CT REIT 2014 Third Quarter Results Conference Call
Tuesday, November 4, 2014 – 9:00 AM EST

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CORPORATE PARTICIPANTS

Ken Silver
Chief Executive Officer

Louis Forbes
Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Alex Avery
CIBC

Sam Damiani
TD Securities

Troy MacLean
BMO Capital Markets

Mike Markidis
Desjardins Capital

Jimmy Shan
GMP Securities

Michael Smith
RBC Capital Markets

Jenny Ma
Canaccord Genuity

PRESENTATION

Operator

Good morning. My name is Alana, and I will be your conference Operator today. At this time, I would like to welcome everyone to CT REIT's Third Quarter Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during that time, simply press star then the number one on your telephone keypad. To withdraw your question, please press the pound key.

The speakers on the call today are Ken Silver, Chief Executive Officer of CT REIT; and Louis Forbes, Chief Financial Officer of CT REIT.

Today's discussion may include forward-looking statements. Such statements are based on Management's assumptions and beliefs. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. Please see CT REIT's public filings for a discussion of these risk factors, which are included in their Q3 MD&A, and which can be found on the CT REIT's website and on SEDAR.

I will now turn the call over to Ken Silver. Ken?

Ken Silver, Chief Executive Officer

Thank you, Operator, and good morning, everyone. We're very pleased to welcome you to CT REIT's third quarter 2014 investor conference call. I'll lead off with a discussion of our recent investment activity, and Louis will then briefly review the financial results for the quarter.

After the close of market yesterday, we announced five additional property investments, all of which are expected to be completed during the first quarter of 2015. Each investment involves a vend-in from Canadian Tire Corporation to the REIT of an existing Canadian Tire retail store, and will be subject to a new 15-year lease containing the rent growth typical of our current leases with Canadian Tire.

In addition, we announced a further eight intensification projects, which will be completed over the next 12 months. These projects include the construction of a new Sport Chek store, and a new Mark's location at our existing property in Waterdown, Ontario. They also include some Canadian Tire retail store expansions.

All told, these new investments represent $77 million of capital, 400,000 square feet of incremental gross leasable area, and are expected to earn a 6.62 percent weighted average going-in cap rate. Funding of these investments is expected to come from a combination of the issuance of Class B LP Units and Class C LP Units to CTC, and from draws on our credit facility.

During the third quarter, the REIT completed five previously announced property acquisitions from third parties at a total cost of $125 million. Two of these acquisitions closed in July, and the remaining three closed in late September. Altogether, these properties will generate an average going-in cap rate of 7.1 percent.

The investments completed since our IPO, together with what we expect to complete in the fourth quarter of this year, represent $269 million and 1.5 million square feet of additional GLA, or a growth of 7.4 percent since our IPO.

On top of that, the new investments we announced yesterday give us a great jump on our 2015 investment agenda.

With that, I will turn it over to Louis for a review of our financial results.

Louis Forbes, Chief Financial Officer

Thanks, Ken. Our third quarter results are positive and we continue to expect to meet our forecast for the year. In addition, operations are going very well, and our expense recovery rate is above forecast.

In Q3, we reported FFO per unit of $0.247 as compared to the forecast of $0.243 per unit. AFFO per unit was reported at $0.185 as compared to $0.182 in our forecast.

I'd like to point out that when looking at our results this quarter, there are a number of small variances to the forecast that warrant mention. First, the exercise of the over-allotment option at IPO increased our unit count, and that had a dilutive effect on our per unit results in Q1 and Q2. During the third quarter, we invested our cash and so this dilution did not contribute to our Q3 results. It is this cash investment that explains part of the positive trend line in our quarterly per unit results.

Second, there was a positive variance of $2.5 million in NOI during the third quarter. Approximately $2.8 million of this variance is the result of acquisitions completed but not included in the forecast. More importantly, approximately $125,000 relates to an improved recovery rate of certain property operating expenses, and this variance is expected to recur throughout the remainder of 2014.

Third, the forecast assumed different timing for recognizing property tax expense for the IPO portfolio than is being recorded. This timing difference contributed a negative $483,000 variance to NOI during the quarter, partially offsetting the other variances. This variance is expected to reverse during the fourth quarter.

