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SL Green Realty Corp. (SLG)

Citi Global Property CEO Conference

CORPORATE PARTICIPANTS

Marc Holliday
Chairman and Chief Executive Officer

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Michael Griffin
Analyst, Citigroup Global Markets

MANAGEMENT DISCUSSION SECTION

Michael Griffin

Analyst, Citigroup Global Markets

Welcome to the 8.35 Monday AM Session at Citi's 2023 Global Properties CEO Conference. I'm Michael Griffin with Citi Research and we are pleased to have with us SL Green and CEO Marc Holliday. This session is for Citi clients only. If media or other individuals are on the line, please disconnect now. Disclosures are available on the webcast and at the AV events.For those in the room or on the webcast, you can sign on to liveqa.com and enter code citi2023 to submit any questions, if you do not want to raise your hand.

Marc, I'll turn it over to you to introduce SL Green and members of management to provide any opening remarks and then we'll get into it.

Marc Holliday

Chairman and Chief Executive Officer

Okay, great. Thank you. And I'm going to go quick because I know time's short, a lot to cover and we have some questions. So good to be back I think to your hands [indiscernible] . Okay. I don't know it seems like we had at least a gap, but good to be back and thank you for joining us this morning. Wanted to give a quick update. This has been three months since our investor conference when we do a bit of an in-depth market review and you know, these markets move quick and what's happened. So I wanted to go through what's happening today.

I've got a deck in front of me and I think it's available online. If anybody wants to pull it up all along, feel free. You know, first to starting out with New York City's economic recovery, which, you know, I think when you get past the leasing the month-to-month leasing stats that affect our business, in particular being office rental, the city itself I think is doing reasonably well and continuing its recovery and upward trajectory, you know measured by, you know, private sector jobs, which have recovered to about 90%, 91% of pre-pandemic office using jobs are 115%, 115% of the level that they were at in 2019, which is something that, you know, doesn't deviates quite a bit from a 17% vacancy rate.

But that's the reality is there are a lot of jobs out there. And December and January again were growth month. I don't have the February numbers. We'll see. But both December and January, we're plus and plus on office jobs increases. And, you know tourism rained in at around 56 million domestic and foreign tourists last year. That's this year projected 61.5 million so that's plus 5 million new visitors to New York City, most of those coming in, you know both leisure and business, which puts it only about 7% down from peak in 2019.

And you know it has a big stimulative effect on the New York economy. I'd also say you saw yesterday or two days ago articles came out for February in terms of more advancements in crime reduction in New York City, which I think is very positive in terms of I think there's seven major crime stats that they follow. They were down 6% year-over-year for February, which I think shows that the city is moving in the right direction, getting tougher on crime in the streets, you know in some ways feeling better.

You know, one of the important new developments to follow is the opening of the $11 billion East Side Access Program, otherwise known as the New Long Island Railroad Station into Grand Central. It's called Grand Central Madison. It opened about a month ago I want to say. It started with service just between Grand Central and Jamaica, but now has been expanded throughout most of Long Island. Right now, about 30% or 35% of the LRS trains, which used to run 100% to Penn Station, 30%, 35% are now running to Grand Central Madison. And I think they expect to stabilize that number at about 45% once people and commuters get accustomed to the new commute pattern, which saves people anywhere between 40 minutes and 50 minutes a day on their commute, it's a seismic, you know moment for East Midtown and, you know, for SL Green's portfolio. There are some phenomenal images of the city, you know that's been built beneath the ground, which you can see online or go see it in person. And, you know it affects so many of our buildings that are within 5 minute walk of where the new Grand Central Madison Station is. We've diagrammed that in the online proposal, but it's about a dozen buildings or, you know almost half the portfolio, a 5 minute walk from this new train station. They'll become one of the biggest and business commuter rails in the world from nothing, you know, not counting Subway, obviously.

