FINAL TRANSCRIPT

PRO Real Estate Investment Trust

Fiscal 2023 Second Quarter Results Conference Call

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Sam Damiani
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PRESENTATION

Operator

Good morning and welcome to the PROREIT Second Quarter Results Conference Call for Fiscal 2023. 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. To ask a question, simply press star followed by one on your touchtone phone. If you would like to withdraw your question, please press star followed by two.

For your convenience, the results release, along with second quarter financial statements and management's discussion and analysis, are available at www.proreit.com in the investor section and on SEDAR and 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, levels of activity, performance, achievements, future events, or developments to differ materially from those expressed or implied by the 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 August 9, 2023, available at www.sedarplus.com. Forward-looking statements represent management's expectation as at August 9, 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 second quarter earnings release and MD&A. A reconciliation of non-IFRS to IFRS results, as applicable, may also be found in the earnings release and MD&A for the second quarter. Please refer to the non-IFRS measures section in the MD&A for the second quarter for additional information.

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

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

Thank you, Colin. Good morning, everyone, and welcome. Joining me today is Alison Schafer, our CFO and Corporate Secretary.

I will start with a high-level overview of our Q2 results. Alison will then provide a more detailed discussion on the quarterly financials.

With most of our key metrics up over last year, I am pleased with our performance. Our results reflect our solid operating environment and the strength of our balance sheet. We continued to benefit from our long-standing and robust tenancies, as evidenced in our occupancy rate of 99% at June 30, 2023, which includes committed occupancy.

Leasing activity continues to be very favourable. To date, we've renewed 85% of our gross leasable area, or GLA, maturing in 2023 at a 43.2% positive average rental spread. Same-property net operating income, or same-property NOI, was up 0.8% in Q2 compared to the same period of the prior year. This is due to the occupancy increases in both retail and office sectors as well as contractual increases in rent and higher rental rates on lease renewals.

As I prefaced in our last call, our industrial segment was impacted by a temporary vacancy in a 102,000 square foot property in Montreal, vacant as of April 1st. The property has been fully re-leased on 10-year terms with two tenants with occupancy starting in Q3 at an average positive spread over the previous rents of 55%. When excluding the impact of this temporary vacancy, adjusted same-property NOI was up 3.9% in Q2 year over year. On an annualized basis, NOI from this property will go from $900,000 to approximately $1.5 million with these two new lease deals. Our 2023 fourth quarter results will include the full benefit of this attractive renewal.

The temporary vacancy has also affected our AFFO payout ratio in Q2, which amounted to 97.3%. Higher variable interest rates on the credit facility and increased weighted average interest rate on mortgage debt also impacted our AFFO ratio during the current quarter. At June 30, 2023, the industrial segment now represents 80.5% of our total GLA, 70.6% of our total base rent, and 77.9% of our investment property value.

Moving to the balance sheet, I'm pleased to note that we significantly increased our liquidity position in Q2, mainly as a result of our successful $35 million convertible debenture offering that closed in May. We also received a new $10 million term loan in the second quarter. Proceeds from these transactions were used to partially repay our credit facility with the balance used for general corporate purposes.

With respect to our portfolio, we sold one non-core office property in the quarter for gross proceeds of $2.1 million. Then on June 29, 2023, we entered into a binding agreement to sell two other non-core office properties for gross proceeds of $9.1 million. We intend to continue strengthening our portfolio by recycling assets to capitalize on future acquisition opportunities.

I will now turn the call over to Alison for a more detailed look at our second quarter results for fiscal 2023.

Alison Schafer — Chief Financial Officer & Corporate Secretary, PRO Real Estate Investment Trust

Thank you, Gordie, and good morning, everyone.

As Gordie noted, our Q2 results were solid. At June 30, 2023, we owned 129 investment properties with 50% ownership interest in 42 of the properties compared to 120 investment properties fully owned at June 30, 2022. At the end of Q2, we owned approximately 6.5 million square feet of GLA and we managed approximately 10.8 million square feet of GLA through our wholly owned subsidiary, Compass Commercial Realty.

