CENTURION ASSET MANAGEMENT INC

Well, we're just about to get started for the REIT spring now, I guess summer 2021 Advisor Zoom Webinar with Greg Romundt.

I'm just seeing the participants all roll in, so we're going to give it about 30 seconds and we'll get started.

Well.

Hello everyone.

Welcome and thank you for joining this Centurion apartment. REIT zoom webinar with Greg Romundt, president and CEO of Centurion Asset Management. My name is Paul Mayer, head of Sales, and I will serve as moderator for this webinar, which should last around 30 minutes. This webinar will take the form of two parts.

The first part will be Greg will discuss the Centurion Apartment REIT's Q1 2021 results, and then he will answer questions based on topics submitted prior to this webinar by you, the adviser community. Given the large number of participants on this call, all participants have been placed on listen only. I should also like to mention that this webinar is being recorded and will be available on our website before the end of the week. Greg, as always, thank you so much for your participation in this webinar.

Thanks very much, Paul, and thank you, everyone for attending.

You wish to begin with the discussion of the REIT's Q1results over to you.

Perfect, thank you. So we're really quite pleased with where we are. I guess now almost 15 approaching 16 months into the pandemic, and I think it showed into the results in Q1 is going to continue to show in the following quarters. So I'll take you through some highlights I recognize on smaller screens. Depending on how you're viewing this webinar, you might not be able to see all the numbers, but I'll refer to the page numbers so that you can follow along later or refer to some of the numbers later if you'd like to on the rerecord. So interestingly, overall portfolio occupancy dropped from 95.3 down to 87.7, but this was largely due to new acquisitions and student housing.

So if we start breaking some of this out and we see that stabilized properties actually dropped from 292.5 from 98.8, but this was almost entirely due to the student housing portfolio. So adjusting that out, basically occupancy in the standard apartment portfolio didn't change, and the overall occupancy was really affected by both the student housing portfolio and also us on boarding a number of new properties which are vacant or lease up. So we don't really like to consider that as part of a part of our overall occupancy.

So that's why we break them out. Most schools have already announced that in person learning is going to start this fall, so we're anticipating mostly normal student occupancies this fall, so we're expecting to close this gap pretty quickly. The NOI margins, which we have over here, I'm going to break this apart. The headline is not the story. The NOI margins dropped from 67.7 to 61 and a half, again almost entirely due to the new buildings being acquired and the student portfolio. So if we look at same store apartment NOI margins they barely moved down about 0.6%, which we think is really excellent during COVID, during COVID we had a couple of things which even affected this.

Even though rents went up, we did have a lot more money that we spent on things like turnovers. We had more turnover time in prior years and I've talked about this on previous sessions is that prior to COVID when we get a notice of someone moving, we'd be able to go in and scope the work maybe three weeks to a month in advance, start selling the units. So by the time the resident moved out we were already ready with the work scoped vendor like a contractor lined up to go in and do the work. We could turn the unit very quickly and then release the unit with a high degree of confidence. We'd minimize the loss of rent in COVID that was a little different.

Right, so what happened was you want to send somebody into a unit, they don't want anyone in their unit during covet so you would only really be getting to scope the unit after they moved out. Then you'd have to get a contractor to come in so you're already losing a lot more. We expect this is to kind of normalize as we go back into the fall and needless to say, a 0.6% change in stabilized margins I think is really quite good. A trailing twelve month returns were on the lower end of our seven to twelve range with the A class achieving 6.9% in the last twelve months and seven and a half for the F class. The acquisition side was fairly busy but it's set to ramp up quite substantially.

We closed a total of 542 suites and five acquisitions, taking sweet count to $12,300. Collections again as we've messaged have been basically normal almost since the start of the year or since middle of last year. Same store operating revenues were up by 3.7%, which is really quite good. We're very happy to see revenues increasing on a same store basis and even same store NOIs went up by 2.8% over the same quarter of last year. Rental revenues were up 22 and a half percent or 22.4%, which is a strong number but is also affected by the fact that we've on boarded new properties.

