Easterly Government Properties, Inc.
First Quarter 2015 Earnings Conference Call
May 11, 2015

Operator:

Greetings and welcome to the Easterly Government Properties First Quarter Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief 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. As a reminder, this conference is being recorded.

I'd now like to turn the conference over to your host, Evelyn Infurna. Thank you, Ms. Infurna, you may begin.

Evelyn Infurna:

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 fact 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 Litigation Act Reform of 1995, and is making this statement for purposes 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 assurance that these plans, intentions, expectations or strategies will be attained or achieved. Furthermore, actual results may differ materially from those described in the forward-looking statements and will be affected by a variety of risk 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 year ended December 31st, 2014, and its other SEC filings. The Company assumes no obligations 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 and cash available for distribution. You can find a tabular reconciliation of these non-GAAP financial measures to the most currently comparable 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. Thank you. Please go ahead.

Darrell Crate:

Thanks, Evelyn. Good morning, everyone. Welcome and thank you for joining us today in what is our first earnings conference call after our IPO on February 11th. I'm also joined by Bill Trimble, our CEO, and Alison Bernard, our CFO. We're very appreciative of the support of our investors and we look forward to executing the strategy we articulated in the road show in an effort to create material value for our shareholders over time.

I'd also like to take a moment to thank our Board for their enthusiasm in our effort to accelerate growth, and for their guidance and wisdom. We are fortunate to have a Board comprised of independent directors who have directly created value for investors over their careers and we are confident that our shareholders will benefit from these experiences.

For folks who did not get the opportunity to know us on our road show, I'd like to briefly review our strategic objectives. Bill will then discuss these objectives in the context of our current business activities and Ally will follow up with highlights of the quarter.

DEA is the only internally-managed public REIT that focuses primarily on US Government leased real estate. We own 30 real estate assets and 96% of our leasing comp is backed by the full faith and credit of the US Government. Say what you will about Washington, but it is still one of the strongest credits you can find. We have and will continue to work to assemble a portfolio of mission-critical buildings that we believe provide the most attractive return opportunity to our investors. We work to be good partners with the Government and we believe this orientation enables us to find ways to enhance both the returns and the Government's efficient delivery of its varied missions.

Our portfolio provides stable returns, we are 100% leased and our buildings are relatively early in their lives, with a weighted average life of approximately 10 years. Our most meaningful opportunity to grow earnings and dividends is through new acquisition and development opportunities. We have deep experience and a very strong track record of delivering results in a public company environment from an external growth strategy.

We are very proud of our team at Easterly. They have been laser-focused for years in US Government leases and, in particular, the leases that are within our investment discipline. Our roots are in private equity and, accordingly, our culture is focused on achieving significant compound returns for our shareholders over time.

We are on track to achieve the goals that we articulated in our road show, and most relevant today of which is to deliver double-digit earnings FFO as adjusted growth year-over-year, with the intent of these earnings further supporting dividend growth into the future.

Now, I will turn the call over to Bill to specifically address and discuss the strengths that we possess as an organization and how these are translating into earnings-accretive activities for our shareholders.

William Trimble:
Thanks, Darrell. Let me take a moment for those who are new to our story to share bit of our history. We, through our predecessor entity, constructed our investment discipline in 2010, and attracted a diverse group of experienced professionals, who, as a team, have enabled us to develop the value-creating organization we have today. We have experts in each of the areas of necessary focus, government insights, finance, public company operations, asset management, development and acquisitions. These disciplines work together to enhance continuously our definable edge in the originating, underwriting and servicing of our portfolio of important US Government buildings. We have acquired 30 building since our founding, including those acquired in connection with our IPO, and we look to continue this growth as a public company.

Now, let me take a moment to give you some color on each of these value-creating activities.

The first is origination. We identify potential acquisitions through our deep relationships with owners and developers throughout the country. Our pipeline focuses on a certain type of federally-leased asset and we are currently tracking over $700 million of properties. As we indicated on our road show, we continue to believe that we will be able to buy between $70 million and $125 million of buildings on an annual basis for 2015, in a way that is consistent with our investment discipline. We expect the value of each acquisition to be between $15 million and $35 million.

On the development side, we look forward to discussing the plans we are currently working on later in the year and expect our development efforts to start to have an impact on earnings in early 2016. Easterly's experienced development team is only focused on non-speculative preleased government facilities, so that the buildings are 100% occupied upon completion.

I want to draw a very clear distinction between our development activities that enhance our stable recurring cash flow and some of the speculative development that occurs in our industry.

