FINAL TRANSCRIPT

Choice Properties Real Estate Investment Trust
2018 Fourth Quarter & Year End Results
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PRESENTATION

Operator

Good morning. My name is James, and I will be your conference Operator today. At this time, I would like to welcome everyone to the Choice Properties Real Estate Investment Trust Fourth Quarter Results Conference Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, press the # key. Thank you.
Archna Sharma, you may begin your conference.

Archna Sharma

Thank you, James, and good morning, everyone. Welcome to the Choice Properties REIT Q4 and Year-End 2018 conference call. This call is also being webcast simultaneously on our website at choicereit.ca.

Before we begin, we would like to advise you that some of the statements made this morning may contain forward-looking information, including statements concerning Choice Properties' objectives, strategies to achieve those objectives, as well as statements with respect to management's beliefs, plans, estimates, intentions, outlooks, and similar statements concerning anticipated future events, results, circumstances, performance, or expectations that are not historical facts.

These statements are based on our current estimates and assumptions and are subject to a number of risks and uncertainties that could cause actual results to differ. We refer you to the cautionary statements contained in our financial reports, including the MD&A for the quarter ending December 31, 2018 and other public documents for the full details. These forward-looking statements are made as of today's date, and Choice Properties REIT assumes no obligation to update or revise them to reflect new events or circumstances, except as required by law.

On today's call, we have our Chief Executive Officer, Stephen Johnson; our Chief Operating Officer, Rael Diamond; and our Chief Financial Officer, Mario Barrafato.

I will now turn it over to Stephen.

Stephen Johnson

Thank you, Archna. Good morning, everyone. Thank you to all of you for taking the time to attend our Q4 and year-end 2018 conference call. Yesterday, we put out two news releases; one for our quarterly earnings results, and the other we announced my decision to retire as CEO of Choice Properties, which will be effective as of May 1st of this year. We also announced Rael Diamond as my successor, and I am absolutely delighted with this appointment.

Rael has been a valuable partner of mine over the last seven years, both as President and COO of CREIT and, most recently, in his role as COO at Choice Properties. Rael has nearly 20 years of experience in asset management and real estate operations. He has the trust of our organization and the respect of the industry. Rael is very well suited to lead Choice Properties into the next chapter. I will be working with Rael to transition the CEO role between now and May 1st, and after May 1st, I will serve as an advisor through to May 2020 as our organization continues to execute its strategy.

Now, on to the other news release, which summarized our Q4 results. We were very pleased with both the financial results and the operational results for the fourth quarter and for the full year of 2018. Our results met expectations. Operationally, same-asset net operating income was up 1.4 percent for the quarter and period-end portfolio occupancy remains strong at 97.7 percent.
Our development program delivered 105,000 square feet of new leasable area, and our capital recycling continued with the sale of 107 million of noncore assets and the reinvestment of 75 million into high-quality, income-producing properties.

Our fourth quarter results have built upon the positive momentum that we have had since the merger of CREIT and Choice Properties at this time last year. The combination of CREIT and Choice was a transformational transaction. Choice now has an enterprise value of approximately $16.4 billion.

Since closing the Choice-CREIT transaction, our management team has spent a considerable amount of time working on the integration of the two businesses, and the integration continues to go very well. This involves many important steps, each of which must be completed in the context of a long-term business model and strategy for the combined entity. And while our business has grown substantially, our primary goal remains the same, the ownership of a high-quality, income-producing real estate portfolio.

Our business now, for the most part, has evolved into two functional areas, our income producing property or IPP portfolio and our development business. Our IPP portfolio generates a high-quality rental revenue stream. Net operating income on an annualized basis is now well over $900 million, and there are contractual rent escalations in a significant part of our portfolio. We are positioning our IPP portfolio to provide long-term stability and net operating income growth over time.

Our development business is now divided into five categories including retail intensification, redevelopment, greenfield, major mixed use, and residential projects. In our currently active development program, we anticipate investing approximately $1.1 billion, of which $500 million is already invested. A significant portion of the balance of the $1.1 billion will be invested to complete our high-quality residential projects, now at various stages of development within the Greater Toronto Area.

