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# EDITED TRANSCRIPT

SLG - Q3 2016 SL Green Realty Corp Earnings Call

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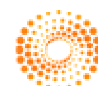

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**Jamie Feldman** *BofA Merrill Lynch - Analyst*

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## PRESENTATION

**Operator**

Thank you, everybody, for joining us, and welcome to SL Green Realty Corp.'s third-quarter 2016 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. Actual results may differ from the forward-looking statements that management may make today. Additional information regarding the factors that could cause such differences appear in the MD&A section of the Company's Form 10-K and other 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 SEC Regulation G. The GAAP financial measures most directly comparable to each non-GAAP financial measure discussed in the reconciliation of the differences between each non-GAAP financial measure and the comparable GAAP financial measure can be found on the Company's website at www.SLGreen.com, by selecting the press release regarding the Company's third-quarter 2016 earnings.

Before turning the call over to Matt DiLiberto, Chief Financial Officer of SL Green Realty Corp., I ask that those of you participating in the Q&A portion of the call please limit your questions to two per person. Thank you. I will now turn the call over to Matt DiLiberto. Please go ahead, Matt.



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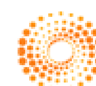

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**Matt DiLiberto** - *SL Green Realty Corp. - CFO*

Thank you, operator. Good afternoon, everyone. Before I turn the call over to Marc I just wanted to take the opportunity to remind everybody of our annual investor conference being held on Monday, December 5, here in New York City at Jazz at Lincoln Center. For more information you can email SLG2016@SLGreen.com. The invitations should be going out in the next couple of weeks.

The format has changed slightly this year. We will be beginning at 9 AM on Monday, December 5; the doors opening at 8:30 AM for a light breakfast and we would expect to be completed by 1:00 in the afternoon. For more information, please email SLG2016@SLGreen.com.

With that, I will turn it over to our CEO, Marc Holliday.

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

Thank you, Matt, and thank you for dialing into the call today. We are happy to have the opportunity to review with you the results of the third quarter and provide some additional commentary on how we see things shaping up in New York City.

Continuing a trend this year where we have outperformed many of our 2016 operating and financial goals, we had a very strong third quarter punctuated by 1.3 million square feet of Manhattan office leases signed at a market-leading 29% mark-to-market. Once again, SL Green has demonstrated its ability to outperform on the leasing and operational fronts, notwithstanding any perceived or actual slowdown in the tenant market.

In fact, in the first 20 days of October we concluded nine additional Manhattan office leases for a total of 212,000 square feet, highlighted by the two leases we announced this morning with Comcast and Nixon Peabody at Tower 46. And we welcome those two tenants to our portfolio.

This brings our total Manhattan leasing production to 3 million square feet. Year-to-date that's 50% more than we originally forecast and a 28% mark-to-market on replacement leases, which is about double what we originally projected at the beginning of the year.

These accomplishments are not just market-leading; they are extraordinary by any measure and will rank among the two or three best leasing years in our 19-year history as a public company. All the more notable because we achieved these results notwithstanding additional supply from Hudson Yards, making the point that high-quality, well-located, and reasonably-priced office space is still in very high demand.

As further evidence of that tenant demand, we have a current leasing pipeline of nearly 600,000 square feet, approximately half of which are leases pending and held for signature. So I think that stat shows that notwithstanding we have cleared out a substantial amount of pipeline year-to-date. We still expect to achieve a lot more over the next 2.5 months as we close out the year.

Assuming the successful completion of these pending leases, we are looking at a rollover schedule in New York City for 2017 and 2018 that averages less than 900,000 square feet per annum, or just about 3% of our portfolio square footage each year. That's the lowest rollover rates in recent history. That places our portfolio and this company in an unusually excellent offensive and defensive position by allowing us to focus our efforts on those future rollover spaces as and when they come up over the next 24 months and selectively make early deals with those tenants, the ones that allow us to drive the best economics possible.

Notwithstanding our track record of keeping our portfolio well-leased throughout market cycles, we get the inevitable question, whether we can continue to outperform the market. And I believe the answer is absolutely and unequivocally yes.

While office-using job growth has slowed in the second half of the year, the information sector continues to add jobs while the losses in the financial sector have been quite modest through August, even though the prevailing view is much different and inaccurate; that being a significant shedding of jobs in the financial sector. The numbers simply don't back that up. And those are numbers that come right from OMB.



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September job numbers are not out yet, but there are a few interesting points to make about the health of the city economy up and through Q2. And part of these numbers are through September.

Each of the big five banks have reported third-quarter results, financial results, and pretax earnings were up 50% year over year. Revenues, which were flat for Q1 and Q2 for the big five, were up 20% year over year in Q3. Add to that that total New York City jobs has reached another record level this year of 4.3 million workers, driven by private-sector job growth through the second quarter of 77,000 new jobs, with third-quarter numbers coming out imminently.

Hotel occupancies are still as strong as last year, in the high 80%s occupancy range, and only a slight decline in ADR, the average rate, even though there is a lot of new supply being absorbed this year as a result of construction that has taken place in years past. And Airbnb continues to be a competitive force. Notwithstanding hotels having an excellent year, showing that tourism in the city is still very robust and has not missed a beat as a result of Brexit or otherwise.

So while New York's economy and job growth metrics aren't on the same pace as last year's record levels -- by the way, something we had forecasted to you at the beginning of the year -- it is still shaping up to be a relatively good year with above-average job growth, economic performance, and leasing activity, along with below-average sublet availability, well under 2%. We also have a positive outlook for longer-term trends in tenant demand due to the expectation that New York City will continue to benefit from nation-leading population and job growth, extremely low interest rates by any historical standard, and fairly limited new contributions to office inventory over the next five years, as compared to the total 400 million square foot portfolio -- inventory of office properties that currently exists in all of Manhattan.

