PRO Real Estate Investment Trust

Fiscal 2022 & Fourth Quarter Results Conference Call

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Length: 33 minutes

CORPORATE PARTICIPANTS

James Beckerleg
PRO Real Estate Investment Trust — President & Chief Executive Officer

Gordon Lawlor
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Alison Schafer
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CONFERENCE CALL PARTICIPANTS

Frederic Blondeau
Laurentian Bank — Analyst

Brad Sturges
Raymond James — Analyst

Mark Rothschild
Canaccord Genuity — Analyst

Sam Damiani
TD Cowen — Analyst

PRESENTATION

Operator

Good morning and welcome to PROREIT’s Fiscal 2022 and Fourth Quarter Results Conference Call. At this time, all lines have been placed on mute to prevent background noise. Management will make a short presentation, which will be followed by a question-and-answer period, open exclusively to financial analysts. In order to ask a question, simply press star then the number one on your telephone keypad. If you would like to withdraw your question, please press star two.

For your convenience, the press release, along with the fiscal and fourth quarter financial statements and management’s discussion and analysis, are available at proreit.com in the investor section and on SEDAR.

Before we start, I have been asked by PROREIT to read the following message regarding forward-looking statements and non-IFRS measures:

PROREIT’s remarks today may contain forward-looking statements about its current and future plans, expectations, intentions, results, level of activity, performance, goals or achievements, or other future events or developments. Forward-looking statements are based on information currently available to management and on estimates and assumptions made based on factors that management believes are appropriate and reasonable in the circumstances; however, there can be no assurance that such estimates and assumptions will prove to be correct.

Many factors could cause actual results, level of activity, performance, achievements, future events, or developments to differ materially from those expressed or implied by forward-looking statements. As a result, PROREIT cannot guarantee that any forward-looking statement will materialize and you are cautioned not to place undue reliance on these forward-looking statements. For additional information on the assumptions and risks, please consult the cautionary statement regarding forward-looking statements contained in PROREIT's MD&A dated March 22, 2023, available at www.sedar.com. Forward-looking statements represent management's expectation as of March 22, 2023 and, except as may be required by law, PROREIT has no intention and undertakes no obligation to update or revise any forward-looking statement, whether as a result of new information, future events, or otherwise.

The discussion today will include non-IFRS financial measures. These non-IFRS measures should be considered in addition to and not as a substitute for or in isolation from the REIT's IFRS results. For a description of these non-IFRS financial measures, please see the 2022 fiscal and fourth quarter earnings release and MD&A. A reconciliation of non-IFRS to IFRS results, as applicable, may be found in the earnings release and MD&A for the 2022 fiscal year and fourth quarter. Please refer to the non-IFRS measures section in the MD&A for the fiscal and fourth quarter for additional information.

I will now turn the call over to Mr. James Beckerleg, President and Chief Executive Officer.

James Beckerleg — President & Chief Executive Officer, PRO Real Estate Investment Trust

Thank you very much, Michelle, and good morning, everybody. Welcome to this call. Joining me from the management presentation today is Gordie Lawlor in his capacity as Executive Vice President and Chief Financial Officer and Alison Schafer, our Senior Vice President of Finance.

Just before I get into our year-end numbers, I'll note for everybody that this March PROREIT is celebrating its 10th anniversary, and it's a period that we're very proud of and we will be taking (inaudible) to congratulate ourselves.

This call also represents my last analyst call because, as most of you know, I'll be stepping down from the CEO position to take a non-executive role on the Board of Trustees as of April 1st. So, after a very successful transition year, which we'll speak to, Gordie will take the helm as Chief Executive Officer and Alison Schafer will assume the position of CFO and Corporate Secretary. I have to tell everybody that it has been a real privilege to lead this organization for the past decade and I also have to tell everybody that I have every confidence in the management team that's in place to successfully lead PROREIT into the future.

Now let me turn briefly to speak to the REIT's performance in 2022 and start out by saying I'm very pleased to say we delivered these solid results despite the very challenging macroeconomic and high interest rate environment in which we all found ourselves. Not only has the REIT surpassed $1 billion in total assets in 2022, but we also successfully refocused our portfolio towards the robust industrial sector and achieved meaningful operational and leasing synergies.

