CORPORATE PARTICIPANTS

Blair Welch
Chief Executive Officer

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CONFERENCE CALL PARTICIPANTS

Li Chen
Laurentian Bank Securities

Jenny Ma
BMO Capital Markets

Himanshu Gupta
Scotiabank

PRESENTATION

Operator

Good day. Thank you for standing by, and welcome to the Slate Grocery REIT Fourth Quarter 2021 Financial Results Conference Call. At this time, all participants are in a listen-only mode.

After the speaker's presentation, there will be a question and answer session. To ask a question during the session, you will need to press star-one on your telephone. Please be advised that today's conference is being recorded. In addition, if you require any further assistance, please press star-zero. Thank you.

I would now like to hand the conference over to your speaker, Mr. Braden Lyons. Sir, please go ahead.

Braden Lyons, Associate

Thank you, operator, and good morning, everyone. Welcome to the Q4 2021 conference call for Slate Grocery REIT. I'm joined this morning by Blair Welch, Chief Executive Officer; Andrew Agatep, Chief Financial Officer; and John Harricks, Vice President, Asset Management.

Before getting started, I would like to remind participants that our discussion today may contain forward-looking statements, and therefore we ask you to review the disclaimers regarding forward-looking statements as well as non-IFRS measures, both of which can be found in management's discussion and analysis. You can visit Slate Grocery REIT's website to access all of the REIT's financial disclosure, including our Q4 2021 investor update, which is available now.

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

Blair Welch, Chief Executive Officer

Thanks, Braden. Good morning, everybody. This past year has proven again that grocery anchored real estate is extremely resilient. It is a central part of food distribution, which is required in all kinds of market conditions, and we have consistently loved this type of real estate.

2021 was a transformational year for Slate Grocery REIT. We achieved record growth at attractive valuations. We invested about $470 million in accretive grocery anchored assets at compelling values.

What does that mean? We grew by about 3.7 million square feet, or 40%, and we increased our exposure to leading omnichannel grocers in the U.S. in large metropolitan areas such as New York and Texas, and we further enhanced our portfolio's durability through proactive asset management.

The team had a record year where we completed 375,000 square feet of new lease deals at an almost 18% weighted average rental spread, and we are now at about 94% occupied. It is our sixth consecutive quarter of occupancy growth. And when you look at that in the pandemic lockdowns, I think that's a very impressive stat that shows this real estate is in demand and people want to be in these assets. Our same property NOI was up about 3%, and I'll let Andrew later talk about our AFFO, which was about $0.22.

Heading into 2022, we feel the REIT is well-positioned to pursue organic growth and high-quality accretive acquisitions. We can do that through buying single assets, as we've mostly done, but we can also be opportunistic as the market dictates or shows us opportunities. We are actively underwriting compelling investment opportunities always, and we have maintained a strong balance sheet through a period of growth, so we have ample liquidity and flexibility.

Slate Asset Management owns and operates over $3 billion of grocery assets worldwide. The grocery REIT has over 100 assets in the U.S., and we own over 240 assets in Europe. I think our expertise with these leading retailers gives us a competitive advantage to all the unitholders of Slate Grocery REIT.

I will now hand it over for questions.

Operator

Thank you. And as a reminder, to ask a question, simply press the star then the number one on your telephone keypad.

And your first question comes from the line of Li Chen from Laurentian Bank Securities. Your line is open.

Li Chen, Laurentian Bank Securities

Hi. Good morning, guys. Just some quick questions for me. Blair, can you give us some more color regarding your acquisition pipeline for 2022 and what would be the REIT's acquisition capacity?

Blair Welch, Chief Executive Officer

We've always looked at the opportunity to acquire great assets at a strong basis where we know the tenants. If I take a step back, when we started it, we loved this business. We know it's food logistics. Then about five years ago, e-commerce was changing things and we knew it. We still believed in our business, we wanted to wait and see what was happening.

Over the last several years, what we saw is our tenants like Walmart and Kroger have invested billions of dollars in click and collect to make their stores able to really embrace e-commerce. And when we saw that, we felt that this is just food logistics. When they're investing in their stores to fulfill that, we wanted to buy more.

So, we started buying again a couple years ago, onesie-twosies and in portfolios. We were opportunistic during COVID. I think that will continue. Our pipeline in the U.S., if there's almost 40,000 grocery stores, it's hard to put into context, but we're probably tracking $3 or $4 billion of grocery deals in the U.S. and that could be one-off assets or portfolios.