Today we gathered -- sorry, Tuesday -- it seems like today, but it Tuesday -- we gathered for a very proud moment in this company's history as we, along with Mayor DeBlasio and many other elected officials, formally broke ground on the development for 1 Vanderbilt, a spectacular project that will transform the skyline and establish a new blueprint for the revitalization of East Midtown. This groundbreaking event followed on the heels of our announcement recently of the $1.5 billion construction loan closing. That was led by five different domestic and international banks and carries with it an up to seven-year term, which is largely unprecedented in the construction loan market.

Also, on top of that, we announced the withdrawal of litigation of claims against the city and the project. So a lot accomplished since our last phone call in terms of clearing the decks for continued progress on the construction of 1 Vanderbilt, the financing. Along with that we continue to be on budget and on track with that project.

Andrew and I are extremely proud of our team for these great accomplishments and we are excited to be part of this truly historic project. We understand that investor sentiment is mixed, but we look forward to fully educating everyone at our upcoming investor day that Matt just spoke about as to the incredible physical attribute of the building, the compelling economics of the project given our cost basis, and the transformative effect it will have in the surrounding area in which the majority of our invested dollars reside.

So with that, I'm sure there are people out there that have many questions on the quarter's results and we would like to get right into it and field the first one, operator.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) John Kim, BMO Capital Markets.

**John Kim** - *BMO Capital Markets - Analyst*

Thank you. I was wondering if you could provide an update on the Aeropostale lease as far as if termination fee is still being negotiated. And also, if you could discuss what the mark-to-market may be and, in comparison, where that fits on page 50 of your supplemental.



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**Marc Holliday** - *SL Green Realty Corp. - CEO*

Let's start first with status of the lease. It's beyond (multiple speakers).

**Matt DiLiberto** - *SL Green Realty Corp. - CFO*

John, it's Matt. Aero vacated early in the third quarter, so the space is now vacant. It's out being marketed by our retail team. There's no termination fee involved because that is a bankruptcy.

We were able to get them out so we can market the space and get the mark-to-market, which we have highlighted as being somewhere between 20% and 40%, which is -- Andrew can expand on that a little bit. But there is no termination fee coming from that and Aero is now out.

**John Kim** - *BMO Capital Markets - Analyst*

As far as the retail leases on page 50 of your supplemental, is that the vacancy portion of it?

**Matt DiLiberto** - *SL Green Realty Corp. - CFO*

Yes, correct. In the vacancy.

**Marc Holliday** - *SL Green Realty Corp. - CEO*

They paid rent up and through the date of their occupancy.

**Matt DiLiberto** - *SL Green Realty Corp. - CFO*

Yes, so they paid all the way up through the day of their bankruptcy; they were current. And then they paid through the end of their occupancy in early third quarter.

**John Kim** - *BMO Capital Markets - Analyst*

And what are your views of street retail rents overall? It looks like it has been declining in most -- some markets in Manhattan. Where do you see the trend as far as rents in the near term?

**Marc Holliday** - *SL Green Realty Corp. - CEO*

We haven't seen many declines. I would characterize rents generally as flat in the submarkets that we operate in, primarily Fifth Avenue, Times Square, SoHo, and Upper Madison. We are still seeing tenant demand, but I would say tenants are slower to make decisions, which has led to some longer lead time in terms of leasing of vacant space. But there's still active tenants looking in the market and we are in discussions on a lot of our vacancy in the portfolio now.

**Matt DiLiberto** - *SL Green Realty Corp. - CFO*

I think we feel pretty good about being able to achieve our mark-to-market on the vacated Aeropostale space and that will ultimately come to pass as a positive event for the Company. I think we feel highly confident in that.



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**John Kim** - *BMO Capital Markets - Analyst*

Thank you.

**Operator**

Alexander Goldfarb, Sandler O'Neill.

**Alexander Goldfarb** - *Sandler O'Neill & Partners - Analyst*

Good afternoon. Just, Marc, on 1 Vanderbilt, you guys have finished the construction loan, so sort of going against the list, the checklist that you guys signed off. As you guys think about -- especially in light of the leasing activity that you have, as you think about next steps, whether it's JV or leasing, you guys have paid off almost $1 billion I think of incremental debt so in a sense you have shored up the balance sheet.

Do you still feel like you need to JV it before you get substantially more leasing done? Or do you feel that if you get more leasing done there's more value to be extracted when you do, if you should bring in a JV partner?

**Marc Holliday** - *SL Green Realty Corp. - CEO*

It's a great question, Alex. I just want to clarify one thing: I don't think we felt or feel the need to JV it. From day one I have always said we had absolute flexibility to build it out of cash flow as we go forward over the next four years or bring in a JV partner.

So I would characterize it more as an intent and desire to bring in a JV partner, which is there simply because of the scale of the project and for the significant amount of yield enhancement we can create by bringing in a JV partner, obviously at the right time, given that our cost basis in the property is low. And there's a lot of execution in terms of development and the leasing for which there's a lot of fee income that is associated with that.

I think it has always been our goal from the outset to bring in a JV partner. I think the kind of schedule we had -- I had mentioned to investors at the beginning of the year was something along the lines of towards the end of this year to start to get to what we would consider more serious discussions with investors, knowing that we had to get a few milestones behind us in order to best position our presentation of this project to shareholders.

And I think we've done that. I'd say we've done it as good or better than I even could have contemplated in terms of we have best-in-class financing. The site -- if you or others on the phone haven't seen it recently, it's really exciting and I think very impactful to walk over to 42nd and Vanderbilt just and get a sense of the scope of the project and the location of the project in its direct proximity to Grand Central and just how extraordinary it will be when that building is up in four years.

