Alexander & Baldwin Inc

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ALEX Participants:
Christopher Benjamin; President & Chief Executive Officer
Lance Parker; Executive Vice President & Chief Operating Officer
Brett Brown; Executive Vice President & Chief Financial Officer
Clayton Chun; Senior Vice President & Chief Accounting Officer
Moderator:
Brad Cohen; ICR

Event Transcript

Brad Cohen: Thank you very much for joining us today for Alexander and Baldwin's presentation. I'm sitting in for Sheila McGrath. So she wasn't able to join us. With us today are CEO Chris Benjamin, CFO Brett Brown, Lance Parker, Chief Operating Officer, and Clayton Chun, Chief Accounting Officer. With that, let me turn it over to Chris for some opening remarks. Chris?

Christopher Benjamin: Thanks a lot, Brad. Thank you all for coming today. And it's great to be back in person at Nareit. So let me just start with a quick overview of Alexander and Baldwin. We are a Hawaii-based and focused REIT. We are primarily in grocery-anchored retail. But we also have some industrial assets and a number of ground lease assets.

We've operated in Hawaii for over 150 years. We know the market extremely well. We have great relationships and a strong reputation in the market. And as a result of that, we are a little bit of an unusual REIT in that we are geographically focused but slightly diversified by asset class. But again, it's only really in grocery-anchored retail, industrial, and ground leases. So it's a relatively narrow focus. But it's a very-- by asset class-- but a very strong focus on one geography, which is Hawaii.

The reason for focusing on Hawaii is not only our historic presence there but the very strong fundamentals of the market. I can talk about that more later. But we believe that it's a market that is dynamic, exciting, and in which we have a competitive advantage.

We have 85% or so of our assets either in commercial real estate or in commercial real estate development projects. And within a year or so, we would expect to have that be north of 95%. We have been going through a dramatic simplification process to focus on commercial real estate in Hawaii. And we're nearing the completion of that process. And as we've completed the process and sold off a lot of our non-core assets, we have been able to strengthen our balance sheet. And we now have significant capacity to invest in Hawaii real estate. And our plan is to actively grow the portfolio both through ground-up development, redevelopment of existing assets, and acquisition of new assets. And so, that's a little snapshot of where we are. And excited to talk about our business today.

Brad Cohen: Thank you very much, Chris. And by the way, I'm Brad Cohen from ICR. So thank you for having me. Chris, you talked about Hawaii. Why focus on Hawaii? What's so exciting about that market?

Christopher Benjamin: Well, I think first and foremost, we really believe in the long-term fundamentals of Hawaii. They're not making more of it. You can't just drive further out. It's a space constrained. And in many ways, there are many barriers to entry in Hawaii from, again, both the land constraint issue but also just the entitlement, permitting, the cost of doing business there-- so many barriers to entry. And we feel that we're on the right side of those barriers. Having been there as long as we have as a landowner, we have developable land. We have a great portfolio. Some of it is a little bit long in the tooth. And that presents opportunities to reposition and redevelopment. And Lance can talk at some point today about the fact that we have done a lot of that in recent years, repositioning, redeveloping assets, and generating very attractive returns on those assets.

But as I said, we're also acquisitive. And we think that our local presence gives us a competitive advantage in buying assets in Hawaii. And so, for all those reasons-- and it's worth pointing out that Hawaii is-- it's not only a pretty nice place. But it's a domestic location. It's a safe location. And it's a very comfortable place for people to travel. And there doesn't have to be a global pandemic for that to be the case.

Just in general, I think, it's a very attractive market for people to travel to and that. And of course, it's attractive for the military. So there are a lot of really good long-term economic fundamentals in Hawaii. And then you pair that with our experience there, and it makes sense for us to focus in Hawaii.

Brad Cohen: Can you-- just a little bit-- is Hawaii dependent on-- for Alex's business, is it dependent on tourism?

