Transcript of
JLL Income Property Trust
Second Quarter Public Earnings Call
August 18, 2020

Participants

Allan Swaringen - President & Chief Executive Officer
Gregg Falk - Chief Financial Officer
Samantha Selzer - Assistant Portfolio Controller, LaSalle

Presentation

Operator
On behalf of JLL Income Property Trust, I'd like to welcome you to their second quarter 2020 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 Sam Selzer, from JLL Income Property Trust. Sam, please go ahead.

Sam Selzer
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, 2019, 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 June 30, 2020.

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 August 10, 2020 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. Hello, everyone, and thank you for joining us for the review of our second quarter 2020 results.

When we met in this forum around 90 days ago, the challenges of COVID-19 in the US were just beginning to emerge. Now, some four months further into the evolving global pandemic, the individual health risks, social upheaval and economic implications of the virus are better understood, though significant challenges remain and as a country, we continue to grapple with a struggling economy, reopening schools at every academic level, the end of the summer across many parts of our country and an upcoming Presidential election. While 2020 has already been a year of unprecedented change and unique, never before contemplated challenges – the story of this year feels like it may have a few more meaningful chapters yet to be written.

Throughout the pandemic, we have focused our asset management efforts on supporting communities and local businesses operating within or near our portfolio properties, whether they be our tenants or neighbors. Within our grocery-anchored retail portfolio, while our grocers and pharmacies are thriving, many of our smaller service-oriented tenants were forced to close. As a long-term and committed owner of these high-quality properties, we are working tirelessly to support hundreds of America's small businesses as they reopen.

One example of our community outreach efforts that we are proud to highlight is LaSalle's recently announced collaboration with the American Red Cross to host blood drives at properties within our portfolio. Traditional blood donation activities, often conducted at schools, churches and community centers have been drastically reduced or suspended due to the pandemic, while the need for blood and plasma donations has dramatically increased. Given our national footprint of properties, we can provide hosting sites at our shopping centers, office buildings and apartment communities where customers, tenants and residents can safely and conveniently donate blood. This represents the first time a national commercial real estate owner has teamed up with the American Red Cross to provide use of space across multiple properties for blood drives to advance its lifesaving mission at scale.

We remain cautiously optimistic about the broader economic outlook for the real estate industry and the value proposition of our conservative approach to investing in core real estate. Extraordinary monetary and fiscal stimulus coupled with the temporary nature of business shutdowns may dictate a stronger and quicker recovery as some businesses reopen. Pent up demand and unprecedented savings and liquidity, along with the backdrop of commercial real estate's strong positive fundamentals and muted levels of new construction should all bode well for real estate's long-term performance. With that as background, we will now turn to recapping Q2 and June 30 year to date investment performance.

We continue to focus on managing and improving our $3.2 billion-dollar portfolio of 78 core properties spanning the apartment, industrial, office, and grocery-anchored retail property sectors. In the second quarter, valuation changes resulted in a net decline of $45 million dollars reflecting an aggregate 1.5% decline in gross value due to COVID-19 impacts. Across all share classes net of fees, we realized an approximate 1% positive income return, an approximate 2.8% negative appreciation return and an overall 1.7% negative return for Q2 2020. Quarterly dividends have now been paid for 34 consecutive quarters, with an average annual increase of 4.3% over that 8-plus year period.
Year to date total return is a negative 2.9% through June 30, which is a combination of a positive 2.3% income return and negative 5.1% depreciation. Since inception, we have delivered stockholders an annual total return of 6.6% which is a combination of 2.1% appreciation and 4.5% income. These returns are for Class M-I Shares and are net of fees. Durable income, which has grown at a 4.3% annualized rate over the last seven years, and modest appreciation are a cornerstone of JLL Income Property Trust's investment thesis.

Before going into further detail on our second quarter accomplishments, I will provide an overview of the broad economic environment in which we operated.

