20-Jul-2023

SL Green Realty Corp. (SLG)

Q2 2023 Earnings Call

CORPORATE PARTICIPANTS

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.

Steven M. Durels
Executive Vice President & Director-Leasing and Real Property, SL Green Realty Corp.

Andrew W. Mathias
President & Director, SL Green Realty Corp.

Harrison Sitomer
Chief Investment Officer, SL Green Realty Corp.

OTHER PARTICIPANTS

Michael Lewis
Analyst, Truist Securities, Inc.

Steve Sakwa
Analyst, Evercore ISI

Alexander Goldfarb
Analyst, Piper Sandler & Co.

Thomas Catherwood
Analyst, BTIG LLC

John P. Kim
Analyst, BMO Capital Markets Corp.

Blaine Heck
Analyst, Wells Fargo Securities LLC

Anthony Paolone
Analyst, JPMorgan Securities LLC

Ronald Kamdem
Analyst, Morgan Stanley & Co. LLC

Anthony F. Powell
Analyst, Barclays Capital, Inc.

Michael A. Griffin
Analyst, Citigroup Global Markets, Inc.

Caitlin Burrows
Analyst, Goldman Sachs & Co. LLC

Nicholas Yulico
Analyst, Scotia Capital (USA), Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Thank you, everybody, for joining us, and welcome to the SL Green Realty Corp. Second Quarter 2023 Earnings Results Conference Call. This conference call is being recorded. At this time, the company would like to remind listeners that during the call management may make forward-looking statements. You should not rely on forward-looking statements as predictions of future events as actual results and events may differ from any forward-looking statements that management may make today. All forward-looking statements made by management on this call are based on their assumptions and beliefs as of today. Additional information regarding the risks, uncertainties and other factors that could cause such differences to appear are set forth in the risk factors and NDA sections of the company's latest Form 10-K and other subsequent reports filed by the company with the Securities and Exchange Commission.

Also, during today's conference call, the company may discuss non-GAAP financial measures as defined by Regulation G under the Securities Act. The GAAP financial measure most directly comparable to each non-GAAP financial measure discussed, and the reconciliation of the differences between each non-GAAP financial measure and the comparable GAAP financial measure can be found on both the company's website at www.slgreen.com by selecting the press release regarding the company's second quarter 2023 earnings, and in our supplemental information included in our current report on Form 8-K relating to our second quarter 2023 earnings. Before turning the call over to Marc Holliday, Chairman and Chief Executive Officer of SL Green Realty Corp, I ask that those of you participating in the Q&A portion of the call to please limit your questions to two per person. Thank you.

I will now like to turn the call over to Marc Holliday. Please go ahead, Marc.

Marc Holliday

Chairman & Chief Executive Officer, SL Green Realty Corp.

Thank you, and good afternoon, everyone. Welcome to SL Green's Earnings Call. I want to thank all of you for joining us today as we review the second quarter's results and discuss our progress on our 2023 business plan. I want to begin by commending the entire SL Green team on a very strong half of year, this first half, particularly as we were confronted by the dual challenges of a partially remote workforce and increasing interest rates. But headwinds notwithstanding, our team added to the year's accomplishments in meaningful ways during the second quarter. No one in the business works harder for shareholders than the men and women of SL Green who lead by example and show what can be achieved by a 300 person corporate workforce that is present, productive and positive every single day of the week.

By the numbers, it was a solid quarter as our FFO was above expectations, we leased another 410,000 square feet of office space. Our same-store NOI increased by 3.6%, and our same-store office occupancy at quarter's end was slightly ahead of our original projections back in December. These performance stats are in stark contrast with the negative drumbeat of media coverage proclaiming the demise of office space. We continue to see demand building as businesses who hit the pause button during the prior three years are more and more frequently acting on plans for future growth, particularly in the finance sector, which accounted for about 38% of market leasing during the second quarter, as well as business services, healthcare and education sectors, all of which continue to be active and all of which helped to mitigate the pause in the tech sector.

While overall leasing in the market in the first half of the year was below historical average, SL Green has garnered more than its fair share and is now entered into year-to-date leases totaling 950,000 square feet of space leased. And we are trading people with a lot more tenants, evidenced by our 1.1 million square foot leasing pipeline, more than two-thirds of which represents new leasing activity. Midtown continues to outperform with the lowest availability rate and the highest leasing volume among all Manhattan submarkets. This affirms our core property strategy and should enable us to gain occupancy during the second half of the year from what we believe to be our current low point. However, the financial stats only tell part of the story, as significant progress was also made on the property front.

Of course, the highlight for the quarter was the completion of our joint venture partnership with Mori Trust. The transaction culminates years of relationship building, affirms the global allure of investing in trophy assets and prime corridors, and now fully resets ownership and capital stack in what is a case study of opportunistic investment, enforcement and recapitalization of an important asset on Park Avenue. We continue to evaluate and refine different redevelopment scenarios and hope to commence physical work towards the end of this year. I want to acknowledge the extraordinary efforts of our Chief Investment Officer, Harrison Sitomer, who was backed up by Young Hahn, our SVP of Investments. They literally worked day and night for months on end to ensure the successful completion of an important component of our business plan.