Next, there was a positive variance of $363,000 in G&A, as compared to forecast, resulting from the reporting of a deferred tax asset. This was partially offset by negative variances relating to higher filing fees, reporting costs and legal fees.

The positive variance in interest income of $38,000 is the consequence of the cash balances resulting from both the exercise of the over-allotment option, as I just mentioned, and from a normal increase in working capital.

Further, there is a negative variance in interest expense that will grow through the balance of the year. Interest on debt used to fund investment activity that was not included in the forecast will generate a negative interest expense variance.

With respect to the balance sheet, the financial position is strong and liquid. At September 30th, the REIT's indebtedness ratio was 49.1 percent. There was a small amount of cash and over $153 million of undrawn credit on our facility. In addition, interest coverage for the quarter was a strong 3.15 times.

Our AFFO payout ratio for the third quarter was a solid 87 percent, reflecting the benefits of our investing activity on operating results.

On an operating basis, our portfolio continues to be 99.9 percent occupied, and as such, there was no leasing activity during the quarter. Canadian Tire represents 94.5 percent of our annualized base minimum rent, and when combined with other CTC banners, represents 96.6 percent of our annualized base minimum rent.

With that, I'll turn it back to Ken.

Ken Silver, Chief Executive Officer

Thanks, Louis. The week before last, CT REIT celebrated its first anniversary, and we had much to celebrate, and I'm pleased to say we're kicking off our second year of operations on the right foot as well. In addition to announcing our first round of 2015 investments, yesterday, our Board approved our first increase in our rate of monthly distributions, beginning with the January 2015 distribution. The new annualized rate will be $0.663, representing a 2 percent increase over the rate in 2014, and we're pleased to strike a balance between an increase in distributions and a reduction in our payout ratio.

I'd like to take the opportunity at this time to say thank you to the analysts that have launched research coverage, and the investors we have met to date. We've enjoyed meeting and working with all of you, and look forward to continuing this relationship next year and beyond.

To the team at Canadian Tire, who so ably support us, thank you very much for your hard work and successes. There is a lot of work to do going forward with the many opportunities we see before us. I have confidence that our predictable and attractive baseline growth, together with our investment program, provide us with lots of runway and a winning formula. All our contributions will foster the appreciation of what CT REIT has to offer.

Now, Operator, I'll turn the call back to you for any questions from our listeners.

QUESTION AND ANSWER SESSION

Operator

Certainly, thank you. At this time, I would like to remind everyone in order to ask a question, please press star, then the number one on your telephone keypad. We ask that you please pick up the handset or step close to your speakerphone system when asking your question to provide maximum audio clarity. We'll pause for just a moment to compile the Q&A roster. Thank you for your patience.

The first question is from Alex Avery with CIBC. Please go ahead.

Alex Avery, CIBC

Sorry about that. Thank you. I was just wondering on the G&A, you've got the cap in place for the first two years. We're about halfway through and performance has been in line with expectations. Is there anything to suggest that there would be a material change in the G&A run rate as we move into 2016?

Louis Forbes, Chief Financial Officer

The fast answer, Alex, is no.

Alex Avery, CIBC

Okay. And then turning to the CAM recoveries, you noted that they've been running ahead of expectations. Can you I guess give us a little bit of insight to what's behind that, and you know, the sustainability of that as well?

Louis Forbes, Chief Financial Officer

I would say the forecast was conservative, which is what led to it, and we suspect it will be sustainable.

Alex Avery, CIBC

Was it conservative in any specific respect, or was it just broadly conservative?

Louis Forbes, Chief Financial Officer

I would say the conservatism related to the multi-tenant properties rather than the single tenant properties, so it's focused on 10 to 15 percent of the portfolio from a property count perspective. But, that's probably the only way to describe it.

Alex Avery, CIBC

Okay. Then as far as third party acquisitions go, you've obviously completed the acquisition with Partners REIT. What do you see as the landscape for opportunities out there today?

Ken Silver, Chief Executive Officer

Alex, it's Ken. As you'd expect, you know, we have a pipeline of potential acquisitions that we're working on or looking at. I guess the long and short of it is, you know, we certainly don't see any shortage of opportunities that we think would be a good fit for our portfolio.