Christopher Benjamin: Not directly. So we are not-- even though we are in retail, we tend to be in grocery-anchored community retail. So we are not heavily in resort markets. We do have-- out of our 22 or so retail properties, two of them are in resort markets. But even those are probably about 50-50 resort tourists, local. So we're not in Waikiki. We're not heavily dependent on the tourists.

Now, everybody-- the saying is, the rising tide lifts all ships. And so, when tourism is strong, everybody does better. But we're not at the tip of the spear in terms of relying on the tourist spend. So that means that even though, for example, right now the Japanese tourists have not come back to Hawaii, the US arrivals in Hawaii are very, very strong. That fills hotel rooms. That gets housekeepers back to work. That gets cab drivers-- Uber drivers, and rental car employees, and airline employees back to work. And that's what really fuels our business. It's that secondary impact of the tourism, not that primary tourist dollar. So we're pleased that we are somewhat insulated from the direct tourism spend with our portfolio.

Brad Cohen: And obviously, others own real estate in Hawaii. But what does ALEX offer over other Hawaii real estate investment options?

Christopher Benjamin: Well, first of all, for the retail tenant coming to Hawaii-- well. Let me back up. You mean, what do we offer to investors, or to--

Brad Cohen: I think so. Yes, to investors. Please, yes.

Christopher Benjamin: Yeah, to investors. So what we offer to investors is just that market knowledge. Our tagline is, Partners for Hawaii. And that has a few meanings. One is that we really work to partner with the local communities in Hawaii. We look to partner with our tenants. And certainly, COVID gave us a great opportunity to do that.

But for investors, we consider ourselves the best partner for anyone who wants to invest in Hawaii. Because we are the only geographically focused REIT in Hawaii. There certainly are other REITs that own assets there. But we're based there. We know the market extremely well. And I think that we've proven historically that we can unlock opportunities, again, both on the development and on the acquisition side that others cannot.

And I will go back to where I started the answer, which was on the tenant side. For the tenant, we offer really one-stop shopping for a tenant that wants to enter the Hawaii market. And that, again, makes our portfolio attractive not only to the tenant but to the investor.

Brad Cohen: What would be really helpful to understand is talk a little bit about asset class. What's the opportunity set for ALEX given your market focus? And what-- talk about your asset types too.

Christopher Benjamin: Yeah. Let me share the microphone a little bit here and ask Brett to talk a little bit about that.

Brad Cohen: Oh, thanks. Yeah, Brett, please.

Brett Brown: Sure. Of course. So right now, we have 22% ownership by GLA of the grocery-anchored type retail centers and only 2% of the industrial type. And so, by square footage, that's 2.2 million out of 10 for the anchored retail. And it's only 1.2 million square feet out of 60 million square foot total sector type there. So plenty of room to grow in those. We like those asset classes a lot.

We also have ground leases, as Chris mentioned. We see plenty of opportunity in that area. We may explore other asset classes, maybe partnering with through a joint venture or through other ground lease opportunities. But we see plenty of opportunities out there. Of the 22% retail, I think we could grow that by 50%, up to, say, 33% to 35%, whatever, 40% even, push that as we see the opportunities. And then on retail, we could-- or excuse me, on industrial then we could go in multiples, obviously, at only owning 2% of that current market. So we see plenty of opportunity there, Brad.

Brad Cohen: Would be great-- maybe this is for Chris and Lance. Can you guys share a little bit about the commercial real estate growth and your acquisitions, maybe even give us some insight-- what's the environment looking like right now? Be great to understand that.

Christopher Benjamin: Yeah, Lance you want to take that?

Lance Parker: Sure. So maybe just to expand a little bit on Chris's opening comments as well as what Brett just shared. So we are focusing our growth aspirations on our existing asset classes. Again, that's retail, that's industrial, and that's ground leases. And we think of growth really in two opportunity sets. One is internal and the other being external.

