Weingarten Realty - 2018 Global Property CEO Conference
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Christy McElroy: -- PM session of Citi's 2018 Global Property CEO Conference. This session is for investing clients only. And if media or other individuals are on the line, please disconnect now. Disclosures are available up here and on the webcast on the Disclosures tab. For those in the room or on the webcast, you can sign on to veracast.com/ask and enter Citi18 to submit any questions if you don't want to raise your hand.

We're pleased to have with us Weingarten Realty, President and CEO, Drew Alexander. Drew, I'm going to turn it over to you to introduce your team to provide some opening remarks and to give us three reasons why investors should buy your stock today.

Drew Alexander: Thank you, Christy. Good afternoon, everybody. Joining me is Steve Richter, our long-time CFO; and Michelle Wiggs, our Vice President and Head of Investor Relations. So thank you all for your interest in Weingarten.

So as you probably know, Weingarten is a principally supermarket anchored shopping center portfolio, Southern and Western United States. Principally a necessity-based goods and services. And I think the three reasons that people should look at in terms of buying our stock is number one, the quality of the portfolio. Number two, that we're very good value from many perspectives, with great operating metrics. And number three, we have an excellent and improving balance sheet.

In terms of what investors maybe don't fully appreciate, which I like better than wrong; is I think--

Christy McElroy: Are you front-running my next question?

Drew Alexander: Well, I thought I was supposed to. I'm sorry, Christy. I thought I was supposed to.

Christy McElroy: You're stealing my thunder.

Drew Alexander: Go ahead. Ask your question. Go ahead. Ask your question.

Christy Alexander: I was just kidding. So the first question we're asking again in every meeting, what's the single-most important thing that investors get wrong about your company?

Drew Alexander: So, what a surprise. I didn't see that coming.

Christy Alexander: Shocking, I know.

Drew Alexander: So and I like to say what I think investors maybe don't fully appreciate goes back to the quality. We're very much a hands-on operator who makes decisions at the local level with a lot of properties in markets where we have offices and great local expertise. So we don't totally looking at a lot of the public metrics and things that drive a lot of the decisions from 30,000 feet. A great example is the cost of living adjustments that are huge in terms of how well $100,000 income spends in Houston versus Washington DC, as an example.

So back in 2011, we started a major transformation effort that we basically concluded. And in 2016, things were pretty good. We bought about $500 million of property, great assets in '16. And then as we get into the fall of '16, people get concerned, the narrative changes and stock starts to drop. So we pivoted, bulked up our disposition efforts and sold a lot of property in 2017, some $444 million. And year-to-date in '18, we've sold over $220 million. So that's over $650 million of property in, say, the last 15 months, strengthening an already strong and improving balance sheet and strengthening a very good portfolio.

So we just basically feel if we can sell the bottom of the portfolio, the bottom half, the bottom quartile at NAV when the stock is at a pretty good discount to NAV that that's a very good long-term strategy.

Christy McElroy: Great. So I wanted to start off with capital allocation, specifically dispositions. Your dilution that you're expected to see in 2018, both from dispositions late in the year in '17 as well as into 2018; the timing and the pricing hits FFO pretty hard from a dilution perspective. This came up a little bit on the conference call. But I just definitely wanted to follow up on it. I wanted to get sense for-- I mean you guys have a great balance sheet, low leverage, modest free cash flow. I know you have development and redevelopment commitments. But you're not -- you do have the ability to lever up a little bit. You do have that free cash flow. So I'm wondering why you felt the need to sell this much, to do this much in terms of dispositions, raise this much capital at such a high cost, just given that it is a very high cost, given the cap rates that are there today.

Drew Alexander: Well, it's again, very uncertain times. And I don't think it's something that we need to do. Again, I think it's something that is strategically the right thing to do, balancing all the factors. But it's certainly not perfect. So while our leverage is good, as we look at some amount of uncertain times potentially, possibilities of rising interest rates; though I don't personally think they'll go up that much. It seemed to us again that if we can sell lower-rated assets somewhat risk assets at about NAV, then that's a good thing to do.

