FINAL TRANSCRIPT

Choice Properties Real Estate Investment Trust
Second Quarter Results
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CORPORATE PARTICIPANTS

John Morrison
Choice Properties Real Estate Investment Trust – President and Chief Executive Officer

Bart Munn
Choice Properties Real Estate Investment Trust – Chief Financial Officer

Kim Lee
Choice Properties Real Estate Investment Trust – Vice President, Investor Relations

CONFERENCE CALL PARTICIPANTS

Pammi Bir
Scotia Capital – Analyst

Troy MacLean
BMO Capital Markets – Analyst

Alex Avery
CIBC – Analyst

Jimmy Shan
GMP Securities – Analyst

Michael Smith
RBC Capital – Analyst

PRESENTATION

Operator

Good morning. My name is Melissa 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 Second 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 at this time, simply press star, then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. Thank you.

Ms. Kim Lee, VP Investor Relations, you may begin your conference.

Kim Lee – Vice President, Investor Relations, Choice Properties Real Estate Investment Trust

Thank you, Melissa. Good morning and welcome to the Choice Properties REIT Second Quarter 2015 Conference Call. This call is also being webcast simultaneously on our website at choicereit.ca, where you will also find a copy of our Q2 Summary Information Package that we will be referring to on this call. I'm joined here this morning by John Morrison, President and Chief Executive Officer, and Bart Munn, Chief Financial Officer.

Before we begin today's call, I want to remind you that by discussing our financial and operating performance, and in responding to your questions, we may make forward-looking statements, including statements concerning Choice Properties' objectives, its strategies to achieve those objectives, as well as statements with respect to Management's beliefs, plans, estimates and intentions, and similar statements concerning anticipated future events, results, circumstances, performance or expectations that are not historical fact. These statements are based on our current estimates and assumptions and are subject to risks and uncertainties that could cause our actual results to differ materially from the conclusions in these forward-looking statements. Additional information on the material risks that could impact our actual results, and the estimates and assumptions we applied in making these statements can be found in our 2014 Annual Report and Management's Discussion and Analysis related thereto, together with Choice Properties' Annual Information Forms that are available on our website and on SEDAR. I will now turn the call over to John.

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

Thank you, Kim, and good morning everyone and thank you for joining our conference call. I'm going to start with an overview of the quarter and Bart will follow with a presentation of the financials, and after that we'll open it up for questions.

I am pleased to report that Choice Properties delivered another successful quarter. For the second quarter of 2015, we achieved year-over-year growth in FFO and AFFO per unit of 5.3 percent and 3.8 percent, respectively. Our financial results for the quarter reflect our continued focus on adding value to our portfolio through accretive acquisitions, development of new square footage, and active management of our properties.

In the second quarter of 2015, we completed the acquisition of a portfolio of 38 properties from Loblaw, adding approximately 1.5 million square feet of gross leasable area across Canada. This acquisition was immediately accretive, with a purchase price of $201.3 million and an expected stabilized NOI of $14.5 million, which represents an implied capitalization rate of 7.19 percent. With this acquisition, our portfolio now stands at 513 properties spanning 41.3 million square feet.

On the development front, we completed another small site intensification project, constructing a gas bar on our existing site in Sudbury, Ontario. Including the two projects completed in Q1, the three projects completed year-to-date will yield 9.8 percent.

As for ongoing projects, we continue to make headway on our development pipeline. While we continually update our development program to reflect adjustments with timing, occupancy and costs, progress on leasing, municipal approvals and construction on seven projects totaling approximately 110,000 square feet of new retail space remain on target for delivery to tenants by year-end 2015.

With the development timeline shift of approximately 100,000 square feet of new GLA for our greenfield development projects in Barrie and Burlington, Ontario, for 2015, we expect to invest approximately $138 million in development capital to complete construction of about 122,000 square feet of additional GLA, with yields ranging from 7 to 10 percent.

As we continue to build and strengthen our internalized business platform, we are gaining momentum on our leasing activity. Leasing activity during the quarter resulted in more than 300,000 square feet of committed GLA. This includes approximately 238,000 square feet of renewals with an average increase on rental rates of 8.4 percent and representing a renewal retention rate of 95.8 percent. Leasing activity during the quarter increased the occupancy rate for ancillary GLA to 86 percent from 8.46 percent at the end of Q1 2015 and 83.6 percent at the end of 2014. Overall, we continue to maintain our high occupancy rate, ending the quarter at 98.5 percent compared to 98.3 percent and 98.1 percent at the end of Q1 2015 and year end 2014, respectively.

With that, I will turn the call over to Bart to provide you with a review of the financials for the quarter.

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

Thanks, John, and good morning all. I refer you to Slide 8 of our presentation material, where you will find selected financial results for the second quarter.