We get asked about the lending book. Lending book was very stable with many minimal issues in the portfolio. While the one notable thing to talk about, everyone's talking about inflation and cost repair when hearing about lender, lumber costs and steel costs. So developers for the most part have dealt with that so far pretty well. It might affect newer projects but most of the time the projects were financing are already before you commit funds or 80% costs are already fixed.

So there's limited impact on the development center in progress. We did announce in the quarter $150,000,000 capital raise which was fully allocated about three days. Most of the funds are in with small balances, anticipated to close in on July just to clean up, given our processes as some of the funds tend to close over a period of months just to wait the sales process works. So today fund liquidity is excellent, sitting at about $340,000,000.

But the vast majority of that is earmarked against acquisitions that have been announced and the ones that we have high confidence that will be closing.
So there are many market opportunities today and I refer you to our last newsletter about COVID disrupting life inertia for some perspective on why I think that is. I think that those conditions continue to persist. A couple of notable achievements on the human capital side. We were named as the one of the best workplaces in Canada and we're also named as the company with the happiest employees in the finance industry by Tiny-pulse. Which is the tool that we use to sample employee feedback and try to respond to employee concerns and try to make our culture and our work environment as best as can be.

So that's really nice. Assets are now about 3.4 billion in the reach today and we anticipate with pipeline deals that have already been announced both from developments and in progress completions and transactions that are shortly to be announced, that the book will end between four and a half and $5 billion by the end of the year.
A little bit about our acquisitions. So in the quarter, these are the five that we purchased, which is in Montreal, new construction apartment building Headstrom house a new construction apartment in Langford building on our portfolio there. And then we had a portfolio we bought, which is not a new construction portfolio, but we think has reasonable upside in Oshawa adding to our portfolio there. So two buildings in Oshawa and one in Ottawa. So we don't have much portfolio in Ottawa but we have a number of transactions which are in progress in Ottawa.

So we're very happy to put a beach head there because it's been a market we've wanted to get into for a very long time. But I've had difficulty getting something of scale that would allow us to do that.

So this is one of the things when we talked earlier about what changed margins and things. So if you look at these two charts you will see that what's in green bars is the proportion of the portfolio that is stabilized and you can see how it's come down in the last call a year and 15 months or so and made up in the blue bars here is unstable and I'm properties. So that's not a reflection of that. Good stabilized properties are becoming unstabilized, but that we're adding new properties. So you can see that right down here and the lower chart and the green bars.

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So the color coding is the same the green bars we're adding to the stabilized properties or increasing the number of properties that are stabilized. And the blue represents new properties that we're adding that we have yet to take to complete our process.

We look here, you can see that there's about 18 to 24 months. If you look at the top chart here, this is stabilization by year of vintage. You can see it's almost everything prior to 2019 is basically stabilized. And anything we bought in the first quarter is not yet anything we bought in 2020. About 80% of the portfolio is not stabilized yet. But most of this, I'd expect this bar will look very similar to this bar, and this bar will look like this bar by the end of the year.

Here's something that I found to be really interesting. So if you look at the rental and turnover analysis, so new residents on this is a twelve month or a quarter over quarter over the last year. And stabilized units, new tenants paying in the apartment portfolio, 8.8% increased rent. You compare this against 6.29% for repositioning or even in student land where we said we had occupancy issues due to the schools being closed to in person learning on units that turned over 4.27% increase on the same store basis. So really what this is telling me is that rents are still increasing in a time and revenues are still increasing in pretty unprecedented times.

COVID was a challenging time for most businesses. I think very few businesses would be able to say that they were able to increase them. Store rents on our new clients of almost 9% on their apartments and four and a half on their student housing. So I think this is a really great result. Gap to market rent stayed basically intact. Although, as we've talked about before, when we on board new properties that have market rent gaps, we tend to mark them as having zero gap until we start to prove them out.

When you're bringing on an unstableized property, you tend not to be pushing rents and you can see that. And this is consistently the case. Like these numbers might not be the same every quarter, but the pattern is the same. Which means we get the best rent increases at stabilized properties, less good in repositioning properties and less than that unstableized. Right?

