RPT REALTY
Q2 2019 Earnings Call Transcript

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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 second Quarter 2019 Earnings Conference Call. At this time, management would like me to inform you that certain statements made during the 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 and 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 second 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 would like to provide highlights from our quarterly results, update you on our small shop and remerchandising initiatives, comment briefly on our capital recycling plans and end with a discussion of recent organizational changes. I will then turn the call over to our CFO, Mike Fitzmaurice, who will provide more details regarding our second quarter operating and financial results and discuss the drivers of our increased guidance for 2019.

As I mentioned on our last call, with the completion of our foundational work in 2018, we have now turned our organizational focus towards leasing, leasing and leasing. On this front, I am happy to report yet another strong operating quarter, headlined by better-than-expected same-property NOI growth of almost 4%, putting year-to-date same-property NOI growth at 4.2%. Growth in the quarter and over the past few quarters was again driven by the success of our leasing platform with 62 leases covering 339,000 square feet signed in the quarter. Blended rent spreads on comparable leases averaged 6.2%, including 5.5% on renewals and 19.7% on new leases. This quarter's rent spreads were negatively impacted by a single anchor renewal, without which, the blended and renewal spreads would have been 8.7% and 8.2%, respectively.

Second quarter leasing activity pushed our leased rate to 94.9%, up 10 basis points quarter-over-quarter and 100 basis points year-over-year. Economic occupancy was 92.4% at quarter end, up 60 basis points, sequentially, and 160 basis points year-over-year. This 250 basis point spread between leased and economic occupancy represents $4.5 million of future annualized base rent, of which $4 million is expected to commence by the end of the year, providing us with great comfort in our ability to achieve our increased 2019 targets. And combined with our total leasing activity this year, we feel good about the trajectory of our performance headed into 2020.

Turning to our small shop and our targeted remerchandising initiatives. We ended the quarter with a small shop lease rate of 88.8%, down 80 basis points sequentially, but up 160 basis points year-over-year. This sequential decline in our lease rate was consistent with our expectations, given expected move-outs, particularly Payless shoe store. Importantly, economic occupancy was up 70 basis points sequentially to 85.7% in the second quarter and up 150 basis points year-over-year. We remain on track to hit our small shop occupancy goal of 91% to 92% over the next few years. On the remerchandising front, we signed a lease with Burlington at River City Marketplace, replacing half of a former Gander Mountain at an attractive 17% return on capital. With this lease, I'm happy to report that we now have signed leasing activity on 18 of our 20 identified remerchandising projects, which add dynamic tenant categories that enhance the consumer experience at these properties. It's also worth noting that we do not expect any further rent declines from our remerchandising program as all 20 of our targeted remerchandising projects are already vacant with upside from rent commencement to pick up significantly in the fourth quarter 2019 and to be almost fully in the run rate by early 2020.

While I'm pleased about our second quarter performance, what I'm most proud of is the consistency of our results over the past several quarters. The real estate and operating platform improvements that we made in 2018 have driven strong and consistent quarterly performance. Over the past 12 months, we have generated an 8.8% blended rent spread on 186 comparable leasing deals, covering almost one million square feet, including a 26.7% spread on comparable new lease deals. This has fueled our third consecutive quarter of at least 4% growth in same-property base rent, which, in turn, has been a key driver behind our same-property NOI growth that has averaged over 3.5% over this period.

Last quarter, we completed our disposition program, which was focused on balance sheet and portfolio de-risking. With the sale of the Shoppes at Fox River in Q1, we have turned the page on earnings dilutive net asset sales with our future investment focus now on capital recycling activities. Following the completion of our disposition program, we now derive over 96% of our annual base rent from the top 40 MSAs, where retailer demand is focused. In the coming quarters, we will be looking to exit slower growth markets and properties and to match fund these sales into target markets that we've previously discussed, such as Nashville, Miami, Raleigh, Charlotte, Orlando, Tampa and Minneapolis. We see greater potential for long-term growth in these markets, driven by population, household wealth and pro-business trends, and it is where our retailers want to be. Our investment activities will be viewed with an eye toward improving the long-term growth profile and quality of our portfolio on a leverage and near-term earnings neutral basis.

