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Robert Armstrong
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CONFERENCE CALL PARTICIPANTS

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CIBC World Markets

Jonathan Kelcher
TD Securities

Stephan Boire
Echelon Wealth Partners

Himanshu Gupta
GMP Securities

Matt Kornack
National Bank Financial

Brendon Abrams
Canaccord Genuity

PRESENTATION

Operator

Good morning. My name is Denise and I will be your conference operator today. At this time, I would like to welcome everyone to the Slate Office REIT Third 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.

Madeline Sarracini, Investor Relations, you may begin your conference.

Madeline Sarracini, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the third 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 Q3 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 joining the call today. Before we open up the lines for some questions I'll take a few minutes to touch on some of the highlights from Q3 2018.

During the third quarter of 2018 the team completed over 258,000 square feet of leasing at an attractive spread of 6.0% over expiring rents. Year to date, the numbers are even more impressive. In the first three quarters of 2018 the REIT completed over 925,000 square feet of leasing at a weighted average rental rate spread of 9.5%.

As we maintain our active leasing momentum, overall portfolio occupancy has increased by 30 basis points from the prior quarter to 87.1%. We expect the occupancy will continue to be positively impacted in future periods as a result of leasing activity completed in the third quarter of 2018.

Same property net operating income was up 13% compared to the same period in the prior year. This is largely a result of new leasing coming on line along with rental rate increases on renewals across the entire portfolio. We were very pleased with our leasing results, which continued to prove that the strategy of buying well-located assets below replacement cost is an excellent way to drive organic growth and create value for unitholders.

On the acquisition front, we are pleased to report that we closed on our previously-announced acquisition of 120 South LaSalle and the adjacent parking garage in the Central Loop of downtown Chicago for US$155.5 million. In keeping with the philosophy of owing clusters of assets in a particular node, the REIT now owns over one million square feet in downtown Chicago. The properties are in close proximity to each other and offer leasing and operations synergies. The acquisition affirms our commitment to our recycling capital program and acquiring higher-quality assets at attractive prices. We will continue to pursue similar acquisition opportunities going forward.

Continuing on that theme, the REIT disposed of two assets this quarter, 135 Queens Plate in Etobicoke, which sold for $16.7 million, which was approximately 10% higher than our IFRS book value and reflected a 20% levered IRR during our ownership period. Additionally, 139 Water Street and the Water Street Properties in St. John's, Newfoundland were sold for $17.3 million, a 40% premium to IFRS book value. The net proceeds from these dispositions were used to reduce outstanding debt and create liquidity for future investments. The team will continue to pursue similar opportunities and dispose of non-core holdings through outright or partial interest sales.

Looking ahead at the remainder of 2013, we will continue with our program of selective dispositions and exploring new opportunities to enhance the portfolio through acquisition or investment in our existing asset base in order to continue to generate value for unitholders.

We thank you for your continued support and I'll now open the line up for questions.

QUESTION AND ANSWER SESSION

Operator

Ladies and gentlemen, to ask a question, please press star followed by the number one on your telephone keypad.

Your first question comes from Chris Couprie with CIBC. Your line is open.

Chris Couprie, CIBC World Markets

Good morning, guys.

Scott Antoniak, Chief Executive Officer

Hi, Chris.

Chris Couprie, CIBC World Markets

Just wondering if you could delve into the capital recycling program a little bit more in terms of your expectations for the balance of this year and how 2019 could shape up.

Scott Antoniak, Chief Executive Officer

Through the remainder of 2018 and into 2019 there are certain assets that we would deem to be non-core and non-strategic to the REIT going forward. For those assets we'll pursue outright sales. Those would include fully-valued assets that don't really fit with our strategy or assets maybe in individual markets where we don't think we can continue to create critical mass, where we have a one-off or something like that situation. We would look to dispose of those at 100%. We are also exploring and pursuing a strategy of potentially joint venturing in certain assets within the GTA portfolio and perhaps Atlantic Canada. We expect that would unfold over the final quarter of 2018 and the first two quarters of 2019.

Chris Couprie, CIBC World Markets

Okay. And what about the hotel? Would that be something that is kind of considered non-core in that bucket?

Scott Antoniak, Chief Executive Officer

The hotel, Chris, in and of itself, is probably not a strategy that we would look to expand, but because of the nature of it and the ownership of it as part of Brunswick Square it is not easily kind of divisible or demisable. It is part of an office retail mixed use development, so I would view that as an entire asset as opposed to just the hotel. I wouldn not look for us to increase our hotel holdings but I think that is part of a larger whole.

