Stockholder Call -

JLL Income Property Trust Q3 2015 Earnings Call

OPERATOR

On behalf of JLL Income Property Trust, I'd like to welcome you to their third quarter 2015 earnings conference call. This call is being recorded and our audience lines are currently in a listen-only mode. [Other operator instructions.] At this time, I would like to turn the conference over to Jodi Akers, Head of Stockholder Services. Jodi, please go ahead.

Jodi Akers

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, 2014, 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 September 30, 2015.

Links to a transcript and audio replay of this call will be posted and available on our website, www.JLLIPT.com. For further information on the Company's performance, we invite you to review our Quarterly Report on Form 10-Q filed on November 6, 2015 and other filings which are available on the Company's website, as well as the SEC's website, www.sec.gov.

Now I would like to turn over the call 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

Thank you, Jodi. Hello, everyone, and thank you for joining us for our third quarter earnings call. Just a few weeks ago, October 1st, marked a significant milestone for JLL Income Property Trust – the three year anniversary of launching this product. So, before we highlight this quarter's achievements I'd like to reflect back on what we have accomplished since we began this program back in the fourth quarter of 2012.

Investment performance is the most relevant measure of success for an investment manager; however, an investment manager's success in attracting capital as a critical barometer of the market's receptivity to and confidence in a manager's offerings. Since 2012 investors and their financial advisors have chosen to allocate approximately $650 million to Income Property Trust – an endorsement that is both energizing and humbling. In keeping with the investment objectives we outlined for investors three years ago we have deployed that capital across three principal strategies – first, acquiring new properties to grow and diversify our portfolio; second, repaying or refinancing debt to reduce our leverage and financing costs and to extend our debt maturities, and third, repurchasing our shares from stockholders that desire to invest elsewhere.

In the last three years we've acquired 25 new properties with a gross value of approximately $630 million and growing our initial portfolio from 33 properties to a far more diversified portfolio of 37 properties. We also repaid or refinanced over $240 million in higher interest rate and loan-to-value mortgages and at a company level reduced our overall leverage ratio from 69% to its current record low level of 36%. And on our third priority, we have repurchased more than $130 million of our shares, returning capital to stockholders that desired liquidity or chose to reduce their allocations to core real estate. During this time we also disposed of 21 properties for an excess of $300 million - all closing within a very narrow range of plus or minus 1% of their most recent independently determined valuations – which we believe should provide investors with confidence in our appraisal-based daily determined NAV.

JLL Income Property Trust remains the preferred daily NAV core real estate offering in the marketplace attracting more capital than nearly all of our competitors combined. We have also significantly expanded our distribution partnerships, which now spans eleven different wealth management platforms representing wirehouses, private trust banks, RIA's and major national independent broker dealers.

We continue to see strong inflows of new capital as general economic and real estate market conditions are favorable. The outlook for property fundamentals remains positive, supported by a resilient US economy and even amid global uncertainty. Preliminary third quarter GDP growth came in at 1.5%, a deceleration from the 3.9% growth seen in the second quarter. The modest headline GDP number masks robust growth in consumer spending and a strengthening housing sector. The expensive dollar and international instability have served as headwinds for US trade and manufacturing in recent months.

Job growth slowed somewhat in the third quarter, averaging 156,000 jobs per month compared to monthly average payrolls of 207,000 in the first half of the year. October saw a reversal of this trend with 268,000 new jobs. Unemployment has been on a steady decline from 5.6% at the end of last year to 5.0% in October. Moody's Analytics predicts hiring will remain strong for the remainder of 2015 and averaging over 200,000 per month through 2016. A robust labor market increases the likelihood that the Fed will begin to gradually normalize interest rates and a modest December rate hike is a strong possibility.

Real estate capital markets remain very active, despite this year's interest rate uncertainty and volatility. 2015 transaction volume is still on pace to exceed its 2007 peak. During the first three quarters, $295 billion of office, industrial, retail, and apartment properties traded hands. Valuations continued to trend upward in the third quarter across a wide range of markets with cap rates near, or in some cases below, previous market lows. Liquidity has strengthened in secondary markets and for lower quality assets as investors search for higher returns beyond the lower yields currently available in prime properties located in gateway markets. Investors, especially those outside the United States, with the lowest cost of capital continue to bid aggressively to win trophy properties in gateway or coastal markets.

Looking ahead, given a healthy labor market and a solid GDP forecast, real estate demand should remain strong for the balance of the year and into 2016. New construction is increasing supply in many markets; however, continuing strong demand for new space is expected to keep occupancies high and may even put upward pressure on rents for the foreseeable future. The potential for continued volatility in the broad financial markets is an ongoing risk with an interest rate hike on the horizon. Our expectation is for rate hikes to be well-managed, ideally resulting in slow and steady increases to interest rates. This has the potential to stabilize valuations in the US commercial real estate markets, however, we do not believe it will reverse recent gains or negatively impact transaction volumes.

