Transcript of
JLL Income Property Trust
1Q22 Public Earnings Call
May 18, 2022

**Participants**

Sean Nolan - Senior Portfolio Accountant, LaSalle Investment Management
Allan Swaringen - President and Chief Executive Officer, JLL Income Property Trust
Gregg Falk - Chief Financial Officer, JLL Income Property Trust

**Presentation**

**Operator**
On behalf of JLL Income Property Trust, I'd like to welcome you to the first quarter 2022 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 Sean Nolan, from JLL Income Property Trust. Sean, please go ahead.

**Sean Nolan**
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, 2021, 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-K for the year ended December 31, 2021.

Links to a transcript and audio replay of this call will be posted and available on our website, JLLIPT.com until June 17, 2022. For further information on the Company's performance, we invite you to review our Annual Report on Form 10-K filed on March 11, 2022 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, 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, Sean. Hello, everyone, and thank you for joining us for our first quarter earnings call.

As of March 31st, our portfolio aggregated to $6.3 billion-dollars comprised of 119 core properties spanning the residential, industrial, healthcare, office, and grocery-anchored retail sectors. We realized an approximate 1.0% income return, an 8.7% appreciation return and an overall 9.7% total return for the first quarter on our M-I share class, which is the highest quarterly return we have posted in our nearly decade-long history. Quarterly dividends have now been paid for 41 consecutive quarters, with an average annual increase of 3.9% over that 10-year period. Durable income and modest appreciation across market cycles, from core stabilized assets, remain the cornerstones of JLL Income Property Trust's investment thesis.

Before highlighting some of our specific first quarter accomplishments, I would like to begin today's discussion by reviewing the economic environment in which we operated.

A broad characterization of the US economy and real estate markets in the first quarter is that there was a slow-down relative to the very positive environment in 2021, but not a change in overall direction.

The official report was that GDP declined at a 1.4% annual rate in Q1. However, further analysis of this report shows this GDP decline may be more noise than a recession signal as underlying economic growth drivers were in fact sustained. The drivers of the GDP decline were a wider trade deficit and inventory growth below the breakneck pace seen in the prior quarter. Consumer spending and business investment were both solidly positive contributors and more reflective of the trends expected to continue in 2022. Job growth is also a positive for the US economy with jobs gains averaging a robust 519,000 during the first four months of 2022.

The downside of the strong growth experienced since the Pandemic has been inflation and higher interest rates. CPI rose 8.5% year over year as of the end of Q1. With energy and food seeing elevated inflation, core inflation (prices less food and energy) was up 6.5% year over year. While most forecasts are for inflation to decline in the second half of 2022, such predictions have been overly optimistic recently. In response to the continued elevated inflation, the Federal Reserve raised interest rates for the second time this year in early May, by 50 bps to a range of 0.75%-1.0%. The Fed has a year-end target rate closer to 2.5% portending further increases.

The real estate markets have benefited from this robust economic growth with fundamentals and strengthening across most property types. National vacancy rates are under 5% for apartments, industrial, life sciences, and single-family rentals. In Q1, vacancy rates across these property types were broadly stable, with the near record low levels limiting further declines. The retail property sector continues to recover, with open-air retail rents seeing positive growth. Office markets remain the outlier, with subdued demand and elevated vacancy rates as hybrid working arrangements remain the norm. By contrast, medical office vacancy is half that of traditional office vacancy and was stable at 8.9% last quarter. Property types with strong fundamentals have so far proven to be a good inflation hedge as rising rents have kept pace with elevated inflation.

Real estate capital markets were healthy in the first quarter despite interest rate increases, but there are early signals that higher rates are having an impact. The transaction market remained active, with volume setting a record for the first quarter of the year, up 58% from Q1 2021 to around $160 billion in the first quarter. The expectations for continued Fed rate hikes and higher long-term interest rates led to increases in property borrowing costs. Pockets of the real estate debt markets, especially the CMBS market, saw spread expansion on top of higher interest rates. But debt availability for stabilized properties at lower LTVs, often from life company or bank lenders, remains plentiful. One impact of higher interest rates is that highly leveraged investors are becoming less aggressive buyers, thinning out what had been competitive bidding pools. Lower leverage buyers, such as ourselves, are now considered preferred options for sellers where certainty of close is returning as an important differentiator.

