CORPORATE PARTICIPANTS

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Allen Gordon
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Braden Lyons
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Shivi Agarwal
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CONFERENCE CALL PARTICIPANTS

Sairam Srinivas
Cormark Securities

Brad Sturges
Raymond James

Pammi Bir
RBC Capital Markets

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Slate Grocery REIT First Quarter 2024 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. If at any time during this call you require immediate assistance, please press star-zero for the operator. This call is being recorded on Wednesday May 1, 2024.

I now would like to turn the conference over to Shivi Agarwal, Manager, Finance, of Slate Grocery REIT. Please go ahead.

Shivi Agarwal, Manager, Finance

Thank you, operator, and good morning, everyone. Welcome to the Q1 2024 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 Q1 2024 investor update, which is now available.

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

Blair Welch, Chief Executive Officer

Thank you, Shivi, and hello, everyone. Slate Grocery REIT's first quarter results demonstrate the continued strong demand for our high-quality grocery-anchored real estate and the rental growth imbedded in our portfolio.

Our team completed over 770,000 square feet of total leasing in the quarter. Over 98,000 square feet of new deals were completed at 31% above comparable average in-place rent. Non-option renewals were completed at 15% above expiring rents, and at quarter end occupancy was 94.4%.

Our positive leasing momentum at double digit leasing spreads continues to translate to income growth for the REIT. Same-property NOI increased by $1 million, or 2.5% year-over-year. We expect NOI to continue to increase over the coming months as the impact of new leases completed over the last 12 months is realized.

At $12.49 per square foot, our average in-place rent is well below the market average of $23.21, meaning we have significant runway to continue increasing our rents and growing our net operating income.

Our team also continues to prudently manage the REIT's balance sheet to ensure we remain protected in the current interest rate environment. The REIT exercised a six-month extension option on its $300 million revolver, and over 94% of the REIT's total debt remains fixed at a weighted average interest rate of 4.4%, and a weighted average remaining term of 3.1 years on the REIT's interest rate swap contracts. This provides us with stability in today's interest rate environment.

We continue to have strong conviction in the fundamentals of the broader grocery-anchored real estate sector. Vacancy levels in the neighborhood, community, and strip center segment continue to hover near record lows, and new retail supply remains muted. At the same time, tenant demand for well-located grocery-anchored spaces remains high, and grocers continue to see increases in sales and foot traffic.

America's leading grocers like Walmart, Kroger, Publix, and Aldi continue to invest significant capital in both new and existing stores, underscoring the important role of physical stores as local distribution hubs.

With in place rents that are well below market, Slate Grocery REIT is uniquely well positioned to capitalize on these fundamentals and increase rents over time to deliver long-term growth for our unitholders.

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

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press star followed by number one on your touchtone phone. You will hear a prompt that your hand has been raised. Should you wish to decline from the polling process, please press star, followed by number two. If you are using a speakerphone, please lift the handset before pressing any keys. One moment for your first question.
Once again, ladies and gentlemen, if you wish to ask a question, please press star, followed by number one on your touchtone phone. You will hear a prompt that your hand has been raised. Should you wish to decline from the polling process, please press star followed by number two.

Your first question comes from the line of Sairam Srinivas of Cormark Securities. Your line is now open.

Sairam Srinivas, Cormark Securities

Thank you, operator. Good morning, guys.

Blair Welch, Chief Executive Officer

Good morning, Sai.

Sairam Srinivas, Cormark Securities

My first question is on leasing. So, when you look at a non-anchored renewal pad as such, or renewal or new leasing pads, and when you compare the kind of tenants you've seen in the last couple of years, how does that compare to the kind of tenant you saw a couple of years ago pre-pandemic? Has there been any change in the profile over there?

Blair Welch, Chief Executive Officer

I'll try and answer the question, Sai, but if I missed it, please ask again.

We're seeing tenant demand from different types of tenants than we would have seen five or ten years ago in the neighborhood anchored strip center. I think there are a couple reasons for that – I think B&C enclosed malls have higher costs and less foot traffic, so tenants that typically weren't located in these types of centers are relocating to centers like ours, grocery-anchored, neighborhood strips. That's creating more tenant demand than we've seen in the last decade, and I think that's because of foot traffic and our cost.

But we're also seeing typical pad users come in line, or in other words, the cost required to build a pad, and therefore, the rent they need to pay for that pad, is higher than perhaps they want, so we're seeing demand from pad users come in line, as well. We're seeing tenant demand from all sorts of retail tenants, and I think it's because of the traffic the anchors generate and the low cost of our rents. Does that answer your question, Sai?

Sairam Srinivas, Cormark Securities

Yes, that's exactly the color I was looking for. The second question I had was on renewal spreads. Obviously spreads this quarter looked really good, and they've been looking good the last couple of quarters, as well. Can you guide us as to how we should think about option versus non-option renewals?