As of June 30, Choice Properties' portfolio comprised 513 properties, with a total gross leasable area of 41.3 million square feet. Under IFRS, the REIT investment properties were valued at $8.2 billion, based on a weighted average cap rate of 6.2 percent, which is essentially unchanged from Q1 2015.

For the quarter, rental revenue was $183.1 million and net operating income was $126.9 million, 7.5 percent and 6.9 higher than in Q2 2014, respectively. The increases were primarily due to acquisitions which contributed $10.6 million in incremental revenue and 7.3 million in incremental NOI.

Same property NOI increased by approximately 1 percent from $116.1 million to $117.3 million. This increase in same property NOI was driven by a higher base rent and net recoveries as a result of improved leasing activity related to ancillary GLA and incremental NOI from recently developed GLA.

General and administrative expenses for the quarter, excluding internal expenses for leasing, were $4.3 million, a decrease of $1 million compared to Q2 2014. This decrease in G&A spend was largely due to the transition—to renegotiated service agreements with Loblaw, which resulted in lower expenses that took effect at the start of Q3 in 2014. Excluding the impact of unit-based compensation, general and administration expenses as a percentage of revenue were 2.8 percent for Q2 '15 compared to 3.2 percent in Q2 '14.

FFO for the quarter was $95.9 million, or $0.24 per unit, compared to the comparative period of $86.7 million, or $0.228 per unit, which excludes a 2014 non-cash financial charge of $52.3 million related to the early repayment of transfer notes issued to Loblaw at the IPO. The 10.6 percent improvement in FFO over the comparative period was primarily due to higher NOI and, to a lesser extent, lower general and administrative expenses during the quarter. These improvements were partially offset by an increase in interest, other financing charges and amortization of other assets.

AFFO for Q2 was $76.4 million, an increase of $6.6 million over the comparative period. AFFO per unit was $0.191 compared to $0.184 in Q2 2014.

As at June 30, our debt metrics are stable with a debt to total asset ratio of 5.1 percent, which is well within our maximum threshold, a debt service coverage ratio of 3.5 times, and a debt to EBITDA ratio of 7.4 times.

So now let me turn it over to John to provide closing remarks.

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

Thanks, Bart. With the close of Q2 2015, Choice Properties delivered another solid quarter. We are delivering on all of our growth initiatives, expanding our portfolio through acquisitions, progressing with development projects and improving our leasing metrics. Looking ahead to the balance of 2015, we will maintain our focus on growth and continue to execute on enhancing the strength of our business to deliver solid operational and financial results.

Now, Operator, we would be pleased to take questions.

Q & A

Operator

At this time, I would like to remind everyone, in order to ask a question, press star, then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question is from the line of Pammi Bir from Scotia Capital. Your line is open.

Pammi Bir – Analyst, Scotia Capital

Thanks. Good morning. Just can you maybe expand on some of the delays in the 2015 development projects, and your comfort level with the 2016 estimates that you've disclosed?

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

Yes, thanks, Pammi. The delay really is a result of just timing. It's not really related to leasing. It's just a bit of a slowdown in construction starts, getting site plan approvals in place, other municipal approvals in place. So it's not as a result of anything you would think to be economic; it's just process more than anything.

Then, in terms of 2016, that's our latest view based on where we are today with our development pipeline, so it's current as of how we see things at this point.

Pammi Bir – Analyst, Scotia Capital

Just looking at the schedule again, in terms of what would be transferred, say, from properties under development to income properties, it would be for 2016, roughly, about $220 million?

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

That's correct. Yes, that's right.

Pammi Bir – Analyst, Scotia Capital

Then, just on the—you know, the yields, the ranges are fairly wide, more so in 2016 but, from 7 to 12 percent, but can you give us a better sense of what we should expect on a weighted average basis?

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

Well, when you look at the range, yes, they are quite wide, and it's reflective of the nature of the types of projects, but I would suggest that we would see yields in the 8 to 8.5 range on a weighted average basis.

Pammi Bir – Analyst, Scotia Capital

Okay. Then just in terms of the current distribution level, you know, the payout ratio is in good shape. How do you feel about going to the Board with a potential increase at some point this year, or any colour around that?

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

Yes, Pammi, I think as we said in Q1, we certainly are looking at it. I think as we start to move now down into the 85 percent range, and possibly break through that, we certainly are considering it and we will have discussions with the Board later this year. We can't really say what the final decision was, but I think as we see it drop like this, there'll probably be a review to look at whether we can increase the distribution, but also continue the downward trend of lower payout.

Pammi Bir – Analyst, Scotia Capital

Okay, and then, sorry, just one last one for me. In terms of the pipeline, you've talked in the past about acquisitions from Loblaw sort of mirroring what we saw maybe last year. Is that sort of the same expectation at this stage, perhaps, for maybe another couple hundred million in Q4 this year?

