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Prologis, Inc. (PLD) CEO Hamid Moghadam on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-15-19 Earnings Summary

Press Release SEC *10-Q* *Slides*

EPS of $0.71 beats by $0.21 | Revenue of $710.47M (16.67% Y/Y) misses by $-5.25M

Earning Call Audio

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Prologis, Inc. (NYSE:PLD) Q3 2019 Earnings Conference Call October 15, 2019 12:00 PM ET

Company Participants

Tracy Ward - SVP, IR and Corporate Communications

Tom Olinger - CFO

Hamid Moghadam - Chairman of the Board of Directors and CEO

Gary Anderson - CEO of Europe and Asia

Chris Caton - SVP and Global Head of Research

Mike Curless - Chief Custom Officer

Ed Nekritz - Chief Legal Officer

Colleen McKeown - Chief Human Resources Officer

Gene Reilly - Chief Investment Officer

Conference Call Participants

Craig Mailman - KeyBanc Capital Markets

Jeremy Metz - BMO

Derek Johnston - Deutsche Bank

Vikram Malhotra - Morgan Stanley

Jamie Feldman - Bank of America Merrill Lynch

Blaine Heck - Wells Fargo

Ki Bin Kim - SunTrust

Eric Frankel - Green Street Advisors

Caitlin Burrows - Goldman Sachs

Manny Korchman - Citi

Nick Yulico - Scotiabank

Michael Carroll - RBC Capital Markets

Steve Sakwa - Evercore

John Guinee - Stifel

Michael Mueller - JP Morgan

Operator

Welcome to the Prologis Q3 Earnings Conference Call. My name is Michelle and I will be your operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. At that time, please limit yourself to one question. If you have a follow-up, please get back in the queue. Also note that this conference is being recorded.

I would now like to turn the call over to Tracy Ward. Tracy, you may begin.

Tracy Ward

Thank you, Michelle. Good morning everyone. Welcome to the Prologis third quarter earnings call. If you have not yet downloaded the press release, it's available on our website at prologis.com under Investor Relations.

This morning, you will hear from Tom Olinger, our Chief Financial Officer and also joining us for the call is Hamid Moghadam, Gary Anderson, Chris Caton, Mike Curless, Ed Nekritz, Colleen McKeown and Gene Reilly.

Before we begin our prepared remarks, I'd like to state that this conference call will contain forward-looking statements under Federal Securities laws. These statements are based on current expectations, estimates and projections about the market and the industry in which the Company operates as well as the beliefs and assumptions of management. Both of these factors are referred to in Prologis' 10-K or SEC filings.

Additional factors that could cause actual results to differ materially include but are not limited to the expected timing and likelihood of the completion of the transaction with IPT, including their ability to obtain the requisite approvals of their stockholders and the risk that the conditions to the closing of the transaction may not be satisfied.

Forward-looking statements are not guarantees of performance and actual operating results may differ. Finally, this call will contain financial measures such as FFO, EBITDA that are non-GAAP measures and in accordance with Reg-G, we have provided a reconciliation to those measures in our earnings package.

With that, I'll turn the call over to Tom. And, Tom will you please begin.

Tom Olinger

Thanks, Tracy. Good morning everyone and thank you for joining our call today. We had another outstanding quarter. Customer sentiment remains positive and we see no meaningful impact on our business from uncertainties surrounding trade. Our proprietary operating metrics reflect healthy demand, showing deal gestation, conversion rates are positive and in line with last quarter as our customers improve their supply chains and response to consumer demand for ever faster delivery times.

U.S. market fundamentals are strong. I'd like to share our assessment of third quarter market statistics as we've seen more divergent viewpoints than normal. We see historically low vacancy in the mid 4s, with supply and demand balanced at 75 million square feet each. Rents have outperformed and as a result, we are raising our 2019 U.S. rent growth forecast from 6% to 7%, leading to an 80 basis point increase in our global rent forecast to 6.5%.

Activity across Europe remains healthy. In the UK, while overall demand is solid and our build-to-suit pipeline is very active, we are highlighting the Midlands as a supplier risk. We continue to forecast 2019 rent growth on the continent to be the highest in more than a decade. Fundamentals in Japan are improving with vacancy in Tokyo had less than 3% and Osaka at less than 6%, the lowest points in five years.

