Transcript of
JLL Income Property Trust
JLL Income Property Trust 2Q21 Public Earnings Call
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Participants

Allan Swaringen - President and CEO, JLL Income Property Trust
Gregg Falk - Chief Financial Officer, JLL Income Property Trust
Samantha Selzer - Assistant Portfolio Controller, LaSalle Investment Management

Presentation

<u>Operator</u>

Greetings on behalf of JLL Income Property Trust, I'd like to welcome you to their Second Quarter 2021 Earnings Conference Call. This call is being recorded and our audience lines are currently in listen-only mode. [Operator Instructions].

At this time, I would like to turn the conference over to Samantha Selzer from JLL Income Property Trust. Sam, please go ahead.

<u>Samantha Selzer</u>

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, 2020, 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, 2021.

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 11, 2021 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, Sam. Hello, everyone, and thank you for joining us for our second quarter earnings call.

As the longest-tenured daily NAV REIT in the industry, we are proud of the resiliency JLL Income Property Trust exhibited during the challenges that 2020 brought and the strengthening performance we have now seen midway into 2021. One important factor driving our success is that our portfolio had two-thirds of its investments in what proved to be pandemic-resistant property sectors: industrial, residential, and healthcare-related office. Going forward, as we continue our accelerated acquisitions pace, we intend to increase allocations to these property sectors. We remain cautiously optimistic about the broader economic outlook for real estate markets but are excited about the new investments we have already closed and those we have in the pipeline for the remainder of the year. With that, we will now turn to recapping the second quarter results.

We continue to focus on managing and improving our $3.9 billion-dollar portfolio of 90 core properties spanning the residential, industrial, healthcare, office, and grocery-anchored retail property sectors. We realized an approximate 1.1% income return, 2.2% appreciation return and an overall 3.3% total return for the second quarter on our M-I share class. Quarterly dividends have now been paid for 38 consecutive quarters, with an average annual increase of 3.9% over that 9-plus year period. Durable income and modest appreciation across market cycles remain the cornerstones of JLL Income Property Trust's investment thesis.

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

US economic output regained its pre-pandemic peak level during the second quarter this year, a rapid rebound from the historic deceleration during the second quarter one year ago. Vaccine rollout, fiscal stimulus, and pent-up consumer demand lie behind this quick return to economic expansion. Employers hired 1.8 million net new workers in the 2nd quarter and another 943,000 in July, leaving total payrolls just 3.4% below the pre-pandemic level as the unemployment rate decreased to 5.4%. Inflation, however, has remained elevated through this period of recovery; the CPI rose 4.8% year-over-year in Q2 in the largest quarterly increase since 2008.

Increased spread of COVID-19 variants is becoming a risk to continued growth, though a more widespread return to in-person schooling and the expiration of some enhanced federal unemployment payments are likely to enable further hiring gains as labor supply remains a challenge.

Strengthening economic conditions are increasing demand for most property types. Apartment net absorption, which was equal to 2.8% of inventory in the last year, had its best quarter since the early 1990's. National apartment vacancy declined to 4.0%, giving owners strong pricing power and enabling rent growth to accelerate to 4.8% year-over-year in June.

Open-air retail vacancy showed signs of stabilization in Q2 as brick-and-mortar retail sales benefitted from the US economic re-opening. Net absorption turned positive for the first time in six quarters and vacancy declined slightly in Q2 to 7.3%. The retail construction pipeline remains very low at 0.2% of existing stock.

Industrial fundamentals remained exceptionally strong, with total leased space rising by 308 million square feet over the last year. In Q2, industrial availability declined to 6.4%, 40 basis points lower year-over-year, and rents grew 5% year-over-year. Industrial deliveries in 2021 are expected to total 1.8% of inventory, an elevated level but still below the pace of demand.

Conventional multi-tenant office was the weak spot with fundamentals continuing to deteriorate. National vacancy rates rose 50 basis points in Q2 to 16.5%, a 350 basis point increase over the prior year. Effective rents are down almost 15% year-over-year. Medical office, however, is performing better as the vacancy of 9.2% remains lower than conventional office and is up only 70 basis points over the last year.

Real estate capital market activity is robust, especially for the property types with strong fundamentals. Transaction volume in June reached 95% of its June 2019 level, boosted by apartment and warehouse trades. Downward pressure on cap rates has continued for favored property types such as industrial, apartments, and medical office. Investor interest is also returning in the more resilient retail and office assets, such as grocery-anchored shopping centers and long-leased office buildings.

The trailing year NCREIF Property Index, or NPI, total return improved to 7.4% in the second quarter as the index reflects the recovery in market pricing. Industrial properties continue to outperform other property types. Apartments had their strongest quarterly return in ten years – driven by the garden-apartment subtype. Office and retail both underperformed the overall NPI but did improve relative to the previous quarter.
Having covered the industry-wide performance and market update, Gregg will now share a closer look at our portfolio's financial performance during Q2 before I continue. Gregg?

