CORPORATE PARTICIPANTS

Braden Lyons
Investor Relations

David Dunn
Chief Executive Officer

Andrew Agatep
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CONFERENCE CALL PARTICIPANTS

Fred Blondeau
iA Securities

Himanshu Gupta
Scotiabank

Pammi Bir
RBC Capital Markets

Jenny Ma
BMO Capital Markets

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Slate Grocery REIT Third Quarter 2020 Financial Results Conference Call.

At this time all participants are in a listen-only mode. After the speaker 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. If you require any further assistance, please press star zero.

I would like to now hand the conference to your speaker today, Braden Lyons, Investor Relations. Please go ahead, sir.

Braden Lyons, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the Q3 2020 conference call for Slate Grocery REIT. I am joined today by David Dunn, Chief Executive Officer, and Andrew Agatep, Chief Financial Officer.

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 financial 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 Q3 2020 investor update, which is now available.

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

David Dunn, Chief Executive Officer

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

In a world that has been dominated by uncertainty since the onset of the COVID-19 pandemic, we continue to be pleased but not surprised by the strength and resilience of the Slate Grocery REIT portfolio. We assembled our portfolio of grocery-anchored assets to generate significant and durable cash flow in all market conditions and its defensive nature has been further proven out over these last seven months.

As of September 30th, all 76 of our assets have remained open during the pandemic, 64% of our tenants have been deemed essential by the government and 99.4% of our tenants are currently open and operating. Slate Grocery REIT has led the strip centre sector in terms of cash rent collections since the beginning of the pandemic and that has continued in the third quarter with the REIT collecting, on average, 95% of contractual rent in cash.

We agreed to an aggregate of $1.3 million of rent deferrals. We have received the expected repayments to date and even have some tenants paying deferred rents ahead of schedule. We also agreed to approximately $170,000 of rent abatements. In exchange, the REIT secured benefits in excess of $3.1 million in the form of increased rents and term as well as other non-monetary benefits.

Now a few comments on the third quarter, in which we achieved record results. Our team completed more than 196,000 square feet of new leasing in the quarter that will generate $2.1 million of base rental revenue. This is the strongest quarterly new leasing performance since the REIT's inception in 2014, a significant achievement in the best of times, let alone during a pandemic. We also completed over 235,000 square feet of renewals, resulting in over 431,000 square feet of total leasing at a weighted average rental spread of 13.1%. A large portion of the quarter's leasing volumes were attributed to high-credit grocer tenants, including Publix, Aldi, and Hy-Vee. We believe these deals highlight the desirability of our assets while also adding to our portfolio in terms of rent growth and grocer credit.

Our record new leasing activity more than offset vacancies within the quarter and occupancy rose 35 basis points on a quarter-over-quarter basis to 92.5%. We have 306,000 square feet of gross leasable area expiring in the next three quarters, representing 3.1% of our portfolio. This is well below the portfolio's typical run rate in terms of lease maturities and we are confident that we can continue to increase portfolio occupancy.

Same property net operating income grew by 0.5% on a year-over-year basis in the third quarter. We expect same property NOI growth to be positive for calendar year 2020. Looking forward, there are significant contractual rent commitments that have not been captured in our financial reporting. These amounts total $2.9 million in annual base rent, which will primarily be recognized in 2021 with the remaining to hit our books in 2022.

We are pleased with the outcome of our disposition program, which began in January 2019. We disposed of over $240 million of assets since then at a weighted average cap of 7.15%. We redeployed a portion of the proceeds into our seven-asset portfolio acquisition at a weighted average cap rate of 8.7%, achieving a yield spread of 155 basis points. While our disposition program is substantially complete, we will continue to be opportunistic in disposing of select assets to recycle capital into accretive investment opportunities that will further high grade our portfolio and add value for unitholders.

2020 has provided us all with a unique set of challenges on both personal and professional levels; however, throughout this period I have been constantly reminded of the passion and commitment that our team brings to the office each and every day. I could not be more impressed by or thankful for our team's efforts throughout this challenging period, which have been instrumental to our business's strong performance. On behalf of the entire Slate Grocery REIT team, we wish you and yours good health and we thank you for your continued support.

I'll now hand it over for Q&A.

QUESTION AND ANSWER SESSION

Operator

As a reminder, to ask a question, you will need to press star one on your telephone. To withdraw your question, press the pound or hash key. Please stand by while we compile the Q&A roster.

Your first question comes from the line of Fred Blondeau, from iA Securities. Your line is now open.

Fred Blondeau, iA Securities

Thanks and good morning. High-level question for me: How far off is the 93% cash collection for October versus historical averages?