Alex Avery, CIBC

Okay, so just mostly focused on the stuff that you've disclosed for the next 12 months?

Ken Silver, Chief Executive Officer

Well, we're working on a number of things, but you know, they're not firm deals at this point or—so we haven't obviously communicated everything that we've been working on.

Alex Avery, CIBC

Okay, that's great. Thank you.

Operator

Thank you. The next question is from Sam Damiani with TD Securities. Please go ahead.

Sam Damiani, TD Securities

Thanks, and good morning and congratulations on the distribution bump. Just on the newest investments announced here, the $77 million, could you give a little bit of colour on the yield at 6.6 percent? Given the smaller market concentration with this group of assets and the development component, it is a lower yield than we've seen in previous acquisitions since the IPO. I was just wondering if there was any other reasons or colour you could provide to help us better understand that?

Ken Silver, Chief Executive Officer

Yeah, Sam, I could provide you with some additional colour on that. Of the 400,000 square feet, you know, probably more than 75 percent of that is reflected in the five vend-ins, which have a more, in some cases, urban flavour, if you like; you know, properties like Chambly in the Greater Montreal area or London. The smaller proportion of the portfolio carries a higher yield on some of those expansions and intensifications.

Sam Damiani, TD Securities

Okay, okay. What would be the length of the lease on these five vend-ins?

Ken Silver, Chief Executive Officer

They're all—would be 15-year initial terms. The lease is effectively the same as the balance of the portfolio, so we have built in 1.5 percent annual escalation in the rents on those.

Sam Damiani, TD Securities

Okay, great. With the credit facility, it's expandable by another $100 million. Is there a threshold in terms of, I don't know, coverage or something that you need to achieve to be able to do that, or is it pretty much as of right?

Louis Forbes, Chief Financial Officer

Sam, it's as of right, with the exception that I believe there was a Credit Committee review process at the banks. At the time of originating the loan, it was fine, but at the time we make a request to expand, they would revisit it.

Sam Damiani, TD Securities

Okay. All right. Any reason to think it wouldn't be doable?

Louis Forbes, Chief Financial Officer

No.

Sam Damiani, TD Securities

Okay. Just lastly, on the payout ratio, growing your distribution 2 percent and bringing down the payout ratio, what is the target to AFFO payout ratio, I guess next year and then longer-term as well, if you wouldn't mind?

Ken Silver, Chief Executive Officer

We don't have a specific target, Sam. You know, I think we're supportive of a balance between, as we communicated, in terms of increasing the distributions and seeing our payout ratio kind of consistently come down gradually over time.

Sam Damiani, TD Securities

Okay, great. Thank you.

Operator

Thank you. The next question is from Troy MacLean with BMO Capital Markets. Please go ahead.

Troy MacLean, BMO Capital Markets

Hi, good morning.

Ken Silver, Chief Executive Officer

Good morning.

Troy MacLean, BMO Capital Markets

On the new investment announced in the quarter, how much of that do you expect to fund with Class B Units?

Louis Forbes, Chief Financial Officer

Troy, it's Louis speaking. That is still subject to resolution. So, we strongly suspect it will be a mix of the two, but we have not decided what the mix will be yet.

Troy MacLean, BMO Capital Markets

And then just on—you mentioned the, you know, the opportunities you're working on for next year. Is, you know, kind of the $250 million you acquired this year, is that kind of a good guide for what you expect to acquire next year?

Ken Silver, Chief Executive Officer

Troy, it's Ken. You know, it'll obviously be a function of the opportunities that we see in the marketplace—you know. So, you know, it's difficult for us to say at this point, but you know, as long as we continue to see good opportunities, then you know, we'll continue to pursue them.

Troy MacLean, BMO Capital Markets

Perfect, thank you. I'll turn it back.

Operator

Thank you. The next question is from Mike Markidis with Desjardins Capital. Please go ahead.

Mike Markidis, Desjardins Capital

Hi. Thanks and good morning. Just a follow-up on Sam's question with respect to the payout ratio. It seems like you're committed to bringing that down over time. I was just wondering if you had any comments on your current balance sheet leverage, not to suggest that it's too high, but just with the trend in the Canadian REIT space and leverage gradually tweaking lower on the debt side, what your thoughts are there as you move forward?