From an operating standpoint, you will see that our quarterly results reflect our strategy of prioritizing rents over occupancy to maximize long-term lease economics. We leased 38 million square feet, including nearly 6 million square feet in our development portfolio. Quarter end occupancy was 96.5%, down 30 basis points sequentially and remains above our five-year average. Rent change on roll for the quarter hit an all-time high of 37%, led by the U.S. at 41.7%.

Our share of cash same-store NOI growth was 4.3% for the quarter, which was impacted by a 60-basis point reduction in average occupancy, again consistent with our strategy to push rents. Globally our in-place to market rent spread widened by 40 basis points in the quarter and is now almost 15.5% or over $400 million in nominal terms. Core FFO was $0.97 per share for the third quarter, which included $0.18 of net promote income from our Co-In venture. The promote came in above our forecast as Europe valuations increased more than 2% in the third quarter.

For deployment, starts in the quarter were $577 million with an estimated margin of 22% and included about two-thirds build-to-suits. The pace of starts will increase significantly in the fourth quarter. Stabilizations were $658 million with an estimated margin of 37% and value creation of over $242 million. We continue to access capital globally at very attractive terms. During the quarter we issued $2.8 billion of debt primarily in euro at a weighted average fixed interest rate of under 1% and a weighted average term of more than 14 years.

It's worth pointing out that we have an annual need for an incremental $600 million of non-dollar debt to naturally hedge our growing international assets. These issuances lowered our total weighted average interest rate by 10 basis points to 2.4% and lengthened our weighted average maturity by about two years to just under eight years. We continue to maintain significant investment capacity on the balance sheet with the $11.7 billion of liquidity and potential fund sell downs. In addition, there is an incremental $5.4 billion of existing third-party investment capacity in our ventures today.

Guidance for 2020, which I know many of you are looking for will be provided at our upcoming Investor Forum on November 5th.

For 2019 guidance, I'll cover the highlights and then I'll share basis and note this guidance does not include the positive impact of the IPT acquisition. We are increasing the bottom end of our cash same-store NOI guidance by 25 basis points and now expect a range of 4.75% to 5%. We are raising the midpoint for development starts by $250 million and now expect starts to range between $2.2 billion and $2.5 billion.

Build-to-suits will comprise more than 40% of total starts which is above our initial expectations. We are projecting $650 million of net deployment uses which we plan to fund with free cash flow and debt. Net promote income for the full year is now expected to be $0.18 per share, an increase of $0.02 from our prior guidance. For the full year, we are increasing our 2019 core FFO guidance midpoint by $0.03 and narrowing the range to between $3.30 and $3.32 per share.

And our revised midpoint growth in core FFO per share excluding promotes is 10% higher than last year. Over the past five years, our growth has clearly been exceptional with a CAGR of almost 12%, while de-levering from 27% to 18%. As I mentioned, this guidance excludes the acquisition of IPT, which we expect to close in January of 2020. We plan to split the $4 billion portfolio equally between our two U.S. vehicles. Private capital investor interest continues to be robust as evidenced by the record fundraising in our ventures in the third quarter.

Our pro rata investment will be approximately $1.3 billion, which we will fund with cash and debt. We continue to expect the annual core FFO accretion from IPT to range between $0.05 and $0.06 per share or roughly 2% on a stabilized basis. The acquisition of this high quality portfolio will capture significant revenue and cost synergies and deliver shareholder value on day one.

To sum up the third quarter was a continuation of what has already been an excellent year. I feel great about our outlook for the rest of the year and beyond.

And with that, I'll turn it to Michelle for your questions.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from Craig Mailman from KeyBanc Capital Markets. Your line is open.

Craig Mailman

Hey, guys. Maybe just wanted to hit here on demand and kind of where you guys have the availability in the portfolio. Could you guys just kind of talk through what you're seeing in the demand profiles between kind of larger and smaller tenants, and your ability to push rents there and maybe improve credit quality. And then kind of talk a little bit about what you guys see as your ability to push the occupancy in under 100,000 or under 250,000 square foot space where you have more opportunity? And maybe talk is there any more frictional vacancy in those type of spaces than in your bigger box? Or could we see those kind of spaces kind of narrow to where your average occupancy could be?

Hamid Moghadam

Now, that's some question…

Gene Reilly

Did everybody write down? Well, let me take a stab at this, first maybe talking about the smaller spaces. So these are spaces where we can push rents and we're seeing pretty broad-based demand frankly across all sectors. But I think those with the smaller segment is where we can reach rent growth and I think if you look inside rent change numbers which are obviously at all-time highs that would be the highest.