The response from the tenant community so far has been nothing short of excellent in terms of having, I would say, checked every single box of what we possibly could check in what you would want to do when delivering a best-in-class office building. With an understanding that tenants in 50,000 to 250,000 square foot range typically are not making those kind of space commitments much more than 18 to 24 months ahead of time, which given our schedule, would put the bulk of that leasing effort sometime towards the end of 2017 and into 2018. I think 2018 being kind of the sweet spot of our marketing efforts.

So with that said, we are in front of -- we are having discussions with a number of different potential JV partners. The good news is we are on a path and I feel very comfortable that we will be able to achieve our goals, but obviously our goals are to make sure that the deal is properly structured with the kind of partner that shares our view and vision for long-term ownership and on economic basis that is equitable and fair for both parties. So I think that we are on track there and we will just see how it goes.





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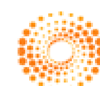

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**Alexander Goldfarb** - *Sandler O'Neill & Partners - Analyst*

Okay. But the point is do you feel that it's better -- it's more prudent to JV it because it's a really large project or --? It sounds like you don't feel like you're giving up upside, because once you have more leasing done it would seem like a JV partner would pay more for it. (multiple speakers)

You said, Marc, your spend now through next year really isn't that much, given it's just dirt right now. It's not like you have a structure up.

**Marc Holliday** - *SL Green Realty Corp. - CEO*

And, Alex, I'm not speaking as to exact timing. Whether it's the beginning of the year, middle of the year, end of the year next year, I think you got to trust us to do the right thing by the asset.

I don't think -- we've done a lot of really successful joint ventures, successful for us, successful for our JV partners. I think we are very skilled at this in terms of, most importantly, selecting the right partner, having the right structure, sharing the right vision, and then obviously getting the right economic package for both parties. So I'm confident we will do a good job there.

We don't feel pressure. We don't feel the need. There is a desire, for the reasons that I mentioned. The timing I think you got to leave to us to be the measure of when the right time to do it is, but we are not the kind of people that try to grab the last dollar. We don't warehouse space if we think rents are ticking up.

It's a business. We've got a lot of other projects and investments to focus on beyond 1 Vanderbilt, so we don't want to let it consume us. As important and spectacular as it is, it's one investment and this is a $20 billion-plus company, so we have a lot of other things we are focused on as well.

I think we will take it in due course and we will time it for when it's optimal to do it. And I don't think we're going to ever look back -- we never look back and say, oh, shoulda, coulda. It will be fine when we get it done.

**Alexander Goldfarb** - *Sandler O'Neill & Partners - Analyst*

Okay, and just quickly second question. Matt, you didn't mention guidance. You beat to the Street was pretty big in the third quarter. Is there anything offsetting in the fourth quarter that we should be thinking about that would affect the run rate, because it looks like otherwise it's like $1.35-type-ish number for the fourth quarter?

**Matt DiLiberto** - *SL Green Realty Corp. - CFO*

To be at the upper end of our range implies a $1.39 fourth quarter; to be at the upper end of our normalized or absolute guidance range. We are certainly trending at the high end of our range.

Looking ahead to the fourth quarter, there aren't many anomalies like was seen in the -- or nonrecurring items like was seen in the third quarter so it should be a pretty clean quarter. And we look at it within the range, at the upper end to maybe slightly ahead, but not warranting a change to guidance.

**Alexander Goldfarb** - *Sandler O'Neill & Partners - Analyst*

Okay, thank you.



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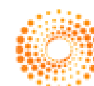

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**Operator**

Jamie Feldman, Bank of America.

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**Jamie Feldman** - *BofA Merrill Lynch - Analyst*

Great, thank you. I guess going back to 1 Vanderbilt; we have seen the higher end of the market, see some slowdown from hedge funds, financials under pressure. What are you guys monitoring as you think about -- you remain confident in the project, but what are you monitoring? What should the Street be monitoring as they think about your prospects to be successful there and hit your target rents?

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**Steve Durels** - *SL Green Realty Corp. - Director of Leasing*

Well, you know it's important to keep things in perspective as far as the timing goes. We don't deliver this building until -- for occupancy until 2020. So to measure the depth of the market by what's happening today in 2016 at the high end of the market, I don't really think is necessarily the barometer that anybody should be focused on.

I think that whether the market is robust or not, this is a unique product that offers a unique value proposition to those tenants that need the finest office product in the world. We know that it's going to be -- receive a warm welcome because the feedback that we get from tenants today as they evaluate the project really don't look at it on a dollars per square foot basis.

They look at it on the cost per seat basis and what the building offers from an efficiency point of view. Meaning the amount of -- the lesser amount of square footage per employee that tenants can occupy in this building, offset because of the column-free floors, the amount of infrastructure that's already baked into the building. And the amount of amenity space that tenants house outside of their demised premises allow them to reduce their total occupancy cost per head.

I really think that as we get closer to the prime lease-up period, we are going to be converting those conversations that we are already having with prospective tenants over to leases. And just I think -- and we will speak to it in greater detail at the investor conference, but the rents that we are targeting are not the high end -- not the highest end of the market, surprisingly enough. When you really normalize the rents for the majority of the office space in this building, you get into, what one could argue, is an affordable rent for those tenants that need the best product in the world.

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**Jamie Feldman** - *BofA Merrill Lynch - Analyst*

Okay. Are you able to quantify in terms of the conversations you are having, like how many square feet, of interest there really is at this point?

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**Steve Durels** - *SL Green Realty Corp. - Director of Leasing*

I have a presentation an hour after this call today for a 0.5 million square foot tenant. I had two presentations last week and I'm probably running at a clip of one to three presentations almost every single week.

The majority, you'll be interested to know, are financial-related businesses and most of them are in the 100,000 to 200,000 square foot range. Some as small as 30,000 to 60,000 square feet. And I point that out because when you are in that size range, as Marc mentioned earlier, we are early to the game for those type of tenants to really pull the trigger on a decision.

