Transcript of
JLL Income Property Trust Q3 2020 Earnings Call
Stockholder Call
November 19, 2020

Participants

Jill Passmann – Senior Portfolio Accountant
Sean Meehan – Portfolio Manager
Gregg Falk – CFO

Presentation

Operator
On behalf of JLL Income Property Trust, I'd like to welcome you to their Third 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'd like to turn the conference over to Jill Passmann from JLL Income Property Trust. Jill, please go ahead.

Jill Passmann
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 September 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 November 6, 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 Sean Meehan, Portfolio Manager and Gregg Falk, Chief Financial Officer. At the conclusion of their comments, we will open the call for your questions.

Sean, if you'd like to begin?

Sean Meehan

Thanks, Jill. Hello, everyone, and thank you for joining us for the review of our third quarter 2020 results. As Jill mentioned, our CFO Gregg Falk and I will be sharing an update on JLL Income Property Trust today. Our President and CEO, Allan Swaringen, sends his apologies as he has joined every one of our earnings calls since inception over eight years ago. During today's call, unfortunately, he is unable to attend due to a scheduling conflict, and he looks forward to speaking with you on our next call when we discuss our fourth quarter and full year results.

The effects of COVID-19 in the US are far from over. Some three months further into the evolving global pandemic than the last time we met in this forum, health risks, social upheaval and economic implications of the virus remain, and as a country, we continue to grapple with a struggling economy, the reopening of schools at every academic level, and a newly elected President-elect. While 2020 has already been a year of unprecedented change and unique challenges – the story of this year feels like it may have a few more meaningful chapters yet to be written.

JLL Income Property Trust enters the fourth quarter in a strong position; hopeful for strengthening market fundamentals and optimistic over the recent vaccine news, but also bracing for uncertainties that could arise from the recent election and a near-term, winter COVID-19 resurgence. However, with this backdrop, the quality and attractiveness of our properties and locations could not be demonstrated more clearly than by the over 700,000 square feet of new and renewal leases we have executed throughout 2020. The resiliency of our core investment thesis is also highlighted by our overall 95% leased status. 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. With that, we will now turn to recapping the third quarter and September 30th year to date investment performance.

We continue to focus on managing and enhancing our $3.1 billion-dollar portfolio of 79 core properties spanning the apartment, industrial, office, and grocery-anchored retail property sectors. While the first and second quarters saw an aggregate 2.8% decline in gross values due to COVID-19 impacts, in an encouraging sign, third quarter property values were relatively flat across the portfolio. In what was expected to be one of our most challenging quarters of the year, our team overcame significant headwinds to deliver stable investment performance for Q3. Across all share classes net of fees, we realized an approximate 1.1% positive income return, 0.4% negative appreciation return and an overall 0.7% positive return for Q3 2020. Quarterly dividends have now been paid for 35 consecutive quarters, with an average annual increase of 4.2% over that 8-plus year period. Year to date total return is a negative 2.3% through September 30th, which is a combination of a positive 3.2% income return and a negative 5.4% valuation decline. Since inception, we have delivered stockholders an annual total return of 6.4% which is a combination of 1.8% appreciation and 4.5% income. These returns are for Class M-I Shares and are net of fees and expenses. Durable income, which has grown at a 4.2% 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 third quarter accomplishments, I will provide an overview of the broad economic environment in which we operated.

Third quarter US economic data showed a strong rebound from COVID-19 lockdowns in the second quarter, yet also an economy that is still short of a full recovery and characterized by widely diverging performance by industry. GDP grew 7.4% quarter-over-quarter in Q3, following a 9.0% decline in Q2. US payrolls, a key driver of tenant demand for space, have rebounded by 12 million jobs between May and October, equal to 54% of the jobs lost in March and April. Impacts diverge by sector, with leisure and hospitality seeing the most volatility. The strong recovery thus far, lack of clarity on additional fiscal stimulus, and a rising rate of COVID-19 hospitalizations contribute to an outlook for slower, but still positive economic growth in the coming months. In this environment the uncertainty around the economic outlook remains high, with potential out-performance from quicker control of COVID-19 and potential under-performance if COVID-19 control is not possible without additional government mandated shut-downs alongside a lack of government support.