Private real estate returns remained strong in the first quarter, with the NCREIF Property Index, or NPI, trailing year total return rising to 21.9%, the highest one-year return since 1980. Income returns have been stable over the last year, with the majority of return coming from appreciation, and that appreciation has largely been driven by higher rents and expectations of increased future cash flows.

Looking ahead, the changing economic landscape will impact the real estate markets, but property fundamentals remain healthy and in our view, real estate is in a good position to remain a durable source of income for investors.

Having covered the industry-wide performance and market update, Gregg will provide a closer look at our portfolio's financial performance during Q1 before I continue. Gregg?

**Gregg Falk**

Thanks, Allan. We started the year off strong, with total quarterly revenues of $77 million, as compared to $53 million dollars in the prior year, which represents an increase of 47%. The increase is primarily related to new acquisitions made in 2021. Net income was $37.9 million dollars for the quarter compared to net income of $30.1 million dollars in the prior year. The increase in net income was primarily driven by non-cash unrealized fair market value gains in our unconsolidated real estate investments.

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 $19.5 million dollars, an increase of 2% from the prior year, which translates to $0.09 cents per share.

We also track adjusted funds from operations, or AFFO, as a supplemental measure of operating performance. AFFO is calculated as FFO adjusted for non-operating expenses and non-cash items. AFFO for the first quarter was approximately $25.3 million dollars, an increase of $9.1 million dollars from the prior year, primarily related to acquisitions made in 2021. AFFO was $0.12 per share for Q1.

Stabilized occupancy remained strong through the first quarter of 2022 with the portfolio leased at 96% at March 31st. Our occupancies by segment were 100% for Industrial, 95% for Residential, 91% for grocery-anchored Retail, 87% for Traditional Office, and 97% for our Healthcare portfolio. Maintaining higher occupancies through active tenant retention strategies continues to be a priority of our asset management team. The team has been focused on working with current and potential tenants to sign new and renewal leases. Trading lease term extension and early renewals in exchange for future lease execution risk is a strategy of our asset management team, which has provided great benefit to us today and we expect will continue to do so into the future. During the first quarter, we signed new and renewal leases for over 654-thousand square feet, with a weighted average rent increase of 7.6% over the previous rental rate or underwritten rental rates. This includes a 559-thousand square foot renewal at Suwanee Distribution Center at a rental rate 11% greater than the expiring rents. Active asset management has been a key to our strategy since we launched in 2012. One of the primary ways that we generate predictable, attractive income for distribution to our stockholders is through long-term lease agreements with higher credit tenants. We also continue to strive to lengthen our weighted-average lease term of our overall commercial portfolio, which was 6 years at the end of Q1.

Offering a reliable and attractive level of current income to our stockholders that steadily grows over time is a primary focus of JLL Income Property Trust. On May 10th, 2022, our Board of Directors approved a gross dividend for the second quarter of 2022 of $0.14 cents per share to stockholders of record as of June 23, 2022. The dividend is payable on or around June 29, 2022. All stockholders will receive $0.14 cents per share, less share class specific fees, and the annualized yields will differ based on share class.

Since we launched our initial public offering in October of 2012, we have provided net of fees annualized income returns of 4.2% and an appreciation return of 4.4% for a total return of 8.8% over that nine plus year period for our no fee share class.

Our NAV grew to approximately $4.0 billion at the end of the first quarter. Our daily NAV methodology has provided stable market valuations, as evidenced by our 3% standard deviation of share price.

During the first quarter, we reinvested approximately $3.7 million dollars of capital improvements into our existing portfolio, all geared toward maintaining our higher occupancies.

Now, I'll hand the call back over to Allan to discuss our key first quarter activities.