Louis Forbes, Chief Financial Officer

Mike, it's Louis. Yes, we're aware of the trends, and generally we think the trends are good ones. We think the right spot for each REIT is perhaps unique to each REIT, and so what I'm saying there is the right place for us is not necessarily the right place for somebody else. What I'm trying to draw attention to here is that with our—the credit strength of our tenant, and the length of our leases, and the high occupancy rates, and the long-term fixed rate debt that we have, we have a very predictable financial model, and therefore don't need to make, perhaps, the same allowances for volatility that some other REITS might have to make. So, that's the rationale behind our thinking.

So, you know, we see our balance sheet leverage in the 48 to 50 percent zone, so not much different from where we are, and our interest coverage, we'd like to keep it above three times, so expressing it slightly differently. But I don't know if that answers your question.

Mike Markidis, Desjardins Capital

No, that does; 48 to 50 and it's coverage above three. It sounds like reasonable metrics there. Just on the $77 million of incremental investment that you announced, you gave some metrics in terms of the 75 percent of the GLA would be from the five vend-ins? Do you have a rough split on the dollar investment amount handy?

Ken Silver, Chief Executive Officer

Yes, the vend-ins were about $64 million of the $77 million.

Mike Markidis, Desjardins Capital

Sixty four million, okay. Then just to follow-up on Troy's question, it sounds like the mix of Class B Units and Class C Units is obviously still subject to resolution. I'm not sure if you'll be able to answer this question, but I'm just thinking back to the comments from Tire that they made at the Investor Day at the beginning of October. They seem to be very clear that they wanted to make it evident that the REIT was self-funding, and that they would actually expect that their 83 percent interest would, if anything, go lower not higher. So, I'm just trying to reconcile those comments with this transaction specifically and what we might be able to expect going forward.

Louis Forbes, Chief Financial Officer

Okay, well, first of all, let me speak to the reference to the Canadian Tire Investor Day comments, and let me start by saying what it doesn't mean. It does not mean that CTC is in any way severing or reducing its relationship with the REIT, and some context may help.

Canadian Tire has certain rights to approve the REIT's capital activity, and some might have incorrectly read that as restrictive on the REIT. So, Canadian Tire's statement means that to the extent that the REIT needs capital to fund external investment activity that Canadian Tire is okay with the REIT accessing equity markets or perhaps issuing unsecured debt back to third parties. So, coming back to the first part of your question, how do we reconcile that with Bs and Cs being issued on vend-ins? Canadian Tire at IPO didn't have a need for cash and they had a tax position that they wanted to manage, and those were the two drivers for the Bs and Cs having been issued then. The tax agenda is still relevant today, as is the cash agenda.

I think directionally you've got the right message that if there's movement in the 83.2, it is probably to the downside, but you shouldn't read that in any way that they won't take back Bs as we deal with vend-ins, and there, you know, may be a subsequent event where they do a very small sell-down of some regular units or whatever. We don't know, and I'm not saying that's what's going to happen, but I think you should consider lots of potential activities in the future that would support that trend line downwards.

Mike Markidis, Desjardins Capital

Okay. Just finally on, you know, with respect to third party activities. I'm just curious if you had any comments with respect to pad development for third parties and maybe if it would be reasonable to expect some of that activity to become evident in 2015?

Ken Silver, Chief Executive Officer

Yes. You know, we are working on leasing out some of those pads, and yes, you could expect to see us doing some of those deals.

Mike Markidis, Desjardins Capital

Okay, that's it for me. Thank you very much.

Operator

Thank you. The next question is from Jimmy Shan with GMP Securities. Please go ahead.

Jimmy Shan, GMP Securities

Yeah, just a follow-up on the issuance of B and C as opposed to tapping the public markets. Does the nature of the acquisition, does that dictate how you would—whether you would tap the public markets as opposed to issuing B and C units? In other words, if it's a third party acquisition, is it more likely to be funded, you know, through the public means as opposed to issuing shares, or does that really, you know, that really does not factor into the equation?

