Transcript of
JLL Income Property Trust
4Q 2023 Public Earnings Call
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Participants

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Lucas Kimmel - Portfolio Manager, LaSalle Investment Management
Gregory Falk - Chief Financial Officer, JLL Income Property Trust

Presentation

Operator
On behalf of JLL Income Property Trust, I'd like to welcome you to the Fourth Quarter 2023 Earnings Conference Call. This call is being recorded, and our audience lines are currently in a listen-only mode, and we will open the floor for your questions and comments after the presentation.

At this time, I'd like to turn the conference over to [Sean Nolan] [ph] from JLL Income Property Trust. Sean, please go ahead.

Sean Nolan
Thank you 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, 2023, and in our other reports filed with the SEC. The Company disclaims any undertaking to update or revise any forward-looking statements.

Links to a transcript and audio replay of this call will be posted and available on our website, JLLIPT.com.

Now I'd like to turn the call over to Lucas Kimmel, Portfolio Manager, and Gregg Falk, Chief Financial Officer of the company. At the conclusion of their comments, we will open the call for your questions.

Lucas, if you'd like to begin?

Lucas Kimmel
Thanks, Sean. Hello, everyone, I'm Lucas Kimmel, one of two portfolio managers for JLL Income Property Trust. I've been involved with IPT since its inception and am today covering

for our President and CEO, Allan Swaringen, who had a conflict with some business travel. I'd like to thank you for joining us for our fourth quarter earnings call.

As of December 31st, our portfolio aggregated to approximately $7 billion dollars comprised of 137 core properties spanning the industrial, residential, healthcare, grocery-anchored retail, and office sectors, which includes 20 million square feet of commercial assets and over 10,500 residential units. And it's worth noting that over 80% of our portfolio is in the first three property sectors – residential, industrial and healthcare – three of the top performing sectors over the last three years. Our overweight allocation to the "beds, sheds and meds" property sectors - as well as our move to underweight office beginning more than five years ago has served our investors well. For the year ending December 31, 2023, we delivered a positive 4.4% income return combined with a negative 13.1% appreciation return for a total return of negative 9.3% on our M-I share class. A tenet of our longer term, core investment strategy is delivering durable income that helps temper the inevitable valuation fluctuations across normal real estate cycles. Quarterly dividends have now been paid for 48 consecutive quarters, with an average annual increase of 3.7% over that 12-year period. Durable income and modest appreciation across market cycles, from core stabilized assets, remain the cornerstones of JLL Income Property Trust's investment thesis.

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

2023 ended with solid economic growth in the fourth quarter. The US added 494,000 payrolls and unemployment declined ten basis points to 3.7%. In December, headline CPI was up 3.4% year-over-year, while the Core PCE Price Index increased by 3.9% year-over-year. Q4 GDP growth of 3.3% was substantially above the 2.0% expected, while down from the very robust Q3 growth of 4.9%. Throughout Q4 and now through March, the Fed Funds rate was maintained at 5.25 to 5.5%. According to the US Federal Reserve, the expectation is at the next move in the Fed funds rate will be lower, but the Fed will keep rates steady until it is confident about inflation reaching the target of 2%, likely well into the second quarter.

The LaSalle base case economic outlook aligns with the revised Oxford Economics forecast, which predicts slowing economic growth but not a slowdown of a magnitude that would push the economy into recessionary territory. We remain mindful however that as long as the yield curve is inverted the risk of recession remains elevated.

While the Fed funds rate was stable in the fourth quarter, market-driven interest rates were volatile, and these longer-term rates are very meaningful for real estate pricing and transaction volume. As of the end of Q4, the 10-year Treasury rate was 4.02%, down 36 basis points from the end of Q3 but more significantly almost 1% lower than the peak rate during the fourth quarter, when it touched 5.0%.

The impact of the decline in rate at the end of the fourth quarter is expected to show up in future quarters' capital market activity. The interest rate increases in Q3 and the first half of Q4 weighed on the real estate capital markets, with Q4 quarterly transaction volume 54% lower than in 2022. The Q4 2023 transaction volume of $50 billion was the lowest since Q3 2020 and only 45% of the quarterly average since 2015, despite the fourth quarter historically being a seasonally more active quarter.

