H&R REIT Q3 2024 Conference Call

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OPERATOR

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use of non GAAP financial measures are described in more detail in H&R's public filings with which can be found on H&R's website and www.cedarplus.com. I would now like to introduce Mr. Tom Hofstedter, Chief Executive Officer of H&R REIT. Please go ahead, Mr. Hofstedter.

TOM HOFSTEDTER

Thank you Operator and good morning everyone. Thanks for joining us today with Larry Froom and Emily Watson. I will hand it over to Larry to give his recap of the quarter.

LARRY FROOM

Thank you Tom and good morning everyone. In my comments to follow, references to growth and increases in operating results are in reference to the three months ended September 30, 2024 compared to the three months ended September 30, 2023. Headline FFO per unit for Q3 2024 was 29.4 cents compared to 42 cents in Q3 2023. As a reminder, FFO in Q3 2023 included a $30.6 million gain on disposal of a purchase option held via a mortgage receivable. Excluding this gain, FFO would have been $87.1 million or $0.31 per share in Q3 2023. Overall, given the headwinds we faced at the end of last year with multifamily supply concerns, a weak office market, inflation and rising interest rates, we are very pleased with our results. We continue to execute on the strategic repositioning plan. In 2023, we sold $432.9 million of income producing properties and this year to September 30, 2024 we have sold $344.8 million of income producing properties. We expect to end the year with approximately $440 million of real estate

sales this year. I would now like to spend a few minutes providing commentary on each of our segments.

Starting with office, we are hearing of more back to the office policies from different companies and it seems clear that more and more employees are heading back to the office which is positive for the sector as a whole. Our office portfolio of 16 properties (which includes four properties as residential rezoning opportunities) now only comprises 19% of H&R's total portfolio. 87.6% of our office revenue comes from investment grade tenants, a testament to the quality and location of our office properties. Our office occupancy at September 30 was 96.8% with an average remaining lease term of 6.1 years. Lease expiries between September 30, 2024 and December 31, 2025 only total approximately 400,000 square feet so the portfolio will continue to provide solid cash flow.

Our downtown Toronto office properties with residential rezoning opportunities are valued at $140 per square foot, which is less than half the value they were at the peak of the market and the rest of the portfolio has a weighted average cap rate of 8.86%. Our office properties are valued at approximately $1.9 billion and there are only two mortgages totaling $140 million, the net of which equates to $6.24 per unit. Excluding our office portfolio in its entirety, our NAV per unit would be $13.42, which is significantly higher than our current share price. Our sales of office properties to date of $2.3 billion since the announcement of the strategic plan demonstrate that there is value to our office portfolio.

On the residential segment, while there has been a lot of new supply added in our residential markets, the positive immigration trends have continued and our tenants are also staying longer. Since the announcement of H&R's strategic plan, H&R's average U.S. residential rents increased from $21.16 per square foot as of June 30, 2021 to $26.97 per square foot at September 30, 2024 in U.S. dollars. Our residential portfolio at September 30, 2024 comprised 47% of H&R's overall portfolio and is continuing to grow. Lantower West Love in Dallas is substantially complete and was transferred from a property under development to an investment property. West Love has become the 25th residential income producing property in our portfolio. Lantower Midtown, also in Dallas, is not far behind and will become our 26th investment property very soon. In addition, we have another two residential developments currently under construction and expected to be completed in 2026. H&R's ownership interest in these two new developments is 29.1%.

Our retail portfolio at September 30, 2024 comprises 15% of H&R's overall real estate assets. The tenants in our retail portfolio are mostly grocers and the portfolio has been very stable with growth in rent and net operating income incurring from the lease up at River Landing in Miami.

Our largest retail tenant is Giant Eagle who has close to 200 locations in our portfolio. Giant Eagle recently announced that they are selling the Get Go convenience stores and leases to Couche-Tard. This will further diversify our tenant mix with Couche-Tard

comprising about 1.7% of our revenue. Giant Eagle will then comprise about 3.9% of our revenue.