Louis Forbes, Chief Financial Officer

Jimmy, you've hit the nail on the head. The higher the proportion of third party acquisition activity or external acquisition activity, the more likely you are to see us doing public equity offerings.

Jimmy Shan, GMP Securities

Okay, got it. Then in the property revenue line there's an Other Revenue of $412,000. I'm just wondering what that number is? I don't think it appeared in the past.

Louis Forbes, Chief Financial Officer

Well, you've stumped me, Jimmy.

Jimmy Shan, GMP Securities

It's on—it's in Note 13; it's the financials, and it's Other Revenue in an Other column.

Louis Forbes, Chief Financial Officer

Maybe I can look for the answer if we can carry on and then we'll bring it back if that's okay. Do you have more to your questions?

Jimmy Shan, GMP Securities

No, that was—actually I do have one last one. On Canada Square, I wonder if there's any updated thought in terms of that project there in terms of redevelopment or intensification. Any update there?

Ken Silver, Chief Executive Officer

Hi Jimmy, it's Ken. We don't have an update at this point. You know, when we talked about Canada Square initially, I think we conveyed that we viewed it as a longer-term redevelopment opportunity, and I think that redevelopment opportunity will become clearer and we'll be able to communicate more clearly about the potential there really over the next couple of years.

Jimmy Shan, GMP Securities

Okay. Okay, great. Thanks.

Louis Forbes, Chief Financial Officer

Okay, and Jimmy, it's Louis coming back to you. We see the number and the Note that you're talking about, but I don't have the reason for what it is, and so we'll have to take that offline and I will get back to you.

Jimmy Shan, GMP Securities

Okay, great. Thanks.

Operator

Thank you. The next question is from Michael Smith with RBC Capital Markets. Please go ahead.

Michael Smith, RBC Capital Markets

Thank you. Just on the $77 million of intensification and vend-ins, so if I heard correctly, $64 million roughly is vend-ins and the balance is intensification. I think you said you were building one Sport Chek and a Mark's. What—could you give us some colour on what some of the other intensification activities you're going to be doing?

Ken Silver, Chief Executive Officer

Yeah, Michael, it's Ken. There—the balance of them are all small expansions of Canadian Tire retail stores.

Michael Smith, RBC Capital Markets

Okay. Last question, just on the pipeline, how would you split it between vend-ins and third party in terms of, let's say, high conviction or high level of confidence that they'll go through?

Ken Silver, Chief Executive Officer

Michael, I guess I'd characterize it this way, is that, you know, obviously the potential pipeline of vend-ins is, you know, what I would describe as a relatively low risk opportunity. The extent to which, you know, we access that opportunity is somewhat reflective of the third party opportunities that we see out there. So we kind of see those as two, you know, complementary growth levers, and we'll pull those levers, you know, depending on how we see the growth unfolding.

Michael Smith, RBC Capital Markets

Okay, thank you.

Operator

Thank you. The next question is from Jenny Ma with Canaccord Genuity. Please go ahead.

Jenny Ma, Canaccord Genuity

Thanks. Good morning. Just want to talk about your debt maturity schedule. So, a lot of it is weighted towards the long end. I was wondering if there was any thought to kind of laddering it a little bit more evenly with a few more securities issued at the shorter end to take advantage of lower rates, or if the view is to go as long as possible to match the lease term?

Louis Forbes, Chief Financial Officer

Jenny, it's Louis speaking. You know, we actually think the debt maturity schedule is fairly well laddered, and we don't have any more than I think 11 percent or 12 percent in any one year. A lot of thought went into structuring the Class C LP Units with that view. So—and our—the weighted average terms of maturity in our debt is probably above 12.5 years as of September 30th, which is, compared to our peers, is at the very long end if it's not the absolute longest, so we're not seeing that number of 12.5 being too low.

But to get to your point, I mean we're—we actually—we obviously have some resets or maturities coming up in 2015 and '16, and we are considering our options as to what we do about that. We'll consider what the term of the new debt or what that debt should be as we go through that, so it's not something we're ignoring.

Jenny Ma, Canaccord Genuity

Okay. That actually is my next question with regards to the '15 and '16 maturities. Can you just remind us what the mechanism or the process is in terms of addressing those, and in terms of potential conversion of Class B, which doesn't sound likely, but whose option is that, too?

