wealth Partners

Okay. Okay, good. And a final one, I was wondering how much acquisition you expect this year and also, to push on my previous question, what percentage you would expect that would come from the US.

Scott Antoniak, Chief Executive Officer

It's hard to say specifically, Stéphane. I mean we've added 1.5 million square feet in the first quarter, so I'd say we're a little bit ahead of schedule in terms of acquisitions, and the year will unfold as it does in terms of where those opportunities are but we'll continue to look for the type of investments that we've done in the past. At this point I'm uncertain as to where they'd be, but we'll certainly be looking for them.

Robert Armstrong, Chief Financial Officer

Yes, I think the same thematic approach will be that, and we're quite happy, to tell you the truth, where we are right now. We're at March first and we've already got $300 million of acquisitions done for this year, including the Cominar acquisition. But I think the real opportunity will be on the potential for 2018 to be a year of capital recycling and, you know, there may be opportunities where we take fully valued properties here and where we have realized full value and recycle that capital into better opportunities. The US continues to be attractive but it'll be a capital allocation decision.

Stéphane Boire, Echelon Wealth Partners

Okay. That's perfect. Thanks for everything.

Operator

Once again, if there are any questions at this time, please press star then the number one on your telephone keypad.

Your next question comes from the line of Jonathan Kelcher with 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

First, the Q4 results were below our expectations, below consensus. How did they compare to your internal expectations?

Robert Armstrong, Chief Financial Officer

On an NOI basis we were slightly ahead of where we thought we'd be. It was really close to our internal budgets, probably within $50,000. I think interest costs were up a little bit just from the floating rate interest and then, as you can see, as we've disclosed, G&A was up a little bit per some pursuit costs that we, ah, where we didn't finalize the acquisitions.

Jonathan Kelcher, TD Securities

Okay. Just looking at your IFRS value and some of the commentary around that in the MD&A, the $1.28 billion in investment properties and 6.21% cap rate, and I guess in there it says that that's based on your 12 month forward NOI expectations. Would that be fair? That's about $79.5 million.

Robert Armstrong, Chief Financial Officer

Yeah, that's the number it implies. That's correct.

Jonathan Kelcher, TD Securities

Okay. So, prior to the Cominar and Chicago acquisitions, you would expect like the Q4 or December 31st portfolio to produce just under $80 million in NOI next year?

Robert Armstrong, Chief Financial Officer

Yeah, that's what the number implies. That's correct.

Jonathan Kelcher, TD Securities

Okay. And then just finally on 2285 Speakman, you said $700,000 in NOI. Is that annual?

Robert Armstrong, Chief Financial Officer

Jonathan, just to clarify on that one point, the implication that there's $80 million of NOI would be $80 million of NOI plus the datacentre.

Jonathan Kelcher, TD Securities

Yeah, yeah. For sure. The datacentre is not in your IFRS number, right?

Robert Armstrong, Chief Financial Officer

That's correct. And sorry, can you just repeat your second question?

Jonathan Kelcher, TD Securities

The 2285 Speakman, the $700,000, is that an annual NOI number?

Robert Armstrong, Chief Financial Officer

That was the Q4 number.

Jonathan Kelcher, TD Securities

Okay. Thanks. I'll turn it back.

Operator

Your next question comes from Matt Kornack from National Bank Financial. Please go ahead, your line is open.

Matt Kornack, National Bank Financial

Hi, guys. Just wanted to drill a little bit further into Stéphane's question with regards to next year on the NOI front. Can you provide a little bit of colour on when the major leases that you've talked about will come on? And is there a free rent period or is it going to be in straight line and then convert to cash rent? I'm just trying to get a sense of how NOI will progress over the course of 2018.

Robert Armstrong, Chief Financial Officer

Sure. I think Steve can walk through some major leases and, just as a reminder, we do do NOI on a cash basis, so we do have fixed (inaudible) periods. We're not getting the benefit so there is a little bit of oscillation in that regard.

Matt Kornack, National Bank Financial

There is no straight line rent if you've signed a lease if they haven't started paying cash rents?

Robert Armstrong, Chief Financial Officer

That's correct. In revenue or IFRS there is, but when we do NOI we look at it on a cash basis.

Matt Kornack, National Bank Financial

Okay.

Robert Armstrong, Chief Financial Officer

But I'll let Steve speak to the specific leases for 2018, where they'll be coming on and start paying cash rent, because I think that is a substantial point.

Steve Hodgson, Chief Operating Officer

Of the 157,000 square feet that we completed, of new leasing that we completed in 2017 that commences in 2018, there's a few deals that I'd highlight, one being the Cogeco Peer 1 deal at West Metro Corporate Centre. That's significant because we actually allowed SNC to terminate one floor early and so you would have seen some termination income in Q3. And we saw them vacate in Q4 and so there was some downtime in Q4 as a result of that deal. That's 28,000 square feet that will start paying rent again on February 1, 2018.

The Volta Labs deal at the Maritime Centre, which is 58,000 square feet, they start paying rent April 1, 2018. Paladin Security at Commerce West, 13,000 square feet, they start paying rent in October. That's a 10-year transaction as well. And then finally Fortis Inc. at Fortis Place, they did a blend-and-extend transaction, so their existing premises obviously is rent paying but they did expand by 11,000 square feet and that commences May 1, 2018. So, generally, of the 157,000, most commence in Q1 or early Q2, with the exception of Paladin, which is later in the year.