Our industrial portfolio of 66 properties at September 30, 2024 comprises 19% of H&R's total real estate assets and continues to perform well. Since the announcement of H&R's strategic plan, H&R's average Canadian industrial rents increased from $7.17 per square foot as at June 30, 2021 to $9.42 cents per square foot as at September 30, 2024. In addition, industrial properties located in the GTA made up 35% of H&R's industrial portfolio as at June 30, 2021 compared to 50% of H&R's industrial portfolio as of September 30, 2024. We continue to grow our industrial portfolio and added two newly constructed properties at the beginning of this year. We currently have one industrial property and a 50% interest in two industrial properties under construction scheduled to be completed in 2025.

Our balance sheet remains strong. Debt to total assets at the REIT's proportionate share September 30, 2024, was 44.9% and debt to EBITDA was a healthy 9.1x. Liquidity at September 30, 2024, was in excess of $900 million with an unencumbered property pool of approximately $4.1 billion. Our unencumbered assets to unsecured debt coverage ratio was 2.2x at September 30, 2024.

In summary, we are well positioned to continue executing the strategic plan to sell office and retail properties as and when the market allows and management remains committed to doing so.

On the ESG front, we are pleased to report that our project at 6900 Maritz in the GTA was shortlisted for the World Demolition Award in the Recycling and Environmental category. The previous 104,689 square foot steel structure office property had a total weight of 8,758 tonnes. The waste diversion program recycled 8,113 tonnes of steel and concrete or 93% of the total material weight. In addition, our Lantower West Love development in London sorry in Dallas reached substantial completion and received the National Green Building's Silver certification. And with that I would like to turn the call over to Emily.

EMILY WATSON

Thanks Larry and good morning everyone. I'm happy to be on this call to discuss our third quarter same store results from our multifamily platform and discuss some operational achievements and market insights. Our year to date results continue to align with our expectations as the new supply deliveries officially peaked at a 50 year high in the third quarter. Additionally ending Q3, the trailing 12-month absorption was 85% above the long-term average, further demonstrating the strengthening drivers for our industry. We remain focused on the fundamentals of our business and creating NOI expansion through our repositioning opportunities development pipeline and other innovative value add strategies that add to our bottom line. Given the declining levels of new supply ahead and growing demand in our markets, combined with the strength of our operating platform, we are well positioned for substantial growth and value creation in the coming years.

Same asset revenue growth in US dollars increased 50 basis points for the third quarter and same asset net operating income for our portfolio in US dollars decreased by 1.4% for the three months ending on September 30, 2024 when compared to the respective 2023 period, primarily due to higher property operating costs including taxes and insurance costs and a decrease in average rental rents from the Sunbelt properties, which was partially offset by rental growth at Jackson Park in Long Island City, New York and River Landing Residential in Miami, Florida.

Same asset occupancy ended the quarter at 94.1, a 50 basis points decrease over the second quarter and an 80 basis points decrease from Q3 of 2023. Same asset occupancy in the Sunbelt for Q3 was 93.4 with 51% retention and Jackson Park with 99.2 occupied and 64% retention. The Sunbelt continues to show strong demand metrics moving into fourth quarter with resident retention at 58% for October and 60% for November. Sunbelt blended trade-outs in Q3 were negative 2.5% in the third quarter, ranging from approximately negative 8% in Austin to slightly positive in North Carolina and Orlando, which coincides with levels of supply expansion.

Based on a recent third-party appraisal and a handful of Sunbelt sales comps, we have maintained our fair market value Sunbelt cap rates at 4.98% and believe the rate is appropriate and supported. Cap rates are expected to remain low, relatively speaking for the institutional quality assets in the Sunbelt with capital flows interested and focused on long term heavy Sunbelt multifamily allocation.

On the development front, Lantower West Love in Dallas, Texas received final TCO at the end of September and is currently 40% occupied and 43% leased. We are excited to celebrate Lantower West Love achieving the National Green Building Standard Silver certification. We will share final development budget economics for West Love on the fourth quarter call after we close out the project. Also, in Dallas, Texas, Lantower Midtown received its final TCO on October 31st and is currently 15% occupied and 25% leased. Both properties are leasing well with an average monthly velocity of 25 leases per month, which is above industry reports for our market. Another testament to the superior product and unparalleled amenities of our development team has delivered. We will also share final development budget economics for the Midtown project on next quarter's call.

