CORPORATE PARTICIPANTS

Katie Talbot
Associate, Investor Relations

Greg Stevenson
Chief Executive Officer

CONFERENCE CALL PARTICIPANTS

Troy MacLean
BMO Capital Markets

Dawoon Chung
National Bank Financial

Dean Wilkinson
CIBC World Markets

Jimmy Shan
GMP Securities

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Slate Retail REIT Third Quarter 2016 Financial Results Conference Call. As a reminder, this is being recorded today, Thursday, November 3, 2016, at 9:00 a.m. Eastern Time. Your host for today's call is Katie Talbot. Please proceed, Ms. Talbot.

Katie Talbot, Associate

Thank you, operator, and good morning, everyone. Welcome to the third quarter 2016 conference call for Slate Retail REIT. I am joined today by 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 statements, 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 November 2016 investor update, which will be available shortly after today's call.

We'll allocate most of this call to answering your questions but first I will hand the call over to Greg Stevenson to discuss some highlights from the quarter.

Greg Stevenson, Chief Executive Officer

Thanks, Katie.

Another solid quarter for Slate Retail REIT as we continued to execute on a number of strategic initiatives. I'll turn the call over for questions but quickly I want to talk about some of the things that we did this quarter. We continued to execute on recycling capital and improving our portfolio to increase the quality. We closed on the Food Lion portfolio midway through the quarter and while results are temporarily lower from the contributions of this portfolio sale, and Ocean Plaza not contributing NOI within the quarter, we have either reinvested or put under contract all of the remaining funds that will be invested. We expect that NOI and FFO will contribute partially in Q4 and will be back in full swing for the first quarter of 2017. In addition, leasing was very strong across all renewals. We saw an 8.6 percent spread over expiring rents and this came with modest spend on both leasing capital and landlord work. We leased to 11 new tenants at an average of $16.56, which we think compares very well to our in-place portfolio rent of $10.34. As a result of the leasing this quarter, same property NOI increased 70 basis points compared to the same period in the prior year. We also added eight properties to our same property count this quarter, making this 76 percent of our portfolio and a bit more of a meaningful statistic than in the past.

In September, we announced a distribution increase of 4 percent as our cash flow per unit continues to grow, our third increase since listing in 2014. That brings our payout ratio around mid 70's with a pro forma of low 70 percent. We should note that we do not capitalize interest on development properties. In addition to this, we entered into a $300 million swap, which will take our fixed rate debt from about 25 percent to 75 percent and increase our weighted average cost of debt by only 30 basis points. It would be about a $0.05 per unit hit to AFFO or, said differently, it would bring our payout ratio up about 200 basis points. We think that this is a great strategic initiative for the REIT and as we've been monitoring swap rates over the last few years, they've come down and cut in half. We think we're entering into the swap rate at a very strategic time and we've saved our unitholders millions of the dollars in interest costs by doing this. Now we've protected ourselves from future interest rate increases. Lastly, the team continues to do an exceptional job executing on value-add opportunities within the portfolio that will set us up well to see some success in the future. And we continue to make progress on a handful of our redevelopment initiatives in the portfolio.

So, with that, I will turn it over for some questions.

Q U E S T I O N   A N D   A N S W E R   S E S S I O N

Operator

At this time, I'd like to remind everyone in order to ask a question press star then the number one on your telephone keypad.

Your first question comes from the line of Troy MacLean with BMO Capital Markets. Your line is open.

Troy MacLean, BMO Capital Markets

Good morning. Do you have any guidance for same property NOI growth for 2017?

Greg Stevenson, Chief Executive Officer

We don't provide guidance but if you take a look at leasing spreads over the last four quarters, they've averaged between 5 percent to 10 percent on renewals, and our new leases are being signed at anywhere between 30 percent and 50 percent above comparable space across the portfolio. We are pretty meticulous about our OpEx spending and our NOI margins continue to be between 70 percent and 72 percent, which are some of the highest amongst our peer group. We expect it to be positive but we're not going to get into trying to guide as to what we think that will be. When you look across and compare Slate Retail REIT's leasing statistics relative to our peers I think it should shake out pretty strong. The one thing that we've got the benefit of is not just our team but what's going on in the United States today. There is a 35 year to 40 year low in construction supply so rents and occupancies are ticking up across the board, not just for Slate Retail but for all the strip centre REITs in the US. In addition to getting out there and getting hands-on managers we've also got some fundamental tailwinds at our back as well. We expect it to be positive going forward.

Troy MacLean, BMO Capital Markets

And then given the rent growth what do you think the spread is between your in-place rents and where market is right now?

