Easterly Government Properties

Fourth Quarter 2019 Earnings Conference Call

February 25, 2020

CORPORATE PARTICIPANTS

Lindsay Winterhalter, *Vice president, Investor Relations and Operations*

Darrell W. Crate, *Chairman of the Board of Directors*

William C. Trimble, *Chief Executive Officer, President, and Director*

Meghan Baivier, *Executive Vice President, Chief Financial and Operating Officer*

CONFERENCE CALL PARTICIPANTS

Emmanuel Korchman, *Citigroup, Inc.*

Michael Carroll, *RBC Capital Markets*

Jon Petersen, *Jefferies*

PRESENTATION

Operator

Greetings. Welcome to the Easterly Government Properties Fourth Quarter 2019 Earnings Conference Call.

At this time all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. Please note this conference is being recorded.

I will now turn the conference over to your host, Lindsay Winterhalter, Vice President, Investor Relations. Ms. Winterhalter, you may begin.

Lindsay Winterhalter

Good afternoon.

Before the call begins, please note the use of forward-looking statements by the Company on this conference call. Statements made on this call may include statements which are not historical facts and are considered forward-looking. The Company intends these forward-looking statements to be covered by the Safe Harbor provisions for forward-looking statements contained in the Private Securities Litigations Act Reform of 1995 and is making this statement for the purpose of complying with those Safe Harbor provisions.

Although the Company believes that its plans, intentions, expectations, strategies, and prospects, as reflected in, or suggested by, those forward-looking statements are reasonable, it can give no assurances that these plans, intentions, expectations, or strategies will be obtained or achieved. Furthermore, actual results may differ materially from those described in the forward-looking statements and will be affected by a variety of risks and factors that are beyond the Company's control, including, without limitation, those contained in Item 1A Risk Factors of its Annual Report on Form 10-K for the year ended December 31, 2019 to be filed with the SEC on February 25, 2020 and in its others SEC filings. The Company assumes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events, or otherwise.

Additionally on this conference call, the Company may refer to certain non-GAAP financial measures, such as funds from operations, funds from operation as adjusted, and cash available for distribution. You can find a tabular reconciliation of these non-GAAP financial measures to the most comparable current GAAP numbers in the Company's earnings release and separate supplemental information package on the Investor Relations page of the Company's website at ir.easterlyreit.com.

I would now like to turn the conference call over to Darrell Crate, Chairman of Easterly Government Properties.

Darrell W. Crate

Thank you, Lindsey. Good afternoon, everyone, and thank you for joining us for this fourth quarter conference call.

Today, in addition to Lindsay, I'm also joined by Bill Trimble, the Company's CEO, and Meghan Baivier, the Company's CFO and COO. We're pleased with our results for 2019. We delivered our first completed development project, won our third, and have further positioned the Company to continue to win accretive technical projects like these FDA laboratories. The acquisition execution was disciplined with material additions to our bullseye properties; we continue to build upon our definable edge in the United States Federal Government lease market; and most importantly, we were able to deliver an attractive return to our shareholders.

Just last month we marked our fifth year as a public company with 71 properties, comprising 6.6 million square feet with 36 agencies. During our time as a public company, we've achieved scale in our operations, meaningfully diversified, and maintained the average length of our leases. I'm proud of our team and the expertise they bring to our market each day.

I'd also like to thank our Board for the guidance and wisdom they brought to our efforts.

As we look ahead to 2020, it's shaping up to be a very good year for the Company. We appreciate the confidence that investors have shown in our business model through the strong appreciation in our stock price. The equity currency, combined with a very attractive rate so we can obtain in the debt markets, gives a very attractive cost of capital relative to our market. We've spent 10 years identifying high-quality properties and cultivating their owners.

With our stock trading at a premium to NAV, we find ourselves with the ability to deploy capital in an attractive, disciplined, and accretive way. We believe we may be entering a period which gives us the opportunity to deliver particularly accretive growth, and we are grateful for the confidence investors have shown in our capital deployment discipline.

With that, I'll turn the call over to Bill to give you insights into the 2019 results.

William C. Trimble

Thanks, Darrell, and good afternoon.

Thank you for joining us for our fourth quarter earnings call. The Acquisitions Team closed out a successful 2019 with another two great additions to the Company's growing portfolio in the fourth quarter of 2019. The first was the U.S. Citizenship and Immigration Services Facility in Tustin, California. This 67,000 square foot LEED certified facility is 100% leased to the GSA for the beneficial use of the U.S. CIS. The facility recently underwent a sizable renovation to suit for U.S. CIS whereby the tenant provided a substantial capital investment into this facility. The Government recently signed a 15-year lease for the building which expires in 2034.