And that reflects a really simple reality is that if an apartment is experiencing banging and noises and disruptions, you have trouble asking people to pay good money for that. So you have to get to the point where you're able to offer them a premium experience or a better experience than your neighbors and things are quiet and there's the construction dust to settle down or these other kinds of disruptions. And now you've got a small number of units to rent, so you have a lot more pricing power.

So overall rental situation is really looking quite good. Total portfolio today is around 95% Canada and about just a little less than 5% in the US. In terms of a net operating income basis, the portion of Canada is actually increasing. So the US is decreasing, not because we're disposing the US stuff necessarily, but because the opportunities that in Canada for us currently is so much bigger and bigger and better. So we're just much more active and focused on the Canadian market right now than we are in the US.
So here's a little bit further of our same store sales. So that's why we break it out into apartments and student on a total basis, if you look at apartments again here, total operating revenues up, doing very well. Total almost 3.7%. Total NY, almost 2.8%. Small decline in the NY ratio, if anything, like you said, higher vacancy turnover costs due to COVID, which I think you're going to correct next year.

Average rent per unit up 3.34%. Student the story was the opposite. Total property renters were down about 12.7 and NOI ratio declined. Again, this is almost an entirely Occupancy related issue, and based on the velocity of leasing that we have today, we anticipate that we'll be back to full house and almost normal operations in the fall.

A little bit about total returns, they were decent, but not amazing in the year. Like I said, about seven and a half percent on our Class F in the last twelve months, and just short of 8% on the A's 8.5% for the F last year. It's okay. It's on the lower end of our band. Are we disappointed?

No. We think to achieve those results in a period where there's a tremendous amount of uncertainty across the entire economy, across the average rent per unit up 3.34%. Student the story was the opposite. Total property renters were down about 12.7 and NOI ratio declined. Again, this is almost an entirely Occupancy related issue, and based on the velocity of leasing that we have today, we anticipate that we'll be back to full house and almost normal operations in the fall.

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No. We think to achieve those results in a period where there's a tremendous amount of uncertainty across the entire economy, across the entire world, and we think that that's a really solid result and we're really happy with it. And we think we're setting ourselves up for a very profitable, potentially high return next couple of years as inflation starts to move ahead. With that, that's basically the run through the major things here, Paul.
No, actually, that was great.

Thanks, Greg. You really hit upon a lot of very interesting issues, and I found how, in fact, the rent to market rent gap is actually interestingly understated. So that's going to be an interesting story going forward. So turning to Q and A now, even though we are in a low interest rate environment, we do get a lot of questions regarding the REITs distribution. The question really is, can we expect an increase in the REITs distribution in the near future? And if not, what would be your rationale for not doing so?

Look, I've messaged this before. The rate really needs to keep the distribution rates where they are if it's to remain competitive in acquiring new buildings. We compete for not only capital, but for opportunities with other major market competitors. And if we're in a position where we have to distribute more than we think is possible, that means it puts us in, I think, a really negative situation. he first is I think it forces you to stretch on deals that you probably shouldn't. And I never like to have to stretch. And if it cuts you out of an opportunity because you have to make a distribution, I've always tried to balance making a reasonable distribution with making what I'm really trying to do, which is a good total return with very low volatility. And ultimately if people want a 7% yield rather than 5% yield, then they can sell 2% of their units to create their own yield synthetically while we deliver the total returns. It's also worthwhile keeping in mind that two thirds of distributions are returned capital in 2020. So when you think about distribution yield in terms of after tax return, it's even better.

Fantastic. So Greg, you alluded to the great returns, and let me just elaborate again. The re put in fantastic returns of 17% in 2017, 23.4% in 2018, 21.8% in 2019, and then a more modest return of 7.9% last year.

What is the rates expected return going forward and when do you think that will be reflected in property appreciation for the portfolio?

Okay, well, look, as we've always maintained, the rate really should be considered as a conservative holding in a portfolio to provide investors with stable cash distribution and the opportunity for long term growth and focus on capital preservation. And we've always said, look, we're trying to get between seven and twelve. That's our goal. That said, we think that there's opportunity for outsized returns. We've been able to deliver them.