For real estate investors, economic conditions impact real estate demand on a delay, with variation across property types. This delay was shortest for apartments, where high-frequency market data showed signs of a rebound during the third quarter. While urban apartment markets continue to weaken, suburban apartment effective rents stabilized in Q3 after declining in Q2. National apartment vacancy edged down about 10 basis points to 4.4% at stabilized properties. Apartment rents declined 2.2% year-over-year, with declines fueled by higher free rent concessions.

Open-air retail saw an immediate impact from pandemic store closures and reduced rent payment rates, but other data is only beginning to reflect the pandemic fallout. Open-air retail vacancy rose 40 basis points in the third quarter to 7.2%, though re-openings allowed rent payment rates to recover and most tenants are operating, although some with restrictions. As for the Office sector, traditional office occupancy is deteriorating as vacancy rose 100 basis points in Q3 to 14.0%.

On the other hand, industrial and medical office fundamentals are proving resilient. National warehouse vacancy declined 10 basis points to 5% in Q3. And while fewer than 30% of all office workers are back in the office, medical office buildings are open and active and employment in health services is rebounding.

Transaction volume in the third quarter remained low, reflecting the aftereffects from the pullback in new offerings and the withdrawal of properties from the market in the second quarter. In September, however, volume picked up meaningfully as the first round of post-COVID transactions began to close in greater numbers. US transaction volume increased 34% in September from August. Offerings of industrial, apartments, and life sciences are up, while retail and office transaction activity remain more limited. For industrial and apartments, pricing has been strong, close to or even exceeding pre-COVID levels. Debt for core properties is widely available at attractive terms.

The NCREIF Property Index, also referred to as NPI, quarterly appreciation return improved to negative 0.3% in Q3, up from negative 2.0% in Q2. Combined with a Q3 quarterly income return of 1.0%, this moved the quarterly total return to a positive result. Malls have been the worst performing major property type with appreciation over the trailing four quarter period at negative 12.2%. Neighborhood and community retail centers fared better but saw a trailing year appreciation return of negative 6.5%. Apartments, where NOI is usually the fastest to react to market changes due to short lease terms, had an appreciation return of negative 1.7%. Office, helped thus far by its longer lease terms, had negative 1.5% trailing year appreciation. Industrial had a robust 5.4% positive trailing year appreciation as many investors look to increase their industrial holdings.

Now having covered the national market update and industry-wide returns, Gregg will share a closer look at our portfolio's financial performance results for Q3 before I continue. Gregg?

Gregg Falk

Thanks, Sean. As of September 30th, we earned year to date revenues of $145 million dollars, compared to $127 million dollars in the prior year. The increase of $18 million dollars is primarily related to new acquisitions we made during the past year. Third quarter net loss was $10 million dollars compared to a net loss of $5 million dollars in the third quarter of 2019. The increase in net loss is 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 and a prepayment penalty on the early payoff of a mortgage loan to allow us to take out a new mortgage loan at a significantly lower interest rate.

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 30th, we reported FFO of $39.4 million dollars, a decrease of $5 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 was $0.23 cents per share through September 30th.

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 third quarter was $49 million dollars, an increase of $1 million dollars or 2% over the prior year, primarily related to the new acquisitions we have made over the past year. This translates to $0.29 cents per share.

Rent collections picked up in Q3 compared to the first half of the year, as businesses continue to recover from COVID-19's effects. Total portfolio collection rates as a percentage of billings in the third quarter were in the low to mid 90's range each month. 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 $3.7 million dollars, made up of $2.6 million in rent deferrals and the remainder in rent abatement. We expect to recover the rent deferrals over a longer period of time, generally six months to one year. We also expect our credit losses to be higher when compared to our operating history.

Portfolio occupancy remained quite strong throughout 2020 with the portfolio leased at 95% through the third quarter. Our occupancies by segment were 98% for Industrial, 95% for Apartment, 93% 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.

