CORPORATE PARTICIPANTS

Madeline Sarracini
Investor Relations

Scott Antoniak
Chief Executive Officer

Robert Armstrong
Chief Financial Officer

Steve Hodgson
Chief Operating Officer

CONFERENCE CALL PARTICIPANTS

Stephane Boire
Echelon Wealth Partners

Jonathan Kelcher
TD Securities

Chris Couprie
CIBC World Markets

Brendon Abrams
Canaccord Genuity

Himanshu Gupta
GMP Securities

Matt Kornack
National Bank Financial

PRESENTATION

Operator

At this time, I would like to welcome everyone to the Slate Office REIT Second Quarter 2018 Financial Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session. If you would like to ask a question during this time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question, please press the pound key.

I would now like to turn the call over to Madeline Sarracini, Investor Relations. Please go ahead.

Madeline Sarracini, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the second quarter 2018 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 Q2 2018 investor update, which is available now.

I will now hand over the call to Scott Antoniak.

Scott Antoniak, Chief Executive Officer

Thanks, Maddie. Good morning, everyone, and thanks for participating in the call. Per usual, I'll take a few minutes to touch on some of the highlights from the quarter before we open up the lines for Q&A.

During the second quarter of 2018 the team completed over 440,000 square feet of leasing at attractive spreads of 9.2% over expiring rents, resulting in our most active quarter of leasing to date.

As we continue to complete a high volume of lease deals, overall portfolio occupancy has increased by 90 basis points during the quarter to 86.6%. Moreover, that is a 240-basis point increase over the same period in 2017. Occupancy will continue to be positively impacted in future periods as a result of the leasing activity completed this quarter.

Same property net operating income was up 11.7% compared to the same period in the prior year. The increase in NOI is largely a result of leasing coming on line that was completed over the preceding 12 months. As we mentioned last quarter, we are pleased to see our leasing efforts generate positive NOI growth and drive value creation.

Last quarter we expressed our intention to continue to pursue compelling acquisitions in the US market. We are pleased to announce that subsequent to quarter end Slate Office REIT has acquired 120 South LaSalle in Chicago and the adjacent parking garage located in the Central Loop for US$155.5 million and it is expected to close in the third quarter. 120 South LaSalle is a 656,000 square foot building located in close proximity to our 20 South Clark asset, providing operating, leasing, and marketing synergies. 120 South LaSalle is anchored by CIBC, a leading, Canadian-based global financial institution, which occupies approximately 45% of the building's gross leasable area. This acquisition exemplifies our commitment to recycling capital to acquire higher-quality assets at pricing which is not available for comparable assets in certain markets in Canada. We will continue to pursue similar acquisition opportunities going forward.

On that note, during the quarter we completed the previously-announced sale of 135 Queens Plate in Etobicoke for $16.7 million, which was approximately 10% higher than our IFRS book value at year end 2017. Subsequent to the quarter we also entered into an agreement to sell 139 Water Street and the adjacent Water Street properties in St. John's, Newfoundland for $17.5 million. We are very pleased with these results and going forward will look to strategically dispose of non-core fully-valued assets in Toronto and elsewhere in the portfolio that allow us to recycle capital for future growth. As we continue to complete our capital recycling plan we expect our leverage will reduce to levels achieved in the same period of the previous years.

We thank you for your continued support and I will now open up the call for Q&A.

QUESTION AND ANSWER SESSION

Operator

If anybody has a question at this time, please press star one on your telephone keypad. Again, that is star one on your telephone keypad.
Your first question comes from Stephane Boire from Echelon Wealth Partners. Your line is open.

Stephane Boire, Echelon Wealth Partners

In terms of the G&A expense, which increased a little bit between Q1 and Q2, what should we expect in the second half of the year?

Robert Armstrong, Chief Financial Officer

The G&A for the second quarter of 2018 was higher probably about $150,000, $200,000 for professional fees that were accrued in the quarter, so I think it's a little bit above what our run rate is. Aside from the management fee though, coming up because of additional acquisitions, I think this quarter is a couple hundred thousand bucks too high.

Stephane Boire, Echelon Wealth Partners

Okay. That's good. Thank you. And what are your target occupancy rates for both US assets for 2018 and 2019?