Historically, the rates delivered over 13. Historically, if you go back to the founding fund, I think we're just under 16 compounded over 15 years, 16 years. So we're pretty happy with that. We also think the supply and demand imbalance in the Canadian multi residential sector, irrespective of COVID, remains solid and apartment buildings really remain coveted, which means the values I believe, will continue to increase, which will be reflected in our portfolio. Increased buying in the sector leads to more comparable property data points which are used to value our property and NAV.

But probably even more importantly, as the economy and the borders reopened and with the money printing that's gone on for the last 15 months, with low housing affordability to the rapid price increases across the country, we anticipate significant tightness in the rental market, along with rent increases to follow likely into early next year. We're already starting to see this in the periphery and we have seen buyers and apartments completely look through the COVID market as I think most of my industry compatriots see exactly what's coming. And I saw COVID really as something was you just have to manage through it. But it's going to open up the amount of money printing, the amount of tightness in the market, it's going to open up some significant opportunities in the months ahead, but probably towards the latter part of the year or early into next year.

Fantastic. Greg, at the risk of having you reiterate a little bit about stabilization, you mentioned that last year we acquired twelve buildings and they were all reflected, as you mentioned, as unstabilized in the REIT's 2020 year end financials. So what assessment is made to designate a building as unstable and how does the stabilization process work to translate itself into NAV increases?

Okay, it's a complicated question. I'll try and make it profusely simple. So, three categories of stabilization.
So we have UN, stabilized, repositioning, and stabilized. Usually a new property goes into our unstabilized category or unstabilized bucket. Then as we move it along, it goes into the repositioning and then we'll move it. Once we think it's gotten through that process, we put it into the stabilized category. So depending on the asset and the strategy, the amount of time spent in any of those buckets really drives that.

So if there's heavy capital work, it could stay in unstabilized for a long period. If it's a new property which is mostly leased up, it might stay in unstabilized for a very short period of time before it flips over to stabilize. So it really is on a building by building assessment. So this process includes leasing up new buildings, as I said, if it's empty or not fully occupied, completing capital projects or implementing upgrades or cost savings initiatives. All those play into which category will put it into and determine how quickly it moves between categories.

And as we progress through this process, it usually translates into higher rents. And if you go back to the chart I had earlier, which shows the rent increases by stabilization category, and if you go back to prior reports, you'll see it's almost always consistent. We're getting the fastest increases in rents and in NOI's in those type of property. Ultimately the NOI increases flows into higher value, but the process, depending again on the specific asset, can take anywhere from months to years.

That's great. So putting on now our macroeconomic lens, it's well known within the industry that you very presently changed your macroeconomic outlook about nine to ten months ago, right before the green shoots of inflation were apparent, from one of broad based deflation to one of inflation. While this is now bearing out in spades, how significant will this become, how interest rates respond, and what impact do you foresee all this having on the roof?

That's a good question and not entirely easy answer. But look. I think the way to look at this is my view for about ten years has been one of deflation increasing inflation.
If not outright stagnation massive worldwide sovereign and non sovereign debts pre existing and then exacerbated by COVID a boxed governments in of having no choice but to inflate themselves out of the debt burdens despite galloping inflation. Which for the moment is being characterized in many quarters as transitory. But governments will be reluctant to raise rate for fear of sinking debt burden individuals and corporations as well as crippling themselves with unsupportable debt service payments. In many ways the situation today is similar to the 1940s and 1950s and that the government's post World War II were heavily indebted and needed to use financial repression via low interest rates to inflate the debt away in real terms. Just to give you a sense, I was looking across my commodity trackers today and if you look on the one year commodities prices and across the board they're almost 70, 75% year on year.

So please tell me that that's not inflation. I think 75% increase in commodities and input costs is inflation and we're really just getting going. Rental apartment buildings are, I think, excellent hedges against inflation. The asset class has the ability to raise rents, not to mention the appreciation of properties as people gravitate towards the yield of hard assets. And I do believe that as more people get caught onto the inflation story, the grab for hard assets will continue to be a dominant theme. We think that the reader is well positioned to navigate a rising interest rate world should this come to pass. I really don't see it that there's much scope to raise rates because our leverage is low at about 38% and we're continuing to decrease our cost of debt.