In terms of the composition of the demand from an industry perspective, again, that's pretty broad based. Obviously auto is weak, almost no matter where you are in the globe. But otherwise, we're still seeing pretty broad-based growth. We're seeing continued growth from the e-commerce sector and that's probably a combination of reconfiguration of the supply chain as well as net demand. So that's a start on it.

Tom Olinger

Craig, this is Tom. So two of your questions, one on credit quality, our credit quality continues to be exceptional. Our bad debt experience has been below 20% or 20 basis points of rent -- below 20 basis points of rent for the last six years continues this quarter. So I feel great about our credit quality and then just regarding your question on small spaces and frictional vacancy.

We do have many more units in our smaller spaces. So naturally there is going to be more churn in that particularly as Gene pointed out, we are pushing rents. So you could see a higher -- a little higher frictional vacancy, but the pay-off is much higher rents. So the economics are clear to keep pushing rents.

Operator

Your next question will come from Jeremy Metz from BMO. Your line is open.

Jeremy Metz

Hey, good morning. Hamid, FedEx on its earnings call last month, they added they were citing more challenges ahead in 2020. They talked about the typical the global trade disputes and concerns over economic slowing having created significant uncertainties. In your opening remarks, Tom did mention that you hadn't started that that you hadn't started to see that in your customer behavior yet, but clearly those risks are out there. So just wondering, has that surprised you at all that you really haven't seen it in the customer behavior yet? And then maybe just any broader thoughts on how this all impacts your outlook for development starts beyond call it $2.3 billion you have under way in terms of cadence or desire to take on spec et cetera? Thanks.

Hamid Moghadam

Sure. I think both statements can be true at the same time. FedEx cares more about flows and obviously those become very volatile when its trade wars one day and no trade wars the next day. And they have a very fixed cost basis infrastructure planes and trucks and all that. So erratic volume cannot be good for them because they either miss the peaks or can handle -- either, they can't handle the peaks or have too much capacity for the troughs.

We are in the stock business. So actually uncertainty in the short-term is extra demand for our space, because when you don't know when that mix good is going to get to you, because the tariffs are at what cost, you're going to carry more inventory and more stock closer to the customers. So I think FedEx is right as far as the metrics for their business are concerned, and I think the metrics for our business are just different.

Operator

Your next question will come from Derek Johnston from Deutsche Bank. Your line is open.

Derek Johnston

Can you discuss the leasing process for the multistory facility in Seattle where Amazon and Target ultimately signed, and how competitive was this bidding process? How many interested parties did you have? And where did rents shake out versus underwriting? And what type of future demand do you anticipate? Thank you.

Hamid Moghadam

I would say the rents and the economics turned out better than our expectations. It took a little bit longer to lease up, but it leased up at higher rents and the reason it took a bit longer to lease up is that nobody ever seen a multistory building before, so they wanted to look at it, lay out a lot of different configurations and make sure they could get the efficiencies out of it. So we couldn't be more pleased with the quality of the tenants or the financial performance of the asset.

With respect to its implications, look I -- for some reason this building has gotten a lot of attention and people think that there is a multistory strategy. There is no multistory strategy. The strategy is to provide space at places where our customers want to, which is increasingly close to their ultimate customers. The solution in some places, it's multistory and in other places is single story. So we're not in the business of building so many multistory buildings, we are in the business of growing our infill position.

Operator

Your next question will come from Vikram Malhotra from Morgan Stanley. Your line is open.

Vikram Malhotra

Thanks for taking the question. So Blackstone just sold part of their original GLP acquisition. Wondering if you looked at that portfolio and if you can just more broadly, give us any sense of any portfolios across regions and sort of how pricing or cap rates are shaking out?

Hamid Moghadam

Vikram, you can assume that we look at everything. People know our phone number and they know we are -- what business we're in. So we absolutely, positively have never thought of a material transaction that we haven't seen. So you can assume we look at everything. I think the implications are you're going to have to ask Blackstone, but obviously they bought that portfolio and presumably, they paid the pretty good price to get it and presumably, they sold it to these guys two months that presumably paid a really good price to get it. That was attractive enough for Blackstone to sell it. So I can't be any more specific than that, because I'm not in Blackstone's decision making rooms, but those would be -- those assumptions would be probably pretty fair.

Operator

Your next question comes from Jamie Feldman, Bank of America Merrill Lynch. Your line is open.

