RPT REALTY
Q3 2019 Earnings Call Transcript

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CALL PARTICIPANTS

EXECUTIVES

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President, CEO & Trustee

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PRESENTATION

VINCENT H. CHAO
Vice President of Finance

Good morning and thank you for joining us for RPT's third quarter 2019 earnings conference call. At this time, management would like me to inform you that certain statements made during this conference call, which are not historical, may be deemed forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Additionally, statements made during the call are made as of the date of this call. Listeners to any replay should understand that the passage of time by itself will diminish the quality of the statements made. Although we believe that the expectations reflected in any forward-looking statements are based on reasonable assumptions, factors and risks could cause actual results to differ from expectations. Certain of these factors are described as risk factors in our annual report on Form 10-K and in our most recent quarterly report on Form 10-Q. Certain of these statements made on today's call also involve Non-GAAP financial measures. Listeners are directed to our third quarter press release, which includes definitions of those Non-GAAP measures and reconciliations to the nearest GAAP measures, and which is available on our website in the “Investors” section.

I would now like to turn the call over to President and CEO, Brian Harper and CFO, Mike Fitzmaurice for their opening remarks, after which we'll open the call for questions.

BRIAN L. HARPER
President, CEO & Trustee

Good morning and thank you Vin. This morning, I will provide highlights from the third quarter, update you on our small shop initiatives, discuss our transactions in the quarter, provide some brief comments about our financing activity, and end my prepared remarks with the key takeaways from the quarter. I will then turn the call over to our CFO, Mike Fitzmaurice who will provide more details regarding our third quarter financial results, review our capital markets activities in more depth and discuss the drivers of our increased guidance for 2019.

Let's start with our results. Our strong third quarter performance reflects our rigorous execution and the embedded value within our revamped portfolio, platform, and our re-energized organization. Nowhere was this more evident than in our 4.7% Same Property NOI growth for the quarter and our YTD Same Property NOI growth of 4.4%. We expect to deliver above-trend growth over the next few years as we stabilize the portfolio through our small shop lease up and targeted remerchandising initiatives, while planting the seeds for sustainable same property NOI growth through contractual rent escalators, increasing the percentage of small shop tenants, and targeted investments in growth markets and high quality assets.

Turning now to leasing activity. We signed 54 comparable and non-comparable leases totaling 228 thousand square feet including 42 comparable leases covering 185 thousand square feet that generated blended rent spreads of 7.1%, modestly ahead of last quarter's 6.2%. Spreads on comparable new and renewal leases were a healthy 7.5% and 7.1%, respectively.

We ended the third quarter at 94.7% leased, up 50 basis points year over year, but down a modest 20 basis points from last quarter. The year-over-year increase in the leased rate was generally broad-based from a geographic and asset type perspective. Our small shop leased rate of 88.2%, was down 60 basis points sequentially, but up 10 basis points year-over-year. The sequential decline was consistent with our forecasts given the expected recapture of four Charming Charlie and three Avenue leases. Our total exposure to Charming Charlie was about 37 thousand square feet at roughly $11.60 per square foot and represents a tremendous opportunity to uplift the rent and tenancy at four of our top centers. We are currently at lease with a national tenant to backfill one of those spaces and are in active negotiations on the others. In the former Avenue spaces, which totaled 13 thousand square feet at average rents of $16.80 per square foot, we are actively negotiating with several tenants and are at lease to backfill one space with a national tenant. In addition, we have made great progress on releasing our two Dressbarn locations that we expect to recapture at the end of the year. We are at lease on one location and under LOI on the other location, each with national tenants at strong releasing spreads.

Occupancy for the quarter was 93.1%, up 70 basis points sequentially and up 230 basis points year over year. Small shop occupancy was 85.7%, up 130 basis points year over year but was flat quarter over quarter as the impact of Charming Charlie and Avenue offset new lease commencements. Some of this quarter's small shop commencements included Athleta and Cycle Bar at Shops on Lane, and Helzberg Diamonds at Woodbury Lakes. We remain on track to achieve our 91-92% small shop occupancy goal over the next few years, which will help us drive towards our small shop target of 50% of ABR. Raising our shop mix will not only improve our already healthy tenant recovery ratio and boost our average portfolio rent escalators but will also help us curate a better tenant experience while meeting market demand.

