CORPORATE PARTICIPANTS

Madeline Sarracini
Investor Relations

Greg Stevenson
Chief Executive Officer

Robert Armstrong
Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Stephan Boire
Echelon Wealth Partners

Sumayya Hussain
CIBC World Markets

Jenny Ma
BMO Capital Markets

Himanshu Gupta
GMP Securities

Johann Rodrigues
Raymond James

PRESENTATION

Operator

Good morning. My name is Denise and I'll be your conference operator today. At this time I'd like to welcome everyone to the Slate Retail REIT Fourth 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, press the pound key. Thank you.

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 fourth quarter 2018 conference call for Slate Retail REIT. I'm joined today by Robert Armstrong, Chief Financial Officer, and Greg Stevenson, Chief Executive Officer.

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 Retail REIT's website to access all of the REIT's financial disclosure, including our Q4 2018 investor update, which is available now.

I will now hand over the call to Greg Stevenson for opening remarks.

Greg Stevenson, Chief Executive Officer

Thank you, Madeline, and thank you to the participants for joining the call this morning.

We continued to gain momentum and our achievements in the fourth quarter reflect both the team's tremendous efforts and highlight the durability and attractiveness of the REIT's grocery-anchored and necessity-based real estate portfolio.

Strong organic growth continued. Ended the quarter with an occupancy rate of 94.2% and executed on more than 640,000 square feet of leasing, including several anchor renewals. We also achieved an industry-leading 95.8% tenant retention ratio, demonstrating that our properties continue to be highly sought after by tenants in our markets.

As a result of these efforts, we achieved a 4.2% increase in same property net operating income year over year. In addition, our proactive approach to leasing has resulted in 43% of all 2019 renewals already completed by the end of the fourth quarter of 2018. We also completed two of our major redevelopment projects in Q4 at Buckeye Plaza and County Line Plaza. The first quarter of 2019 will be the first full quarter of contribution from these projects, which had a weighted average yield on cost of 22.3%.

Funds from operation has decreased as a result of de-risking our capital structure and moving to 99.2% fixed-rate debt, which results in paying a higher rate of interest on our bank

debt. While the increased interest cost from fixing our debt lowered FFO in the short term, we feel it was a prudent decision from a risk management perspective and protects us from future interest rate increases. In addition, we believe growth in income from leasing activity will more than offset the interest costs in the coming quarter.

Net asset value decreased over the year as a result of negative sentiment in the retail sector and, in spite of taking a conservative approach to valuation this year, we believe it was the prudent thing to do. As we highlighted in our unitholders letter this quarter, we feel sentiment is improving and deals are being completed at pricing above general market expectations. While negative sentiment may impact cap rates in the short term, the REIT's continued solid operating performance and positive underlying fundamentals in our sector will ultimately serve to drive value higher over the medium to longer term. As a result, we expect cap rates to compress and property values to increase again in 2019.

Heading into the new year we are excited about continued growth in net operating income driven by both active projects in the portfolio today and our ability to continue to reset rents higher in line with market rents. We have identified a pipeline of properties totalling approximately $200 million that we can sell to recycle capital into more accretive opportunities, including unit repurchases. The dispositions will also allow us to pay down debt and reduce our leverage.

As income grows and capital spent on existing projects nears completion, we expect our AFFO payout ratio to decline below 90%, setting the stage for a sixth consecutive distribution increase in 2019. Units of Slate Retail generate substantial excess yield, today close to 9%, and we believe represent an attractive investment opportunity for the REIT at these levels. We will continue to buy back units at these levels that we deem attractive. Unit repurchases in 2018 and under the substantial issuer bid will also help generate excess cash from no longer paying distributions on those units of approximately $2.2 million annually. As importantly, we were able to accomplish this capital recycling program by selling properties that are stabilized, where we have executed on our business plans and extracted value, but the properties would rank lower tier of our portfolio. Upon execution of the disposition pipeline, we will be left with a higher-quality portfolio and excess liquidity to deploy.