Our second acquisition of the fourth quarter was a new VA outpatient facility located in the Northeast U.S. This 56,000 square foot facility is an expansion and relocation of an existing VA presence in the region. The facility is located in close proximity to the existing VA hospital campus and carries a new non-cancelable lease term of 15 years. This facility has been designed to achieve Green Globes Certification for new construction and will serve as the new home for a multitude of services and programs, including: primary care, mental health care, team vocational services, and various national VA programs, including the National Center for PTSD Clinical Neurosciences Administration Division and the Pain Research, Informatics, Medical, Co-Morbidities, and Education Center.

Upon reflection, 2019 was an incredible year for the Acquisitions Team, and I congratulate each member of the team for growing the Company's portfolio so materially. In 2019 we closed on $381 million in acquisitions, $228.8 million of which was predicated on our 2019 acquisition guidance of $200 million. We grew the Company's portfolio by 23% through the acquisition of eight properties in 2019, and the delivery of one build-to-suit development for the FDA, while still maintaining 100% occupancy throughout the entire portfolio. We also increased our LEED certified portfolio by 15% based on total square feet.

These are all metrics to be proud of and ones that contributed to the overall success of our 2019.

I'm pleased to report that 2020 is off to a strong start. Subsequent to quarter end, we began executing on our stated target of $200 million in acquisitions for the year 2020 by acquiring a 116,500 square-foot Defense Health Agency facility in Aurora, Colorado. DHA Aurora is a build-to-suit property specifically constructed for the DHA that was originally built in 1998 and underwent a sizable renovation in 2018 upon the execution of a new 15-year lease. This facility has a portion of the DHA's Health Insurance Program, referred to as Tricare. The Tricare program is responsible for providing insurance to approximately 9.5 million beneficiaries through private medical providers or the DHA's own network of 51 military hospitals, 424 military medical clinics, and 248 dental facilities located worldwide.

Through these 2019 and early 2020 acquisitions and our delivered FDA laboratory development project in Alameda, California, we maintained the average age of the Company's portfolio and the remaining average lease term at our properties even with time working against us. In short, we are constantly ensuring we keep our portfolio young and relevant for missions of the Federal Government.

Turning to development, our team, led by Mike Ibe, continues to make meaningful progress at our two active development sites, FDA Lenexa and FDA Atlanta. On the development pipeline, we continue to monitor potentially relevant projects that could provide us with an opportunity to deploy our capital accretively and expand the portfolio with a new mission-critical facility.

Finally turning to lease renewals, we're pleased to report that we have signed a new lease with the GSA for the FBI Field Office located in Albany, New York. Executed well in advance of its current lease expiration, this new 15-year, 10-year firm lease will go into effect no later than September of 2021, thus extending the FBI's tenancy in our facility through 2036. This early lease renewal gives us the opportunity to begin working with the Government to determine the scope of work through the building's TI package, which will allow the FBI to continue their effective operations from our facility for decades to come. Much like last quarter's FBI Richmond renewal, this is a center of the bullseye property, and we were able to earn highly attractive re-leasing spreads on this location. This is another great example of how Easterly's bullseye acquisition strategy is the benefit when it comes time for lease renewal conversations with the Federal Government.

To summarize, Easterly has delivered on all fronts in 2019. We have grown the square footage of our portfolio for the accretive acquisition of bullseye properties. We have delivered a state-of-the-art laboratory for the FDA; we have maintained the overall age of our portfolio as and its remaining lease term; and we've added growth and scale, and with that, diversity to our expanding portfolio.

There's a lot to be proud of at Easterly, and I thank you again for your partnership and commitment to our investment thesis. I will turn the call over to Meghan to discuss the Company's quarterly and year-end financial results.

Meghan Baivier

Thank you, Bill. Good afternoon, everyone.

Easterly's unique portfolio and business strategy allowed us in the fourth quarter and for the year of 2019 to once again post strong earnings results. As you saw in our earnings release, for the fourth quarter net income per share on a fully diluted basis was $0.02. FFO per share on a fully diluted basis was $0.30; FFO as adjusted per share on a fully diluted basis was $0.31; and our cash available for distribution was $22.4 million.

For the year-ended December 31, 2019, net income per share on a fully diluted basis was $0.10; FFO per share on a fully diluted basis was $1.20; FFO as adjusted per share on a fully diluted basis was $1.18; and our cash available for distribution was $81.3 million.

To summarize, for the year 2019 we grew FFO per share on a fully diluted basis by 2.5%, FFO as adjusted per share on a fully diluted basis by 15%, and CAD by 49%. These are impressive numbers and, as we enter an election year, we believe stable growth from DEA is now more than ever appreciated by our shareholders.

