Transcript of
JLL Income Property Trust
1Q19 Public Earnings Call
May 23, 2019

Participants

C. Allan Swaringen – President and Chief Executive Officer
Gregg Falk – Chief Financial Officer
Mallory Becker

Presentation

Operator
On behalf of JLL Income Property Trust, I'd like to welcome you to their first quarter 2019 earnings conference call. This call is being recorded and our audience lines are currently in a listen-only mode. [Operator instructions.] At this time, I would like to turn the conference over to Mallory Becker, from JLL Income Property Trust. Mallory, please go ahead.

Mallory Becker
Thanks, and welcome, everyone, to today's call.

Any statements made about future results and performance or about plans, expectations or objectives are forward-looking statements. Actual results and performance may differ from those included in the forward-looking statements as a result of factors discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, and in our other reports filed with the SEC. The Company disclaims any undertaking to update or revise any forward-looking statements.

In addition, all non-GAAP financial measures discussed during this call are reconciled to their most directly comparable GAAP financial measures in accordance with the SEC rules in our Form 10-Q for the quarter ended March 31, 2019.

Links to a transcript and audio replay of this call will be posted and available on our website, JLLIPT.com. For further information on the Company's performance, we invite you to review our Quarterly Report on Form 10-Q filed on May 8, 2019 and other filings which are available on the Company's website, as well as the SEC's website, sec.gov.

Now I would like to turn the call over to Allan Swaringen, President and Chief Executive Officer and Gregg Falk, Chief Financial Officer. At the conclusion of their comments, we will open the call for your questions.

Allan, if you'd like to begin?

Allan Swaringen
Thanks, Mallory. Hello, everyone, and thank you for joining us for our first quarter earnings call. JLL Income Property Trust continues to focus on managing and improving our $2.6 billion-dollar portfolio of 69 core properties spanning the apartment, industrial, office, and grocery-anchored retail property sectors. In the first quarter, we achieved total net of fees returns of 1.1% on both Class A and M shares. Quarterly dividends have now been paid for 29 consecutive quarters, with an average annual increase of just over 5% over that 7-plus year period. I would like to begin today's discussion by reviewing the economic environment in which we operated, before highlighting some of our specific accomplishments from this quarter.

The real estate market sailed smoothly into 2019, with continued economic growth complementing a real estate market that is seeing broadly balanced tenant demand and new construction and an active environment for buyers and sellers of commercial real estate. Tenant demand is tracking steadily with economic growth. Payrolls have increased for a record 103 consecutive months. Despite slower growth in February according to the Bureau of Labor Statistics data, employment growth averaged 186,000 new jobs per month in the first quarter and the unemployment rate remains below 4%. According to the US Bureau of Economic Analysis, US GDP grew at an inflation-adjusted annual rate of 3.2% in the first quarter. The pick-up in growth was driven by net exports and expanding inventories while consumer spending, typically the biggest driver of GDP growth, rose by just 1.2%. The relatively slow growth in consumer spending is attributed to the partial government shutdown and volatility in financial markets affecting consumer confidence. The performance of the US economy in the first quarter was a surprise to some after sharp stock market declines at the close of 2018. Financial markets rebounded in the first quarter as the Federal Reserve softened their view on future increases in interest rates.

Balanced market fundamentals continue to endure across all four major property types. According to CBRE, over the last year, office vacancies have declined by 50 basis points to 12.5% nationally. Co-working providers, like WeWork, have been a major driver and have accounted for nearly 40% of all net office absorption nationally in the first quarter, according to market tracking by JLL. RealPage reported that national apartment vacancy declined by 20 basis points year-over-year to 4.8%, with tenant demand closely tracking job growth. CBRE data on warehouse vacancy indicates a decline of 10 basis points over the last year to 4.5%. The tightness in the warehouse market is constraining absorption in many metros while new supply is accelerating in some major markets. Finally, despite the overall negative headlines on retail, data on open-air retail indicated national vacancy rates declined by 10 basis points over the last four quarters.