Total assets amounted to $1.06 billion at June 30, 2023, up 1.6% year over year. We achieved property revenue of $24.9 million, a 5.1% increase compared to the same quarter last year. The increase was mainly due to the change in the number of properties in our portfolio and their related ownership percentages over the last 12 months.

Net operating income was $14.5 million, up 1.3% year over year, also as a result of the number of properties and ownership percentages in our portfolio. G&A expense was $1.3 million in Q2, in line with our G&A run rate for the remainder of the year. As you recall, we had a one-time CEO retirement cost of $2.2 million included in G&A expenses in Q1 this year.

Net cash flows provided from operating activities was $0.6 million in our second quarter compared to $2.2 million in Q2 2022, largely as a result of the timing of cash receipts and settlement of payables.

AFFO totaled $7.0 million, down from $7.9 million in the same period last year. The decrease was related to the temporary vacancy in the industrial property that Gordie discussed and higher weighted average interest rates.

As Gordie noted, we are benefiting from a strong liquidity position at June 30, 2023 with $42 million available on our credit facility and an additional $15.8 million in cash. We have $33.8 million of maturing mortgages remaining for 2023 to be refinanced on market terms and in consideration of our overall strategy.

The weighted average interest rate on mortgage debt was 3.75% at June 30, 2023 compared to 3.40% at the same date last year. As mentioned on our last call, this quarter, we refinanced six industrial properties in Winnipeg with a new seven-year mortgage with 5.07% interest rate for $20.5 million. Most of the proceeds were used to repay mortgages maturing in July 2023.

Debt to gross book value was 50.9% at June 30, 2023, down from 51.3% at the same date last year. Compared to the end of Q1 this year, debt to gross book value was negatively impacted at June 30, 2023 by our temporary excess cash position, annual property tax payments, as well as the non-cash impact of the fair market value adjustments, mainly in our office portfolio. At June 30, 2023, the weighted average cap rate of our portfolio was 6.0%.

I will turn the call back to Gordie for some closing remarks before we open the call for questions from our financial analysts.

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

Thanks, Alison.

We remain mindful of the high interest rate environment and the macroeconomic challenges that are still very much a reality. Despite these challenges, we are committed to our strategy to continue to grow our quality portfolio organically and through disciplined acquisitions in the light industrial sector.

This marked my official first quarter as CEO of PROREIT and I'd like to thank the entire PROREIT team for their dedication and support. We look forward to pursuing our objectives while optimizing our balance sheet and capital allocation to the benefit of all stakeholders.

This concludes our formal remarks. Colin, if you could please initiate the question-and-answer portion of this call. Thank you.

Q & A

Operator

Thank you. Ladies and gentlemen, we will now conduct the question-and-answer session. If you'd like to ask a question, please press star then the number one on your telephone keypad. If you'd like to withdraw your question, press star followed by two. If you are using a speakerphone, please lift the handset before pressing any keys. One moment for your first question.

Your first question comes from Mark Rothschild. Mark, please go ahead.

Mark Rothschild — Analyst, Canaccord Genuity

Thanks and good morning, everyone. Gordie, with the sale of office properties, can you just maybe give a little more colour on, you know, with these sales, was it more opportunistic? Was it just deciding that we've maximized the value from these assets? I know that there's definitely a balance between you wanting to focus on certain property types and not wanting to sell assets where you still see good upside or stable cash flow.

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

Yeah, so this was two 30,000 square foot properties that one had a 15-year long-term lease on it with steps and the other one had a year and a half left on the lease. So we had entertained a bid from, these are Ottawa assets, from Ottawa Group for the assets, so we put it under contract at just over a 7% cap. In the due diligence period we were notified by the one-and-a-half-year remaining tenant that they would not be renewing, so it was a pretty advantageous timing to the purchaser, I'd say. That said, we proceeded with the deal with an adjusted price and so that basically sold at an 8% cap but on a non-stabilized basis. So the call there is keep the property and re-lease it, which it was under market rent by about $4, so I think a good deal was had here by both parties, but it's just tied strategically to reducing our office exposure.

Mark Rothschild — Analyst, Canaccord Genuity

And to what extent should we expect more of that over the next few quarters?