Scott Antoniak, Chief Executive Officer

Long term, we view the entire portfolio getting into the low 90s. We think we view economic occupancy as about 92%. We're looking to get half way there, to about 90%, by the end of this year and then all the way there towards the end of next year, 2019, and starting into 2020.

Stephane Boire, Echelon Wealth Partners

All right, thanks. That's very helpful. That's it for me. Thank you.

Operator

Your next question comes from Jonathan Kelcher from TD Securities. Your line is open.

Jonathan Kelcher, TD Securities

Thanks. Good morning. When does 120 South LaSalle close?

Scott Antoniak, Chief Executive Officer

The 31st of August.

Jonathan Kelcher, TD Securities

Okay. And in terms of recycling capital, do you have a volume target or a dollar amount that you're looking to sell?

Scott Antoniak, Chief Executive Officer

Yes, we do. It will be a blend, we believe in the clustering strategy, so one-off assets in markets where we maybe not are inclined to grow, we may look to exit those entirely. And then we'd also consider a kind of strategic sell-down of percentages of minority interests and assets.

The total amount of equity, Jonathan, we'd be looking to raise would be in the range of $100 million to $150 million. So that translates to, depending on the percentage, it could be between $250 million and $500 million of assets, depending on whether they're whole sales or partial sales.

Jonathan Kelcher, TD Securities

Okay. And would it be fair, if we're just thinking about modelling this would it be fair to just take your weighted average cap rate on that?

Scott Antoniak, Chief Executive Officer

Yes, that's fair.

Jonathan Kelcher, TD Securities

Okay. And what was the cap rate on 135 Queens Plate?

Robert Armstrong, Chief Financial Officer

6.2.

Jonathan Kelcher, TD Securities

6.2? Okay. Thanks. I'll turn it back.

Operator

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

Chris Couprie, CIBC World Markets

Good morning, guys. I just wanted to touch on the Water Street assets in terms of what drove the decision to sell these assets considering the redevelopment potential.

Scott Antoniak, Chief Executive Officer

We were approached by someone specific to these assets. They weren't necessarily a target as part of the dispositions but the group expressed interest at a price that we viewed to be compelling. We pursued that process. Longer term, I do believe in the future of the Water Street assets. I think that might have been a longer-term horizon than we had necessarily expected when we acquired the portfolio. I think we're very happy with the assets we have in St. John's, so we now have basically a fully stabilized portfolio of four of the top-five assets in that market with long-term leases in place with some really great tenants. We are thrilled with that portfolio and the valuation was such that it made sense for us. Given what we're doing in other markets in terms of the broader recycling initiative, I think this made sense for us at that time and that was the motivation.

Chris Couprie, CIBC World Markets

Great. Any update on Speakman?

Steve Hodgson, Chief Operating Officer

On 2599 Speakman? The leasing?

Chris Couprie, CIBC World Markets

Yeah, sorry.

Steve Hodgson, Chief Operating Officer

We are just completing the white-boxing of the space and we're conducting tours. No conditional deals to note.

Chris Couprie, CIBC World Markets

Okay, thanks. And then just when you're looking at your kind of acquisition pipeline, what are you looking at in Canada these days, if anything?

Scott Antoniak, Chief Executive Officer

We look at everything in all the markets, so we're not exclusively looking in Chicago and we're not ignoring Canada. Never was that part of the strategy. I think it speaks to the recycling. If certain markets, and let's use the Greater Toronto Area as an example, if we view those to be aggressively valued then perhaps we're looking to reduce exposure in a market like that. That said, if we can find compelling acquisitions that fit what we're trying to do, whether it's through clustering or from a valuation perspective that are compelling, then we'll do those.

I wouldn't say there's one isolated market that we're focusing on. As you know, we have nothing out west, it's still a little bit volatile maybe for a distribution-paying vehicle, but we look at all the traditional office nodes and markets in Canada and we're looking in Chicago and other places in the US as well. And part of, I think, you know, one of the great benefits of this asset management platform is that we have people and opportunities in all of those markets across North America, so whether it's through relationships through the Slate Retail REIT experience or other groups and people within Slate, we're seeing opportunities in markets all over North America all the time and I think that's a big benefit of the platform.

Robert Armstrong, Chief Financial Officer

We continue to be somewhat market agnostic, as Scott was kind of referring to. What I would say has not changed is we are still looking at properties that we feel we can add value to over the, say, two- to three-year horizon. And I think you have seen that play through in the portfolio currently in that we're getting very good results from that strategy.