The second quarter of 2020 saw a sharp decline in US economic activity, as measures to contain COVID-19 shuttered businesses, halted production, and unemployment spiked. US GDP shrank at a 32.9% annualized rate in Q2, driven largely by a steep decline in consumer spending. However, by the end of Q2, the economy began to show signs of a modest recovery. After nearly 21 million jobs were lost in March and April, the labor market added back 9.3 million jobs from May to June. The unemployment rate peaked at 14.7% in April and currently sits at 10.2%. The scope of the economic slowdown – and the shape of the recovery across sectors – is still largely unclear given the ongoing spread of COVID-19, the different measures across the country being taken to limit that spread, and the current uncertainty on additional Federal stimulus.

Q2 data on US property markets indicates that national vacancy rates are generally rising across the four major property types, though there are several contrasts of note. In addition to resiliency across the apartment and industrial sectors, several specialty property types, such as medical office and self-storage, are proving to be defensive.

The national industrial sector sustained positive net absorption in the second quarter, although its overall occupancy rate is still down significantly from last year. The vacancy rate for industrial rose by 50 basis points (bps) year over year to 7.6%. Apartment data from June points to pent-up demand boosting leasing activity in contrast to the April and May declines; however, national apartment vacancy stands at 4.5%, up 60 bps year over year.

Office vacancy rates rose 70 bps to 13.0%. Office asking rents were mostly flat while rising concessions implies a meaningful decline in effective rents. Despite numerous store re-openings in June and July, the retail sector continued to be hit the hardest by the effects of the pandemic with open-air vacancy increasing 40 bps over the year to 6.9%.

The second quarter delivered a recovery to broader capital markets, with the equities market recovering and corporate bond spreads falling. This played out in real estate largely through a partial recovery in publicly traded REIT share prices and with increasing availability of real estate debt at interest rates in some cases at or below pre-pandemic levels. However, ongoing government mandated closures, travel restrictions and increased time required to complete real estate transactions mean that property transaction volumes declined by 67% year over year in Q2, reflecting a near-halt in new property offerings in late March and April. Transaction activity began to recover in June and July, and we are starting to see more properties being made available for investments and more investors moving to bid on assets. Transaction activity is strongest for the lower risk, more desirable assets which in this environment is well-leased, higher-credit industrial, suburban apartments, and higher-credit, long-leased office properties.

The second quarter total return for the all NCREIF Property Index (NPI) was negative 1.0%, with appreciation returns being negative 2.0% and income returns at positive 1.0%. This reflects pre-fee, unleveraged property level returns, which are not directly comparable to investment or fund-level returns, but are a guide to the magnitude of value changes of institutional portfolios and the relative performance by sector. Industrial returns were resilient, with a 1.02% positive quarterly total return. Apartments posted a negative 0.6% loss for the quarter. Office returns were similar at negative 0.5% for the quarter. Retail saw the worst performance in the quarter with a negative 3.9% total return, with open-air retail at negative 2.8% outperforming malls which lost 4.8% for the quarter.

Gregg will now share a closer look at our portfolio's financial performance results for Q2 before I continue. Gregg?

Gregg Falk

Thanks, Allan. As of June 30th, we earned year to date revenues of $96 million dollars, compared to $82 million dollars in the prior year. The increase of $14 million dollars was primarily related to new acquisitions made during the last year. Second quarter net loss was $8 million dollars compared to a net loss of $3 million dollars in the second quarter of 2019. The increase in net loss was primarily related to non-cash unrealized fair-value losses on our investment in the New York City Retail Portfolio due to the COVID-19 impacts on retail.

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 six months ended June 30th, we reported FFO of $25.8 million dollars, a decrease of $2.7 million dollars from the prior year primarily as a result of non-cash-fair-value adjustments to our interest rate swaps and an increase in reserves for uncollectible accounts. FFO per share was $0.15 cents for the first half of 2020.

We also track AFFO as a supplemental measure of operating performance. AFFO is calculated as FFO adjusted for non-operating expenses and non-cash items. AFFO through the second quarter was $34 million dollars, an increase of $1.5 million dollars or 5% over the prior year primarily related to the new acquisitions we have made over the last year. AFFO per share was $0.20 cents for the first half of 2020.