What we'd like to do is, we could do a couple hundred million of asset acquisitions, but if there is a portfolio opportunity, we will look at that as well.
What Slate Asset Management sees is, as in the Annaly deal, that was a $3 billion deal that contained $400 million of grocery. There are grocery assets stuck in structures that we think are compelling where we can buy them very attractively, so we'll look to do that.

However, we're not going to grow for growth's sake. We love our in-place rents. There's going to be organic growth in our portfolio. Inflation will cause rents to grow. Our basis is cheap. So, we are only going to buy if we think we can have stable cash flow that will grow in the long-term.

I think that, if we could do several hundred million of acquisitions, that would be our plan, nothing too crazy, and we have the ability to do that. But we're always looking for compelling opportunities, and we can be dynamic.

Li Chen, Laurentian Bank Securities

That's great. And have you identified any potential assets for capital recycling in the near future?

Blair Welch, Chief Executive Officer

Yes, I think we always are. I'll let John talk about that, but I think we are always doing that.

John Harricks, Vice President, Asset Management

Thanks, Blair. As Blair mentioned, we're always looking and reassessing our portfolio to see where there are opportunities to recycle out of assets and into other more opportunistic assets. I would say of our portfolio currently, there are three that are non-grocery anchored. Those would be ones in the next year or two that we would look to dispose of.

Li Chen, Laurentian Bank Securities

Okay, perfect. And can you just provide any updates on renewals regarding the remaining leases for 2022?

John Harricks, Vice President, Asset Management

I can take that one as well. In 2022, we have six anchors rolling totaling about 390,000 square feet. We're in discussions with all of them already and don't expect to lose any of those tenants this year. I'd also add that we don't expect on spending any capital meaningfully to renew those tenants either.

Li Chen, Laurentian Bank Securities

Perfect. That's it for me. Thanks, guys. I'll turn it back.

Operator

And your next question comes from the line of Jenny Ma from BMO Capital Markets. Your line is open.

Jenny Ma, BMO Capital Markets

Thanks and good morning. Just wanted to dig a little bit further into the potential acquisitions. In the MD&A, you mentioned that it was a deep pipeline, and I guess that's reflective of the size of the market. But can you talk about what's coming across your desk? Is it a mix of the onesies and twosies you talked about, portfolios, you know, where the bulk of the opportunities are in the market right now and what kind of cap rates and geographies, if there's anything to be gleaned from that?

Blair Welch, Chief Executive Officer

Slate Grocery was built predominantly on onesie-twosie acquisitions. And I think it made us really good on the buy, and we grew it. It took a lot of time, but in the last couple of years, we did a couple of portfolio deals. We did a Phillips Edison deal, we did an Armada deal, and we did the Annaly deal.

And those were sizeable transactions that we hadn't done before, more onsie-twosies. But we are seeing both, Jenny. There's been deals done in the U.S., large portfolios, the Donohue Schriber deal done in California, Blackstone buying Preferred Apartments, which is grocery and apartments. So, there's more activity in the space.

But I'd just like to highlight, to our knowledge, we don't think there's an owner of more than 500 grocery stores in the United States. When you think about that as a percentage of the entire markets, it's highly fragmented. We're seeing activity on the portfolio side and on the onesie-twosie, but it still doesn't really put a dent in the opportunity that we see.

We are looking at portfolios. We are involved in the market. I think the team has done a great job. There's probably not a grocery anchored deal, a large one, or even onesie-twosies where we wouldn't see or know about it. And I think that intelligence makes us better buyers. So we're seeing it from all places.

What we really like, and we've always known this, industrial is a great asset class. We all know it, and we like it. But the problem is everyone likes it so it gets expensive. I think people look at grocery as food logistics. It acts like industrial.

You think of a grocery asset in a neighborhood center, the site coverage is similar. It's a 30 foot clear height building with a loading bay in the back, and what they need is van parking or whatever to click and collect. That's what a grocery store is. It does act like industrial, and I think people are starting to come to look at it like that. And we think we're in a really good position to benefit because of it.

Jenny Ma, BMO Capital Markets

Okay. And there's obviously been some cap rate compression. Can you talk about what degree you're seeing and how that compares to I guess the rising or cost of capital and whether or not the investment opportunity remains--the investment spread for Slate Grocery remains the same or better or worse? How do you think about that going forward?