So this time last year we call it 2.9% average cost of debt and today we're about two and a half percent cost of debt and new financing we're doing, we've done anywhere from the mid 150s in the last twelve months to I think the highest in the last few months on standard CMHC. Conventional we've done some at three and a quarter. Still very cheap money for long term.

Average term that we're borrowing for is called ten years. So the average book today has about a death maturity of around seven and a half years. We do also believe future upticks in interest rates, if they come, which I don't think that they will not for a while, will be mitigated by our ability to charge higher interest rates on our loan.

Thanks Greg, again, I know you've addressed student housing already so we don't need to belabor it, but any additional comments that you'd like to make regarding the student housing book?

Yeah, there are a couple of things I am pleased to announce Centurion is running a 482 student residence complex at Simon Fraser University, which we were the financing partner for in a public private partnership.

And this development adds to our student residents portfolio of now 13 communities and adds to our previous residence financing and acquisitions at the Hub at the University of Calgary in September, simon Fraser University in Burnaby in BC. So it's a nice add on campus, brand new asset. The outlook for the student residence portfolio, which makes up roughly 10% of the portfolio, is definitely looking more promising than last year when a few of our student residents, particularly in Montreal, were adversely affected by the decrease in foreign students and the inability of students to learn or to go to classes. So we saw average occupancy drop about 15%, which was better than about what we expected, but better than we feared could potentially happen. And we're seeing very strong leasing today I think our leasing stats last week we're doing a run rate of about 120 beds per week of leasing, which is really quite strong. And most universities have announced that they're going back in fall, either partial or full. And we expect normal student leasing velocity as we head into the fall. And if we're not fully occupied, we will be very close to fully occupied and COVID will be in the rear.

Right. So changing gears a little bit is the wholesalers and I have been noticing that there's been a growing interest over the last few years b vadvisors to learn more and more about the investment management process, really almost getting under the hood and understanding the details. Now, given that Centurion has a well oiled acquisition team, I was wondering if you might share some of the broad steps by which a property is acquired and placed into the root.

Sure. So it's a lengthy process that involves quite a few people organizationally, both internally and externally, but I'll try and give you a decent feel for it. Generally deals are brought to us through multiple channels, either real estate brokers, developers, either ones we have an existing partnership with, or potentially new partners.

We have lots of off market contacts, so people are bringing deals to us all the time. And we've been very active in financing new construction apartments both from debt and equity point of view. So we have a proprietary pipeline of deals that are coming as well. I think we also have very deep industry relationships, which really particularly given our strong focus on new product today, which is coming out at very rapid rates, which is what we've been messaging would happen. So we're really seeing it as a top place to go if you're a developer looking to either raise finance, to build equity debt, buy, lease up, manage all these different things.

So we get a lot of flow that way. But really the first step is the opportunity will get screened. And we're trying to answer the question is the opportunity worthy of consideration based on an investment thesis and based on indicated kind of pricing request, can we make the returns that we want to? And if the answer to that is yes, then really we go to the next stage which is review and analysis of the property documentation. So for example, rent roles, tax bills, utility bills, other staffing models.

And this is reviewed with broad market neighborhood analysis, rental demographics, retail amenities and other things in the area. And want to understand are the units well rented, under rented or over rented? Because you can't just look at what's the rent that's in place. You have to say, is that a stable rent? Can it go up or could it drop on you?

So you have to do that kind of work. Then there's things like site visits where we inspect basically a representative sample of units and to get a really a sense for is this the product that we think has been represented to us. And then we're starting to prepare deal packages, which includes performance returns, operating capital assumptions, and we start modeling it. Then we start looking at things like the deal merits, which are evaluated by myself and other team members.

And are we looking at things like, are we worth repositioning? What metrics should we be considered if it's a forward sale? What are projected vacancy rates? What are the benefits of economies of scale, if any? And what are we going to get for financing?

