Stockholder Call -

JLL Income Property Trust Q1 2015 Earnings Call

OPERATOR

On behalf of JLL Income Property Trust, I'd like to welcome you to their first 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 Brittney Mazewski from JLL Income Property Trust. Brittney, please go ahead.

Brittney Mazewski

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 March 31, 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 May 7, 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 the call over to Allan Swaringen, President and Chief Executive Officer and Gregg Falk, Chief Financial Officer. At the conclusion of their comments, we will open the call for your questions.

Allan, if you'd like to begin?

Allan Swaringen

Thank you, Brittney. Hello, everyone, and thank you for joining us for our first quarter earnings call. JLL Income Property Trust had strong first quarter operating results and exceptional progress in attracting new capital, raising $51 million in the quarter. Building on last years momentum, we continued to add value to our portfolio through active asset management, property acquisitions, strategic dispositions and securing accretive financings. This morning, I will first cover recent economic events that directly influence our business and commercial real estate markets. Gregg will then review our financial results and I will conclude with noteworthy accomplishments that occurred in Q1 and our progress toward achieving our longer-range objectives. We will then take your questions.

Despite a slowdown in economic growth in the first quarter, the outlook for US real estate in 2015 remains strong. First quarter growth came in at an anemic rate of 0.2%. This weak growth reflects the severe East Coast winter, cuts in energy investments, the negative impact of a rising dollar, and a strike at West Coast shipping ports. With the exception of the strong dollar, these factors are expected to fade over the rest of the year, paving the way for stronger growth. Oxford Economics forecasts that GDP growth will accelerate to 2.8% for the year, which would be the strongest growth in a decade if it transpires.

Labor market indicators are mostly positive despite a slowdown in employment growth in March. Payrolls gained only 126,000 jobs in March, the first month of sub-200,000 job

gains in over a year. However, other labor market indicators are generally positive. Initial jobless claims remain well-below their long-term average and job openings continue to rise. Moody's Analytics predicts that hiring will regain strong levels for the remainder of 2015, resulting in full year payroll growth just slightly below last year's strong numbers. And as expected, unemployment fell to 5.4% as a result of 223,000 jobs added in April.

While job growth has been strong, wage growth has remained subdued throughout the recovery. A recent acceleration in labor costs over the quarter indicates that wages might finally be picking up. Combined with lower oil prices, this bodes well for consumer spending over the remainder of the year. Lower gas prices are a positive for consumers generally, but it does weigh on individual energy markets. In addition to energy prices, the other notable economic news in the first quarter was the strengthening US dollar. This dollar appreciation limited earnings growth for some US companies, particularly export-oriented businesses such as manufacturing.

There was no let-up in demand from commercial real estate tenants last quarter, a result that is consistent with a continued recovery and strength in the labor market. Property owners continue to gain pricing power as vacancy rates fall, though the pace of vacancy declines is now slowing as construction deliveries pick up. Office and warehouse vacancies have fallen the most over the previous year: office by 100 basis points and warehouse by 90 basis points. Over the quarter, office vacancies declined 10 basis points to 13.9%. Warehouse availability dropped by 20 basis points to 10.2%. Retail recorded a

50 basis point vacancy decline over the last four quarters, although vacancy was flat over the past quarter. Apartment vacancy has changed little over the year, declining 5 basis points over the last four quarters. While vacancy rates are likely to remain flat or fall further for office, warehouse, and retail, apartment supply has caught up with demand and further vacancy declines in the apartment sector are not expected.

Rent growth has been strong, with office and apartment rent growth leading among major property types. Apartment rents grew 4.3% year-over-year, as low vacancy and high renewal rates gave property owners strong pricing power. National office rents increased 3.5%. Edge of CBD locations in Manhattan and San Francisco continue to benefit from robust demand from technology tenants. Houston's office market, by contrast, has started to soften, with large increases in sublease space coming to market. National warehouse and retail rent growth both decelerated but were still up 2.8% over the last four quarters.