We've grown occupancy 90 basis points over this quarter and we're really happy with what the team's done from a same store perspective, and a lot of that's being just the result of buying properties that are below occupancy that we can do some leasing at and when leases turn we can take them out to market and get additional NOI from that perspective. Anything we continue to do that, whether it be in Chicago or the GTA or Atlantic Canada, we'll be very interested in those opportunities.

Chris Couprie, CIBC World Markets

Okay. Thanks, guys. I'll turn it back.

Operator

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

Brendon Abrams, Canaccord Genuity

Good morning, everyone.

Robert Armstrong, Chief Financial Officer

Good morning

Brendon Abrams, Canaccord Genuity

As you and your team start to allocate more capital into the US, do you have a view on the foreign exchange or perhaps managing the FX?

Robert Armstrong, Chief Financial Officer

Yes, we do. We constantly watch it. I think where we are right now with, one, just with 20 South Clark and then 120 LaSalle, the exposure at this point won't be huge, but we are monitoring. I think we look at it from two perspectives. One, we do have natural hedges as far as the debt. We're debt financing the US dollar acquisitions with US dollar debt, so from an equity perspective I think that helps. Plus, we have lots of opportunities for additional acquisitions and opportunities in the US, so I think we're not necessarily looking to repatriate some of that capital back to Canada at this point. But I think going forward we definitely have plans to put in place FX strategies to the extent we see volatility, but at this time, with this level of exposure, we predominately let that float. But that could change.

Brendon Abrams, Canaccord Genuity

Okay. And with the recent disposition done at a significant premium to IFRS book, do you think that's specific to those properties in terms of Water Street and the Etobicoke asset or is that kind of indicative of the appraisals or the lagging of the valuation in the portfolio as a whole?

Robert Armstrong, Chief Financial Officer

I don't think it's a lag. I wouldn't even say it's specific of those two properties. I think for the stuff we have sold over the last two, three years, you know, it's almost in all cases been at levels above our IFRS value, which maybe we're being a little bit conservative throughout the portfolio. I don't think necessarily any of those deals are entirely opportunistic as a whole, it's just really, you know, we've been quite conservative in the way we've underwritten and valued those things. But I think, just given where GTA values are specifically, if we do have and we do execute on the capital recycling program, I think we'll be quite pleased with where those values come out.

Scott Antoniak, Chief Executive Officer

Yes, if they're not fully valued and/or stabilized or entirely non-strategic, then those are probably not assets that we would sell. I think it speaks to the whole philosophy of what we are trying to do, which is to buy well and then manage in a best-in-class fashion and create value for these. Whether we're going to keep them over the longer term or recycle them into other opportunities, I think, you know, and we have real empirical data points right now that point to that success, whether it's on the leasing side or through the sales, you know, the two sales that we completed in the quarter, that speaks to exactly what we're trying to do throughout the portfolio, whether it's in the US or with the existing portfolio, new acquisitions or legacy assets.

Brendon Abrams, Canaccord Genuity

Okay. That makes sense. And just from a leasing perspective, we're seeing tremendous strength in down-town Toronto office leasing. Are you seeing that spread out to some of the more kind of suburban nodes your assets are located in? (Inaudible) the environment there?

Scott Antoniak, Chief Executive Officer

Yes, I would. I think it's starting to trickle over into that. I think we are very cognizant of the type of assets that are in the GTA and I think we're always big believers in location, as most folks are when it comes to real estate, but in terms of infrastructure, on highway, on transit, et cetera, those assets have many of the characteristics that the downtown assets do, so that translates well from a leasing perspective.

We are starting to see groups who had focused entirely on downtown leasing starting to make overtures for clients, where it makes sense on the leasing side, where they can consider maybe non-traditional or non-downtown uses, because there's a material spread in the cost on a gross rent basis for tenants. Not everyone needs to be downtown. I know there are significant benefits to that but not every part of every business needs to be downtown and I think the leasing agents are realizing that, that probably beyond economic occupancy downtown that they're going to have to look in other places, and it's better located suburban assets such as the ones we have in our portfolio we're starting to see that trickle through. We're starting to see it in occupancy and also in rent.