Louis Forbes, Chief Financial Officer

It's all set out in the terms of the LP Agreement; Limited Partnership Agreement, which I believe is filed on SEDAR. So, if you're ever having trouble sleeping, give it a read. But the Agreement does speak to it, and both parties—both the limited partnership, which is controlled by the REIT, and Canadian Tire entities which hold the Class C LP Units have various rights, and so the REIT can choose to serve a Notice of Redemption with respect to a series of Class C LP Units, and that has a certain lead time attached to it. Canadian Tire, if it were to receive such a notice, can respond by saying, sure, go ahead, redeem, or they can say, no, we'd rather you don't redeem, and here are the choices we're giving you. Whatever—in that scenario, whatever choices they give us will be referenced to what are market terms on debt for CT REIT at that point in time. So, it's a market test that keeps the relationship true and balanced.

Now, if the REIT were not to serve Notice of Redemption on the holder of the C Units, there are some, I'll call them autopilot features, in the LP Agreement that would leave for the rate to be reset automatically or on a fixed basis or a floating basis, and how the coupon or the rate would be determined is spoken to in the LP Agreement. So, that's a long-winded answer probably for your question, but it's—there are a few pages of ink that speak to it.

Jenny Ma, Canaccord Genuity

No, that's helpful. I appreciate it. So, you said on the autopilot feature the rate will reset. Is there an automatic term that is goes for?

Louis Forbes, Chief Financial Officer

Yes, it would be a five year term, and the credit spread is fixed at 200 basis points under certain conditions. So, if the REIT is seeing the market rate for its credit spread being better than that, then that would incent the REIT to serve a Notice of Redemption.

Jenny Ma, Canaccord Genuity

Okay, great. That's very helpful. Thank you.

Operator

Thank you. Once again, in order to ask a question, please press star, then the number one on your telephone keypad.

The next question is a follow-up question from Sam Damiani with TD Securities. Please go ahead.

Sam Damiani, TD Securities

Thank you. Yeah, actually my questions have pretty much been addressed, but I'd like to just, you know, if you could, review the third party acquisition pipeline again. You know, the growth since the IPO was pretty strong. Did the third party portion of your growth surprise you to the upside, or is this the kind of pace that we really should expect to see continuing from the REIT?

Ken Silver, Chief Executive Officer

Sam, I would say, you know, that, you know, when we went post-IPO when we got into business, we clearly saw, you know, a wider range and more opportunities than, frankly, we even imagined, and we imagined a lot of opportunities for CT REIT. So, you know, I would say that some of the transactions were not originally contemplated. You know, Canada Square would be, you know, obviously the most notable exception. So we're—we continue to be very positive about, you know, all the growth options that are available to the REIT, and you know—but we're going to look at all of those very carefully and select carefully amongst those opportunities going forward.

Sam Damiani, TD Securities

Okay. And just, you know, with the pipeline at Canadian Tire, has that materially changed in terms of your outlook for volume over the next couple of years from what you saw a year ago at the IPO?

Ken Silver, Chief Executive Officer

No, I don't think so. You know, we are—we're working very closely with the Canadian Tire team in terms of planning for growth, you know, across all of their retail banners, as well as other areas that, you know, where they may have a space requirement outside of retail. And, of course, you know, given the nature of real estate, is, you know, we've got years of visibility as to what that requirement looks like. So I would say it's steady going forward, and no material, you know, changes up or down.

Sam Damiani, TD Securities

Okay. Just to—just one final small question. The development projects that are underway and planned, I assume they're all essentially 100 percent leased?

Ken Silver, Chief Executive Officer

Yeah, anything that we've announced is 100 percent leased.

Sam Damiani, TD Securities

Perfect, thank you.

Operator

Thank you. There are no further questions registered at this time. I would now like to turn the meeting back over to Mr. Silver.

Ken Silver, Chief Executive Officer

Thank you, Operator, and thank you all for joining us today. We expect our fourth quarter and 2014 year end results will be released the week of February 23rd, and we look forward to speaking with you then. Thanks and have a good day.

Operator

Thank you. The conference has now ended. Please disconnect your lines at this time and we thank you for your participation.