With this quarter's strong performance, we continue to build our operating and executional track record. Over the past twelve months, we have generated a 9.6% blended rent spread on 176 comparable lease deals covering almost 900 thousand square feet, including a 25.2% spread on comparable new lease deals. We have also increased occupancy by 230 basis points over the past year, driving average quarterly same property base rent growth of 4.0%, which in turn has been the key driver of our industry leading average same property NOI growth of 3.9% over the past twelve months.

Our leased versus occupied spread ended the quarter at 1.6%, down 90 basis points from last quarter, highlighting the strong collaboration between our leasing, construction, and asset management teams that allow us to quickly turn leasing activity into earnings. The current leased versus occupied spread represents $3.3 million of signed but not commenced annualized base rent that is expected to commence over the next 12 months, most of which will come online in the fourth quarter 2019. We are also actively working on our 2020 leasing plan with 60% of the 2020 plan already signed at the end of the third quarter providing us confidence and visibility into what should be another strong organic growth year in 2020.

Turning to redevelopments, we continue to make progress on a number of fronts, but I wanted to highlight activity at our Parkway Shops property in Jacksonville, FL. Here we are completing site work in preparation for a new ground lease pad with Aldi. Additionally, we are concurrently working on completing a land-use modification on a ground lease with a residential partner that will add approximately 280 residential units to the site, utilizing undeveloped land for the highest and best use, and doing so in a very low risk manner to RPT. This densification will create an opportunity for additional small shop space, which will allow for a different tenant pool and higher development returns. We think this is a great example of our approach towards development and redevelopment that maximizes value while limiting risk.

On the disposition front, during the quarter we sold our last remaining joint venture property, Nora Plaza in Indianapolis for $29 million, receiving $2 million for our 7% stake, further reducing our exposure in non-core markets. As we have noted in the past, proceeds from future dispositions will be redeployed into acquisitions that meet our rigorous property, market, and financial underwriting criteria on a match funded, leverage and earnings neutral basis. We are actively combing our target markets for off market investment opportunities in Austin, Nashville, Orlando, Minneapolis, Richmond, and Raleigh, just to name a few.

Without stealing Mike's thunder, I also wanted to highlight the terrific job that the finance team did this quarter in negotiating and executing on $660 million of debt transactions which, upon final close, will drive earnings accretion, extend debt duration, and significantly reduce our refinancing needs through 2021.

And with that, I'll turn the call over to Mike.

MICHAEL P. FITZMAURICE
Executive Vice President, CFO & Secretary

Thanks Brian and good morning.

Today, I will discuss our above-plan third quarter financial results in more detail, our financing activities in the quarter and end with additional color regarding our improved 2019 outlook.

Starting with results, same property NOI growth was ahead of our internal projections at 4.7% for the quarter driven by base rent growth of 3.5%, which contributed 3.7% of our same property NOI growth, with lower non-recoverable expenses contributing about 60 basis points to growth.

As outlined in last night's release, we are again raising our same property NOI growth assumption for 2019. We now expect same property NOI growth to end the year between 3.75% to 4.25%, a 25-basis point increase at the midpoint. The uplift in our outlook reflects our outperformance in the quarter and the high visibility we have over the balance of the year, with close to zero speculative leasing risk remaining in 2019. While we are optimistic to the high end of our same property NOI growth range, unplanned store closures remain a possibility and we continue to model a credit loss reserve of 60 basis points in the fourth quarter.

Moving to earnings, Operating FFO for the third quarter was $0.28 per share, which was ahead of our own internal projection. Upside to our plan for the quarter was driven by higher-than-expected same property NOI and a $1.4 million acceleration of a below market lease related to the recapture of our Charming Charlie leases. Given the better-than-expected performance in the quarter we are raising our 2019 Operating FFO per share guidance to $1.08 to $1.10, up from $1.07 to $1.09, a one cent increase at the midpoint.