Gregg Falk

Thanks, Allan. 2021 has been a strong year, with $109 million in YTD revenues, as compared to $96 million dollars in the prior year, which represents an increase of 14%. The increase over 2020 is primarily related to new acquisitions and positive leasing activity over the past couple years. Net income was $26 million dollars for the first half of the year compared to a net loss of $27 million dollars in the prior year. The increase in income is primarily driven by the gain we recorded on the sale of South Seattle Distribution Center of $33 million dollars.

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 first half of the year, we reported FFO of $41.3 million dollars, an increase of $15.5 million dollars from the prior year, primarily related to non-cash fair value adjustments to our interest rate swaps and COVID related expenses in 2020. Year to date FFO was $0.23 cents per share.

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 June 30th was approximately $36.5 million, an increase of $2.5 million from the prior year primarily related to the new acquisitions we have made. Year to date AFFO was $0.20 cents per share.

Rent collections across our portfolio have continued to improve as most tenants have been able to reopen their businesses and return to normal payment patterns. Collections have been in the upper 90 percent range and we have seen very few new requests for rent relief over the last few quarters. Our retail tenants continue to be a slight laggard in collection of outstanding receivables as compared to the other property types.

Stabilized occupancy remained strong through the second quarter of 2021 with the portfolio leased at 96% at June 30th, an increase of 1% over March 31st. Our occupancies by segment were 100% for Industrial, 94% for Residential, 91% for grocery-anchored Retail, 89% for Traditional Office, and 96% for our Healthcare Office. 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 in exchange for future lease execution risk is a strategy of our management team, which has provided great benefit to us today and will continue to do so into the future. Through the second quarter, we have signed new and renewal leases for over 900 thousand square feet, with a weighted average rent increase of 4.9%. Of particular note, during Q2, we executed a 108,000 square foot early lease renewal with a tenant at O'Hare Distribution Center at a rate 44% higher than the expiring rent. 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 portfolio, which was 6 years at the end of Q2.

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 August 10th, 2021, our Board of Directors approved a gross dividend for the third quarter of 2021 of $0.135 cents per share to stockholders of record as of September 24, 2021. The dividend is payable on or around September 29, 2021. All stockholders will receive $0.135 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 return of 4.5%, an appreciation return of 2.3% for a total return of 6.9% over that almost nine year period.

Our NAV grew to approximately $2.2 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. Valuation gains in the industrial and apartment sectors drove an overall 2.7% increase in valuations during Q2.

Throughout the second quarter, we have reinvested approximately $8.8 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 second quarter activities.

<u>Allan Swaringen</u>

Thanks, Gregg.

During the second quarter, we continued to be active in terms of new investments and expanded our portfolio with two new acquisitions, one in the industrial sector and one in the residential sector. The first of these is Princeton North Andover, a newly constructed, Class-A, apartment community in the desirable town of North Andover. North suburban Boston has one of the strongest demographic profiles, highly rated public schools, and an infill location with a market vacancy rate below 3%, presenting potential for attractive rent growth. The second acquisition is Louisville Airport Distribution Center, a newly constructed, fully leased Class-A warehouse totaling 284,000 square feet. This property is located in Louisville's top industrial submarket, boasting a central location near irreplaceable transportation infrastructure and a vacancy rate of just 1.1% for larger buildings in this submarket. The property is fully leased to two tenants with a weighted average lease term of over five years. This investment increases our allocation to high quality, state-of-the-art industrial warehouses in select, primary transportation hubs. The industrial sector has proven to be resilient amid the pandemic and is on course to maintain its position as an outperforming property type for the foreseeable future. We remain focused on the industrial sector as the demand drivers have been stronger than any other major property type and rent growth has exceeded expectations.

In addition to these investments, we recently acquired a 47% interest in a stabilized portfolio of over 4,000 single family rental homes. Single family rental homes offer a compelling risk-return profile relative both to apartments and to other specialized property types given the limited asset specific risks with low turnover and a strong growth outlook supported by underlying macroeconomic and tenant demand trends. The acquisition was funded with an equity investment of $205 million dollars. The $1.2 billion dollar portfolio is encumbered by a $761 million dollar securitized loan, interest only at a fixed rate of 2.1% maturing at the end of 2025. We have also closed on a portion of another multi-property industrial portfolio that is 100% leased and totals approximately 420,000 square feet. Three of five properties in this portfolio closed in July, with the remaining two targeted to close later this year. In addition to these July and August closings, we have a number of other investment opportunities in our pipeline targeted for acquisition later this year.