REDT 1 properties are progressing well and remain on budget with completion expected in mid-2026.

Lantower currently has an additional nine development projects in the Sunbelt Pipeline, totaling over 2,900 suites at H&R's ownership interest, with multiple sites ready and prepared for construction. We are progressing through the different phases of design, drawing and permitting on the remainder of our Sunbelt development pipeline and currently have an additional two projects shovel ready.

In summary, the Lantower Residential platform continues to achieve encouraging results and strong performance relative to our multifamily counterparts. I would like to recognize our Florida and Central Services team members for their preparation for back-

to-back Hurricanes - Helene and Milton. By following the hurricane protocol and communication to our residents, we sustained only minor damage in a few areas. During Milton, over the course of three days, our central team members managed over 1100 incoming and outgoing emails, calls and text messages with our residents with an impressive 98% response rate under four minutes around the clock. The unity of our Lantower team is one of the many reasons we were certified as a “Great Places to Work” in the third quarter and Best Places to Work in Florida by the Best Companies Group. And with that I'll pass it back to Tom.

TOM HOFSTEDTER

Thanks, Emily. Operator, you can open up the call for questions.

OPERATOR

Thank you. Ladies and gentlemen, we will now begin the question and answer session. Should you have a question, please press the star followed by the one on your touchtone phone. You will hear a prompt that your hand has been raised. If you are using a speakerphone, please lift the handset before pressing any keys. Your first question comes from Sam Damiani at TD Cowen. Please go ahead.

SAM DAMIANI

Thanks and good morning everyone. Maybe Tom, just for you, just like to get your sense on the outlook for dispositions today versus maybe versus last quarter. Considering

everything that's unfolded over the last three months. Just wondering what the outlook and pipeline looks for activity into 2025.

TOM HOFSTEDTER

Hi Sam. Good morning. It's basically cloudy. Last quarter there was more optimism on interest rate reduction and therefore that was fueling the buy side, also the debt side. The debt side is dormant and without debt you're not going to have acquisitions. So, nothing's on the market. There's very little. We have nothing on the market. There's very little on the market that anybody has. It's really off market deals and those are opportunistically driven. So, you can't forecast those. In general terms, I'll tell you that the brokers are dry right now and its part and parcel of the uncertainty over interest rates. I have no visibility into when that is going to change. I don't think it's the office market deteriorating further. I think that is what it is and the residential market is also pretty static. The industrial market is a little bit down, but there's more interest in industrial than any other sector right now. Just because the institutional funds have to put their money somewhere and because of all the uncertainty, there's nowhere else for them to put it. So I don't really have a vision of what we'll be selling over the next 12 months. It's really, as I said, opportunistically driven and we get better visibility after Trump comes in with interest rates and where the Canadian dollar lies. That will significantly alter and give us our ability to forecast our dispositions going forward.

SAM DAMIANI

Okay. And I guess the cap rate on the US office portfolio was up close to 30 basis points, if I'm not mistaken. Was there a reason for that? Something that required that?

TOM HOFSTEDTER

Well, as time marches on, you keep on eating into your rents. Logically speaking, unless there's a change of sentiment is the office market, the NAV's of office will go down.

SAM DAMIANI

And maybe just one last one for Emily. Just looking at the organic NOI sort of same property NOI trends at Lantower. What's your expectation for things to turn more meaningfully positive?

EMILY WATSON

Good morning, Sam. Great question. So, I definitely think that we'll see some overhang in 2025 and every year we meet with CoStar and RealPage and some market economists and really mid-2025, I think for most of our markets, I think Austin, where they have bigger expansion that might go to the end of 2025 before we go into 2026, which we anticipate to be a really robust year. So, I think we still have 75,000 units that will deliver in 2025 on the heels of the 100 plus that delivered 24.

SAM DAMIANI

Sorry, that was 75,000 units in the Sunbelt?

EMILY WATSON

Yes, just in the Sunbelt in our market.

SAM DAMIANI

To come over the next year? Okay.

EMILY WATSON

Yep.

SAM DAMIANI

Thank you. And I'll turn it back.

OPERATOR

Thank you. Ladies and gentlemen, as a reminder, should you have any questions, please press star one. The next question comes from Mario Saric at Scotiabank. Please go ahead.