This is our first partnership with Mori Trust and they have already proven themselves to be excellent partners. We are making great progress on other fronts as well. At One Madison, we now believe we can obtain a TCO for the project in September of this year, a full three months ahead of schedule and open our doors to tenants in the second quarter of 2024. The ability for us once again to deliver ahead of schedule and under budget is a testament to the efforts of Robert Schiffer, Robert DeWitt, our amazing Head of Construction, and John Krush our Project Executive Along with our partners at Hines. Additionally, it accelerates the receipt of $577 million from our partners on the project, which is triggered upon the TCO of the project later this next quarter.

I'm also pleased to report that during the second quarter we topped out 760 Madison and began marketing that project. The project is absolutely spectacular, excited to show it to shareholders who have not yet seen it. Please walk by, check it out. It's already impacted the skyline in the historical district of Upper East Side, Madison Avenue, in a very positive way. It's been extremely well received by the market. And we're proud to have initiated this project and foster it along with our partners at Giorgio Armani. We already have several units under contract with significant interest on the balance of the units, at prices which will be market leading for Upper East Side condos, a testament to the power of the SL Green and Giorgio Armani brands and vision. We expect to turn over the retail to Armani by end of September and rent would start right away. First closings on residential units will commence in June of next year, with all net proceeds of sale available for use by us as there is no indebtedness against the project.

We'll have more commentary on the sales effort and pricing metrics on our next earnings call, which I guess is in October. Finally, we received our TCO for 15 Beekman this month and plan to turn over the project fully to Pace University in August. The props here go to the SL Green team of Peter Flynt, John Hefferon and Jason Pastuzyn. And if that weren't enough, a reminder, that in April, just after our last earnings call, we closed the refinancing of 919 Third Avenue, proof that the credit markets are still available for the highest quality office assets and reputable sponsors. So the first half of the year is now in the books, but no rest for the team. We're going to continue to forge ahead through the rest of the summer to set the table for a successful second half of year. Management is completely aligned with our shareholders, and we will work hard to create value, generate earnings and protect the dividend. Thank you.

Operator, we can take some questions.

QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] And our first question will come from Michael Lewis of Truist Securities. Your line is open.

Michael Lewis
Analyst, Truist Securities, Inc. Q

Great. Thank you. My first question is for Matt. I want to ask about your debt coverage ratios, particularly the fixed charge coverage ratio relative to your covenants, it keeps coming up in conversation. Your fixed charge coverage fell to 1.7 times this quarter, the covenants 1.4 times. Can you just maybe discuss the mechanics and how close do you expect that ratio to get for the covenant over the next few quarters?

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp. A

Yeah. Sure. I've read some of the commentary about it. I'm somewhat surprised that it gets that much attention. It's a pretty simple calc, it's consolidated only calc, this is just the covenant, and it's been impacted, one, by rates, rates are up, but also been impacted by 245 Park being a wholly-owned consolidated asset for about three quarters now. Now, that that is a JV, it rolls out of that calculation and that in of itself improves the calc. And we obviously watch all of our covenants and our metrics very, very closely, and are not as fussed about that one as people seem to be out in the market.

Michael Lewis
Analyst, Truist Securities, Inc. Q

Great. So notwithstanding a big move in rates, I guess, I mean, should we expect this coverage ratio to improve from here, is it trough thing, or do you think it gets a little tighter before it goes back up?

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp. A

It'll get tighter before it gets better because the effect of 245 Park Avenue has to work its way through the trailing 12 calc. So it goes lower before it gets better. But just by having 245 Park Avenue in the JV as a JV, that alone improves it because that was a sub 1 coverage asset.

Michael Lewis
Analyst, Truist Securities, Inc. Q

Okay. Got it. Thank you. My second question about portfolio occupancy. So you could correct me if I'm wrong. I think you said at your Investor Day in December you trough around 90% in 2Q and rebound to about 92% in the second half of the year. I think what we're talking about your lease percentage which was 89.8%. So just about exactly what you predicted. So my question is, do you still expect to reach that 92% this year or has that expectation changed to maybe you could tie in, kind of, how – I know the leasing pipeline had been building in the early part of the year. What do you see in on kind of conversion in turning that into leases?

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp. A

Yeah, just want to make sure I understand the question. I mean, I think we were 89.8% or something for the quarter. We expect that to be a low point. I think I said that in my commentary, and we expect to gain occupancy from here regardless of which direction the market goes just based on our pipeline and visibility. I mean, all that we set out 2021 goals a year, they're all stretch goals. We never make all, but we generally make most or certainly more than half. And we're going to do everything possible. I forget the exact metric on the occupancy stat for the year was...

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp. A

92.4%.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp. A

92.4%. So we're going to try and end the year certainly there as closely as possible. We've got a big pipeline. If everything falls into place, then, I think we have a chance of doing it. And if it doesn't, we'll be damn close. So I mean, that's why we call it stretch goals. We don't make them easy, to be anywhere above 90% in a market that's 18% vacant, I think is enormous testament to Steve Durels and his team.

Michael Lewis
Analyst, Truist Securities, Inc. Q

Thank you.

Operator: And one moment for our next question. And our next question will come from Steve Sakwa of Evercore ISI. Your line is open, Steve.