It is also significant that beyond the current development program of approximately 1.1 billion, we have a pipeline of additional development opportunities on sites already owned. This includes a number of sites planned for major mixed-use development, three of which are in an active predevelopment stage where we are finalizing land assemblies and working through the zoning process. The three properties are located in key urban markets with close proximity to public transit. There are two sites in Toronto and one site in Coquitlam, British Columbia. Each of these mixed-use projects will include a significant residential component.

It is also important to note that there are a number of other sites, which we now own, that have significant potential as major mixed-use projects. It is just too early to credibly quantify the total extent of this opportunity. However, we expect it to be meaningful over time. The important point is that we already own these sites. Our development business is a very exciting part of our REIT that will add high-quality assets to our portfolio, and we anticipate will contribute to growth in our net asset value.

In summary and from a macro perspective, we are building our business for stability and growth. Our focus is to position both our IPP portfolio and our development business to grow net operating income, to grow cash flow, and to grow net asset value over a long-term investment horizon. Mario will now provide an overview of our financial results for Q4, and then Rael will provide an overview of some of the operational and investment highlights. Mario?

Mario Barrafato

Thank you, Stephen, and good morning, everyone. I'll begin with a brief overview of our results and then comment on our balance sheet. Overall, our fourth quarter results were in line with our expectations and reflect the stability that is inherent in our portfolio.

Our reported funds from operations for the fourth quarter was 171.9 million or $0.256 per unit diluted. With the exception of $400,000 of lease surrender fees, there were no unusual items in the quarter. FFO per unit for the quarter was consistent with amounts reported last quarter. On a year-over-year basis, FFO per unit declined $0.026 per unit compared to the fourth quarter of last year, primarily due to the change in capital structure resulting from the CREIT acquisition.

As communicated last quarter, adjusted funds from operations for the fourth quarter reflects increased maintenance capital spending relative to prior quarters. This is merely a function of timing, bringing the year-to-date amount of maintenance capital spending in line with our annual expectations. On a full year basis, our AFFO exceeded our distributions by $52 million, and our AFFO payout ratio was 89.5 percent, both in line with our expectations.

Included in our results was stable year-over-year growth in our same-property cash NOI. For the quarter, same-property cash NOI, excluding development activities, increased by 1.4 percent. And for the year, same-property NOI growth was 2.4 percent.

Furthermore, our overall period-end occupancy remained unchanged at 97.7 percent compared to the third quarter of 2018. Slightly negative absorption was offset by a net increase in occupancy arising from property transaction activity and developments coming online. At December 31, retail occupancy was 98 percent, industrial occupancy was 97.8 percent, and office occupancy was 92.3 percent. So overall, very solid operating results.

Now turning to our balance sheet, on the transaction front, our capital recycling program continued with two dispositions during the quarter for proceeds of 107 million and the acquisition of four properties at a cost of 78 million. These acquired properties consist of one industrial and three retail properties, and Rael will provide more colour on these investments.

We continue to be active on the development front, with ongoing investments of $88 million in the quarter, bringing our full year spending to $242 million. As well, 45 million of development properties were transferred to income-producing status during the quarter, bringing our year-to-date transfers to $193 million.

Our book net asset value increased marginally, quarter over quarter, as our net earnings for the quarter were offset by cash distributions and an adjustment to the fair value of our investment properties. For the quarter, we had a fair value loss of $20 million, which was mainly due to changes in leasing and capital spending assumptions for specific assets in the portfolio.

It was a quiet quarter from a financing perspective, as we had a net decrease in our outstanding debt, having a net repayment of $62 million on our credit facility and mortgage repayments of $9 million. This was offset by $10 million in new mortgages, which had an average term of five years and a weighted average interest rate of 4 percent. And we also had $11 million of new construction loans.

Our financial metrics remain solid. Using amounts from our proportionate balance sheet, our debt to gross book value is approximately 47 percent, and normalized leverage and interest coverage ratios are at 8 and 3 times respectively. These metrics are further backed by 1.2 billion of liquidity on our credit facility and 11.8 billion pool of unencumbered assets.

So overall, this is another strong quarter for Choice. We end the year having made significant progress on our integration and with two full quarters of financial results provided a baseline for the new combined entity.

I'll now turn the call over to Rael.