They have to be -- they are educating themselves as to the opportunity. They are preparing themselves to make a decision, but they need it closer to the finish line for delivery before they actually pull the trigger.

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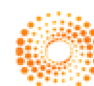

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

Hopefully that answers your question, Jamie; puts you a little bit at ease on 1 Vanderbilt. Let's move to the next question, which hopefully is not 1 Vanderbilt.

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**Operator**

John Guinee, Stifel.

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**John Guinee** - *Stifel Nicolaus - Analyst*

Marc, I was going to ask you a question on 1 Vanderbilt but (laughter).

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

All right, fire away. By the way, welcome to the third-quarter 1 Vanderbilt [call].

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**John Guinee** - *Stifel Nicolaus - Analyst*

Actually, Steve, these are a couple softballs for you. First, Steve, how many tenants, when it's all said and done, do you think you would actually just pull from existing SL Green buildings, existing SL Green tenants? That's one.

Then, second, are you thinking about this joint venture to appease the shareholders or it's the right real estate thing to do? Said another way, if doing a joint venture was not going to help your stock price, repeat not going to help your stock price, would you actually do it?

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**Steve Durels** - *SL Green Realty Corp. - Director of Leasing*

All right, so I'll take the first one and Marc will respond to the second one. You know, we have shared the 1 Vanderbilt presentation with a couple of tenants within our portfolio and they are good candidates for the building.

It is an interesting conversation because in some of those discussions with those tenants we point out to them -- assuming they're the right profile tenant, we point out to them that where their anticipated escalated rent will be upon expiration of their current leases in our portfolio, which we could speak to obviously knowledgeably about that, is that it puts them within $5 to $10 of what our pro forma rent is for 1 Vanderbilt.

Then when we further point out to them the ability for them to lease less square footage because of the relative attributes of the building that I spoke about earlier, that in reality it would translate into an occupancy savings for those tenants. So we are having those conversations. We have targeted some of those tenants and we are out there actively getting in front of them.

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

Let me -- does that answer that, John, before I move on? Okay. So I think -- because I'm not sure if it's exact [point] of what you said, but I think your question was why a JV --

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**Steve Durels** - *SL Green Realty Corp. - Director of Leasing*

Would we JV if we thought it -- if we didn't (multiple speakers)?



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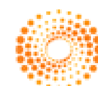

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

Didn't think it was going to move the stock price? Okay, interesting.

The answer is -- and you have to just trust and believe in what we say -- we are not JV-ing it to get a few bucks of stock price. That would be criminal; you know what I'm saying? It would be outlandish to do something like that for the sole purpose of thinking the stock is going to go up or down quickly.

By the way, it's almost like everything we have heard for the past 18 months about do this, stock price will do X has been completely wrong. So if anything, I would take the under on that.

We are doing it for the same fundamental and sound reasons we would typically JV any large project: for some diversification of investment opportunity. We have other uses for the capital and, if properly structured economically, while we won't maximize aggregate profit, we should maximize aggregate return. And that's what we have always been about.

That's how we have been able to drive 7.7% growth in FFO from the day of -- compounded growth in FFO from the day of our IPO back in 1997. It's how we have been able to drive outsized investment-class total return to shareholders. And it's really how we do our business is by balancing aggregate gain, which would drive you to retain everything, versus maximizing return on capital, which leads you to do a JV.

Maybe it's a partial JV. Maybe it's not half; maybe it's 40%, like we did with Pru at 11 Madison. Maybe it's 35% or 30% or 25% and then you don't give up much in the way of governance.

But there is something between 30% and 50% where we can structure I think a very appropriate joint venture, introduce this product to the domestic and more weighted international community who loves to own best project, best market, best location. When you can check those three boxes -- it's unusual you can check those three boxes, but when you can there's deep demand for that product.

I think it is warranted that we -- and prudent that we do that for diversification, for return maximization, and I think that is a good course. We don't give up much by doing it. We will always own the majority of the project, whether it's 51% or more.

It will have SL Green's brand on the building and it's something that we are all going to be very, very proud of no matter what -- anyone who has reservations about this project now is going to be standing at that ribbon-cutting in 2020 and is going to feel like a champion when we open the doors to a lease successful, number one building in New York City. And we are going to be able to stand up there and say, which many others can't, we did it profitably, on time, on budget.

**John Guinee** - *Stifel Nicolaus - Analyst*

Perfect, thank you.

**Operator**

Jonathan Petersen, Jefferies.

**Jonathan Petersen** - *Jefferies - Analyst*

Thank you. No 1 Vanderbilt question from me; I will let you off the hook. Maybe a little more straightforward in general though, on the balance sheet side of things you guys have obviously been a net seller over the last few quarters and the leverage levels continue to come down.



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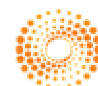

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Trying to figure out what the debt to EBITDA is right now, but probably somewhere maybe high 7s at best or in the 8s. I'm just curious; in the leverage metrics, have you guys got where you want to be? Maybe -- I know you will probably talk about this in the investor day, but kind of give us a sneak peek on what you're thinking about in terms of leverage going into next year.

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**Matt DiLiberto** - *SL Green Realty Corp. - CFO*

Yes, so on a consolidated basis our debt to EBITDA is 6.5 times and on a combined basis -- that's all-in -- it's about a turn higher than that. It's about a full turn on both metrics lower than we had originally projected to be at for the year, so we were certainly comfortable being at 7.5 times and now we're at 6.5.

We are right in the area we like to be with $2 billion of liquidity. Our target is $1 billion. We have a very comfortable liquidity position. So I think we are exactly where we wanted to be and slightly ahead and gives us a lot of flexibility on the balance sheet.