We now own a high-quality portfolio of 130 properties, and that includes those in our joint venture with Crestpoint Real Estate Management, which was created in the third quarter of 2022. That joint venture transaction has been a benefit to us on all fronts, including that it has led us to become a leading landlord in the very strong Halifax industrial market. In addition, we're increasing our footprint in the industrial sector. We are the sole property manager for the entire portfolio, which can generate property and leasing project management fees of over $1 million a year to us on an annual, $1 million a year to us. Our industrial segment now accounts for 69% or our base rent compared to 64% at the end of 2021.

In 2022 we also disposed of 11 non-core retail properties, representing 108,400 square feet, and that provided us with a gross return of $25.8 million just before closing costs. The benefit of those sales was twofold: as I've mentioned already, increased the weight of our portfolio towards the industrial sector, but it also contributed to debt reduction. Specifically, we successfully reduced our debt to gross book value ratio during the year to below 50%. That was a goal that we managed to achieve 10 months ahead of our target date, again something we're very pleased with.

Well, that's an overview, and I'm pleased to turn it over to Gordie, who will provide more details on the results for the period.

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

Thank you, Jim, and good morning, everyone.

Let's start by saying I am very pleased with our performance in 2022. On an operational front, we sustained a high occupancy rate of 98.5% at year end compared to 98.4% at the end of 2021. With 99.2% occupancy rate in our industrial portfolio, it continues to perform well.

During these uncertain times, we are not only maintaining our focus on these defensive aspects of our portfolio, but also on exploiting the mark-to-market opportunities in our industrial sector. Despite the current high interest rate environment, increasing rental rates at our maturing and new leases are offsetting increases in interest expense as well as offsetting some upward movement in (inaudible) cap rates and discount rates in assessing our portfolio.

Turning to same property NOI, I'll preface the discussion with the fact that, for the year, our overall same property NOI represented only 69 properties out of our 130 property portfolio. As such, this measure is not fully representative of our growing portfolio nor does it provide a complete picture at this time, but we will benefit from the higher industrial concentration in future quarters.

Having said that, for fiscal 2022 industrial same property NOI was up 4.3% compared to the same period last year. At December 31, 2022, the weighted average in-place rent on our industrial portfolio was $7.78 per square foot, an increase of 5.3% compared to the same date last year. Our retail sector, mainly comprised of necessity-based properties, continued to perform well with a 2.7% increase in same property NOI for the year. Our office segment, which now comprises just 13.3% of our total same property NOI for the year, reported a decrease in occupancy in two of our eight buildings.

On the leasing front, we continued to be very successful in our renewal activities. We've renewed 93.2% of our leases maturing in 2022 at a positive average spread of 16.4%. As well, a very positive 49.8% of leases maturing in 2023 have been renewed at an average spread of 36.7%. Our successful leasing spreads have not yet fully impacted our financial results but, as I mentioned earlier, we will see the benefits over the coming quarters. Rental rates are continuing their upward trend in the robust Halifax, Southwestern Ontario, and Ottawa markets where we have a strong presence. In the year we also updated independent external appraisals for 44 properties contributing to the fair market value gain over the year of $52.5 million.

Let me now briefly go over some financial metrics for 2022. Our solid growth across key indicators was mainly driven by the net acquisition activity in the last 12 months. We ended the quarter with 130 properties in our portfolio, including a 50% ownership interest on 42 properties compared to 120 properties owned at 100% at the same time last year. As such, at the end of 2022 we owned approximately 6.5 million square feet but in total managed approximately 8 million square feet.

Total assets amounted to $1.04 billion at the end of the year, up 4.6% year over year. Property revenues grew $9.2 million, a 25.2% increase compared to 2021. Net operating income reached $57.7 million, up 24.8% year over year. AFFO grew to $31.3 million, up 24.8% year over year. Our basic AFFO payout ratio stood at 86.9% compared to 87.7% a year ago. At $8.21 per unit at December 31, 2022, I'm pleased to highlight that our NAV per unit continued the upward trend, increasing $0.94 per unit since 2021 and $1.90 per unit since 2020. We also strengthened our balance sheet during the year, reducing our gross debt by $10 million. As Jim mentioned, we also reduced our debt to gross book value ratio to 49.7% at year end compared to 53.1% at the end of 2021, a trend we intend to continue to pursue over the coming years.

This year, the joint venture with Crestpoint, the sale of our non-core properties, and our successful leasing spreads were the greatest contributors to debt reduction. Our debt maturities are quite modest with $52 million of mortgages coming due in 2023 and only $26 million coming due in 2024, allowing us to be disciplined in managing our balance sheet.