Greg Stevenson, Chief Executive Officer

Between 25 percent and 30 percent on average. Our spread at renewal is somewhere between 5 and 10, while new deals are where you see a much larger jump, averaging around 30 percent since inception. And I think we'll continue to see that as we roll. And if you look at our expiry schedule over the next few years we've got anywhere between 10 percent to 12 percent of our GLA expiring but, more importantly, the average rental rate at expiry is around the $9 to $10 range and if you look to see where we've been both renewing rents and doing new deals, it's been anywhere between $12 and $17.

Troy MacLean, BMO Capital Markets

Given the lack of new supply is it getting easier to renew tenants? Is retention going up or is it becoming cheaper to renew them?

Greg Stevenson, Chief Executive Officer

It continues to be cheaper, and has something to do with lack of construction. It also has something to do with the asset class. It's strip centre retail; we don't have to worry about elevators or escalators or fancy water features or moving sidewalks or palm trees or anything of the like that you'd see in some of the higher end markets. In some cases, we have to replace an HVAC, a roof, or overlay a parking lot. What we really like about this asset class is that capital reinvestment is typically modest and the grocers, our anchor tenants, spend their own dollars on remodelling the insides of their stores so leasing packages for our anchors are never usually too punitive, just like retail. I think it's a mixture of both of those things.

Troy MacLean, BMO Capital Markets

Okay. That's it for me. I'll turn it back.

Greg Stevenson, Chief Executive Officer

Thanks, Troy.

Operator

Your next question comes from the line of Dawoon Chung with National Bank. Your line is open.

Dawoon Chung, National Bank Financial

Good morning, guys.

Greg Stevenson, Chief Executive Officer

Good morning.

Dawoon Chung, National Bank Financial

With regards to the swap deal, is this a function of getting attractive swap rates or has your views on interest rates changed? Going forward, would you be inclined to use fixed rate debt and, if so, what would be the rate on those?

Greg Stevenson, Chief Executive Officer

With where we are in our life stage, having grown from 29 assets two years ago, and if you assume that we close on everything we have under our contract we'll be at 70, we've more than doubled in size. We want to make sure we maintain flexibility in the capital structure. Said differently, if you have a bunch of fixed rate debt in your portfolio and you believe, which we believe, that you have assets that there are value-add initiatives, because we believe we're buying assets that have been largely undermanaged and ignored, you're trapping that equity in the asset and that's not what we want to do. We've experienced it. If you want to do leasing at a property, build and out parcel, redevelop an anchor, we don't want to have to go to a lender for approval, because we're the experts and we want to make that decision. If you put mortgage-level debt on your properties, you handcuff yourself in some instances. In other cases, take the Food Lion portfolio for example, if we had put mortgage debt on those properties and went to sell them and break the debt, the prepayment or defeasance penalty would have been in the millions and millions of dollars.

We never wanted to make a call on interest rates but we wanted to make sure we did our research and were very thoughtful about how to fix the debt, because we do think we're at a historical spot and at some point, interest rates are going up. We have no idea when. Swap rates have come in from 200 basis points to around 110 today and we were able to fix our debt at 57 basis points above where our floating rate debt cost is today, which we think is pretty attractive. Our weighted average cost of debt is only going to increase by 29 basis points. We believe this is a great way to de-risk the portfolio, it's very asymmetrical, and I think that the $0.05 hit we take from doing this will more than pay off interest rate increases. If you understand the swap, interest rates rise and actually turns into the money, so if we were to break a swap, let's say we wanted to sell some assets and we have to break the swap, we actually get a cheque for that as opposed to property-level debt you end up cutting a cheque, which can really cut into your returns.

On your last question, I don't think at this stage we have much interest in mortgage-level debt because while our all-in cost today on the swap is around 3 percent, mortgage-level debt for the same sort of term would be still 75 to 100 basis points higher. It's more expensive and it's far more limiting in terms of operating the business. We don't want to do that.

Dawoon Chung, National Bank Financial

Great. Thanks for the colour. Related to other development costs that was notified in the MD&A, could you provide some colour on this front? And is this related to County Line in Philadelphia?

Greg Stevenson, Chief Executive Officer

County Line is the lion's share of that number and we're in the preliminary stages on a few others where construction hasn't started but we're doing renderings with architects and talking to the planning department at the cities. Yes, the majority is County Line but, as we've talked about in the past, we're partnering with a few of our anchor tenants on some redevelopment projects and we expect that pipeline to grow into the future and so that other is the beginning of some of those projects coming on line.

Dawoon Chung, National Bank Financial

Great. That's it for me. I'll turn it back.