Robert Armstrong, Chief Financial Officer

There is probably still some value to be had there as well, so we would be opportunistic if someone wanted to buy it but in the short term it is not in our sell bucket.

Chris Couprie, CIBC World Markets

Right. The NOI on that hotel piece seems to have been showing some pretty good trajectory. When do you think that kind of starts to stabilize?

Scott Antoniak, Chief Executive Officer

2020.

Chris Couprie, CIBC World Markets

Oh, really? Great. Okay, I'll turn it back for now. Thanks.

Robert Armstrong, Chief Financial Officer

Thanks, Chris.

Operator

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

Jonathan Kelcher, TD Securities

Thanks. Good morning. Just to follow up on Chris's questions on selling assets, is it still around $250 million that you guys are looking to sell in aggregate?

Scott Antoniak, Chief Executive Officer

Yeah, plus or minus, Jonathan. Maybe a little bit more than that. It is depending. From an equity perspective, it would be in the range of, we are looking to raise between $100 million to $150 million, if you look at it that way, and so that would probably translate into plus or minus $300 million. So, $250 million to $350 million would be fair.

Jonathan Kelcher, TD Securities

Okay. And do you have a target leverage?

Robert Armstrong, Chief Financial Officer

Yeah, I think in the short term, given where we are now and the financing we undertook for the acquisition of South LaSalle, the proceeds immediately would go to repay that. We think once we execute on this disposition plan we will be down to 57%, 58% leverage, looking to push it to about 55% in the short term to kind re-stabilize the balance sheet a little bit, but we fully expect to be able to do that.

Jonathan Kelcher, TD Securities

Okay. You target that, sounds like, by sort of middle or Q3 of next year?

Robert Armstrong, Chief Financial Officer

Yes, that's fair.

Jonathan Kelcher, TD Securities

Okay. And maybe give us your thoughts on fixed versus floating rate debt, because it certainly looks like we're going to get at least a couple more bumps from the Bank of Canada over the next year or so.

Robert Armstrong, Chief Financial Officer

Yes, we would agree going into 2019. I think what we tried to do over the last year has been reflective of that. We have taken a bunch of debt to the fixed-term market. We have also purchased some interest rate hedges in order to fix some of the debt. I think we are up to about 65% relative to, say, a year ago we were about 40%, so moving in the right direction.

We have a number of assets in the pipeline that over the next, call it, six months we will also move to put to the fixed market. So, that 65% fixed right now will continue to creep up. But we want to remain flexible where we are, looking to undertake capital recycling to make sure we do have flexibility to take those assets off of our balance sheet without having to be in a position of taking out some fixed-term debt.

So, we will be cautious in balancing the flexibility of our balance sheet and the debt structure with our ability to execute on the capital recycling plan but, at the same time, where we're can, we'll continue to increase the fixed-rate debt.

Jonathan Kelcher, TD Securities

Okay. Thanks, I'll turn it back for now.

Operator

Your next question comes from Stephan Boire with Echelon Wealth Partners. Your line is open.

Stephan Boire, Echelon Wealth Partners

Hi. Good morning. I just had a quick question, a quick fairly general question on your views on the U.S. market versus Canadian market. With interest rates that might increase more than the market currently anticipates, do you continue to see much better opportunities south of the border? And for how long do you think such discrepancies will exist?

Scott Antoniak, Chief Executive Officer

Let us maybe look at Canada and then the U.S. I think, from our perspective, Canada has shrunk somewhat for this vehicle. Our view of Alberta's volatility is still maybe a ways off perhaps. We think that the GTA, Ontario and the GTA specifically and British Columbia are fairly expensive. Prices have moved aggressively in Montreal and we already have significant holdings in Atlantic Canada. So that dramatically reduces the investible universe. And it is not to say we would not look for deals here but I think they would have to be, as we have done in the past, more creative opportunistic kind of deals and buying in the, say, marketed processes.

In the US, I think the first thing is the scale. It is enormous relative to Canada. We don not have to do—here we have to really look at every single deal that comes up. In the US we are not limited but kind of narrowed our focus to the markets we talked about before, so Chicago and Columbus, Minneapolis in the Midwest, and then certain markets in the southeast. I call it non-Miami Florida, like Jacksonville, Tampa Bay, places like that. They are markets with significant growth where we are still seeing a per-square foot basis relative to replacement cost and also relative to the per-square foot basis here. I mean 50% probably to 75% of what costs are here. And then a yield perspective stabilized. The premium is a couple hundred basis points over a similar product in Canada in a much bigger market with much deeper leasing and tenants and things like that.