Robert Armstrong, Chief Financial Officer

Brendon, I would comment that our occupancy is up this quarter 90 basis points and I think if you contrast that to downtown, doing that in a single quarter for downtown is almost impossible, because downtown Toronto would be at economic or above economic occupancy. But you are paying for that if you're an owner of downtown Toronto office properties. We are not paying for that in the markets we're at. This is still good real estate but we have a team that's continuing to drive value and you're seeing that through the 90 basis points of increased occupancy and our 11% year-over-year same store NOI growth. And we really think that's a huge opportunity that continues to exist within our portfolio and in the acquisition pipeline.

Brendon Abrams, Canaccord Genuity

Okay, that's great. That's it for me. Thanks.

Operator

Again, if anybody would like to ask a question, please press star one on your telephone keypad. That is star one on your telephone keypad.

Your next question comes from Himanshu Gupta from GMP Securities. Your line is open.

Himanshu Gupta, GMP Securities

Thank you and good morning, guys. So, on the leasing activity, healthy leasing spreads, renewal was done at 9%. Is there any specific lease or geography which is driving the growth or is it broader based?

Steve Hodgson, Chief Operating Officer

Hi, Himanshu. I would say it's broad based. The deal that we did at Maritime Centre for 52,000 square feet, that was a huge success and continues to be a large spread to both building in-place rents and where the Bell Aliant lease expired at. In addition to that, we're seeing healthy growth in rents on the 427 corridor where we're seeing a more supply-constrained market there and some of the spillover impacts of downtown market being so tight from an occupancy perspective.

Himanshu Gupta, GMP Securities

Okay. And maybe just a follow up: How is the actual leasing cost tracking against the amount allocated for normalized leasing cost for AFFO calculation? Are you seeing any elevated leasing expenses for this kind of leasing activity?

Steve Hodgson, Chief Operating Officer

No, I think we're tracking to market, Himanshu, and to where we've been in subsequent quarters. Again, one area I'd point to is some of the former Fortis portfolio had some space that had been occupied by former tenants for a long period of time. There is some additional cost associated with that from a landlord work perspective but once that work's done once it's done for several years and the next renewals or subsequent deals will be at much higher NERs. We are quite pleased and we're beating underwriting on all of our acquisitions over the last 12 months in terms of both rents and leasing costs.

Himanshu Gupta, GMP Securities

Sure. And maybe just to follow up on the capital recycling, so you mentioned to reduce debt in the short term through sale of fully-valued and non-strategic assets. So what assets would you put in this bucket? I mean these are mostly Atlantic assets, Atlantic Canada assets, or more GTA and more of like challenging assets?

Scott Antoniak, Chief Executive Officer

Hi, Himanshu. It's Scott. Not challenging assets. I think it would be a mix. If we have one-off assets or non-clustered assets in certain markets in Atlantic Canada, those might make sense from a disposition of 100% of those. And I think for the GTA and perhaps some of the stabilized assets in Atlantic Canada, we'd look to sell down a partial interest in those. We like the assets and like to continue to own them and participate in even future upside, but I think it would be more of a partial sales type decision. And there are certain assets in central Canada where if we're not going to be growing in those markets, having a small concentration of assets, you know, ones and twos in places like that, that might be another place we look for it, depending on where valuations are there.

But management and the board review the entire portfolio every quarter, as you can imagine, and we look for opportunities where if we can recycle existing assets into new compelling acquisitions with upside, whether that's in the United States or Canada, then we'd be remiss if we weren't doing that. And I think if we think certain markets are approaching fully valued and we can recycle that capital, that makes sense from our perspective.

Himanshu Gupta, GMP Securities

Sure. And maybe just one final question. Can you talk about the Chicago market in general? I mean what is the market vacancy and what are the market cap rates and why do you like the market?

Scott Antoniak, Chief Executive Officer

I'll start and, Steve, you can jump in if you like. I'd start with, Himanshu, it's an enormous market. It is about 250 million square feet between downtown and suburban. It's roughly evenly split, depending on what you count, so call it between 110 and 135 in downtown and suburban. Even within the downtown market there are specific nodes - four or five nodes within that. These two assets that we have acquired are within the Central Loop. I would say that the vacancy there historically is in the 10% to 15% range. I think it's about 12% or 13% right now.