Our portfolio diversification by property type through the end of Q2 was 32% Residential, 31% Industrial, 22% grocery-anchored Retail, 6% Healthcare, 8% Office, and 1% Other, which currently consists of two parking garages.

Our overall company leverage ratio was 34% at the end of Q2. 97% of our borrowings are at a fixed interest rate and we have minimal debt maturities for the next two years through the end of 2022. Our portfolio-wide weighted average remaining loan term is 6 years and our weighted average interest rate on outstanding borrowings is 3.25%. As we shift to a more offense-oriented investment strategy, we intend to moderately increase our loan to value ratio throughout 2021 while also locking in attractive long-term fixed interest rates. In the second quarter, we also extended our credit facility by three years and expanded the capacity by $250 million dollars through a syndicate of eight national banks. We now have a $650 million dollar revolving credit facility to fund acquisitions and other liquidity needs.

As for stock transactions, we repurchased approximately $37 million dollars in shares pursuant to our share repurchase plan during the second quarter, which had a quarterly limit of $106 million dollars. Third quarter share repurchases will have a limit of approximately $112 million dollars, which is 5% of our NAV as of June 30th. 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 we are well positioned to weather uncertainties in the current environment with our lower leverage, strong liquidity and recent capital raising success enabling us to seize attractive investment opportunities. We intend to focus on investing capital in the industrial and residential sectors, as well as complementary lower beta strategies such as health care, which fulfill key portfolio investment goals of reliable income and moderate NAV growth over time.

Over the last nine 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. The fundamental reason for including real estate in a portfolio is long-term performance. Since inception in October 2012, JLL Income Property Trust has delivered attractive total returns with a 6.9% annualized net of fee return all the while focusing on core, stabilized lower-risk investments.

As market conditions improve and the US economy enters a recovery period, we are focused on enhancing investment performance in the current year and beyond, while also keeping our employees and tenants safe and supporting the communities in which we work and invest. We also sincerely appreciate the trust that you place in us, and wish you and your families good health and safety.

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

<u>Operator</u>

At this time, I’ll open the lines for your questions. [Operator Instructions]. Our first question is coming from the line of Jack Rappe [ph]. Please proceed with your questions.

Q: Congratulations on the strong performance for the second quarter. Could you share some of the main contributors and any detractors to performance?

<u>Gregg Falk</u>

Yes, sure. Jack, I'll take that. Thanks for the question. So we're really pleased with how our portfolio performed this year. Q2 returns, as Alan mentioned were 3.3% in total 1.1% of that being income and 2.2% of that being appreciation. Year-to-date we're at a 6.5% return and trailing one-year, we're at an 8.9% return. Looking at what contributed to those returns was that, we had net appreciation of about $59 million during the second quarter.

We define net depreciation, appreciation as the change in the appraised value as coming from our independent valuation advisor RERC plus any CapEx that we're spending on the properties during that time frame. Our industrial sector had appreciation of $41 million during the quarter the most of any sector in our portfolio, industrial continues to be one of the best performing sectors amongst the four major core property types posting strong returns really nationwide. Our residential portfolio we realized about $15 million worth of appreciation in the second quarter.

Again, strong demographics there and owning good properties in good markets and good school districts really contributed there. And I'd say for the first time since the pandemic started, our retail sector had some net positive appreciation of a bottom million dollars. For the last year it's been flat to slightly negative. But this really supports our expectation that in the medium to long-term. Grocery anchored segment is going to remain resilient and will continue to provide essential services and food to it. So local customer base and really drive traffic to these types of centers with essential use type tenants like grocers. So thanks for that question, Jack.

Operator

Thank you. Our next question is coming from the line of Jack Eastman. Please proceed with your question.

Q: Thank you. How are utilizing the portfolio's credit facility to compete for new investments in this incredibly competitive new environment?

Gregg Falk

I'll take that as well, Allan. So the credit facility we had was maturing in May of 2021. We began working with our lending group back in 2020, to see what we could do there to extend and expand it. And we were able to successfully extend it by three years will be the maturity date out to May of 2024, and expanded the facility from $400 million to $650 million. Adding two new national banks to our syndicate. We also have the ability with this new facility to use an accordion feature and grow it to $800 million, as we continue to grow.

We're a low leverage strategy, which makes us very attractive to the banks. Our line is supported by $1.2 billion of unencumbered assets, which really makes it easy for credit departments have these banks to approve us for growth. As you mentioned about it being a very competitive acquisition market. Having this credit facility of this size really gives us an advantage. We can go out and bid on properties without having to add in a financing contingency. We can buy them all cash and put them on the -- put a mortgage on them later if we want to and use those proceeds to pay down the line.

So far this year, this strategy has been very successful in this very competitive market. We have an acquisition pipeline of nearly a billion dollars in investments that we should close between now and the end of the year. So everything is working the way that we kind of had planned on it and very happy to have this credit facility that all done and documented and being able to use it out in the market to get an advantage when it comes to acquisitions. Thanks for that question Jack.