Andrew Agatep, Chief Financial Officer

Hi there – Andrew here. Collections for Q2 and Q3 have been about 95%. These are sector-leading cash collections amongst our peers and it is something that we are happy to put on our shoulders. We expect that in October, as well as in the future, as our tenants remain in operation, 99.4% to be exact, that collection figure will continue to trend upwards.

David Dunn, Chief Executive Officer

And Fred, this is Dave. Good morning. I would just say that by the time it is all said and done in the month of October, we expect that that 93% becomes 95% or above. There is a bit of a delay in processing cash payments and allocating them to the appropriate period.

Fred Blondeau, iA Securities

Yeah, absolutely. And I guess from your comment and from your perspective on cash collection, at least for October, it seems like so far you have not been too much affected by a so-called second wave of the pandemic. Is that fair to say, that you are not expecting an impact in Q4 and Q1?

David Dunn, Chief Executive Officer

Fred, you cut out there, if you don't mind just restating your question please.

Fred Blondeau, iA Securities

Yeah, I was just saying it seems like the portfolio continues to perform relatively well in October, so I was just wondering is it fair to say that you expect the portfolio to continue to perform well despite that second wave of the pandemic?

David Dunn, Chief Executive Officer

Yeah, I think we do. We have trended up significantly in tenants open for business over the last couple of months. We expect it will go to 100%. There are six tenants that are not open yet. So, we are aware of what is going on from a health and wellness standpoint in America, but tenants are open for business, the majority of our tenants are essential regardless of a second wave. They are going to stay open and their sales will probably thrive. So, right now we are expecting what we have seen over the last seven months to continue.

Fred Blondeau, iA Securities

That is great colour. Thank you.

Operator

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

Himanshu Gupta, Scotiabank

Thank you and good morning. Just to follow up on the rent collection question, Q2 and Q3 collections are around 95%, 96% levels. What is your visibility on the remaining 4% or 5% that is left? And then any update on the government stimulus programs and, as the programs run off, do you think cash collection could be impacted, especially, as Fred mentioned, we are seeing a resurgence in the COVID cases now?

David Dunn, Chief Executive Officer

Hi, Himanshu. Thanks for your question. We are collecting our deferred rent repayments ahead of schedule. We actually have tenants, as I alluded to, paying more. We are actually 147% collected on deferrals to date. That trend, the required collections in the fourth quarter are higher than what we have seen from a deferral standpoint. So, obviously the next few months are important from recovering that deferred rent, but we believe that, based on the nature of our tenants, we are going to continue to collect it. We agreed to $170,000 of abatements. We think they were strategic and on a case-by-case basis they make a lot of sense to us. We did tell our tenants we would work with them where it made sense and I think we have stayed true to that.

Himanshu Gupta, Scotiabank

Sure. Sure. And on the leasing side now, I am looking at the small shop occupancy at around 87% levels, so where do you see the upside or downside to this number in the next 12 months or so? And especially, you know, what do you think, what do you see the risk from COVID-sensitive tenants such as restaurants or fitness in the near term?

David Dunn, Chief Executive Officer

All of our tenants are back open. Like what we are seeing on a macro level with shoppers returning, with retail sales, they are all trending higher. We think that America is going to continue to try to get back to a sense of normalcy.

We have strong leasing velocity. We had a record quarter in Q3, we had a strong Q2, and there is velocity there right now. Spreads are strong. I have suggested in the past that deals look a little different, maybe they are shorter in term length, maybe market rent is a basis point or two lower, but there is still velocity. And, frankly, there are tenants in the market and if you have the desired asset in a given trade area with the right anchor then you are going to get the lion's share of the opportunities to do deals, and right now that is what we are seeing with our portfolio.

Himanshu Gupta, Scotiabank

Yeah. That is fair. And maybe have you renewed any of the restaurant or fitness leases in the last six months? I know a fair bit of leasing was done, it was a record small shop leasing this quarter, but what kind of tenants have you been renewing and where you are getting all the lion's share of the rental growth, the rental spread?

David Dunn, Chief Executive Officer

So, we have renewed gyms. The ones that have come up are trying to remain open for business and they are trying to add term and stability in our shopping centres. As far as restaurants, we took certain amounts of bad debt for tenants we did not think would stick around. We feel like we have addressed those tenants. And yeah, the ones that have a solid business and are good operators are sticking around and that is the majority of those tenants in our portfolio.

Andrew Agatep, Chief Financial Officer

And the way we want to think about it, Himanshu, too, is the way it operates in the US is quite different from what we have here in Canada. So, although we do have fitness in our portfolio mix, they are up and operating for the most part. And the way we see it is our collections, which are hovering around 95%, continue to reflect this and we do expect that number to continue to trend upwards. So, we feel comfortable with the mix that we have in our portfolio, inclusive of fitness centres.