Our acquisitions and asset management teams continue to navigate the robust property markets, further execute on our strategic priorities and enhance our diversified portfolio of high quality, stabilized real estate assets. I will discuss these and other Q3 activities in greater detail after Gregg gives you a recap of our financial performance. Gregg?

Gregg Falk

Thanks, Allan. Our success with active asset management, property acquisitions and strategic dispositions are reflected in our financial results and operating performance. As I highlight our results I will discuss key underlying drivers of our performance.

For the nine months ended September 30, 2015 we reported net income of $19.9 million or $0.36 per share, an increase of $16 million and $0.29 per share compared to the prior year. As discussed in prior quarters, the disposition of our four student housing properties in Q1 generated large gains.

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 nine months ended September 30, 2015, we reported FFO of $19.6 million, a decrease of 12% compared to the same period in 2014 the result of an increase in debt extinguishment costs related to the sale of our student housing properties, acquisition expenses and accrued performance fees related to our current strong investment returns this year.

We closely monitor AFFO as a supplemental measure of operating performance. AFFO is calculated as FFO adjusted for non-cash items and non-operating expenses. Year to date

AFFO was $20.8 million compared to $19.6 million for the same period in 2014, a 6.3% year over year increase in total AFFO. The increase in AFFO is principally attributed to the performance of our new property acquisitions and increased rents from our office properties.

The ongoing economic recovery and related labor market strength drove improvements in the fundamentals of each of the four main property types during the third quarter. Vacancy rate declines continue to be the most pronounced in the office and warehouse markets, with vacancy rates in both sectors falling 80 basis points year-over-year. In our portfolio the overall office occupancy remained steady at 93% and compares favorably with National office occupancy at 87%. During September we signed Amazon to an expansion and extension of their lease at Monument IV at Worldgate. The lease amendment increases their occupancy in the building by approximately 83,000 square feet and extends the expiration for twelve years to April 2027. The lease amendment also keeps Monument IV 100% leased through 2027.

According to CBRE-Economic Advisors, occupancy for the national Warehouse sector averages 94%, an occupancy rate now above the highest level seen during the peak of the previous economic cycle. In this property type we continue to perform better than the national average with our industrial occupancy at 99%. The slight decrease in occupancy from Q2 is the result of acquiring a 7 building industrial portfolio located near O'Hare Airport in Chicago, IL, which is 92% leased. The portfolio is leased to 14 tenants in a diverse mix of industries. Of the seven buildings, only one building has vacancy and we are actively engaged in leasing the space.

National Retail occupancy rates rose to 94% during the quarter. This was a 10 basis point increase in occupancy in what has been a slow, but steady recovery for this sector. Our portfolio retail occupancy increased to 97% this quarter, in-line with the prior year. Over the last two years we have acquired 5 well-leased grocery-anchored community oriented retail properties, which has positively impacted the occupancy in this segment of our portfolio.

The National Apartment occupancy rate at 96% is the highest ever recorded for the apartment sector spurring attractive rent growth in this property type. Our apartment occupancy remained stable at 95% this quarter. We experienced strong leasing efforts at two of our student housing properties. Campus Lodge Tampa and The Edge at Lafayette increased occupancy by 4% and 9%, respectively, compared to the prior year. Looking ahead, accelerating new construction in the overall apartment sector may make it more challenging for occupancy in this sector to continue to rise.

We feel positive about the occupancy of the portfolio remaining stable around 97% at the end of the quarter. Our weighted average lease duration at September 30th was 6.8 years, a slight increase compared to the prior quarter. The acquisition of Whitestone Market, located near Austin, TX, increased our portfolio's weighted average lease duration. This retail property has an average remaining lease term of approximately 14 years with limited near term roll.

Low vacancy continues to support positive rent growth across all major sectors. Supply levels are rising but have been matched with record high demand, keeping fundamentals in balance. Office rents have seen the highest growth over the past year, increasing by 4.8%. Warehouse and apartment rent growth are also both strong, at 4.6 and 4.3%, respectively, on a year-over-year basis. Retail rent growth continues to lag as compared to other property types; however, at 2.7% annual rent growth still outpaces annualized inflation.

Touching on our returns and distributions, offering an attractive level of current income for distribution to our stockholders is one of our primary investment objectives. Our board of directors approved a gross distribution for the fourth quarter of 2015 at $0.12 per share to stockholders of record as of December 30th, payable on or around February 5th. This was the sixteenth consecutive quarterly dividend declaration dating back to the first quarter 2012. These gross dividends will be paid out to stockholders, but will be reduced for share-class specific fees.

Since we launched our initial public offering in October of 2012 we have provided annualized total returns for our Class M shares of 7.6% and annual year to date total returns of 8.3%. At the end of the quarter our NAV per share for Class M shares was $11.10 with 5.0% realized share appreciation as a result of increasing property valuations and a positive impact from property operations. Returns for Class A shares are slightly lower because of the different fee structure. We experienced valuation increases across the portfolio with our office properties leading the way, including 111 Sutter Street, our office building in San Francisco, which is currently one of the strongest office markets in the US.