To summarize, we ended the quarter with an occupancy rate of 94.2%, achieving one of our highest quarters of same property NOI growth at 4.2%; completed two of our redevelopment projects at a 22% yield on cost; and all of this contributed to a very strong quarter. But, as importantly, we are encouraged by the positive underlying fundamentals in our portfolio that will set the stage for our team to execute on the business plan ahead and deliver stable and growing distributions to our unitholders.

With that, I will turn it back to questions.

QUESTION AND ANSWER SESSION

Operator

Ladies and gentlemen, 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 Stephan Boire with Echelon Wealth Partners. Your line is open.

Stephan Boire, Echelon Wealth Partners

Thank you. Good morning. I was just wondering, what is your target leverage ratio by the end of the year? I know that long term it's 50%-ish, but was is it for next year? And actually, in parallel, what percentage of the $100 million sell proceeds would be used to pay down debt this year versus buyback or even land development?

Robert Armstrong, Chief Financial Officer

The $100 million we have targeted in the disposition pipeline, our expectation it would be dollar for dollar would go to repay debt from that. We think that if levels continue, we would be active purchasers of units again and throughout the remainder of 2019. But that is hard to do and target a number but I would say anywhere between $5 million and $15 million could be easily achievable based on what we've done in the past.

And then as far as target leverage, I think we would get down to about 55% or so by the end of the year.

Stephan Boire, Echelon Wealth Partners

Okay, that's good. In the previous call, Greg, you mentioned that any acquisitions you do are going to be to replace income from sold assets if you don't have any better use for

the proceeds, but right now I'm under the impression that acquisitions are a bit on hold at the moment. Do you expect any new acquisitions at this point for the next two years?

Greg Stevenson, Chief Executive Officer

Yes, in the next two years I think absolutely. I think it's always going to be what's the best use of our capital, whether that's units or properties. I think the current environment basically means that there's going to be good opportunities and we're always looking. It's never on hold. We're active from an acquisition perspective in terms of hunting for things to do. We're active today and we'll be active in the future. So, it's going to always come down to what's the best use of our capital and as of late it's been our units, because our units traded down and became quite attractive, but if we find something on the acquisition side and it's the best use of our capital, we're going to do it.

Stephan Boire, Echelon Wealth Partners

Okay, great. Just a final point, on a more macro standpoint, how do you see your asset disposition program in the context of, ah, well, in the current economic context, as there are more and more discussions about a potential recession in the US?

Greg Stevenson, Chief Executive Officer

We have no control over the macro but what I will say and what we talked about in the letter is that grocery and necessity-based retail is sort of going in its own direction as it relates to sentiment and desirability from investors, meaning that it's being favoured. There's been other US strip centre REITs that have sold a significant amount of similar but probably lower-quality product than what Slate Retail owns by a meaningful margin and they've done it successfully. I think that grocery and necessity was and will continue to be highly sought after by investors, for all of the reasons we talked about in the past. It is stable, you are getting rent growth, you have limited to zero new supply in our markets, which is driving occupancy and rents. Fundamentals are positive. If there is a recession, again, there is no predicting when or if, but it is countercyclical, this asset class. People go to the grocery store more and eat out less.

Looking back to other recessions, this asset class performed tremendously well. That is why there is available debt for it today and there will be in the future. It is something that we think is very attractive. I think that our asset dispositions in 2019 will actually prove out our IFRS cap rate and if it's the lower tier of our portfolio at a 7.5 cap, I think what that means in our view that the 7.5 cap currently from an IFRS cap rate perspective probably looks pretty conservative.

Robert Armstrong, Chief Financial Officer

I would add as well, the $100 million we talked about disposing, a good chunk of that is at various points in the market or we're getting soundings from the investment community, and all the feedback has been good and consistent with our evaluation so far.

Stephan Boire, Echelon Wealth Partners

Okay, that's a good point. It was also a side question. So, you would expect to get, to be able to get book value from those assets for sale.

Robert Armstrong, Chief Financial Officer

That is correct.