We are not going to be, as we have done here, and I think even more focused on this now, we are going to try to focus where we can cluster. So, we have already started building that in Chicago and maybe look to add another market or two where we can build scale. But because of the nature of the market being so big, we think there are lots of opportunities. And there is still room, I think, even if interest rates do grow a little bit more aggressively than people think, still the returns on a related basis to Canada are more compelling. For how long, I don not know, but for now.

Robert Armstrong, Chief Financial Officer

What I might add as well is while we are making a macro view on Canada versus the US at a certain level, where the acquisitions will take place, we still believe will always be a story related to the individual asset, just like there was for 20 South Clark and 120 South LaSalle. We still think there is value creation there.

So, as opposed to taking that at a macro level and allocating capital, at the asset level it needs to make sense and we need to be able to see that we can increase NAV for the business as a whole over the short term of that asset.

Scott Antoniak, Chief Executive Officer

That is a great point. Stephan, like we viewed this internally, so maybe we can start using it externally now too. You can think of Slate as buying office with a story and right now we think that story is compelling in Chicago, and there might be other places, but it's never going to be just a macro view. It will always be where we can create that dynamic with replacement costs and in-place rents, et cetera, and there will always be a story around what we buy and why we are buying it.

Stephan Boire, Echelon Wealth Partners

Right. Okay. Perfect. That's very helpful. Thank you very much.

Scott Antoniak, Chief Executive Officer

Thanks, Stephan.

Operator

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

Himanshu Gupta, GMP Securities

Thank you and good morning, guys. Just a follow up on balance sheet, debt maturity specifically. So, some amount of debt is up for renewal next year. What are your thoughts here on pricing on the renewals? And does the higher leverage will have any impact on the kind of pricing you guys achieve?

Robert Armstrong, Chief Financial Officer

The maturities coming up in 2019, the largest one is the $120 million facility that's up next June. We expect a normal course renewal in that regard in and around the same pricing. We do think there is an opportunity in the portfolio as a whole where we have created value to take some assets out to the term market and get higher proceeds than we currently have now. But generally, notwithstanding base interest rates are going up, we do feel like there is some spread compression in the market generally, but we think on the whole we would be able to finance that at or better terms than we have now for the most part.

Himanshu Gupta, GMP Securities

Okay. On Chicago assets, you mention in the letter to drive leasing and rental rates in Chicago into a capital plan. Can you elaborate? I mean how much are you planning to spend? And is the increase in occupancy contingent upon this capital spend?

Scott Antoniak, Chief Executive Officer

Was the question around 20 South Clark or 120 South LaSalle or just all of our properties in Chicago?

Himanshu Gupta, GMP Securities

I think all the assets in Chicago where you mentioned that, you know, through more amenities and better options at these complexes and there is some capital spend expected there.

Steve Hodgson, Chief Operating Officer

With 20 South Clark, it is a very boutique building. The average tenant size is about 3,000 to 5,000 square feet. There are some cosmetic renovations that we plan to do with that asset but nothing overly extensive that would be beyond normal course capital improvements that we would make in any of our properties. We just think the opportunity there is better management and more attentive on the brokerage relationships and the tenant relations.

With 120 South LaSalle, that is more of a repositioning. We have the stability of the income with the CIBC lease but the balance of the building, there is a tremendous opportunity to grow rents and change the tenant mix in our favour, from both a covenant and a growth perspective. And to do so, I wouldn't say it is contingent, Himanshu, but it is strategic and it is adding new amenity programs to 120 South LaSalle probably in the magnitude of, we are still working out the budgets and the physical feasibility of the project but probably in the magnitude of $3 million to $5 million of capital spend to add gym facilities, conference facilities, and tenant lounge amenity. We know that that is what the market is looking for and on the basis that we own this and if we are able to add these amenities we will be very successful.

Robert Armstrong, Chief Financial Officer

What I would add as well is that the plans for both the improvements at South Clark as well as the amenity package at South LaSalle and the budgets in that respect are both consistent with what we had planned to do in underwriting, so we are still within our underwriting budgets at the execution phase.