So we think that will have a significant uplifting effect on office in a market where, you know commute ability is probably the number one on the checklist items for all business tenants. And also say office to resi conversion is a topic that's out there that people should keep their eye on. It's been talked about for years and years. People always said, well, it's too political, it's too complicated and not wrong. But there is so much momentum behind this effort to take secondary and tertiary office, expand the universe of what's eligible to be converted right through buildings built to 1990, adding over 100 million square feet of potential convertible inventory, eliminating the 12 FAR cap that has constrained certain conversions, and also putting in place tax incentives, meaningful tax incentives for conversion that the governor has included in one of her two bills related to this topic as part of her executive budget in for the upcoming fiscal year that begins in April.

So it has nearly unanimous political support. It's really just a question in my mind of what the changes to the zoning will be and what the tax incentives will look like in the end in order to make sure there's enough incentive there to offset the cost of conversion. So that estimated between 20,000 and 40,000 new residential units can be developed. You know what I'll call fairly easily in our parlance, through the conversion of office to resi. I'll end now with, you know just a quick snapshot on our leasing progress since over the last 90 days that being, you know what we felt was a recent time period. We've done about 446,000 square feet of leasing deals that bigger deals that ranged anywhere between 20,000 and 185,000 feet in 28 other transactions, making 145,000 feet for a total of 446,000.

And with that done, we're obviously off to a good start for the year and meeting our leasing objective, about 1.7 million square feet for the year. We hope to end March, you know, at least somewhere around a half million square feet. So 1.2 million square feet let's call for the remainder of the nine months, 400,000 a quarter, not a small task in this market. So I don't want to in any way make light of it because, you know we'll have to really outperform and hustle and get leasing done. But at least in my mind, keeps us on track to meeting our objective for the year based on a pipeline that we have right now of about 700,000 square feet of either leases out, leases in negotiation or term sheets in substantial progress.

So with that, I'll open up for questions.

QUESTION AND ANSWER SECTION

Q

Outstanding. Well, thank you, Marc. Appreciate that overview. We're starting off each one of these sessions with the same question. What are the top three reasons investors should buy SL Green?

A

I mean one stock price I think, you know there's a lot of value I think that underlies the portfolio. And, you know, we've got a premier portfolio of assets. We've got great development pipeline. I think the price, as we've seen in the past 25 years of SL Green's existence tends to exaggerate on the high and exaggerate on the lows. And I think we're in one of those lows right now where, you know, in terms of our free cash flow or dividend or relative stability of the portfolio at around 91% occupancy, with a goal to increase that by year end to 92%. You know, the East Side Access kind of unlocking value and half the portfolio, our ability to deliver hospitality and amenity I think is kind of a market leader in New York City, which, like I said, you know top tenant checklist items that are computability, our portfolio things up nicely with that amenity and service. I think we're doing an excellent job there. You know, buildings are well leased in a good shape and, you know almost all redeveloped at this point. And we've got, you know, what I think would be so those are let's call it two reasons. I don't know how you define that. But and then lastly, I think when the market settles, there'll be a very big opportunity set for doing what I think we do best, which is coming in to complicated situations and recapitalizations and bringing our platform and our special servicing and our, you know market relationships to bear, in order to capitalize on, you know what will be for sure, you know dislocation in the office market in 2023 and 2024.

Q

I guess to expand on that a little bit, just given the headwinds the office sector is facing currently, you touched on it somewhat, but, you know if you could expand a little bit what differentiates Green's, you know business in terms of your portfolio composition, tenant makeup, any growth opportunities kind of relative to your competitive set?

A

Well, I think that, you know, locationally East Midtown is our territory. And I think East Midtown is where you're seeing the most traction right now in terms of, you know, in terms of what leasing there is out there. A lot of it is really centered in this area. A lot of financial firms, even some tech firms are in the area.I think the whole Park Avenue spine from, you know, 100 park on the south to, you know, I don't know, 450 park on the north where we have all these great buildings. We're seeing pretty good leasing demand, you know for those product. And so I think on a relative basis, we have more of that in the sweet spot than a lot of our competitors. And I think that's only going to be aided by Grand Central Madison because you're taking you know I forget how many commuters a day, but it's over 200,000 commuters a day that exclusively were commuting into Penn Station. And now we'll have a choice between Penn Station, Grand Central.