Turning briefly to the balance sheet, we ended the third quarter with ample liquidity to fund our business plans with almost $400 million of total liquidity, including full availability on our $350 million line of credit and $48 million of cash. Our net debt to annualized proforma adjusted EBITDA was 6.6x at the end of the quarter, unchanged from last quarter and consistent with our expectation of remaining near the mid-6x's level as we execute on our targeted remerchandising and small shop leasing initiatives, before falling towards our longer term goal of 6x.

Now I'd like to spend a moment discussing our financing activities. One of our strategies is to maintain a conservative and flexible balance sheet to support our growth initiatives as well as to protect the company during more challenging times. I am happy to report that we made great progress on this front while taking advantage of the still very low interest rate environment. Given the amount of detail that we provided in our separate press release regarding our financing activities, I will only highlight the key takeaways once the transaction closes in the next few weeks. First, we will have extended our average debt maturity to five and a half years up almost one year from 4.6 years at the end of the third quarter. Second, we will have significantly reduced our debt maturities through 2021 to just $62 million or about 7% of our total debt over the next two years. And lastly, we will have done all of this while generating roughly one cent of annualized interest expense savings. I want to thank our banking partners for helping us achieve what I believe is a win-win for all parties. While I'm happy with these results, we will continue to look for opportunities to push out maturities, reduce refinancing risk and lock in today's attractive rates.

As you begin to model 2020 earnings, I'd like to point out a few items. First, keep in mind that we have already signed new leases in 2019 that will generate $10.8 million of annualized base rent, which should contribute roughly $5.3 million of base rent in 2019 and an incremental $5.5 million in 2020 providing a solid base for another strong year of Same Property NOI growth. Second, as I mentioned in my earlier remarks, we expect to have approximately one penny of interest expense savings as a result of our refinancing activities in the fourth quarter of this year. And lastly, we experienced a total of $0.03 of non-cash revenue benefit from the acceleration of below market leases related to the early termination of a few leases in 2019 that we expect not to re-occur in 2020.

Before turning over the call to the operator, I want to point out a change in this quarter's supplemental. You may have noticed that we are now providing our non-cash revenue and expense breakouts along with our discretionary and non-discretionary capex spending on page 10 of our supplemental. Though this is not new information, we consolidated these items on one page based on feedback from the investor and analyst community. We hope you find this change helpful.

With that, operator, please open the line for questions.

QUESTION & ANSWER

OPERATOR

[Operator Instructions] Our first question is coming from Derek Johnston of Deutsche Bank.

DEREK JOHNSTON
Deutsche Bank AG, Research Division

Can you talk about the same-store NOI strength? I mean you guys run a pretty nimble portfolio. Was the print driven by a few assets?

BRIAN L. HARPER
President, CEO & Trustee

I'm extremely pleased. It was really broad-based across the platform and across our geographic footprint. And if I were to say the -- at the top of that list, Minneapolis -- our 2 Minneapolis properties, our Columbus asset, Atlanta assets and our one asset in Colorado were the highest performers. But I'm really pleased that was really broad-based and was not an anomaly with 1 or 2 assets. Now I'll say to this is we really have -- 99% of our team is decentralized -- of our leasing team is decentralized in these territories for these assets. And they're proactively approaching these tenants and these troubled tenants, and our asset management team is laser focused on expenses. I can say we're studying every square inch of this portfolio and trying to maximize value where we can.

DEREK JOHNSTON
Deutsche Bank AG, Research Division

Okay. Great. And then just shifting to private markets. How are cap rates trending? How competitive are deals with other investors? And specifically on the acquisition front, what kind of opportunities are you guys seeing out there right now?