Blair Welch, Chief Executive Officer

We like to quote our non-option renewal spreads like our US peers do because when a tenant has control of the space, there's a bit different of a negotiation. That being said, as you've seen over the past quarters and years, our non-option renewal spreads are quite high, and I think that speaks to the demand that I just talked about earlier.

Given the entire market is pretty tight, there's not much vacancy and not much new construction, there's tenant demand. We anticipate those non-option spreads will continue to be double digit, and I think that's a combination of tenant demand, our team's really good work with tenants we know, being aggressive, and really, our strategy of buying low in-place rents.

We quote it a lot, but at $12.49 in-place rents, when the market average is over $23.00, there's tons of room for growth because we offer quality space at a discount to operators where they can improve their margins.

Sairam Srinivas, Cormark Securities

When we look ahead in '24 now, how should we be thinking about that mix between option spreads - the leases with options for renewals - versus those that don’t have it?

Blair Welch, Chief Executive Officer

I think if you look at our non-option renewals over the last three quarters, it’s been in the mid-teens. We continue to see double digit non-option renewal spreads. It gets a bit choppy when you look at it on a quarterly a basis, because certain tenants, at certain times, and in certain market – rents roll, but I think if you’re thinking double digit on that, that’s how we look at it, and renewals are going to be high single digits.

It's significant rental growth, and I’d like to point out that we quote those spreads, and it’s important, but when we do a lease deal, we pay the cash from a landlord's perspective in tenant inducement, leasing commissions and any capital work at signing. Therefore, the net operating income direct from that lease comes on in the following quarters.

The team did over 3 million square feet of leasing in the last 12 months, and that NOI you'll now start to see in 2024 and 2025. We're pretty excited about our NOI growth, because we can talk about leasing spreads, but I think our unitholders want to see some cash, and we're looking forward to delivering that to them in the coming years.

Sairam Srinivas, Cormark Securities

That makes sense. The last question I had was if you think about all the renewals that are coming up this year, what will be the proportion of those renewals that have options in them?

Blair Welch, Chief Executive Officer

I would say on the shop space side, they're all looking to renew at market, so you can think about it as non-option. A lot of them do have options; we're really talking about the difference between the grocers and the shop space in those renewal numbers.

I would say when we think of all the shop space, assume that they're going to be renewing at the non-option spreads, because they have less control and we manage our grocers. It's a bit different because we want to control that anchor. We're still seeing great growth in our grocer rent. If you get more in the weeds, our grocer rent in our portfolio is $9 a foot. If you had a 5% or 10% lift, you're still under $10, and when you think about what comparable industrial rents would be, for their main warehouse, we're inside that. We think our real estate is extremely valuable for their supply chain.

Braden Lyons, Vice President

Sai, I might just add one more piece. For the 2024 expiries, we have about 1.1 million square feet remaining to be renewed. About 50% of that would be grocers, and the remaining 50% is shop space, so, the 50-50 to what Blair said is what I would model.

Sairam Srinivas, Cormark Securities

Awesome. Thank you. That's actually really good color. I'll turn it back.

Blair Welch, Chief Executive Officer

Thanks, Sai.

Operator

Thank you. Your next question comes from the line of Brad Sturges of Raymond James. Your line is now open.

Brad Sturges, Raymond James

Hey, guys.

Blair Welch, Chief Executive Officer

Hey, Brad.

Brad Sturges, Raymond James

To go back to the leasing comment, in terms of what you've done so far, obviously, you've had a lot of activity that hasn't been effective quite yet in the operating results. When would that start to take effect? Is that back half of 2024?

Blair Welch, Chief Executive Officer

Yes, we're starting to see it now, but if we think of 2024, we think we're going to get good NOI growth. That is booked, we can see that, and that's going to be 2.5% or more, and that will continue into 2025. We did all that leasing in 12 months, by the time you pay for all that stuff, that starts coming on six, nine months later, and that's what we're starting to see right now. It's a little bit muted now, even though it's not bad, you'll start seeing it in the next two or three quarters for sure.

Brad Sturges, Raymond James

That 2.5% going into 2025, that doesn't include redevelopment activity, right?

Blair Welch, Chief Executive Officer

Yes, but there's not too much. I would say that of the cash we've spent without any new leasing, what we can look through on what we've already spent, that's how we quote that number. There could be new stuff that could make it better, but that's what we've already booked at 2.5%.

Brad Sturges, Raymond James

In terms of redevelopment, there was one project identified in your disclosures, East Little Creek. I'm curious to get a sense of the budget, your timeline, and your expected return with the project.

Allen Gordon, Senior Vice President

Yes, this is Allen, Brad. We're still working through that redevelopment. We've got several national tenants that are interested in that location. As we continue to work through that, finalize pricing, we'll certainly update that, but there's definitely interest from the city in that redevelopment and multiple tenants that we are in discussions with about a potential redevelopment at that site, as well.

Blair Welch, Chief Executive Officer

I think our yield on cost have been in the double digits, so that's how we think about cash spent.