Himanshu Gupta, Scotiabank

Got it. Thanks for the colour. And just staying with the leasing subject, on the anchor tenant leasing in Q3, I know you mentioned a couple of grocery tenants as well, like Publix and Aldi. My question was what kind of CapEx or TIs or leasing costs are you spending on this leasing to get the very strong rental spreads and are these tenants, the grocery tenants, looking for shorter duration leases now compared to, let's say, pre-COVID period?

David Dunn, Chief Executive Officer

We did three new grocery-anchored deals in the quarter and we renewed another. The renewals typically with grocers have very little, if any TIs. We received an option exercised from the grocer I referenced who renewed.

As it relates to new deals, these are the deals that reset and reposition your asset. So, in large part, the tenants take care of the improvements and the cost relating to their boxes and they will usually look for a landlord to invest in the common areas, maybe overlay a parking lot or put a roof on or just spruce up the property. I like allocating capital to those deals, because the grocer is going to put a new prototype in our centre and then I get to go allocate capital to improving the centre, which is going to drive that shop leasing. It is going to make our centre desirable. And I think that is a great partnership.

So, I would just suggest that it is equitable in terms of capital allocation. These are deals that we would do all the time. And we are fortunate that we have the ability to talk to these traditional investment-grade grocers that have capital and want to keep their premises in a first class manner.

Himanshu Gupta, Scotiabank

Got it. And maybe just a final question from my side on the disposition this quarter. It was Pinewood Plaza with Kroger as the anchor tenant. So what was the investment case for the disposition there? And in general in the market, do you think the overall deal flow for the transaction activity has picked up in Q3 compared to Q2, for example?

David Dunn, Chief Executive Officer

We sold Pinewood Plaza in Dayton, Ohio. This was the last asset of the first fund we raised in 2010. It is non-core to our strategy going forward. We wanted to redeploy that capital into major markets that are growing, more in the southeast and mid-Atlantic, like the markets where you are seeing us do other deals, in the Carolinas and Florida and Georgia. It is what we have been talking about on a regular basis in terms of high grading the portfolio and I think we executed on that very well.

As far as activity in the investment community right now, it is down. Some of our capital markets partners are saying it is down 80% from 2019. Though deals are starting to materialize again. We are looking at it closely. We feel like there are compelling opportunities out there. And in the creative way that we can find deals, I think there is a lot of value out there as well. So, we will continue to track that and execute on deals that make sense to us looking ahead.

Himanshu Gupta, Scotiabank

Awesome. Thank you, guys. Thank you for the colour and I will turn it back.

Operator

Again, if you would like to ask a question, please press star one on your telephone. Your next question comes from the line of Pammi Bir from RBC Capital Markets. Your line is now open.

Pammi Bir, RBC Capital Markets

Thanks and good morning. Maybe along the same lines, what was the motivation behind the sale of Roxborough Marketplace? And can you also maybe just provide some colour on the cap rate on that transaction?

David Dunn, Chief Executive Officer

Good morning, Pammi. Thanks for the question. Roxborough was a different story. We had simply executed our business plan. We feel like we had created the value that we set out to create when we underwrote the deal and there was an opportunity to sell the asset. Colorado is not a place where we have a ton of scale and we think that there are more intriguing opportunities. Again, I reference creating that spread from disposition to acquisition. We feel the opportunity exists to continue to buy high-quality real estate. It was a sub-seven cap.

Pammi Bir, RBC Capital Markets

Got it. That is helpful. Your comments around the acquisition, or what is happening in the investment market overall, are you seeing any dislocation in pricing, that would seem inconsistent with how the assets in the grocery-anchored space have performed, but can you just comment, are there perhaps any distressed vendors out there or what that pipeline looks like overall?

David Dunn, Chief Executive Officer

Certainly think there is opportunity out there, so finding deals creatively, there is definitely dislocation. We feel like there are more opportunities to create instant value by buying the right transactions.

As far as larger challenges from some owners on the horizon, we certainly think that that is going to become a storyline as we look ahead. What we are hearing in the markets is the next couple of quarters could be very telling from that standpoint. So we will be ready to take advantage of that if opportunities present themselves.

Pammi Bir, RBC Capital Markets

Got it. Maybe just one last one, I guess with respect to the balance sheet. How high would you be willing to perhaps push leverage to fund acquisitions? Obviously you have some proceeds to redeploy on the back of a couple of dispositions, but any colour you can provide there?

Andrew Agatep, Chief Financial Officer

Sure, Pammi. It is Andrew. Yeah, first we just want to highlight that with our most recent refinancing that we did in Q1 of 2020 we do have liquidity on our balance sheet. We have borrowing capacity of about $160 million, which allows us to execute on deals. We are slightly under 60% right now, and over time we do want to bring that down.