Our asset management 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 was a strategy of our management team, which has provided great benefit to us today and into the future. In fact, 2019 was one of our best leasing years ever, signing over 1.5 million square feet of leases. 2020 has had significant leasing activity as well, despite the additional challenges COVID-19 has caused this year. Through September 30th, we have signed leases for over 700,000 square feet, with the weighted average rent increase of a half of a percent. During Q3, a 114,000 square foot lease was signed with a new tenant at the Valencia Industrial Portfolio at a rate 5% above the previously expiring lease and a 60,000 square foot lease was signed to fill up the vacancy at Taunton Distribution center. Shortly after the close of Q3, we had 2 grocery tenants sign 10-year lease extensions taking these 65,000 square foot stores lease maturity out to 2033 and 2035. Active asset management has been a key to our strategy since we launched in 2012. With only 7% of our commercial rental space 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 November 5, 2020, our Board of Directors approved a gross dividend for the fourth quarter of 2020 of $0.135 cents per share. The dividend is payable on or around December 30, 2020 to stockholders of record as of December 23, 2020. All stockholders should receive $0.135 cents per share, less share class specific fees, and the annualized yields 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 1.9%, for a total return of 6% over that eight-year period.
Our NAV was approximately $2 billion at the end of the third quarter. Our daily NAV methodology has provided stable market valuations, as evidenced by our sub 2% standard deviation of share price.

Third quarter valuations were relatively flat when compared to the second quarter, with positive valuation adjustments for our apartment and industrial sectors being offset by capital expenditures across our portfolio. Year to date, we have reinvested approximately $8.1 million dollars of capital improvements into our existing portfolio, all geared toward maintaining our higher occupancies. We will be thoughtful with our capital improvement expenditures over the near term as we continue to assess the impacts of COVID-19 on our existing portfolio.

Now, I'll hand the call back over to Sean to discuss Q3 activities.

Sean Meehan
Thanks, Gregg.

We suspended all acquisition activity underway before the shut-down to preserve capital, maintain our strong liquidity position and to take advantage of more attractive investment opportunities upon re-opening. Industry wide, transaction activity has recently begun to recover, and we are now pursuing several attractive opportunities as well.

As of September 30th, our portfolio diversification by property type was 32% Apartments, 26% Industrial, 26% grocery-anchored Retail, 15% Office, of which 6 percent is medical office, and 1% Other, which currently consists of two parking garages.

Our overall company leverage ratio decreased slightly to 36% at the end of Q3. Approximately 95% of our borrowings are at a fixed rate and we have minimal debt maturities through 2022. Our portfolio-wide weighted average remaining loan term is 4.9 years and our weighted average interest rate on outstanding borrowings is 3.6%.

As for stock transactions, share repurchases significantly decreased compared to Q1 and Q2 as the market began to stabilize. We repurchased approximately $45 million dollars in shares pursuant to our share repurchase plan during the third quarter, which had a quarterly limit of $99 million dollars. For the fourth quarter 2020, share repurchases will have a limit of approximately $98 million dollars, which is 5% of our NAV as of September 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 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.

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 toward 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 what we believe to be ample liquidity with over $270 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 our colleagues within the JLL Income Property Trust team and within

LaSalle who continue to perform incredibly during this pronounced challenging environment. We also sincerely appreciate the trust that 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

Thank you. Ladies and gentlemen at this time, we will be conducting our question-and-answer session. [Operator Instructions] Our first question comes from the line of John Guinee. Please proceed with your question.

Q: Great. Well wonderful job, nice job on the call. A few questions, first on the sources of capital, the fundraising side of the equation. It looks like you really had a strong 2Q '19 to 1Q '20 at about $125 million a quarter. But has fallen off a lot in the last couple of quarters, 2Q being very understandable, but 3Q being a little bit of a surprise. Any thoughts on the ability to ramp up fundraising?

Gregg Falk

Sean, I'll take this one. So yes, we did have a bit of a falloff you know with the COVID going on and such and as we kind of look at – look forward and what we're seeing today out there in the markets you know, that – the pace is starting to pick up a little bit although it isn't up to where it was you know, pre-COVID when we were raising you know significant amount of money like you were identifying there. But we are starting to see some green shoots in areas. You know it's challenging for some of our wholesalers as a lot of the offices are closed and they're unable to go you know visit the financial advisors and you know walk them through what we are and what we do, so that's definitely led to some of the slowness in our capital raise. Thanks.

Q: Great. And then thinking about asset recycling. You focused on multifamily, industrial and there'll be life sciences which is you know what everybody else is doing throughout the country and it's really driving capital raise and price is up. Is there a price or a set of circumstances where you begin to think office product and retail product might be more attractive on an overall yield and risk return underwriting?