Operator

Thank you. Our next question is coming from the line of Chris Hill. Please proceed with your question.

Q: Thank you. Can you tell me how the investment in New York City retail you made a few years back fair during the pandemic and your outlook for going forward?

Allan Swaringen

Yes, Chris. Thanks for the question. So almost all of our retail allocation, which setting about 22% of the fund today is predominantly in the grocery anchored sector. But we did make a venture investment in the existing portfolio of very high quality, long dated, high credit lease, what we thought was essential, kind of forever location type properties in the five boroughs of New York.

Really high profile locations like Atlantic station, Atlantic center, locations on Time Square. And, but that sort of retail certainly was not immune from the pandemic, and businesses being shut down. So a number of larger tenants certainly continue to pay rent during according to their lease obligations. But some of them had requested rent deferrals and rent relief to keep those businesses open and running inviable. We granted that during the pandemic. That said, we're starting to see increased traffic at all of those locations and increased sales. And we're seeing higher collections and good recoveries there. That was a very long-term investment for us with a time horizon of 10 years more.

A lot of that was because a number of the properties have very long leases, and leases that we consider to be well below current market rents. And so the opportunity here is to hold on to those locations, continue to collect rents, and then hopefully negotiate better rent deals, when those leases come due. So we have high conviction about that investments. We’re seeing signs and trends, that it's recovering, probably one of the few things in our portfolio that was impacted more by the pandemic, but we see upside and opportunity as vaccinations continue to slow down the spread of COVID.

And we hope that continues. So high conviction investment for us for the long-term, but certainly was impacted during the downturn.

Operator

Thank you. [Operator Instructions] Our next question comes from the line of Max Stegner [ph]. Please proceed with your questions.

Q: Thank you. You've mentioned your recent single-family rental acquisition, can you expand on the portfolio details and how it fits in with IPT's overall strategy?

Allan Swaringen

Yes, Max, I'd be happy to provide a little more color on that, this was a very strategic and we consider meaningfully and very impactful on the IPT portfolio. This is a sizable investment for us. Some of the transaction, we've been working on for many, many months. So just to get it closed, a couple of weeks ago, there's something the team was very pleased to finish and get executed. I think the first way I would frame this is talking about the single-family rental market overall, which our Research and Strategy team has been looking at and kind of investigating pretty thoroughly over the last five years.

And so it's a sector we've been watching. There's a number, there's two large public REITs, and a number of other institutional investors that have been making investments in the sector, this is a sector that didn't really even exist until after the kind of 2007 or 2009 global financial crisis. But the single-family rental sector throughout the United States is estimated to be about a $4 trillion market cap. And less than 2% of that is institutionally owned, which means it's a sector that is really dominated by small owners, renters, mom and pops, folks that just might own two to five homes, kind of within their surrounding area that they rent out.

And so we think it's a sector that's ripe for consolidation and ripe for institutional capital. So that makes it quite attractive. And our research team has really kind of identified it as kind of the next core or near core property sector that that we think will continue to attract institutional capital. So that's kind of the macro perspective. The micro perspective here was this is a $1.2 billion portfolio of fully owned and leased, 96% leased and occupied 4,000 homes across 14 different markets in the 11 different states.

So well diversified, high level of occupancy, all of the homes have been renovated. And we had a chance to kind of buy in at what we felt like was a more attractive going into yield and cap rate than even the traditional multifamily apartment communities that we also invest in. So I think what also what we really like about this is if you look at this portfolio, 4,000 homes, no individual home, because these homes are kind of middle home price values plus or minus $300,000. And it's just a little below the national average of home pricing.

So it's not high-end or nor is it low-end housing, it's kind of right Middle America pay homes, but no single, no individual home in this whole 4,000 portfolio is more than 0.02% of the overall investments. So we love that kind of diversification and feel like there's some real kind of interesting risk mitigation strategies from investing in SFR here where you've got that sort of lack of concentrated risk in a single-market, single property, single location.

So we think it'll be a good source of long-term income and cash flow for the fund and are excited to add it just in terms of kind of continuing to increase our residential allocation, but also doing it in a highly diversified way. And our operating partner Amherst is one of the top five players in the whole single-family rental market. So very good, strong operating partner with a great track record that kind of had built this portfolio up property-by-property.

So we're excited to add it to the portfolio. It's a significant source of growth for us. Thanks for that question.

Operator

Thank you. There are no further questions at this time, I would like to turn the call back over to Allan Swaringen for any closing remarks, Allan?

Allan Swaringen

Thank you all for joining us today. We look forward to updating you on our activities after the end of the third quarter. Everyone have a great day.

Operator

Thank you. This does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a great day.