So I think, you know, on that basis, we're differentiated also. I think we have you know, kind of a unique skill set that we've been able to express in terms of the debt markets through our debt and preferred equity program. So we're I think the only rated special servicer in that subset of peers that gets hired routinely today more than ever to perform special servicing functions on SaaS be assets where, you know, we get a seat at the table to earn fees, work out recaps and in some cases bring investment opportunities to our shareholders and or partners. I think that differentiates us because we're so deeply embedded in that market, you know, to and I think our focus on hospitality and service, I mean there's a lot of good owners out there that are focused in that area. But, you know we are diversifying in ways that I think are not just, you know, areas that are trying to meet the tenant demand or meet public demand, but are really showing some thought leadership when it comes to great restaurants, like Le Pavilion and Joji were great immersive destination experiences like Summit, which we project will do over $100 million of revenue this year in only its second year of existence and, you know is frequently sold out very successful and we've got plans there to expand Summit both you know within One Vanderbilt and then globally.

You know so I think that's a bit of a differentiating factor. And you know or just our work ethic. I mean, everyone works hard, but, you know we're five days a week in the office still, you know unchanged doing, you know, working, you know, very, very hard to try and keep everything well leased, stabilized, finish out One Madison big project, 1.4 million square feet, which right now is six weeks ahead of schedule and $60 million below budget.

Q

We've had a couple of questions in for come in from our live QA feeds. So thank you for standing those. And a reminder, if you want to use the microphones, ask a question, you have to push a little button on it in front. Our office tenants taking more or less space when their leases expire? And do you think where do you think long term office utilization rates shake out in that?

A

I think the trend right now and what we hope to try and see is to have tenants, you know, maintain their existing footprints. We have some expansion for sure that's occurred throughout the portfolio, but I would say it's offset more by tenant contraction. So the way we're going to maintain our occupancy and go forward is not necessarily by net absorption in the city because I don't think, you know we're necessarily going to see net absorption in 2023. You know, February was obviously a tough month, but the first quarter's always a bit slow. And I think the real telling signs will be, you know April on into July and then again from September to year end. I mean, that's when we do the bulk of our leasing. Our pipeline indicates is pretty good. So, you know, how we're going to sort of meet this market is by, you know bringing other tenants into our portfolio through consolidations, which may be consolidations that are at equal space or even if they're consolidations for less space. You know, what we care about is they end up in an SL Green building, so that our properties stay above 90% occupied. And at that level, you know, we're in great shape, regardless of the trend you know for some tenants towards downsizing space because of primarily remote work.

Q

And then what percentage of your portfolio would you characterize as Class B in which you would need to put more CapEx in order to stay competitive?

A

You know, I don't have a Class A Class B designator. So it's, you know, whoever asked that question, it's a tough question to answer. I mean, we've got every year, you know we're a big seller of assets, you know, every year even through pandemic, we sold quite a bit of real estate always somewhere between, I would say, 1 billion and 2 billion a year consistently. And that goal for us is true again this year, whether it's outright sale or joint venture.You know, I would say that there are certain assets that we look to either sell entirely which don't fit the business plan, doesn't mean they are Class B assets just means, you know we don't see the risk reward for us in terms of investing more capital given the earnings growth potential. But that could be on Class A or Class B assets. Obviously the portfolio size wise, revenue wise is weighted now more than ever in our 25 years as a public company towards irreplaceable highgrade assets, like One Vanderbilt, One Madison, 245 Park. I've got a whole presentation in here about what we're going to be undertaking starting in December of this year for basically a $200 million redevelopment of that asset to be what I think will be a world class Park Avenue asset to line up with our other holdings, like 450 Park and 280 Park and obviously One Vanderbilt and 100 Park and other assets in and around that area. So, you know, we've got great assets like 1550 Broadway and 461 fifth. So I don't know percentage wise, but I could say it's -- here's what I'd say with confidence. The portfolio today with One Madison is, you know monstrously better than it's ever been in the past.

