Columbia Property Trust (NYSE:CXP)
First Quarter 2018 Earnings Call and Webcast
April 26, 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 Q1 2018 Earnings Call webcast.

Operator

Good afternoon, and welcome to the Columbia Property Trust First Quarter 2018 Conference Call. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference call over to Mr. Matt Stover, Director of Finance and Investor Relations. Please go ahead.

Matt Stover, Director – Finance & Investor Relations

Thank you, and good afternoon, everyone. Welcome to the First 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 in the Investor Relations section of our website and on file with the SEC on Form 8-K. We also filed our 10-Q with the SEC this afternoon.

Additionally, we will be providing a copy of the prepared remarks for today's call on our website shortly after the call, and an audio replay will also 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 Factor 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 turn the call over to Nelson Mills.

Nelson Mills, President and Chief Executive Officer

Thank you Matt, and welcome, everyone, to today's call. It was great to see so many of you at our recent property tours and meetings in New York and San Francisco.

We're certainly excited about the portfolio transformation we've accomplished, we're very pleased with the financial results we're now generating, and we're even more energized about the growth opportunities ahead.

Let's start with a look at our current portfolio, one of the best positioned portfolios in the office sector. More than 80% of our gross real estate assets are located in the three, high barrier, coastal gateway markets of New York City, San Francisco and Washington, DC. Drilling down further, we have an attractive niche positioning in well-performing submarkets such as Midtown South in Manhattan and the SOMA and financial districts of San Francisco. Our portfolio is highlighted by well-located and recently renovated, boutique properties with attractive amenities and efficient floor plates. This has created a competitive advantage in attracting TAMI and other dynamic tenants. These tenants seek unique space, and a landlord that can accommodate their needs for growth and flexibility.

We now have a leased rate of nearly 97%. That's up another 270 basis points in the past year, and we have very little in lease expirations in the next few years. A substantial number of signed leases will commence over the next several months, which will drive dramatic same-store NOI and FFO growth as we move through 2018. Between this cash flow growth, and our solid balance sheet, we're truly operating from a position of financial strength.

Our quarterly results are beginning to reflect the success of our repositioning and leasing efforts in a substantial way. During the first quarter of the year, we produced Normalized FFO per diluted share of 38 cents, up 36% from 28 cents a year ago. We leased 123,000 square feet during the quarter, with a 63% increase in rental rates based on GAAP rents and a 56% increase based on cash rents. This leasing success included a 27,000-square-foot lease with Ernst & Young at 218 West 18th Street, and a 17,000 square-foot lease expansion with Gemini at 315 Park Avenue South, both in New York City's Midtown South.

During the quarter, we sold a second 22.5% interest in University Circle in East Palo Alto and 333 Market Street in San Francisco to Allianz, our joint venture partner, for $235 million. This transaction helped us to spread our investable capital across more properties in our key markets. The attractive pricing was possible because of the desirable portfolio we've assembled and the value we've created through leasing and capital improvements.

Our marketing efforts for the NYU Langone building at 222 East 41st Street in Manhattan are also moving ahead. We believe this process will conclude in the next few months, and we're still expecting a cap rate in the low 4's and net proceeds in the low $300 million range.

But what's most exciting to me is our financial outlook and forward growth trajectory, derived from the high quality portfolio we've assembled in the most desirable markets, and the leasing we've accomplished that has created an embedded growth story. And as Jim will tell you in a moment, due to these efforts we're able to raise our guidance for the year.

First and foremost, our economic occupancy is just 83.4%, considerably below our leased percentage of 96.8%. This gap is going to close as rent abatements burn off, and with it, we'll see the dramatic same-store NOI growth to which I referred. Said another way, over 13 percent of our leased square footage is not yet producing rents, but it will soon.

Our growth story gets another lift from our leasing opportunities. At a nearly 97% leased rate, much of the heavy lifting is behind us, but we still have 253,000 square feet of vacancy and 218,000 square feet scheduled to expire this year and next. I have no doubt that our local teams will make the most of this, pushing rents and developing a strong pipeline of prospective tenants, as they've consistently demonstrated.