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

I know as much as we try to orient the thinking on this particular topic to debt to value as opposed to debt to EBITDA, because not all EBITDA is created the same and I think it's a distortive metric to be used when applied towards all sorts of disparate companies. Putting that aside, if you look at debt to value for those few people out there that still look at the traditional definition of a leverage ratio, we are right about 35% debt to value, which I think by any measure in New York City, maybe even nationally, but certainly in Manhattan is considered to be at a very low level.

So I still look at -- one out of every 10 reports uses the words "above average leverage." I'm not exactly sure what that means. But the reality is our leverage level, based on our assets and the equity subordination we have in those assets is something much closer to 35%, which -- we have to compete against people who are 50%, 60%, 70% debt to value routinely and we do it. We do it because I like to think we have a best-of-class investment team here and we are able to do it.

But it's obviously not as easy to achieve the kind of growth that we do achieve using more expensive capital than our competitors. So we just have to be that much better on the buy and that much better on the execution to make up for it and we have. But looking at it from that standpoint, not just debt to EBITDA, that's where our levels reside right about now.

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**Jonathan Petersen** - *Jefferies - Analyst*

Great, thanks for the color.

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**Operator**

Manny Korchman, Citi.

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**Manny Korchman** - *Citigroup - Analyst*

Good afternoon, guys. Marc, appreciate your commentary earlier about the oncoming supply. Given the fact that that supply is newer product, the fact that there is incentives that make it economically beneficial to the tenant, why wouldn't it be a bigger factor to you realizing rental rate growth and you realizing leasing in your new project?

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

Well, I think there's two reasons. I'm going to give you a bit of a curveball here.



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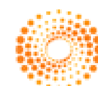

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The addition to supply of new inventory in Manhattan is a good thing, whether -- I don't know how it's -- it has gotten characterized as kind of this awful thing. You didn't hear that from us, that's for sure.

Because what that addition is is a representation of a great market, because only great markets can create the demand to warrant the construction of new projects and do it in a way where the vacancy levels are unchanged -- still roughly right around 9.5%, 10%, which is where they have been for several years now -- and do it in a way where there is very little sublet space. And I think, Steve, that's about 1.5% if I'm not mistaken. So historical lows. And do it in a way that's very measured, so it's not all coming on in one year.

When you look at the inventory, as we've done in depth and will do again in December when we meet with a lot of you folks on the phone, I won't take you through the math now, but you basically wind your way down to sort of, at most, I'll say about 2.5 million to 2.75 million square feet per year. And when you calculate sort of the breakeven job growth to absorb that incremental square footage, it's only about 10,000 office-using jobs a year. And over the past five years, at least, the city has done two or three times that.

So the issue is not the inventory, to me; it's the job growth. And if we have office-using job growth, then we are going to have a drop in the vacancy level. Even with about a -- I guess that works out to be -- no, not even -- to 75 basis points per year addition to inventory. Because we have 400 million square feet in Manhattan and, as I said earlier, we would be adding about 2.5 million, 2.75 million square feet a year.

And that's if most everything goes. Not everything necessarily will go; but if everything goes. And that's a healthy market. As evidence of that, in 2015 and 2016 we competed against that and yet we had two of our best years on record last year and this year.

Those are not aberrations. That's just a reflection of a market that can withstand this sort of incremental and pretty modest increase in inventory over the next few years. It's not going to be more than that.

I would challenge anyone to show us a calculation where it's more than about 75 basis points a year of increase. And as long as we have the job growth to offset or exceed that we are in great shape. Even if the jobs fall below that in any one or two given years, I think the effect on the vacancy rate will be de minimis.

We seem to be able to outperform within the market anyway, so even -- I think we are always going to get more than our fair share of leases. If anything, I see over the next two years the issue for us is we're not going to have that much space to lease. So to kind of worry about what the effect of this incremental space delivery is going to be -- much of which has been spoken for already and represents growth out of the space that's moved out of and we factor that into our analysis.

We don't have a lot of space so we're going to focus in hard on that space; try to get it done ahead of time, the best economics possible. If we can't renew, we are going to re-tenant. And I have no real concern that we won't be able to maintain a very high vacancy rate or a very high occupancy rate, low vacancy rate.

Right now we are 97.5% leased. I don't know if there's another company in New York City that's 97.5% leased same-store. Maybe by a year it will be higher than that.

So it's mostly -- we are very positive in the, what I will call, the modest additions coming to market and the fact that those additions are largely, almost exclusively, far west side and downtown, which no matter what are going to compete at a rental price point that is less than core Midtown. And that's not in any way to disparage those markets. Those are important markets for companies that want to be there and want to sacrifice certain of the amenities and locational attributes of being in Midtown for a lower rent price point.

That's fine, but for every one that does, there's many that don't. And that's why we lease 250 leases a year in Midtown is because those 250 tenants don't want to be far away from downtown. But there are some that do and there's room for both, so I don't see it as an issue.





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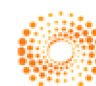

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**Manny Korchman** - *Citigroup - Analyst*

Thank you for the detailed answer. Much shorter response to this one I think. The debt and preferred equity book, you added a project in Brooklyn. Can you give us any color on what the project is?

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**Andrew Mathias** - *SL Green Realty Corp - President*

It's an office repositioning project, large very well-located office repositioning in Brooklyn Heights.

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**Manny Korchman** - *Citigroup - Analyst*

Thanks, guys.

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**Operator**

Dave Rodgers, Robert W. Baird.

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**Dave Rodgers** - *Robert W. Baird & Company - Analyst*

Maybe just quickly on operations and, I don't know, maybe this is for Matt. But NOI margin or NOI over revenues fell this quarter; same-store NOI kind of retrenched. If you said it earlier on the call, I didn't hear you; was there any kind of one-time impact or thing we should be thinking about that impacted the quarter that either repeats or doesn't repeat going forward, Matt?