Blair Welch, Chief Executive Officer

The cap rates are coming in. It's a function of where the asset is, the quality of the tenants and the like and--as I said. But what I'd--instead of cost of capital, it's coming in. And--but it's still a spread to our industrials.

But if you think of, and I'll use Kroger as an example--or actually, I'll put it as a Canadian example because we're in lovely Canada today. If there is a Sobeys warehouse in Oshawa and it's a new facility, their rents they would have to pay on their hub, I'll call that, is probably--what is that, low double digits? Well, when you think of a grocer, like if they have a Sobeys in Mississauga in a suburban neighborhood, maybe that grocer rent, if it's 10 years old, is probably the same cost or rent in place as the hub.

So, the spoke where they deliver the grocery is probably at industrial rents. So, that is extremely valuable for the retailer, the Kroger, the Sobeys, the whatever, because the last mile logistics is the most expensive mile. And they have these sites locked up for long terms at very cheap rents.

So, when you think about the rent in place, if our anchor rents are high single digit rents, for us to develop that site, cost of construction is probably $250 to $300 a foot. You would need high teen rents, low 20 rents to make that work. There is tons of protection for us to increase rents slowly with the tenants, but the tenants love that site because our in-place rents are low.

What are we seeing with cap rates? They're coming in, but they're still wider than industrial and there's embedded rental growth or rental room. I think it's a combination of all those things that gets us excited. And we think there is opportunity to allocate our capital in good real estate.

And our distribution is covered. And we love the yield, and we're a big owner and we love this. But we also are creating a total return play. We know this real estate's valuable long-term. So, the yield's important but it's just not about buying a cap rate and matching it to a financing rate. It's about growing with these tenants and growing those rents over time.

Jenny Ma, BMO Capital Markets

Okay, great. I guess further on that point, if there's going to be that gap between rent on the grocery store last mile and the distribution facility, when you guys go to renew your leases with your grocery tenants then, I mean, for the bulk of the portfolio, are there the options in place that you simply roll over, or does--every five years you come in and you get to renegotiate everything or really have the opportunity to raise the rent? Because if there is indeed this gap and it's growing over time, you know, what is your ability to capture that gap, I guess?

Blair Welch, Chief Executive Officer

Well, I think there's a couple of things here. These grocers that we deal with are some of the world's largest companies and they're extremely sophisticated. Many times, if an anchor is renewing, they might have the site locked up for a long period of time at no to minimum rent bumps, to your point.

But if you think about it that way, if I'm buying it at a six cap and it's a Kroger lease, what is a Kroger bond for a 20 year? Like, the spread on that is okay if I think of it that way, but more importantly, if they what capital or we could open up, that's all we can get more rental growth out of the anchors.

But the anchors probably represent 40% to 50% of the GLA of the sites. When I said we had six consecutive quarters of occupancy growth, once you have that anchor and every other tenant wants to come and be beside it because of traffic, and that's where we're going to get more dynamic growth.

We might not get dynamic growth out of the grocer, but we think that credit covenant is mispriced and we still like having them there long-term--because their business is a tough business. If they're earning--you know, if their margin is 6%, so for every $100 of groceries they make six bucks. It's transportation costs and labor are the biggest, and then rent. So, if we can give them margin expansion by charging them or they have a low rent, they will be at that site for a long period of time. We will get rental growth off of all the other space. That’s how we'll get that growth, Jenny.

Jenny Ma, BMO Capital Markets

Okay, great. And then last question for me is you get some good yields on your redevelopment projects, and you've always got a handful on the go at any given time. What opportunities are you seeing from the Annaly portfolio that you acquired? Is it a similar profile to the rest of the portfolio, and would you say the return opportunities and the yields are similar?

John Harricks, Vice President, Asset Management

Hey, Jenny, it's John. I'll take that one. In 2020 overall, we spent about $26 million on redevelopment, and we're coming off of a couple of larger ones that we're bringing back online. Yields were pretty attractive on those, in the 14% range. In 2022, we expect redevelopment spend it to be down slightly, maybe about 10% to 15% from 2021 based on what's under contract as well as projected.

As it relates to the Annaly portfolio, redevelopments typically happen under a couple of different scenarios, either where we find opportunities within the existing land to develop net new, or in instances where we have lost a grocer, for example, or an anchor and we're going to backfill that space. Yields targeted are typically above 10%, and we're not going to build on spec.