Matt Kornack, National Bank Financial

It sounds like there will be a slight uptick into Q1 but it's mostly Q2 and then the back half of 2018 when you'll see the full impact of that. And then in terms of—so that's the positives. Is there any potential slippage that you see or non-renewals of meaningful tenants in 2018?

Steve Hodgson, Chief Operating Officer

No. In fact, same time last year we would have been messaging that MMM was vacating, we would have been messaging that the head lease was coming up, would have been messaging that Bell Aliant was expiring. This year the only messaging I would have with respect to known vacancies would primarily be 2599 Speakman, which, as you recall throughout this redevelopment for SNC, one of the buildings has always been vacant, so it'll just be reverting. We'll start getting rent on 2285 Speakman and rent will stop being paid on 2599 Speakman. It will not be a decline in income, it'll actually present an opportunity once we re-lease the 2599 Speakman space.

Matt Kornack, National Bank Financial

Okay, thanks. In-place occupancy should, I guess, trend up during the course of 2018 then?

Steve Hodgson, Chief Operating Officer

Right. The point is it will impact occupancy but it won't impact NOI.

Matt Kornack, National Bank Financial

Fair enough. Great, thanks. That's it for me.

Operator

Once again, if there are any questions at this time, please press star followed by the number one on your telephone keypad.

Your next question comes from Chris Couprie with CIBC. Please go ahead, your line is open.

Chris Couprie, CIBC World Markets

Good morning, guys. I was wondering if you could talk a little bit about the pursuit costs that you guys expensed in the quarter, what that was related to. And is this something that, um, I mean is this just the ordinary course of business where you are looking for acquisitions that you don't consummate?

Robert Armstrong, Chief Financial Officer

Sure. There were a number of deals in there I want to put in two buckets. In one bucket there were deals where we just couldn't get to a price that we could agree on with the vendor. And then there was one deal that we dropped because we concluded, from a capital allocation decision, that our return thresholds weren't going to be met, but we did incur some cost in that respect. And I think that's an important point because in Q4 we saw an opportunity, and there's always product to buy in Canada but we saw an opportunity in the US that the return thresholds were far superior to what we could buy at that time and so we decided to drop that transaction.

Chris Couprie, CIBC World Markets

Okay. And just on acquisitions, the MD&A cites a significant pipeline in markets you're active in as well as new markets. Can you make some comments on some of the new markets you're considering?

Scott Antoniak, Chief Executive Officer

Hi, Chris. It's Scott. I mean the obvious one would be Chicago. I think it's not necessarily new but maybe suburban Chicago would be considered new in that I think we've certainly seen a number of interesting opportunities so far and that pipeline remains robust. Other markets in the US, I mean part of the benefit of the broader Slate relationship, as you know, and most of these deals we're referencing are off-market deals, is the relationships that we have through Slate Retail REIT and other ventures that we have. So, some of the markets in the southeast might be of interest. We've started to look at some product there. We certainly view Chicago as kind of the beachhead in the US but, you know, those are the nationals and rallies in places like that, so not gateway cities again but we've started to look in the southeast.

Then in Canada it'll be return dependent. We think that pricing has moved materially up in the Toronto assets, which is a positive for our existing ownership. It's a little bit challenging on the buy side but to the extent that we can find more of the off-market deals and do more in and around Toronto, we'd be happy to do that, it's just, to Bobby's point earlier, it'll be a capital allocation decision through the year where we can find the returns. The final point on your first question is I don't expect we think that, you know, that'll be a recurring number on the (inaudible), but it had some, ah, as a one-time thing just in Q4.

Chris Couprie, CIBC World Markets

Okay. And then in terms of capital recycling, you sold, it looks like, one of your industrial properties in the new year here.

Can you talk about what you might be doing this year in terms of capital recycling?

Scott Antoniak, Chief Executive Officer

Yeah. I think there are two true non-core assets, I think there's one industrial and one retail, and that'll be market condition dependent. And I think that we'll look at—there are some perhaps non-strategic assets on the office side in the GTA that we might look at pruning. I expect we'll do some capital recycling through the year and it'll be, you know, either they're non-strategic or we think we've taken them to full valuation and look to do other things with capital where we can get outsized returns like we're forecasting on the Chicago and the Comair deal. And, for that matter, on the 427 deals we did last year.

Chris Couprie, CIBC World Markets

Any kind of rough guidance on the magnitude that you may sell this year?

Robert Armstrong, Chief Financial Officer

Rough guidance I'd say $50 million.

Chris Couprie, CIBC World Markets

And then just one last kind of nitpick question. The bad debt jumped up in the quarter. Anything to see here?

Robert Armstrong, Chief Financial Officer

No. I think there's nothing really of note. I think that collections across the portfolio continue to be normal. There were two small food vendors that had some larger write-offs but nothing of note.

Chris Couprie, CIBC World Markets

Okay. Thanks, guys.

Operator

And there are no further questions in the queue at this time. I will turn the call back over to Madeline Sarracini for closing remarks.

Madeline Sarracini, Investor Relations

Thanks, everyone, for joining the call. Have a great day.

Scott Antoniak, Chief Executive Officer

Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.