Rent collections continue to be strong, especially in light of COVID-19's effect on businesses. Total portfolio collection rates as a percentage of billings were strong at 93%, for April and May and 92% for June and July. Our grocery-anchored shopping center segment has been impacted the most in terms of value and collections. However, we remain confident that grocery-anchored shopping centers, featuring dominant grocers located in affluent trade areas, will make a strong recovery over time. To date, we have granted rent relief of $3.2 million dollars, made up of $2.3 million in rent deferrals and the remainder in rent abatement. We expect to recover the rent deferrals over a longer period of time. We also expect our credit losses to be higher during the second half of the year when compared to our operating history.

Portfolio occupancy remained quite strong throughout 2020 with the portfolio currently leased at 95% throughout the second quarter. Our occupancies by segment were 99% for industrial, 93% for apartment, 91% for grocery-anchored retail, and 85% for office. Maintaining higher occupancies through active tenant retention strategies continues to be a priority of our asset management team. Our higher occupancy significantly reduces our re-leasing risks as some property markets are predicted to have lower rental growth rates and increased downtime for existing vacancies as a result of COVID-19.

During the last few years, recognizing that we were later in the then current economic cycle, our asset management team was aggressively working with current and potential tenants to sign new leases. Trading lease term in exchange for future lease execution risk was a strategy of our management team, which has provided great benefit to us today and into the future. To that effect, in 2019 we had one of our best leasing years ever, signing over 1.5 million square feet of leases and increasing the rental rate on those leases by a weighted average of 3.6% over the previous leases. 2020 has had significant leasing activity as well; through June 30th, we have signed leases for over 400,000 square feet, increasing the rental rate by almost 6% on those leases, primarily driven by leases in our industrial portfolio. In the second quarter of 2020, we signed leases for almost 180,000 square feet with an average rental rate increase of 4.5% over the previous leases. Active asset management has been a key to our strategy since we launched in 2012. With only 11% of our commercial leases expiring in 2020 and 2021 we feel well situated given the current economic environment.

We strive to offer a reliable and attractive level of current income to our stockholders that steadily grows over time. On August 6, 2020, our Board of Directors approved a gross dividend for the third quarter of 2020 of $0.135 cents per share. The dividend is payable on or around September 29, 2020 to stockholders of record as of September 24, 2020. All stockholders should receive $0.135 cents per share, less share class specific fees, and the annualized yield will differ based on the share class.

Since we launched our initial public offering of Class M Shares in October of 2012, we have provided net of fees annualized income returns of 4.1%, appreciation returns of 2.0%, for a total return of 6.2% over that almost eight-year period.

Our NAV was approximately $2 billion at the end of the second quarter. Our daily NAV methodology has provided stable market valuations, as evidenced by our sub 2% standard deviation of share price.

Our independent valuation advisor, RERC, determined that the near-term impacts of the COVID-19 pandemic has impacted the value of certain of our properties. The appraisals resulted in combined Q1 and Q2 valuation changes across the portfolio totaling $86 million, which reflects an aggregate 2.8% decline across our approximate $3.2 billion gross asset value. Through June 30, declines in property valuations resulted in a NAV decline equating to $0.40 per share, an approximate 2.9% decline in net asset value. About half of the aggregate valuation declines are related to our grocery-anchored retail portfolio as a result of increased credit loss reserves and reduced market rental growth rates among other factors. While it is impossible to predict the magnitude of future valuation movements, we are confident that the valuation changes recorded year to date place the fund in a more conservative position going forward.

Now, I'll hand the call back over to Allan to continue discussing Q2 activities.

Allan Swaringen
Thanks, Gregg.

We halted all of our pre-COVID acquisition activity that was underway before the shutdown and continued this discipline through the end of the second quarter in order to preserve working capital, maintain our strong liquidity position and preserve "dry powder" anticipating more attractive investment opportunities that may evolve post-COVID-19. Industry wide, transaction activity has recently begun to recover, and we are now pursuing a number of attractive acquisition opportunities. The timing and outlook for new investing activity will be measured, however, for the rest of 2020.