Real estate fundamentals are not nearly as impacted by interest rates as real estate capital markets. As of the end of 2023, retail and industrial vacancy rates remain below their long-term historical averages while office and apartment vacancy rates are higher than historical averages. Industrial availability rate was up 60 basis points to 7.1% during the quarter, but that is coming off historically low levels. National apartment vacancy at stabilized properties rose for a fifth consecutive quarter to 5.9% in December, marking a 30-basis point increase compared to Q3 and an 80-basis point increase compared to a year ago. Apartment rents remained flat year-over-year with sunbelt markets under-performing due to elevated levels of new supply.

Office vacancy rose by 20 basis points in the quarter to 18.6%, a level that is putting stress on owners of office properties. In contrast medical office vacancy remained stable at 9.7%, as demand is much more durable in that sector. National open-air retail vacancy decreased by 20 basis points to 5.5% and is now 120 basis points below the pre-pandemic level.

Having covered the industry-wide performance and market update, Gregg will now share a closer look at our portfolio's financial performance during Q4 before I continue. Gregg?

Gregory Falk

Thanks, Lucas. We finished the year with $394 million dollars in year-to-date revenues, as compared to $337 million dollars in the prior year, which represents a 17% increase. The increase is primarily related to new acquisitions made in 2022 and 2023 and increases in rental rates. Year-to-date net loss was $112 million dollars compared to net loss of $43 million dollars in the prior year. The increase in net loss was primarily driven by non-cash interest expense related to our DST Program and non-cash unrealized fair market value losses in our unconsolidated real estate investments.

Funds from Operations, or FFO, is a supplemental measure of operating performance used by the real estate industry, which most closely resembles GAAP net income. For the year ended December 31st, we reported FFO of $41 million dollars, a decrease of $44 million dollars from the prior year, primarily related to non-cash interest expense related to our DST Program. 2023 FFO was $0.17 cents per share.

We also track adjusted funds from operations, or AFFO, as a supplemental measure of operating performance. AFFO is calculated as FFO adjusted for non-operating expenses and non-cash items. AFFO for 2023 was $110 million dollars, an increase of $17 million dollars, or nearly 18% growth, from the prior year, primarily related to the acquisitions we made in 2022 and 2023 and increases in rental rates. 2023 AFFO was $0.46 cents per share.

Stabilized occupancy remained strong throughout 2023 with the portfolio leased at 96% at December 31st. Our occupancies by segment were 98% for Industrial, 94% for Residential, 96% for grocery-anchored Retail, 99% for our Healthcare portfolio, and 80% for our Traditional 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 extension and early renewals in exchange for future lease execution risk is a strategy of our asset management team, which has provided great benefit for us today and we expect will continue to do so into the future. In 2023, we signed new and renewal leases for 1.6 million square feet, with a weighted average rent increase of 26% over the previous rental rate or underwritten rental rates. Our industrial sector was the largest contributor to leasing in 2023, with 1.2 million square feet of signed leases at 53% above expiring rents. Active asset management has been a key to our strategy since we launched in 2012. One of the primary ways that we generate predictable, attractive income for distribution to stockholders is through long-term lease agreements with higher credit tenants. We also continue to strive to lengthen the weighted-average lease term of our overall commercial portfolio, which was over 6 years at the end of the year. In 2023, we reinvested approximately $42 million dollars of capital improvements into our existing portfolio, all geared toward maintaining our higher occupancies.

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 March 11, 2024, our Board of Directors approved a gross dividend for the first quarter of 2024 of $0.145 cents per share to stockholders of record as of March 25, 2024. The dividend is payable on or around March 28th. All stockholders will receive $0.145 cents per share, less share class specific fees, and the annualized yields will differ based on share class. It is worth noting that we will have paid a consistently growing and reliable dividend now for twelve years.

Since we launched our initial public offering in October of 2012, we have provided an income return of 4.4%, an appreciation return of 2.0%, for a total return of 6.5% over that 11-year period for our no fee share class.

Our total company NAV was approximately $4.1 billion at the end of the year. Our daily NAV methodology has provided stable market valuations, as evidenced by our 3% standard deviation of share price.

As an SEC registered company, JLL Income Property Trust holds annual stockholder meetings to seek approvals for various proposals, including the election of our majority independent board of directors, and occasionally other business. Our stockholder meeting is scheduled to be held virtually via internet webcast at 8:30 AM Central Time on June 13, 2024. Beginning in early April, we will be delivering to all stockholders a copy of our Annual Report and Proxy Statement and launch our Proxy solicitation outreach program. We need a majority of our shares of common stock voted in order to have a quorum for the stockholder meeting. We ask for your help in voting your shares or encouraging your clients to vote their shares.