Steve Sakwa
Analyst, Evercore ISI Q

Great. Thanks. Good afternoon. Marc, maybe you could just touch on the dispositions and what your expectations are for other further sales at One Vanderbilt, what your plans are potentially for additional sales at 245 Park Avenue and maybe other assets that you've got on the market today.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp. A

Well, I think our big focus now is on One Vanderbilt, and the reception there is very good as you would expect. I consider One Vanderbilt just objectively, although it's hard not to be biased, one of the best office buildings [indiscernible] (13:43), in the city. And it's got an amazing blue-chip rent role. It's got great embedded financing, low rate financing in place. It's just a wonderful asset. And as you would expect, the reception in the investment community has been high level of interest. And I would say that that's going to get a lot of our attention now through the end of the year. So that's that. On the 245 Park front, which I think is the other asset you mentioned, I don't know. I think, there the redevelopment program that we are designing and working through is so good, and I think now with the leasing being probably ahead of where we expected to be at this point, both in terms of, Steve, the leases we signed with – give me those leases, 245 Park Avenue. EQT...

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp. A

75,000 square feet, and then we expanded by 10,000 square feet. [indiscernible] (14:51).

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.
A

Yeah. Okay. And we have others pending with trading papers.

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.
A

Six proposals out.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.
A

Six proposals out. So not unlike One Vanderbilt where we initially went out to sell, I think it was down by up to 40%. We wound up selling 30%. Now we're going out for additional 10%. We may do the other 25% towards the end of this year. We may hold back and get some more leasing done. We'll see.

Steve Sakwa
Analyst, Evercore ISI
Q

Okay. And I'm just wondering if you can provide any color on the 625 Madison situation. I know there's been a lot of back and forth with different defaults and the ground leases and the land position. Is there anything you can sort of provide us on that front today?

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.
A

Well, it's always, until there's some ongoing litigation surrounding this asset, you know that there was a rent reset, I think we talked about on the last call or no, was that?

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.
A

It happened after last call, but we disclosed in our Q.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.
A

In the Q. Okay. So there was a rent reset. It was somewhat higher than we had anticipated, although far, far below, I think what the fee owner had been putting into the market at that point, which was actually very deleterious to our position because there were discussions of rent levels of double or more which were really never to be the case. And we took a write-down on the leasehold portion of the asset in this quarter. And on the other side, from previous commentary that we have a mezzanine position on the fee which has come due and we'll see how things shake out there. There is a foreclosure date scheduled for August 8th on that asset. So we'll know quite soon how things will shake out there.

Operator: One moment for our next question. And our next question will be coming from Alexander Goldfarb of Piper Sandler. Your line is open, Alexander.

Alexander Goldfarb
Analyst, Piper Sandler & Co.
Q

Great. Hey, good afternoon. Thank you. Marc, in your commentary at the start you said that you guys are working hard and to protect the dividend is – so just want to explore that a bit more. I know, Matt, you always say, hey, dividend gets reassessed at the end of the year and you'll probably tell me the same thing right now. But if you guys seem to be on the plan for this year, you've done the 245 Park Avenue sale, seems like 245 Park Avenue leasing is going well, One Vanderbilt is next up for disposition. Doesn't seem like anything is out of whack. Should we take your comment, Marc, about the dividend that we should think about the current level being maintained into next year, or was the comment more just a holistic point that, hey, you guys were in charge of shareholders' capital, you husband it to the best that you can, you do everything to preserve the dividend, but obviously things could change. I'm just trying to understand which way to read the comment.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Okay. Well, there's a lot of ways I guess you can read it. The way I meant it to be, because it's the way we approach it and believe in the dividend is, I guess, akin to what you just said, Alex, which is that, we think when people invest in SL Green and buy our stock, it's a blended play. People want current return and they want evidence of our ability to be able to generate cash flow, either through ordinary operations or gain on assets and be able to reward shareholders throughout the year with a dividend in addition to doing our redevelopments and developments and creating growth and driving share value. And in most years that's reflected, in some years like we have today where the market sentiment is very negative, we just work our way through that.

But I think, what I wanted to state is that, we believe that a dividend is an important component of the overall investment thesis for anybody who invest in the stock. We all own the stock at the managerial level. For most of us, it is the largest, if not, almost the exclusive source of our net worth, is the stock that we own, and we want to create value and we want to create cash flow and see distribution as the form of dividends. So we are very comfortable with where the dividend is today given the earnings that we're generating and the gains that we're generating on some of these very important sales. We'll do next year's business plan next year. We'll have a sit down in November, December, and we'll roll that entire plan out with our objectives and our earnings levels, et cetera. But suffice it to say, which is what I said earlier, as we take all of those points very seriously and our goal is as best as possible to maintain the levels as much as we can.

Alexander Goldfarb
Analyst, Piper Sandler & Co.