Jamie Feldman

Thank you. I want to get your -- more of your thoughts on just the supply outlook. I mean we do have historically high supply coming online. But you just said your development starts were 63% pre-leased in the quarter, and you want to start more. You expect to pick up in the fourth quarter. So can you kind of paint the big picture of how we should be thinking about the supply risk heading into '20? And as you think about your development opportunities, the pre-leased percentage and what gives you comfort at these -- this level of volume?

Hamid Moghadam

Hey, Jamie, Hamid here, I think there is a lot of confusion about supply numbers. People mix supply which is annual concept with what's under construction, which is a snapshot that they've given point in time. So let me have Chris take you through those numbers because they are materially different as construction duration has lengthened.

Chris Caton

Yes, absolutely. Jamie, let's talk about three concepts. First, completion. Completion is actually are on pace to be down this year by about 8%. When we look at a more real-time indicator like starts, starts are flat this year. Now as Hamid mentioned, duration to build projects has gone up and so we've seen under construction rise, that time to deliver product has gone up by about a third in this cycle for all the challenges around supply that we've previously discussed. And so deliveries out of that pipeline now are much less than kind of 100% in a given following four quarters. So you got to look at the time to deliver product to understand what deliveries will be in the following four quarters.

Hamid Moghadam

So basically if you had the same level of supply, the same level of property under construction, you would have two-thirds the annual supply if the trends of the recent past continue. So those two concepts need to be really kept apart.

Operator

Your next question comes from Blaine Heck from Wells Fargo. Your line is open.

Blaine Heck

Thanks. Hamid in the press release you pointed out the exceptional interest that you're seeing for your strategic capital ventures and you guys have obviously done a great job raising money on that side of the business. Can you just talk about whether there are any specific groups that you're seeing incremental interest from? And then on the flip side, what do you think could cause that investor interest to decrease I guess is there anything that kind of sticks out to you as a threat to that capital source in particular?

Hamid Moghadam

Yes. The sources are pretty much from everywhere. I would say the U.S. pension funds are probably a flat to down compared to their call it 10-year type numbers, but Japan is up significantly. Generally Asia is up significantly as these large institutions, sort of the pension system gets active on alternative investments. So it's everywhere. On the margin, I would say U.S. is a little less and Asia a little bit more.

With respect to the threats to that, it's the same old threat that we've seen in every cycle. It's the denominator effect. If these guys are generally at today's investment levels under allocated to real estate and alternatives generally, and really under allocated to industrial because it's a tough property type to access. But if the stock market goes down and the bond market goes down and the rest of the portfolio goes down, the same percentage allocation to real estate will have to go down and that's usually been the cause of reductions in the capital flows.

Operator

Your next question is from Ki Bin Kim from SunTrust. Your line is open.

Ki Bin Kim

Just two questions, Hamid. What's your view on the potential impact from growth for e-commerce on the warehouse business and how PLD would potentially a play a part? And second, just on lease spreads, obviously it's some really good numbers and interesting about the mix of what roll this quarter that might be different going forward?

Hamid Moghadam

Yes. I'll let Tom answer the second part. I think there are three things that drive the share of the economics to drive the share of the e-commerce in our portfolio and for the space devoted to it. Number one is, penetration increasing, penetration of e-commerce as a percentage of total sales, retail sales. That number is going up every year. And I think it will go up for the foreseeable future as more categories become e-commerce friendly.

And as you know the millennials, I guess they are non-millennials, the generation, the years, could grow up with an iPhone start entering their prime shopping years. So the iPhone, I think is 11 years old and 12 year olds who are now graduating from college or 11 year olds who are graduating from college basically have never known the world without an iPhone in e-commerce. So I think as those guys enter the population to spending part of the population, I think the percentage will go up.

And then there is the old 3X factor of space that e-commerce takes which are well on top of the gaining share of e-commerce and underlying retail growth which is probably the slowest of the three factors, maybe 2% type of thing. All those three factors combined should make for a really good environment for e-commerce demand over time. Now I don't -- the real strategic question is, how does automation affect the 3X factor? It -- does it reduce it, does it expand it?

The answer on that is unclear at the moment and in certain instances, the increase, the need for real estate and in certain cases it reduces the need for real estate, but one area that for sure over time, we'll get more efficient is the returns business. And returns are really caused by free shipping and free returns and all that sort of thing. And over time I think fit and issues like that will get better, so I would guess that part of the demand in warehouse space will go down.