Q

Maybe just on the transaction activity in the capital allocation plan for 2023, I think you highlighted during your Investor Day targeting about $2.5 billion of disposition proceeds. You know, is there any way you can take advantage of distressed deals you've seen in the market as it relates to your disposition program? And then can you comment on any expectations around buyer interest, you know valuations, that sort of thing?

A

Sure. I'm going to turn it over to Matt DiLiberto, who I'm joined here today for all of you in the room and not in the room. Our CFO for another three years per the 8-K this morning. Matty is not going anywhere. We're not letting him out, just like we all intended to out.

A

I said it wasn't coming this morning until we filed this morning.

A

So we filed it about a minute before this talk. And he can sort of go into detail on where we stand on the disposition plan for the year.

A

Yeah. So as you noted, we put out an ambitious business plan back in December, $2 billion plus of dispositions, $2.5 billion of debt reduction and $500 million mortgage maturity just to throw that in and, you know, please report that's all going well, only you know to months in a weekend. The $500 million mortgage financing, that's 919 Third Avenue, everybody here knows well, the financing markets are tougher today than they have been in a long time. The conventional financing for this asset would have been a 10 year fixed rate CMBS or LifeCo execution. That's what's maturing. Those markets are very tough today. It's bank financing and it's you know banks are more likely to say no these days and to execute. So it's all about sponsorship and property and we are advantaged in both at 919. So feel good about getting that refinancing done at its existing proceeds, which is our target. And knock on wood, hopefully we can get that done even before maturity.

The disposition program, the highlight of that was obviously a 50% to 75% JV interest in 245 Park. That is part of the deleveraging strategy as well. We took on 245 fantastic asset we've had our eye on for many, many years. It's right in that sweet spot that Marc talked about, sits right on top of Grand Central Madison. But it's big and it's got a lot of leverage on it. So we have gone around the world looking at various partners, gotten good reception to the asset, because of its size, quality and location, and then us as the operator. So feeling good about that execution that was, you know towards the mid to latter part of the year. So, you know, still have a lot of wood to chop getting it done but feel good. And 753rd Avenue another targeted sale, that's an asset that was in redevelopment, lower occupancy sets up well actually for residential conversion. So those are the people we've been talking to are likely residential converters of the tower in particular and wholly owned unencumbered assets that's 300 million of proceeds. And that is going reasonably the beauty of not having our CIO here is I can say whatever and you can't stop me.

But you know, shooting Harrison or he is doing a good job and sourcing these transactions and then we see the opportunity set. You know that ambitious business plan along with debt reduction was a bolstering of liquidity. So we do see as Marc said earlier, some opportunities likely later in 2023 to 2024 as owners that are not as well capitalized and structured as we are, may find themselves in some distress. So, you know, we are setting ourselves up to be more opportunistic once we execute this 2023 business plan.

Q

Maybe to that end, Matt, I think you also targeted, I believe it was seven day the apartment building in Lower Manhattan for sale, just given the more favorable fundamentals for residential real estate now compared to office and you've talked about conversion opportunities. I mean it seems like a building you might want to keep in the portfolio. You know, why does this make sense to sell now?