BRIAN L. HARPER
President, CEO & Trustee

Yes. Let me answer your cap rate questions. They're holding. Depending on the asset size -- and we're really seeing it more competitively at $50 million and under, more people show up at the table. So that could lay an opportunity for us of north of that, but that could be an opportunity to get under $50 million for off-market transactions. I'm really pleased with the pipeline. With my rolodex, with Courtney's rolodex, with Tim's rolodex, we're seeing a lot of off market activity, which is really encouraging. And that off-market activity is in these growth markets such as Nashville, Austin, Tampa, Minneapolis, Miami, Orlando, Raleigh and Richmond. So we're really focused on grocery with convenient neighborhood retail, as well as some potential street retail down the road.

OPERATOR

Our next question is coming from Craig Schmidt of Bank of America.

CRAIG RICHARD SCHMIDT
Bank of America Merrill Lynch, Research Division

Yes. I just wanted to focus on the small shops. I heard you obviously want to obviously raise the number for that benefit but also boosting curation and a better tenant experience. If you could outline either the type of tenants or the tenants themselves that you are looking to target to add to your centers.

BRIAN L. HARPER
President, CEO & Trustee

Yes. Thanks, Craig. So we're really focused on service providers, and that service could be bank, financial institutions. That could be your dry cleaners. And we're doing some medical deals as well. We've talked about the 3 Fs of fitness and food -- and the food could be fast casual or sit-down restaurants, and then cosmetics. We really feel we're doing a lot with Sephora and looking to do some deals with the Bluemercuries of the world and others and certainly have done a whole host of deals with ULTA. So really between those and really having the right appropriate mix by each asset, that's really where we're focused on.

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

And Craig, the only thing I would add to that is at the end of the quarter, we ended small shop occupancy at 85.7%. Based on the visibility we have today, we should end the year right around 87%, positioning us to get to that 91%, 92% goal. And if you look back at the last 5 quarters, we've done about 20,000 of positive net absorption per quarter. So if you extrapolate that out and assume that over the next 2 years, that'll put us right at the midpoint between 91% and 92%.

CRAIG RICHARD SCHMIDT
Bank of America Merrill Lynch, Research Division

Okay. And then just out of curiosity, is there much difference between like a general merchandise tenant rent versus a service provider rent?

BRIAN L. HARPER
President, CEO & Trustee

Really depends. I mean we like to say every day we try to create tension in the market. So it depends on the space, and it depends on the center. So you could have some financial institutions. Yes, it really depends on the market demand. And we really -- that's our whole point of getting this portfolio into this small shop ratio, where really the demand is under the 5,000 square feet of small shop space.

OPERATOR

Our next question is coming from Floris van Dijkum of Compass Point.

FLORIS VAN DIJKUM
Compass Point Research & Trading, Research Division

I wanted to ask you about the outstanding preferreds. There is a conversion feature, I believe, at a price below where your shares are currently at. How do you think about that going forward? And what could that do in terms of obviously reducing your comprehensive leverage but also dilution?

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

This is Mike. Like what we've done with the entire portfolio on the leasing side and the balance sheet side, we're pretty proactive about everything that we do here. And you see that with the capital markets activity that we're going to experience here in the fourth quarter to recast the credit facility. So the preferreds are definitely top of mind given the higher rate that’s associated with those -- that debt instrument. But the forced conversion price on that isn't below what we're trading at today. It's actually above. It's about $17.50, which limits the opportunity to possibly tender those. But we're still exploring the opportunity to see if we can, at some point in the future, get those back and recycle into lower-cost debt.

FLORIS VAN DIJKUM
Compass Point Research & Trading, Research Division

Great. And then a follow-up question, I guess, related to what Craig talked about before. But you guys have done a really nice job in increasing the occupancy, which obviously drives your same- store numbers. The – how much -- do you think there's any more room on the anchor side? The anchor has seen the largest increase in occupancy gains. Do you think there's more juice in -- on your anchor occupancy going forward?

BRIAN L. HARPER
President, CEO & Trustee

We do. I mean we really see a 98% number on that for overall. And I mean you've seen our yields or have heard about our yields in double digits on this targeted remerchandising. And really, a lot of that has resulted in our same-property NOI growth, kind of sector-leading. So we are extremely proactive. We're looking out to 2022, trying to recapture some of these tenants that might not have the best balance sheets or might not be doing the best sales at certain centers. We have a plan in place for that, and our goal is 98%.