Anyway the biggest, biggest strategic driver of all this, long-term secular driver of all this, is the need for speed and choice. Because the more choices you want and the quicker you want them the more inventory, you need to position near the customers. So, that's all really good for our business.

Tom Olinger

Ki Bin, this is Tom. On your question about rent change for the quarter. We did see higher mix this quarter in the West and East region, so the coastal markets the U.S., that being said almost every region had its all-time high or near its all-time high in rent change. So we're seeing very positive rent change across the board, almost without exception. You ask about a trend, our four quarter trailing average rent change is right at 28%.

This quarter, I think that's a pretty good outlook in the near term for where rent change should be. But remember, when we talk about in-place to market at being 15.5% below market, that means rents need to grow 18.3% to get to market. Right. So if you're 15% -- 15.5% under rented, you need to grow by 18.3% that's just math to get to market rents. So think about are in-place, built-in rent change of being 18.3% and think about what's rolling, near term is obviously signed further ago, so naturally our rent change would be higher in the near term.

And then the last thing I'd point out is rent change. The rent change on roll of that four quarter average, we're now at 28%, that's up 600 basis points in the last year. So we've seen that number move up meaningfully and I think we can hang around there based on our in-place to market.

Operator

Your next question comes from Eric Frankel from Green Street Advisors. Your line is open.

Eric Frankel

Thank you. Just two quick questions. One is related to portfolio sales is based on the Black -- information Blackstone activity, do you see any meaningful differences between portfolio sale prices versus smaller transactions you guys might pursue. And then second, just on the demand front, you know, obviously there's a lot of press kind of given to smaller buildings in multi-tenant leasing, my conclusion is that that kind of leasing and the rent -- the rent growth you can get is really more dependent on location than property size, can you affirm whether that's true or not, or is a smaller building in some Midwest market getting record rent growth as well. Thank you.

Hamid Moghadam

Eric, let me jump in the middle of that before Gene starts on the first part. The most important thing with respect to rent growth is location in terms of macro market and the micro sub-market. By far, more important than tenant size and all the stuff we talked about before, so you're spot on that one. And those were the scarcest properties. Gene, do you want to answer it.

Gene Reilly

Yes, Eric. With respect to the portfolios, I mean as, Hamid mentioned, of course, we look at all these things we price them and for sure lately portfolios are selling at a -- what we consider a premium to the sum of the parts. So I think that that is true. Having said that, there is also plenty of one-off transactions and very, very good market pretty stunning metrics associated with it.

Operator

Your next question comes from Caitlin Burrows from Goldman Sachs. Your line is open.

Caitlin Burrows

I was just wondering maybe on the development side, the total development portfolio declined slightly since last quarter, but the 2019 starts were actually up. So is -- this just a function of pulling forward previously expected activity and what's your confidence in being able to sustain that level of starts going forward as Prologis grows? And then just on the yield side. Those have come in a little I think from about 6.5% to 6.1%. So what's driving this and could that increase back up?

Tom Olinger

Yes. The second point, that's really basically mix. But having said that, you have generally seen cap rates declining frankly over the last -- well for 20 years, but over the last couple of years, cap rates have been declining and you will see some change in the returns on costs as well. In terms of the development volumes, what we are implying is a big fourth quarter about $1.2 billion, but I think that's about right on top of what we did in the fourth quarter of last year. We're highly confident that and in terms of the future beyond that we'll talk about that when we give guidance in the future.

Hamid Moghadam

Yes and this reminds me of a previous question that something I answered which is what's our attitude toward spec development, and I would say the bar on spec development has been high and continues to be pretty high, and you can see the results of that in the build-to-suit percentage being a lot higher.

Operator

Your next question comes from Manny Korchman from Citi. Your line is open.

Manny Korchman

Tom, just thinking about your year-end occupancy guidance, your retention in the quarter was actually higher than the trailing Q and yet you commented in the press release that you're focusing on rent growth versus occupancy. So does that mean that new leases aren't happening as fast as you thought? And is that because the rent levels or is there something else that does not connecting between retention rates and occupancy?

Hamid Moghadam

So, this is not Tom, but I'll answer your question. The retention ratio you're dealing with tenants that are already in this space. And today, labor, is a huge issue for people. And every time they move, they have to go higher bunch of people, because now the workers have choice and they're not going to change their commuting patterns, etc, etc.

So customers that are in existing space have a much higher propensity to stay regardless of almost rent, which is an afterthought for a lot of them. So where you see the effect, the primary effect of pushing rents is on capture of new leasing in the developments, that's where you're likely to see at the most. And that of course doesn't affect the retention numbers that we report.