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

We're taking a close look at that. As you know, when we initially went public we said we had 12 million square feet and that we were going to bring that in over a 10-year period. We accelerated that, where we brought about half of it in within two years. So, what I would say at this point is, as our development program has accelerated, we'll probably be focusing capital more on the development area, so I think you will see a slight slowing down on the amount of vend-ins coming in from this point on, but they will still be a significant dollar amount.

Pammi Bir – Analyst, Scotia Capital

Okay. Thank you.

Operator

The next question is from the line of Troy MacLean from BMO. Your line is open.

Troy MacLean – Analyst, BMO Capital Markets

Good morning.

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Trust

Good morning.

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

Good morning.

Troy MacLean – Analyst, BMO Capital Markets

Just on acquisition cap rates, would it be fair to assume that any additional acquisitions from Loblaw this year would be completed at a similar cap rate as Q2?

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

I don't think I'd make that assumption. I mean each vend-in is unique and it's based on the assets that are coming into the portfolio. As we said on our last vend-in, there was considerably more sort of rural locations than had been in the past. We're still in the process of looking at the assets that are coming into the portfolio in the second half, and I would say for modeling purposes, it probably would make sense to be in sort of the high sixes, and because it's in the latter part of the year, it's not going to swing results much one way or the other.

Troy MacLean – Analyst, BMO Capital Markets

Have you seen any change in retailer demand for new GLA over the last couple of quarters?

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

Not particularly. The types of properties that we have and the types of retailers that we're attracting, for us it's in a steady state. I think the only comment I would make, Troy, is we're noticing it sometimes takes a little bit longer to get deals completed, but we haven't seen a material slowdown in demand for our type of properties.

Troy MacLean – Analyst, BMO Capital Markets

Then, just lastly, was there any lease surrender income in Q2?

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

No.

Troy MacLean – Analyst, BMO Capital Markets

Okay. I'll turn it back. Thank you.

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

Thank you.

Operator

The next question is from the line of Alex Avery from CIBC. Your line is open.

Alex Avery – Analyst, CIBC

Thank you. John, you talked a little bit about, I guess, you know, there was 12 million square feet back at Loblaw after the IPO; you've brought in about half of that. I guess I'm just a little curious as to what remains within the Loblaw's portfolio, and has the Loblaw's portfolio evolved or grown as you've acquired some of the properties out of there? Have they been adding to that pool of assets?

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

Alex, I would suggest that the remaining portfolio is very similar to our existing portfolio in terms of types of properties, markets, et cetera, so it doesn't materially look or perform differently than what we already own.

In terms of new square footage, Loblaw really hasn't added anything in terms of new square footage, in terms of what they own. That activity actually now comes through us. So, as you may recall, we acquired a parcel of land from Loblaw in Barrie, Ontario, and previously we acquired a parcel of land from Loblaw in South Surrey, British Columbia, so we're under construction in both those sites, building new stores for Loblaw. So, that's where the new square footage comes from. I can't speak for new square footage that they would add, potentially, in markets with other landlords, but the pipeline of growth generally comes through Choice Properties.

Alex Avery – Analyst, CIBC

Okay, I recall that structure, but there were some carve-outs where, you know, to the extent that they wanted to, they could buy a site and build it, and I think they had at some point offered that to you afterwards, but there was the potential for them to grow that portfolio a little bit.

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

There was, and that certainly is—they certainly do have the ability to do that, but that hasn't materialized to date.

Alex Avery – Analyst, CIBC

Okay. Then, just turning to the developments in 2016 and 2017, as you've been mentioning some pretty high NOI yields, particularly on the intensifications, are there any notable or unique projects in there that you can identify and then give us a sense as to why you might be able to achieve an un-levered 12 percent yield?

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

Well, they all vary in terms of size and location. Whether we're adding a smaller amount of square footage, be it pad development, or we're adding an additional CRU component, every site is different and unique in various markets. There's nothing really that I would say is, you know, is a massive project, if you will, at this point, it's just a combination of a number of projects.

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

Yes, Alex, I think you can make the assumption is that the 12 percenters are usually the smaller more profitable pieces of the business, and it's not really a big influence on our income numbers, but it is within the range that we're showing. As John said earlier, we're in sort of the 8 to 8.5, and what you'll find is the low end tends to be the development of the food store, and so that would be the lower end of that range, and then at the higher end of the range will be the ancillary, and I think the other thing, we do know that the returns in the west, I think, because of lower land values, are in the high end of the spectrum, and in the east here, in Ontario, are kind of more in the lower to mid-range.

Alex Avery – Analyst, CIBC

Okay. I mean, even 8 and 8.5 are pretty handsome development yields today. I think most of your peers would be jumping at any opportunity that they had like that.

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

We agree.

Alex Avery – Analyst, CIBC

Just on the expected yields, that is after the Loblaw participation?