Steve Hodgson, Chief Operating Officer

I will note too that, acquisition of 20 South Clark, we bought the property at 84.2% occupancy. We have increased, we have now committed occupancy of 85.7%. So, it's really, that asset, as I mentioned, is just making incremental improvements quarter over quarter without a large-scale capital program.

Himanshu Gupta, GMP Securities

All right. Thanks. So, nothing big, it's $3 million to $5 million you said. Okay. Downtown Toronto office market continues to be tight and performing well. Do you see evidence of demand trickling down to the suburbs? And on the flip side, I mean we keep hearing about co-working or open-floor formats, tenants right-sizing the space requirements; do you see any impact there?

Steve Hodgson, Chief Operating Officer

Absolutely. Less so on the second part of your question, but certainly on the first part. Downtown is a very tight market, as you noted, in Toronto. The assets that benefit most from that I would say would be the 427 corridor where we are seeing a lot of downtown requirements look at our properties. I think that is evidenced in the leasing we have done there since acquisition.

I will also say that we were successful this quarter in leasing up the vacancy that we had at Sheridan Exchange, which would be technically in Mississauga but on the border of Oakville and Mississauga, and that is a tech business as well and that would be competing with downtown space. But because it is transit orientated and it is a little bit more mature tech company we were able to secure that business.

Himanshu Gupta, GMP Securities

Okay. Thank you so much. I'll turn it back.

Operator

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

Matt Kornack, National Bank Financial

Good morning, guys. Just wanted to quickly touch on the disposition program. I think I heard in your opening comment that you are looking at a JV sale. Can you speak to the timing on that $250 million to $350 million? Is that going to be a chunky sort of one-time sale in late this year, early next? And then just in terms of cap rates on sales, consistent with IFRS cap rate or are these higher or lower relative to the overall portfolio?

Scott Antoniak, Chief Executive Officer

I suspect, Matt, it will be probably more than one transaction. Your timing is right; it will be end of this year, first quarter of next. It will probably be more than one transaction, but one larger and maybe a smaller supporting one.

In terms of valuation on a cap rate perspective, it would be consistent with or lower than, on a cap rate basis, IFRS.

Matt Kornack, National Bank Financial

Okay. To take your leverage down to 55% near term and sell that amount of assets at that cap rate, it is going to be dilutive to FFO and AFFO. Just wondering, the interplay between your lease up and stabilization of the existing portfolio versus that dilution, how that plays into your views on payout ratio and distributions.

Robert Armstrong, Chief Financial Officer

Yes, we think if you turn back a number of quarters we were in and around 58% leveraged, so we think that is kind of a return to that level and right-sized to where we would be at this point in time. I think that the balancing of the capital recycling is that, as opposed to selling assets and then buying, we have executed on over $500 million of acquisitions this year, so it is really trying to right-size back to that point. So, I think we've kind of chased ahead a little bit on the NOI growth from an acquisition standpoint and this is really just simply going back to where we otherwise would have been but with a better portfolio, more focused and more upside.

Matt Kornack, National Bank Financial

So, 58% is where you anticipate landing, but did I hear that you're going to temporarily going to be at 55% and then would that presume that you do further acquisition activity to get back to 58%?

Robert Armstrong, Chief Financial Officer

No, I think we will continue to try to push that down, either through earnings or just simply debt amortization. The other side of that is we still think that there is value upside in the portfolio that naturally will have the opposite effect of pushing that down based on what we are trying to execute on and fully expect that to happen, save for any changes in the pricing environment. But ideally, as a team, we would like to get that down into beyond or below 55%, just to be able to create some additional capacity on the balance sheet. But there is no plan to immediately take it back up for the sake of taking it back up.

Matt Kornack, National Bank Financial

Okay. Fair enough. With regards to occupancy, you don't have a ton remaining in terms of lease maturities this year and a reasonable program next year. In the MD&A I think it mentioned that you're in the process of pursuing a few large potential incremental tenancies. Can you speak to what those would be and how you see occupancy unfolding over the next few quarters? And then also where do you see sort of a stabilized occupancy number for the portfolio more generally?

Steve Hodgson, Chief Operating Officer

Sure, Matt. I think it is worth noting initially that there is 1.2% of occupancy that is already contractual that has not commenced yet, so would not be in our in-place number that we will see before the end of this year. In addition to that, there are some pockets of leasing that we think we can still do, certainly in the 427 and 2599 Speakman, we think there will be a deal there at some point in 2019, which is currently sitting vacant and certainly a drag on our occupancy. The Chicago strategy with 120 South LaSalle in particular will help drive that number. From a stabilized perspective, as we messaged in the prior quarter, low 90%. 91%, 92%.

