Transcript of
Jones Lang LaSalle
JLL Income Property Trust - 1Q16 Public Earnings Call
May 17, 2016

Operator
On behalf of JLL Income Property Trust, I'd like to welcome you to their first quarter 2016 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, Head of Stockholder Services
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, 2015, 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, 2016.

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 May 12, 2016 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 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 – CEO & President

Thanks, Jodi. Hello, everyone, and thank you for joining us for our first quarter earnings call. JLL Income Property Trust closed 2015 with exceptional performance in both capital raise and acquisition activity. Building on last year's momentum, we received just shy of $130 million of new capital during the first quarter; a very promising year over year growth trend exceeding Q1 2015 by 150%. This strength in capital raising during the first quarter enabled us to pay off our revolving line of credit that ended the year with a $30 million balance. In the first quarter, we also repurchased approximately $29 million of shares from stockholders rebalancing their asset allocations and we invested $5 million of capital improvements in our portfolio of existing properties. We've also built up a strong pipeline of new acquisitions, two of which already closed in early Q2, with more to come throughout the balance of this year.

We continue to be the preferred daily NAV core real estate offering in the marketplace, achieving a milestone of exceeding $1 billion in NAV at the end of the quarter; an 84% increase in our net asset value over the last 12 months. Our investment performance in the first quarter was positive despite a weaker start to the year for commercial real estate markets. Our daily NAV methodology has provided stable market valuations and we have realized moderate appreciation in share price since we began this offering in 2012. As a non-exchange traded REIT, JLL Income Property Trust is not subject to the same market fluctuations that affect the pricing of listed stocks as our share price is determined based on the appraisals of the real estate investments we own. The receptivity to our program continues to demonstrate the market's overall confidence in our methodology and investment strategy.

From a broader perspective, first quarter GDP growth was 0.5%, representing a deceleration from the fourth quarter's 1.4% growth rate. A drop in business spending contributed to this tepid growth rate, along with declines in net exports, federal government spending and inventories. First quarter GDP has been similarly weak during the past two years, equating to -0.9% in 2014 and 0.6% in 2015. In prior years, GDP rebounded in the second quarter and it is expected to do the same this year. Oxford Economics forecasts GDP growth of 2% for 2016, somewhat below the 2.4% annual growth rate experienced in 2014 and 2015. Inflation remains below the Fed's 2% target. The Fed did not move interest rates at its April meeting but a rate hike is still on the table for June. Normalization of interest rates is expected to be gradual and will proceed only under continued strengthening economic conditions.

The labor market continues to show signs of good health. The unemployment rate is 5%, down 60 basis points from the end of 2014. Monthly payroll growth has averaged 234,000 jobs over the last four quarters. Wage growth has been the missing piece of the job market recovery. Wages are up 2.3% year-over-year, which is below the 3 to 4% typical of a mature economic recovery. The oil and gas industry continues to shed jobs, while

construction employment is trending upward supported by rising housing starts and home prices. The US job growth outlook is solid with Moody's Economy.com forecasting average monthly job growth of over 200,000 for the next two years.

Real estate capital market conditions have stabilized in Q2 after a bumpy start to 2016. Transaction volumes fell in the first quarter, after a record year in 2015 in which $423 billion of real estate traded across the four main property types. During the first quarter, $87 billion of office, industrial, retail, and apartment properties traded, which is 10% lower than the first quarter last year. While investment activity was down in the first quarter, pricing has remained in line with 2015. US listed REIT prices declined in January and February but then rebounded, finishing the quarter 5.3% higher than where they began at the start of the year. The broader equity markets were also quite volatile in Q1. The S&P 500 Index fell 10.5% from the end of December to mid-February, but these losses were reversed by the end of the quarter.

Gregg will now give you a recap of our first quarter financial performance and I will discuss our noteworthy activities in greater detail after his review. Gregg?

Gregg Falk – CFO & Treasurer

Thanks, Allan. We are pleased with our financial and operating results this quarter despite a pause in the capital markets early in the year which we don't believe is a trend. As I highlight our financial results I will discuss the key underlying drivers of our performance.

