CORPORATE PARTICIPANTS

Blair Welch
Chief Executive Officer

Joe Pleckaitis
Chief Financial Officer

Allen Gordon
Senior Vice President

Jennifer Pyper
Senior Vice President, Investor Relations

Braden Lyons
Vice President

CONFERENCE CALL PARTICIPANTS

Brad Sturges
Raymond James

Gaurav Mathur
Laurentian Bank Securities

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Slate Grocery REIT Fourth Quarter 2023 Financial Results Conference Call.

At this time, all lines are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. And if at any time during this call you require immediate assistance, please press star-zero for an operator. Also note that this call is being recorded on Wednesday, February 14th, 2024.

I now would like to turn the conference over to Jennifer Pyper, Investor Relations. Please go ahead.

Jennifer Pyper, Senior Vice President, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the Q4 2023 conference call for Slate Grocery REIT. I am joined this morning by Blair Welch, Chief Executive Officer; Joe Pleckaitis, Chief Financial Officer; Allen Gordon, Senior Vice President; and Braden Lyons, Vice President.

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 2023 investor update, which is available now.

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

Blair Welch, Chief Executive Officer

Thank you, Jenn, and hello, everyone. Slate Grocery REIT delivered a strong year of growth in 2023. Our team set a new record of 2.9 million square feet of total leasing in the year at some of our highest annual rental spreads.

Of the 635,000 square feet of total leasing we did in the fourth quarter, new deals were done at 31% above comparable average in-place rents. Non-option renewal spreads were similarly strong, at almost 16% above expiring rents.

And our leasing momentum supported healthy occupancy gains. We are up 150 basis points from the start of the year, bringing occupancy to 94.7% at the close of the quarter, our highest level in nearly a decade.

After adjusting for completed redevelopments, our same-property NOI increased by $2 million on a trailing 12-month basis, and we expect our 2023 leasing to further drive NOI growth in the coming year.

We have continued to prudently manage the REIT's balance sheet to mitigate risk in the current interest rate environment. In November, we amended the terms of a $137.5 million interest rate swap to lock in a 2027 maturity and limit the REIT's exposure to floating rate debt. Over 94% of the REIT's debt is fixed at a weighted average interest rate of 4.4%.

Our low in-place rents provide additional protection. At $12.41 per square foot, we are well below the market average, meaning we have significant runway to increase our rents and, in turn, grow NOI.

The grocery-anchored sector has displayed resilience in the face of the broader market turbulence. Tenant demand for grocery-anchored centers continues to accelerate, and essential goods and service providers want to be in our well-located centers, in populated markets, close to consumers.

New supply has remained very limited. The amount of new retail space delivered in Q4 set an all-time quarterly low, and we expect elevated interest rates and high construction costs to continue to limit new supply into and throughout 2024.

At the same time, our tenants are investing heavily into their stores, demonstrating continued conviction in their physical locations. Together, all these factors create a favorable dynamic for landlords, providing pricing power to increase rental rates.

We believe Slate Grocery REIT is uniquely well-positioned to unlock higher rents and grow net operating income over time. In our view, the REIT's current discounted unit price presents a compelling investment opportunity for investors.

The REIT's unit price at year-end indicates an implied cap rate of 7.9% on a trailing 12-month NOI, which represents a 33.5% discount to net asset value. Year-to-date, the REIT has purchased 1.2 million class U units at a weighted average price of $9.61 per unit. This demonstrates management's belief that the underlying value of the REIT's units are well above current public market pricing.

On behalf of the Slate Grocery REIT team and the Board, I would like to thank the investor community for their continued confidence and support. I will now hand it over for questions.

Operator

Thank you, sir. Ladies and gentlemen, if you would like to ask a question, please press star followed by one on your touchtone phone. You will then hear a three-tone prompt acknowledging your request. And if you would like to withdraw from the question queue, simply press star followed by two. And if you're using a speakerphone, please let the handset before pressing any keys. Please go ahead and press star-one now if you have any questions.

And your first question will be from Brad Sturges at Raymond James. Please go ahead.