On the internal side, we're wrapping up a repositioning of a grocery-anchored center on the island of Oahu. It's a very representative type of redevelopment opportunity that we have in the portfolio. We're starting another one where we're deploying just north of $10 million in total capital, some of that being more aggressive with return on investment or return on cost metrics at the high single digits, some of it being CapEx. But at any given point in time, those are the types of opportunities we see on the retail side.

Industrial-wise, we do have an industrial park on the island of Maui. It's called Maui Business Park. It's 54 acres immediately adjacent to the airport. It also has close proximity to the harbor. And it has very flexible zoning. All off-site infrastructure is fully in place. And so, that gives us flexibility to do anything from retail, which we've done ground-up on a grocery-anchored basis, to industrial, either in a built-to-suit or on a speculative basis. And so, I will share that we are in discussions with certain tenants for smaller build-to-suit opportunities on the island of Maui.

And then, lastly, internally Brett mentioned-- or actually both mentioned ground leases. And this is an interesting part of our portfolio where we own the leased fee. We lease to typically a sandwich lessee who in turn sub-leases the improvements to others. So if you imagine a shopping center with the fee simple bifurcated into two portions of ownership. We've got the most secure piece in the leased fee.

And here, we have opportunities in the near term that have natural expirations in the next 15 to 20 years, where the reversion of those improvements-- so all of those leasehold improvements come back to us for free. But in the meantime, as our sandwich lessee is unable to get financing, unable to give term to tenants, unable to pay commissions, they find themselves in a very challenged cash flow position. And so, we're able to step in and buy at an inflated cap rate and then aggregate that fee simple and leasehold. And so, that's our opportunity set, I would say, in a bundle internally.

And then externally, we continue to be very acquisitive in terms of our interest, similarly, across all three asset classes. I will say, the Hawaii market from what we're hearing doesn't feel very different than other markets across the country in terms of tightness. We have not had a lot of comps to really bench pricing to. I would have expected last quarter to say cap rate compression just based on some of the activity we're seeing in the marketplace, given some of the volatility in the interest rate environment. I might expect to see some cap rate expansion. But right now, that's playing out in real time.

And so, I think the message for us is that from a capital allocation perspective, it's really all about risk-adjusted returns. And we're more agnostic as between external versus internal and feel well-poised on the internal side as well as our capital balance sheet to be able to deploy capital where we see the best fit.

Brad Cohen: Anything on redevelopment you want to expand on? You talked about it [INAUDIBLE], correct?

Lance Parker: So on the redevelopment side, I guess I'd go a little deeper into our most recent grocery-anchored repositioning opportunity on the island of Oahu. So this is Albertson's-anchored, CVS-anchored. Again, we're going to be putting about $10 million plus of capital to work there, high single digits return on cost. It allowed us to go long with our tenants. It's going to be, to Chris's point, really a much needed facelift for a very strong urban community that's got very favorable demographics. The center is just-- it's a little long in the tooth. And so, this is a much needed deployment of capital, good return. And then, it's also allowed us to attract some pretty exciting tenants that we have not yet announced but are looking forward to doing so in the near term.

Brad Cohen: Great. We'd like to open it up. If there's any-- I asked a bunch of questions. Would anyone else like to ask a question, please step up to the mic or just raise your hand.

Audience Question: Yeah. On the simplification part of the story, are there any updates on the Grace Pacific subsidiary?

Christopher Benjamin: Yeah. Let me give a quick update on simplification and address your question on Grace. First of all, for anyone who's not familiar, we made great progress last year toward our simplification goals and getting up above-- up to 85% all commercial real estate. The biggest step last year was the sale of our Kukui'ula resort residential project on Kauai as well as the sale of some other non-core lands. We expect to continue monetizing non-core lands this year and have some deals in the works there.

And then, on Grace, the prospects there, we are actively preparing for a marketing process. We are seeing improved financial performance, modest improvement in financial performance there, which we think will accelerate both as a result of the existing book of business that we have at Grace and increasing bid activity at the county and state levels.