Operator

Your next question will come from Nick Yulico from Scotiabank. Your line is open.

Nick Yulico

Thanks. I just had a question on the leasing spreads. I know you -- Tom you gave some infill on what drove it higher this quarter. I just want to make sure as well though that the switch to the clear leases in the past year, has that had any impact on the way you guys measure the releasing spread?

Tom Olinger

No impact at all.

Operator

Your next question will come from Michael Carroll from RBC Capital Markets. Your line is open.

Michael Carroll

Yes. I just wanted to follow up on the, I guess PLD stands on pushing rents over occupancy. Haven't -- hasn't that's been your stands over the past two years or are you just being more aggressive today and is that a good fair way to say is what's being reflected in lease spreads and how they're pretty much doubled than what they were for the trailing four quarters?

Hamid Moghadam

It's been our stated objective to do this for previous quarters, but they are these messy things called human beings and people feel that there have been need to change their mindset, and that took a couple of years to really get that going. We track why we lose tenants, when we don't renew somebody and we track them for a long, long time. And I'm not kidding you. But there were years that we had literally zero tenants leaving because of rent on renewals, literally. So that number is no longer zero, but it's a lot lower than I think it should be or I would have expected it to be.

Operator

Your next question comes from Steve Sakwa from Evercore. Your line is open.

Steve Sakwa

Thanks. Hamid, I just wanted to clarify, when you talked about the -- you and Chris talked about sort of the construction pipeline or time to build getting longer, is that 9 months to 12 months or is that more of a 12 month to now 16 months. Just trying to understand that. And then are there any markets in the U.S., you didn't really call anything out, but just trying to get a sense of the markets in the U.S. that you're a bit more worried about or really just seeing much less rent growth today?

Hamid Moghadam

Yes. By the way the on the duration of construction it depends on where. In Japan, they will be, they were 16 months. And I don't know what they are today, but it takes longer to build the multi-story building. But let's focus just on a single story U.S. style warehouse and Chris as the numbers for you.

Chris Caton

Yes. Hey, Steve its going from eight to nine months to something more than a year, call it, call it 13-14 months. What I think we will see is that deliveries over the next four quarters, can be roughly 75% of the under construction pipeline, that's how we see the numbers coming together. As it relates to market, we talked about how we -- on the last call how we haven't added any markets to our supply risk list, that's remains the case today and in fact markets like Chicago comes off that list this quarter. So...

Steve Sakwa

I know. Osaka came off a little bit earlier. So...

Chris Caton

Yes. Osaka is a market that came off. And then on that list included Atlanta, Pennsylvania, Houston, Spain and the Midlands was covered in Tom's script.

Hamid Moghadam

I would say the one that I would point out as being more at risk today than last quarter, even though it was on the list is Houston. There is a lot of space under construction in Houston. And I think some people are going to get surprised. Now and some of it is not in the best sub-markets. So some of the outlying sub-markets in Houston you need to watch. Fortunately, we are not exposed to the sub-markets.

Operator

Your next question will come from John Guinee from Stifel. Your line is open.

John Guinee

Great. I think Mike Curless is in the room. I was just looking at Page 24, and I noticed an uptick in a pretty sizable land acquisition year-to-date and also acquisitions and other investments in real estate. Can you walk through -- Mike, where you're buying the dirt? And also what the other investments in real estate might be?

Hamid Moghadam

Probably, Gene should answer that question since Mike has a new job, but Gene, go ahead.

Gene Reilly

Yes, and Mike can maybe offer customer color where they want the dirt. But John, where we generally need to replace dirt is in the coastal markets where we've got a lot of development absorbed a lot of land bank. So there is a piece in LA included in that, but as we look out going forward, replacing land is very, very expensive these days. As you know, we've done a lot of work to work this land back down to what we considered a manageable level. As we replace land going forward, we're trying to do it creatively, we're trying to tie up land through options, but it's going to be more expensive. And we will see the land bank pick up a little bit, but we're going to remain very disciplined on that front as we have been.

Hamid Moghadam

Our biggest needs for land, I would say are Southern California -- we're good in Seattle, good in the Bay Area. Southern California, we need more land. Chicago, we need more land, and I would say in New Jersey we need more land for sure. Those are the top three that I would call out.

Gene Reilly

And with respect to the customers and where they want to be two, three years ago, 80% of our land that we're doing build-to-suits and we're in -- were global markets, those numbers are closer to 95% these days.