Operator

Your next question comes from the line of Dean Wilkinson of CIBC. Your line is open.

Dean Wilkinson, CIBC World Markets

Thanks. Good morning, Greg.

Greg Stevenson, Chief Executive Officer

Hey, Dean.

Dean Wilkinson, CIBC World Markets

Just on the non-anchor occupancy there's a decline of about 2.5 percent. Was that more a retention rate issue or was that the Food Lion disposition?

Greg Stevenson, Chief Executive Officer

We didn't lose any anchors, so it had nothing to do with retention. It was all the result of selling and buying assets and just the combination of the two.

Dean Wilkinson, CIBC World Markets

Looking at where the occupancy levels sits vis-à-vis the leasing that's happened through the quarter, should we expect that to probably be flat into year end and then maybe it ticks up as we go into the new year?

Greg Stevenson, Chief Executive Officer

When we've talked about occupancy levels in the past, we looked at the MD&A and saw that we were net positive on leasing and it was the result of acquiring properties with lower occupancy and disposing of properties with higher occupancy. What we've done is we've de-risked the portfolio because we're buying higher quality properties, but with lower occupancy. We are leaving ourselves some runway for upside in the future. Yes, no huge changes in occupancy, but as we lease up this vacant space, because we've been successful in doing it in the past, you'll see occupancy tick up from where it is today.

Dean Wilkinson, CIBC World Markets

Turning to the dividend increase, you've got a 70 percent payout target, running just shy of 76 on the quarter. What was the thought there in perhaps leapfrogging your target and are you looking out maybe 18 months in terms of setting that? How are you thinking about that?

Greg Stevenson, Chief Executive Officer

It was largely because last quarter we were sub 70, Q2, and the only reason we jumped to mid-70s this quarter was because of the timing on the sale of both Ocean Plaza, which we lost a full quarter, it closed June 30th, and then the timing of the proceeds from Food Lion. That is a temporary jump in the AFFO payout ratio. If you were to normalize for reinvesting those proceeds on a full-year basis we'd be back below 70 percent again. We based it on that.

Dean Wilkinson, CIBC World Markets

In a bigger picture, are you familiar with the DDR assets in upstate New York that were sold in October? It's a bit of a bigger acquisition, close to $400 million, but is that something you took a look at? And how did those assets compare to sort of the stuff you own?

Greg Stevenson, Chief Executive Officer

It compares—there's some similar. It's not all grocery anchored, which if it's not grocery anchored we don't want to do it. It was largely upstate New York and there were some pretty tough assets in there. We looked at it but we were inevitably a pass.

I think that if you compare the markets we're in, Charlotte, Atlanta, Jacksonville, Nashville and some of these MSAs, they compare quite favourably both from jobs and an income perspective. We also we think that our anchors like Kroger and Publix are better than KOPs and some of the other anchors that were in upstate the New York/Rochester portfolio. It was definitely of lower quality. I think that where it traded, the yields were high enough to make sense we can buy assets at the same yield with probably more upside and of much higher quality, so we were inevitably a pass.

Dean Wilkinson, CIBC World Markets

Cool. And the $86 a square foot it went for, roughly what cap rate was that?

Greg Stevenson, Chief Executive Officer

It was just shy of an 8, so it was like a 7.7 cap rate.

Operator

Again, if you'd like to ask a question, press star and the number one on your telephone keypad.

Your next question comes from the line of Jimmy Shan with GMP Securities. Your line is open.

Jimmy Shan, GMP Securities

Thanks. Just to be clear, putting a swap on the debt, that does not trap the equity, right? For example, at the two or three development assets you've got, if you were to create $10 million of additional value to the redevelopment process, how do you tap into that equity with the new swap program in place? That has no impact at all, right?

Greg Stevenson, Chief Executive Officer

That NAV accretion would flow through to the balance sheet. But if we wanted to get the equity out of the asset the swap wouldn't prevent us from doing that. We would effectively have two options and one would be sell the asset, or, two, we would have to go down the long-term fix rate mortgage route. Either way if we were to sell the asset and/or put mortgage financing on it, it wouldn't affect the swap or anything to do with the swap. There would be no cost to that.

Jimmy Shan, GMP Securities

Turning to the same-store stats, I appreciate the new disclosure on the retention rates. What I'm trying to figure out is the same-store NOI of 0.7 percent versus when I tally up the renewal rate increases and the new leases. I'm referring to page nine of the MD&A, it seems like the additional NOI should be a lot bigger than the 0.7 that you're showing on the other page and I'm just trying to understand what could I be missing when I compare the two? Is it that the Buckeye renewal was, had that had a disproportionate impact on the same-store stats? I'm just trying to understand that.