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

So we started, we had nine office assets. One is jointly owned with our partner in Halifax. And we sold one, so we're down to six here. Three of them are in Ottawa, two suburban office and one downtown office, and then two small legacy office properties in Atlantic Canada. So it's a difficult office market, as everybody knows, right now. We're in no rush for those. But if we get interest on these properties at reasonable prices, we'd continue to sell. We have a mortgage due at the end of the year with most of this office portfolio, so it's just all timely in that respect, whether we refinance some of these properties or if we're available to sell them by the end of the year, we don't need to refinance them, obviously. That said, we could still get short-term financing and keep them. And they're performing well. So there's no need for a fire sale for any of this stuff, so we're just being opportunistic.

Mark Rothschild — Analyst, Canaccord Genuity

Okay, great. Maybe just one more question in regards to the balance sheet. When you look at the debt to EBITDA, is this a level that you're comfortable operating? Do you want to bring it down? Would you allow leverage to go higher? Just how do you think about it as far as the way you're going to finance growth?

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

Yeah, so I mean our target since a long time has been to get to the 50%, and we're at that now, just slightly above. This quarter's a little bit of an anomaly, but we'd like to stay around the 50% range. Q2 is always a challenge for us. We actually pay out $10 million in property taxes in Q2 to the $20 million we owe for the entire portfolio, you know, and only get it back over the next 12-month period. So that's a little bit of an anomaly for us. I think we've indicated that we'd like to go lower on a debt basis over the next five years with a target of 45%, but we're happy, plus or minus the 50% right now, but we would not lever up for acquisitions that's not in our plan, other than if it's temporary between an acquisition and a sale that was coming.

Mark Rothschild — Analyst, Canaccord Genuity

Okay, great. Thanks so much.

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

Thank you.

Operator

Your next question comes from Jenny Ma from BMO Capital. Jenny, please go ahead.

Jenny Ma — Analyst, BMO Capital Markets

Hi. Good morning, everyone.

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

Hi, Jenny.

Jenny Ma — Analyst, BMO Capital Markets

You had a pretty strong rental spread achieved in Q2. I was just wondering if you could give us some more colour on how much of it, ah, what you were getting for the industrial assets, which I presume is the vast majority of it, and what you're getting from retail.

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

So, our industrial spreads like are in the plus 50%. I think 54% was our industrial spread for the quarter. Alison is just pulling up the retail there. So, strong industrial, retail kind of like above average as well. But I believe it's 54%. I'll defer that for a second and I'll come back with the number. It's just not at the top of my head. But it was in excess of 50% on industrial and then I think retail was almost close to 10% over.

Jenny Ma — Analyst, BMO Capital Markets

Okay. Great. Is that broad based or were there certain properties that skewed that number? Or are you just getting some good leasing spreads all around?

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

Yeah, I mean it's pretty much broad based. The positive leasing spreads we're seeing of significance is Halifax and Southwest Ontario. Winnipeg is a little more muted that way, but still positive leasing spreads, but definitely we see Halifax, Southwest Ontario. And then tied to these numbers is the downtown Montreal property and St. Laurent. So that's a 55% spread there on basically 100,000 square feet. That's a pretty good math driver for this quarter.

Jenny Ma — Analyst, BMO Capital Markets

Absolutely. When it comes to the terms, what are tenants looking to lock in for? And can you also talk about the quantum of rent steps that you've been able to negotiate?

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

So, for example, on the two Montreal properties, one has a 3% rent step and the other has 3.5%. In Halifax we're achieving 3% rent steps on all of our deals right now. And Southwest Ontario recent deals that we've done as well were 3% rent steps as well. So 3% is almost our new base and then every so often we get to a 3.5% there.

Jenny Ma — Analyst, BMO Capital Markets

And that's (inaudible) years?

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

Yes, annual rent steps. Yes.

Jenny Ma — Analyst, BMO Capital Markets

Okay, great.

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

Sorry, Jenny, I have that number. So it's 49.3% for industrial year to date and retail average was 9.1%.

Jenny Ma — Analyst, BMO Capital Markets

Great. And what kind of lease terms are you getting for renewals?