Tom Olinger

And John, your question about the other investments, just think about those being covered land place, not land but will become land soon.

Hamid Moghadam

Yes. Those are actually yielding, probably pretty close to the local market cap rate maybe a tad below maybe 20-25 basis points below, but they're basically current land place.

Operator

Your next question comes from Michael Mueller from JP Morgan. Your line is open.

Michael Mueller

Yes. Hi. I was wondering, do you expect the elevated mix of build-to-suits to be a little bit more of the norm over the next year or so?

Mike Curless

This is Mike Curless. We did have a robust quarter at almost two-thirds build-to-suits. If you look across the year that's blending in the high '30s and I would expect in our numbers to be in the low '40s as we look forward. I think this was an unusually high quarter but directionally indicative of how important the build-to-suit part of the business is to us these days.

Hamid Moghadam

You know, I'll compare to five or 10 years ago or 15 years ago, I mean, that number would have been 20%-25%. So I think the tightness of the markets is forcing the build-to-suit percentage up.

Operator

And your next question will come from Craig Mailman from KeyBanc Capital Markets. Your line is open.

Craig Mailman

Hey guys. Just wanted to kind of hit on some of your liquidity here in the funds and on balance sheet, your cost of capital is clearly advantageous. But you have a lot of kind of well-heeled competitors as well. I'm just kind of curious you guys look at the acquisition landscape, you've been successful in some, missed some others, but just kind of how you look at return requirements for on-balance sheet acquisitions here versus the in-funds. And just talk a little about what you're seeing on the quality spectrum of portfolios that you have traded or may be out there and kind of interest level?

Hamid Moghadam

Let me start that and Gene jump in if you'd like. I think the quality, the pricing for quality differences is getting compressed, in other words, cap rates for a lower quality, lower growth assets are compressing high quality assets and location. And that always happens in this part of the cycle. People are really anxious to get into this asset class. And if it's industrial, it's industrial and they become less discriminating over time. Also if you're a leveraged buyer to the end you're really looking at locking in the cost of capital, debt capital today and you employ a lot of it. Obviously this is a really good environment for you're buying things and financing them.

With respect to the way we look at our unleveraged [WACC] our cost of capital, I would say, we look at that every quarter or so, and we occasionally and only in a very limited way have dropped our requirements. I would say for a U.S. high-quality portfolio probably a 6 IRR would be the right number today, very high quality portfolio for us. And, you know, take it up from there but unfortunately some stuff in the marketplace even for low quality assets is getting priced to tighter than that.

Now a 6 IRR in a 1.6% or 1.7% 10-year environment is pretty attractive. I mean those are some of the wider spreads, I've seen in my career. And so, yes, then our absolute numbers sound low but would in relation to cost of capital or debt capital they are actually pretty attractive.

Operator

Your next question comes from Vikram Malhotra from Morgan Stanley. Your line is open.

Vikram Malhotra

Thanks. Just wanted to follow up on two things. One for Chris, you mentioned sort of some of the rent growth and obviously it's different by sub-markets. I'm wondering if you're starting to see any divergence from recent trends within sub-markets within MSAs meaning more divergence and what you've seen recently. And then just one for Tom on the clear leases, wondering how that's -- if any impact on the expense side and if it may be positively or negatively impacting NOI growth?

Mike Curless

Yes. Hey, as it relates to rent growth. A couple of ways to look at that, one is we continue to see that divergence between in-fill and non-infill as Hamid was discussing earlier in terms of sub-market strategy. As it relates to markets, we've seen better outperformance in the East in New York and in Toronto for example, and we continue to see really good growth in Europe, much like we telegraphed last year and the year before. And what you see there is some of the early recovery markets continuing to outperform whether that's Germany or the Netherlands or Czech Republic, and some late recovery markets really starting to pop rents comes to mind. So that's how the rents are trending.

Tom Olinger

Great. Vikram on your question around the clear lease and expenses, those leases are set up where we fix all the cost for real estate taxes, the tenant bears that. And we are collecting slightly more on the expense reimbursements right now. But essentially, call it even. So we set it up that way to be expense neutral. So no impact on NOI, and to go back to next question, just on the clear lease and did that have any impact on how we're calculating rent change? It does not. That clearly, just think about it simply having a rent component and an expense reimbursement component and the rent change is calculated on the revenue, the rent component, not the expense component. So no impact.