But as performance improves, we believe we're better positioned to take that to market. So we are actively preparing for that. So whether it would be later this year or first half of next year, I don't know for sure. But that's the window that we're looking to monetize Grace.

Brad Cohen: That's helpful. I'll go back to a question and come back to the audience. Any macro-impacts on business or the redevelopment pipeline that you're seeing? I don't know if that's for Lance or--

Christopher Benjamin: Lance, you want to address that?

Lance Parker: Sure.

Brad Cohen: That'd be great.

Lance Parker: Yeah. So I will say we are seeing impacts in terms of delayed timing, so supply chain issues as well as increased costs with inflation. From a development perspective, redevelopment perspective specifically, we've just been more, I would say, conservative in our planning and our contingencies both from a timing perspective where it's permitting, it is some material sourcing that's causing some of that delays. And then on the construction side, just being, again, a little bit more conservative with some of our contingency pricing, where not that long ago, even in early days of COVID, it was not unusual for us to get six-month locks on construction bids. Really, that time frame has compressed to something more like 30 to 60 days at best. And so, that's just an example of where we're having to be a little quicker in making decisions and just factor that in to our planning.

What I will add to that though, in terms of our tenant impacts, Brett and I as well as our head of leasing-- we're at ICSC-- two weeks ago-- and this was a common theme for conversation with not just in general but with many of our tenants. And it was something that we really wanted to try to pull out of them. I will say, that in general, both our tenants in terms of representation within our top 10 and just generally, still felt bullish about the market despite that this was the week that we had corporate earnings from Target, Walmart, Ross that all sort of missed, but really didn't have a lot of pushback, even on pricing. I think just at least from our exposure to retailers, I think a lot of people have been pricing these-- thinking of these things and pricing it into their expectations.

Brad Cohen: That's helpful. Anyone in the audience? Or we can continue here. Yes, please.

Audience Question: Just as far as the remaining non-core lands that's still on the books [INAUDIBLE]?

Christopher Benjamin: Yeah. We have probably roughly 25,000 acres of land left in Hawaii. The majority of that is on Kauai. And it's a combination of conservation and agricultural land. And then, we have quite a bit of agricultural land on Maui, but probably 5,000 or 6,000 acres remaining.

And so, compared to what we sold several years ago, we sold over 40,000 acres on Maui. It's a relatively small footprint. Actually, I guess it was closer to 60,000 we sold on Maui. It's a relatively small footprint. But it still has, I think, some significant value.

The single most valuable piece of land we still have in Hawaii is Maui Business Park. And that land we will continue to either develop, do vertical development on, build-to-suits, or just ground-up spec development, or we will sell some of that to third parties for owner-users.

And then the agricultural land, which is, again, by acreage, the majority of the land, we will continue to look to monetize that. And I would expect-- that was what I was referring to earlier-- that I expect we'll make some more progress in monetizing that agricultural land this year.

Brad Cohen: Maybe building on that, going back to the simplification question, it seems like is that going to-- are you close to that transition point to head to growth [INAUDIBLE]?

Christopher Benjamin: Yeah. I really think that the Kukui'ula sale last year was the turning point, the tipping point for us for two reasons. One is the Kukui'ula transaction took a lot of time and a lot of internal resources just to facilitate that sale. It was a very complicated deal-- very successful deal in the end. And so, we were able to pivot those individuals, essentially our investments team, from the sale-side back to the acquisition focus. But as importantly, it generated a significant amount of cash that helped us pay down debt, strengthen our balance sheet, and be in a position to grow. So Kukui'ula really was for me the turning point.

Yes, we still want to monetize Grace. We think that's an important part of simplifying our story. Yes, these ag lands will generate some more cash and further simplify the story. But more than anything else, it was that pivoting back to having the dry powder to go out and acquire and having the team available to sell. Because for the remaining assets, most of the remaining assets, we have third-party brokers managing those sales processes. So we don't need to devote the internal resources to it as much. So we're full-on focused on acquisitions, and development, and growth. And so, I think the pivot really took place really about the fourth quarter last year when we closed the Kukui'ula sale.