Stephan Boire, Echelon Wealth Partners

Okay. I don't have any more questions. Thank you.

Operator

Your next question comes from Sumayya Hussain with CIBC. Your line is open.

Sumayya Hussain, CIBC World Markets

Good morning. Thank you. Just a couple of questions on mainly the AFFO payout guidance. So, that level of 89%, does that assume that the entire $200 million of asset sales are completed in 2019?

Greg Stevenson, Chief Executive Officer

Correct.

Sumayya Hussain, CIBC World Markets

Okay. And then, I guess, just as a follow-on, what assumptions for capital spending, maybe as a percent of NOI, are you guys using to get to the 89% payout level?

Robert Armstrong, Chief Financial Officer

About 12%.

Sumayya Hussain, CIBC World Markets

Okay. Expect it to be a little higher H1 and then more normal at the back end of the year?

Robert Armstrong, Chief Financial Officer

Yes, that is right. I think the capital that we are spending, have spent over the last little bit is all a result of the large amount of leasing that the team's been able to do recently. So, it has had a trailing effect. We see that as great, because we are adding value. Typically, we have run a run rate right on about 10%. If you go back to early 2018 and before that, it was dead on 10%. We are at 16% this quarter. But I think our go-forward run rate, we're expecting around 12%.

Sumayya Hussain, CIBC World Markets

Okay, great. I'll turn it back.

Operator

Your next question comes from Jenny Ma with BMO Capital Markets. Your line is open.

Jenny Ma, BMO Capital Markets

Hi. Good morning, everyone.

Greg Stevenson, Chief Executive Officer

Good morning, Jenny.

Jenny Ma, BMO Capital Markets

A question about the targeted dispositions. You guided to a 7.5% cap rate. Is that partly reflective of some of the transactions that you're seeing in the market? And do you contemplate the split between the conventional assets versus the outparcels? Because I know in 2018 there was a bit more of the outparcel sales versus just the conventional assets.

Greg Stevenson, Chief Executive Officer

I think the split will be similar, maybe a few more properties as opposed to outparcels, which I would define as a standalone single tenant building with a restaurant or a bank or something where there is a long-term lease and no real value for us to add. But, as Bobby said earlier, I think it is—the 7.5 is really just feedback from market participants on the product we've already got out in the market and that we've sold in 2018 and to date. There is one property in the bucket that we sold so far that if we took out, like the sales to date, the $52 million, is 7.4 cap, so it's also reflective of what we've already done.

Jenny Ma, BMO Capital Markets

Okay. Bobby, I think I heard you correctly. You mentioned that about $5 million to $15 million of the $100 million for sale is going to be allocated to share buybacks after you pay down debt?

Robert Armstrong, Chief Financial Officer

Yes. We don not necessarily have an allocation but I think we would spend up to, say, $20 million, $25 million. But realistically, what we're able to achieve on the NCIB in volume, given the restrictions in our timing, I'd say $5 million to $15 million is executable. We also have to wait for the price to come back a little bit. We are probably buyers just a little bit lower than this. But that is a good number, I think. It is hard to estimate.

Jenny Ma, BMO Capital Markets

Right. But as far as the debt that's attached to the $200 million bucket for dispositions, I assume it's roughly in line with the entire REIT's leverage?

Robert Armstrong, Chief Financial Officer

Yes, that is right. But to be clear, every single dollar of net proceeds that otherwise doesn't go to the NCIB would go to repay debt.

Jenny Ma, BMO Capital Markets

Okay, gotcha. So, it would be higher than just simply repaying.

Robert Armstrong, Chief Financial Officer

Yep.

Greg Stevenson, Chief Executive Officer

And it is a revolving facility, so we can then use it again should we need to.

Jenny Ma, BMO Capital Markets

You mentioned that there was about 40%-plus of the 2019 leases committed. Can you comment on what the lift on renewal was for that chunk?

Greg Stevenson, Chief Executive Officer

Well, that's been reported, so this quarter, for instance, it was 4.4%, which includes greater than 10,000 and less than 10,000, and the greater than 10,000 are usually anywhere between 1% and 3% because our anchors have fixed options. The less than 10,000, they are somewhere between 7% and 10% and you blend the two.