As of December 31 we owned 70 operating properties, comprising approximately 6.5 million square feet of commercial real estate, with two additional projects totaling 222,000 square feet under development or in design. The weighted average age of our portfolio was 12.8 years. As Bill mentioned, it is through the acquisition of young, mission-critical bullseye properties and the delivery of our latest state-of-the-art FDA laboratory project in Alameda, California that we were able to maintain the relatively young age of our portfolio.

Our portfolio has grown from 62 to 70 properties since this time last year, representing approximately 23% growth in the overall size of the Company's portfolio based on square footage. Through added scale, the superior credit quality of our primary tenant and a more diversified stream of cash flows, the Company is able to support its growing operations and generate earnings predictability and an attractive dividend yield.

Turning to the balance sheet, at quarter-end the Company had total indebtedness of $908 million with a fully available $450 million line of credit for future acquisitions and development-related expenses. As of December 31, Easterly's net debt to total enterprise value was 30.9% and its adjusted net debt to annualized quarterly pro forma EBITDA was 6.1 times. As previously mentioned, meaningful progress on our development projects will bring higher levels of reported leverage as we near project completion. Adjusted leverage, in part, neutralizes this leverage drag, and at 6.1 times, demonstrates the strength of the balance sheet and available dry powder as we continue to pursue our target of $200 million of acquisitions in 2020.

In 2019, the Company pursued a number of capital market transactions which have ensured that our balance sheet remains conservative and the Company continues to have capacity to pursue accretive acquisitions and development opportunities. In September, the Company closed on the private placement of $275 million of unregistered freight senior unsecured notes. This transaction further extended the Company's liabilities at an attractive fixed rate. All-in, the weighted average maturity of these notes was 12.4 years, and the weighted average interest rate was 3.85%. The second entry into the debt private placement market was well-received by the investor community and helped fortify strong relationships with our existing and new lenders.

Further, in December the Company implemented a new ATM program with $300 million in capacity for future equity raising opportunities. In the fourth quarter, the Company issued 1.4 million shares of common stock, raising approximately $32 million in total gross proceeds at a weighted average price of $22.26 per share.

Turning to our earnings guidance, for the 12 months ending December 31, 2020, the Company is maintaining its guidance for FFO per share on a fully diluted basis of $1.22 to $1.24. The midpoint of this guidance is based on the Company completing $200 million of acquisitions and $40 million to $50 million of growth development related investment in the year. The midpoint of this 2020 guidance represents approximately 2.5% growth from our 2019 results, in line with our long-term goal of delivering 2% to 3% annual earnings growth to investors. As mentioned, we believe that long-term steady growth, paired with is a secure sector-leading dividend is the recipe for consistently improving our cost of capital, and we strive to achieve this combination again in 2020.

As always, thank you for your time and partnership. With that, I will turn the call back to Omar.

Operator

At this time, we will be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Our first question is from Manny Korchman of Citi. Please proceed with your question.

Emmanuel Korchman

Hey. Good afternoon, everyone. Meghan or maybe Bill, if we think about your acquisition pipeline going up from here, how many large or larger portfolios are you looking at rather than one-off assets?

William C. Trimble

Hi, Manny. We've got about $2 billion worth of portfolios. We're looking in various sizes from quite large to sort of attractive sizes in the $50 million to $150 million. So, yes, absolutely we're taking a hard look at them and especially with the confidence we've seen with the market of late.

Emmanuel Korchman

Just what do you put sort of the success rate on, is it seller willingness, is it pricing, is it quality—though if you're underwriting it, the quality is probably already taken care of?

William C. Trimble

I think the quality of the underwriting, I've got to say with our team, is unmatched. I think it's always the quirky—I don't mean they're quirky, but the nature of our sellers who we've cultivated relationships for almost a decade now, but I think many of them understand that this will be the best exit for them long term, whether it's for many generations to follow and their family through tax protection, or maybe it's through seeing that maybe this might be a high point in the market for them, or it might be in fact that they're having to enter into renewal conversations with the Federal Government, and I think they'd rather have us do it than try to do that themselves. So, a number of different catalysts. I think it's usually in the eye of the seller that we have to work on.

Emmanuel Korchman

Bill, just remind me because I don't remember off the top my head, but how often have you bought properties that had sort of that shorter lease term remaining where the seller didn't want to or wasn't willing to enter the renegotiations and you guys saw the value patience (phon) for doing that.

William C. Trimble

I'd say a handful, Manny. The one that sticks out most to me is DEA Albany, the field office in New York. That's one that had two years left and, through our team, were confident of the renewal and saw a 34% increase and actually not TI's and no brokerage fees when we turned it over. So, we are happy to entertain short-term leases if we're confident of the renewal. We do find, though, that when they get within about 18 months or a year, often the owners will just choose at that point to do it themselves.

