Columbia Property Trust (NYSE:CXP)
Third Quarter 2018 Earnings Call and Webcast
October 25, 2018

These prepared remarks are provided for the convenience of investors only. For a recording of the full call, including the question and answer portion that followed these remarks below, please review the [Q3 2018 Earnings Webcast] (link will be active for approximately 12 months after the call).

Matt Stover, Director – Finance & Investor Relations

Good afternoon everyone and welcome to the third quarter 2018 Columbia Property Trust investor conference call. On the call with me today are Nelson Mills, President and Chief Executive Officer; Jim Fleming, Executive Vice President and Chief Financial Officer; and other members of our senior management team. Our results were released this afternoon in our quarterly supplemental package, which can be found on the Investor Relations section of our website and on file with the SEC on Form 8-K. We filed our 10-Q with the SEC this afternoon, and we'll be providing a copy of today's prepared remarks on our website after the call, and an audio replay will be available by this time tomorrow.

Statements made on today's call regarding expected operating results and other future events are forward-looking statements that involve risks and uncertainties. A number of factors could cause actual results to differ materially from those anticipated, including those discussed in the Risk Factors section of our 2017 Form 10-K. Forward-looking statements are made based on current expectations, assumptions and beliefs, as well as information available to us at this time. Columbia undertakes no obligation to update any information discussed on this conference call. During this call, we will also discuss certain non-GAAP financial measures. Reconciliations to comparable GAAP financial measures can be found in our supplemental financial data.

With that, I'll now turn the call over to Nelson Mills.

Nelson Mills, President and Chief Executive Officer

Thank you, Matt, and welcome everyone to today's call. Our results this quarter demonstrate the benefits of the transformation we've undergone, and the tremendous progress our leasing and operations teams have made in recent quarters.

Let's begin with a look at our portfolio, which is one of the best positioned across the entire office sector. We have about 80% of our assets in the high barrier, coastal gateway markets of New York City, San Francisco and Washington, D.C. Better yet, we've focused our efforts on attractive and growing neighborhoods in these key cities. Within these targeted submarkets, a growing number of dynamic companies are seeking recently renovated, flexible boutique space with attractive amenities and services. These features are hallmarks of the Columbia portfolio. As a result, we've been able to attract some of the world's most exciting companies to our tenant roster, such as Twitter, Amazon Web Services, DocuSign, Snap, Gemini and Inspire Brands.

Let's take a look at how this strategic positioning is driving our quarterly results. We generated normalized FFO of 40 cents per share, a 43% increase over the 28 cents delivered in the third quarter of last year. Our same-store NOI growth accelerated to 14.4%, up from 11.7% in the second quarter, and 5.5% back in the first quarter. We also raised 2018 guidance for the third time this year.

Though our portfolio has little vacancy and very few near-term expirations, our team continues to generate significant leasing activity. We leased 421,000 square feet during the third quarter, our strongest leasing performance since the fourth quarter of last year. During the quarter, our leased rate climbed another 20 basis points to 97.3% — that's up more than two hundred basis points since this time last year.

One of our notable leasing successes during the quarter was with Arby's, a subsidiary of Inspire Brands. We negotiated an expansion of the company's lease at our Three Glenlake property in Atlanta's Central Perimeter submarket to take the entire 355,000-square-foot building, which will serve as Inspire's headquarters through at least March of 2033.

We continue to have steady success in Washington, D.C., where we've achieved an 87% leased rate at our Market Square property. This is up from 73% two years ago. We continue to achieve top of the market rates and terms, due in part to substantial renovations we've completed there in recent years, as well as our new rooftop deck that will be opening soon. We expect to have this building 90% leased by year end. The D.C. office market continues to be soft, but at Market Square we are capturing an outsized portion of the trophy office market each year and our rates compete with new construction. We have over 30 Fortune 500 companies as tenants. This tenant community has created a center of gravity for government affairs offices, and all of our remaining vacancy is now in smaller blocks and specifically geared to these tenants.

Just this week, in New York, we signed WeWork to a 15-year lease for all of the office space at 149 Madison in Midtown South. We acquired this property in late 2017 and have explored various options for renovation and re-leasing. After weighing costs, lease terms, and timing, we concluded that a full building lease with WeWork was most compelling. We were able to achieve rent at the equivalent of high-$70's per foot, gross, while saving substantial renovation costs. While WeWork is taking all 115,000 square feet of the office space, 6,600 square feet of prime retail space remain. Assuming market rate and terms on the retail space, we expect to achieve approximately 6% stabilized return on cost for this property overall.

