Easterly Government Properties, Inc.

First Quarter 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

Lindsay S. Winterhalter, *Vice President, Investor Relations and Operations*

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

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

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

CONFERENCE CALL PARTICIPANTS

Michael Carroll, *RBC Capital Markets*

Merrill Ross, *Compass Point*

Frank Lee, *BMO Capital Markets*

PRESENTATION

Operator

Greetings, and welcome to the Easterly Government Properties First Quarter 2021 Earnings Conference Call.

At this time, all participants are in a listen-only mode. As a reminder, this conference is being recorded.

It is now my pleasure to introduce Lindsay Winterhalter, Vice President, Investor Relations. Thank you. You may begin.

Lindsay S. Winterhalter

Good morning.

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 Litigation 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 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 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, 2020, filed with the SEC on February 24, 2021, and in its other SEC filings, and risks and uncertainties related to the adverse impact of COVID-19 on the U.S. regional and global economies, and the potential adverse impact on the financial condition and results of operation of the Company. 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 operations 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, Lindsay. Good morning, everybody, and thank you for joining us for this first 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.

Easterly continues to consistently execute on its strategy of owning Class A mission-critical facilities leased to the United States Federal Government. Our story is simple. We seek to own a pristine portfolio of buildings, many built to suit, that are occupied by some of the country's most important tenant agencies. We aspire to be the chosen partner of our tenants to maintain and enhance their facilities to aid in the execution of their missions. We grow our FFO through acquisitions, nonspeculative development and through the renewal of existing assets. Our acquisitions this quarter were consistent with all these objectives.

The first quarter of 2021 marks the sixth anniversary of Easterly as a public company. Looking back at the value created during these six years, we are pleased with our progress. We have scaled our platform from 29 to 82 properties through accretive acquisitions and development. We have diversified the tenant base from 12 to 39 U.S. government agencies, each with enduring missions. We've grown the percentage of lease income backed by the full faith and credit of the U.S. Government from 96% to 99%. We've increased our stable, recurring cash flows in aggregate contractual rent due from the U.S. Government from $360 million to $2.1 billion. We've increased our weighted average remaining lease term from 7.7 years to 8.6 years. And finally, we've grown FFO at a compound rate of approximately 4% annually while also paying a dividend of 4% to 5%. This supports a 9% total return which implies a premium of 730 basis points above treasuries. We are proud that we've delivered this attractive return profile to investors and we're pleased that the fundamentals of our business remain materially the same, going forward as they've been in the past.

All of this has been achieved while maintaining the same investment discipline and values we established six years ago. We're not a complicated story; we keep it simple. We purchase and develop U.S. Government leased assets and pass along the stable cash flows and superior tenant credit quality to our shareholders, generating strong risk-adjusted returns. And with a highly actionable pipeline, we believe we'll be able to continue to execute on our original thesis for many years to come.

In closing, the fundamentals of our business are strong, our pipeline is robust and the credit quality of our underlying tenant with leases backed by the full faith and credit of the U.S. Government remains the best of any public REIT out there.

We thank you for your continued partnership and engagement as we work to grow this premier portfolio of real estate assets leased to the United States federal government.

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

William C. Trimble

Thanks, Darrell, and good morning. Thank you for joining us for our first quarter earnings call.

The Acquisitions Team continued its elevated acquisition pace with the closing of a bulls-eye portfolio of Class A real estate leased to the United Stated federal government. The three-building, approximately 177,000 square foot portfolio is comprised of some of the government's most important tenant agencies including the Federal Bureau of Investigation, the U.S. Attorney's Officer and the U.S. Immigration and Customs Enforcement Agency. This LEED certified portfolio is entirely built-to-suit and operating under its first-generation lease terms. FBI Knoxville is a 99,000 square foot LEED certified, build-to-suit property completed in 2010 and leased until August of 2025 for the initial 15-year lease term. FBI Knoxville is one of 56 field offices of the FBI, a bureau level federal agency within the U.S. Department of Justice, which serves a dual role as both a federal criminal investigative body and an intelligence agency. With this acquisition, Easterly now own 12 of the FBI's field offices.

USAO Louisville, a 60,000 leased square foot build-to-suit property completed in 2011 is leased through December of 2031 by the GSA on behalf of the U.S. Attorney for the Western District of Kentucky, which serves as the main U.S. Attorney office for this district. Located directly across the street from the Gene Snyder U.S. Federal Court House, USAO Louisville houses the U.S. Attorney's Office for the Western District of Kentucky.

And finally, ICE Louisville, a LEED Silver, build-to-suit office facility completed in 2011, is leased through May of 2021 to the GSA on behalf of the agency. This 17,420 leased square foot office facility works in close cooperation with other customs agencies within the interior of our country, and provides critical administrative support for efforts such as customs, trade and immigration.