In 2022 we published our inaugural ESG report and our Sustainability Steering Committee has been working diligently to prepare the follow up. We continue on our ESG journey and an increase in tracking efforts to better understand where and how we can improve our efforts to reduce our carbon footprint and strengthen our social impact. We are excited to be able to report on our progress this spring.

I'll now turn the call over to Alison to discuss Q4 financial results.

Alison Schafer — Senior Vice President Finance, PRO Real Estate Investment Trust

Thank you, Gordie.

We recorded a solid financial performance in the fourth quarter. Property revenue amounted to $25.1 million, a 9.3% increase compared to the same period in 2021. The net operating income was $14.6 million, up 9.1% year over year. These increases were mainly driven by the impact of the net acquisition activities over the last 12-month period.

AFFO totaled $7.7 million, a 4.5% increase compared to Q4 last year. The growth was largely related to the net increase in the number of properties acquired in fiscal 2022 combined with the increase in property management fees resulting from our joint venture transaction as sole property manager of the entire 50% owned portfolio.

I am pleased to highlight our FFO and AFFO unit performance in the quarter coming in slightly above 2021. We achieved this while also reducing our debt-to-gross book value by 3.3%. Our basic AFFO payout ratio stood at 88.5%, an improvement compared to 91.5% from the prior year period. Our overall same property portfolio represented 92 properties out of our 130 property portfolio.

Industrial same-property NOI was up a robust 5.0% in Q4; however, our overall same-property NOI remained relatively flat in the quarter as a result of increased vacancy in two out of our eight office properties.

Our liquidity position remained healthy with $23 million available under our credit facility at the end of the year. Our weighted average cap rate for the portfolio was approximately 5.8% at the end of the year, or $155.89 per square foot, down from 5.9% at the end of 2021. We saw some cap rate expansion in a few areas of our office portfolio.

For almost all of our discounted cash flow models, we have increased discount and terminal rates to reflect the interest rate risk in the market. In general, valuations are holding due to increased cash flows in our model. Finally, distributions of $3.75 per unit were incurred monthly throughout the fourth quarter of 2022.

I will now turn the call back to Gordie for closing remarks.

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

Thanks, Alison.

In the context of the heightened macroeconomic uncertainty, market volatility, and high interest rates, we believe we are well positioned and view this as a time of opportunity to focus on operational efficiency. We have lower leverage to perform sustainably. Optimizing our portfolio by increasing our concentration on high-performing assets in the industrial sector while disposing of smaller and non-strategic properties and reducing debt remains our primary focus. Increasing our industrial cash flow as a percentage of the total portfolio is key as we set out our next target to reach 80% in the near term from our current 69% at year end. This strategy has proven successful, as evidenced by our strong results, and we are confident it will continue to generate stable cash flow as we progress towards our goal of $2 billion in assets in the near term. We remain steadfast on our commitment to create sustainable value for all stakeholders.

I would like to conclude by thanking my long-time partner and friend, Jim. It has been privilege and an honour working side by side with him over the past decade and to build PROREIT into what it is today. I look forward to benefiting from your contributed guidance and expertise as a member of the board. Thank you, Jim.

Operator

Are we ready for questions?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

We are.

Q & A

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 the one on your touchtone phone. You will hear a three-tone prompt acknowledging your request. Should you wish to decline from the polling process, please press the star followed by the two. If you are using a speakerphone, please lift the handset before pressing any keys. One moment please for your first question.

Your first question comes from Fred Blondeau of Laurentian Bank. Please go ahead.

Frederic Blondeau — Analyst, Laurentian Bank

Thanks and good morning. Gordon, just on the $65 million of debt maturities, or I guess, if I understood well, I guess around $55 million, $56 million remaining this year, I was wondering what's the timing of those and how are the discussions progressing so far?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

We have about $17 million coming due in June. We've already got a term sheet signed on that with some good margin terms. And the final rate, obviously, depends on when we get the committed financing and fixed rate, but that one performed well. That was part of our Winnipeg Industrial. We've got a couple of small million dollar-ish assets during the year and the next piece is about $30 million maturing at the end of December, so we haven't really worked on that yet.

Frederic Blondeau — Analyst, Laurentian Bank

Okay. And can you give us, is it too early to give us a bit of indication on rates that you're seeing today?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

Yeah, it's probably too early. We have an attractive spread, you know, depending on the term, we have options between three and ten years, and so the margins on that, based on bonds, would be between 200 and 215. But as you know, the basis point spread on the curve have moved 50 to 60 basis points weekly, so I can't really comment on an all-in price right now.