Matt Kornack, National Bank Financial

Okay. That's perfect. Thanks, guys.

Operator

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

Brendon Abrams, Canaccord Genuity

Good morning, everyone. Just sticking with the capital recycling theme, I mean you guys are in the market every day looking at assets, bidding on assets. How would you kind of characterize the disposition environment for the type of assets that you would be looking to sell? And I guess secondly, how confident are you that you'll achieve kind of the expected valuation that you're proposing?

Scott Antoniak, Chief Executive Officer

We are confident on the valuation side of it. In terms of the demand metrics, for the reasons we explained earlier in the call with respect to expanding our markets and considering the US, I think there remains lots of demand for office assets in Canada. I think we have been, to a certain extent, the beneficiary given, the largest concentration of our assets is within the GTA and we have benefitted from lower cap rates and increasing values there. I think we have some compelling assets and compelling stories in and around the GTA in the nodes where we have got concentration. We are fairly confident on transactability, if that is the right word, and where valuations will be, because there continues to be considerable demand and it's competitive in Canada for office acquisitions.

Robert Armstrong, Chief Financial Officer

What I would add as well is we feel good about where we have got the portfolio marked and what we will be able to execute on from the disposition plan. We think the values are realistic and potentially expect to do a little better than we have currently got them marked at. We have been pleased with what we have seen so far on the disposition plan on being able to exit assts at fairly decent marks above what we had the assets valued at, so that has been really good from our perspective, just looking at Queens Plate and the Water Street properties. We have a number of deals in the pipeline with still some work to do on them but we feel would be at decent prices and around where we expect.

Brendon Abrams, Canaccord Genuity

Okay. That makes sense. As you have deployed more capital in the US, and I guess are looking to deploy further capital through acquisition, how do you guys view, just at a high level, the currency risk or foreign exchange in terms of handling that risk?

Robert Armstrong, Chief Financial Officer

At this point in time the NOI impact is not all that significant. You have about 12%, 13% of portfolio in the US, so the variability of the dollar of 13% of the portfolio is not a huge magnitude. So, we are watching that and we are paying attention but it is not something we feel we need to actively, synthetically deal with at this point in time.

On the other hand, we do have $85 million of capital that we've deployed in the US from an equity perspective and we do have variability there. We have entered into hedges to protect ourselves from that NAV risk of an appreciating Canadian dollar. But we will pick our points in that respect but, again, it is not significantly material, but it is something we will actively monitor as we go ahead.

Brendon Abrams, Canaccord Genuity

Okay. And then just last question for me, I mean leasing spreads were pretty healthy during the quarter, about 6%. Would you say that's specific to the leases that were rolling during the quarter or would you say that's reflective of the broader portfolio?

Steve Hodgson, Chief Operating Officer

I think that is reflective of the broader portfolio. Every quarter we look at our building in-place rents versus market and come up with a weighted average number that we reflect in our MD&A, and that would be in and around that 6% to 7% number. So that is where we view it going forward.

Robert Armstrong, Chief Financial Officer

That has been typical in our strategy in trying to purchase buildings with below-market rents. You are seeing that come through in the same property NOI numbers, that 13%, and it was 11% last year, and I think that is really just a reflection of moving a number of those rents to market as well as the guys have done a ton of leasing, so we are really pleased to see that value creation come through. But I think Steve is right that that will be the general theme going forward and about the right number.

Brendon Abrams, Canaccord Genuity

Great. That's it for me. Thanks.

Operator

Again, to ask a question, please press star one on your telephone keypad. Your next question comes from Chris Couprie with CIBC. Your line is open.

Chris Couprie, CIBC World Markets

Just one quick one on G&A: How should we be thinking about G&A, the kind of run rate on an annual basis going forward?

Robert Armstrong, Chief Financial Officer

I think this last quarter was a little bit higher, this quarter was a little bit lower, but it was really the timing of accruals. But I think in and around Q3, Q2 is about the variability we expect, the average of the two is a good run rate.

Chris Couprie, CIBC World Markets

Okay, great. Thanks, guys.

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 third quarter 2018 conference call for Slate Office REIT. Have a great day.

Operator

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