Brad Cohen: And is that-- let's turn to financials for a moment-- you revised guidance upward with a positive revision. Did that flow from that change? Or can you guys talk a little bit about the upward revision in guidance at the end of the quarter last--

Christopher Benjamin: Yeah. Maybe, Clayton, can you talk to the guidance?

Clayton Chun: Sure. Yeah. So our revision that occurred in the first quarter, it was largely reflecting the strong CRE performance that we experienced. And so, in the first quarter we generated 17% Same-Store NOI growth. And that was largely attributable to the recovery of our tenants, which resulted in us being able to collect more on current as well as prior period rent. And so, that was largely the basis for which we then revised our guidance upwards.

Christopher Benjamin: Yes. So it's really been-- over the last six months, I think we've had very favorable turn of events with respect to both our tenants getting back to full strength and not only collecting current rents at higher levels than pre-pandemic but also collecting a lot of the deferred rent from the pandemic. And, in conjunction with that, what I just said about pivoting our team, and our focus, and really our mindset back to growth after having been focused for several years on de-levering, selling assets, we're now very much back in growth mode.

Brad Cohen: That's helpful. [INAUDIBLE] Yeah, Chris, please.

Audience Question: [INAUDIBLE] the land, it's just a-- how would you best describe your land lease business and the potential pick up in value over the next five or 10 years as some of those leasehold reversions start coming to the table, also the [INAUDIBLE] that can occur between what you're saying [INAUDIBLE] position. I'm assuming that the analysts or investors are just-- they'll be trying to cap that or put a simple multiple. But what are the other value drivers that you see in that business?

Christopher Benjamin: Yeah. So let me start by repeating the question. So it's a question about our ground lease portfolio, and not only a brief overview of how that business works, but also what some of the embedded growth opportunities in the ground lease portfolio are. And I'll let Lance take that.

Lance Parker: So maybe, somewhat in reverse order, just in terms of how we typically have investors value that, it's a compression on cap rates relative to the asset that sits above the ground lease. So for example, if we have a leased fee under a shopping center that we think is a 4.7 cap, we may get 150 basis point cap rate compression to value the ground lease. I think that helps. But it really doesn't speak to the true valuation opportunity. And for us, there's two ways that we can see that come to fruition.

The first is just through natural step-ups. And so what ends up happening in ground leases is, typically these were deals that were cut mid-1900s. They were typically cut for 70 to 99 years in length. First 30 to 40 years were known rents. And they were fixed. And they had to be that way to get bank financing in order to build on vacant land. And so, they would have built whatever improvements are there-- industrial buildings, office buildings, shopping centers. Thereafter, they're subject to fair market value step-ups. And those typically happen every 10 years. Way that language and deal structure has historically been handled in Hawaii, fair market value is based on 8% return of the value of the land as if unimproved. And so, you can imagine some of the dynamics that we're talking about, about why we view Hawaii as a unique market, barriers to entry. We get sizable step-ups in ABR, particularly as we're on the back end of these leasehold terms.

So representative examples, last year we had a-- I'm going to be off a little bit on the numbers. But we're talking 30%, 40% ABR steps with some of these FMV steps that we get every 10 years. And in some times, we've been willing to negotiate with the sandwich lessee to fix that and to push it out a little bit, but ultimately to position ourselves to buy into that leasehold space. And that I think is the real opportunity.