We are pleased with the announcement of the acquisition of the 115,000 square foot Department of Energy's Western Area Power Administration, or WAPA, facility in Lakewood Colorado. This $20.3 million facility is just at the start of a succeeding 15-

year renewal and operates and maintains a 1.3 million square mile service area for the Western transmission system. This building is consistent with the high-quality additions that you should see from us in the coming quarters.

This is a perfect segue to our second edge for driving shareholder value, which is our underwriting methodology. We underwrite the tenant agency first, the hierarchy of the asset within that agency second, and evaluate the dearth and structure third. For example, we prefer law enforcement agencies, such as the FBI, DEA, ICE and CBP, as well as the Federal Judiciary. We are looking for agencies that execute an enduring mission of government, a mission that we expect would not go out of favor no matter who occupies the White House. After determining that the federal agency is important, enduring and growing, we look to the specific hierarchy of mission of the target building. For example, the FBI's 56 regional field offices would be prime candidates for acquisition, and we currently have three.

Our experienced team includes Joe Moravec, the former Commissioner of the GSA Public Building Service, and Ron Kendall, a 32-year government veteran with experience in the GSA, US courts, and the GSA's Oversight Committee in Congress. Ron's last stint at GSA was leading the National Capital Region's Leasing Team.

Easterly targets a specific set of buildings that typically have important attributes, including Class A construction, they're over 40,000 square feet, they're less than 20 years old, and are being the result of built-to-suit competition, which makes it very difficult for the Government to leave. All of these properties are 100% leased to the United States Federal Government and, on average, renew 93% to 95% of the time, according to an expert. Our team spends their time getting that number to as close to 100% as possible.

Finally, we do a thorough underwriting of the actual property, paying special attention to such areas such as environmental sustainability, relative market rents, location and long-term suitability to mission.

Our third Easterly edge is servicing our portfolio. We have a dedicated asset management effort supported by our Government Relations team that strives to provide our tenants with excellent service. We understand the importance of the mission of our facilities, and our goal is to be a constructive and helpful partner to the Government. Because our facilities have enduring missions, 22 of our properties have received additional investment by the Government to enhance mission delivery. These upgrades provide additional return opportunities for our shareholders, enhance the building's ability to remain functional, and make the asset relevant for long-term occupancy. In the end, these projects increase the likelihood that the underlying agency will renew upon lease termination. It is a value-creating system for both the Government and our shareholders.

For example, our approximately 190,000 square foot Patent and Trademark Office facility, located four miles from downtown DC, is undergoing mission and facility upgrades. This facility is located three miles from the main PTO campus in Alexandria, and is connected to headquarters by dark fiber and transportation shuttles. The PTO has identified PTO Arlington as the future relocation site for 130 plus patent reviewers and judges. While it's still in its first lease term, it is undergoing upgrades to four of its eight floors, as the continuing upgrade in the personnel's mission requires more secure workspaces. An interesting fact about PTO is that it is a net contributor to the United States Treasury from patent fees, so expansion is expected.

We do not believe this will be a major driver of earnings, but will contribute over time, and highlights that these facilities are important to the enduring mission of the Federal Agency.

On the renewal front, I'm pleased to report that our Albany, New York, DEA field office has officially renewed for a firm 10-year term that is consistent with our communicated expectations. Working with the GSA and the Drug Enforcement Administration, Easterly is proud to be a partner of the Government. The facility fits the needs of the DEA and, due to our active asset management, minimal additional capital expenditures were necessary for the succeeding 10-year lease.

Thank you again for the opportunity to create value for you, our shareholders. We're excited about the coming years and delivering on the expectations we have articulated.

I will now turn it over to Ally for a discussion of our quarterly results and earnings guidance.

Alison Bernard:

Thank you, Bill. I would like to take a few minutes to touch upon our current portfolio. With the addition of our Department of Energy building in Lakewood, Colorado, we have 30 properties, which account for over 2.2 million square feet. The weighted average lease term for the portfolio is 7.7 years and our portfolio occupancy remains at 100%. As Darryl mentioned, 96% of our lease income is backed by the full faith and credit of the United States Government. The average age of our buildings in our portfolio is 10.7 years.

We are grateful that this is the last quarter that our results will use investment company accounting in our financial statements. It is important to note that our Q1 financial statements contain the investment company basis of accounting from January 1st through February 11th, the date of our initial public offering. From the date of IPO thereon, we are using historical cost accounting, which is familiar to REIT investors. As we progress through subsequent quarters, it will be easier to compare our results to prior periods.

As previously announced last week, our Board of Directors declared a dividend of $0.11 per share, which represents the dividend related to prorated first quarter of operations. Investors should interpret this dividend level to be consistent with the $0.21 share dividend if it were on a full-quarter basis.