Hamid Moghadam

Yes. I just want to clarify something Tom said. We actually don't collect reimbursements, That's why it's a clear lease. But we do track what it would have been under a triple net lease. And actually for the last 1.5 year or two years that we've been implementing this, the numbers have been remarkably on top of one another and that's the advantage of having an 800-million square foot portfolio to spread this stuff around.

Operator

And your next question will come from Manny Korchman from Citi. Your line is open.

Manny Korchman

Yes. So Hamid, I had a follow-up from my -- on my previous question that I have a new one for you guys. But so you mentioned leasing as developments, I guess that wouldn't impact your occupancy guidance. But just going back to that in isolation of retention is where you expect, it's at 81%, and you've lowered your occupancy guidance. That means that your pace of lease-up in already vacated space or space to be vacated is going to be slower. Is that the wrong read through?

Hamid Moghadam

We are pushing -- remember the part that I said that we -- in the year as we had zero people that we were losing as part of the renewal discussion that number is not zero, but it's not as high as I would like it to be. You're also talking about occupancy declines from 98%, and I've been doing this for 37 years, there was only one year where we were in the 98% range. And I said guys don't get used to this. We're going to push this number down. So I think we were very clear on what our strategy was. And I would say it was executed as exactly the way we described it.

Operator

Your next question comes from Jamie Feldman from Bank of America Merrill Lynch. Your line is open.

Jamie Feldman

Thanks. I was just hoping you could explain more why developments are taking so much longer to deliver. And then also just thinking about the TI number in the quarter and what we've seen this year, I mean are you spending more on leases -- on TIs on leases, and if so, can you explain what those -- why that's happening or what that's going to and is that impacting your ability to push rents as well?

Gene Reilly

Jamie, I'll take the first one. It's Gene. It's basically a combination of construction time frame and there is some entitlement timeframe in that as well, and which by the way can affect the projects through its construction. And as you pull secondary permits as you go forward. So it's really those two items. And of course depending on where you are geographically, there is pretty wide range of outcomes.

Hamid Moghadam

We've also had kind of weird weather patterns that I think most of you have noticed that definitely methods quick construction schedules.

Tom Olinger

Jamie, on your second question on the turnover costs. I -- it's a little higher this quarter. I think it's due to two things, its mix and timing. But I go back and look at what our -- what we've been on a trailing four quarters, I think that's a better representation. We have been coming down pretty clearly over the last, on a trailing four-quarter basis over the last, really three years and that makes sense. Just given concessions are falling across the board. The other thing I'd point to is look at free rent as a percent of lease value that is consistently declining again. So I think overall this quarter's mix and a little bit of timing, it's not impacting our -- we're not trying to buy rent change if that's the question.

Operator

And your next question comes from Steve Sakwa from Evercore. Your line is open.

Steve Sakwa

Thanks. Hamid, I was just wondering if you could provide an update on sort of the big data initiatives and the procurement and sort of where you stand? And is that something we're likely to get a lot more detail on for 2020?

Hamid Moghadam

On the big data we are, as I mentioned to tackling one very specific project which is yield management. And I would say that's going really well. We're piloting in four markets, and we'll be expanding that to the portfolio, and we are encouraged by the early results. I don't know, Chris may have more to say about that. Gary, you want to talk about the other initiatives.

Gary Anderson

Yes. On the procurement initiatives, we stood at procurement organizations, we talked about in the past and things are going well there I'd say both in terms of procuring construction related items and CapEx and G&A. So that is often running. And with respect to the revenue side of the equation, I'd say that we're off to a good start. We're starting to build that business. We're probably getting into the tens of millions of dollars in terms of revenue. So it is becoming more meaningful and we're seeing roughly double-digit growth.

Mike Curless

Yes. I would say that that business today if you isolate it would be pennies a share of incremental earnings. I think in two to three years, it will be dimes, and we're hoping that it's potential is more than $1. So, but that is going to take us a while to get to. So don't put in the dollar, don't put in the [indiscernible]. Put in a couple of pennies that we're talking about right now, we're doing better than that actually. But it's a slow ramp, nobody has done this before. So, we need to educate ourselves and our customers and a lot of other people to get this done.

Hamid Moghadam

I think Steve you were the last person. So thank you all for your interest in the Company and I want to put in a big plug for our Analyst Day, which is coming up and that's why we saved all the good guidance for that date and encourage you to come. Take care.

Operator

Thank you everyone. This will conclude today's conference call. You may now disconnect.