We feel comfortable with the range though, I should note, given that we own grocery-anchored real estate, it has proven out during the pandemic as a durable cash flow and we are comfortable with our ability to satisfy our obligations. So, if there is an opportunity that does exist, we will execute if we think it provides the right return to our unitholders, but we do have the intent, over time, to bring down our leverage.

Pammi Bir, RBC Capital Markets

Great. Thanks, Andrew. Thanks very much.

Operator

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

Jenny Ma, BMO Capital Markets

Thank you. Good morning. I just wanted to discuss the bad debt expense that went up in Q3 versus Q2. I am just wondering if the Q3 number is a bit of a catch-up for some of the tenants that you may have thought were able to pay in Q2 and decided to go into bad debt in Q3. And then further on to that, what is your view of how the bad debt expense will look over the next couple of quarters?

Andrew Agatep, Chief Financial Officer

Thanks, Jenny, for the question. Yeah, we made a business decision this quarter in review of our tenants, which we do on a tenant-by-tenant basis, on what is collectable and we took the view that tenants that are in bankruptcy are not going to be collectable.

To put that number into context, that represents 3% of our contractual rent for this quarter, which is low in comparison to our peers. Going forward, we feel that we have addressed the bankruptcies inside our portfolio. And on the flip side, we think that we can collect on the 97% and actually 97%, 98% in general on a going-forward basis.

When we think about the spaces themselves, we feel confident that, for those tenant boxes, that they continue to be desirable and that there is strong backfill potential. Our leasing this quarter as well as throughout the 2020 year is a testament to this.

David Dunn, Chief Executive Officer

Yeah, Jenny, it is Dave. Good morning. We have activity on these boxes. They are compelling. And that made it a little more palatable to move on. We think there is a better scenario on the horizon from tenant credit as well as possibly some rent growth. So the decision we made impacts us in the short term but we think it sets us up for a lot of success going forward.

Jenny Ma, BMO Capital Markets

So, net-net between the bankruptcies and I guess a bit of a time lag with some of the new discussions, do you see Q4 bad debt sort of being in the same range or maybe sort of in between Q2 and Q3 number?

David Dunn, Chief Executive Officer

We certainly do not—based on what we know now, we do not foresee it being nearly as high. We think we have addressed the, quote-unquote, pain in our portfolio. And we are meaningfully higher than the run rate for bad debt this quarter. It is usually in the low $200,000 range. We think we are going to go back to more normal levels, subject to anything unforeseen in the future.

Jenny Ma, BMO Capital Markets

Okay, great. And then with regards to the $3.1 million of benefits that you had mentioned as far as your rent abatements go, is that the net increase in rents over the duration of the extended term? I just wanted to unpack that number a bit. And if you have an average term extension number, that would be great too.

David Dunn, Chief Executive Officer

What we did with tenants, and again, we looked at tenants that we thought were going to be able to pay us rent in the future. We did not cut a future deal if we did not think this tenant was going to be around. So, in exchange for a short-term abatement, if you will, tenants popped options for us, they extended term. We negotiated future benefits. So, it is what you are thinking. What is not captured in that is we were able also to collect in the moment $190,000 in rents. If you think about the alterative, if you cannot come to a deal, well, then you end up having to pursue these tenants legally, which is not what we wanted to do. So, on measure, we thought that it was the right thing to do in the moment and the right thing to do looking ahead.

Jenny Ma, BMO Capital Markets

And what is the average extension that you have been able to get? Are these five-year deals or are you just going a year at a time?

David Dunn, Chief Executive Officer

Yeah, more or less. A tenant option would be five years. We would not have secured term in excess of five years. So call it five years with a few that would be sort of three- or four-year extensions as well.

Jenny Ma, BMO Capital Markets

Okay. And so the $3.1 is just increases in rent, right? You didn't quantify sort of the intangible benefits and include it in that number?

David Dunn, Chief Executive Officer

No. No, we did not. And those intangibles could be improved covenants. If there were restrictions, we may have been able to negotiate those. You know, just digging in, understanding more about tenant sales, things that, over time, will help us manage our portfolio better. So we were able to make some wins there and we did not quantify that in terms of that $3.1 million.

Jenny Ma, BMO Capital Markets

Okay, great. And then my last question is just a clarification. You mentioned that some of your broker partners mentioned that sales volume or investment volume is down 80% year over year. Is that just for the grocery-anchored shopping centres they were referring to?

David Dunn, Chief Executive Officer

Generally, on retail.

Jenny Ma, BMO Capital Markets

Okay. Okay, great. Thank you very much.

David Dunn, Chief Executive Officer

Thanks, Jenny.

Operator

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

Braden Lyons, Investor Relations

Thank you, everyone, for joining the Q3 2020 conference call for Slate Grocery REIT. Have a great day.

Operator

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