There is the dilution to deal with. Nothing's perfect. The other thing that hopefully we've been very clear about is this will almost certainly trigger another special dividend. So it's something that in a perfect world we could petition the IRS and they'd be nice and not make us do that. But I don't think that's very realistic. So again, balancing all the pluses and minuses, if we can sell a lot of power centers, if we can sell geographically outlined properties, non-metropolitan area properties at our internal assessment of NAV; you know, it's a good long-term thing to do. It definitely has some FFO dilution and appreciate we don't get anywhere near full credit for the special dividend. But again, it seems like the right thing to have an even stronger balance sheet to further improve a good portfolio, as we look at some uncertainty in the retail real estate world.

Christy McElroy: And you're selling around sort of upper 7s, low 8s. As you think about reinvesting that capital and I think you're getting about 8% to 10% returns on the redevelopment side. But then you also have a fairly sizeable new development and mixed use pipeline where the yields are somewhat lower in the sort of 5% to 6% range. So I'm wondering how you think about the balance of that, the risk associated with new development and the lower yields in a time when cap rates have risen in terms of the cost of that capital and then your cost of equity clearly in the public markets has changed. How does that make you feel about putting incremental dollars to work in new development at those lower yields?

Drew Alexander: So I would say we're generally more selling in the middle 7s with some range in any given quarter could certainly get into the 8s. But we've also sold some pretty big properties into the 6s. So I would say that general numbers, in middle 7s. That said, we are very active in a lot of different redevelopments. There's one large project that we've singled out which is a high-rise residential for-lease product, apartment product, at our River Oaks Center in Houston, which is the third-oldest shopping center in the country between the River Oaks area, which is the historic wealthy, a lot of oil business, and downtown. So it's a fabulous location and a great long-term investment. When you do most redevelopments, you don't really put the land in at its current market value. That's part of why the returns on most developments are up into the double digits.

Well obviously when you're building a 30-story tower, the land value doesn't really matter and getting a 6% return on that product, again with residential where it will go up from there; we think is a good investment. We think it sort of transforms that center, the image of the country. And I can go through, if folks are interested, but we could see four other high-rise towers at the River Oaks Center over the next, call it, 15 years. So that project is a little bit unique.

The bulk of our redevelopment efforts we continue to work on $30-40-50 million of tenant repositionings, big box anchor expansions where we can plugging in supermarkets, adding other business and we work a lot of those deals really hard and we'll continue to knock out those singles. We had a great announcement of a Sprouts that added to a center up in the St. Petersburg area on our last earnings call a couple weeks ago.

As to new development, hopefully we were clear that we've got some projects that we're finishing up, great projects in Seattle, Washington and in the Virginia suburbs of Washington DC. And we'll continue to look at things. But we're going to be very, very selective. And I don't see us doing a lot of new development over the near term. It's a function of, as you say, interest rates where tenants are, constructions costs. I don't see us doing a tremendous amount of that.

Acquisition-wise is sort of a similar story. We'll continue looking. We'll continue competing. But we don't think that we will be the winner in a number of cases. The world has dramatically changed. As I said, in 2016, we bought over $500 million and we really did that in about 8 months. Because by September we were starting to slow things down, so 2016 over $500 million. 2017 we bought $2 million, both in little out parcels next to existing shopping centers for redevelopment. So we'll continue to push on the small great risk reward redevelopments and we'll work on finishing the new developments, which are very good long-term projects.

Christy McElroy: And I sort of came away from the call feeling like, given how frontend loaded dispositions are that that buybacks are very much on the table. You made it a point to say that it's not going to be the full $200 million. But it sounds like there's going to be some activity there. What's your desire to do buybacks?