Frederic Blondeau — Analyst, Laurentian Bank

That's fair. And then in the press release you mentioned capital recycling. I was wondering if you could possibly quantify expected dispositions for this year and I guess the expected net impact on the debt ratio.

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

Yeah. So I mean we've got about, give or take, the same as last year, $30 million circled in some assets that we would sell if the pricing was right and the market was there. Can't really comment on that right now as to where the debt level would be with that, but we would use the net proceeds of any of that for debt repayment.

Frederic Blondeau — Analyst, Laurentian Bank

Okay. But do you have like a target, do you have a debt rate you target for 2023?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

We have a three-year target to move below 50%, but we haven't quantified it on an annual basis or anything like that.

Frederic Blondeau — Analyst, Laurentian Bank

Okay. That's great. Thank you.

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

Thank you.

Operator

Thank you. The next question comes from Brad Sturges of Raymond James. Please go ahead.

Brad Sturges — Analyst, Raymond James

Hi there. Just on the asset build there, the $30 million that you've circled, is that predominantly retail assets?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

Retail, potentially some office, but these are just assets that we circled at this time.

Brad Sturges — Analyst, Raymond James

Okay. Nothing is on the market right now?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

On the market is a difficult discussion. We get calls all the time about certain of our assets, so it just depends on the calls and what's going on in the market. But nothing, ah, you won't see any flyers or anything as such, I don't think, in your inbox, put it that way.

Brad Sturges — Analyst, Raymond James

Fair enough. Just on the leasing side of things, obviously you've made good progress on your 2023 expiries. Just in terms of what's left to do or what's remaining, what would you be expecting for your leasing spreads given it's, I think it's mainly industrial leases that are rolling this year?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

Yeah, I mean there's a couple of chunky ones and then a bunch of small assets, which we own (inaudible) with Crestpoint. So, what we've been seeing is, you know, as you see in the numbers here, 30% to 40% leasing spreads in those numbers, so I think we'd expect that largely to continue.

Brad Sturges — Analyst, Raymond James

Okay. And a similar type of retention rate then, I guess, with your tenants. I think you were 90% last year. Is that kind of what you're expecting for 2023?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

Yeah, I mean that's our target. I think for the past six or seven years we've achieved in excess of 90% of leasing and re-leasing, so I wouldn't expect to end that much different this year.

Brad Sturges — Analyst, Raymond James

Okay. That's great.

James Beckerleg — President & Chief Executive Officer, PRO Real Estate Investment Trust

Increase in vacancy (inaudible) the industrial sector.

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

Yeah, we don't see any increase in vacancy during the year or anything like that where we are right now. Nothing significant.

Brad Sturges — Analyst, Raymond James

But nothing abnormal versus like transitional vacancy that a larger lease might have some downtime?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

We have a 100,000 square foot building in Montreal by the airport and that will, committed vacancy will stay the same, but we'll have about six months' downtime where three tenants need to replace with new tenants on a ten-year lease and rents going from $10 to $15.50, $15.75 over, so basically Q2 and Q3 that property will be down on an NOI basis, but then will be fully leased and back up September.

Brad Sturges — Analyst, Raymond James

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

Operator

Thank you. The next question comes from Mark Rothschild of Canaccord Genuity. Please go ahead.

Mark Rothschild — Analyst, Canaccord Genuity

Thanks and good morning. Let me just start congratulate Jim and Gordie on all of this. It's been a pleasure. Look forward to seeing you, working with you guys, and following the company. As far as the asset sales, you sort of touched on this already, you've done some good leasing on the office side, do you see potential for much more this year and does that play into your thoughts on timing of potentially selling some of those assets as you increase your focus on industrial?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

It's Gordie. So, the challenge for (inaudible) the markets is really is the debt. So, you know, we have office assets that we're asked about all the time, we have solid retail assets with long-term tenancies out west that hasn't been a focus for a while. Those are the assets that we've kind of got circled. But the actual potential for sale is really driven by the debt market and when you have, you know, the bond rates jumped 50 to 70 basis points in a two- or three-week period when it takes two to three months with somebody to negotiate, diligence, and then close on the property, that's really what's (inaudible) in the market right now. It's not really the debt for real estate, especially if it's well performing. So that's really the driver of whether asset sales can happen this year or not. We have to have some reduced volatility in the debt markets. That's my opinion anyway.