Because financing either both leverage and rate and type affect the overall rates returned. If we get all of that and it's continuing that we want to seem to be going forward and it's kind of meeting all these tests.
And we're generally putting out an offer letter, almost always conditional. Sometimes we're afforded advanced due diligence materials which we can vet and make a firm offer. But it's usually a conditional offer where we set price terms and conditions to put the property under contract. And then really, that's more when the hard work starts. So then you're going into leases, permitting warranties, floor plans, more detailed review of units, more deeper inspection or walk through.

And then we're also engaging third party consultants so that's when we start to spend money. So we'll have usually a building condition or engineering study that will look at condition, apartments, life safety systems, elevators, firesticks systems, fire safety, all these other things, and environmental conditions. So that's part of the process as well. Once we've gotten through this and we continue to progress through proposal packages prepared and presented either to the board or to the asset manager or the investment committee, depending on the size of the transaction, as we have three approval tiers one is myself, and we have an investment committee above that and then full board above that. So the bigger the transaction, then it gets filtered according to the amount of the number of eyes that we need to have on it.

Once the appropriate approvals are in place, then we're onto legal documentation. And closing tends to follow 30 to 60 days. After that, the total process tends to run anywhere from 60 to 90 days. If it runs normally. Sometimes it takes much longer than that. We've had deals that have taken a year to do, but it's usually 60 to 90 days.

Well, even in that summary, it really shows that it's an involved process. Thanks again, Greg. You did touch upon the mortgage book in the REIT, wondering if. You wanted to provide a little bit more colour as we get to the end of this webinar.

Sure.

So the incorporation of REOT into REIT pretty smoothly. We had almost 100% approval on the merger. The finance deals in the mortgage will continue to be a strong source of deal flow. Now, having acquired ten properties to date, and from your development pipeline, I think it's actually larger than that.

Two which were in 2020 during Q1, the loan portfolio had about 79 investments totalling over 600 million. Of these, 17 were participating equity, nine were straight equity, and the rest were loans with no equity participation.

About 70% of the loans were first position and 30% and second position. Interest payments and arrears and current defaults are negligible. So we have a current provision of about $1.8 million, which would be fairly stable. The provision is an accounting provision. It's not necessarily a representation of anything we expect to lose.

So really we're very pleased with how the loan book has performed. It's been very stable. People have paid well throughout the process, and even with things like cost increasing and for development projects and for disruptions. We've seen a number of developers who've had their construction projects delayed or approvals delayed because of either COVID work stoppages slow downs because of covet precautions, or cities moving very slow because they were all working from home or weren't working at all. So the developments seem to have weathered that pretty well, but honestly, better than we even expected.

And so that's very good. I'm very happy with that.

Greg, last question. I know it could be a long question or a short question, or answer rather, but how do you see Centurion growing in the next few years?

So I would say that the opportunity pipeline we have today is larger than it's ever been. I know I've said that a few times over the years or over the years, and it still is true. I really would refer people back to one of the white papers I put out recently, how COVID shattered life inertia and seems to have shaken out a lot of opportunities for us and for the market. So I really do see that we're going to see a lot of opportunities in the space. We've been very busy, I think we have, in pipeline today, assuming we go pencils down for the rest year, about a billion and a half of acquisitions which will close in the next four to six months.

That's if we're gold pencils down and we're only five months into the year, so we've got a lot more opportunities left. So we're pretty excited about that.

Wow. So short answer is stay tuned, the future looks very bright.

Yeah, I think there's going to be some announcements within the next short period of time that I think we're really excited about. Some of them I would call benchmark transactions, so we're very excited about them.

Greg, well, that brings us to the end of this webinar.

Greg, once again, thank you, as always, for your insights into the REIT and into the broad based Canadian multi residential apartment real estate sector. On behalf of Greg, myself and your wholesaling teams, I would like to thank everyone on this webinar for your time and continued support. It is truly greatly appreciated.

Should anyone have any follow up questions, please do not hesitate to contact myself or your wholesaling team.

Once again, thank you all for being your time and interest and support.

Have a great day. Bye.