Sean Meehan

Hey, John. Gregg, I'll take this one. You know that's a good question, we think about that all the time and the short answer is yes, we look at every deal on an asset-by-asset basis you know risk return, so when the price in our mind is right, and when the basket of risks that we're underwriting, you know it is well defined first, for you know office and retail in particular, then, if we feel good about those point for our returns and are getting accounted for the risk, we would certainly think about that as well.

As you do know, there is just that a wall of capital lining up for the sectors, that you had mentioned. So at the balancing act, we are going to be more active. However, in suburban garden-style apartments you know, there's no shortage of those assets across the country that in our view and we think there is plenty of deal flow there for us that we can underwrite effectively and well – using our leverage in-house research and strategy teams.

And then same with the industrial and we have – we're purposefully staying away from the cap rates that are sub 4% and say it in Inland Empire or Seattle for instance and looking at other markets with you know, still really great growth opportunities that run good transportation networks closer to end consumer as well. So we do feel that we can still be nimble and execute there on our strategy but circling out back to your initial question, yes, when the time is right, when the price is right then the returns are more well defined but the risks we'll also you know it's a diverse side funds we're going to look at everything.

Q: Great. Then probably a question for Gregg, looking at JLLIPT versus the other non-listed daily NAV REITs, your balance sheet is probably the best, meaning the lowest levered and I know you got a pretty conservative board, particularly at the top, very smart people. How far up you lever for example, REIT and S-REIT are plus or minus 50 maybe even higher percent levered.

Gregg Falk
Yes, sure I will take that one. So, you know today as we mentioned in the call today, we're at 36% LTV and we do consider ourselves to be under-levered. You know per our perspectives, we're generally going to be in the range of 30% to 50% with kind of 40% having been our kind of historical target.

You know, we have taken advantage of the low interest rate environment, especially with apartments. We recently took out a 10-year mortgage loan at 2.5%. You know so we're locking in a good spread there between the income that the property is generating and our debt service there. And we're also working in two other apartment mortgage loans right now that should go prior late December, early January.

So I think what you're going to see is we're probably going to have our leverage tick up a little bit over the next six months with the intention of probably getting a bit over 40%, but not too much more than that, just to take advantage of these kind of historically low interest rates than you know the type quality core properties that we have, so thanks. Appreciate that question.

Q: And then my last question is, it looks like your NAV REIT FFO for the year are well little lower $0.30 looks like your AFFO maybe $0.40 if you look at a fad number which takes out your run rate on your CapEx, you're probably maybe $0.33, $0.34 for the year and that's against a $0.54 dividend. Does that give you any concern on your payout ratios?

Gregg Falk
You know, we look at our payout ratios over a long period of time. We don't look at it quarter-to-quarter or year-to-year, it's really we're looking like three years out into the future as we model out how our ability to generate cash flows.

So, you know what we're seeing right now is definitely the impacts of COVID that it's with us having on our portfolio and the cash flow is generating and we're pretty conservative company in that how we're tracking our receivables from our tenants you know we've been very aggressive in booking reserves against things that we believe might be uncollectible. So that's definitely taken a hit out of our cash flows this year, but we do see it rebounding likely in the future and you know we don't have any real big concerns with where we're at today.

Q: Great. Thank you very much. Keep up the good work.

Gregg Falk
Thank you.

Operator
Our next question comes from the line of Mike Laudizio. Please proceed with your question.

Q: Hi, thank you. You'd mentioned your occupancy rates have stayed high at 95%. How do you keep occupancy so high? And what's the average lease duration of the portfolio?

Sean Meehan
Thanks, Mike. I'll take that one, Gregg. Yeah, so the high occupancy even in today's challenging environment is a function of a few items. Number one, simply just starting from high occupancy we have got coming in at this. Number two, our managed rollover profile and lease duration which I'll get to, and then three, executing on the re-leasing of our current year maturities.

So just real quickly on each point. First, we came in, in this pandemic on really stable footing at 95% leased, you know I should point out that the stabilized well occupied properties are a cornerstone of core investing and that's how the position coming in. Secondly, you – as you're alluding to with your question on duration, our commercial assets and our fund have a weighted average lease term remaining of about 6 years and so – and we're mindful of any annual concentrations on rollover which is one of the risk mitigation strategies where we look to in versify that risk each year.