Now, I'll hand the call back over to Lucas to discuss our fourth quarter activities.

Lucas Kimmel
Thanks, Gregg.

During the fourth quarter, we remained active in terms of new investments, adding to our Single-Family Rental portfolio. We invested approximately $17 million dollars to this high-conviction sector and added approximately 54 fully renovated and newly leased homes to our portfolio.

Further capitalizing on the current void in the debt capital markets, we closed on our third real estate debt investment in the fourth quarter. Over the next few years, we intend to invest a meaningful allocation to floating rate, senior secured real estate loans. These investments complement our equity investment portfolio and we believe will enhance cash flows and our income returns.

To that end, in December we closed on a $48 million dollar floating rate first mortgage loan secured by a 358-unit apartment community located near North Charleston, South Carolina. This three year, senior secured loan earns an interest rate of 3.85% above SOFR - the Secured Overnight Financing Rate - which today is 5.31%. This investment should deliver an all-in yield of between 8 to 10%. In an environment where many banks and lending sources have restricted lending activity significantly, we see opportunities to invest accretively by filling a void in the debt capital markets as a first mortgage lender, a core competency of our organization with more than $5 billion of real estate loans globally and 20-plus years of experience in real estate debt investing across multiple economic cycles.

Our portfolio diversification by property type at the end of Q4 was 42% Residential, 33% Industrial, 12% Grocery-anchored Retail, 9% Healthcare, and only 3% Traditional Office.

Our overall company leverage ratio was 39% at the end of Q4. Nearly 90% of our borrowings are at a fixed interest rate and we have minimal debt maturities over the next eighteen months. Our portfolio-wide weighted average remaining loan term is four years and our weighted average interest rate on outstanding borrowings is 4.1%. While our portfolio is substantially insulated from currently higher interest rates, we intend to closely monitor rate movements and will employ leverage judiciously as and when it is accretive to target risk-adjusted returns.

As for our stock transactions, we repurchased 100% of all redemption requests, approximately $119 million dollars in shares pursuant to our share repurchase plan during the fourth quarter, which had a quarterly limit of $157 million dollars. For twelve years , we've never had to limit share redemptions. First quarter 2024 share repurchases will have a limit of approximately $146 million dollars, which is 5% of our NAV as of December 31st. Stockholders should aspire to be long-term investors and hold our shares for seven to ten years or longer. Our share repurchase plan is available to stockholders subject to the quarterly limits and a twelve-month holding period.

Over the last twelve years, we have built what we believe to be a strong, stable real estate portfolio with a conservative strategy and resilient balance sheet, and we will remain true to our disciplined core investment philosophy. The fundamental reason for including real estate in a portfolio is long-term performance. Since inception from October 2012, JLL Income Property Trust has delivered attractive net of fees total returns of 6.5%, while consistently focusing on core, stabilized lower-risk investments.

JLL Income Property Trust continues to deliver a competitive current yield and attractive since inception total returns, all the while maintaining a high-quality portfolio of institutional-caliber investments. We believe both property type and geographic market selection will continue to be the greatest contributors to our long-term investment performance. We are confident that we will continue to add value to our current portfolio and look forward to growing and further diversifying our investments throughout the remainder of the year.

The Fed's recent pause in rate increases – and signals of likely rate cuts later this year – should help real estate property values recover in the back half of 2024. Once interest rates decline, we may see a recovery – ideally a decline in the cap and discount rate appraisal metrics – that has the potential to improve valuations across the industry. While we do not expect the Fed to return to a zero-interest rate policy, real estate valuations should see some recovery during a more normalized interest rate environment.

As an institutionally sponsored real estate fund, JLL Income Property Trust was designed to be an all-cycle investment vehicle, providing the potential for attractive, tax-efficient current income, portfolio diversification, modest capital appreciation and wealth preservation across a wide range of economic conditions.

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
Certainly. Everyone at this time, we'll be conducting a question-and-answer session. [Operator Instructions] Your first question is coming from [Henry Thompson] [ph]. Your line is live.

Q: Hey, guys. You mentioned a significant amount of lease renewals in the portfolio. Can you provide an example of one or two new leases signed in 2023 and the impact it had on the portfolio? Thanks.