Real estate capital markets remain highly active. Q1 had the highest first quarter transaction volumes on record: $104 billion of office, industrial, retail, and apartment properties traded. The high level of transaction activity creates more investment opportunities, but pricing remains competitive. Cap rates moved lower as US Treasury yields moved down 25 basis points over the quarter. Pricing continues to broadly strengthen for trophy properties, and many secondary markets and B quality assets are seeing sharp cap rate declines amid improved liquidity. Buyers with the lowest cost of capital continue to bid aggressively to win trophy properties in gateway or coastal markets.

With a healthy labor market and a 2015 GDP forecast for the strongest growth in a decade, real estate demand should remain strong for the rest of the year. While new construction is increasing in certain markets, we expect occupancies to remain at high levels and rents to continue to increase. The potential for financial market volatility has increased slightly this year with the Fed expected to raise interest rates while growth remains low abroad. Nonetheless, our baseline expectation is for rate hikes to be well-managed, resulting in a slow and steady increase to other interest rates. This has the potential to stabilize valuations in the US commercial real estate markets, however we don't believe it will reverse recent gains or negatively impact overall transaction volumes.

Given the extremely strong investment demand for apartments, in the first quarter we disposed of four of our student housing properties that no longer fit within our investment strategy. With this sale we also retired a significant block of our near term debt maturities. We prepaid another loan during Q1 and successfully completed one new acquisition shortly after quarter-end. I will discuss these and other Q1 activities in greater detail after Gregg gives you a recap of our financial performance. Gregg?

Gregg Falk

Thanks Allan. I'm going to briefly walk through our financial results and certain operating statistics for the first quarter and describe some of the key underlying drivers of our performance.

In the first quarter, the Company had net income of $23.5 million or $0.48 per share compared to net income of $1.3 million or $0.03 per share for the first quarter of 2014. The increase in net income between the first quarter 2015 and first quarter 2014 was primarily related to the disposition of four of our student housing properties during Q1 2015, which resulted in an accounting gain on this sale, but had no impact on NAV as we had previously written the properties up to their fair value.

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. FFO was $6.2 million, or $0.13 per share for the first quarter of 2015 compared to FFO of $7.4 million, or $0.17 per share for the first quarter of 2014. The decrease in FFO between 2015 and 2014 was primarily related to the sale of our student housing properties during 2015 which were owned for the full quarter in 2014. The decrease in per share FFO is the result of the large increase in the number of shares outstanding due to our successful continuous public offering.

We also use Adjusted FFO or AFFO as a supplemental measure of operating performance. AFFO is calculated as FFO adjusted for non-cash items and one-time non-operating expenses. AFFO was $7.0 million or $0.14 per share for the first quarter of 2015 compared to AFFO of $6.6 million or $0.15 per share for the first quarter of 2014. The slight increase in AFFO for the first quarter of 2015 was related to the positive influence of our new acquisitions and strong performance by Monument IV at Worldgate. For the rolling four quarters ending with this first quarter, our FFO to dividends paid coverage was 132% and our AFFO to dividends paid coverage was 124%.

Enhancing the operational performance of our properties continues to be one of the key priorities of our asset management team. At quarter end, our total portfolio occupancy was stable at 98% and increased 1% from the prior year. Our weighted average lease duration at March 31, 2015 was 7.4 years, up 1.8 years from March 31, 2014. We view extending our lease duration as strategically important for our portfolio as it is an indication of the reliability of our earnings.

Looking at each operating segment which we define as our primary property types, our apartment occupancy increased 1% from the prior quarter and prior year to 96%.

Our industrial occupancy remained unchanged at 100% this quarter. This will be the twelfth consecutive quarter having our industrial segment fully occupied.

We continued to maintain our office occupancy around 96% for the quarter and in line with the prior year.

Our retail occupancy was stable at 97% this quarter and increased 3% compared to last year primarily due to the sale of a non-grocery anchored property in 2014.

In all cases, our segment occupancies compare well with national averages of 95% for apartments, 90% for industrial, 86% for office and 94% for retail. Overall, we feel positive about the occupancy of the portfolio, which is near or better than national averages across all property types.

On February 6th and May 1st we paid gross dividends of $0.12 per share related to the fourth quarter of 2014 and first quarter of 2015. These gross dividends were paid out to stockholders, but were reduced for share-class specific fees.