Despite having a well-leased portfolio with very little near-term rollover, we continue to create growth opportunities within the portfolio. Earlier this month, we entered into a joint venture agreement with Normandy Real Estate Partners on an exciting project in Manhattan's Midtown South. 799 Broadway is a fully permitted and entitled, $300 million, ground-up development project. This 12-story, loft-style office building will be located at the convergence of Union Square Park and Greenwich Village. This is a highly desirable live-work-play neighborhood with terrific transportation options, and importantly, there is almost no competing new office supply in this submarket.

The end result will be a stunning 182,000-square-foot, boutique office building, with floor plates ranging from 3,600 to 22,000 square feet, floor-to-ceiling glass, private terraces, and 15 foot high ceilings. We'll break ground soon and expect to complete the project by mid to late 2020. We are already seeing significant demand and are highly confident that this will be yet another value creator for our shareholders.

Another opportunity ahead is our remaining vacant space and future lease expirations. While we only have approximately 200,000 feet in vacancy across the portfolio, the vast majority is located in our top submarkets and best performing properties. As always, we'll continue to be proactive and creative in addressing both upcoming and longer term expirations. And, across the portfolio, our in-place net rents today are on average 10% below current market rental rates. You can see this playing out in our leasing spreads in the third quarter, which were greater than 8% on a cash basis and just above 19% on a GAAP basis.

In addition, we have significant unrealized growth embedded in our recent leasing activity. Our economic occupancy is at 90.6%, still well below our leased rate of 97.3%, so this gap will close as recent leases commence and as free rent burns off and add to our already accelerating and industry-leading same-store NOI growth, which came in at 14.4% this quarter.

Of course, this is just our same store activity. We'll have substantial proceeds from the sale of our remaining non-core assets, and we're also working hard to find the right opportunities to use these proceeds to advance our strategy. This may include some share buybacks, but we're also looking at selected development opportunities like 799 Broadway as well as other value add acquisitions, keeping in mind the potential risks in the overall economy. We may also look to bring in other joint venture partners to spread our capital further, especially if that can be done without requiring more of our own capital. We're not in a position to get into more details today, but want you to understand that we're spending a lot of our energy on finding ways to advance our strategy and create more growth going forward.

I want to thank our team for their drive and hard work that delivered another quarter of strong results. I know they share my excitement about what we've accomplished and what's ahead, and I know they'll make the most of the many opportunities emerging. We're in a healthy financial position, we've maintained a strong balance sheet that allows for opportunistic share buybacks, and we are well positioned to identify new opportunities that will help us meet our ongoing commitment to create shareholder value.

As most of you know, we've gone through a dramatic transformation over the past five years, selling nearly $4 billion of our legacy properties and reinvesting most of those proceeds in New York, San Francisco and Washington D.C., plus one building in Boston. In doing so, we've created a lot of redevelopment and leasing opportunities, most of which we've now capitalized on. We have three large properties left in non-core markets — Glenlake and Lindbergh in Atlanta, and the Westinghouse campus in suburban Pittsburgh. These have not been sold yet because of specific circumstances at each of the properties. However, as we've discussed, we believe now is a good time to market all of these. As a result, Glenlake and Lindbergh are now both in the market, and we plan to do the same with the Westinghouse campus very soon.

Our 710,000 square foot, two-building campus at Glenlake isn't in one of our focus markets, but it's a great success story. A couple of years ago, we added amenities to the ground floor of One Glenlake, as well as to the outdoor common spaces shared by both buildings. As a result we leased all remaining space in Building One at very good rates, and shortly thereafter we completely backfilled all of Three Glenlake with a new lease with Arby's. This project is now 100% leased at good lease terms, and we're expecting a good price.

Our 950,000-square-foot Lindbergh property is at the other end of the investment spectrum. It's only 16 years old, and is situated on the second busiest MARTA rail station in Atlanta, between Buckhead and Midtown, with good parking and attractive residential nearby. However, it is fully leased to AT&T, who will be leaving in just over two years. We think now is the time to market the property so that the buyer has plenty of time to plan and execute its re-leasing strategy before AT&T expires. This is very much a value-add opportunity, and we'll try to find the right buyer to take this on. If we get decent pricing, we'll sell; if we don't, we'll do as we have at many other buildings and re-lease this property ourselves. We'll know more about that over the next couple of months.

Finally, there's the three-building Westinghouse headquarters campus in suburban Pittsburgh. We've completed all of the exterior work on these buildings, and more importantly, the Westinghouse bankruptcy is now resolved after Brookfield bought the company and received all of the required regulatory approvals. As many of you know, during the bankruptcy process we were able to extend the lease to 15 years, so now we have a fully leased property with a good sponsor and about 14 ½ years of remaining lease term. Our plan is to put that property on the market soon.

We expect these non-core asset sales in Atlanta and Pittsburgh will provide about $600 million in proceeds, which we plan to reinvest to advance our strategy in our key markets. These sales will also narrow our investments into just New York, San Francisco, and Washington D.C., plus one building each in Boston and Los Angeles. At that point, we'll be only in high barrier markets, with cash flows that are very high quality and growing. These remaining non-core dispositions will pull back our earnings a bit temporarily, and Jim will provide more color on that in a minute, but we're looking forward to creating solid future growth as we reinvest the proceeds.