Industrial and office properties are vying to be the rent growth leader. Office asking rent growth accelerated to 4.4% year-over-year in Q1 2019, but some of that rent growth is being eroded by higher tenant concessions. Industrial rents increased by 4.1% over the last year and when concessions are considered, warehouses are likely ahead on an effective rent basis. Apartment rent growth has accelerated by 70 basis points over the last year to 3.3%. Open-air retail rents grew the slowest, but still increased 2.3% year-over-year.

In the Capital Markets, private and public real estate valuations converged in the first months of 2019. Data from Green Street Advisors indicated that after approximately 30 months of publicly traded REITs trading at a discount to private real estate values, the traded REIT sector implied property values moved slightly above private values in April. This gap was closed by a rebound in pricing in the public REIT market rather than a shift in private real estate values. Private real estate returns according to NPI data from NCREIF showed a continued steady trend with quarterly total returns of 1.8% leading to a trailing year total return of 6.8%. The majority of the return continues to come from income, but appreciation remains modestly positive. Real estate transaction volume started 2019 at a pace similar to one year ago, and declining Treasury yields resulted in a wider real estate income spread.

The economy's performance over the last couple of years has benefitted our portfolio in terms of leasing, occupancy and our outlook for future rent growth. We continue to focus on investing in higher quality, stabilized real estate that is diversified across property type and geographic markets in order to generate durable income and positive returns for our investors.

Gregg will now provide a recap of our portfolio's financial performance results for Q1 before I continue. Gregg?

Gregg Falk
Thanks, Allan. We started the year off strong, with total revenues of $41 million dollars and net income of $107 million dollars primarily driven by the gain on sale of 111 Sutter Street, which we will discuss in detail later.

Funds from Operations, or FFO, is a supplemental measure of operating performance used by the real estate industry, which most closely resembles GAAP net income. For the quarter ended March 31st, we reported FFO of $15.2 million, which equates to $0.11 cents per share, a decrease of $0.03 per share from Q1 2018 as a result of non-cash fair-value adjustments to our interest rate swaps.

We also closely monitor AFFO as a supplemental measure of operating performance. AFFO is calculated as FFO adjusted for non-operating expenses and non-cash items. AFFO in the first quarter was $16.5 million, an increase of 6% over the prior year. Q1 AFFO was $0.12 cents per share.

Portfolio occupancy remained consistent at 94% throughout the first quarter. Our occupancies by segment were 95% for Apartment, 93% for Industrial, and 94% for both the Office and grocery anchored Retail segments. Maintaining high occupancies has been an area of focus for our asset management team. As evidence to this, we successfully executed upon a lease up strategy at The Huntington, an apartment community we acquired in 2018, by achieving an occupancy of 97% by the end of Q1, up from just 44% at acquisition.

We strive to offer a reliable and attractive level of current income to our stockholders that has the ability to grow over time. For the second quarter of 2019, our Board of Directors approved a gross distribution of $0.135 per share to stockholders of record as of June 27th, payable on or around August 1st. These dividends will be paid out to stockholders, but will be reduced for share-class specific fees, if any.

Since we launched our initial public offering in October of 2012 we have provided net of fees annualized total returns for our Class A and M shares of 6.6% and 7.2%, respectively. We continue to search for investment opportunities that will further diversify our portfolio, enable moderate NAV growth, and generate favorable risk-adjusted returns.

Our NAV grew to just over $1.7 billion at the end of the first quarter. Valuation gains were generally attributable to favorable market conditions, with our top five performing properties generating about $10 million dollars of appreciation during the quarter. Our daily NAV methodology has provided stable market valuations, as evidenced by our sub 2% standard deviation of share price, and we have realized moderate appreciation in share price since we began the offering in 2012. As a perpetual life, daily NAV REIT, JLL Income Property Trust is not subject to the same market fluctuations that affect the pricing of listed stocks. Our share price is determined based on independent appraisals of the real estate investments we own and the income they generate.