Rael Diamond

Thank you, Mario, and good morning, everyone. As Stephen mentioned, I'll provide a brief overview of our income-producing portfolio and an update on transaction activities.

Our consolidated portfolio of income-producing assets includes 751 properties comprising 67 million square feet of GLA. This high-quality portfolio includes retail, industrial, office, and residential properties and is located across Canada with a concentration in Canada's largest markets.

Our retail portfolio is primarily focused on necessity-based retail tenants. This portion of our portfolio is the foundation of our reliable cash flow. Its stability is attained through our strategic relationship with Loblaw. This relationship provides a strong anchor tenant on long-term leases resulting in stable, secure, and growing cash flows.

We continue to add to our retail portfolio through development, including a mix of greenfield development, redevelopment, and intensifications. In Q4, we completed and transferred a total of 105,000 square feet of retail development at a total cost of 45 million. This includes 73,000 square feet of intensifications and redevelopment projects, which are primarily focused on adding at-grade retail density to our existing portfolio of retail assets at a cost of $35 million and 32,000 square feet of greenfield development at a cost of $10 million.

For the year ended 2018, we completed and transferred approximately 0.5 million square feet of retail development at a total cost of $182 million. Our development initiatives are key components of our business model, providing the opportunity to add high-quality real estate to our portfolio.
Our industrial portfolio includes 113 properties and approximately 16.5 million square feet of GLA. The properties include Loblaw distribution facilities on long-term leases and high-quality distribution and warehouse facilities in key industrial markets across Canada that readily accommodate a broad range of tenants.

In terms of industrial development, Choice is now 100 percent leased and has recently constructed 665,000 square foot modern distribution facility on Peddie Road in Milton, Ontario. We have finalized long-term leases for approximately 550,000 square feet with Kimberly-Clark, a multinational consumer products company. The remaining 150,000 square feet was leased to a distributor of flooring products on a long-term lease.

The rents achieved exceeded our regional pro forma by more than 15 percent. This asset will be a great addition to our industrial portfolio as it is in the GTA west submarket of Milton, one of the strongest industrial markets in the country, and will be transferred to income-producing status in Q1 of 2019.

Next is our office portfolio. Fundamentals in most large office markets in Canada are healthy due to a strong economy and robust job growth. In the GTA, there is significant tenant demand and limited availability. Our portfolio is almost fully occupied when considering all committed leasing. Office property fundamentals in Calgary continue to be challenging. In Q4, we significantly reduced our exposure to the market with the sale of our 50 percent interest in Sun Life Plaza for $104 million. The decision was based on several factors including the current market conditions and the lease expiry profile of the asset. Ultimately, we believe there are better uses of our capital including new acquisitions, like the Loblaw vend-ins and funding our ongoing development program.

Our residential platform provides an opportunity to further diversify our portfolio. Choice has been working on expanding our residential platform. Currently, we have three residential rental assets that are income producing and another seven rental residential assets that are in various stages of development.

We're also currently under contract to acquire another rental residential development site located between Grosvenor Street and Grenville Street in Toronto. When complete, these residential projects will represent approximately 1,500 units at Choice's share. This includes over 1,000 units located in the GTA, all of which are in close proximity to major transit. We're excited about the prospects of our residential initiative.

Next, I would like to provide an update on transaction activities. During the quarter, we closed on the acquisition of three grocery active income-producing retail properties from Loblaw for a total cost of $55 million. This includes a 104,000-square foot grocery store in Calgary with an ancillary liquor store and gas bar at a purchase price of $32 million, this asset is in the expanding residential community of Seton in southeast Calgary; a 103,000-square foot, stand-alone grocery store in Ottawa at a purchase price of $15 million; and an 80,000-square foot retail centre anchored by Loblaw and a liquor store in Bedford, Nova Scotia for $9 million. These properties are all subject to long-term leases with Loblaw.

Finally, we acquired a 130,000-square foot industrial building from Weston Foods for approximately $20 million. The asset is located in the Langley submarket of the Greater Vancouver area and is subject to a long-term lease with Weston Foods. Greater Vancouver is one of Canada's tightest industrial markets, and it is in extremely short supply of industrial assets, making this a very attractive acquisition.