Brad Sturges, Raymond James

Hey, good morning.

Blair Welch, Chief Executive Officer

Hey, Brad.

Brad Sturges, Raymond James

I want to touch on occupancy. You're approaching the 95% level. I think that's the level that you've talked about in the past of where you expected it to trend to. Looking forward, where do you think you go from here? It seems like you're getting good momentum on the shop space and seeing further lease up on that side of things. Just curious your thoughts on occupancy trends.

Blair Welch, Chief Executive Officer

The strong leasing the team's done over the last couple of years, you'll start to see that net operating income growth in 2024 and 2025. You'll see that pick up. That couple hundred basis points of occupancy gain, you'll see it in our income in the next couple of years, which is great.

As it relates to your question specifically on where we think occupancy is, the whole market is tight. We believe there's probably a bit more we can squeeze out in basis points for occupancy uptick. However, you're getting to the point where it's full. But given the market is full, we're going to continue focusing on driving face rates and operating efficiencies through the portfolio to keep driving that NOI growth.

We don't think the strong leasing has flown through our numbers yet, but we're extremely confident we'll achieve good NOI growth in the next couple years.

Brad Sturges, Raymond James

That leads to my next question on leasing spreads. When we look at your numbers, clearly the spreads that you're achieving have been at the higher end of the historical range at the 6% to 10%. Do you have a different target in mind in terms of those leasing spreads going forward, given how full the market is, or how tight it is now from a vacancy perspective? And is that range going forward going to be higher than that 6% to 10% range?

Blair Welch, Chief Executive Officer

We think in 2024, in the near-term, rental spreads will continue to be high because they're coming off such a low base rent. That $12.41 PSF is almost half of the Green Street average for the space in the entire United States.

We feel confident. Simply put, if there's no available space anywhere and our rents are $12.41 PSF, we think there's good a probability and momentum for us to keep those higher rental rate spreads given current market conditions. As you know, Brad, we are always focused on buying cheap rents, and I think we're going to see that play to our favor in growing net operating income in the next couple years.

Brad Sturges, Raymond James

Okay, last question. Obviously, we've seen, and you've highlighted, some of the retailers focused on reinvesting into their own stores, and you guys highlighted the Walmart announcement in the fall. Curious to get your thoughts on other discussions you're having with your tenant base today, whether they're approaching you to help fund that and maybe there's a return that you can generate, or how we should think about that activity in the near-term in the context of the current economic environment.

Braden Lyons, Vice President

Hey, Brad. It's Braden. A couple of interesting anecdotes from Walmart last year. In Q4 '23, they came out saying they were going to invest multiple billion dollars across 1,400 stores. It's roughly $6 million a store across their entire retrofit portfolio. Our stores are in that portfolio as well, I would add. And then they said earlier this year they're going to be opening 150 new stores over the next three to four years, which is the first time they've opened new stores in three or four years.

So, that's what were seeing from Walmart. They're the most public about it out of all our tenants, but we've had conversations with others, like Publix and Kroger, about similar types of investments in their stores. It's investments in their stores across omnichannel, across new service offerings inside the stores, new exterior improvements, etc.

I think the overwhelming fact is that those are within their own four walls, so that's grocer funded. If they ask us for capital, there needs to be return on that, and that's the way that conversation goes.

Blair Welch, Chief Executive Officer

To be clear, in the Walmart case, there's zero dollars required from Slate Grocery REIT. What Braden is saying is, when they do ask for something, then we get something in return, and I would say those development yields would be double digits.

Right now, the announcements are that they do it all themselves, which is why we love the business, because its below the line costs are very thin, and I think it shows their commitment to the store.

Moreover, in the last several years, I believe 100% of our grocers have invested in improving their stores for omnichannel distribution at no ask from Slate Grocery REIT. So, they're all doing it.

Brad Sturges, Raymond James

Got it. And with Walmart, there's no change in the box size at this point? They're just making changes to the format or modernizing the format within the existing box?