As an SEC registered company, JLL Income Property Trust holds annual stockholder meetings to seek approvals for various proposals, including the election of our majority independent board of directors and occasionally other business. Our annual stockholder meeting is scheduled for June 13, 2019 at 8:30 a.m. in Chicago. All stockholders will have already received by mail, a copy of our Annual Report and Proxy Statement. We have started our Proxy solicitation outreach program and will be calling stockholders and sending follow-up mailings to encourage stockholders to vote their shares. We need a majority of our shares of common stock voted in order to have a quorum for the stockholder meeting. We ask for your help in voting your shares or encouraging your clients to vote their shares.

Now, I'll hand the call back over to Allan to highlight some Q1 accomplishments.

Allan Swaringen
Thanks, Gregg.

To highlight Q1 strategic initiatives, the sale of 111 Sutter Street, a multi-tenant office property located in the central business district of San Francisco, closed in February. The $227 million sale resulted in after-debt repayment cash proceeds of $167 million. With these proceeds, we paid down our line of credit and turned our focus to further diversify JLL Income Property Trust's portfolio by reinvesting across a number of other properties. We are targeting property types that have historically required less ongoing capital and generated more free cash flow from operations than traditional office properties like 111 Sutter. In March, we acquired a two-building, 240,000 square foot, fully-leased industrial warehouse portfolio located in Fremont, California for $47 million dollars. This property is an excellent fit with our strategy to own high-quality industrial warehouse buildings in dense, in-fill locations. Another acquisition in our pipeline that recently closed was Stonemeadow Farms, an apartment community located in the desirable Seattle suburb of Bothell, Washington. At a purchase price of just under $82 million, or approximately $293,000 per unit, this garden-style community is well aligned with our investment strategy, given the property's higher quality and desirable location within a highly rated school district. These two recent acquisitions along with other properties in our pipeline should have the Sutter proceeds fully invested by the end of Q2.

Our overall company leverage ratio decreased to 35% at the end of Q1. 100% of our total debt is currently fixed rate. With limited near-term debt maturities, we have a portfolio-wide weighted average remaining loan term of approximately 7.1 years and our weighted average interest rate on outstanding borrowings is 3.7%. As of March 31st, our portfolio diversification by property type was 30% Apartments, 26% Industrial, 12% Office, 30% Retail and 2% Other, which currently consists of two parking garages.

Turning to our stock transactions, in Q1 we repurchased approximately $31 million dollars in shares pursuant to our share repurchase plan, which had a first quarter limit of $84 million. For the second quarter 2019, share repurchases will have a limit of approximately $86 million, which is 5% of the NAV of the company as of March 31st. Stockholders should aspire to be long-term investors and should plan to hold our shares for five to seven years or longer as we are typically underwriting new property investments over a similar time horizon; however, our share repurchase plan is available to the stockholders who desire to rebalance their asset allocations subject to the quarterly limits and a twelve-month holding period.

We remain focused on investing capital in the industrial, apartment, and grocery-anchored retail sectors, as well as complementary low beta strategies such as medical office, which fulfill key portfolio investment goals of stable income and moderate NAV growth over time. During Q1, we reinvested approximately $4.3 million dollars of capital improvements in our existing portfolio, all geared towards maintaining our higher occupancies.

We remain committed to actively managing our real-estate portfolio to generate attractive income returns, preserve investor capital, and realize moderate appreciation over time. Our NAV has continued to steadily increase as our asset management team strengthens our portfolio through carefully planned investments and leasing opportunities. Financial Advisors and Portfolio Managers are looking for both diversifying investments and alternative sources of income and core real estate is well positioned to provide both.

JLL Income Property Trust continues to deliver a competitive current yield and attractive annualized total returns all the while maintaining a high-quality portfolio of institutional-caliber investments. We believe both property type and geographic market selection will continue to be one of the greatest contributors to our strengthening investment performance. We are confident that we will continue to add value to our current portfolio and look forward to growing and further diversifying our investments throughout the balance of the year.

Thank you for your time and attention today and I hope you found our remarks informative. Operator, we would now like to open the call for any questions.