As of June 30th, our portfolio diversification by property type was 33% Apartments, 25% Industrial, 26% Grocery-Anchored Retail, 15% Office, and 1% Other, which currently consists of two parking garages.

Our overall company leverage ratio increased modestly to 38% at the end of Q2. Approximately 90% of our borrowings are at a fixed rate and we have minimal debt maturities through 2021. Our portfolio-wide weighted average remaining loan term is approximately 5.6 years and our weighted average interest rate on outstanding borrowings is 3.5%.

As for stock transactions, we repurchased approximately $85 million dollars in shares pursuant to our share repurchase plan during the second quarter, which had a quarterly limit of $104 million dollars. For the third quarter 2020, share repurchases will have a limit of approximately $99 million dollars, which is 5% of the NAV of the company as of June 30th. While share repurchases understandably increased in Q2 given equity and debt market volatility, over the last few months repurchase activity has slowed significantly from their March and April highs. 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.

We believe that we are well positioned to weather the current turbulent environment with our lower leverage, strong liquidity and recent capital raising success, enabling us to seize on attractive investment opportunities once they present themselves. We intend to focus on investing capital in the industrial and apartment sectors, as well as complementary low beta strategies such as medical office, which fulfill key portfolio investment goals of reliable income and moderate NAV growth over time. Year to date, we have reinvested approximately $5.4 million dollars of capital improvements into our existing portfolio, all geared towards maintaining our higher occupancies. We will be thoughtful with our capital improvement expenditures for the remainder of the year as we continue to assess the impacts of COVID-19 on our existing portfolio.

As we continue to address the challenges brought on by this pandemic and the recession it has triggered, we are confident that we will emerge stronger and more resilient. Armed with a conservative, lower leverage balance sheet, ample liquidity, and an extraordinary team of seasoned professionals, battle tested from working together during the Global Financial Crisis, we are confident in our strategy and have the conviction to remain steadfast during these unprecedented and challenging times. Over the last eight years, we have built what we believe to be a strong, stable real estate fund with a conservative strategy and resilient balance sheet, and we will remain true to our disciplined core investment philosophy.

Our priorities are geared towards preserving and protecting principal and operating cash flows of our existing portfolio as well as continuing our track record of responsible, managed growth, always with the goal of maximizing investment performance for our stockholders. We have ample liquidity with over $280 million in cash and line of credit capacity, representing nearly 10% of our gross asset value. As real estate capital markets begin to reopen, we are eager to attract and invest new capital in what will no longer be the later stages of a "long in the tooth" cycle, but now at the formative stages of the next cycle.

We continue to send our deepest gratitude to everyone on the front lines of the pandemic. I also want to personally thank all our colleagues within our JLLIPT team and within LaSalle who continue to perform incredibly during this evermore challenging environment. We also sincerely appreciate the trust you place in us, and we wish all of you and your families good health and safety.

Operator, we would now like to open the call for any questions.

Operator
At this time, I will open the lines for your questions. [Operator Instructions] Our first question is from [Paul Aries] [ph]. Please proceed with your question.

Q: Have you seen a change in rent payment in August, now that the unemployment benefits have lapsed?

Allan Swaringen
Paul, thanks for that question. This is Allan Swaringen. We really have not seen a significant change in August month to date that we can attribute to the change in kind of the Fed stimulus and the unemployment support. And in fact, each of the last few months, our collections have trended more positively. And we see that as a good sign.

But we're obviously cautious and aware that some of that stimulus might have been supporting tenants in their businesses. So we're going to keep our fingers crossed here and hope that we don't see any negative trends, but we've not seen any to date.

Q: Thank you.

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

Allan Swaringen
Great. Thank you, operator. Thank you for your help today. And thank all of you – I'd like to thank all of you for joining us for today's call. And we look forward to updating you again after we close out our third quarter later this year.

Everyone, have a great day and be safe. Bye now.

Operator
And this concludes today's conference and you may disconnect your lines at this time. Thank you for your participation.