Sure, we could wait until the end of a lease expiration. I'm thinking of one shopping center in particular. I mean, if we were just to rank order opportunities in the Hawaii marketplace, this shopping center would be a top five asset, period. We are the leased fee owner under the ownership structure. It expires in 2035. So if nothing else, we would expect to get a 50% to 70% bump in ABR next year. We could sit and in 2035 we'd get all of the value of those improvements back to us for free. But I think the real opportunity is to step in sooner. And we've had representative examples where we've done that. We took a Macy's box back. We redeployed capital in mid-teen return on cost, improve-- or investments. We did it with Aikahi. We're talking about Manoa Marketplace, which I spoke about earlier today. All of those examples came from leasehold opportunities that we were able to step into earlier. Typically, we're getting cap rates on a valuation basis low-to-mid teens on a cap rate.

Now, granted, there isn't much term left. You may have 10, you may have 15 years. But if you think about just from a risk-adjusted return perspective relative to potential cap rate compression in our market, that's a very compelling opportunity for us not just to step in, increase NOI, but also to deploy additional capital.

Audience Question: [INAUDIBLE] retail assets?

Lance Parker: Within our portfolio, it is largely retail. We do have some other asset class types. So we've got, I would say, top four opportunities, two are retail centers. And then one is actually 36 acres of vacant land on the island of Oahu that's very similar to Maui Business Park. Fully infrastructured, fully entitled for industrial in the heart of the submarket. It's called Kapolei in West Oahu that will provide us very good development opportunity going forward.

Audience Question: [INAUDIBLE] take [INAUDIBLE] about your market share in Hawaii retail 20%?

Lance Parker: 22%.

Audience Questions: If you convert all of those leaseholds, what is your ownership share in the market?

Lance Parker: Yeah. So the question was, if at 22% current market share in the strip retail space, if we were to take the embedded reversion opportunities within our ground lease, what would our ownership percentage share be at the end? I think we'd have to do a little bit of math. But it wouldn't be difficult to do.

Audience Question: Just [INAUDIBLE].

Lance Parker: Yeah. I would imagine we'd probably increase our percentage share by a couple to a few hundred basis points.

Audience Question: OK. [INAUDIBLE] Thank you.

Brad Cohen: Thank you very much. We're getting to the end. Let's touch on ESG, a very important part. Can you describe your ongoing ESG initiatives and efforts?

Christopher Benjamin: Yeah, I'd love to. One of the things I'd like to say about A&B is that I think our DNA as a company is very consistent with ESG. We've been in the renewable energy business for almost 120 years. We built our first hydroelectric plant 120 years ago. I don't think a lot of REITs can say that. But-- [LAUGHTER] --we-- and we also had founders and a succession of CEOs through time who are very focused on giving back to the community. So I think it's in our DNA. But now how do we evolve to the current environment? And what we've been doing is, we've not been resting on the laurels of a 120-year-old hydroelectric plant.

We have been going very proactively at trying to increase the energy efficiency of our properties, increase energy generation. We're right now building out a 1.3 megawatt solar PV project on our largest rooftop at Pearl Highland Shopping Center. We've also undertaken energy audits of all of our properties. And we're doing all the things that you would expect us to do.

But what we're also doing this year, what we've done-- and this is both on the social and the environmental side, is we've created employee councils to really lead our ESG efforts. For the last several years, it's been very C-suite driven. And we've had pockets of employee engagement on that. But what we're doing is trying to flip the script by creating an environmental council and a social council, each of which is made up of a very diverse-- diverse in terms of, in all ways, gender, and ethnicity, and position within the company, function within the company. These councils that are now tasked with identifying ESG priorities, and really having them be employee-driven.

And of course, we're also marrying this with proper reporting consistent with emerging guidelines and requirements. And we are getting set to put out our third annual corporate social responsibility report this summer. So as I said, I think it's very consistent with the DNA of the company. We've also done, I think, a great job of updating our corporate governance. Our board is now entirely independent with the exception of the CEO. And really, very positive steps in all aspects of ESG.

Brad Cohen: Chris, team, thank you very much for your time. And thank you for—
[INTERPOSING VOICES]

Christopher Benjamin: Thank you, Brad. Thanks, everybody.

Brett Brown: Thank you, Brad.

[APPLAUSE]