Q

Okay. The next question is on compensation. Every year it for whatever reason, it seems to always be a big topic ahead of the shareholder meeting. This year you guys put out some really interesting data just showing the fact that like, Marc, your comp is 40% lower than the stated value. The rest of the team 30% lower. But here's the rub, is that, shareholders are sort of dis-serviced because you guys expense 100%. You realize 30% or 40% less than you're expensing. People obviously don't get paid, it's sort of dis-rewarding. So is there something better, like the consultants or people can put in place that better ties you guys to performance, but something that actually is more directly correlated, not only to you guys being paid for results delivered, but also to the P&L because right now FFO is being penalized because it's not paying. It just seems like the current system doesn't seem to be an ideal one. So just, I didn't know if you guys have thoughts around that, but I thought I'd ask.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Got it. I'm going to let Matt address the accounting issues with respect to that. I'll just give you, the philosophy is, at the top levels of the company and our EVPs, and even down to the SVP ranks for sure, we're big believers in creating the alignment and having a large portion of total compensation in the form of stock. In some cases it's a very, very high percentage. I don't have them in my fingertips. But in some of our cases it might be 75%, 80%, 85% of our total compensation, and in other cases, maybe half, but in all cases, material. And I think that makes sense. I mean, I am a shareholder, and as a shareholder and as in all my different hats I wear, I think that is the best at creating the alignment I referred to earlier. And I don't see us moving away from what I would call proportionately more stock compensation as you move up the ranks as a component of total compensation. Now, how those plans are structured and the charges that are taken upfront versus charges that could be taken later, fixed charges, variable charges, I leave to Matt.

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.

A

Yeah. You make a good point, Alex, I mean, the challenge with the accounting for these plans is, once the charges or the cost, the plans from accounting perspective are established day one, they do not change, the plans or value we were talking, stock plans or outperformance plans which have multi-year measurement periods, investing periods. The accounting rules say, you value that plan day one and if it's worth full value to the recipient at the end, the accounting charges what it is, and if it's worth zero or close to zero to the recipients, the charge is still the same.

And of late these plans have not been paying anywhere near what they're expected to. So they're not a retention tool. But the charge is still flowing through G&A, and more than 50% of our G&A is non-cash, primarily related to stock-based compensation, because we do believe it's an important part of the program. The challenge is finding the right form of stock-based compensation so that the expense to the company is mitigated and actually more closely mirrors the benefit to the recipient, because these plans, I'll say it again, largely hit expense in a disproportionate way in this environment than they benefit their recipient.

Alexander Goldfarb
Analyst, Piper Sandler & Co.

Q

Thank you.

Operator: And one moment for our next question. And our next question will come from Tom Catherwood of BTIG. Tom, your line is open.

Thomas Catherwood
Analyst, BTIG LLC

Q

Excellent. Thanks so much. Maybe one for Steve to start out. Nice uptick in leasing, percent lease in number of your buildings. One that jumped up to us was Graybar. And I know this probably reflects the pickup in small tenant demand that you've referenced over the last few quarters. But on the other side of that, what's the market like for large block demand right now, and are there specific submarkets or buildings in your portfolio that are garnering more of that large block demand?

Steven M. Durels
Executive Vice President & Director-Leasing and Real Property, SL Green Realty Corp.

A

Yeah. It's a great question because what we saw in the first half of the year, in particular, if you read a lot of the market reports from some of the brokerage houses that are out there is that, leasing overall velocity in the marketplace has been very modest year-to-date, despite the success that we've had within our portfolio. And a lot of the leases have been signed this year have really been on the smaller side of the market. We started off the year with very few larger size requirements active in the market. But having said that, in the past 30, 45 days, we've seen a lot of increase both in tenant tours and in proposals that we've received for larger sized tenants. So that's the good news.

Just to put a little meat on the bone, we've got 16 active proposals that we're trading paper with right now, that range between 45,000 and 300,000 square feet. Eight of those proposals came across our door only within the past two weeks, and only three of those 16 proposals of good-sized tenant requirements are in our 1.1 million square foot pipeline. So it shows you, there's a growing wave of larger tenants that have re-entered the market. And hopefully that's going to pay off for better leasing success for the overall marketplace and certainly within our portfolio as we go into the second half of the year.

Thomas Catherwood
Analyst, BTIG LLC

Q

Got it. I appreciate that, Steve. Then kind of second one from me, maybe Marc, over on One Madison, you mentioned the early completion and how that gets you access to your JV partner's contribution sooner rather than later. Kind of two-parter there. First, when is the new expected TCO date? And second, in the press release, you mentioned restructuring the loan so that you could invest more in amenities and invest some of the savings. What's envisioned amenity wise and kind of what more does that building need from an investment standpoint?

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Okay. So first question, I think, the original, original completion date was December of 2023. That was for TCO. We move that forward, and later, when we kicked off and got our GMP under our belt a few years ago to November of 2023, and then we internally kind of felt like we can maybe hit October, and now the team is pushing hard for September, middle-ish to end of September. So when do we expect it? We expect it as soon as possible. I don't know, we're aiming for middle to end of September. I hope we get there. We should get there. But you got weather and all sorts of other issues. But we should get there.

But regardless, the bigger point is, we ran a great project. We're at the final or whatever, two, three, four yard line, almost done, property looks great. We're way, way ahead of schedule, thanks to the good work of the people I mentioned and hundreds of thousands of others who worked very hard to get the building to this point. And the primary mission is get the job done right. But the secondary mission is get it done expediently so we can button it up and get tenants moved in and open the building and have it be a great addition to the neighborhood. In terms of the amenities, I think we had something on the order of $60 million of construction cost savings.