We'll keep you posted on our progress with these dispositions.

With that, I'll turn it over to Jim to discuss our results in more detail and provide our updated outlook.

James A. Fleming, Chief Financial Officer

Thank you, Nelson, and it's a pleasure to speak with everyone today and bring you up to date on our progress. Similar to last quarter, we're again reporting strong results, and again raising our full-year guidance ranges, for our year-end lease percentage, our same-store NOI growth and our normalized FFO. For the quarter, we reported normalized FFO of 40 cents, up from 39 cents last quarter, and same-store NOI growth of 14.4%.

Our portfolio is now 97.3% leased, up another 20 basis points as Nelson mentioned, and with limited rollover through the end of year 2020, of just 545,000 square feet. Our economic occupancy, at 90.6%, is now 6.7% below our leased rate. That spread is down from 8-percentage points in June, and 13 percentage points in March. The continued narrowing of this spread will further drive top and bottom line growth.

Our balance sheet continues to be a source of strength. Back in the second quarter you'll recall we sold 222 East 41st Street and used most of the proceeds to pay down debt. We ended the third quarter with a debt-to-EBITDA ratio of 5.7 times.

In October, we paid off the One Glenlake mortgage loan, leaving only one property with mortgage debt – Market Square in Washington, D.C. We now have more than $4 billion of unencumbered properties, and our net debt is now less than 30% of gross assets.

This solid balance sheet, along with the sale of our Atlanta and Pittsburgh assets, will allow us to opportunistically find new growth assets to invest in and continue to execute on our share buyback program. Year to date we've repurchased $42 million of shares, and we have $153 million still available under our current authorization, with 118 million shares outstanding.

Now that we're nearing the end of the year, we have more certainty about our results, and we're able to narrow the guidance ranges for most of our metrics. We've had very good performance throughout the year, and we've already moved our guidance up for most of our metrics. We're now able to move the lower end of our ranges up for leased percentage and same store NOI, with a projected year-end leased percentage of 96-97%, and full-year same-store NOI growth of 12-13%.

FFO is being driven by both solid same-store performance and transaction timing, and for that, we've moved up both the bottom and top ends of the guidance, to a new range of $1.51 to $1.54.

In summary, we're having a very strong year at Columbia Property Trust, and you can see it in our industry-leading metrics and our increased guidance. We're in a strong position given our earnings and cash flow growth, and we're benefitting from a high-quality portfolio and a solid balance sheet. We continue to believe our valuation is not fully appreciated and at these levels represents a great value.

We're pleased with our results this year, and our properties are performing very well. But there is also a timing element to our 2018 FFO. When we first provided FFO guidance for 2018 of $1.41 to $1.46, we expected some down time after the sale of our Atlanta assets. Both Glenlake and Lindbergh are now in the market, but we started this process later in the year than we originally expected, and it's now unlikely that we'll close the sale of either property much before year end. As a result, we expect to have down time in 2019 instead of 2018, resulting in higher FFO in 2018 and lower FFO in 2019.

The growth in our core portfolio should continue to be strong in 2019, with double-digit same store NOI growth for the second year in a row, and this will minimize the dilution and down time, but FFO should be a bit lower next year than this year. Timing of transactions will be important, but in rough terms we think next year's FFO will be in the same general range as we originally projected for 2018, assuming we sell both of our Atlanta properties, as well as the Westinghouse campus in Pittsburgh.

Of course, selling all three of these will leave us with investments only in high barrier markets and very high quality cash flows going forward, and as long as we're able to achieve good pricing, we believe it's the right thing to do for the business. We're going to be patient reinvesting the proceeds. We'll look for additional value-add opportunities and potentially some share buybacks, but we expect that all of our reinvestments will allow us to increase cash flow and FFO per share, and we'll have a strong balance sheet as we look for the right opportunities.

I hope this gives you a general indication of what we're expecting, but more to come when we provide guidance on our next call.

Before we take your questions, Nelson would like to address a question that we've received a number of times recently from analysts and investors.

Nelson Mills, President and Chief Executive Officer

Thank you Jim. As many of you know, there were articles in the *Wall Street Journal* and *Bloomberg* last month that speculated we might have received an unsolicited offer to buy the company and were running a process to evaluate our options. I have three comments on this topic. First, we can't and won't comment specifically on these market rumors. Second, you should rest assured that our board is focused on its fiduciary duty to provide the best result for our shareholders, and our management team is on the same page. And third, all of us at Columbia are excited about our business plan, and we're working hard to add to our track record and to create value for our shareholders.

With that, Jim and I will now be happy to take your questions.

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