A

Well, I mean we're a asset, you know rotators. I mean we've in terms of, you know what it makes sense, it's a function of what the price and the cap rate is and relative to how we can reinvest and try and make, you know, yields. There's going to be some opportunities for some pretty substantial yields, investment yields that I think we're going to see in the back half of this year and into 2024. And, you know, for the right situation, these are double digit yields that might be plus 500 bps from -- 500 basis points from what they were previously for high grade opportunities. And you know with that said, you know a fully rented residential building, you know, that we could, you know try to attempt to sell at an attractive cap rate, an attractive price, you know would make sense for us to sort of clip that gain and reinvest. So that's how we generally look at these things. I mean, you can always make a case to keep the asset, but you know, we like to invest, add value make marginally higher returns and move on. So, you know, that one is got some traction. And you know, we hope to be able to consummate a deal I think this year.

Q

Maybe just sorry we got a question from the audience. Just a quick question. What kind of ROIC do you expect on new investment opportunities going forward?

A

You know, it depends where you are in the capital stack and how levered. I mean, we're going to be very judicious in how we use our capital. So I would expect that you would see us taking relatively smaller positions in relatively bigger opportunities that, you know, may have, you know a debt stack that's in the process of being worked out. So it's a levered situation, but with not a lot of downside to whatever position we would be coming into to kind of help clean things up. And, you know, on that capital, it could be 15%, 20% for sure is you know would sort of have to be. But again that would be what I would call rescue capital at the bottom of the capital stack.

Q

Just return on capital employed. And just curious what the specific number, do you have in mind today? Does the 1520 do it or is I mean, that was the number again is that that's a leverage. Yes. You're talking about an unlevered? I mean what asset where and what kind of you know, I mean, you know some assets I think you're going to sell if it's multifamily asset that's relatively new and in good shape, you could be talking about, you know, 7%, you know, unlevered. And then if you have trickier situations, it could be closer to like, you know, 10% or higher. I mean, so, you know, there's a range, but it's just too broad a universe of situations out there to pin it down any further than that I would say?

Q

I think we got another one down there.

Q

[indiscernible]

A

Well, you know, look the city says it needs 500,000 new housing units. So if measured in that regard, you know the solution is going to have to be new development. It's not going to be conversion. You're not going to able to convert and get a half million units. But to me, that's not a reason not to do it. You know, I mean, there's a double benefit of conversion you don't get with new construction, which is you're winnowing the office inventory while you're adding new units, more rapidly than you can achieve with new construction and without the displacement and all of the nimbyism that accompanies that, you know people are relatively relaxed about a change of use. And it's just a matter of, you know getting possession of the space and converting the buildings. So, you know, in that regard, I think there's enormous merit because of that double benefit. Like I said earlier, I think that could produce 20,000 to 40,000 units, you know in Manhattan, which that's a lot of units. You know, I mean we spent a lot of time building seven day, which was just brought up 250 units. So there is a path to convert, you know to adding 20,000 to 40,000 units. City should pursue it. And, you know it's not a question in my mind as you know well, you know is that going to solve the problem? That doesn't matter. It's good business. It should be done and it'll help the city's ratable because it will stabilize the office space by taking the marginal buildings out of play.

And it'll help the residential because it'll be fastest to be delivered. In terms of the economics, you know, when I look at it, I think there's a very good play for maintaining podiums and converting towers. I think that I don't know what you've underwritten, but I think that's kind of the sweet spot for a lot of these buildings is a mixed use in nature, which I think underwrites, you know reasonably well because the tower is where you can get, you know, your better rents and the floor plates typically line up and set up better for conversion of the tower. And you push your tenants into the podium if you can or relocate them out of the portfolio. And, you know I think it's a win-win in that regard. And, you know, we think the numbers work. And I think you will see more than just a couple of buildings downtown going to tax incentive.

Right now, what you're looking at and underwriting, I assume or without the tax incentive, you know, the governor has a plan out there in her budget for a 50% real estate tax abatement over 19 years, with 20% set aside for affordable housing at around a blended average of a 70 AMI or average median income, so 70 percentile. You know, we gave testimony. I'm sure if we give testimony at the city council hearing that was last week on this particular issue. And, you know we stated that we think the incentives should be a need to be much more and that there's a big upside for the city in doing so. And it's not this kind of perceived windfall to landlords just isn't there is, as you've shown. But, you know it makes the deals economic and you know, if it happens as we hope it will, and if the incentives are broadened out a bit, which I think there's an opportunity for, then I think you'll see buildings convert.