Operator
Thank you. At this time I'll open the lines for questions. [Operator instructions]. One moment please while we poll for questions. Our first question comes from the line of Mike Laudizio. Please proceed with your question.

Q: Yes, what is your approach to portfolio leverage with so much discussion about real estate investing this late in the cycle?

Allan Swaringen – Chief Executive Officer
Sure, I'll take that one. Thanks for the question, Mike. So we are a low leverage strategy. Our target range is 30%-50%. And we kind of consider ourselves fully invested at about a 40% loan-to-value ratio. Today we're at 35% primarily as a result of the sale of our 111 Sutter [ph] asset. So we're going to be looking through the rest of this year to get back up to that fully invested point.

As for strategy on our debt, right now what we're looking at is trying to lock in long-term fixed rate mortgages, generally from life insurance companies. We like to stagger the maturities over the timeframes so that we don't have too much debt maturing in any one year. Right now we're at a good point in the cycle in that we're very attractive borrowers to the life insurance companies. When we go out to get a new mortgage we'll have 10-12 life insurance companies bidding in an auction style to win the business from us. So we get very competitive terms and conditions. So that's one of the benefits of being the low leverage borrower that we are.

The other thing is we really like to have as much of our debt as fixed rate as possible. Today we're at 100% fixed rate. We do get floating rate loans from time to time but generally what we will do is swap those for a fixed rate to minimize our interest rate risk going forward. And then the other big tool that we have on our debt strategy is our $400 million credit facility. It has two years left of term plus two one-year extensions. So we have a lot of time remaining in that.

That facility really provides us with maximum flexibility for acquisitions, redemptions, for working capital needs. It's supported by about 30 properties and $800 million of value. So we feel very comfortable with that structure and I believe that we have kind of all the best bells and whistles on the leverage side to run the company. So thanks for that question, Mike.

Operator
Thank you. Your next question comes from the line of Joe Werner. Please proceed with your question. Mr. Werner, you line is now live.

Q: We continue to have a lot of discussion on ESG and sustainability in real estate. What are your views in approach in the income property trust?

Allan Swaringen – Chief Executive Officer
Thanks for that, Joe. So investing with an emphasis towards consideration of impacts on our environment, societal issues and concerns, along with operating within a culture of strong corporate governance is quite different for a real estate fund like ours than it is say for trying to pick a basket of stocks that might align with strong ESG principles. That said, the income property trust along with our advisor, LaSalle, and JLL, our parent, are truly one of the market leaders in terms of ESG investing in real estate. IPT's ESG credentials and accreditations are really at the top end of the industry and we really hold ourselves out to be a leader in that space where historically it's really been dominated by the largest publically traded REITs.

To demonstrate this, in fact, last year we were awarded with a four out of a five-star rating by GRESB, the Global Real Estate Sustainability Benchmarking organization, which is the leading global ESG organization for real assets. And to further demonstrate IPT's leadership in this space, just to put that award in context, in 2018

GRESB assessed 903 real estate funds and property companies, over 79,000 assets, and over $3.6 trillion of real estate. And JLL Income Property Trust was the only NAV REIT that submitted all of its data across their ESG metrics. And again, the result was that we were awarded a four out of five-star rating.

So that's kind of a long answer but it really exemplifies our commitment to operating at the highest standards of ESG investing in a real estate community. And as I said, not only our fund but our firm is a market leader in this area, and not just because we say so but because the leading industry rating agency says so, so where we're very proud of that accomplishment.

Operator
Thank you. [Operator instructions]. Our next question comes from the line of Jack Eastman. Please proceed with your question.

Q: With the large sale of your San Francisco office and your industrial and apartment acquisitions, are you deliberately moving to a new portfolio composition? And if you could please provide a little more color on your retail allocation?

Allan Swaringen – Chief Executive Officer
Great. Thanks for that, Jack. So the answer to the question is really that the selloff of a large CBD multi-tenant office property and the redeployment of that capital into both high quality industrial properties and well leased high barrier to entry apartment communities is not a shift or a change in our strategy whatsoever. It's in fact an exemplification of the strategy that we've been talking about really for 18-24 months.