That was the ultimate cost of the project that we are now projecting relative to the original GMP. A lot of saved contingency and other components which is great. Some of that obviously is being retained. Some will go to defray higher interest expense. But we took a very significant amount of that, and we are constructing an amazing rooftop, indoor, outdoor rooftop venue that I think will rival some of the great rooftops in and around the city, that'll be there as both a tenant amenity and also as some very attractive and exclusive event space, that can be activated evenings, weekends, as well as I mentioned earlier, being, I think, a world-class amenity for the building.

The amount of investment we're making in One Madison amenities overall, that which was planned and that which we added, exceeds that of what we did at One Vanderbilt. And I think One Vanderbilt is recognized as having an amazing amenity program. So this, at its completion with the market and the Daniel Boulud steak place, and an exclusive tenant commons, and the Chelsea Piers four-level fitness center, and upstairs this kind of piece there [indiscernible] (30:41), this David Rockwell group designed rooftop amenity in the aggregate is going to make One Madison just an amazing destination experience.

Thomas Catherwood
Analyst, BTIG LLC

Q

Got it. Can't wait to see it. Thanks all.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Next summer.

Operator: One moment for our next question. And our next question will come from John Kim of BMO Capital Markets. John, your line is open.

John P. Kim
Analyst, BMO Capital Markets Corp.

Q

Thank you. I suppose you had your mic drop moment with the 245 Park sale. But now that that's done and you're expecting proceeds in One Madison, potentially a JV sale at One Vanderbilt, in your view, is that enough to avoid a credit rating downgrade from Moody's?

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.

A

It's a question I can't answer definitively because they have moved somewhat as a result of the market, not just as a result of us. I'll say this as it relates to the ratings. I mean, we're focused on a business plan that puts us in a financial position that we feel is prudent and we want to be in. It is not a stated objective to satisfy Moody's or anyone of the other rating agencies. Our ratings are important, but the fixed income market has not been a reliable source of funding for us. And the ratings will come back as a by-product of an execution of the business plan, but it's not the goal of the business plan. If Moody's makes a move, that's fine. If they don't, that's fine as well. We think we're executing on a prudent business plan for our business and for the shareholder base.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Yeah. And I would add to the mic drop moments, not just capital transaction but leasing of space. I mean, we're at these levels with increased interest costs and a vacancy rate that, as I said before, is our low point. We now think we're going to be able to turn the tide and start building occupancy again. And as we do that has as much or more effect, if you will, on an improving ratio as any of the other things you mentioned. So I would say, stay tuned. We've got a big pipeline and we think the market is starting to come around, and we're believers in this market and that'll be as big a help as anything.

John P. Kim
Analyst, BMO Capital Markets Corp.

Q

Another asset that you've had some leasing success with, I think, with GIC was at 280 Park. But there are still some tenant departures scheduled and the debt maturity next year. How confident are you that you will be able to refinance that asset on economically viable term for you?

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Andrew, you want to address? I know you've been involved with 280 Park Avenue and the refinancing.

Andrew W. Mathias
President & Director, SL Green Realty Corp.
A

Yes. Fortunately, 280 Park Avenue sits in the hottest submarket of Manhattan, Park Avenue corridor. We have strong interest in the space that's coming available, and we're constantly in discussions with the existing lenders on the property and obviously other lenders around the world like we accessed for 919 Third Avenue. And we think we have a great business plan with Vornado on that asset. Steve and Glen Weiss are working on it day in, day out, and I think there are some very positive developments that are possible given the building's location and the renovation we did there. And it's getting a lot of attention because of the profile of the asset, and I think we're confident that there's a good future for us with that asset.

John P. Kim
Analyst, BMO Capital Markets Corp.
Q

I appreciate it. Thank you.

Operator: One moment for our next question. And our next question will come from Blaine Heck of Wells Fargo. Blaine, your line is open.

Blaine Heck
Analyst, Wells Fargo Securities LLC
Q

Great. Thanks. Can you talk in general about asset pricing in the market? What sort of cap rates and IRRs are potential investors targeting, and how large is the bifurcation between well-positioned assets like 245 Park versus more commodity type buildings?

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.
A

Andrew?

Andrew W. Mathias
President & Director, SL Green Realty Corp.
A

Well, I think, we probably never seen a gap of high as currently in terms of well-located and amenitized buildings versus more call Class B and Class C buildings, which fortunately we really have rotated the SL Green portfolio out of. So we still have submarkets that are struggling, the financial district for sure, Third Avenue, just a lot of inventory, but investors are very attuned to that. And I think you saw that with the 245 Park transaction. You'll see it in further transactions where they're willing to pay up for the stability of improved, amenitized assets. And if you have a off the beaten path asset or an asset that's not been invested in and amenitized, it's honestly – there's not a lot of comps out there. Most of the comps are lender and loan-related rather than owners selling. So it's a huge gap, in answer to your question, but we do feel investor demand for the former, for well-located, amenitized and improved continues to be there in New York City.

Blaine Heck
Analyst, Wells Fargo Securities LLC
Q

Okay. Great. And then for my second question, kind of related to that, it seems like we're still seeing the flight to quality trend play out with net absorption and leasing activity taking place at higher rent buildings. But just curious if you're seeing any better activity at the lower rent buildings within your portfolio, or is it still relatively soft in that segment?