We had exceptional growth in assets over the last 12 months reaching $1.6 billion in gross assets, an increase of approximately $733 million or 82% from the prior year. We reported total revenues of $29 million this quarter, an increase of approximately $8 million or 35% over the prior year. The Company had net income of $1.5 million or $0.02 per share for the quarter, a decrease from the prior year related to a strategic disposition of four of our student housing properties in the first quarter last year that resulted in an accounting gain. Since that sale the performance of our apartment segment has improved incrementally and we intend to further rebuild our multifamily allocation through acquiring conventional apartments that may provide growth to our portfolio as the economy continues to expand.

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 quarter ended March 31st, we reported FFO of $10.1 million, an increase of approximately $4 million or 62% from the prior year, primarily due to the performance of our 2015 acquisitions. Our per share FFO was $0.12, in-line with the prior year, despite the 78% increase in the number of shares outstanding due to the success of our continuous public offering.

We closely monitor 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 $10.3 million compared to $7.0 million for the same period in 2015, a 48% increase. The increase is principally attributable to contributions from our new acquisitions and increased revenues from our office properties. Our per share AFFO for the quarter was $0.12.

Real estate fundamentals remain in balance as high occupancy continues to support positive rent growth across all four major property types. Class A office rents rose 6.3% year-over-year. Warehouse and apartment rents grew 4.7% and 4.5%, respectively, over the same period. Structural headwinds from e-commerce are holding back the retail sector as rents grew a more modest 1.3% over the past year.

Our office segment occupancy decreased by 6% to 90% compared to the same period last year, but still compares favorably with the national office occupancy rate of 87%. Railway Street Corporate Center our office property in Canada has been experiencing slower leasing activity due to softer market conditions in the Calgary office market amid persistently low oil and gas prices. To put Calgary in perspective, however, our net equity in that property is $5 million or less than 0.5% of our portfolio wide NAV.

According to CBRE-Economic Advisors, occupancy for the national warehouse sector averages 94%, in-line with the previous cycle peak. Our industrial segment continues to perform better than the national average with occupancy at 99%.

The national retail occupancy rates remained unchanged at 94% this quarter. There was a slight increase in our retail occupancy to 95% compared to the prior quarter. Our retail investment strategy continues to focus on retail centers driven by consumer staples, primarily grocery stores. Our asset management team focuses on leasing strategies that retain credit tenants at our centers and back-fill vacancies with strategic tenants that will strengthen the center's overall performance. During the first quarter, at Rancho Temecula Town Center, one of our anchor tenants, Bev Mo, exercised their renewal option for an additional five year term at a current market lease rate. We also added two new leases at the center that will positively impact the tenant diversification at the property.

US apartment occupancy declined 20 basis points during the first quarter as supply exceeded demand. The current occupancy rate of 96% remains near historic highs. Our apartment occupancy remained stable at 95% this quarter, in line with the national rate.

We feel positive about the occupancy of the portfolio remaining stable around 97% at the end of the quarter. This is our tenth consecutive quarter with portfolio occupancy of over 95%. Our weighted average lease duration at March 31st was 6.7 years, in-line with the prior quarter.

Touching on our returns and distributions, it is one of our primary investment objectives to offer an attractive level of current income for distribution to our stockholders. Our board of directors approved a gross distribution for the second quarter of 2016 at $0.12 per share

to stockholders of record as of June 29th, payable on or around August 1st. This was the eighteenth 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 A and M shares of common stock of 6.7% and 7.3%, respectively. Our first quarter total return for Class A and M shares were both 0.7%. We reported total returns over the trailing four quarters for Class A and M shares of 8.4% and 9.1%, respectively.

For the first quarter, there was a decrease in our NAV per share for our Class A and M shares of 0.2% and 0.3%, respectively, as a result of a net decrease in the value of the portfolio as capital expenditures for leasing commissions, tenant and building improvements exceeded the increase in property valuations. Property operations had an insignificant impact on our NAV as dividends declared offset property operations for the period.

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

Allan Swaringen – CEO & President
Thanks, Gregg.