Now, I'll hand the call back over to Allan to discuss in detail our significant accomplishments for the quarter.

Allan Swaringen

Thanks, Gregg.

We had another strong quarter closing three new property investments. Success in attracting new capital along with effectively investing that capital is providing investors with a growing and increasingly more diversified portfolio – diversified by property types, geographic regions and underlying tenant industries.

In July, we acquired AQ Rittenhouse, a newly constructed, 110 unit, 12-story apartment building located in downtown Philadelphia for approximately $51 million. The property is located in the trendy Rittenhouse Square neighborhood that has become a Millennial magnet in recent years. This newly constructed property features studio, one and two bedroom units with condo-quality finishes and numerous tenant amenities including a rooftop lounge and outdoor patio with unobstructed views of the Philadelphia skyline. This investment increases our exposure to the Eastern region of the United States. After closing this property all cash, we put in place a $26 million, 10 year, fixed rate mortgage loan at 3.65% interest rate.

As Gregg mentioned earlier, on September 30th, we acquired O'Hare Industrial Portfolio, a 7-building, 642,000 square foot, industrial portfolio located in close proximity to Chicago's O'Hare International Airport for $71 million. Chicago is the second largest industrial market in the U.S. at approximately 1.2 billion square feet. The O'Hare submarket is a mature, infill area with excellent access to a regional network of highways, rail, and air transportation. The portfolio is strategically located in DuPage County, a county whose more diverse tax base often provides tenants with lower total occupancy costs. With little to no available land, very few new buildings have been built in this infill location in the past several years. This acquisition reflects our strategic approach to grow our industrial allocation through investments in targeted "hubs of transportation" markets like Chicago. With the addition of O'Hare Industrial Portfolio we have completed 7 new industrial investments adding 16 new properties and 3.2 million square feet and investing more than $255 million in this sector since 2013.

Also on September 30th we acquired Whitestone Market, a high quality, grocery-anchored community shopping center located in Cedar Park, just north of Austin, TX. Anchored by H-E-B, the leading grocer in Texas and one of the nation's largest independent food retailers, the 145,000 square foot center is 100% leased to 17 tenants. Located at the intersection of North Austin's main east-west artery and major north south corridor, the shopping center has excellent drive-by visibility and convenient accessibility. Research shows that Austin's economy is among the country's strongest, with projected continued growth in employment and population. In addition to Austin's rapid northern expansion, Cedar Park's projected residential and economic growth should enhance the long-term outlook for this investment due to improving population density and increasing household incomes. This acquisition reflects our strategy to increase our portfolio's exposure to high-quality, grocery-anchored centers in top national retail markets. With the acquisition of Whitestone Market, over the last 2 years we have invested more than $230 million in this property sector, all in targeted retail locations rated in the top-quartile of LaSalle's proprietary ranking of more than 40,000 grocery-anchored shopping centers in the U.S. LaSalle's criteria grades shopping centers based upon their surrounding population density, household income and trade area competition and is a strong buy signal for us as we filter through the billions of dollars of property currently coming to market.

Acquiring new properties with low leverage has allowed us to maintain our Company leverage ratio within our target range of 30% to 50%. At September 30th, our Company leverage ratio was at a record low of 36%, a 10% decrease from the prior year. We have no debt maturities until October 2016, giving us a portfolio-wide weighted average remaining loan term of 6.5 years. For the quarter, our weighted average interest rate on outstanding borrowings decreased modestly to 4.3% as of September 30th.

With the 3 new acquisitions this quarter we now own 37 different properties in our portfolio, comprised of 18 industrial warehouses, 6 grocery anchored retail centers, 6 office buildings, 5 apartment complexes and 2 parking garages. In total, we now own almost 7.6 million rentable square feet. At the end of Q3 our portfolio diversification by property type was 18% for Apartments, 28% for Industrial, 26% Office, 25% Retail and 3% Other (which currently consists of our two parking garages).

As we grow our portfolio of diversified core properties, we remain committed to actively managing our real-estate assets to provide attractive income returns to our stockholders. Financial Advisors and Portfolio Managers are looking for increased diversification and alternative sources of income for their client portfolios and core real estate is well positioned to provide both.

Our target acquisitions remain well located, well leased industrial properties and grocery-anchored community oriented retail properties. We also intend to further rebuild our multifamily allocation through acquiring conventional apartments that may provide growth to our portfolio as our economy continues to expand. We will also dispose of properties when we see better risk-adjusted returns in other property types and markets. We are very pleased with our accomplishments so far this year and are confident we can continue to add value to our portfolio and generate moderate appreciation over time for our stockholders.

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

At this time I will open the lines for your questions. [Instructions for asking questions.]

<Questions.>

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

Thank you for joining us on today's call, and we look forward to updating you again next quarter about our continued progress.