Steven M. Durels
Executive Vice President & Director-Leasing and Real Property, SL Green Realty Corp.

A

No. I think as we've commented in maybe the last call and certainly over the last several months, we've seen an increase in activity in the more price sensitive buildings. Graybar being a good barometer of that part of the marketplace where our vacancy in that building right now is around 12%, and that's from a high of we were up around 15%, 16%. So we've had good velocity in that building. We're starting to see more deal flow in the other – in similar type buildings. A very good example of that is 1185 Sixth, which was very slow to getting leasing traction last year as a lot of the market attention was on the best-in-class buildings.

And right now 1185 has got, I don't know, five, six, seven active proposals that are in negotiation for the building. And that's a price sensitive, rent sensitive type of building. But it also sits in one of the two best submarkets in Manhattan right now, Park Avenue and the Sixth Avenue, [indiscernible] (38:34) being the two best. Another stat worth knowing is that, 62% of the leasing year-to-date in Manhattan has been done in what is termed as commodity type building. So clearly you've seen kind of a reawakening of that part of the market. It's got a long way to go before where it's in a healthy place. But the good news, it's starting to happen.

Blaine Heck
Analyst, Wells Fargo Securities LLC

Q

Great. Thanks, guys.

Operator: One moment for our next question. And our next question will come from Anthony Paolone of JPMorgan. Your line is open Anthony.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Great. Thank you. First question is just, I think your guidance at the Investor Day, I think your disposition guidance was $2 billion. And so I just wanted to understand, like, make sure 245 Park Avenue you're treating that as $1 billion or the $174 million, and then also things like the $570 million and change you'll get from your RMA partners, and then any cash from the DP book maybe over the rest of the year as some of those mature? Like, does that all roll into the $2 billion? Just want to try to clarify like what's coming in the second half.

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.

A

The $2 billion, just use 245 Park Avenue as an example, it would be $1 billion. So 50% of $2 billion. That's what would feed the goal. The $577 million of proceeds on One Madison from our partners is not part of that. DPE is not part of that. It is pro-rata share of sold assets that feed the calc. And getting to that goal will be a function of assets we have in the market currently as well as where we end up with One Vanderbilt, which we said is an opportunistic sale that we've had out there for last couple of years. We're marketing an interest, and we'd hope to get one done, but want to be opportunistic about it. And with regard to another interest sale in 245 Park Avenue, there's likely upside to where we sold the first interest. So we may play that out a bit and watch the redevelopment and lease up, leasing has been strong, Steve mentioned that earlier, watch the redevelopment and lease-up take place before we bring another interest to market.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Well, so with that being said, Mat, if the goal was $2 billion, that's just what I'm hearing from Anthony. If we were to defer the second, the 25% of...

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.
A

We would not hit $2 billion.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.
A

That would be $500 million, like following you. So there's – I mean, that doesn't mean we won't identify other assets to solve for that, but that one, like I said, we're doing it out of a position of strength. I feel very good about 245 Park Avenue, our capitalization there, our partner. And while it was – we got the big part done this year, there's a smaller part to go. This is about making money for shareholders. So if we think we're going to do a lot better next year after we get a lot more leasing traction, then we may defer early. But that doesn't necessarily mean we couldn't get there if we decided to go forward with it now. It just means we have to do what we think is best optimized returns.

Anthony Paolone
Analyst, JPMorgan Securities LLC
Q

Okay. Understand. Then even with that being said, that sounds like, between the RMA, partner capital and maybe some amount of sales, you'll have cash coming in over the second half of the year. That's pretty meaningful. And so my second question, just you may remind us of the priorities of where you see that cash going, whether it's line of credit, buyback, other asset, acquisitions, like whatever.

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.
A

Priority is debt repayment. We've earmarked the entire $577 million coming in from our partners towards debt repayment. All of the proceeds from to 245 Park Avenue went to debt repayment. We have still paused share buybacks since the middle of last year. That was largely a function of the rate environment and where leverage levels were. We have a goal to be more on offense as we get into later 2023, particularly 2024. That was the purpose of our business plan in 2023. Execute sales, increase liquidity, reduce leverage and go back on offense. We are still on that program, but for the time being, we need to get through the remainder of the 2023 business plan.

Anthony Paolone
Analyst, JPMorgan Securities LLC
Q

Okay. Thank you.

Operator: And one moment for our next question. And our next question will come from Ronald Kamdem of Morgan Stanley. Ronald, your line is open.

Ronald Kamdem
Analyst, Morgan Stanley & Co. LLC
Q

Great. Couple of quick ones. So just go back to the DPE book. I think you talked about $289 million of investments on non-accrual. I appreciate $225 million of that is 625 Madison. I think you said on August 8th there will be a resolution. So should we be expecting you to take over that asset or what are some of the other scenarios there? And then the follow up to that is, the remaining sort of $65 million or $55 million plus or minus on non-accrual, can you just comment on what the situation there and what the plan is?

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.
A

So on 625 Madison, we'll stick to what was said earlier. We have to be sensitive to what's going on with the asset. But neither say, there is a foreclosure proceeding on August 8th. And if that went a certain direction, then that affects the investments.