These transactions highlight the competitive advantage of our strategic relationships with both Loblaw and George Weston. We expect that these relationships will continue to be an excellent source of opportunities in the future.
That concludes my comments. I would now like to pass it back to the Operator for questions.

Q&A

Operator

And at this time, I'd like to remind everyone, in order to ask a question, please press *, followed by the number 1 on your telephone keypad.

And we'll pause for just a moment to compile the Q&A roster. And your first question comes from the line of Sumayya Hussain from CIBC. Go ahead, please. Your line is open.

Sumayya Hussain — CIBC
Thank you, and just firstly, congrats to Stephen and Rael. I'll just open up I guess -

Stephen Johnson

Thank you.

Sumayya Hussain

—on a more high-level front first. Just now the REIT is close to finishing the first full combined year, how do you look at capital allocation? Do you see a return to continuous dividend growth? Or is the parity more on deleveraging? Just your thoughts there.

Stephen Johnson

So it's Stephen. Thank you for your comment. So there's three or four questions in there. We're in the process basically of re-sculpting our strategy in many ways. We certainly, directionally, the most important thing is the quality of the IPP portfolio. So we anticipate some culling of that over time. And in terms of level of debt, over time again, directionally, we expect our debt levels to decrease but no immediate plans or no specific target at the present time.

Sumayya Hussain

Okay. Thanks. And can you just remind us on the yields on your residential developments and how they stack up across the different markets?

Rael Diamond

Yeah. Sure. It's Rael speaking. The yields would all be what we've been achieving or slightly north of 5 percent. For example, the one in Toronto, VIA123, we completed that in a very, very robust market, and we exceeded well in excess of 5 percent.

Sumayya Hussain

Okay. And have they eventually changed from say about a year ago?

Rael Diamond

No, because much of the land that we required was acquired pre the run-up in land prices.

Sumayya Hussain

Great. And just lastly from me, there was a little reference to a change in assumptions around leasing and capital spend, specifically on some retail assets. What kind of assets are those? Are they grocery-anchored? Or was it more of a primary versus a secondary market dynamic?

Mario Barrafato

Hi Sumayya. It's really varied. Theses are just normal assumptions based on timing or some capital spend. So no individual was significant, and there was no real trend to take from that. It was just updating our financial valuations.

Sumayya Hussain

Okay. Thanks. I'll turn it back.

Operator

Your next question comes from the line of Michael Smith from RBC Capital Markets. Go ahead, please. Your line is open.

Michael Smith – RBC Capital Markets

Thank you and good morning. Congratulations, Stephen, and wish you the best in your retirement. And congratulations, Rael.

Stephen Johnson

Thank you, Michael.

Michael Smith

It's welcome news. Just a couple questions. For 1880 Eglinton and 2280 Dundas and your Coquitlam properties, you've got a lot of residential there. I know it's early stages, but from a big picture, what are you thinking in terms of condo versus rental? I mean obviously, rental gives you a long-term income, but condo, in some cases, the economics are so skewed towards condo. So I'm just wondering how you're thinking about that.

Stephen Johnson

It's Stephen, Michael. Thank you for your comment and congratulations to you as well on your retirement, so.

Michael Smith

Thank you

Stephen Johnson

So it is too early to talk about or, form our prespective, to determine the mix between the rental residential and condo. Clearly, there is some advantage, basically, to doing a portion of it as condo. But our objective is to build our IPP portfolio. So our bias is to maintain as much ownership as we can, which essentially means more rental residential.

The competitive advantage we have is that these are on sites that we already own and we've owned for quite some period of time. So our ability to do less condo and more rental residential basically would be greater than, say, if we were to just buy the sites at market today. But clearly, our bias is to do as much rental residential as we can on these mixed-use projects.

Michael Smith

Mm-hmm. Sure. That makes sense. And do you anticipate-again, I realize it's early stages, but have you given any thought in terms of partners for those very large projects? Or are they, given, your time horizon and your goals to build the IPP portfolio, are you thinking more on your own?

Stephen Johnson

We have not, and we've certainly discussed it internally, whether brining in a partner would be appropriate, but right now, our plan is to do them on our own.

Michael Smith

Okay. Great. And just switching gears, I know it's only been a couple full quarters, but when do you anticipate the integration to be more or less behind you?