**Allan Swaringen**
Thanks, Gregg.

The first quarter of the year is usually the slowest in terms of transaction activity, however, we expanded our portfolio with one new acquisition. Jefferson Lake Howell is a newly constructed, class-A apartment community in the northern Orlando suburb of Casselberry, Florida. The property is in close proximity to highly rated schools that are part of Seminole County's school system, which ranks in the top five in Florida. This amenity-rich, lakefront, 384-unit garden-style apartment community was acquired for approximately $154 million. Adding higher quality multi-family apartments and single-family rentals to our portfolio is a priority for us in 2022.

Actively managing our portfolio and disposing of non-strategic assets is also a priority. As such, we disposed of two properties in Q1. We sold Norfleet Distribution Center, a 702-thousand square foot industrial property fully leased to Musician's Friend in Kansas City, Missouri in January. Another disposition was The Edge at Lafayette, a 168-unit apartment community located in Lafayette, Louisiana. Total net gain from both dispositions for GAAP purposes was $34 million. On a fair value basis, both dispositions traded within a narrow range to their most recent quarterly appraisal-based valuation.

Our portfolio diversification by property type at the end of Q1 was 43% Residential, 30% Industrial, 13% grocery-anchored Retail, 8% Healthcare, 5% Office, and 1% Other, which currently consists of two parking garages.

Our overall company leverage ratio decreased to 39% at the end of Q1. 70% of our borrowings are at a fixed interest rate and we have minimal debt maturities over the next three years. After the recent increase and extension at our revolving line of credit, our portfolio-wide weighted average remaining loan term is five years and our weighted average interest rate on outstanding borrowings is 2.9%. While our portfolio is substantially immunized from rising interest rates, we intend to closely monitor rate movements and will employ leverage judiciously as and when it is accretive to target risk-adjusted returns.

Turning to our stock transactions, we repurchased approximately $41 million dollars in shares pursuant to our share repurchase plan during the first quarter, which had a quarterly limit of $145 million dollars. Second quarter 2022 share repurchases will have a limit of approximately $198 million dollars, which is 5% of our NAV as of March 31st. Stockholders should aspire to be long-term investors and hold our shares for seven to ten years or longer. Our share repurchase plan is available to stockholders subject to the quarterly limits and a twelve-month holding period.

Over the last ten years, we have built what we believe to be a strong, stable real estate portfolio with a conservative strategy and resilient balance sheet, and we will remain true to our disciplined core investment philosophy. The fundamental reason for including real estate in a portfolio is long-term performance. Since inception from October 2012, JLL Income Property Trust has delivered attractive net of fees total returns of 8.8%, while consistently focusing on core, stabilized lower-risk investments.

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 remainder 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. Ladies and gentlemen, the floor is now open for questions. [Operator Instructions] And your first question today is coming from [Max Stegner] [ph]. Max, your line is live.

**Q:** Thank you. You mentioned a record 9.7% total return for the first quarter. Can you comment on what key factors you believe drove that return?

**Allan Swaringen**
Yeah. Thanks, Max. So in our prepared remarks, I think, we noted that that's our strongest quarter ever, which we're very pleased with that. I also think it's worth noting that, at the same time, real estate – our fund. And even the NPI, the NCREIF index, which did about a 5.3% in the quarter. We all did that. At the same time, where funds kind of delivered the worst quarter and almost 40 years. So it's interesting to highlight the benefits of, I guess, diversification there.

Our 9.7% came from 1% income, our regular quarterly dividend by 8.7% appreciation. Any aggregate we had valuation increases of a little over $250 million in Q1, which is about 5% gain on gross asset value. The sector's that contributed the most to those appraisal write-ups were industrial, residential, and also we saw some nice valuation increases in our healthcare portfolio.