Drew Alexander: So I was very interested in the polling data at lunch on that question and quite a little bit of difference there. So that was interesting. My esteemed colleague, Mr. Richter, pointed out I probably should have said we're not going to spend the full $200 million before we talk to you in April. Because we're at that time in the cycle where the earnings calls are only 60 days apart. So I think buybacks is something that we would look at. But as I said, I don't think we're in any super big rush. I do think in terms of the survey questions at lunch, I do think you have to look at everything, I think. And hopefully we were very clear that we would absolutely only do it on a leverage-neutral basis. And you have to look at your competing alternatives, of which River Oaks is compelling to us, but not a whole lot of other things are. And you have to have the capacity to do it.

So had there been an ABC all of the above choice, I'd have probably went with that. So I think we'll look at some. We report again at the end of April. But I don't see a need again, with the uncertainty about a lot of things, I don't see a need to rush in there and move very quickly on it.

Steve Richter: And I would just add one additional comment on that is that back to a comment Drew made about having a special dividend; if we buy back $300 million or $400 million of-- excuse me-- we sell $300 million or $400 million of property that's going to generate a decent obligation under the special dividend. So if you generate $400 million in dispos, it doesn't give you $400 million in funds available.

Christy McElroy: Sure. It makes sense. I wanted to go back to River Oaks. Because I think it's a really interesting project. I haven't been down there. I think I have been there before, but it's been years. And so I looked at in online before this and I just wanted to make sure I had the whole layout. But it seems like it makes sense. And I get that you want to be part of that upside in terms of the densification. But you also mentioned the potential for four other towers over the next 15 years. What sort of-- we've seen what kind of volatility that the development of apartment buildings and the lease-up and all that can introduce in a company like Federal, who has a residential component. How do you weigh the volatility there that can be introduced in the lease-up of residential into your earnings?

Drew Alexander: It's certainly something that needs to be factored in. The other thing that is important to think about at River Oaks is this first tower is very much vertically integrated, mixed use. There's a very, very successful restaurant right next to this tower. There is some lease space at the bottom of this tower that will likely have some other restaurants. A big portion of why we started the densification was to build more parking. Again, it's a fabulous location between the uptown Galleria area, downtown Greenway Plaza. A lot of people who know Houston, it's what's called a multiple nuclei city where there are lots of different central business mix, downtown being the biggest one, but lots of different ones. So incredible walkability near parks, restaurants. There are four Starbucks in the shopping center. So it is something we think makes an excellent location.

I want to hopefully be clear that four more towers is over a period of 15 years that we will digest things. And this first one we see as rental property, because it is so integrated with the rest of the project. There are other parts of it, if you're looking at the site plan, like where the Pier 1 is that much more lend itself to maybe a condo project. And that is something we could just sell off and make sure a nice condominium is built and not be involved. So there's been some interest in hotels. There's a little bit of office in the product now, but I don't see a lot of that.

So I think it's something that we'll be sensitive to. Again, it's the third-oldest shopping center anywhere. It goes back to the '30s. We bought it in the '70s. It's just a fantastic location that is very much what people want from a walkability, near so many great things perspective. And the nice thing about resi product if you miss the timing a little bit, you get to reprice a year later.

Christy McElroy: Any questions from the audience? And I've got nothing on Veracast. It's like crickets. In terms of you had made a comment on the call in regards to Houston, an asset that you sold. You said you're not averse to reducing your exposure to Houston. I'm just wondering if there's anything more that we should read into that, just in terms of anything else that you're looking to sell or the general comment about the Houston market.

Drew Alexander: So we're pretty comfortable with things. There's a slide in the deck that goes through the transformation and goes through Houston, slide 32. And you can see a lot of the x's there, some of which are sales of substantially all of our investment, some of which are total sales. So the property that we were talking about is a wonderful, wonderful property on the periphery of GGP's Mall and the Sugar Land, First Colony area, Southwest Houston. And it was a great strategic opportunity for us to sell what again is a very good asset, something that we had made a tremendous amount of money in, has a good lineup of tenants with Marshall's and Nordstrom Rack and others. But is what one would think of as a traditional power center.