Stephen Johnson

Most of it is done, Michael. I mean basically, I mean there's always little thinks, basically, that will continue, but the bulk of it is behand us. And some of the larger items were systems. We were on two different enterprises systems, and so that was completed effective January 1st. And that was both the conversion to one system so we have all the same – we're all on the same platform. As I say, that's completed. Office consolidation are more or less complete. The balance of them will be completed during the course of 2019. Personnel reorganization was completed midyear last year. So most of the major things have been done, Michael.

Michael Smith

Okay. Great. And lastly, for the three Loblaw acquisitions and the acquisition form Weston, would they typically be the usual lease term where there's a usual – sort of like 1.5 percent bumps every year?

Rael Diamond

Hey Michael, it's Rael. On the Loblaw side, yes. It is 1.5 percent bumps every year. On the Weston Foods side, it is slightly higher than that.

Michael Smith

Great. Thank you. That's it for me.

Stephen Johnson

Thank you, Michael.

Operator

Your next question comes from the line of Pammi Bir from Scotia Capital. Go ahead, please. Your line is open.

Pammi Bir – Scotia Capital

Thanks. Good morning. And, Stephen, congratulations on the retirement and just an outstanding track record over the years. Rael, congrats to you as well.

Just coming back to the comments around leverage. As you take on more development, do you expect that we may actually see leverage move up rather than down? Or at least make it a bit more challenging to reduce?

Stephen Johnson

Yeah. Certainly, the development program makes it a little more challenging, but it may move up a bit. But we anticipate, directionally, as I said earlier, trying to reduce leverage over time. So I, mean, we are generating cash, and we do plan a divestiture program at some point in time. So, as I say, directionally, we would like to reduce it, but it may mean that it goes up a bit in the short term.

Pammi Bir

And then as you take these projects on, is the intention to primarily fund them, again, through perhaps contributing because they're sites you already own, like contributing the land as your equity source rather than say – and maybe retain cash as well rather than sort of any equity issuance to fund these programs?

Stephen Johnson

No. I mean what we're focused on now, as I mentioned, we've got our current program. Our current ACTO program is about 1.1 billion, of which we've already invested about 500 million. So that, to fund that balance there would be – we expect, basically, to do that with a combination of three things, cash flow that we're generating, maybe some increase in debt, and possibly some divestitures.

Pammi Bir

Okay. And then just with respect to acquisitions, do you have a sense of what we could see from vend-ins from Loblaw over the next call it 12 months or so and how any third-party opportunities may fit into the equation as well?

Stephen Johnson

We do not have a target for that. We don't have a number to give you. We simply do not have a target for that. We look at each one, each individual opportunity, whether it's a vend-in or whether it's a third-party potential acquisition on the merits of the particular opportunity. And we will continue to do that on a go-forward basis.

Pammi Bir
Great. That's it for me. Thank you.

Stephen Johnson
Great. Thanks very much. Thanks for your comment.

Operator
And as a reminder, if you'd like to ask a question, please press *, followed by 1 on your telephone keypad.

Your next question comes from the line of Sam Damiani from TD Securities. Go ahead, please. Your line is open.

Sam Damiani – TD Securities
Thank you, and good morning. Congratulations again. Happy to wish you all the best. Stephen, you've been a founder of the Canadian REIT industry, and so this is quite a moment for our sector. Admirable career and wish you all the best. And, Rael, obviously, congratulations and well deserved.

Just looking at the acquisition opportunities, actually, I wanted to talk about development actually. The past CREIT development activities have been quite active with various private partners. How do you see that program going forward with those same private developers for Choice?

Stephen Johnson
Sam, It's Stephen. Thank you for your comment. Look, we've been very successful in our partner relationships and finding partners that have helped us achieve our goal in terms of finding development opportunities and executing with a lot of expertise. And so, with each of our partners, I mean most of these we've had long-term relationships with, and we will continue to work with them as we go forward to look at new opportunities and not only on acquisitions, but full development projects.

So we don't see that changing as one of the competitive advantages we've had. And it's a competitive advantage just because we have these partners in place and a long trusting relationship with them.

Sam Damiani

So would you envision adding more projects to the active construction pipeline in the near term?