As I mentioned earlier, we kicked off 2016 well positioned for further growth. We are focused on investing capital to enhance our portfolio and increase our diversification by property type, geographic region, lease maturity and underlying tenant industries. The new investments we seek remain consistent with our continuing strategy to target acquisitions of well leased industrial properties, grocery-anchored community oriented retail properties and conventional apartments. We have a strong pipeline of identified acquisitions which we expect to close over the next few quarters. We, in fact, closed on two new properties shortly after quarter end and are encouraged by our current deal flow.

Our apartment acquisition strategy has us seeking investments with two different characteristics that we currently find attractive. First, in urban in-fill locations that appeal to millennial renters, we are seeking newly constructed properties and are willing to take on certain lease-up risks. This strategy has proven to be successful at AQ Rittenhouse, a newly constructed Class A apartment property we acquired in July last year located near Rittenhouse Square in downtown Philadelphia. This property's "millennial magnet" location is characterized by a strong job growth market and equally strong apartment market fundamentals. However, given the property was newly constructed it had an initial occupancy of only 70% at closing. Given the favorable market dynamics and the successful lease up by our asset management team, the property today has achieved stabilization and is currently leased to 95%.

The second pillar of our apartment investment strategy is geared toward identifying suburban locations within highly rated school districts. An example of this is Townlake of Coppell, our 398 unit garden style apartment property located in suburban Dallas, Texas, which also is experiencing strong leasing activity. At acquisition in May of 2015 our monthly rent per unit averaged $1,043. Today, one year later, due to our unit upgrade program which is only partially complete, monthly rents are averaging $1,134 per unit, a 9% year over year increase.

During the quarter we also took advantage of the current low interest rate environment and secured two new financings. In February, we closed on a $40 million mortgage on Monument IV at Worldgate, our office property in suburban Washington, D.C. which is fully leased to Amazon. This loan is for seven years at a fixed interest rate of 3.13%. In March we closed on a $22.8 million mortgage on 140 Park Avenue, our recently acquired medical office property located in Florham Park, New Jersey. That loan is for five years at a fixed interest rate of 3%.

Despite the addition of these financings we maintained our overall company leverage ratio at 38%. With limited near term debt maturities, we have a portfolio-wide weighted

average remaining loan term of 6.1 years. Our weighted average interest rate on outstanding borrowings is 4.2%, a decrease of 4 basis points from the prior year.

During the quarter we also disposed of a non-strategic asset further reducing our exposure to suburban office properties. Over the last four years we have sold 22 different properties in excess of $300 million, all closing within a very narrow range of plus or minus 1% of their most recent independently determined valuations – an outcome which should provide investors with confidence in our appraisal-based property valuation methodology.

After quarter end we closed on two new strategic acquisitions in early Q2. In April we acquired San Juan Medical Center, a newly constructed, 40,000 square foot medical office building in the affluent community of San Juan Capistrano, California, for approximately $27 million. The property is leased to a high quality tenant roster that includes Memorial Care Medical Foundation along with three other medical use tenants. The two-story building is situated in Orange County with immediate access to I-5 and visibility to over 500,000 vehicles a day. The property has a weighted average lease term of over 13 years and annual contractual rent increases in excess of 2.75%. This acquisition represents a continuation of our medical office investment strategy.

Also in April, we acquired Tampa Distribution Center, a 386,000 square foot, Class-A distribution center, for approximately $28.3 million. The property is 100% leased with a weighted average remaining lease term of over six years. This modern, highly functional, cross-docked warehouse is leased to two publicly-traded companies and serves as their primary distribution facilities for Central and Southwest Florida. In keeping with our strategy to invest in "hubs of transportation" industrial markets proximate to irreplaceable transportation infrastructure, the property is strategically located in Tampa's Eastside submarket readily accessible to interstate highways, Tampa International Airport and the Port of Tampa Bay. This is the seventeenth property investment we have made in the industrial sector over the last three years, growing our portfolio allocation from 6% to 22% representing an industrial segment investment of nearly $345 million.

With two new acquisitions, our portfolio is now comprised of 19 industrial warehouses, 22 retail centers, 7 office buildings, 5 apartment complexes and 2 parking garages. In total, across all 55 properties, we now own interests in over 11 million rentable square feet. At the end of Q1 our portfolio diversification by property type was 14% for Apartments, 22% Industrial, 24% Office, 37% Retail and 3% Other, which currently consists of our two parking garages.