As we move into the capital recycling phase of our investment program, I could not be more pleased to announce the hiring of Courtney Smith, who started on July 22nd, as Senior Vice President of Investments. Courtney brings a wealth of transaction experience over his career. He is highly regarded within the industry. And most importantly, is a perfect cultural fit for our organization. I also want to take a moment to thank Cathy Clark, our former EVP of transactions for her many contributions to RPT over her 22 years of service.

I also want to highlight an organizational change with our board. I'm happy to report that on June 27, the board elected David Nettina, as the Chairman of the Board, a position that has been vacant since September 2018. RPT has benefited tremendously from David's Counsel and his 10 years on the board, and we look forward to his continued leadership as new chairman. This appointment marks the end of our board refresh, which saw us bring in 3 new independent board members, reduced our average tenure to 6 years from 18 years and brought our independent board into gender balance, which is unique within this industry.

In summary, the strength that we experienced earlier this year has continued, and our outlook remains optimistic to the upside. Moving beyond 2019, we are harvesting plenty of leasing and redevelopment opportunities to continue to drive growth while we thoughtfully recycle assets into higher growth markets with the objective of improving the risk and growth profile of our business. With that, I would now like to turn the call over to our CFO, Mike Fitzmaurice.

MICHAEL P. FITZMAURICE
Executive Vice President, CFO & Secretary

Thanks, Brian, and good morning. Today, I will discuss our above plan, quarterly financial results in more detail and provide some additional color regarding our improved 2019 outlook.

Same-property NOI growth was 3.9% for the quarter, driven by base rent growth of 4%, partially offset by lower net recoveries due to a tough year-over-year comparison that we mentioned last quarter. Same-property NOI growth was ahead of our internal projections, driven by earlier than expected lease commencements, percentage rent, higher net recoveries and better-than-expected tenant credit losses.

As outlined in last night's release, we are raising our same-property NOI growth assumption to a new range of 3.25% to 4.25%, a 100 basis point increase at the midpoint. This increase is a direct result of our strong quarterly performance as well as our increased visibility regarding the balance of the year with over 95% of our leasing plan complete, limiting speculative leasing risk to our estimates. We do not anticipate any notable abnormal quarterly cadence over the balance of the year. However, we continue to model a credit loss reserve of 60 basis points per quarter over the balance of 2019 to account for unplanned store closures.

As you start to think about 2020, keep in mind that we have already commenced new leases this year that will generate $9.9 million of annualized base rent, which should contribute roughly $5.2 million of base rent in 2019, leaving an additional $4.7 million that is scheduled to be fully realized in 2020, setting us up for another year of solid same-property NOI growth.

Turning to earnings. Operating FFO for the second quarter was $0.27 per share and ahead of our internal plan. 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 at our Deerfield Towne Center. Our outperformance has enabled us to raise our 2019 operating FFO per share guidance to $1.07 to $1.09, up from $1.04 to $1.07. A two and half cent increase at the midpoint.

It is worth noting that while the acceleration of the below market lease in the second quarter is a noncash item, we believe it is reflective of the proactive nature of our leasing team. We were able to recover dark space seven months ahead of the expiration to facilitate the earlier opening of two new tenants that will collectively generate nearly $40 per square foot in rent at a 165% re-leasing spread and a 21% return on incremental costs. Clearly, a win for our portfolio.

Turning briefly to the balance sheet. As discussed on the last call, during the second quarter, we utilized a portion of our disposition proceeds to repay our 6%, $28 million junior subordinated notes, reducing our floating rate debt exposure to ZERO. Despite this use of cash, we ended the second quarter with ample liquidity to fund our current leasing plans with $350 million of availability on our line of credit and $47 million of cash. We ended the quarter with net debt to annualized pro forma adjusted EBITDA at 6.6x, flat from last quarter. We continue to expect leverage to hover in the mid 6x range over the next few years before moderating to our longer-term goal of about 6x. Though we feel good about our balance sheet position, we anticipate refinancing our 2020 and 2021 term loans and recasting our line of credit in the second half of 2019, with the goal of pushing out maturities, reducing refinancing risk, locking in today's attractive rates and reducing interest expense volatility.

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

QUESTION & ANSWER

OPERATOR

[Operator Instructions] Our first question is from the line of Todd Thomas with KeyBanc.

TODD THOMAS
KeyBanc Capital Markets Inc., Research Division

First question, Mike, the same store is running 4.2% year-to-date. The range is 3.25% to 4.25%. So you're at the high end. Just curious if there's any -- are there any known closures or move outs? Or anything we should think about, even below the minimum rent line that might impact same-store NOI growth throughout the balance of the year?