And then finally, third, we've been quite successful with our leasing efforts this year, even in the phase of all the challenges. You know Gregg noted we've signed over 700,000 square feet leases through Q3 in 2020 and then given some post-Q3 activity we should have more good news to report on that front on next quarter's call. So thanks.

Operator
Our next question comes from the line of [Max Steiner] [ph]. Please proceed with your question.

Q: Thank you. With the quarter of your portfolio in grocery-anchored shopping centers, how do you see the impact of ecommerce changing these investments?

Sean Meehan
I'll take that one. So first thanks Max for noting that our retail is centered around the grocery-anchored format, which we think has a much different level of exposure to long-term ecommerce disruption than the mall sector, which we're not vested in or as with retail for that matter. So our retail strategy has been purposefully positioned around concepts that are ecommerce defensive.

So that's providing daily necessities such as food and consumer services like getting haircut, going to the dentist, getting your nails done, et cetera, which cannot be replicated online just by its nature. And we feel that through this pandemic, necessities service and convenience retail has actually proven its medal and has shown that this format still has a place in society and that retailers in our centers still need a physical presence and need to be closely on consumer because it's all about convenience and I would note that our stores have about a three-mile trade area radius.

So while you know the buy online pick and store model has definitely proven and effective for grocers. We think that actually may lead to more free time for our customers to cross shop at our centers you know, not having to go through and pick the grocery themselves maybe they get a little more extra time to go get their haircut et cetera and we've also observed that grocers can't sell online and then deliver the food profitably. So we do like that buy online, pick up and store model more that looking to the future.

And lastly I guess I'd just note, it's interesting to know that the growth in ecommerce that was supposed to happen over the next decade that we've all been reading about, seemingly happens sometime over night while we're sleeping you know back in April and the retail that's less standing including grocery centers we think may therefore have less future risk if you will around that point and we do think that dominant grocery-anchored centers and the affluent trade areas such as that we own will be among the few retail subtypes of retail to see a full recovery here. So thank you.

Operator
[Operator Instructions] Our next question comes from the line of Matt Blackburn. Please proceed with your question.

Q: Thank you. Could you please share the breakdown of your top five allocations by region as well as by property type?

Sean Meehan
Sure and I'll take that one, Gregg. You know I'll start with geography, as a diversified fund we see diversified not only by sector, and tenant, but also by location. So within the US, we own across multiple markets. The general framework that underlies our market selection is to invest where there is population growth and job growth that exceeds a regional or national average as well as defined locations within those markets that are attractive and then also have some level of protection against new supply.

And for us, this is meant focusing our recent acquisitions in markets such as Atlanta, Dallas and Phoenix and those are each top five markets for us. And then in terms of region, about 40% of our portfolio is invested in the west, Western US which is also the largest region by definition, but which is well diversified by metro areas such as you know again, Phoenix, San Diego, Portland, Seattle, LA, among others.

And then in terms of property allocations, our largest sector is multifamily apartments at 32%, which is 75% suburban, garden-style and that's a sector you know as a I noted on the prior question with John that we really like and continue to add to. Within that sector, I should also note, we do own 1 student housing asset which is the subsector we're not enamored with, and which is under strain given the pandemic, but thankfully that one asset is less than $20 million of our entire portfolio. So really material in the context of a you know, $3.1 billion size.

And then our second and third largest allocations are industrial and grocery-anchored retail which is just covered, both of those are at 26% and our smallest allocation is office at 15%. But I should also point out here, 6% of that 15% is medical office and that's a subsector of office that we really like today and going forward looking ahead of that position as well. So there – that then leave less than 10% of our fund in traditional office, which is an underweight we are quite pleased with more so today than ever. So hopefully that was helpful.

Q: It was. Thanks.

Operator
There are no further questions in the queue. I'd like to hand the call back to Sean Meehan for his closing remarks.

Sean Meehan
Thank you. And thank you all for joining today's call, we look forward to updating you again after we close out 2020. Thanks.

Operator
Ladies and gentlemen this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time and have a wonderful day.