The assets we've acquired are about, you know, at plus or minus at market within the node. I would suggest in both cases, you know, we looked specifically at the history of these assets and took the view that their stabilized occupancy would be at the top end of the market, so more in the 90% to 92%, so kind of 8% to 10% vacancy. I think, whether management are just focused on those assets historically, we think there's an opportunity there for us. Like we have done in other markets, whether it's in the Greater Toronto Area or Atlantic Canada, we're buying good, income-producing assets that have a story and have upside in them, so we think that's the case for these two assets.

We believe Chicago has had a fairly strong run the last two to three years. I don't think we see any signs of that abating from an overall leasing perspective. There has been a bit of a move in certain suburban markets to downtown. You hear kind of the marquee transactions, like McDonalds and Wilson Sporting Goods and things like that are coming to downtown, which is good for us, owing those assets, but it won't be as it has been here. It will not be at the absolute exclusion of suburban. We look at both of those markets.

Toronto or any other major urban centre in North America, near the airport, on transit, on the major highways, those are all things we look to if we did look at suburban assets. But I think that there's still good economic activity in and around Chicago so we would expect to see continued success on the leasing side. We really like these assets and the story that they both have and the fact that they're in close proximity to one another. I think it's all good and all consistent with the way we run our business up here and look to continue to do that down there.

Robert Armstrong, Chief Financial Officer

I would add, when we look at the markets we see it as a point of contrast and with this whole capital recycling strategy I think it's been fairly simple from our perspective in that if we can sell a property like Queens Plate at a 6.2 cap rate that is fully valued in a node that, you know, it continues to be a little difficult, and we can take that down and put that in a Chicago downtown asset that will stabilize at an above 8% yield, we think that's a great trade. We'll continue to do that trade all day. And this capital recycling strategy is to allow us to do that in a bigger way going forward.

Scott Antoniak, Chief Executive Officer

Bobby makes a good point, and I didn't answer the entire question. There is a bit of work to do to get our two assets stabilized, but those assets in those locations on a stabilized basis are probably, you know, ours will be in the 8s because we bought them really well, but I think those markets right now or those assets right now, the market cap rate for those is probably in the 6s. So that's still a 250 basis point premium to downtown Toronto for assets that have many of the same characteristics, whether from a tenant, lease term, location, like access to subway and things like that. We think from that perspective it's a compelling trade out of the GTA and into downtown Chicago.

Himanshu Gupta, GMP Securities

Awesome. Thank you for the colour. Eight cap would really look good. Thank you.

Operator

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

Matt Kornack, National Bank Financial

Good morning, guys. Just a quick follow-up on that point: What would be the going-in initial yield on the recent Chicago trade?

Scott Antoniak, Chief Executive Officer

They both high 5s, like 5.8 and 5.78 or 5.68, stabilizing somewhere between 7.5 and 8.5.

Matt Kornack, National Bank Financial

And similar occupancy profiles, at least going in, or is it higher occupancy on the new assets?

Scott Antoniak, Chief Executive Officer

No, they're similar. Mid-80s. I believe 84.1 and 84.5.

Matt Kornack, National Bank Financial

And then just from a timing standpoint with regards to the acquisition versus dispositions, will leverage tick up into sort of the low 60% range and then come down over the balance of the year? Or what is the timing? And from a financing standpoint, what are you looking for there? Is it a conventional mortgage or will you be doing it on a term loan or credit facility?

Robert Armstrong, Chief Financial Officer

I think in both cases, so two parts to that question. So, on the leverage, yes, it absolutely will tick up as we execute on the capital recycling plan, but we'll look to repay and bring that down.

For the US assets, the financing and debt strategy has been to do shorter-term either demand or two-year terms with a view that we would stabilize those over the two years and look to put on higher LTB financing and redeploy that capital after a year and a half or two years after we've completed their leasing and gotten those assets stabilized.

Matt Kornack, National Bank Financial

Okay, great. Thanks, guys.

Robert Armstrong, Chief Financial Officer

Thanks, Matt.

Operator

I have no further questions in queue. I turn the call back over Madeline Sarracini for closing remarks.

Madeline Sarracini, Investor Relations

Thanks, everyone, for joining the second quarter 2018 conference call for Slate Office REIT. Have a great day.

Operator

This will conclude today's conference call. You may now disconnect.