And to put that in context, as you know, fundamentally we're long-term, patient, 10-year hold type investors. And with a portfolio today that's approaching just shy of $3 billion and 71 properties, this is not the kind of thing that you really can make dramatic strategy shifts and short-term herky-jerky moves. So we've been consciously moving the portfolio to an underweight position in office, especially multi-tenant CBD office and an overweight position in industrial and apartments. And as I said, that's been going on for two, nearly three years now. We do like what we consider to be a relatively neutral weight position in retail. While it's a large component of our portfolio, it has been performing very well for us across that portfolio. We're 94% leased and occupied.

And in the retail space we've been very disciplined and focused and avoided a lot of the retail formats and structures that really have been getting hurt by online purchasing. So we don't own malls. We don't own power centers. We don't own lifestyle centers. We don't own big box [ph] discount centers. We really have narrowly focused our strategy in the neighborhood and community [indiscernible] shopping center space. And those assets are continuing to perform very well for us. And we feel like it's a good strategy and it generates a lot of our cash flow for the company. So we're quite positive on that.

The other thing that we are focusing on, we are quite cognizant that we are now ten years into the longest economic expansion in US history. So I don't know that we're at the end of the cycle but we have to acknowledge that we're later cycle investing. So we are focused on positioning the portfolio and trying to identify what we consider to be low or lower beta property types.

And one of those that we like and we've been adding to the portfolio is medical office. Healthcare spending historically has shown to be pretty recession resistant. People really don't stop going to the doctor and needing medical procedures no matter what the health of the broader economy is. And so for the diversification and the late cycle benefits, we're not going to ever grow our office allocation back to I think what it was, 45% six or seven years ago. But we do like adding medical offices, a low beta strategy to the portfolio.

So not a shift. Just actually a demonstration of the strategy that we implemented and started working on two or three years ago.

Operator
Thank you. Our next question comes from the line of Han Jo Huang [ph]. Please proceed with your question.

Q: On May 20th, a Blue Vault report came out reporting that for calendar year 2018 the ratio of share redemptions for Jones Lang LaSalle to capital raise was 59%. Is that a number that's been increasing? Because I don't know the previous years' share redemptions and I'm just concerned what kind of initiative is Jones Lang LaSalle making to reliant investors to stay invested for the long-term?

Allan Swaringen – Chief Executive Officer
Han, thanks for that and I'm aware of that report and I read it, and I think it's generally accurate. I wouldn't say it's totally completely accurate. But we did last year have a higher total percentage share repurchases. It still exceeded our capital raise by 2X. So we grew the funds nicely last year. I would tribute most of those repurchases is—and one of the things I wish Blue Vault had focused on, we're up and running in our seventh year now, and we've been telling investors that you need to be thinking about investing us for five to seven or ten years. And we're also the second largest NAV [ph] REIT in the marketplace. So just as a percentage of our total shares outstanding, and a percentage of—just if you are, think about where we are in the cycle and our longevity—that amount of repurchases is in fact not troubling to us at all.

As a percentage of our total stockholders, it was sub 2% compared to some of the other solutions in the platform who were having 4% and 5% and 6% of their shares repurchases. It's a low percentage of our repurchases. And I'm not really sure the comparison of our repurchases to capital raised is really the right metric. We are allowed to purchase and we endeavor to purchase, and have our balance sheet able to purchase up to 5% of our NAV per quarter, which is 20% on an annual basis. So having sub 2% repurchases on an annual basis doesn't feel that kind of constraining or concerning to us.

Operator
Thank you. There are no further questions and this concludes today's call. I will hand the call back over to Allan Swaringen for closing remarks. Allan?

Allan Swaringen – Chief Executive Officer
Thank you, operator, and thank you all for joining our call today. We look forward to updating you again at the end of the second quarter. Have a great day and a great Memorial Day weekend.