That brings me to the next element of the Columbia growth story, which is the substantial mark-to-market opportunity, given our positioning in some of the most attractive markets nationwide. Across our portfolio, we have in-place net rents that are on average nearly 10% below current market rental rates, and our strong rent spreads this past quarter gives you a sense of what that means.

As an example, we purchased 650 California Street in San Francisco's financial district in 2014 and quickly set about revitalizing and modernizing the building, which was 88% leased at the time with more than a third of the leases set to expire within two years. We've since leased two-thirds of the space at triple-digit rent roll ups, and have achieved a 96% leased rate with a diverse, high-quality roster of small to mid-sized tenants.

Before handing over to Jim, I'll summarize by saying that our attractive portfolio along with the growth opportunities I've outlined, give us the confidence to expect same-store, cash NOI growth of 10-12% this year, which excludes NYU, and we see our strong performance continuing into 2019. Recognizing this favorable outlook, we continue to be opportunistic buyers of our shares.

I'll now hand the call over to Jim.

James A. Fleming, Chief Financial Officer

Thank you Nelson. It's nice to speak with everyone today about our first quarter results and outlook for the rest of the year.

We had a strong first quarter and remain on track to meet our 2018 expectations for same-store cash NOI growth, percentage leased, and corporate G&A. Our FFO is trending a bit ahead of our original expectations, and as a result we're raising our FFO guidance today. We believe our growth expectations for both net operating income and FFO place us well ahead of our peers. Our foundation is solid, with a strong balance sheet, a portfolio that's now 96.8% leased, and very limited rollover for the next couple of years. We're excited to build on this foundation with robust cash flow growth, which has multiple sources.

First, our recent leasing success has created a significant gap between our economic occupancy and our leased percentage. Currently at a 13-percentage point spread, we expect significant progress closing this gap during the second quarter and through the balance of the year, with economic occupancy rising to around 93% by year-end. This will result in another $41 million of annualized cash flow versus the first quarter, from leases that have already been signed.

The two Chelsea properties we acquired last October will also add to our growth this year, as they will contribute a full year of income.

At close to 97% leased, we have less leasing work ahead, as Nelson mentioned, but we do have 253,000 square feet of available space to lease, most of it in very desirable buildings in Midtown South in New York, the Financial District and SOMA in San Francisco, the Back Bay of Boston, and Market Square in Washington, D.C. Almost all of this space is in buildings we've recently renovated to maximize tenant appeal. In addition, we have another 218,000 square feet of leases expiring this year and next, which we welcome, given the mark-to-market potential.

Our balance sheet strengthened further during the quarter, enhancing our flexibility going forward. The Allianz transaction referenced by Nelson yielded $235 million, which we used mostly to pay down our bridge loan and our line of credit. We ended the quarter with more than $4 billion of unencumbered properties and just two mortgages across the entire portfolio.

Our net debt as of March stood at 33% of gross assets, down from 37% at year-end, and we had a weighted average maturity of 6.7 years on our fixed rate debt, and 1.6 years on our floating rate debt. We expect our debt-to-EBITDA ratio to end the year in the low six times range, consistent with our leverage goals and benefitting from the strong cash flows that we've described.

It's this strong balance sheet that allowed us to purchase $27 million worth of stock during the quarter, and we still have $168 million available under our current authorization.

Turning to our updated expectations for the year, we're raising both the low and high end of our normalized FFO guidance to a new range of $1.43 to $1.48, which will be an increase of 25% to 30% over 2017. We expect AFFO will increase by an even greater percentage. For the full year, we continue to expect same-store NOI growth of 10 to 12 percent, year-end leased percentage of 94% to 96%, and corporate G&A of $33 to $35 million. All of these numbers assume the sale of the NYU Langone building in New York. And because of this quarter's share repurchases, we've reduced our estimated weighted-average share count for the year to 119 million.

In summary, we're pleased with our performance, proud of the outlook I just shared, and looking forward to updating you further as the year progresses. With that operator, please open the call for questions.

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