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**Matt DiLiberto** - *SL Green Realty Corp. - CFO*

Sure. The big thing that happened in the quarter that was nonrecurring was Aero, where we not only lost about $2 million in rent, like actual cash rent, but we had a $17 million write-off of old straight line and FAS 141 balances. That goes right through rental revenues on the income statement.

The $2 million cash rent loss also flows through same-store. So you had two factors in our same-store for this quarter, which obviously flowed through the year and will flow through the balance of the year because they also affect the fourth quarter. The lost rent from Aero was about $2 million.

We also give free rent to Omnicom over at 220 East 42nd Street as part of their recent renewal. That was about $1.2 million in the quarter and will be a slightly larger number in the fourth quarter. So we kept our 6% same-store NOI target for the year, which is sector-leading by a lot.

We would be at 6.6% through the nine months were it not for those couple of anomalies. We will work hard to maintain the 6% in spite of those couple things for the full year, but that's what you saw in rental revenues and same-store.

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**Dave Rodgers** - *Robert W. Baird & Company - Analyst*

Great. Second question and maybe two parts to it. But one, just thoughts on more or additional asset sales in your core Midtown markets, assets that maybe are stabilized. You are clearly a little concerned by getting ahead of some of the lease expirations. Are there more assets you can sell despite the fact that you are ahead of your own leverage targets?

And I would put a b) question in there I'd say can you talk about the 11 Madison repurchase that you might have to go through and what's the likelihood of that?



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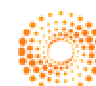

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

So I will address the 11 Madison part. That was a -- the modification we are going for is customary, so there is a very, very nominal chance we have to buy that back. Minuscule is probably a better word.

What we had there was a closing that happened kind of in reverse order to traditional closings. Where normally you get that modification between contract signing and closing, we did it simultaneous and then left a little tail to get that modification done. That will get done here in the next few weeks and alleviate the buyback.

**Dave Rodgers** - *Robert W. Baird & Company - Analyst*

Got it, thanks.

**Marc Holliday** - *SL Green Realty Corp. - CEO*

In terms of more asset sales, we are always evaluating asset sales. I would say getting 11 Madison done and getting the Blackrock recapitalization done on 57th Street, we have satisfied our targets in terms of generating liquidity and the liquidity position that we sit in. However, it's a great market to be a seller of assets.

There's still an enormous amount of demand for prime real estate assets and we are always sort of evaluating the next sale. So I wouldn't be surprised to see us explore the market for more asset sales, but none that we are going to identify today.

**Dave Rodgers** - *Robert W. Baird & Company - Analyst*

Thanks.

**Operator**

Jed Reagan, Green Street Advisors.

**Jed Reagan** - *Greent Street Advisors - Analyst*

What are you seeing in terms of rent growth trends in Manhattan today? Is it fair to characterize the market as flattening out in your view? And are you seeing any changes in the concession environment?

**Steve Durels** - *SL Green Realty Corp. - Director of Leasing*

The rents have been pretty much as we anticipated this year. They have been on the low side, sort of in that 3% to 5% range. Depends on which submarket you are talking about and which part of the marketplace, whether it's the high end or the low end of the market.

Clearly there is more velocity in the more commodity price point portion of the market, so call it the $50 to $80 price point, as compared to the above $100 price points and particularly above $130. But there has been rent growth. We've seen rent growth in certain of our assets and clearly you get a sense of that from the mark-to-market that we are posting.

But on the concession side, at the high price point end of the market the concessions clearly have stepped up on the capital side, not on the pre-rent side, because you've seen a few landlords, rather than adjust any kind of rents for very expensive space, simply sort of offset it with more capital





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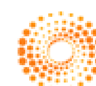

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to stay competitive. But I think that's a thin part of the market as opposed to the overall marketplace. Our concessions on average have been pretty consistent throughout the year.

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**Jed Reagan** - *Greent Street Advisors - Analyst*

Okay, thanks for that. There's been some chatter recently that you may be looking at an investment in NYRT. Would you say those rumors are off the mark?

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

Not going to -- don't even ask. For you to bring it up is absurd, I mean really absurd. I'm not going down this rabbit hole a second time with you guys. Next question.

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**Operator**

Steve Sakwa, Evercore.

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**Steve Sakwa** - *Evercore ISI - Analyst*

Thanks. I guess I wanted to ask about a little bit on the street retail. 650 Fifth is something that you guys have owned for a while and I know the last retailer it seemed like closed in the basement there. I'm just wondering if you could sort of talk about that project.

And just in particular I guess following up; what other investment opportunities do you think might unfold? And do you think you are a net seller or buyer in that business over the next 12 months?

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

On 650 Fifth, we are working hard. It has been a focus of ours. We have had -- seemed to be a little snakebitten on that project with a couple of deals that got within we thought spitting distance of getting over the finish line and then fell apart. But we continue to work hard on that project and we have a couple of interesting prospects for the space, so continue to be optimistic. We will have something to announce there hopefully in the near future.

In terms of the street retail business, and I think the pricing in the market for these assets has definitely moved us a bit to the sidelines. You haven't seen us be as active in retail as we have in the past and that's unfortunate in terms of our acquisition volumes, but it's very encouraging in terms of the value of the assets we own. When you've seen assets like 693 Fifth and many, many other assets trade at really core stabilized type values with enormous valuations, we feel emboldened about the inventory that we own. Just difficult for us to really buy much value-add out there given the investment landscape now.

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**Steve Sakwa** - *Evercore ISI - Analyst*

Okay. Then I guess can you just talk a little bit about the debt and preferred book? You guys were pretty active in the quarter. What is your expectation in the fourth quarter and how do you see that sort of trending over the next couple years?