**Operator**
Thank you. The next question is coming from [Joe Graessle] [ph]. Joe, your line is live.

**Q:** Hi, Allan, you mentioned dispositions in your remarks. How do proceeds from those properties to be allocated?

**Allan Swaringen**
Yeah. So, Joe, when we sell properties and these were non-strategic assets that over time, we just felt like we're not key components to the portfolio, and how we want to reorient the portfolio going forward. So, as you know, we've been active sellers throughout our 10-year history. And when we sell properties, if they've got that home, the proceeds first go to pay off debt, and then any extra proceeds we reinvest. So there's no requirement for us to make dividends or distributions. And we generally try to reinvest that capital as quickly as we can, and properties that we do consider the areas of strategic importance and things we want to add into the portfolio. So our dividends are generally based upon the income we generate. We don't usually make special distributions or anything for property sales.

**Operator**
Thank you. And the next question is coming from [Anthony Fortunato] [ph]. Anthony, your line is live.

**Q:** Thanks, Allan and Greg. So you mentioned getting a new credit facility, in your comments, why don't you provide some details on that?

**Gregg Falk**
Yeah, sure. I'll take that one, Allan. In April, we were able to extend and expand our current facility. We had a $650 million facility that we grew to $1 billion. We have an accordion feature, which will allow us to grow it to $1.3 billion. We added one new bank [to us] [ph] indicate bringing our total, because of lenders to 9 banks. Our strong balance sheet with high quality core properties really allowed us to get this increase in the facility. And we're actually oversubscribed by about $150 million. So the facility is made up of $400 million of term loans and $600 million of revolver.

We were able to extend the maturity date on the term loans from 2024 to 2027. And the maturity date on the revolver from 2024 to 2025, and we also have two 1-year extension options at our discretion.

We did at this time as well move the facility from LIBOR-based borrowings to SOFR-based borrowings. So our kind of all in rate nowadays is adjusted in terms of plus 130 to 135 basis points, depending on our current leverage, happy to get this accomplished in advance of LIBOR going away that will be happening in 2023. This larger facility really gives us increased flexibility. And we're able to borrow and repay with one day notice really allows us to be a buyer preference for our acquisitions team, because they know we have the funds set aside to go ahead and close on an acquisition all cash using this balance. So thanks for that question, Anthony.

**Operator**
Thank you. And the next question is coming from [Griffin Furlong] [ph]. Griffin, your line is live.

**Q:** Thank you. With respect to inflation, you guys commented that inflation defined predictions may be overly optimistic. In the event the Fed is unable to effectively manage inflation throughout the year. Does the portfolio investment thesis change?

**Allan Swaringen**
So Griffin, I don't think our investment thesis changes necessarily based upon inflation or interest rates in particular. From the inflation perspective, real estate it has really proven for a very long time. In most situations, there are some exceptions, if you look back over the long-term. But in most situations, real estate is proven to be a pretty good inflation hedge rents tend to grow over time. And a lot of the lease structures we have allow expenses to be passed through. Our overweight position in the portfolio to residential, which is shorter term leases allows us to capture that and build in Q1 and even looking back into 2021, our rent growth kept up throughout those time periods with inflation, especially on the residential side. So that's worked out well for us.

That said, portfolio is also not immune from some of the negative effects of inflation, which is raising costs and so expenses, real estate taxes, insurance, utilities, operating expenses, those costs go up too. And it's definitely been a focus of our portfolio management team and our asset managers overseeing our properties to be sure we are doing very thoughtful analysis in terms of increasing expenses.

So when we do re-budgeting and re-forecasting, we are also contemplating that expenses will go up in my 35-year plus career in real estate, I think, one of the things everyone have to watch out for is continuing to forecast rent growth at an accelerating percentage growth rate as compared to expenses. And that doesn't make the pro forma look good, but that's not the way the world usually works. So we're being very thoughtful and definitely watching the expense side of the equation too.

In terms of interest rates, as Greg commented in his prepared remarks, 70% of our borrowings are fixed rate, generally long-term fixed rate, we don't have a lot of near-term debt maturities, and most of our debt is fixed. So we do feel like while we're watching interest rates, our portfolios, hopefully, as well protected as we can make it in terms of even increasing expense, interest expense. So lots of watch there, but we're keeping our eyes on it.