Emmanuel Korchman

Thank you.

Operator

As a reminder, if you would like to ask a question, please press star, one on your telephone keypad. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Our next question is from Michael Carroll, RBC Capital Markets. Please proceed with your question.

Michael Carroll

Thanks. I just wanted to touch on, I guess, Darrell's comments in the beginning of the prepared remarks saying that the Company's positioned to particularly drive accretive growth. Can you put some more color on that? Is that driven by the improved cost of capital, or are you willing to pursue some of those portfolio transactions that you were talking about with Manny?

Darrell W. Crate

Yes. I would say it's is of course improved cost of capital, but we have, as you know, cultivated portfolios and individuals for quite some time, and the stock price and the attractive interest rate environment basically says it's time to be buying buildings.

Michael Carroll

Okay. When those portfolio transactions, I guess, do come up, is it with an improved cost capital that you have; is it more likely to trade those because you can be a little bit more aggressive on the price, or is it just still opportunistic waiting for those sellers to reach the conclusion that it's time to sell their portfolio?

Darrell W. Crate

Yes. I mean, you more than anyone knows how disciplined we are in our underwriting and how we think about cost to capital, IRR, and how we can think about growth. But in our market, I mean, again, just finding another five to seven basis points in a cap rate can make all the difference.

Michael Carroll

Okay. Great. Then just finally for me, can you talk a little bit about some of the GSA build-to-suit opportunities? I know you announced a few with the FDA labs over the past few years. I guess what's the timing with the Atlanta project, and is there any more on tap that we could underwrite coming in sometime this year?

William C. Trimble

Yes. I mean, I think that you're going to see Atlanta, which is by the way really exciting project and we're thrilled to be part of it, that's going to be delivering closer to the 2023 timeframe. There's also, as I reminder folks, there are 13 FDA laboratories and there are a number of them in play. I would expect that they be announcing a new project probably every year in that area. We are aware of some FBI opportunities out there, and Mike Ibe has been right on all of those as well. I think from a standpoint of what do we feel like, we were seeing more opportunities than we have in the last five years for development.

Michael Carroll

Great. Thanks.

Operator

Our next question is from Jon Petersen, Jefferies. Please proceed with your question

Jon Petersen

Great. Thanks. I also wanted to kind of dive in on Darrell's comments on driving accretive growth, more acquisition opportunities. I'm curious how you think about balancing your strong cost of capital, especially your strong stock price between driving accretive growth and then also shoring up the balance sheet, so you kind of have a lower leverage profile maybe when the stock price isn't favorable. I can't imagine you guys are going to issue equity to pay down debt, but maybe another way to think about it is when you think about acquisitions going forward, how should we think about the breakdown and funding between how much equity you'll raise through the ATM and how much debt you'll issue?

Darrell W. Crate

Yes. I mean, again, the market will present the assets that the market presents and, of course, we will be vigilant about finding those assets that are in the bullseye that can be most accretive. There's no doubt that creating a little dry powder on the liability side of the balance sheet is helpful because we can't control the timing of when the best buildings become available, though we can certainly prepare ourselves to be ready.

Jon Petersen

Okay. Then curious; any progress on working towards an investment-grade credit rating?

Meghan Baivier

Every day we really guide ourselves on the balance sheet with keeping an investment-grade profile, and so when the time is right and the scale is appropriate, we've got great receptivity in the price placement market, but we think that would be an easy transition.

Jon Petersen

Okay. Then, sorry, one more balance sheet question.

Meghan Baivier

Sure.

Jon Petersen

Just curious on the duration of your debt outstanding right now, kind of looking at the 30-year treasury trading at an all-time low; I think it's at 1.79% right now. Curious if you think about pushing out the duration at all on some of your debt or just how you think about how to manage that.

Meghan Baivier

Yes. We have historically tried to keep it well matched between assets and liabilities. It's something we do think about a lot and talk about, but it does get harder to believe that we're given a lot of credit for extending past kind of the 7, 8-year ZIP code where we are today, so we think that's appropriate for the profile of the portfolio. We may be opportunistic here and there, but we like the position today.

Jon Petersen

Okay. Thank you so much.

Operator

We have reached the end of the question-and-answer session, and I will now turn the call back over to Darrell Crate for closing remarks.

Darrell W. Crate

Great. Thank you, everybody, for joining the Easterly Government Properties Fourth Quarter 2019 Conference Call. We appreciate your time, and we look forward to keeping you posted on all of our work as we strive to build a portfolio of pristine assets backed by the full faith and credit of the U.S. Government.

Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.