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

No, I don't think so Todd. As you pointed out, the math would suggest that we're going to be right around the midpoint of a range around 3.5% in the back half of the year. As Brian mentioned in his prepared remarks, we are optimistic to the high end of the range at this point in the year. We don't expect a significant deceleration in the second half. But 2 things I would point out, we're cycling through a tougher comp in the fourth quarter of '18, which was 4.3% growth. And that fourth quarter number reflected a credit loss expense of only about 51k. And as I mentioned in my prepared remarks, we have about $220,000 per quarter. So that's a headwind there. But outside of that, there's not much more. So, we expect to be pretty consistent within the range.

BRIAN L. HARPER
President, CEO & Trustee

And Todd, this is Brian. I just want to add a couple of things. Just on the visibility relating to Charming Charlie in particular, we've already modeled those closures in for end of August. We see great upside in that. That's $430,000 of gross ABR, which is $11.50. So, I'm eager to get those keys. We think re-leasing assumptions, minimum, $20 a square foot, some of them even $40 a square foot if we divide those boxes.

TODD THOMAS
KeyBanc Capital Markets Inc., Research Division

Okay, that's helpful. And then also, Mike, your comments about 2020. I think you said there will be $4.7 million of incremental ABR that will positively impact 2020 from the 2019 commencements. That alone is running close to 3% growth for base rent. So it seems like you're trending toward a similar range, maybe in the 3.25% to 4.25% range. That's in place for 2019. Is that the right read? Or is there anything specific we should be thinking about?

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

No, I think that's pretty close to the right read Todd, and that's the reason why we gave those numbers and absent anything else happening within our portfolio in terms of fall out, or any new leasing activity that is yet to be signed or we'll continue to sign in the second half of the year and into 2020, we should be at the minimum a 3% company next year.

BRIAN L. HARPER
President, CEO & Trustee

And Todd, a lot of that, too, is the SNO of the 18 of the 20 boxes already signed that they're opening end of '19 and early '20, which gives us great visibility into '20 as of now. So we're very excited about '20 and eager to talk more about '20 in the future quarter.

TODD THOMAS
KeyBanc Capital Markets Inc., Research Division

Right. And then, between the 20 anchor boxes, 18 of which have been addressed and the $4.5 million of ABR from the SNO bucket, can you sort of break that out or remind us what's attributable to redevelopment versus what's not part of the redevelopment?

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

Sure. I can talk about the 20 boxes. With the 20 boxes about $5.2 million of annualized base rent coming from those within the quarter, we had about $400,000. And then that number should stabilize, like Brian said, in the first quarter of '20 at about $1.3 million, to get the incremental of about 900 grand, or so to hit thus far on a quarterly basis.

OPERATOR

The next question is from the line of Collin Mings with Raymond James

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COLLIN MINGS
Raymond James Ltd., Research Division

First question for me, just kind of following up on Todd's a bit. Just in the prepared remarks, again, you referenced, I think it was $4 million that you expected to commence before year-end. But just over the last few quarters, we've heard of many issues that have delayed rents commencing for, I get for a variety of different reasons. Can you maybe just discuss a little bit more, your confidence in the timing of some of these move-ins?

BRIAN L. HARPER
President, CEO & Trustee

Hey Collin, this is Brian. I'll answer that. So we haven't experienced any of the delays. And I really attribute that to the collaboration between leasing and tenant coordination and our construction departments. We're proactive with the tenants even before leases are signed. We're negotiating and spending money, where we have the multiple TJX and Ross' where we know they'll execute those leases. So we're actually seeing some uptick on opening tenants sooner. So it's almost the reverse here. Now with 49 assets and very in the weeds space by space and putting these institutional practices in place that we did day 1. I think a lot of that contributes to that. So we're very confident. And again, where we sit, certainly for 2019 and well into '20.

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

Yes. A great example of that is what we experienced this last quarter with a Burlington deal down in River City in Florida. We expected that to open in the fourth quarter of 2020. But given the collaboration between leasing, construction, and tenant coordination in addition with the tenant, we were able to get that tenant open in the fall this year.