Braden Lyons, Vice President

Yes, it's primarily within the existing box, Brad. They might retrofit what's an existing pharmacy and instead have that be an omnichannel portion of the store with cold storage, robotics, etc., for curbside click and collect, which is emerging as the more favored method of omnichannel for consumers. They might expand by a very small amount, but it's not material.

Blair Welch, Chief Executive Officer

Remember, if they expand outside the existing box terms, they have to come talk to us, and that's an ask. Therefore, we would then get those development returns.

Brad Sturges, Raymond James

Yes, that makes sense. All right. Thanks a lot.

Blair Welch, Chief Executive Officer

Thanks, Brad.

Operator

Once again, ladies and gentlemen, if you do have any questions, please press star followed by one on your touchtone phone.

And your next question will be from Gaurav Mathur at Laurentian Bank Securities. Please go ahead.

Gaurav Mathur, Laurentian Bank Securities

Thank you and good morning, everyone.

Blair Welch, Chief Executive Officer

Good morning, Gaurav.

Gaurav Mathur, Laurentian Bank Securities

First question, we've seen a lot of chatter around real estate debt and the market being overleveraged, especially in the United States, and grocery-anchored being a safe haven for most investors. Are you seeing opportunities now come up opportunistically that you would look to engage on from an acquisition standpoint over the next 12 months?

Blair Welch, Chief Executive Officer

Yes, I would say that it's starting. To answer your first question, lenders are still very comfortable lending to grocery-anchored real estate. I think the difference in the market is, if the average grocery store is plus or minus $25 million in value, it's pretty granular. Those individual purchases, if they were done by privates, many of them were financed through CMBS or regional banks. That has been different in the U.S. They have to go to other sources, and that's good for a company like Slate Grocery REIT that has the capital to go finance through bank facilities.

We are seeing people need to sell real estate assets because of the overall market, and they can sell grocery, so we are seeing some opportunity. I think we will see more starting this year. There is always activity, but I think we will see more motivated sellers.

In certain cases, we are starting to see that. It hasn't really happened, but I think it's related to other parts of people's portfolios or ownership, and they can sell grocery because there's a market and it can still be financed.

Gaurav Mathur, Laurentian Bank Securities

Back to your more motivated sellers point, does that mean that the bid-ask spread for these assets continues to narrow?

Blair Welch, Chief Executive Officer

I would say the bid-ask spread for office is massive. There is a good bid-ask spread in grocery, but it's much tighter than other asset classes. It’s not a 10 cap, but I think you’re going to get spreads in the 7s. Depending on what the situation is, that's what it is.

I think you've got to take a step back and focus on the rents. If we can buy something and be at half of what we think market rent is, that's a great NOI growth. It’s all relative. It’s whether your rents are at market and what is that cap rate. It's still wide because of the way the market is, and we think there's compelling buying opportunities, but we're being very selective.

Gaurav Mathur, Laurentian Bank Securities

Okay, fantastic. Last question. We've seen the payout ratio trend upwards. I'm wondering if you have a view as to where you see that going to for 2024.

Blair Welch, Chief Executive Officer

As you know, we do all our TIs and capital and redevelopment flows right below the line, so it's actual cash. We've done a lot of leasing and development, and we get good returns, so it has crept up, and for other reasons, as you know.

We think, given our NOI growth, that we have forecast over the next couple of years, that is going to go down. We will continue to focus on the payout ratio, but I think our income growth will help offset that. Some operating efficiencies will help offset that. It has crept up because we have done so much leasing and development that it's elevated because of how we do it, which is unlike some of our peers.

Gaurav Mathur, Laurentian Bank Securities

Great. Thank you for that. I'll turn it back to the operator.

Blair Welch, Chief Executive Officer

Thanks a lot.

Operator

Thank you. And at this time, Ms. Pyper, it appears we have no other questions registered. Please proceed.

Jennifer Pyper, Senior Vice President, Investor Relations

Thank you, everyone, for joining the Q4 2023 conference call for Slate Grocery REIT. Have a great day.

Operator

Thank you. Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending. We ask that you please disconnect your lines.