Greg Stevenson, Chief Executive Officer

A quick point on your last question, as the value of these assets increase our LTV obviously goes down, so we can pull out more money on the borrowing base under our revolving facility. We can suck out funds that way without having to sell the asset or put mortgage financing on it.

To answer your current question, I think partially, like I said last quarter, we had 41 of 70 assets in the same store number, which keeps out half of everything that we do from that number and now we are at 75 percent of the assets this quarter, so it is more meaningful. As that number continues to grow and we include more properties that we own where we're doing lots of great things the same store property number and what you see in our leasing statistics will start to close in on each other.

Secondly, the temporary blip from County Line where we're sitting on a dark anchor, although we're working on something there, and Uptown Station and Buckeye where we saw temporary changes in leasing, they have a disproportionate share in our portfolio. Over time you start to see what I can say is, to your point on page nine, and we included that for the first time this quarter and I would suggest that people take note of it, is all of the great things we're doing will eventually show up in our numbers. It is just a matter of time and it takes more than just a quarter for this stuff to flow through, because these are annualized numbers on page nine.

The good news is that we're setting ourselves up for success in the future and, as I said earlier in the call to Troy, we expect same store to continue to trend positively in the future.

Jimmy Shan, GMP Securities

Okay. Lastly, just on the acquisition market, the acquisition that's been done post quarter, can you give us a sense of what the weighted average cap rate was on those assets and then maybe comment generally on what you're seeing on the marketplace. There's been increasingly more talked about in the spread between gateway and non-gateway and how that's tracking.

Greg Stevenson, Chief Executive Officer

The average cap rate is in and around, and more importantly, priced per square foot and is still well below replacement cost in around mid-7s, so 7.3, 7.4. That's on today's income and we think those yields grow over time as we continue to lease space. I think we stabilize closer to an 8 or higher in some cases where we've picked up properties with more vacancy.

In the markets, nothing has changed for Slate Retail. We continue to find great opportunities. The two biggest changes, which aren't really pricing is, firstly, our pipeline continues to grow with every passing day. What doesn't show up on our balance sheet is the relationships we've built over the last five and a half years, both with our tenants and the investment community. We see a lot of direct deals and a lot of off-market deals and people know who we are and know that what we do is very niche-y and when something comes along that someone has that would tick all of our boxes we're typically getting that phone call. On the bid side, we're still running into no competition. [If you want to be the smartest person in the room, go into the room where there's nobody else in.] We manage to continue to do things that other people aren't doing and we're in markets where capital is scarce and operational proficiency is weak.

Secondly, the gap between the core, top five or six gateway cities, and the secondary cities, has continued to widen. Interestingly, it has started to pop up. Green Street wrote about it a few days ago in an article saying that they believe that the pricing differential between primary and secondary markets is becoming very, very difficult, even with higher rent growth in some of these markets, primary markets, for returns to match that of secondary markets. We completely agree and have been thinking the same thing for a couple of years now. As I've listened in to conference calls for some of the other US REITs, there were three in particular where the CEOs explicitly started to talk about having a really hard time finding acquisition opportunities and talking about the spread between primary and secondary markets. It's starting to be recognized. It hasn't affected pricing yet and we think that due to our relationships we'll still be able to find excellent opportunities. Our relationship with some of our anchors highlights this. How many small cap Canadian REITs are the number-one or number-two phone call for some of the largest grocers and retailers in North America? I think the answer is zero. This speaks to our team, Slate Asset Management, and to the fact that Slate Retail REIT can draw from 53 people. I can talk to the CEO of another REIT because he sits down the way from me, I can talk to Brady, Blair, Ramsey, Lisa, and Bobby. I can benefit from all of their relationships as well.

If pricing comes in, and we think over time it will, because that's why we're doing this, we'll continue to find ways to creatively acquire properties at attractive prices. If we can't, then our game plan will change. But for now, nothing has changed and pricing is still very attractive in the mid 7s. When you compare that to what you're seeing in the Canadian marketplace, we're able to acquire wider yields with more upside and higher quality markets. With US fundamentals being strong relative to Canada, we feel pretty confident that Slate Retail will be heading in a different direction over the coming quarters.

Jimmy Shan, GMP Securities

Okay. Thank you.

Greg Stevenson, Chief Executive Officer

Thanks.

Operator

There are no further questions at this time. I turn the call back over to the presenters.

Katie Talbot, Associate

Thanks for joining us on the call, everyone. Please follow up, if you have any additional questions, with myself or Greg.

Operator

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