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

We're getting three to five years in Halifax and the two in Montreal were ten-year deals. And the rest of the country standard is pretty much five years. If somebody wants to go longer these days, we're happy to look at it, as you would expect.

Jenny Ma — Analyst, BMO Capital Markets

Okay, great. And then lastly, you mentioned the NOI contribution for the Montreal new deal. I think you said it was going from—is it $900,000 annually to $1.5 million?

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

Yes.

Jenny Ma — Analyst, BMO Capital Markets

Okay. And do these leases start right at the beginning of Q4?

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

I mean they're under tenant fit up right now. Targets would be September 1st. I believe we're on target for those but, to be safe, we were saying that we should be fully rent flowing by October 1st through [inaudible].

Jenny Ma — Analyst, BMO Capital Markets

Okay. Okay. So it would be a full clean contribution starting in Q4?

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

That is our hope at this point.

Jenny Ma — Analyst, BMO Capital Markets

Okay. Right. Thank you very much. I'll turn it back.

Operator

Your next question comes from Himanshu Gupta from Scotiabank. Please go ahead.

Himanshu Gupta — Analyst, Scotiabank

Thank you and good morning. So, just staying on the lease expiries, I mean the remaining lease expiries this year, I think it looks like all industrial as well, so any thoughts there in terms of rental spread expectations?

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

Yeah, I think we're still going to have the same lease experience like this. Consistency is pretty prevalent. Most of the leases are in Halifax. I think of the leases done this year, 60 of one them, 70 were

Halifax based. So we will expect the same basically for the rest of the year. We don’t have any indication of any problems in the rest of that 15% either.

Himanshu Gupta — Analyst, Scotiabank

And I think, Gordie, you mentioned Halifax and Southwestern Ontario continue to be strong in terms of interest spreads and Winnipeg a bit muted, so are you surprised with Winnipeg or is it just property specific? Basically, the market continues to be tight and you’re not seeing much supply there as well.

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

Yeah, no, muted is only relative to the other two markets. So you’re going from $7 to $13 in Halifax and then Southwest Ontario we went from, for example, on one lease, $4.40 to $8.80. Winnipeg was, our last deal was $6.30 and it went to $8.30. So that’s still $2 on 30,000 square feet. It’s just that, compared to the other two, it’s not, you know, it’s 50%. That’s the point.

Himanshu Gupta — Analyst, Scotiabank

Got it. Thank you. And you mentioned the Halifax, most of the remaining leases are due in Halifax, if I heard correctly. What kind of in-place rents do you have in Halifax and what are you expecting for the remaining (inaudible) this year?

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

Yes, so when we bought the portfolio, most of the portfolio was between $6 and $7, so that's pretty much where the entire portfolio is since last November. And weighted average lease term is three years on them, so we're kind of coming up to a year through, but it's basically the $6 or $7 going to $12 and $13. That's really what we're seeing. With no (inaudible).

Himanshu Gupta — Analyst, Scotiabank

For sure. Like GTA is now talking $20, so I think that $12, $13, I think, very much doable there. Maybe just turning to the balance sheet, I think you have around $13 million of mortgage maturing. Is it all related to office portfolio?

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

No. There's about five that's, ah, three small properties. One is already renewed. So there's another small property that's contracted for sale conditionally. So that will (inaudible) us about $1.7 million of it. There's another $1.7 million we'll just pay out when it comes due. And then when we look at the sale of the office, that leaves us about $25 million left for the year. And that's Ottawa office with one industrial building, if you will. So, four properties there. One is actually industrial. So we'll refinance that on a longer-term basis and then, depending on the other three assets, two, three assets left there, we may put some short-term financing on it, but they're not long-term holds, so we're not going to put five- or ten-year money on that mortgage, on those properties when they come due.

Himanshu Gupta — Analyst, Scotiabank

Yes. But is five-year money available on some of the suburban office these days? I mean the preference is clearly going to credit facility or short-term financing on that piece.

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

No. We've spoken to the lender, which is a large Canadian bank, on those assets and they're there for us for a short renewal or a 12-month renewal there. Those properties, we have full covenant of the REIT there, so they're not concerned about those office properties, and they're over 90% occupied right now. So that's not a concern when you have a relationship lender in these situations.