Gregory Falk
Hey, Lucas, I'll go ahead and take that. Thanks, Henry. So, yeah, as I mentioned in my prepared remarks, in 2023, we had a really robust leasing there, 1.6 million square feet of new and renewal leases with a trade-out of 26% above expiring leases. The real highlight there was in the industrial sector where we had 1.2 million square feet and about a 53% increase over the expiring rents. But we really saw increases across all sectors. In our healthcare portfolio, we had about 200,000 square feet of new and renewal leases at a 9.3% increase over the previous leases; and in the retail sector, we had another 200,000 square feet where we traded out at a positive 5.5%.

A couple specific highlights in the industrial sector, in Dallas, Texas, we had a 425,000 square foot renewal come in at 70% above the expiring rents. Another industrial property in Tampa, Florida, had about a 230,000 square foot lease come due, and we were able to achieve almost 60% increase over the expiring rents there.

And then healthcare, we had a 150,000 square foot lease in New Jersey come due, and we were able to trade that out for a 14% positive impact. So, our operations are strong and really kind of as strong as they've ever been in a lot of these areas, it's really still a landlord's market, and the ability to raise rents has really given us a lot of positive benefits to increasing our cash flow, which will down the road allow us to think about increasing our dividend again. So thanks for that question.

Operator
Thank you. Your next question is coming from [Max Stegner] [ph]. Your line is live.

Q: Thanks. Single-family rentals was cited as one of your highest conviction sectors. How do you see your allocation evolving in the next couple of years and why do you view it as a focus sector for the portfolio?

Lucas Kimmel
Yeah, I'll take that one. Thanks, Max. So IPT's residential sector, about 42% today, is consists of about 70% multifamily and 30% single-family rentals, give or take. We've always said LaSalle is a research driven organization and single-family rentals are kind of one of the top sectors identified for relative outperformance by our research group. A key secular driver for real estate that we've always said is demographic trends.

For example, we've all heard about population migration into the Sun Belt last few years been a hot topic. This triggered a supply response in apartments, which we're dealing with today is causing some red stagnation in certain markets, but there's still shortage of single-family rentals broadly, and there continues to be immense demand. We kind of stick with the demographic story. The millennial generation is getting older, which has helped drive out performance in suburban multifamily sector, which we've been investing in the last probably decade or so. But it's also a key driver for demand in single-family rentals, as families grow or people need more space to accommodate work from home flexibility.

They're looking for more space to accommodate their needs, because of that, we've seen demand in single-family rentals, we've seen higher yields, higher retention ratios, sort of lower CapEx as compared after the initial renovation, of course, but lower CapEx associated with turn costs.

So, we view SFR as a long-term allocation for IPT's portfolio, although that allocation will fluctuate based on opportunities we see in the marketplace.

Operator
Thank you. Your next question is coming from [Anthony Fortunato] [ph]. Your line is live.

Q: Thanks, Lucas, and thanks, Greg. So my question is, do you anticipate growing your allocation to real estate debt investments? And how would those be impacted if the Fed does cut rates later this year?

Lucas Kimmel
Yeah. Thanks, Anthony. I'll take that one as well. So, I mean, the real estate debt allocation has been part of IPT's investment mandates since inception, although in a low or zero interest rate environment, it didn't make a lot of sense for IPT without significant financial engineering or moving out on the risk spectrum, which is not aligned with our core mandate.

So, as I mentioned in the prepared remarks, there is a serious void in the market that we're taking advantage of, but we are being judicious about where we are lending. We're taking first mortgage positions only between 60% and 70% in the capital stack, in markets and in asset classes. We have identified for investment through LaSalle Research. So we're really comfortable with these assets. And they're accretive today, yielding anywhere between 8% and 10%, but all of these loans do have SOFR floors in them.

So, when the Fed begins to cut rates, we will see a decline in those floating rate loans, but we do have a minimum yield, which remains attractive to us. So we'll continue to look investing in this space, we still really like it and we'll grow this investment. I think what we've talked about generally up to 5% of the portfolio although, again, the guardrails are identified in our investments guidelines, but we'll continue to actively manage the portfolio. So if we see significant changes in Fed policy, we will reevaluate that allocation to remain with our core mandate. Thank you.

Operator
Thank you. [Operator Instructions] There are no other questions, and this concludes today's call. I'll now hand the call back to Lucas Kimmel for closing remarks. Lucas?

Lucas Kimmel
Thank you for joining the call today, and we look forward to updating you again as we close out the first quarter in a few days. Thank you so much.