That has been a consistent number going back to inception almost and going forward we think we're going to do very similar numbers into the future, because if you look at our expiry profile, we have a slide in our investor deck, we have a weighted average rent of between $9 and $11 for the next five years and we have been doing renewals between $12 and $14. We think, for the next several years, that those are spreads that we can continue to achieve.

Robert Armstrong, Chief Financial Officer

I think we are really happy with how the leasing started to show itself in results with this quarter with 4% same-property NOI growth on effectively high 90% of the total portfolio. Eight of the last ten quarters have had positive same property growth. We think the team is doing good. The market and the fundamentals continue to be very, very healthy in the face of what you are kind of hearing from a headline perspective, but on the ground our view is the business has never been better.

Jenny Ma, BMO Capital Markets

Okay. And then my last question is sort of higher level. When you put all this together with the dispositions and the unit buybacks and the debt pay down and then you sort of square it against your increased distribution, I mean if most of the proceeds from the dispositions at higher cap rates are going towards debt pay down, then that would suggest it's a little dilutive. So maybe this is a discussion held at the board level more so, but how do you square sort of that pressure versus raising the distribution as opposed to keeping it at sort of a more conservative level and buying yourselves a little bit more wiggle room that way?

Greg Stevenson, Chief Executive Officer

Two things and then Bobby can add to it.

One is we are buying back units and while that cash flow does not, the cash flow savings does not hit FFO, it is real cash flow savings. And at a 9% yield it helps bring down our payout ratio quite significantly.

Then, I think the bigger impact is going from 16% to 12% NOI on a capital spend perspective. That is a few million dollars a year, which is quite meaningful from a payout ratio perspective as well. When you think about our last distribution increase, it was only on an annualized basis, it was something like $800,000. So, if you are cutting capital by $4 million or $3 million per year and you are only increasing distributions by $800,000, plus you have less distributions to payout due to buybacks plus you have growth in your earnings from an NOI perspective, that is effectively how you do that.

Robert Armstrong, Chief Financial Officer

What I would add to that, just for simple math, is we are effectively selling right now at a 7.4 cap is where we have kind of landed and we are buying back units at an implied cap rate of 8.5. We think that trade is going to be and in fact it is accretive to unitholders as a whole on a top line earnings, but on a per-unit basis the value is coming straight back to the unit holder.

Jenny Ma, BMO Capital Markets

Is it fair to say that on a longer-term basis you would look to hold the AFFO payout ratio sort of in and around the 90% range as opposed to bringing it down further?

Robert Armstrong, Chief Financial Officer

I think we would say 90% or lower.

Jenny Ma, BMO Capital Markets

Okay. Okay, that's it for me. Thank you.

Robert Armstrong, Chief Financial Officer

Thanks, Jenny.

Operator

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

Himanshu Gupta, GMP Securities

Thank you and good morning. Just to follow up on the potential disposition of $200 million of assets, so are you looking for bulk sale, I mean portfolio sale, or is it going to be one-by-one asset disposition?

Greg Stevenson, Chief Executive Officer

It will be one by one. I think that is the way we believe and what we have seen so far with the 2018 dispositions that will maximize value.

Himanshu Gupta, GMP Securities

And are you seeing any appetite for a portfolio sale in the market? have you tested that aspect of it as well?

Greg Stevenson, Chief Executive Officer

We have not tested that, largely because the assets we are selling are in different markets and spread out across our geographic footprint. But I do think that pricing for one-off assets is more favourable than pricing for portfolios today, so that's effectively what we are trying to take advantage of.

Himanshu Gupta, GMP Securities

Right. And just to gauge the appetite of the market for the assets, what's the profile of these buyers? And are you still seeing any gap between buyers' and sellers' expectation in the market? The point is, how achievable is this 7.5 cap rate which you guys are (inaudible) to?