Himanshu Gupta — Analyst, Scotiabank

Awesome. Okay. Thank you so much and I'll turn it back.

Operator

Ladies and gentlemen, as a final reminder, should you wish to get in queue for a question, please press star followed by one.

There are no further questions. I'll turn it back to Gordon to close up the call. Actually, we do have someone who just came in, so we've got a question from Sam Damiani from TD Cowen. Sam, please go ahead.

Sam Damiani — Analyst, TD Cowen

Thanks and good morning, everyone. I'm not sure if this was asked already, but do you have an update on the backfilling of the 84,000 square feet in redevelopment?

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

So that's two properties, so there's a 90,000 square foot property there in Quebec City and the other one is 65,000 feet in Montreal, east end of Montreal. We've got fit up for a 25,000 square foot lease on the 65,000 there, so we've made progress that way. The other 40,000 is still available for occupancy. And so kind of that's where we are. The 19,000 square foot property, that may turn into just be a sale of the property outright. So that's kind of an update. So, all things being equal, the 19,000 property will likely be sold by the end of the year, so the only piece left would be this 40,000 square feet in Montreal.

Sam Damiani — Analyst, TD Cowen

Okay, great. Besides this and the Montreal 100,000, is there any other known or expected vacancies in the next 18 months or so?

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

Just looking at Alison and thinking. No, I mean those two properties were unique in that they, those development properties, in that they had long-term leases on them. Like the Montreal property was the tenant was in for 30 years. And COVID-19 hit and changed the demeanor of that property. So that's why those two are like that. We don't see any anything big here coming up in the next little while.

Just to finish (inaudible) the question, I mean leasing has been strong, but one thing we've noted is it has slowed down a little bit just timing-wise as far as how long it takes to get deals done. Part of it's the summertime as well. But we haven't really seen any significant weakness in the markets, a few small tenants and things like that, hangovers from COVID here and there, so there may be some surprises in the next 12 to 18 months, but we don't really have a lot of knowledge of it at this point in time. So everything seems pretty stable.

Sam Damiani — Analyst, TD Cowen

And how is the investment market in Halifax and the Burnside market there? How is transaction activity there? Or is it pretty quiet?

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

No, it's very good. It's robust. We're still below, I think, 3% vacancy there. We're just about entirely full actually for the properties. The challenge always there is tenants expanding or contracting and can you fit them into something that you already have, that type of thing. There's not a lot of options for them for a small bay. Nobody is building any small bay there. So it's still a very solid market and, as you can see, we're seeing these leasing spreads with no tenant inducements. So we're really pleased with it. And I think our partner is as well. So we're happy there. I mean Halifax, economically, there's still five or six cranes downtown building rental housing and condos everywhere. Immigration is up there as well. It's a very robust market down there right now and we're happy to be in it, that's for sure.

Sam Damiani — Analyst, TD Cowen

Great. Last one for me is on the dispositions. I know you had $36 million conditional last quarter. You've dealt with a couple. What's the expectation for the balance of the year and into 2024 and are you open to providing vendor financing? Do you feel that's necessary to get transactions across the finish line?

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

Yeah, I mean it's a tough market out there. You're seen prolonged diligence periods being requested. I mean in the good old days, Sam, I mean when we were buying, we would underwrite a property before we put it under contract almost, 30 days new diligence, 10 days close. It's nothing like that now. It's 45 to 60 days due diligence, then they want sometimes 30 to 45 days for close. It's all around financing, it's all around the debt financing basically. And we talked on one tenant on a deal that actually didn't, just a small asset that didn't go through, but if you put vendor financing behind the first financing, then they still look at the debt service coverage ratio, obviously, and the first lender won't improve it. So, even though you would do some things to get a deal done, it's still controlled by the first lenders, whether you can be that creative or not.

Sam Damiani — Analyst, TD Cowen

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

Operator

There are no further questions at this time. I'll turn it back to Gordon to close out the call.

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

I just wanted to say thanks from Alison and I and everybody at PROREIT and hopefully everybody enjoys the rest of the summer. Thank you.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.