So, SGR currently has no remaining vacant anchor boxes due to the lease up of the last remaining two in 2021, and we don't expect to get any back this year either. While we're constantly reassessing, we see maybe slightly less spend in 2022 on redevelopments. There is one asset within the Annaly portfolio in Dallas where we recently signed a new anchor lease. So, that would be considered a redevelopment, and that's going to be coming online this year.

Jenny Ma, BMO Capital Markets

Okay, great. Thank you very much. I'll turn it back.

Operator

Thank you. And once again, if you would like to ask a question, simply press the star then the number one on your telephone keypad.

Your next question comes from the line of Himanshu Gupta from Scotiabank. Your line is open.

Himanshu Gupta, Scotiabank

Thank you and good morning. So, just on the small shop occupancy, I mean, if I look at the occupancy, it has been in the range of 87% to 88% for the last, I think, few--or many years. And my question is, is this the stabilized occupancy for this asset class for this product? And now, you know, given that we are seeing recovery in the retail leasing front, do you think there's a potential for small shop occupancy to go to, like, 90% level or even higher?

John Harricks, Vice President, Asset Management

Hey, Himanshu, it's John here. I'll take that one. The answer is yes. I would say that there is certainly opportunity that we're seeing to grow occupancy within the small shop space. In 2021, particularly towards the latter half of the year, we saw renewed leasing demand from tenants who had maybe sat on the sidelines for most of 2020 and even early 2021, so salons, restaurants, and even gyms, for example, which has added some additional strength to the market in that under 5,000 square foot range.

In Q4 2021, of the 50,000 square feet of new leasing, about 40,000 square feet of that was in the shop space category, under 10,000 square feet, at an average base rent of 18.70 per square foot. If you look back at prior quarters, that was the highest in terms of square footage of any quarter in 2021 certainly, and also one of the highest quarterly average rents that we were able to achieve.

What we're seeing in our own portfolio and what we're hearing in the market from our tenants is that the shop space tenants who had maybe sat on the sidelines earlier in the pandemic are really coming back and leasing space at normal rental rates and lease terms.

Himanshu Gupta, Scotiabank

Thank you. And as that leasing is coming back, tenants are coming back, do you see any upward pressure on the market rents as well? Are you able to charge higher rents compared to what you were charging pre-pandemic?

John Harricks, Vice President, Asset Management

Yes.

Himanshu Gupta, Scotiabank

Okay. Okay, that's fair enough. And then the other question, similarly on the leasing spreads, actually, if I look at the leasing activity during--again, you know, for the last few quarters, very strong leasing activity, especially on the new leasing side in terms of leasing spreads. Which category of tenants are, you know, driving these double-digit rental spreads there? Any specific category?

John Harricks, Vice President, Asset Management

On the new leasing spreads?

Himanshu Gupta, Scotiabank

On the new leasing spreads, that's right. I think it's been in the, you know, like 20% range. Just wondering, is there any particular category driving that?

John Harricks, Vice President, Asset Management

I would say it's across the board that we're seeing larger leasing spreads. We executed in Q3 and in Q4. New leasing spreads were above 20%, which was a pretty significant increase over Q1 and Q2. We see those wider spreads continuing into 2022.

And in terms of tenant type we're seeing the return of fitness tenants, for example, which had sat on the sidelines for most of 2020 and 2021, completed some larger transactions there, as well as medical. Those tenants have renewed interest in strip center real estate and tend to pay higher rents. And then all of the daily needs tenants that I referenced in the earlier question that are coming back in the market.

Himanshu Gupta, Scotiabank

Got it, okay. Thank you. That's helpful. And then just turning to the anchor leases, and I know you gave some color on the leasing which is coming due in 2022. I think it's around 400,000 square footage. So, I am looking at the in-place rents, so it's around $6.80 or so. What is your view there, and especially in the context of, you know, variables comparing, you know, the grocery rents or the industrial rents as well? In that context, do you think the level will be in and around $6.00 to $7.00 range, or do you see, like, an upside to that number as well?

John Harricks, Vice President, Asset Management

For the grocer rents specifically, as Blair mentioned in an earlier question, those rents are predominantly dictated by where the option rents are structured out. In many cases, those option rents are flat or may see minimal increases.