A

You know I think about a couple of different ways. One, I think that as buildings converted just helps our bolster the market generally, one. Two, there are certain buildings in the portfolio that we think couldn't take advantage of this. But it's not many I mean it's not. And then three, we think we can bring to bear the expertise. We've converted buildings, we build new we've got a very good, you know sort of boutique residential operating division right now that, you know I think we can help others do again for not a lot of capital commitment on our part that may not be the same that you're looking at.When you're underwriting those deals, you might have to be committing larger amounts of capital and you're not getting to your returns, but you know, we would be sort of rolling up the sleeves to sweat and deal and you know, committing equity because we always put our money where our mouth is, but it doesn't have to be the preponderance in these situations that, you know are caught up in limbo right now where resi conversion is the highest and best use.

Q

Marc to those unlevered IRR is that you stated just a little bit ago, I guess how our cap rates not moving up proportionately, just given the difficulty in assuming, you know any NOI growth for the out years?

A

I think there's a perception that rates are going to be coming back in once they stabilize. I think that's why you've got a 390 treasury against a 476 two year. And, you know, I think that, you know when people are talking about cap rates, they're talking about long term, almost in perpetuity cap rates, a 390 10 year, I think is a manageable interest rate in order to capitalize a deal around. And, you know, if you think that rents are kind of at their lows right now because of, you know, all the hell we've been through in the past, you know two and a half, three years, I think it's fair to think that as the rest of this country inflates like on every measure, you know, that hard assets will catch up. And when it does, it's great inflation protector, depending on the asset class. And, you know the cap rates are just not going to be, you know in that range there. New York City is still considered the highest quality market to, you know investor capital dollars in. We are spending at ton of time right now with various forms of private equity investors in various parts of the country. Andrew and I kind of divided the world, and we're making those trips and the reception is very, very strong. There's a lot of equity out there that wants to invest. You know, not just in the US, but, you know, in New York City and Manhattan.

The returns are, I think within the realm of, you know, the kinds of numbers we've discussed this morning and what I talked about in December. And, you know I think there is a real belief that this is a great way to play an economic recovery, where rates will hopefully be falling, you know, in the next several years and rents will be rising. And that the combination of those two very powerful forces should keep cap rates relatively, you know relatively in check.

Q

So it seems like you're in the Fed cutting rates cap at some point in 2023 versus the higher for longer.

A

You know, I think that you know I think this rate environment specifically this 390 Treasury environment in and of itself is a environment we can do a lot of business in. You know, we've worked in 5% treasuries, 6% treasuries and made money. So to me, it's, you know I think that the increases, the data seems to say that the increases are having its effect, economy starting to cool off a bit, should lessen the pace of the increases in the yield curve suggests you know that the rates will be coming down. I don't have any rate projections myself. I always look to the yield curve and they have 50 basis points for cushion. And so, you know based on that, I would say the market expects some tightening, forget about what Marc Holliday expects. And therefore, I think investors are saying I can put some money to work in 2023 and 2024 and then in 2025, 2026, 2027 have a better overall economic environment, you know, for that investment.

Q

Real quick and the rapid fires finish it up, best real estate decision a day buy, sell, develop, redevelop or pause?

A

I got to process [indiscernible]

Q

Buy, sell, develop, redevelop or pause?

A

Recapitalize.

Q

Same store growth for 2024 an office?

A

Same store growth...

Q

Well the mic still work if you want to...

A

Same store growth will be this year [indiscernible] between 3% and 4%.

Q

And then more, fewer or the same office REITs a year from now?

A

In the New York City the same.

Q

Great. Thank you.