So that was a low 6 cap rate sale last fall. The center was impacted a little bit by Tropical Storm Harvey. The center did not flood, but a lot of the area around the center did. And we think it's a great center. We think that the folks who bought it will do very well. But for us, from a public company perspective, it reduces exposure to Texas. It reduces exposure to Houston. It reduces power center exposure. Therefore, it increases the amount of supermarket anchored product in the company and it makes the statistic we cite about how much of our Houston income rents come from within 5 or 6 miles of the Galleria of the uptown area, it takes that number up over 60%-- 70%, Michelle tells me.

So it is something. We love Houston, a tremendous amount of growth. We are in such closely and densely populated areas of Houston that we have the ability to push rents. Everything that is going to be built competing with the vast majority of our centers is going to be multi-level, very expensive and our older lower basis full parking lot properties can compete very well with that. So we love Houston. We sold another center with some power center tenants down in Corpus Christi, Texas that again is a great opportunity for us, great center. But from a public company perspective, I don't think we need to be in Corpus Christi.

Likewise, we sold two of our four centers in Kentucky and are working on the sale of the other two. They're great centers, all Kroger anchored. But I appreciate that from a public company perspective, Kentucky is probably not that relevant to a lot the discourse. Nice place, but--

Christy McElroy: Any questions? There's a slide in your deck. And I think it's a pretty standard slide for you guys, but I was looking at it just because coming to here, page 37 talking about the future FFO growth. And I had a question on the acquisitions. Because it's a little bit of a difference from where you are today, right? So the acquisition versus the new development, acquisitions is almost double the development spend and redevelopment spend over that, as you think about longer term, and adding very little to the FFO growth consequently. So I'm just wondering, given where you are today, what do you think changes in the future that you would move to more of an acquisition strategy as opposed to whether it's reinvesting back into your portfolio or ground-up development?

Drew Alexander: So I think a lot of things would have to change. Because right now, as you said, there's a pretty big discrepancy between what properties are worth on Main Street versus Wall Street. So the company is at some pretty significant discount to NAV. So one would think that that kind of difference doesn't last forever. How it's resolved, I don't know. So that slide is much more of a general hypothetical, much more applicable to the conditions of 2016, where we bought a lot of property. But even then the quality of property that we were buying, let's call it a 5 cap rate with some growth. So it's not like it was in the '90s that you were buying things that were very, very accretive from day one. Everybody has talked about, and it's certainly directionally correct that the market for really good centers that we want to buy still very strong, sub 5s in a lot of cases, down even to 4. And if that weren't bad enough, a lot of times they don't really have a good transparent, clear path to growth over a 3 or 4 year horizon.

So as I said before, we'll keep working on acquisitions, keep it honest for other folks; keep the bids strong. But I'm not real optimistic that we'll do a lot. So we'd have to see a change and return to conditions more like '16, which wasn't all that long ago even though it feels like a long time ago.

Christy McElroy: Maybe switching to same store NOI growth, you gave a lot of detail on the call. And I just wanted to get a better sense, for you have more leases commencing in second half versus first half, which is pretty normal what we're hearing. What's the timing of that lease commencement? Is it more Q3? Is it more Q4? Because your lease to commence spread is pretty wide. It widened out from year-end '16 to year-end '17. And I'm just wondering how we should think about the trajectory of the move-ins.

Drew Alexander: So I think the important things for folks to remember is, as you say, it's quite wide. And I think it's one of the good strong tailwinds that we have for same property NOI as to how-- and it is weighted to the end of the year-- as to how it breaks down between 3 and 4. Michelle, I would say it's pretty even with maybe a skosh towards 4?