We have included a supplement to our earnings release to provide additional information regarding our earnings power and the portfolio. Our hope is to assist investors with understanding the ability for the Company to generate earnings and cash in the future by illustrating one-time charges and accounting anomalies related to the changes in financial statement presentation, as we transition from an SEC-registered investment advisor to a REIT.

As you can see in the supplemental information that we furnished this morning, on a pro forma basis, for our full first quarter, our FFO per share was $0.26 and our cash available for distribution was $0.22 per share.

GAAP measures and reconciliations to GAAP measures were provided in our supplement.

Now, for guidance, based upon our expectations, we believe the existing portfolio will generate FFO, which includes non-cash charges, in a range of $1.03 to $1.07, on an annualized basis, before non-cash stock compensation charges, which translates into a range of $0.91 to $0.95 for the stub period between IPO and year end.

On the topic of non-cash compensation, I would like to take a moment to describe our plan. We are going to take cumulative non-cash charges of $0.20 over the next four years for grants that were awarded by our Board to management under the LTIP program that is outlined in our S-11. We believe this program is meaningfully aligned with shareholders and compares quite favorably with others in the industry. In particular, while we take a non-cash charge, members of Management will not earn a single dollar of value under this plan unless they deliver a three-year compound total shareholder returns of at least 8%, and also deliver at least 95% of the performance of the R&D Index during the measurement period. In order to receive a full award under the program, Management must deliver a three-year compounded total shareholder return of 16% and outperform the R&D by 25%. The entire LTIP program represents up to 4.8% of shares outstanding. As you can see, this was designed to be aligned with our shareholders.

Our guidance also includes an assumption that are G&A will remain at $7 million, which is our current cash run rate.

Further, this guidance does not contemplate acquisitions or developments. However, as Bill stated, on an annual basis, for 2015, we expect to acquire between $75 million and $125 million. While we can't be certain of the timing of these purchases, we believe these acquisitions would be further accretive to our earnings, contributing an additional 10% to 17% of FFO, as adjusted, earnings growth and an annualized basis.

Lastly, I would like to discuss our liabilities and capital resources. The current life of our liabilities, at 11 years, compares favorably with our weighted average lease term of 7.7 years. We have a committed unsecured line of credit of $400 million, which has an additional $250 million accordion feature. We currently have only $31 million outstanding under this line. We have initiated conversations with the rating agencies and we look forward to being able to report our progress in2015. As you can imagine, we believe that the high credit quality and recurring nature of our cash flows would be well received by the investment-grade capital market.

Let me also say thank you for your trust and support of our team. We look forward to executing our business plan and delivering attractive results to our shareholders. It has been a pleasure getting to know many of you and we look forward to welcoming new investors to our Company.

With that, we will open the call to questions.

Operator:

Thank you. We will now be conducting a question and answer session. If you'd like to ask a question, please press, star one on your telephone keypad and a confirmation tone will indicate your line is in 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 pause for questions.

Thank you. Our first question comes from the line Manny Kaufman with Citi. Please go ahead with your question.

Manny Kaufman:

Hey, can you guys just give us an update on the pricing of both the closed acquisition, in terms of a cap rate, and where you expect acquisitions, if we're thinking about $70 million to $125 million, where pricing would be those on those today, if that's changed at since the road show?

William Trimble:

Thanks, Manny, it's Bill. Yes, we're consistent with our guidance on the road show of cap rates between 675 and 725, and we believe we'll be able to do 75 million to 125 million of those this year, on an annualized basis, so we're comfortable what we acquired that property and it was in that zone.

Manny Kaufman:

Can you be more specific on where in the zone?

William Trimble:

Within the zone, I'd say in the middle of the zone.

Manny Kaufman:

Great, thank you for that. Then, since you've gone public, have you seen the competition in the space change, as either people, you know, can now mark your success, or if you've shown sort of that this idea can be more institutional?

William Trimble:

We haven't actually seen any change. As you know, we've been in this sector for number of years and you'll see it ebb and flow, but, really, since we went public, there hasn't been any change in the competition, from our standpoint.

Darrell Crate:

It's Darrell, I'd add to that. The benefit of—one of the unexpected benefits of going public was conversations that have percolated in our pipeline have absolutely accelerated, and that acceleration come from partners understanding that we have broader capital sources and the ability to be a better partner to sellers over time.

Manny Kaufman:

Great. That was it for me. Thank you.

Operator:

Thank you. As a reminder, to ask question, you may press star, one on your telephone keypad. We'll pause a moment to poll for questions.

Thank you. It appears we have no additional questions at this time. I will turn the floor back to Mr. Crate for additional questions.

Darrell Crate:

Thank you very much for joining today, really appreciate your support and we look forward to the coming quarters.

Operator:

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