Brad Sturges, Raymond James

Okay. Is there anything else at this point that would be earmarked for redevelopment, or is this the only project in the near term we should be thinking about?

Braden Lyons, Vice President

Hey, Brad, it's Braden. Good morning. There is something coming online in the next little bit. We acquired a property in New York in 2021 that had a vacant cinema box, about 60,000 square feet. We allocated no value to it at the acquisition. We're now looking at backfilling that with three national tenants, and we expect that will come online in the next little bit.

Brad Sturges, Raymond James

Great. Last question, just looking at your debt maturities coming up, can you give us a sense of where cost of debt would be today, either from like a secured debt basis or if we're thinking about it through the use of fixed interest rate swaps?

Blair Welch, Chief Executive Officer

Yes, we have swaps in place for the next several years, so we'll keep our effective rate of interest down where it is between here and below 5%, which is good.

As it relates to your question on what the market is like, we have been extremely pleased with lender comment and lender interest in grocery-anchored retail, and I think the reason is, when you look on a debt yield basis or rental growth basis, grocery-anchored retail is different than many types of real estate right now, because we're talking NOI growth, not NOI erosion. We do not anticipate significant spread increases from where risk spreads were two, three, four years ago. The difference is the risk free or the underlying rate, but we do not see spread increases, so for the next couple of years, our swaps will protect us from the cost of debt, and we think our NOI growth over this period will offset any interest rate increases because the risk-free rate in years three, four, and five.

Brad Sturges, Raymond James

That's helpful. I'll turn it back. Thanks.

Operator

We have one more question from the line of Pammi Bir of RBC Capital Markets. Your line is now open.

Pammi Bir, RBC Capital Markets

Thanks, good morning. On the commentary around same-property NOI growth, it sounds like the outlook is stronger than what it's been for a little while. I'm wondering just how much of that is actually going to be coming from the rent growth that you talked about on the renewal spreads versus occupancy pickup. I'm just curious if you have any comments on the occupancy outlook. It sounds like it's been pretty firm or pretty constructive, so I just wanted to get some thoughts there.

Blair Welch, Chief Executive Officer

Thanks, Pammi. Good morning. I think that it's going to be a bit of both. The team did a really good job of increasing occupancy. We bought some assets several years ago that we thought were underperforming, and we did it strategically. The team then went to work, and we increased the occupancy, and that money was spent in the last 12 months or so. NOI growth will be a combination that you're seeing in 2024 of leasing and increasing the occupancy.

That being said, the market has also tightened. When you look in the future, the NOI growth will be because of the difference between $12.49 and $23, but right now, I would say it's a combination of the work the team did to increase the occupancy because we were strategic in buying the vacancy. We're seeing that come up, but even though everyone in real estate wants their assets to be 100% full, that's an impossibility with multi-tenant real estate. I think the market is approaching stabilized occupancy, so you're just going to see that all on rental growth now.

Pammi Bir, RBC Capital Markets

Great. Switching gears and looking from a capital standpoint, what can you share with what you're seeing on the transaction side of things? Anything of interest at this stage? And just thinking, of course, where you are relative to where your cost of capital is, certainly with the discount to NAV. I'm just curious how you're thinking about where to put money to work.

Blair Welch, Chief Executive Officer

I would say all real estate transactions are down. That being said, there's 40,000 grocery stores in the United States, and it's a somewhat granular asset class. If the average deal size is $20 to $25 million, we still see transactions because of 1031 exchange buyers or locals, but it’s not what it was. I would say that there are transactions – it’s not as bad as other asset classes - but it's muted, but, it still creates liquidity for us.

As it relates to our cost of capital, 18 months ago, we brought in an institutional investor at NAV, and we believe in our NAV where our IFRS cap rate is just north of a 7%. We have positive leverage if you mark to market our whole debt. Even when you think of our 4.5% debt now, it's a huge spread, and we have the cheapest rents of all of our peers. We believe in our NAV, we think it's fair, and we don’t trade like that.

At Slate, we always are in the market looking at opportunities, and the pipeline in the U.S. for grocery is massive, but we’re not going to do anything foolish to dilute our existing unitholders. We're a large unitholder. We believe in our performance and are focused on that, and we always talk to the Board about allocating capital. To say again, we thought it was a great idea to show our investor base that, you bring in someone at your NAV because we weren’t trading there, and I think that was a great deal for the company. We’ll continue to try and add value and create value for our unitholders, but we’re not going to do anything foolish because of where we trade. We think it’s a great idea to buy the stock right now because our performance is excellent and the market is good, but we’re always in the market looking at new deals just so we canbe able to do creative things.

Pammi Bir, RBC Capital Markets

Got it. Thanks very much. That's helpful, Blair. I'll turn it back.

Blair Welch, Chief Executive Officer

Thanks, Pammi.

Operator

Thank you. We don't have any further questions at this time. Shivi, please continue.

Shivi Agarwal, Manager, Finance

Thank you, everyone, for joining the Q1 2024 conference call for Slate Grocery REIT. Have a great day.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.