Stephen Johnson

Like right now our active one, I don't think so. I mean, nothing substantial, I mean in terms of – as I mentioned in my comments, we have the three major mixed-use projects that are in an active development stage. But those take many years to kind of complete the predevelopment stage, get your zoning done, and so on. So nothing material, Sam, at this stage. I mean that could change next quarter. I mean, we may find an opportunity we like, or , but as we said today, nothing material, nothing substantial.

Sam Damiani

Okay. And just on the topic of vend-ins, is there any opportunity or an expectation that Weston could provide additional opportunities in the near term for acquisition for Choice?

Stephen Johnson

Absolutely. I mean it's part of the relationship. We have a strategic relationship with Loblaw and it's – again, as Rael mentioned in his comments, it's a competitive advantage for us, and we expect, basically, there will be opportunities for the vend-in of high-quality, grocery-anchored retail over the coming years.

Sam Damiani

Okay. Just on to the strategy, which I think you used the word in the process of re-sculpting it in some ways, some aspects. With respect to culling more of your properties, is this something that could be proceeding in a more meaningful way in the sort of near term in the next year? Or do you see this evolving really more over sort of the medium term, one to three, five years down the road? What is sort of the time frame on that strategy?

Stephen Johnson

As you know, basically, with any REIT, I mean there are restrictions on how you manage your divestiture program. And so it's probably a medium term, to use your phrase, strategy as we execute that. We have no intention, basically, of announcing a major, major divestiture program at the present time. So we really look at it as – our plan right now, at the present time, basically, is that we would do it in an orderly manner over a number of years.

And that's consistent with what we did in 2018. As we mentioned, we completed about 107 million of divestitures in Q4, and we expect, basically, that will escalate somewhat. But it's a medium-term strategy, Sam.

Sam Damiani

Thank you. That's very helpful. I'll turn it back.

Stephen Johnson

Okay. Thank you.

Operator

Your next question comes from the line of Tal Woolley from National Bank Financial. Go ahead, please. Your line is open.

Tal Woolley – National Bank Financial

Hi. Good morning, and congratulations to you both. I just wanted to start off by asking a bit about if you were able to sort of quantify the pipeline of assets that there might be at Weston for you to acquire? Can you sort of give us some, quantify like the amount of properties that might be there for Choice to acquire over time?

Rael Diamond

So, we aren't able to quantify it, but they would be of very similar characteristic to the one we purchased in Langley, BC. So essentially, from our perspective, in the industrial facility, that they may be using either as an industrial facility or as a bakery asset that could be converted in the future to an industrial asset. But we aren't able to quantify the exact number or quantum.

Tal Woolley

Okay. And good chunk of their business is in the US too as well. Is that something that would interest Choice?

Stephen Johnson

Tal, it's Stephen. At the present time, no.

Tal Woolley

Okay. And then just a quick question on the CapEx. So just to be clear, from your commentary, between sort of the leasing and the property capital expenditures, around $80 million a year for the combined organization looks about a correct number to be using?

Mario Barrafato

Yeah. A little bit higher, if you take into account that CREIT only had two-thirds of a year in there. There's a bit more -

Tal Woolley

Right.

Mario Barrafato

-CapEx the with the CREIT. But yeah. So really what you saw was just a function of timing. By the time you contract out—a lot of it was roofs and paving—and so by the time you contract it, it gets seasonal, and so really it's just a function of timing. But the quantum is in line with the direction you mentioned.

Tal Woolley

Okay. And then just lastly, if I've done my math correctly, it does look like your equity accounted investments did sort of tick up and produced a little bit more FFO this quarter than last. Was there anything that changed significantly within that portfolio that we should be aware of?

Mario Barrafato

To be honest, Tal, we kind of run the business on a proportionate basis, so -

Tal Woolley

Yeah.

Mario Barrafato

-sorry. I really couldn't tell you exactly what's in that line. But our joint ventures have been performing well. But I can drill down and find out exactly what drove that.

Tal Woolley

Okay. That's great. Thank you very much.

Stephen Johnson

Thanks, Tal, and thanks for your comment.

Operator

And there are no further question in queue at this time. I turn the call back over to Stephen Johnson.

Stephen Johnson

Thank you, everyone. Thanks again for taking the time this morning to attend our conference call and enjoy the long weekend.

Operator

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

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