OPERATOR

[Operator Instructions] Our next question is coming from Collin Mings of Raymond James.

COLLIN MINGS
Raymond James Ltd., Research Division

Brian, can you just expand on your comments regarding the redevelopment pipeline just beyond Parkway Shops? Can you just elaborate on potential capital that you're going to commit on that front looking ahead to next year?

BRIAN L. HARPER
President, CEO & Trustee

Yes. I mean I don't want to get into the capital side. But I would say this, Collin, that we are looking at mitigating risk. And so why I like Parkway where -- it was as much master planning as it is redevelopment. So what we've done there is we've taken a few acres that have never been used and we're ground-leasing to a leading residential unit -- or owner that is going to build 279 units and we'll build 20,000 square feet of ancillary retail. Most of that will be service. We're doing -- looking at doing the same thing in Deerfield Beach at Rivertowne where we're in entitlements right now. That could be a much larger number of residential units, again giving that to – ground leasing that or potentially even selling the parcel to a leading residential partner. We have the same thing in the shadow pipeline of Delray and potentially at Shops on Lane in Columbus, Ohio. So really, until we get through entitlements, until we have precision with the numbers, then we'll share the final cost for that. But it's a balance of that development versus where we can attract. I love this targeted remerchandising plan. We're getting double-digit yields, and that's hitting our cash flows much faster than a longer-term development usually does.

COLLIN MINGS
Raymond James Ltd., Research Division

Fair enough. So it sounds like just right now, from a strategic standpoint, there's a lot of focus on what you can do maybe from a ground leasing standpoint as opposed to putting a lot of capital into any sort of significant redevelopment or development. Is that fair?

BRIAN L. HARPER
President, CEO & Trustee

Correct. I would look at this as a master planning as much as a redevelopment and where we can extract risk and do a 99-year lease. And that gives us optionality to either hold that lease or potentially even sell it for an attractive cap rate.

COLLIN MINGS
Raymond James Ltd., Research Division

And that's an interesting point there, Brian. Maybe just -- you can just remind us how you think about that trade-off between the potential optionality of selling something versus what you could argue would be kind of lower-risk cash flow with some of the ground lease opportunities. Can you just maybe talk about that trade-off as these projects move further along?

BRIAN L. HARPER
President, CEO & Trustee

Yes. We're very earnings-focused, and we look at CAGRs, we're a bottom-up IRR company, and where we can trade at an accretive perspective. I mean if some of those ground leases you can maybe argue a 3% or 4% cap and trade that into a much higher cap where we can have a 3% or 4% or 5% CAGR – annual CAGR, that's something we'll look at. So it's really IRR-driven and where we can accretively deploy capital.

OPERATOR

This brings us to the end of our Q&A session. I would now like to turn the floor back over to Brian for closing comments.

BRIAN L. HARPER
President, CEO & Trustee

Before ending the call, I want to highlight what we believe are the key takeaways from the quarter. First, the operating momentum in our business continued in the third quarter as evidenced by our strong quarterly and year-to-date same-property NOI growth, leading us to once again raise both our same-property NOI growth and our OFFO per share guidance. Second, we expect this momentum to continue into 2020 given the annualization of our 2019 leasing activity and with 60% of our 2020 leasing plan already signed. RPT is setting up for another above-trend year of organic growth in 2020. And third, we are a proactive company that is constantly scouring our business for opportunities to drive growth and reduce risk, highlighted this quarter by our $660 million of financing activities. We've made a lot of progress in a short period of time, including closing in on our best year of same-property NOI growth in over 10 years. But what I'm most excited about is that we are just getting started. Thank you for joining us this morning. We're looking forward to seeing many of you in a couple of weeks at NAREIT. Happy Halloween.

OPERATOR

Ladies and gentlemen, thank you for your participation. You may disconnect your lines at this time, and have a wonderful day.