MARIO SARIC

Hi, good morning. Maybe just sticking to Lantower. Emily, in terms of your kind of expectations for new and renewal spreads in 2025, can you share any thoughts in terms of where that may trend?

EMILY WATSON

Good morning, Mario. Yeah, I definitely think that we will continue in Q4 kind of where we saw it in Q3. In Q1, we usually get a little bit of an uptick. People kind of hunker down for Q4 and start to make any moves and I think we'll continue on the same kind of seasonality that we see every year with Q2 our strength and about the time that our peak is kind of behind us and we're picking up some speed in Q3 and Q4, probably even better. So, I think we'll end the year next year probably flat on lease trade outs in the Sunbelt. Again, diversification is our friend next year because New York will continue to post the 3% lift and Miami is set up for a really great year as well. But the Sunbelt might be flat overall with kind of a slow start, Q1 and Q2, a little bit of a hockey stick in Q3 and Q4.

MARIO SARIC

Got it. And given the relatively low rent to income ratios in your portfolio, what are your thoughts in terms of renewal spreads?

EMILY WATSON

Renewal spreads, I expect to be in the 3 to 4 range next year, Mario. We, you know, we don't see a lot of, even before when interest rates were low, we didn't see a lot of home move outs to single family homes and so forth. So I think our renter base with over 100,000 in the salary range, I think they're not really looking to move to single family homes regardless of what happens there. So I think the three to four, maybe five in the second part of the year will be a healthy range for renewals in 2025.

MARIO SARIC

Got it. Okay, and just from an accounting standpoint, the transition of Dallas West London to IPP this quarter, what was the overall FFO impact on the results this quarter?

EMILY WATSON

I'm going to kick that to Larry.

LARRY FROOM

Good morning, Mario. West Love, it was pretty flat. It's only around 40% occupied. it's probably flat in NOI. It did not provide much NOI this quarter.

MARIO SARIC

Okay, so it's flat NOI, but perhaps slightly negative on FFO.

LARRY FROOM

Yeah, had a bit of decrease in capitalized interest to the project that's no longer been capitalized and that will continue to decrease going forward into next quarter. But offsetting that will be NOI growing this quarter. We didn't have any positive NOI from West Love in Q3.

MARIO SARIC

Maybe switching gears to the disposition environment. Sam talked about the broader overall environment. Can you talk specifically about Hess Tower in Houston and kind of the progress that you're making there on the lease up of the space expected to be given back and the implications of that progress to the sell-ability of the asset.

TOM HOFSTEDTER

So we have around one third of the building, we have exactly one third of the building coming up in mid-2026. Out of that, this week we shall have signed approximately one hundred ten odd thousand square feet of that on a new 10-year deal expected 2026, and we're currently negotiating on another approximately 46,000 square feet of space in that building. I expect by 2026 that the space should be all gone.

MARIO SARIC

Okay, and then in terms of, you know, Echo and Hess Tower, for example, these are very

kind of unique assets or situations. Would it be fair to say that your broader commentary on the broader market in terms of it being cloudy and slow, would it pertain to those assets as well or is there something specific with those assets that you think can buck the trend?

TOM HOFSTEDTER

That's a very good question because it specifically does not refer to those properties. There's a lot of interest today in Echo, simply because it's grocer and it's defensive. It's very, very conservative. My guess is by the end of next year, if not sooner, we'll have something done on Echo and Hess Tower again is opportunistic. I think there will be something done in Hess Tower as it is an “A” building in an “A” location and it's just waiting right now for, there's no large transactions in the office market period. But really nothing to speak of a Houston. So, I'm more optimistic on Hess and Echo just for the reasons I just mentioned and they don't fall into the general category of slow market.

MARIO SARIC

Got it, and would Hess Tower essentially the leasing, do you think it would have to be completed in order for property to sell?