Michelle Wiggs: Yeah, (inaudible)

Drew Alexander: You know, it is something that has been talked about in a lot of different contexts. It takes a while to replace a tenant. And it's not even so much in the lease negotiation, the tenant approval. That's pretty consistent. A lot of it is as we've gotten into markets with more and more barriers to entry, the permit process can be just months and month and months, even on what is fairly straightforward retail use for retail use.

So it again is just one of those things. Nothing is perfect and generally speaking, barrier to entry markets are good. But sometimes they can be a little frustrating and can be a little time-consuming.

Christy McElroy: Your re-leasing spreads, just looking at them over the last couple years, narrowed a bit in 2017 from where they were. Can you talk about trends and demand for space? I know that there was a lot of sot of box leasing, I think, going on in that. But just general demand for space, what's happened to market rents? Has pricing power been affected by this increased cost of down time?

Drew Alexander: So I think things are fine. But I think we are going to be running -- we talk about in an FFO future vision slide, rent growth in the 10% to 15% area. And I think we're in a market that's closer to the 10% and 9% wouldn't be the end of the world either; than we are to the 15%. We talked about on the call that we've done most of our renewals for '18. So we have that locked in and it's a decent increase. We don't have that many boxes left. So we can afford to work on things and be reasonable.

There is some amount of tenant demand from health clubs, craft stores, the pet stores, and of course the value retail, the treasure hunt retail, Ross, Burlington, TJX, et cetera. So it's not January of 2009. It's not what we experienced in Texas in 1985-6-7-8. But it's not as robust as it was in 2004 or '05 when all the office product guys were competing against each other. So times are okay.

I think everybody appreciates at some level that retail is the least commodity of any kind of real estate. The fact that there's broad vacancy in a market, the fact that there's a box that's ill configured 2 miles away and 5 miles away, half a mile away from one of my shopping centers; is not really relevant. Most of my tenants' rent is comfortably under 10% of their sales. So they want the location that's going to do the best sales. They want a fair deal on the rent. They'll negotiate tough for their companies like they all would. But they're not going to cut their noses off to spite their face and move to an inferior location that's not going to do the sales.

So I think we are looking at rent growth is the good thing. I don't know that it will be the best numbers that we've seen over the last 5 years. But it will be growth.

Steve Richter: Well, but I'd just add to that on the slide we were talking about on page 38, we have in there, rent growth of 10% to 15%. And last year for the full year we were at 11.6%. So that's pretty close right down the middle of the fairway. And we've been stating the same thing for multiple years. And that's a balance between 9% for renewals and 23% for new leases. So I think we're pretty much right where we see long-term.

Christy McElroy: What about on the CapEx side, the leasing CapEx? So that's steadily climbed a little bit over the last couple of years. Maybe you can talk about those higher costs and what you're expecting for '18 and '19.

Drew Alexander: So I think CapEx will stay high. And I don't see it going down. I think construction prices will drift up. How much is hard to say. But if there are aluminum tariffs, that's got to affect the price of studs. You know, if there are lumber issues, that affects wood, steel, et cetera. So it's hard to see construction prices going down. Then you get to the whole labor situation in construction which again is anybody you talk to just about in any market talks about increases on the labor side of construction and definite shortages there.

So while there is good demand from tenants, I would say tenants these days want their space and they want it the way they want it. So I think the TI is going to stay pretty strong.

Christy McElroy: Okay and that actually leads to my next question on construction cost. So obviously we've seen upward pressure. How does that, just circling back to the whole ground-up development pipeline on some of these projects and especially the steel, the newness of the steel tariff; does that potentially create downward pressure on your returns?

Drew Alexander: So I think we'll okay on our pipeline, because most of it is bought out as opposed to--

Christy McElroy: It is. Okay. That was the question, yeah.