Andrew W. Mathias
President & Director, SL Green Realty Corp.
A

We said [indiscernible] (44:22) 625 Madison.

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.
A

And then the remainder of the assets, I think your question was what happens with those.

Ronald Kamdem
Analyst, Morgan Stanley & Co. LLC
Q

Yeah. Exactly. What's the plan on those that are on non-accrual? Are you taking over? Just curiosity there.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.
A

No. I don't think we can generalize, Ronald. Every asset, it could be extended, could be restructured, modified, could be turned into equity. I don't want to generalize, and we're not going to go through asset by asset, it's not what we do. But suffice it to say that the remaining book is quite small at this point in terms of number of assets. It's not small in terms of dollars, but I think like more than a third of it is represented by 625 Madison. And for that you'll just have to, like all of us, wait and see what the outcome is after August 8, that we've already said that. For the balance, most of it is on performing, but for how much is non-performing of this 625 Madison?

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.
A

$50 million, $60 million.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.
A

So I mean, for $50 million, $60 million we'll see how it goes. I mean, we're going to do whatever we can to optimize, either restructure, extend or possibly foreclose.

Ronald Kamdem
Analyst, Morgan Stanley & Co. LLC
Q

Helpful. If I could just sneak one in for my follow up. Just going back to the $545 million guided midpoint, you had some other income come in this quarter. The forward curve has moved. Just can you talk through how are you thinking about sort of the guidance for the year and some of the puts and takes and where it's trending. Thanks.

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.

A

Trending within the range with, if we were outside the range, we would have moved it. But given rates and the balance of the business plan to execute for the back half of the year, we feel good with the range where it is.

Ronald Kamdem
Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

Operator: One moment for our next question. And our next question will come from Anthony Powell of Barclays. Anthony, your line is open.

Anthony F. Powell
Analyst, Barclays Capital, Inc.

Q

Hi. Good afternoon. Just a question on the dividend, going back to the prior question. I noticed that the payout ratio of FAD went above 90%. So maybe if you can go over, I guess, what your medium-term dividend policy is, and is that a comfortable ratio for you?

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.

A

So if you recall, we set a dividend level that's, as every year, dividend level is based on taxable income. So the popular measure other than taxable income is FAD. We set our dividend at what was at the time 100% of FAD. Our FAD is slightly better than we projected, so they were slightly under 100%. But it all comes back taxable income. And as I think we alluded to earlier, our program is in line with what we expected it to be, and therefore, the dividend is exactly where we expected it to be.

Anthony F. Powell
Analyst, Barclays Capital, Inc.

Q

Maybe one more if you can comment, I guess there are some reports about an asset in Chicago that may be turned over to you, an office building. If that's the case, would that be a potential sale or is that – can comment on that at all?

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

So Harry Sitomer has been handling the part of the 245 Park Avenue claim that doesn't really relate to the asset but relates to the guarantees and the judgments we received against the prior owner HNA. If you recall, I think we discussed in prior calls and certainly it's been publicized that we received $185 million judgment, which has grown far higher since with interest and passage of time, et cetera, and additional claims. And as a component of that claim, we've exercised against some assets, and Harry can shed some light on that.

Harrison Sitomer
Chief Investment Officer, SL Green Realty Corp.

A

Sure. So there's two assets that we currently have a line of sight to right now as we continue to pursue additional assets under the $185 million judgment, the one that you referenced in Chicago. That asset is currently working through a bankruptcy process, and we're trying to monetize the position that we have there. The second asset is an asset in Orangetown, New York. That asset has no debt against it, and we're working with stakeholders in the town to monetize that position as well. And just to be clear, we have no basis in either of those positions and no liabilities that we've taken on the corporate level.

Anthony F. Powell
Analyst, Barclays Capital, Inc.
Q

Okay. Thank you.

Operator: One moment for our next question. Our next question is going to come from Michael Griffin of Citi. Michael, your line is open.

Michael A. Griffin
Analyst, Citigroup Global Markets, Inc.
Q

Great. Thanks. Maybe just going to the leasing pipeline, the comments in Marc's prepared remarks about the 1.1 million square feet, about two-thirds of those are new leases. Can you give us some more color on these, of these expansions? Is the tenants looking to keep the same size and then Durels, I think he mentioned in a previous question, that you have a lot of large tenants that are in the pipeline. How likely are some of these to close? And any color on that would be appreciated.

Steven M. Durels
Executive Vice President & Director-Leasing and Real Property, SL Green Realty Corp.
A

Well, I'll start with the last part. Anything that's in the pipeline is a deal which we think has a high probability of either closing or if it's a proposal that's being negotiated, being converted over through lease negotiation. So beyond the 1.1 million square feet, there's a significant number of proposals that are being negotiated with prospective tenants. But it's early days in discussion with those tenants, and it's premature for us to then make it part of the pipeline. What composes the pipeline, two-thirds of it is financial service tenants, the balance being law firms and professional services, a little bit of education, a little bit of medical beyond that.