TOM HOFSTEDTER

No, I don't think so at all. Again, it's waiting for, there's no finance ability of office in

North America today and I think because of long nature duration of that lease under Hess, I think you could get financing. I think part of the cloud around Hess is who is Hess? Is it Chevron, is it Exxon or is it Hess? And if it is any one of the three, what's their plans for it which we don't know yet. Because of that ,we can't speak to, that creates a cloud around trying to sell the asset or you having interest in the asset because they just don't know what the future occupancy is going to look like. From a cash flow perspective, it's solid. But again, that puts a little bit of a cloud. By one year's time we'll have the answer to those questions and I'm sure there will be interest at that point in time, if not sooner.

MARIO SARIC

Got it. Okay. My last question is just on the VTB mortgage receivables. There was a bit of a write down this quarter. I may have missed it, but can you remind us what the remaining VTB mortgage receivable balance is? The average term to maturity and kind of conviction level in the collection.

LARRY FROOM

Hi Mario. So, you're asking about the remaining mortgage receivable balance we have on the property we just sold Telus Burnaby. That's our biggest mortgage receivable remaining. I think it's about $55 million. We have 160 Elgin, which was on the balance sheet at September 30th for $20 million which we got repaid on October 1st. We had our First Tower in Calgary, about another $20 million, and we had two or three other

mortgage receivables on land in the US for the remaining balance of our mortgage receivable, the average term for those, I'll have to get back to you on the average term. I don't have that in front of me.

MARIO SARIC

Okay.

TOM HOFSTEDTER

It's around four to five years.

MARIO SARIC

And presumably you feel pretty comfortable with the disclosed balance today?

TOM HOFSTEDTER

Yes.

MARIO SARIC

In terms of collection?

TOM HOFSTEDTER

Yeah.

MARIO SARIC

Okay, thanks guys.

OPERATOR

Thank you. The next question comes from Matt Kornack at National Bank Financial. Please go ahead.

MATT KORNACK

Good morning, guys. Just quickly, on the office de-leasing program, can you give a sense as to how much NOI is maybe generated by the development-oriented assets and how you see that NOI coming off? I know 53 and 55 Yonge sounds like you're going to demolish the building and leave it as land for a period of time, but just want to get a sense as to the earnings impact of that before you ultimately monetize it.

TOM HOFSTEDTER

So 53-55 is scheduled for demolition, I think in around four weeks or so. We've done a deal with the tenant to buy-out. It's around 145,000 square feet, including 53 Yonge call at 150,000 square feet, and it was leased around $12 a square foot. That was past tense again. We did a buyout. So, it's slated for demolition. Demolition will take around one year.

LARRY FROOM

Hi, Matt, and just to add on to what Tom's saying for your first part of the question, we don't really break out the office NOI between the redevelopment properties but we do break out the fair value from it. You can maybe get a guess from it, but the fair value of those redevelopment properties is around $450 million around that for the four properties we have downtown Toronto, and overall, we haven't broken down the NOI, but for 55 Yonge, it went vacant in August. So, for Q3, we would have had already two months of occupancy and one month of vacancy. So, there is still some to come off for Q4, but we already had part of that vacant in Q3.

MATT KORNACK

Okay, that's very helpful, and then Tom, maybe in terms of the process there, it sounds like you're still going back to get rid of office replacement on a number of these properties. What's the thought around kind of monetizing it through a sale or waiting until you get the approvals, etcetera.

TOM HOFSTEDTER

So in all cases we're going to wait for approvals, but approvals I would say are going to be done by no later than the end of next year for all of these properties. 53-55 will be slated, it will be demolished and be done within a year from now. At that point in time, it will wait for the mark to recover. It is a phenomenal residential site, but the

residential market is horrible right now and we’re just going to have to wait for that. There's no, timing is not of the essence. We have patience for that. 145 Wellington will stay the course. We just are renegotiating with one of the tenants to renew. The rental income will be fine over there. It's probably, I would say five to 10 years, probably closer to 10 years away before we demolish that. We're just going through the rezoning process to put that asset to bed as far as its ultimate value. Again, it's across Roy Thompson Hall, Ritz Carlton. It's a fantastic location. It'll be a beautiful building. The market's there, not there right now. But the office market for that asset is still solid. That won't be a problem. Front Street is the more interesting project. It's three towers. Two will be residential, one will probably be storage or office or something, I don't know. It's also a year away from rezoning and probably what we'll have to wait and see what the resident market looks like. But ultimately that highest and best use will be residential.

