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Can make it anywhere

"Sell New York," we said, and someone did. That someone, SL Green Realty Corp. (SLG on the Big Board), is hereby stricken from the list of *Grant's* short-sale candidates (see the issue dated May 6).

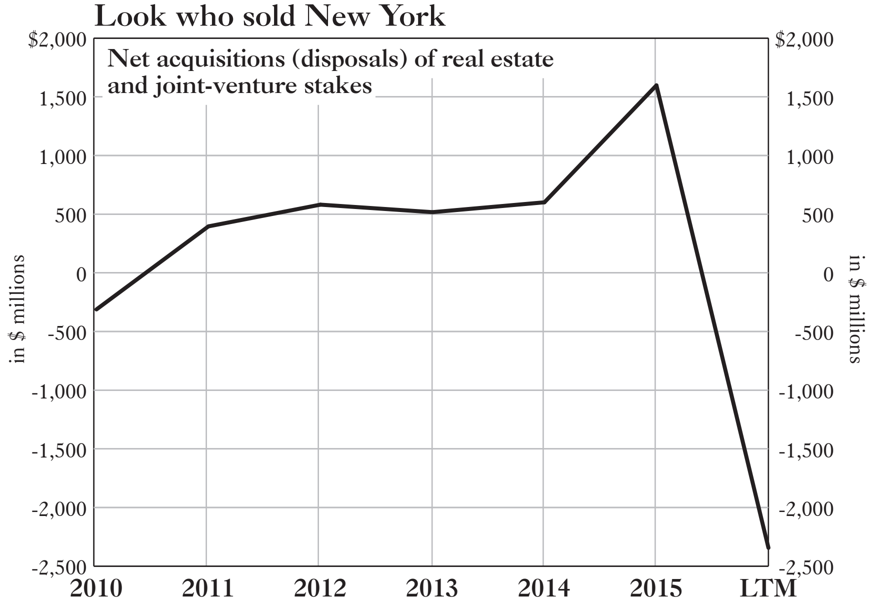
Green, a New York pure-play REIT, was in full acquisition mode when we made our bearish case. Its management insisted that it was likewise deleveraging—and would fund a new trophy property and undertake all needed capital expenditures besides. Altogether, the company seemed to be balancing a large number of goals on comparatively few dollars. For Green, a serial borrower, it was not hard to imagine which objective might fall by the wayside. From 2013 through 2015, borrowings of almost $2.7 billion funded a cumulative shortfall in free cash flow (as calculated by *Grant's*) of nearly $2.3 billion.

"Since our May analysis," relates colleague Alex Hess, "negative free cash flow has reversed. In the first nine months of 2016, SL Green generated $2.9 billion of positive free cash flow—more than enough to cover the preceding three-year deficit. Asset sales account for the bulk of the reversal. We mentioned the biggest of these sales, involving its 388–390 Greenwich Street property for $1.85 billion, in May. Even excluding that transaction, Green has been a repeated seller; its greatest subsequent disposal was of a 40% interest in 11 Madison, its largest rent-generating asset, for proceeds of $484 million. In total, the company shed more than $2.4 billion in properties and joint-venture stakes in the first three quarters of 2016. Neither has management's stated goal of making $1 billion in total acquisitions come to pass—Green's third-quarter cash-flow statement shows $38 million of such outflows in the nine months through September, with no publicized purchases since. 'If they are going to sell and they need capital, then now is the time to do it because the values are pretty high,' says Joshua Stein, a New York commercial real estate lawyer. 'You've still got a bunch of buyers running around.'"

SL Green has earmarked most of its free cash flow for debt reduction. Combined debt (meaning consolidated plus joint-venture borrowings) has fallen to $8.9 billion in the third quarter, from $11.5 billion in the first. Net debt has fallen to 6.1 times likewise-combined EBITDA, down from 9.2 times. "They have reduced net debt . . . at the expense of near-term earnings growth," says John Kim, real estate analyst for BMO Capital Markets (he rates SLG a buy). "So, 2017 [estimated] growth is down from 2016."