**Operator**
Thank you. And the next question is coming from [Rich Ross] [ph]. Rich, your line is live.

**Q:** Hi, there. Thanks for taking my question. If I understood the comments correctly, the FFO for the quarter was $19.5 million and AFFO was $25 million, so higher. My understanding is AFFO really adjusted for CapEx? Is there something else going on there? Or did I misunderstand? And specifically, I was also curious about the $0.12 a share, it generated an AFFO, that's typically aligned with distributions and, I think, distributing a little bit more than that. So as you look forward, is the $0.14 a share per quarter sustainable? For one.

And second, with regard to appreciation in the portfolio, there's been a sharp increase. And as you look forward, do you expect that to level out or perhaps retrace more in line with trend, your long-term trend over the 10-year period of your fund?

**Allan Swaringen**
Greg, if you want to cover the first AFFO specific question, I'll take the comment related to the coverage and then appreciation.

**Gregg Falk**
Yeah. Sure. So on the AFFO side, what you see in our AFFO is being a historic cross reporter, we have a lot of GAAP impacts that are affecting FFO, that aren't really related to the operations with the company. Some of that deals with our DST 1031 program, others that can be with certain fees and expenses that are out there, and then reducing, removing all the non-cash items that could be additions or subtractions to our FFO number. So the $0.12 is a little bit below our distribution.

At this point, we don't look at distributions over a quarter-by-quarter. We look at it over a much longer period of time, 2, 3 years kind of looking at the gross portfolio and that kind of aspect. And that's what our Board of Directors look that as well, when they ultimately make a determination as to the dividends that are paid by this. Allan, did you want to take the other part of his question?

**Allan Swaringen**
Yeah, I got that. And I would just add to what Greg said, we're always looking at a rolling 4 quarters, backwards and forwards in terms of kind of trying to target distribution coverage. So it's even with AFFO adjustments, it's very hard to kind of really completely dig into the coverage in any one quarter, because of certain onetime adjustments even, as Greg said, some of those get taken out for AFFO.

In terms of valuation lifts, we said we had great appreciation throughout the portfolio in 2021. And we saw strong growth and in the first quarter of 2022 here, every single property in our portfolio is appraised every single quarter. We are seeing with higher interest rates, as we commented, buyers. And we have capital to invest, so we're bidding on transactions all the time. We are seeing bidding pools getting a little bit thinner. We're seeing more highly leveraged buyers coming out of some of the competition. And that's allowing us to both win transactions but also win them at modestly better terms now in Q2 then maybe what we were in Q3 and q4 last year.

But as that activities we're still seeing the valuation metrics that are going into our appraisal from Situs, formerly RERC. Most of the gain in terms of appraisal lift for us is more on the rent growth side than it is capital market assumptions. We're not seeing – last year, we saw both rent growth and falling cap rates, and falling exit caps, and lower IRRs. This year, we're both mostly seeing rent growth. And that's what pulled through in our first quarter valuation lift for the most part.

Now we're into the second quarter, and I would say we're not seeing that same level of rent growth in Q2, as we saw in Q1. So I would not be surprised if there was a little bit of a leveling effect throughout the balance of the year. But that really depends upon interest rates and overall economy, and obviously the stock market continues to be going up and down. So don't tend to offer too much guidance or outlook in terms of valuations. We were happy with what happened in Q1 would not necessarily expect to see that sort of gains throughout the rest of the year, though. Hopefully, does that helpful, Rich?

**Q:** Yeah. Thank you.

**<u>Operator</u>**
Thank you. And there are no other questions. And this concludes today's call. I will hand the call back to Allan Swaringen for closing remarks. Allan?

**<u>Allan Swaringen</u>**
Thank you all for joining us today. Appreciate your interest. We look forward to updating you next quarter at the mid-year. Thanks for your time today.

**<u>Operator</u>**
Thank you, ladies and gentlemen, this does conclude today's conference. You may disconnect at this time. Have a wonderful day. Thank you for your participation.