Greg Stevenson, Chief Executive Officer

I think it is very achievable. Again, a lot of it is based on feedback we have already been given, so we feel reasonably confident, which is why we put the number out there.

Secondly, I think the buyers, as Canadians we can sometimes forget how large the United States is, how large the capital pool is, how much money there is out there. They also have 1031 exchanges, which allows investors in real estate to sell assets and then defer capital gains if they invest within 180 days into the same asset class. So, in a yield product, which is what I would describe this as, for a lot of private investors, because unlevered yields are so healthy in this asset class today, there is a lot of demand. Very simply, if you can buy a Wal-Mart-anchored centre for a 7 or even a 6.5 cap relative to an underlying Wal-Mart bond at a 3, there's a lot of private capital in the United States that don't think about capital markets, you know, market cap liquidity or any of these things, and they just say that is a really good deal.

To summarize, there's a lot of appetite and the 1030, I think, fuels that appetite.

Robert Armstrong, Chief Financial Officer

We feel really confident that we will be able to execute and clear these assets at the prices we have them marked at. It is simply based on where we have transacted and the feedback we are getting. I think Slate Retail REIT, over the last couple of years when we have made dispositions, we have done or exceeded where we have had them marked on our books in the large majority.

Himanshu Gupta, GMP Securities

Got it. And just staying on the cap rate discussion, the portfolio cap rate for IFRS was slightly increased to 7.5 from, I think, 7.25 last quarter. So, just a question, how much of the portfolio is appraised by third parties? And the fair value adjustment of, I think it was around $60 million, $65 million for the full year recorded in the books, does that pertain to certain assets or is it just across the board?

Robert Armstrong, Chief Financial Officer

We built that up on an asset-by-asset basis, so every valuation we did was specific to the property. Or, in cases where we have that asset in the market, based on feedback we are hearing as well as what we continue to see from an acquisition front from others. So, it is all our valuations. We think it is real and we feel very confident that it is, if anything, very conservative.

Greg Stevenson, Chief Executive Officer

I think the only thing we would add is, in December when we were doing this, even the first two months of 2019, whether it is real estate or the equity markets or whatever, financial asset classes, it has been quite positive. We are already seeing sentiment and valuations and cap rates come in. I think that for Slate Retail REIT at least specifically, we think that there is a very reasonable possibility of cap rates coming lower into 2019 and that NAV going back up. And when you think about selling some of our lower-tier assets in and around our IFRS cap rate today, I think that is a very reasonable justification for doing so.

Himanshu Gupta, GMP Securities

Sure. Okay. Switching gears to NOI, you mentioned in the letter of expectation of 2.5% to 3% in 2019. How much is that expectation driven by redevelopment and how much is same property? And in general, what is the visibility into NOI growth? I mean are you budgeting some bad debts here or some unseen vacancies as well in your forecast?

Greg Stevenson, Chief Executive Officer

I think in everything we do we are always reasonably prudent or conservative. The split between same property and redevelopment is probably 2% same property, 1% development to get to that 3% number that you just quoted.

Himanshu Gupta, GMP Securities

Sure. That's very helpful. And maybe just last question on Windmill Plaza, the JV with Kroger. I mean what development deal are you expecting here? How does a potential Kroger deal compare to Kmart? And are you looking for more such partnerships?

Greg Stevenson, Chief Executive Officer

Yes, always looking, and whenever you can partner with the largest grocer in the United States or North America, we think it is a good thing. We really like that deal for Slate Retail REIT. I mean we are going to own a brand-new Kroger that we are in a JV with our lead tenant on a 20-plus year lease. It will be accretive once the income starts coming in. And Kroger is paying slightly more than Kmart, but where you get the real lift is the former Kroger box that we are going to backfill. You are getting two to three times what Kroger was paying, if not more than that, on your rents.

Himanshu Gupta, GMP Securities

Right. Okay. And maybe I'll just squeeze in one last question. You made an interesting point about the access land closer to the end-use customers. So, are you seeing any examples of strip centres being converted for better use, you know, like last mile distribution centre, in some of your secondary markets? Are you looking for any of such opportunities?