As we grow our portfolio of 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. We are very pleased with our accomplishments so far this 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.

Operator
At this time I will open the lines for your questions. (Operator instructions.) Our first question comes from the line of Duncan Eastman, a private investor. Please proceed with your question.

Q: Hi, thanks for your time today. My first question is when looking at the diversification of the portfolio, how do your current holdings compare with our target by property type?

Allan Swaringen – CEO & President
Great question. You know when we think about portfolio construction, I think I initially respond that we are very pleased with the current portfolio allocation where we're placing our bets across the four primary property types. But I'd also say we're still pruning a few smaller non-strategic assets. We currently have one of our few remaining student housing properties on the market for sale, still looking to exit any of our suburban office properties. But we also very much are continuing to identify industrial acquisitions, so as we grow the overall company, we'd like to continue to grow our warehouse industrial allocation and continue to grow our grocery anchored retail allocation and our traditional apartments.

So if you look at us on a portfolio-wide basis, I think over time our percentage weightings to different property types should remain consistent over about the next year, though our office allocation just by the math of growing and our investing less in that area, you're going to see our overweight to warehouses, our overweight to retail and our neutral weight to apartments probably continue to grow with our office allocation continuing to shrink a little bit. So very much like where we are today, really feel like what we've been investing in the last two or three years is where we always wanted to get to. So it's nice to be where we want to be, what we were shooting for a number of years ago.

Q: All right, thank you very much.

Operator
Our next question comes from the line of John Roberts. Please proceed with your question.

Q: Hi, good morning. Thanks for taking my question. I just wanted to get your outlook for interest rates and I just wanted to know how do you manage your program to protect against rising interest rates?

Allan Swaringen – CEO & President
So that's a very often-asked question, and I very much wish I had a crystal ball to predict interest rates. We don't, so we do tend to rely a lot on our in-house research and strategy team and our resident economists and experts. I would say generally as a firm, we subscribe to the continued mantra of lower for longer, so underpinning that is the expectation that the generally slower growth economy and trend of the economy will continue. So we would expect short rates to continue to be low for some time, and we'd expect long rates to continue to be low. And when you see what's going on around the world with certain countries having zero to negative interest rates, it's hard to imagine that US interest rates could continue to increase given the credit quality of the US bond market, but still being substantially higher than the negative interest rates in places like Japan and Germany. So we still subscribe to the general lower for longer mantra.

What I would say as far as how we think about interest rates and how we try to desensitize the income property trust portfolio to interest rates, first off we have very little floating rate exposure, so other than our revolving line of credit, we don't have too much floating rate exposure. We may in fact add some floating rate exposure over time just because floating interest rates are so cheap now they're at least 150 to 200 basis points lower than long-term fixed rates. But at the same time we're going to continue to stick to our strategy of when we buy a property and if it's really perceived to be a very long-term hold for us, we're going to typically borrow ten year or longer long-term fixed rate mortgages principally from life insurance companies. So for the most part we work very hard to desensitize our portfolio to interest rates really trying to marry up long-term borrowings with long-term holding assets and not having too much interest rate exposure at the short end of the curve. So that's our current perspective on interest rates.

Q: Okay, thank you.

Operator
(Operator instrucxtions.) Our next question comes from the line of Pierre Ledoux [ph] with Amplified Investments. Please proceed with your question.

Q: Yes, hi. With you guys' current pace of capital raise so far this year, are you still finding the volume and quality of deals that fit your acquisition strategy or have you had to stray at all?

Allan Swaringen – CEO & President
You know, it's a great question, and we are very pleased with the strong response to our continuous public offerings both last year and this year. As I'd mentioned, as Greg and I mentioned in a call and our comments earlier, investment volume, investment sales and purchases activity actually were off in Q1 2016 versus Q1 2015, off by about 10%, so in market where last year about a little over $400 billion traded hands and Q1 this year about $90 billion traded hands, that's still a lot of product coming to market. Overall last year

we bought about $700 million of new properties, so again, $700 million versus a $400 billion market trade, we're a relatively small component of the overall marketplace. So when you put it in that context, we are still seeing ample product coming to market that fits with our strategy. We have a very clearly defined strategy, so we're not trying to buy everything anywhere. We're really focused on a few select property types and certain market types and certain characteristics of those markets.