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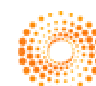

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**Matt DiLiberto** - *SL Green Realty Corp. - CFO*

I think with the fourth quarter we are on track for our stated guidance of about another $150 million, which should put us right around $2 billion for year-end of balances. It's a good time in the market for the business. There's -- the CMBS market has come back, but there's still a lot of uncertainty regarding risk retention and that has moved quite a number of originators a bit to the sidelines.

It's pushing non-traditional capital to the forefront in terms of getting financings done and we feel very good about the opportunities that we are finding and the debt we are originating now. So we have also been active syndicators, which we have been in years past, and are on track this year to be another active syndicator, sort of verifying the liquidity and the positions that we own. And we would expect that to continue as well through the fourth quarter.

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**Steve Sakwa** - *Evercore ISI - Analyst*

Okay, thanks.

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**Operator**

Blaine Heck, Wells Fargo.

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**Blaine Heck** - *Wells Fargo Securities - Analyst*

Thanks, related to that last question, Matt, correct me if I'm wrong, but I think the $41 million of additional income from the recap of your debt investment was included in the investment income line, which would make the residual investment income a little over I'd say $34 million, which is a pretty substantial drop from the first two quarters. So is that right? If so, is there anything else one-time in nature going on?

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**Matt DiLiberto** - *SL Green Realty Corp. - CFO*

No, so you're correct. The $41 million of incremental was in investment income. The balance or the income from the balances moves each quarter based on investments that are in there on an average balance. We did originate a bunch this quarter, but I think on average the balance was lower this quarter and we had some pretty juicy investments pay off earlier in the year, like 550 Madison and 605 West 42nd.

So we are on track for our full-year target on income. The third quarter, barring that one $41 million item that you noted, was below, but we are on track for balances and income for the year.

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**Blaine Heck** - *Wells Fargo Securities - Analyst*

Okay, fair enough. Then, Steve, if I'm hearing you right from your earlier commentary with respect to some of the questions that were asked, it seems as though the higher price point segment in the market continues to be tough currently, but you think it can get better by the time you guys are delivering. So I guess is that right? And what do you think it is that might drive the improvement in demand in that segment?

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**Steve Durels** - *SL Green Realty Corp. - Director of Leasing*

Let's kind of put it in perspective. If your view is the high-end market is well into the triple-digit rents, there will be still a considerable number of leases signed this year at that price point. In fact, there will be more square footage leased this year at $100-plus rents than there was all of last year.



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So there are fewer deals, but what's interesting is the size of the deals is growing in that sector of the marketplace. I think it's misleading to evaluate where a marketplace will be four years from now based upon where it's been over the past two quarters. That's -- I think a lot of our confidence in our rents four years out based upon the tenant feedback that we get as to them recognizing the quality of the asset.

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**Blaine Heck** - *Wells Fargo Securities - Analyst*

Okay, that's helpful. Thanks.

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**Operator**

Nick Yulico, UBS.

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**Nick Yulico** - *UBS - Analyst*

Thanks. Turning to the 28%, a little over that, mark-to-market you've done year-to-date on the new leases signed, how much of that will actually commence this year versus benefiting you next year?

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

I would say from a renewal perspective, obviously those kick in immediately, certainly from a GAAP perspective. The new leasing which are things like BNS or the Tower 46 leases, those have 9 to 12 months of lead time on them. I don't have the numbers at my fingertips in terms of exactly how much of the 3 million square feet we've done now will be next year -- later this year or next year.

I would say the majority, given where we are in the year that's been signed, in the last couple of months is more impactful to the next year. And certainly new leasing is a next-year impacting item.

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**Nick Yulico** - *UBS - Analyst*

Okay, and I guess you're going to go into some of this at the investor day, but if we use like say your lease expiration schedule on page 48 of the supplemental, it looks like your leases in place today are, call it, a little over 10% below where market asking rents are.

So as we think about the 28% you've done this year versus this page which says it averages out at a little over 10%, how do we think about that sort of change in the mark-to-market and how it may affect some of your growth opportunities over the next couple years?

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**Matt DiLiberto** - *SL Green Realty Corp. - CFO*

I will say it's accurate that we will get into this in more detail in December. That's the leadoff. But I would also say, if you look back at where we thought our mark-to-market would be one year ago on what we did this year, it was not 28% either. So Steve has done a very good job in outperforming his own and our expectations and we will get into more detail on our expectations for next year in about six weeks.

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**Nick Yulico** - *UBS - Analyst*

Fair enough. Just one last one quickly on the banks. I know everyone talks about the banks maybe not being as impactful as they were in the last cycle. Banks have trimmed down space; maybe they don't shed some more space in the market.



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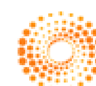

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But I guess one of the things I'm wondering is -- maybe Steve or someone else could comment on -- is there is still some non-headquarters bank space in the market that perhaps banks won't need all of that in the next five years as banks face some new capital rules that haven't even begun yet. How should we think about that risk of this potential excess space for banks in the market? Thanks.

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

Nick, I don't that we can do that on this call. To forecast what we think is the near or midterm demand for banks and the impacts, we can take your question as duly noted and focus in on that in about a month and a half, but you can't answer that in 60 seconds.

And I just want to leave it with I don't think it is a foregone conclusion that banks are going to do poorly over the next few years or do great in the next few years. We sort of take it as we see the numbers come in in terms of profitability and job growth.

The banks right now are reasonably healthy. A lot of the leasing in the first half of the year was financial services driven; not just big five, but the financial sector. Whether that will be the case in the second half or not, we will see.

But we are not seeing -- I think what you heard earlier is any major reductions in bank space demand or putting on the space of sublet space or anything that would raise sort of cautionary flags for us on the banks. It's a good trend that what used to be 40% of the market now is closer to 30% or 35% of the market, probably a third of the market. And maybe in three to five years it will be 30% of the market because you have healthcare growing, education growing, the government sector is growing, information is growing, technology is growing, business services probably the biggest grower.