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

That's correct.

Alex Avery – Analyst, CIBC

That's correct, okay. That's great. Thank you very much.

Operator

The next question is from the line of Jimmy Shan from GMP Securities. Your line is open.

Jimmy Shan – Analyst, BMP Securities

Thanks, just a couple of clarifications on the development again. So, the expected yield, I assume is on total project spend and not just the cost to build?

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

That is correct.

Jimmy Shan – Analyst, GMP Securities

Okay. So then, looking specifically at the intensification projects, (inaudible) 8.5 percent expected yield, that would imply roughly about a net, right, of about $25. Does that sound about right, and would you say that is where the market rent is today for this type of ancillary space?

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

It varies depending on the market. I mean, that sounds like an average across the board, but…

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

Yes, it's getting—like, so, for instance, we're looking at the developing of—one of our projects that we've mentioned is the Surrey project. So, there, in BC, we're getting well above that level, but in the other locations you're going to be averaging it down. So, I think you're number is probably a reasonable check on the return we're getting.

Jimmy Shan – Analyst, GMP Securities

So 2016, for example, the weighted average geography, so to speak, would it be mostly Ontario or western Canada?

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

It's both, actually.

Jimmy Shan – Analyst, GMP Securities

So, roughly 50/50?

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

Yes.

Jimmy Shan – Analyst, GMP Securities

Okay. Then, turning to the leasing activity on the ancillary space, it looks to me that renewable spreads you're getting, if you ex out the warehouse space, it was about like 10 percent, which seems to be like a pretty healthy level, and so I'm just kind of wondering what you thought on (a) whether that number is right, and (b), would that be your expectation for the remaining spaces that are coming up in the next 18 months?

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

Well, the number is right, because those deals are done. I think I would offer that we're able—you know, we're having good success. As you know, we've internalized our Management team here. We've got our own leasing people on the ground who are experts in dealing with the retailers and know the market values of these spaces and are able to renew them at these increases, so we have an expectation that, on average, that will continue. So, you know, we're happy with that result and we hope it continues.

Jimmy Shan – Analyst, GMP Securities

Okay. Thank you.

Operator

The next question is from the line of Michael Smith from RBC Capital. Your line is open.

Michael Smith – Analyst, RBC Capital

Thank you and good morning. John, you were saying that the weighted average yield is somewhere between 8 and 8.5 for 2016 development. For 2017, the range is a little bit tighter, 7 to 9. Is the midpoint a fair assumption?

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

Yes, I would say at this point, Michael, it would be. It might be a little bit lower, but these are early estimates as we go out two years from now or a year-and-a-half from now, and so as we get further down the road with some of these projects then the yields will become a little more defined.

Michael Smith – Analyst, RBC Capital

Okay, and just for your CAPEX for AFFO purposes, is the 10.202—assuming a steady state, is that a good number for like Q3, Q4 and beyond?

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

What was that, 10.002? What was that, sorry?

Michael Smith – Analyst, RBC Capital

Sorry?

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

Sorry, Michael, I didn't catch it.

Michael Smith – Analyst, RBC Capital

The normalized CAPEX expenditures of 10.202, it's in your MD&A, in your notes.

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

Yes, yes, no, it's a reasonable expectation. Like, on the CAPEX side, for instance, we're targeting about $35 million this year, and it's sort of—these are, as you would know, like the roofs and parking, so they're quite short in nature, so they're done very quickly, and so you're now moving into that season where the weather is co-operative, and so there's a real focus on getting this done by our operational team, so that one definitely, and then with the leasing activity that we're having, we expect to be able to achieve that sort of level of cap spend.

Michael Smith – Analyst, RBC Capital

So, like $46 million for the year in terms of total CAPEX deduction, again steady state, that's kind of where you are, that's where the first two quarters were exactly the same.

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

Yes, that's reasonable, yes.

Michael Smith – Analyst, RBC Capital

Yes, and next year, is that just going to grow marginally or is it—what are your thoughts on next year?

Bart Munn – Chief Financial Officer, Choice Properties Real Estate Investment Trust

Yes, I would say on the capital side, which is the biggest piece of that, it will get larger just as the portfolio gets larger. We use about a $0.90 per square foot to sort of give us a reasonable estimate of what we'll spend on that. On the leasing, it's going to be more driven by activity, but as we continue to lease up space, I have to assume the volume of leasing will move down somewhat, so that number may be slightly higher, but you're not going to see a big drop in it.

Michael Smith – Analyst, RBC Capital

Okay. Thank you.

Operator

There are no further questions at this time, Mr. Morrison. I turn the call back over to you.

John Morrison – President and Chief Executive Officer, Choice Properties Real Estate Investment Trust

Well, thank you, Operator, and thank all of you for joining us on our conference call today, and we certainly look forward to speaking with you again next quarter.

Operator

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