On May 5, 2015, our board of directors approved a gross distribution for the second quarter of 2015 of $0.12 per share to stockholders of record as of June 29, 2015, payable on or around August 7, 2015. Again, this gross dividend will be reduced by share-class specific fees for all stockholders.

In terms of share value, the NAV per share of our Common Stock as of March 31st was between $10.64 and $10.67 per share. The NAV of each share class increased this quarter

as a result of increasing property valuations and a positive impact from property operations.

As of May 11, 2015, the NAV of our shares was between $10.74 and $10.78 per share. The NAV increases are a result of our regular accrual of portfolio income and increased property valuations. I'd like to remind you that we generally do see an upward trend in our NAV throughout the quarter as we accrue our portfolio income, and then we see a comparable reduction in our NAV for the accrual of that dividend payment once we reach our record date.

I'll hand the call back over to Allan to discuss a few of our significant accomplishments for the quarter.

Allan Swaringen

Thanks, Gregg.

As I mentioned earlier, we had a few noteworthy accomplishments in the first quarter. In January, we sold, as a portfolio, four of our student housing properties for approximately $123 million and prepaid $71 million in loans associated with those properties. This sale was in keeping with our strategy to reduce our company leverage as these properties had a combined LTV of approximately 59%. Additionally, bundling the four properties together allowed us to realize a portfolio premium over what we believe we would have received had we sold each of the properties individually.

At quarter end we also achieved a new record low Company loan-to-value ratio of 38% when we retired the $9.2 million mortgage loan secured by South Beach Parking Garage in advance of the March 2017 maturity date. These two transactions together retired nearly 40% of our nearer term debt maturities for the next three years.

Disposing of higher loan-to-value investments, extinguishing near term and often times higher rate debt, and acquiring new properties with no or low leverage has allowed us to maintain our Company leverage ratio between our target range of 30% to 50%. For the quarter, our weighted average interest rate on outstanding borrowings increased from 4.2%

at December 31, 2014 to 4.6% as of March 31, 2015 as we retired $80 million of lower cost floating rate debt that also had risks associated with increasing interest rates.

The cornerstone of our investment strategy will continue to focus on acquiring and actively managing higher-quality income-producing commercial real estate properties across the four primary property sectors. We believe this strategy will enable us to provide investors with a portfolio that is well-diversified across property types, geographic regions and underlying tenant industries, both in the United States and, over time, internationally. At the end of Q1 our portfolio diversification by property type was 14% for Apartments, 24% Industrial, 34% Office, 23% Retail and 5% Other, with Other being our two parking garage investments.

In April, just after quarter end, we acquired DFW Distribution Center, a two building, 643,000 square foot, multi-tenant industrial portfolio for approximately $44.3 million. The property is located in Grapevine, Texas just five miles from Dallas/Fort Worth International Airport, the fourth-busiest airport in the world. The two-building portfolio is 100% leased to six tenants with a weighted average lease term of approximately four years; we are comfortable with adding a few shorter duration leases to our portfolio as this is a multi-tenant property with a good mix of lease durations ranging from six years at the long end to two years at the short end.

With the acquisition of the DFW Distribution Center, we now own 26 different properties in our portfolio, comprised of 11 industrial warehouses, 4 grocery anchored retail centers, 6 office buildings, 3 apartment complexes and 2 parking garages. In total, we own over 6 million rentable square feet.

We are extremely pleased with recent accomplishments. Since 2012, we have raised over $400 million of new capital. We have also disposed of 21 non-strategic properties generating approximately $310 million in sale proceeds. With this capital we have acquired 14 new properties (all of these more in keeping with our go-forward strategy) investing approximately $385 million. We also repaid or refinanced over $280 million in higher interest rate and higher loan-to-value loans and repurchased more than $125 million of our shares, returning capital to stockholders that desired liquidity or chose to reduce their allocations to core real estate.

Lastly, we remain 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 span ten 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 economic and real estate market conditions are favorable. 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. 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.

Continued successful capital raising will allow us to advance our strategic objectives and further broaden and diversify our portfolio holdings. Our target acquisitions remain well located, well leased industrial properties and grocery-anchored community oriented retail properties. We also intend to 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 in the first three months of the year and are confident that 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.

<Questions.>

OPERATOR

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