Our pipeline for closing new investments throughout this quarter and going into next quarter is stronger than it's ever been, so even though our hit ratio is very low, we look at 200 to 300 properties to bid seriously on 10 to get 1, so we spend a lot of time casting a very broad net to capture a few fish in our nets. We're continuing to see lots of activity out there, and the low interest rates and the overall attraction of commercial real estate still seems to be very high. We're glad to see that cap rates seem to have settled down and they're not continuing to decline as they declined throughout 2014 and 2015. We're seeing a stabilization of cap rates, so we're also still feeling like we like what we can buy and we feel like we can add investments to the portfolio that are still accretive to our current investment performance.

So we're going to stick to our knitting. We're still seeing a lot of good opportunities and are not at all concerned about necessarily falling behind on our strong capital rating.

Q: Fantastic, thank you.

Operator
Our next question comes from the line of Brian Smith with LPL Financial. Please proceed with your question.

Q: Good morning. Thanks for the call and the information, really good stuff. Just a quick question logistically or on the prospectus. Is there any discussion to change the wording in your prospectus on the 10% wording? For those of us that are broker dealers that have private debt and private equity available, that's very limiting on what we can allocate toward this product because of that 10% being a gross 10% of all non-traded investments. Is there any discussion to updating or correcting that wording in the prospectus?

Allan Swaringen – CEO & President
You know, Brian, we're aware of that challenge that certain advisors face. We are appreciative that advisors have taken the time to understand our strategy and feel like it's something they want to recommend and certainly share and understand your frustration that holy cow, I want to invest in you, my clients want to invest in you, and yet we're blocked out by this 10% limitation.

What I'd say is we're continuing to evaluate that limitation and trying to marry it up with what we're seeing going on with some other regulatory bodies. There's been a lot of

regulatory changes that are impacting the non-traded REIT world, 1502 that is now behind us and IPT was well ahead of, the recent DoL rule which also with our wrap-fee share class we feel like we're ahead of that and the NASAA REIT guidelines which continue to look at these limitations. And as you know, certain states have this 10% limitation and other states don't have this 10% limitation, so we're continuing to evaluate whether it's more appropriate to have and incorporate the specific state limitations, which Brian, I don't know exactly what state you're in, but I think Ohio is one of the most restrictive states where they have a 10% limitation. But other states are less restrictive and can allow advisors to incorporate direct participation products in their programs.

So all I'd say we're evaluating it on an ongoing basis. We appreciate your support and interest in us, and we're doing everything we can to try to balance the need of prudent diversification and prudent asset allocation models with also recognizing that there's strong interest for us. So I don't have a fix that I would say is going to happen in the next 30, 60, 90 days, but it's something we're talking to all of our broker dealer partners with, including LPL's home office as to what's the right solution here.

Q: Okay, I appreciate that. Yes, I'm actually in Ohio, but the 10% in Ohio is per product type. But the wording in your prospectus makes it blanket to all BPPs, so that's what makes it a hurdle is even as restrictive as Ohio is, I still can't use you because if I've already got 10% allocated to private equity or private debt, then I can't use you at all, and I have to go out use other non-traded REIT products because of your 10% wording being BPP related, not real estate related.

Allan Swaringen – CEO & President
Yes, all right, well, I appreciate you further bringing that to our attention and sounds like you definitely know your rules and regs there in Ohio. It is something we're continuing to look at. Again, we're very appreciative of the interest and support and feel like we've built a very differentiated product here that should be attractive, but do share your frustration that sometimes these diversification rules and limitations impair your ability to do your business the way you'd like to. So we're on the same side here; we just got to figure out how the best way to work it through the regulators are.

Q: Okay, appreciate it. Got to make sure, yes, we're on the same page that just worded it just as 10% to real estate, I could use your product a lot more. I appreciate your time.

Allan Swaringen – CEO & President
Great.

Operator
We have no further questions at this time. I would now hand the call back to Allan Swaringen for closing remarks. Allan?

Allan Swaringen – CEO & President

I'd like to thank everyone for joining us on our call today, and we look forward to updating you again next quarter about our continued progress. Thank you very much.