Drew Alexander: Is locked and then in the two DC deals, the bulk of the money is in residential. So as costs go up, rent should go up to reflect that. As I attempted to say before, when it comes to greenlighting new developments, I don't think we're going to do a lot of that. Because there just is so much uncertainty and not enough-- not robust enough tenant demand to absorb what I and I think everybody thinks will be some amount of cost increases from probably materials and labor.

Christy McElroy: And just switching to tenant fallout, so you talk about your high grocery anchored exposure. It's 70%, I think, of your portfolio. Where do you see -- so as we do see fallout in junior anchors, are you seeing more of it at centers that are not grocery anchored in terms of that decision-making on the real estate side? I mean I'm just trying to figure out how much. Is the grocery anchor just there's a wide cap rate disparity in grocery anchored centers? Is it real or perceived?

Drew Alexander: I think the driver is all about the center. I mean one of the things that I think we've learned at the conference that we want to present a little more color on at the next conference is with the sales that we've done, I would think the historic numbers we've talked about is about 75% of the portfolio is supermarket anchored. And given that we've sold some pretty big non-supermarket anchored, that percentage is higher. And we're down to in the non-supermarket, a lot of centers like Post Oak and Westheimer are across from the Galleria and other things that I'm not sure what the best label is, if it's specialty. But they're certainly not what one thinks about in terms of a power center at the intersection of two roads in a suburban area with three centers that look the same at all the different intersections.

So I don't think we see an appreciable difference. And what drives it is again all about the center as opposed to really what kind of center it is. We work very hard with all of our supermarkets that we want to keep the supermarkets fresh, the sales strong, the folks committed, adding fuel centers, adding click-and-collect, stores expanded, parking lots well lit, et cetera. And we've sold off even a lot of supermarket centers. So that's part of why today our supermarkets average over $630 a square foot in sales and that includes, we have about 14 Albertson's flags which are some of the Randall stores in Houston at very good locations, and then some Safeway stores in California that are very good for them. But it will be interesting as the Rite Aid and Albertson's merger happens, where they take that company going forward. So we'll certainly pay attention to that.

Christy McElroy: It seems like there's some building concern around bank branches closing. Chase is a top tenant of yours. What are your thoughts on that?

Drew Alexander: I'm pretty comfortable with the locations we have. I noticed we just did a new Chase deal at a center we recently bought here in South Florida. So it is something that yes, they've talked about rightsizing. But in the locations we have, we just see very good bank demand. And most of the banks are on ground leases. So when you get it back, you get a nice building back that oftentimes you can lease to another bank or a quick-service restaurant or something. So we're very comfortable with it. It is something that we continue to do new ones and really haven't lost very many to lack of renewals.

Steve Richter: We think they're good for the rent.

Drew Alexander: Yeah, their credit is good. They're not somebody we're worried about from a credit perspective.

Christy McElroy: I don't know about that.

Drew Alexander: I don't think we have that many Citi branches, like maybe none.

Christy McElroy: I didn't want to disparage my own company. I think you're expecting a decline in G&A in 2018. What's driving that?

Drew Alexander: Sadly as I think we talked about, we separated from a number of folks last fall, as evidenced of the fact that we're not doing as much development. We've sold a lot of property. So we had a reduction in force last fall and had some severance associated with it and a better run rate going forward.

Christy McElroy: Great. Well, we have a minute left. So I'll do rapid fire. Do you expect public-to-public or public-to-private M&A in the strip center sector in 2018?

Drew Alexander: So I think there will be both. But I think there will be more public-to-private.

Christy McElroy: What will same store NOI growth be for the strip center sector overall in 2019?

Drew Alexander: 2 and 1/4.

Christy McElroy: And what will the 10-year Treasury yield be one year from today?

Drew Alexander: Up slightly, let's say 2.95.

Christy McElroy: So 5 basis points?

Drew Alexander: 2.95, yes, 5-6 basis points.

Christy McElroy: Great. Thank you so much, guys.

Drew Alexander: Thank you.

Steve Richter: Thank you.