Greg Stevenson, Chief Executive Officer

It has already started. What is really happening is it is not being converted per se, but what is happening is—I will take Albertsons for example. They are one of the largest just behind Kroger in the US as a grocer. They are already starting to add 10,000 to 15,000 square feet onto the side of their building. What they are doing is they are bringing in technology to build like a mini-distribution centre, which effectively allows them to do home delivery from the store.

Because, as we have talked a lot about in the past, you have four walls and a box much like an industrial building and if these grocers pay anywhere between $2 to $7 a foot, which is at or well below industrial rents for buildings that are 40 miles outside of the city. So, I think what these grocers are saying is we already have the distribution and logistics, and we want to give our customers this convenience, and what is the most economical way to do it? It is at our stores.

Albertsons is doing it with Takeoff Technologies and I encourage everybody to go to their website and look at that technology, because it is state of the art and it is very cool. It is just in its infancy but it is something that we believe is something that will happen more and more. It is hard to quantify today what that value-add is but, as we said in the letter, we are excited about it and we think that what a lot of market participants are missing from an investment perspective with this asset class is that these boxes and these strip centres, due to the increase in ecommerce, are going to increase in importance and increase in value over time.

Robert Armstrong, Chief Financial Officer

The couple additional comments I would make is, if anything, because the sales are being done in the large majority from the stores, we are actually seeing store volumes go up from a grocer standpoint, which is only fantastic for us. We are getting more and more requests from grocers and our tenants to be able to accommodate delivery, so either by van parking or access to be able to facilitate that or adding kind of quasi-distribution aspects to the existing grocer footprint. That is all hugely positive for us. I think it reaffirms the value of the real estate and only entrenches them more in our centres. Whether or not they get it delivered to their door or they drive their car and pick it up, the sales are happening from the real estate we own, which we think is a fantastic thing, and it is starting to reaffirm what we've been saying for a couple years.

Himanshu Gupta, GMP Securities

Okay. That is very helpful. Thank you, guys. I don't have any more questions. I'll turn it back.

Operator

Again, to ask a question, please press star one on your telephone keypad.

Your next question comes from Johann Rodrigues with Raymond James. Your line is open.

Johann Rodrigues, Raymond James

Hey, Greg. Just picking up on that last line of questioning about the land, I just wanted to clarify, those 850 or so acres, is that unused at the moment?

Greg Stevenson, Chief Executive Officer

Correct. What I backed out was the building, the real estate, and then the parking lot, which is mandated. Your parking ratios are mandated by the local municipalities. So, it is anything outside of that.

Johann Rodrigues, Raymond James

And is it zoned?

Greg Stevenson, Chief Executive Officer

Yes.

Johann Rodrigues, Raymond James

Okay. In talking about that last-mile distribution and what shapes and forms that would take, do you see any potential or would you use some of that in terms of adding mixed use on there and adding potential residential given that some of it is in close proximity to major cities?

Greg Stevenson, Chief Executive Officer

No, I do not think so. I think where we see the value is that, I'll take Wal-Mart for example. Their ecommerce business is growing at roughly 40% a year. That growth is because people are ordering online and they want to either come pick it up or get it shipped to their house. The pickup in store is estimated at about $200 a basket. Amazon's order for online groceries is about $75. So, you are getting a 2.5 times order size from the grocery store.

That is, today, what we really think the value proposition of this access land is. Again, we are talking future. I think it is still in its infancy but I think the nice thing is there is meaningful capital being raised around it. I don't think it is going to be multi-res or condos or anything like that. If anything, maybe there is some self-storage, just because it is in close proximity to households, but ultimately I think it is going to have to do with last-mile distributions and logistics of getting goods to consumers' homes as ecommerce grows in importance.

Johann Rodrigues, Raymond James

Okay, thanks. I'll turn it back.

Operator

There are no further questions queued up at this time. I turn the call back over to Madeline Sarracini.

Madeline Sarracini, Investor Relations

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

Operator

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