COLLIN MINGS
Raymond James Ltd., Research Division

Okay. That's helpful color there. And then, Brian, just going back to the prepared remarks as far as opportunities for match funding moving forward. Just are you actively pursuing any acquisitions right now. Is there anything specifically in your pipeline there. I know we discussed some of those targeted markets longer-term before. But just, again, with a lot of the heavy lifting done in terms of cleaning up the portfolio. And as you articulated in the strategy going forward. Just curious, kind of how far you moved down the path here of actually pursuing some of these opportunities?

BRIAN L. HARPER
President, CEO & Trustee

No, I mean, Courtney, as I mentioned, in my prepared remarks brings a wealth of knowledge, with his database. But that said he is walking into a pretty darn good pipeline. So we've identified the markets where we want to further expand. And these are just examples. There'll be markets outside of those from the natural, Orlando, Miami, Tampa, Raleigh, Charlotte, Minneapolis. I believe in market concentration. So we look at asset classes here. And we say, there'll be a spectrum of it, where there could be some opportunistic deals, where we do have assets in the market where we know tenants are moving too. So opportunistic and core. We're active. We're playing offense, and we're looking at assets where I’ve said time and time again, we are a bottoms up IRR company. So where there might be a slower growth asset within our portfolio. We'll trade that at an attractive cap rate for a higher growth asset at equal or higher cap rate. So again, I just want to emphasize, this will be earnings, at least earnings neutral may be accretive and certainly leverage neutral.

COLLIN MINGS
Raymond James Ltd., Research Division

Okay. And you feel at this juncture, you're in a position to be bidding on assets given the team and the balance sheet, and everything where you're in the market currently?

BRIAN L. HARPER
President, CEO & Trustee

Yes. Again, this is a win. So if there's dispositions, they will be carefully weighed with acquisitions. So it's not going to be buying without a disposition.

COLLIN MINGS
Raymond James Ltd., Research Division

Got it, understood.

BRIAN L. HARPER
President, CEO & Trustee

That's our currency, as of today.

COLLIN MINGS
Raymond James Ltd., Research Division

Understood. One last one for me, and I apologize if I missed in the prepared remarks, but just in the press release, I believe there was reference to 1 strategic anchor renewal that weighed on results. Can you maybe just expand on that? Again, I apologize if I missed that already.

BRIAN L. HARPER
President, CEO & Trustee

It was an office renewal option, office tenant renewal in one of our Chicago assets, and it's just from a cost of capital perspective, it was an above-market lease. I felt it prudent just to renew it at a lower spread, reduce our capital expenditure and look at other alternatives at a later date.

OPERATOR

[Operator Instructions] The next question is from the line of Derek Johnston with Deutsche Bank.

SHIVANI SOOD
Deutsche Bank AG, Research Division

This is Shivani Sood on for Derek. Brian, in your opening remarks, you mentioned some of the recent changes to the board. Can you give us some color on how the new composition might be influencing how RPT is thinking about the company's strategy or vision?

BRIAN L. HARPER
President, CEO & Trustee

Yes, sure, hi Shivani. I'm excited about the board. I thought the nominating Governance Committee did a very, very excellent job and a thorough search across the country. Early innings, we identified skill gaps on our board and then really used those skill gaps to really seek out those individuals, those skill gaps that were in need were certainly hospitality, digital and retail. With that said, we have expertise already on the board with real estate and finance. So we added 3 leading either current or former leaders of major companies within those sectors of hospitality, digital and retail. And as I mentioned previously, we bring, with these 3 new independent board members, the board into a gender balance. I can say I'm equally excited about the appointment of David Nettina as our Chairman. David is a very highly impactful leader, as he demonstrated for 10 years as a member of our board. He will be a very important figure to myself and the management and advancing our governance initiatives here at RPT. We have established a very, very strong working relationship, and I'm extremely excited to be working with him alongside him for years to come.

SHIVANI SOOD
Deutsche Bank AG, Research Division

Great. And then at Nareit, there was some discussion of potential redevelopments, I think Rivertowne and Webster Place were mentioned. I noticed that they're not included in the active pipeline yet. But just wondering if you can share some incremental color there?