Mark Rothschild — Analyst, Canaccord Genuity

Okay, great. Thanks. That's all for me.

Operator

Thank you. Once again, ladies and gentlemen, if you do have a question, please press star one at this time.

The next question comes from Sam Damiani of TD Cowen. Please go ahead.

Sam Damiani — Analyst, TD Cowen

Thanks and good morning, everyone, and congrats on a great finish to the year. Maybe, Gordie, just on that comment you made about that building in Montreal near the airport. Is the replacement lease firm signed up or is that still in negotiation? What's the status of that?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

We've got two binding offers to lease. One of them we have the full lease done, but two binding offers to lease on that building. So it's, give or take, 100,000 square feet. It's been 90% occupied since we bought it in 2014. After this transaction, it will be 100% occupied starting September 1st for both of the properties.

James Beckerleg — President & Chief Executive Officer, PRO Real Estate Investment Trust

Major (inaudible) tenants.

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

Yeah, major tenants and with good covenants and everything you'd expect in basically a Class A (inaudible) industrial building. It's 3200 Guénette property, if you wanted to check on it.

So, for your modelling purposes, give or take $900,000 a year in NOI, so we'll be down two quarters on that, but that number will make its way up to $1.5 million annualized starting in Q4.

Sam Damiani — Analyst, TD Cowen

Makes sense. That's perfect. Great to see. And just on the credit facility, you tapped into a little bit more. I know you've got some mortgages coming up this year. Is the expectation to up-finance those secured assets just, I guess, what's the strategy on liquidity over the course of 2023?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

Yeah, so we're looking at, you know, some other liquidity options at this time, but upward financing is it and then the sale of any assets as well. As we're looking at it, it's all fluid right now. As we sat here at the end of December, we thought that the equity markets might be open by June, but that clearly doesn't look to be the case right now. So yes, we're working on those things, we've got some more opportunities there that we're looking at, but we should be in good shape with it by the end of the year.

Sam Damiani — Analyst, TD Cowen

Okay, great. And just on the outlook for 2023 same property NOI, I mean what should we expect? Will the pool of same property assets get meaningfully bigger this year as a percentage of the total portfolio? I know you've got this one lease with some downtime, but are you willing to put out a number that you're expecting on same property for the year?

Alison Schafer — Senior Vice President Finance, PRO Real Estate Investment Trust

It's Alison here. I think a fair estimate would be somewhere in the 3% to 5% on the same property. I think our industrial will definitely be our leader in that three property asset class and office might be the last one trailing in there.

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

But on our office portfolio will be stabilized. I mean we've got committed occupancy 92%. Some of that real occupancy you won't see until the end of Q3, but, you know, if we talked about the bottom of the office same store, I think we've reached that and we're on the other side of that.

Sam Damiani — Analyst, TD Cowen

Okay. And just final one, I guess, you certainly reiterated the $2 billion goal in terms of total assets for the short term, given the volatility is obviously on capital recycling and chipping away at the leverage, but just, I guess, how would you say your $2 billion goal has changed in the last three months?

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

I don't think it's changed. I think the goal is dependent on the markets, to some extent. Recycling (inaudible) will help but, as you know, $2 billion is $1 billion more than we have now. So really the challenge is just a timing thing from that standpoint, right? I mean that's the target that we have. We didn't do any acquisitions in 2020 with COVID. I mean, we bought $300 million in 2021, integrated it all easily and moved (inaudible). So it'll be, I could say, I guess, the steps might be lumpy just because of where the market is.

Sam Damiani — Analyst, TD Cowen

Yeah. Okay. And thank you for the additional disclosure in the MD&A. That was very helpful. And I'll turn it back. Thank you.

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

You can thank Alison for that. She's been very diligent at increase in our disclosures. So thank you, Alison.

Sam Damiani — Analyst, TD Cowen

Thank you, Alison.

Alison Schafer — Senior Vice President Finance, PRO Real Estate Investment Trust

You're very welcome. It's my pleasure.

Operator

Thank you. There are no further questions at this time. Ladies and gentlemen, this concludes your conference call for today. We thank you for your participation and ask that you please disconnect your lines.

James Beckerleg — President & Chief Executive Officer, PRO Real Estate Investment Trust

Thank you all.

Gordon Lawlor — Executive Vice President & Chief Financial Officer, PRO Real Estate Investment Trust

Thank you.

Alison Schafer — Senior Vice President Finance, PRO Real Estate Investment Trust

Thank you.