But by and large, financial services is driving the trend right now. And of our biggest proposals, one I referred to earlier, the 16 largest proposals that were actively trading paper back and forth, with seven of those tenants are from the fire sector and four from legal. So as far as, whether they're expansions or not, it's a little bit of everything. I see a lot of the financial service guys are driven by expansion, a lot of the law firms are driven by either consolidations or lease exploration. And the balance of the tenancy is – it's a mix bag. Some are downsizing, some are upsizing, some are just being replacing [indiscernible] (51:27) with no discernible trend one way or the other.

Michael A. Griffin
Analyst, Citigroup Global Markets, Inc.
Q

That's helpful. And then maybe just a question on the balance sheet for Matt. I know you've got about 300 million of notional swaps burning off this month. Is the plan to leave that as floating? I know you've done a good job of managing our floating rate exposure, call it, over the past year, but would you plan to swap that back for fixed? And if you are, what kind of rate do you think you'd get on that? Thank you.

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.
A

There is actually a schedule of our derivatives now in the supplemental. We added it last quarter. You'll see there that maturing swaps are replaced already with forward starting swaps. We put those in place a while ago. So we have no near-term swap maturities at all.

Michael A. Griffin
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you.

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.

A

Yes.

Operator: One moment for our next question. And our next question will come from Caitlin Burrows of Goldman Sachs. Your line is open, Caitlin.

Caitlin Burrows
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Good afternoon. Maybe just back to the fixed charge coverage ratio and the expected trend going forward, Matt, you mentioned that it would go down before up, given that you now expect the One Madison JV partner proceeds during 3Q. I guess, what makes it get worse before better?

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.

A

Well, I'm still being conservative. We get the TCO in late September. Those proceeds wouldn't come in until fourth quarter. So obviously those proceeds help it. It's a function of whether we get it in the third quarter or early fourth, and that could be a matter of days.

Caitlin Burrows
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Okay. So once it's in that should make the trough and then it improves?

Matthew J. DiLiberto
Chief Financial Officer, SL Green Realty Corp.

A

Exactly.

Caitlin Burrows
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then just on dispositions, you mentioned earlier how your goals are generally a stretch, and it sounds like further sales at 245 Park and One Vanderbilt could be somewhat opportunistic. So I guess, as we think about the $2 billion goal, how important is it to you that you reach or get pretty close to that target and...

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Yeah. I just want to make a correction, because if I don't want, I don't want to get into the narrative. I did not say One Vanderbilt was an opportunistic sale. I was asked a question earlier, and my commentary was that, there is a lot of interest in One Vanderbilt. It's got primary amount of our focus right now, and we're going to do everything to get that deal done this year. So I think that's inconsistent with what I just heard. I just want to make that clarification. So if you could re-ask me the question.

Caitlin Burrows
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. I guess, I was just thinking, with the $2 billion goal, kind of what is the focus. And obviously, if One Vanderbilt gets done, that could be a decent piece of it. And whether that gets done or not, how does that kind of impact your focus on potential smaller assets?

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

No. I'm still not getting. Let me just, a lot of this was previously said. 245 Park Avenue is a $1 billion of it, the $500 million on One Madison we may choose to defer – 245 Park Avenue we may choose to defer, and One Vanderbilt we're moving ahead on and there's a lot of interest. So that's where we are.

Caitlin Burrows
Analyst, Goldman Sachs & Co. LLC

Q

Got it. And then there were a couple of other properties that you guys had pointed out 753rd or [indiscernible] (54:46).

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Well, I mean, there's other deals we're working on, but those are – I don't want to say they're not, I mean, they're material, but they're not – I mean, I keep my eye on 245 Park Avenue, One Vanderbilt, the $577 million that's triggered to come in, the condo proceeds we'll be getting next year, the rent on Armani that's going to be triggered on turnover on September 30. I mean, these are the big things. And then there's other, we're always in the more – I mean, there is a retail deal we're working on right now. I don't know, you want to say anything [indiscernible] (55:19).

Steven M. Durels
Executive Vice President & Director-Leasing and Real Property, SL Green Realty Corp.

A

There's been significant interest on some of the retail assets we own at Madison Avenue, and there's one transaction that's in the works, Caitlin.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Yeah. But I mean, we do that every quarter. I'm trying to just highlight the big things on this call.

Caitlin Burrows
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Okay. Thanks for clearing those up.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Thank you. Next?

Operator: One moment for our next question. And our last question will come from Nick Yulico of Scotiabank. Your line is open, Nick.

Nicholas Yulico
Analyst, Scotia Capital (USA), Inc.

Q

Hi. Just a clarification question on page 19 of the sup where you give the NOI breakdown of the portfolio. It went down sequentially. Was that all due to the one time L brands payment in the first quarter?

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Correct.

Nicholas Yulico
Analyst, Scotia Capital (USA), Inc.

Q

Okay. Great. Thank you.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

A

Okay. Is that it, operator?

Operator: I'm showing no further questions. I would now like to hand the call back to management for closing remarks.

Marc Holliday
Chairman & Chief Executive Officer, SL Green Realty Corp.

Okay. 02:59 PM, so we did our job well, and we appreciate all the questions, and we thank you for listening in. We thank you for being shareholders. And for those of you that aren't, we hope you'll become so. And we'll look forward to speaking again in three months' time.

Operator: And ladies and gentlemen, this concludes today's conference. Thank you for your participation. You may now disconnect.