BRIAN L. HARPER
President, CEO & Trustee

Yes, sure. So both of those -- I mean, it's really about -- depending on where we're at, Florida is faster through entitlement process than Chicago, but figure a 12-month process through entitlements of Rivertowne down in Deerfield Beach, just outside Miami and Boca. We're in the midst of entitling. We're looking at 600 residential units, of which we'd either ground lease or sell to a multifamily partner. There's great demand from resi, and there's great demand for the 60,000 to 70,000 square feet of retail, that will we will be developing there. I think at the end -- towards the end of this year, we'll be giving you some numbers on that. It's always a -- we believe in precision here. And with entitlements, you just don't actually know for accuracy. You don't get true accuracy until you come out. But we're really excited with that. We do expect that project to start early '20 and open in late '21. As far as Chicago, there are a number of tenants floating around to really potentially backfill the Barnes & Noble box as Phase 1. And then Phase 2 would be residential, which we're in the early innings there of entitlement there. So again, another asset that we'll be giving more color in later quarters.

OPERATOR

Our next question is from the line of Craig Schmidt with Bank of America.

CRAIG SCHMIDT
BofA Merrill Lynch, Research Division

I was just looking at the small shop space. And the leased occupancy was down 80 bps, but the occupancy was up 70 bps. If you could just explain the components of that, whether it's SNOs or whatever? And then where do you expect lease to be by the end of the year? Small Shop.

BRIAN L. HARPER
President, CEO & Trustee

Yes. So let me give you some color, Craig, on the 80 bps decrease quarter-over-quarter. I mean, really, we knew this was coming. We've recaptured weaker tenants, such as the Payless, Ascena, and Francesca's. So I look at this as effectively as saying, our portfolio was de-risked, and there's greater value to be had on leasing that. We did also recapture 2 spaces at Shops on Lane, which is our Whole Foods center in Upper Arlington, Columbus. Where to execute on our redevelopment plan there. As I said, we are 70 basis points of sequential increased to 85.7%, which again signals we're on track to achieve our small shop occupancy target of 91% to 92% over the next couple of years.

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

Yes. So by the end of the year, I'm not going to give you any prognosis on what the lease rate will be, Craig, but I can give you what the occupancy rate is going to be. At this point, like I said, we ended the quarter at 85.7%, I think we're going to be between 86% and 87% occupied by the end of the year.

CRAIG SCHMIDT
BofA Merrill Lynch, Research Division

And that includes the Charming Charlie's shaking out?

BRIAN L. HARPER
President, CEO & Trustee

That's correct.

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

That's correct.

OPERATOR

Our next question is from the line of Michael Mueller with JPMorgan.

MICHAEL WILLIAM MUELLER
JP Morgan Chase & Co, Research Division

A question. So on the $4.7 million of base rent that's going to be coming on next year. You also mentioned about $5.2 million, I guess, tied to 20 boxes. How much of the $5.2 million is embedded in that $4.7 million? Or is it above and beyond that? I mean, how should we...

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

Sure, sure, Mike. The entire $5.2 million is embedded in that $9.9 million number that we mentioned in our prepared remarks. We have $5.2 million of rent contribute in '19, and we have additional $4.7 million contributed in '20. In terms of the run rate for what we recognized in the quarter associated with that $9 million. We had about $1 million in Q2, and we expect that $9 million to stabilize in the quarter, quarter 1 of next year in 2020 and will stabilize at $2.5 million. So the incremental between what we have running through the quarter today of $1 million versus the $2.5 million is $1.5 million.

MICHAEL WILLIAM MUELLER
JP Morgan Chase & Co, Research Division

Got it, and that would take your occupancy, I know you just commented on shop occupancy, but your overall occupancy is at 92.4%, where would that put that at the beginning of next year?

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

Yes. I think it's pretty close to 94% by the end of the year then.

BRIAN L. HARPER
President, CEO & Trustee

Overall, not small shop.

OPERATOR

At this time, there are no additional questions. I would like to turn the floor back to Brian Harper for closing remarks.

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, we have now posted 3 consecutive quarters of 4% or better, same-property base rent growth. While we at RPT understand that consistency is measured in years and not quarters. I'm encouraged by our execution to date. Second, the earnings dilution from strategic asset sales is now behind us, and we are looking forward to further improving our portfolio by selectively recycling our capital and redeveloping our centers while maintaining our healthy balance sheet. And finally, with only 2 of our 20 previously vacant targeted re-merchandising spaces left to lease, we are confident in raising our outlook for same-property NOI and FFO per share for the second consecutive quarter. The drivers of the upside will not only benefit our 2019 results but sets us up well for another strong year in 2020 and beyond. Thank you for joining us this morning. Enjoy the rest of your summers.

OPERATOR

Today's conference has concluded. Thank you for your participation. You may now disconnect your lines at this time.