As for funds from operations, or FFO, they will likely reach $6.96 to $7.04 per share this year. Next year, they will slip to between $6.40 and $6.50 per share—so "guides" the front office. The market appears to have accepted the trade-off of lowered risk for lowered earnings potential. Though sell-side estimates for 2017 FFO are down by 7.7%, to $6.44 from $6.98 per

Look who sold New York

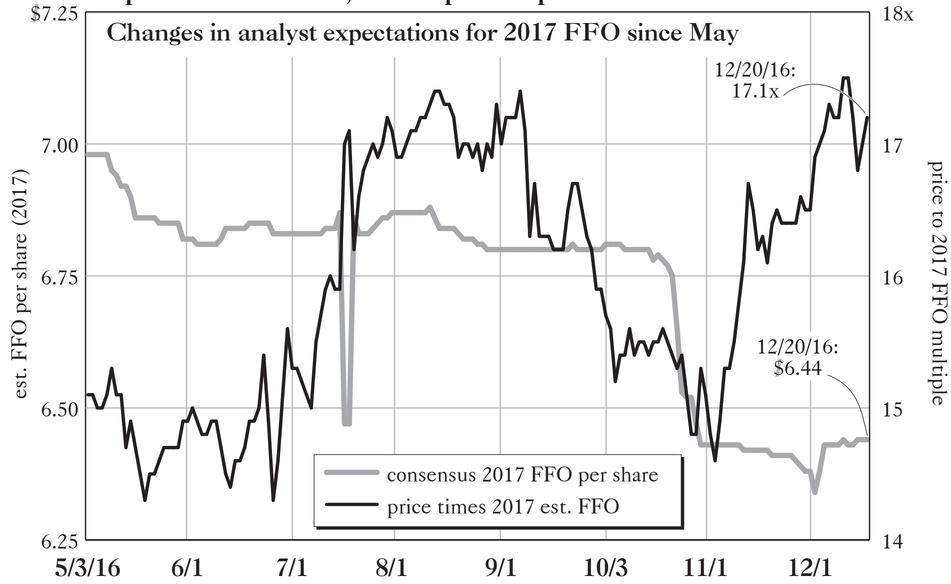


source: company filings

share in May, the stock commands a multiple of 17.1 times the 2017 consensus—up by 14% from our springtime analysis.

Finally, there is One Vanderbilt—the Brobdingnagian office project that SL Green is raising next door to Grand Central Terminal, and which will overshadow (if not overawe) the art deco glory of the Chrysler Building. By the projected 2023 completion, One Vanderbilt is expected to have cost $3.2 billion. With construction financing in place and a joint-venture partner having recently paid in $500 million for a 28% stake in the project, Green projects it will need to invest a further $394 million to see its pride and joy through to completion. Once leased up at office rents of $155 per square foot, the building might earn an unlevered return of 6.3%—assuming it is on-budget, fully inhabited and that its planned observation deck draws the requisite number of visitors to peer down at the spire of the Chrysler Building. There are signs that Green might trade out of the prestige property if a better value opportunity arises: The Dec. 12 edition of *The Wall Street Journal* brought news that the company had proposed a swap of One Vanderbilt for JPMorgan Chase's two nearby headquarters buildings.

Expectations down, share price up



source: The Bloomberg

Throughout the year, SL Green CEO Marc Holliday has decried a perceived gap between the SLG share price and the company's estimate of its net asset value (based on a highly curated and generous methodology). Today, the shares trade hands at a 22% discount to that value. It appears Green is amenable to further reductions in balance-sheet risk to close the perceived gap.

Grant's is no fan of shrunken real estate cap rates at what may be the close of a 35-year slide in interest rates. Neither are we interested in opposing a management that not only seems to understand the risks but also is taking action to mitigate them.

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