As an example, in Q4, we executed two 2022 renewals early with Food Lion, which is Ahold Delhaize' credit. One of them was flat rent and the other one was at 5%. In both cases, Food Lion just exercised on the option. So, in 2022, we expect probably for the most part those rents to remain somewhat flat or maybe a slight increase. And that would be spending no capital, so in instances where the tenants are just exercising their options.

If there are any situations where we would spend some capital, which would mostly be on common areas and for the general benefit of the center overall, then we would certainly seek out rental rate increases.

Himanshu Gupta, Scotiabank

Got it. Okay. And then maybe a question for Blair. Obviously you own a very large grocery portfolio in Europe as well. Any trends, do you think, you are seeing there in Europe which has yet to come to North America, any read across for your asset class?

Blair Welch, Chief Executive Officer

What helps is that —these tenants are very sophisticated and similar. I think what we see from Europe is more of the discounter format, the Aldis and the Lidls, and how excellent they are at operations.

When I made my comment about transportation costs and labor costs if you think about your local grocery store here, when I go to the grocery store, I notice now, compared to 10 years ago, there's less staff, there's more self checkouts, and things like that. That's the grocer becoming more efficient with technology, but they're also lowering their labor costs.

And I think the North American grocers can learn a lot from the German discounters on efficiencies because they are very, very good operators. I think that's coming in. I think that’s what the grocers will be fighting with. All the grocers are embracing e-commerce, and we are working with them to either add space so they can be more efficient with click and collect or they're doing it inside their existing box.

I would say what we really learn is operations from many of the Europeans. But that's just knowing our tenant. It's important to us, but that's really how we see the tenants changing. But I would say we're really pleased with how strong and healthy our grocers are and how they have had great, great sales over the last little bit. And we don't really see a significant change in them. I think they've used this to solidify their own balance sheets and they're going to continue to serve their customers. We're positive about the grocery space in general.

Himanshu Gupta, Scotiabank

Got it. Thank you. And maybe just final question, maybe again for you Blair. You have always looked at the replacement cost basis versus, you know, the market pricing. And, you know, grocery anchored product in U.S. have been--you know, replacement cost has been much higher than the price where these assets have been trading at. So, do you think--do you see further closing of this gapas we come out of recovery? Any thoughts on, you know, how replacement cost is trending or have trended relative to foundation prices?

Blair Welch, Chief Executive Officer

I think that there will be a gap for some period of time. But we think of replacement cost in the context of leasing, right? I'll use the example, if we have a Kroger that pays us eight bucks for building a new Kroger for them. If they were to move across the street, for us to build a new Kroger, we might need to charge them 16, 18 bucks in rent, because that's the cost.

Now, for Kroger to move across the street and double their rent, are they going to get double the sales for moving across the street? Probably not. So, what we find is the grocers want to be in these locations that are already existing with proven sales because they have the lease locked up for a long period of time. That gives us durability of cash flow, and slowly we can move them over time.

We look at replacement cost as a protection for our rent. When we go in and talk to grocers, we think the biggest risk is are they going to leave the market in its entirety because it wouldn't make sense for them to move across the street. That's how we think about replacement cost.

I think there will be a gap. I think the values will go up as inflation goes up and costs go up. But I think you'll see that gap for a while just because these grocers have options for a long period of time at lower rents.

Himanshu Gupta, Scotiabank

Got it. Thank you. Thank you, guys. Awesome, and thanks for the color. I'll turn it back.

Blair Welch, Chief Executive Officer

Thanks.

Operator

And once again, if you would like to ask a question, simply press the star then the number one on your telephone keypad.

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

Jenny Ma, BMO Capital Markets

Thanks. Just a quick follow up. What was the rent collection for Q4? Did you see any impact from the Omicron variant, or was it consistent with the past few quarters?

Andrew Agatep, Chief Financial Officer

Hey, Jenny, it's Andrew. In short, collections have been consistent from what we've seen in the past periods. U.S. has been open since August 2020, and we've seen collections north of 95% since then. Since Delta and Omicron, we've been collecting business as usual.

Jenny Ma, BMO Capital Markets

Okay, great. Thank you very much.

Operator

And there are no further questions at this time. I would like to hand it back to Mr. Braden Lyons for closing remarks.

Braden Lyons, Associate

Thank you, everyone, for joining the Q4 2021 conference call for Slate Grocery REIT. Have a great day.

Operator

And ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.