So it's a dynamic market. That's the beauty of New York City, dynamic. You have so many calls; there's so many claims on a limited amount of building inventory that it's just not easy for most tenants to lease space. And when they can they are relatively quick to do so.

We will see -- we will forecast how we see banks playing into that mix in December, but it's a complicated question -- not that we'd do it justice on this call, but it's duly noted, so thank you.

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**Nick Yulico** - *UBS - Analyst*

Appreciate it.

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**Operator**

Craig Mailman, KeyBanc Capital Markets.

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**Craig Mailman** - *KeyBanc Capital Markets - Analyst*

Just quickly I think you noted that you guys have actually checked off a lot of boxes of what I think investors had thought would move the stock, but you're still trading at a mid to high 20% discount to NAV. You guys put in the $1 billion share repurchase plan not too long ago.

Just curious your thoughts on executing on part of that. How you view returns on buying back stock versus investing elsewhere and how you manage levers potentially.

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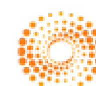

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

My first instinct is let's handle that in December, too, but it's a fair question so --. We put that program in place because A) it would be imprudent not to. We wanted to put something in place and make it meaningful so that we have a tool available to us if we see things happening within the stock that we feel are so violently dislocated that we view it as an opportunity that exceeds all other opportunities available to us at that time.

One, it could be viewed as there for moments in time and then there's a second view which could be, if there continues to be this systematic dislocation between private sector valuations, which continue to be fairly robust, and public market valuations, which I would say in general are below that and stocks like us seem to be far below that, then I think you have to start looking at systematically dealing -- how you approach that problem with stock buyback being one of the tools that could be used along with asset sales and dividends and special dividends and everything else.

So it certainly isn't exclusive, but it's certainly something we are becoming increasingly focused on as we see a year like this year, where there's going to be $40 billion of sales probably by end of year, all of which are executed at cap rates and per square foot prices pretty much right on top of last year's record $60 billion or $65 billion of sales, and while the volumes have decreased, the pricing for the well-located, redeveloped, well-positioned assets really haven't decreased.

We could see scenarios where, in 2017, that demand may increase, because on a relative basis the kinds of returns those assets produce, which are anywhere between 5.5% to 6% unlevered and that might translate to 7% to 8% levered, those are, by and large, considered to be excellent core returns for great properties which justify the pricing levels which are so dramatically ahead of what the implied pricing levels are in the public securities. So I would say it's there out of prudence. It's there for opportunistic and maybe it will be there systematically if this diversion doesn't seem to correct itself at some point in time.

But, for now, we have not executed on it at this point. It's not I would say the current focus of us at the moment, because we have all these other what I consider to be excellent opportunities that we are taking advantage of both in the equity, 1 Vanderbilt, other equity investments, and leasing and redeveloping and structured finance. So we are having a robust year, but it is there and it's something that I think we are going to pay a lot of attention to.

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**Craig Mailman** - *KeyBanc Capital Markets - Analyst*

Thanks for the color.

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**Operator**

Brad Burke, Goldman Sachs.

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**Brad Burke** - *Goldman Sachs - Analyst*

I'll just ask one question. Marc, a bigger picture question to follow up on your point about New York not needing much growth to offset the 75 basis points or so of annual supply growth.

The office job growth in New York has been pretty robust over the last five years and it doesn't seem to have translated into meaningful improvement in Midtown availability rates. So if we are now looking at what looks like decelerating job growth, why wouldn't that translate into higher availability rates going forward?

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

I don't know what period time you're looking at, Brad, but if you look at -- we can again do this in December. I hope (inaudible) we've got a lot of stuff we've got to knock off in December. If you look at from I'll call it the trough of the market to where we are today, I think the availability rates in about 400 basis points and that's all job growth. As best I can tell, because --. (multiple speakers)

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**Steve Durels** - *SL Green Realty Corp. - Director of Leasing*

Our occupancy is up at least 400.

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

Well, our occupancy is up about 400 basis points and I think availability has gone down from about 13.5 or to 9.5. That's a lot of space, 400 million square feet, and since a lot of the inventory is future inventory, all of that absorption, if you will, and reduction I think is -- I have to think it through, but it seems like predominately, if not exclusive, to me job growth.

So I think it has been there. The only reason you haven't seen it take a whole other ratchet down in 2016 is because the office -- while private-sector job growth is almost 80,000 new jobs this year, which may put it on pace for 100,000 total by end of year, which would make it one of those rare record or near-record years, the office usually has lagged behind that. We may only get this year, I'm speculating, but 10,000-plus jobs which would be let's call it half of prior year.

But as I mentioned earlier, the big five numbers are up. And even though you can't bench everything off of that, looking more broadly at Wall Street firms, broadly defined, their profits for the year were estimated to be by the city $10 billion. In fact, through the first half of the year they were $9 billion. And the city, I believe, will be revising its estimates for the full year and it's going to be well in excess of $10 billion.

So it is not to say, by a long stretch, that office-using job growth for the balance of this year into next year couldn't pivot and be higher. But any way, to answer your specific question as to whether it's been translated or not, we will do a little study for December. But I think you have seen the correlation between job growth and reduction in availability, which has been fairly programmatic through 2015 and has leveled off a bit in 2016.

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**Brad Burke** - *Goldman Sachs - Analyst*

I appreciate it, thank you.

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**Marc Holliday** - *SL Green Realty Corp. - CEO*

All right, everyone. Thank you for the call. We are right about 3:05, so right on time.

We looking forward, as we always do, to a great investor day in the newly revamped style that Matt took you through at the beginning. I guess that will be the next time we have an opportunity to speak to everyone, so until then we will keep working hard. Thank you very much.

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**Operator**

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone, have a wonderful day.

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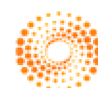

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