MATT KORNACK

Okay, perfect, and then just quickly, not as familiar with the New York City market, but can you give us a sense as to the land and condo market and as it relates to maybe Jersey City and your recent Brooklyn purchase? Is it better there tone wise than what we're seeing in Toronto at the moment or similar?

TOM HOFSTEDTER

Well, pretty well safe to say that anything is better than Toronto. So, how's that for a

starting point? Gowanus is very, very, strong. There's a lot of institutional and large big money managers looking for sites that can build 1,000 units in prime locations. So Gowanus, our plan is to sell it probably in 2025. We're just waiting for some not zoning issues but more environmental issues to finish off over there. That will be in high demand and will sell for a significant dollar amount. There won't be any issue with that at all. Jersey is a very strong residential market. Again, not like Toronto. Jersey, there is some development but Jersey is going to have to wait a little bit for interest rates to come down. It's a large project. We haven't made a decision to pull the trigger on the first phase of Jersey which will be finished, as far as planning goes within around four or five months. At that point in time we'll decide how we want to launch it. I don't think we'll be building it. The market is strong enough. It's waiting for interest rates to come down and that's the only problem in the United States market. Unlike Canada which has a host of other affordable issues that the United States does not have. So, Cove and Gowanus I think long term are good assets. Gowanus will be sold in 2025 and generate a lot of cash. Cove will wait for interest rates to come down and Toronto is wait and see.

MATT KORNACK

Okay, perfect. Appreciate the colour.

TOM HOFSTEDTER

Thanks.

OPERATOR

Thank you. The next question comes from Jimmy Shan at RBC Capital Markets. Please go ahead.

JIMMY SHAN

Yeah, just a couple of quick follow ups on the asset sale. There's also a lot of optimism in the New York office leasing market. So what is your confidence in your ability to transact Two Gotham and then the Couche-Tard GetGo transaction, does that have any implication on the sale of Echo?

TOM HOFSTEDTER

Good questions in both regards, the New York City market, Gotham's market is much stronger than Toronto. Again, I hate to say this because I'm a Canadian and born and bred here, but Toronto is really, really lagging North America as is Canada lagging the United States in a big, big way. The New York office market is getting stronger. There is more importantly than that, there will be a host of probably 30% of the office product that will be reconverted under the program in New York to residential and that will happen sooner rather than later. It will make the buildings that are not viable as office, which are quite frankly a host of buildings because of the age of the buildings, convertible to residential. I expect the United States market to pick up dramatically. Two

Gotham, it's not going to affect its sale-ability. It's a tenant that's using the building completely. It's a perfect location for them. I think we'll have to wait for visibility as to our plan would be to wait and have patience. As the market recovers, we expect the tenant to stay there. It's just a question of what the rental rate would be. So, we're in no hurry to dispose of two Gotham. We'll wait and see on that market. So, Toronto, way behind, New York way ahead, Two Gotham not losing sleep over and Toronto has to wait for the residential market to improve. Echo is an interesting story. The Couche-Tard is a game changer. Not only do we get covenants on the GetGos, Giant Eagle disposes of an asset class within their portfolio that was not a laggard in earnings but was hurting their ability to sell Giant Eagle as a company, because the supermarket chains don't want to take on environmental responsibility nor do they want to get into the oil and gas business. So it now cleans up Giant Eagle. It pays off all the debt of Giant Eagle, Giant Eagle becomes debt free. Our covenant then becomes a very high investment grade tenant although it has no debt. That's a shadow rating, and Couche-Tard now goes to will trade like a Wawa in the market. Probably 5-ish cap as opposed to probably 6 and a half which it was under the GetGo banner. So, it improves all of the metrics, improves the ability for Giant Eagle to be sold and therefore the attractiveness of Echo is a lot better. Our value of our asset is a lot better because the covenant of our tenants is better, and as I said previously, I do expect something to occur by the end of no later than the end of next year.

JIMMY SHAN

Okay, great.

TOM HOFSTEDTER

Thank you.

OPERATOR

Thank you. That concludes today's question and answer session. I will turn the call back over for closing comments.

TOM HOFSTEDTER

Thanks everybody. Have a good quarter.

OPERATOR

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