Further, just recently announced and subsequent to quarter end, Easterly purchased another build-to-suit mission-critical facility for the U.S. Attorney's Office in Springfield, Illinois. USAO Springfield, a three-storey Class A facility for the Department of Justice Attorney's Office for the Central District of Illinois was constructed in 2002 and is 100% leased to the GSA on behalf of the USAO for a 20-year leasing, which does not expire until March of 2038.

With 40% of our targeted $200 million of acquisitions for 2021 already completed, we are, as stated on our previous call, seeing a lot of promising opportunities in our universe and will continue to drive towards adding accretive opportunities in both marketed and off-market transactions. Our Acquisitions Team is constantly sourcing new, high-quality opportunities that mirror our average portfolio building size and help drive FFO growth. We achieve scale and growth through a highly disciplined acquisition process that targets buildings leased to a single tenant of the U.S. federal government that are often the result of a design build award and they're usually over 40,000 square feet in size. As mentioned previously, in our targeted universe we know and have already underwritten every property that fits into our bullseye for acquisition.

Another source of growth at Easterly comes from our development programs. We continue to make progress with the GSA and the FDA at the 162,000 square foot FDA laboratory in Atlanta, Georgia, which we expect to deliver in the third quarter of 2023. Given the highly technical mission-critical nature of these sophisticated laboratories, we appreciate the opportunity to work so harmoniously with our federal partners to ensure we deliver a state-of-the-art facility. In addition to FDA Atlanta, our team, led by Mike Ibe and Mark Bauer, are currently pursuing other opportunities that fit our nonspeculative development pipeline.

Turning to leasing updates, our Asset Management Team made great strides in the first quarter of 2021 as we renewed the lease at ICE Pittsburgh for a 10-year term that will go into effect in 2022 and will not expire until 2032. We also renewed the Treasury Parkersburg facility for a new 20-year term commencing in March of 2021 and expiring in 2041. The DEA laboratory in Sterling, Virginia was renewed for another 15-year term, as well as the DEA Bakersfield facility for another 17-year term. In total, this represents four renewals, approximately 270,000 square feet or 3.1% of the total portfolio's annualized lease income that renewed in the first quarter of 2021.

Finally, we remain fully committed and focused on our ESG efforts, ensuring we deliver meaningful progress for our shareholders, employees, our board of directors and the communities in which we serve. We welcome those on the call today to soon visit our Corporate Responsibility website and review our commitments in what will be our newly amended Environmental Sustainability Social Responsibility and Human Rights Policy, as well as our inaugural Vendor Code of Conduct.

In closing, we are off to a strong start in the new year with a three-building portfolio and subsequent to quarter end the acquisition of the USAO Springfield facility. From here, you can expect the Easterly team will continue to execute on its disciplined strategy, acquiring the most important assets in the federal government's leased real estate portfolio.

We will also continue to work hand-in-hand with the GSA and underlying tenant agencies on upcoming renewals and long-term strategic planning as it relates to nonspeculative development opportunities. We look forward to seeing you in person at upcoming conferences and investor meetings in the not-so-distant future.

With that, I thank you for your time this morning and will turn the call over to Meghan to discuss the quarterly financial results.

Meghan G. Baivier

Thank you, Bill. Good morning, everyone.

It gives me great pleasure to post another strong quarter of demonstrable growth at Easterly.

As with prior quarters, COVID-19 had no material negative financial impact on the organization as Easterly received 100% of rental income due from our tenants in the first quarter.

As of March 31, we owned 82 operating properties totaling approximately 7.5 million square feet of commercial real estate, with one additional development project in design comprised of approximately 162,000 square feet.

Through the acquisition of newer facilities, the weighted average age of our portfolio remains young at 13.4 years. Successful long-term renewals at existing properties have also allowed us to grow our weighted average remaining lease term to an historic high of 8.6 years. This represents a year-over-year lengthening of our weighted average remaining lease term of 0.9 years.

Maintaining a young portfolio age and a long weighted average remaining lease term is reflective of our strategy of owning relative new build-to-suit assets with enduring missions. This strategy provides us with distinctive future cash flow visibility which in turn allows us to prudently manage the Company's balance sheet and support our highly accretive acquisition and development project pipeline.

Turning to our quarterly results for the first quarter, net income per share on a fully diluted basis was $0.09, FFO per share on a fully diluted basis was $0.33, up nearly 8.5% year-over-year, a rate we are particularly proud of given the backdrop of a global pandemic. FFO as adjusted per share on a fully diluted basis was $0.31, and our cash available for distribution was $24.4 million.

Turning to the balance sheet, at quarter end, the Company had total indebtedness of approximately $1 billion with $341 million available on our line of credit for future acquisitions and development-related expenses.

As of March 31, Easterly's net debt to total enterprise value was 34% and its adjusted net debt to annualized quarterly pro forma EBITDA ratio was 6.2x. As previously mentioned, with this low leverage level, numerous sources of available debt capital, access to equity sold on a forward basis and an attractive cost of equity, we are well poised to lean into future growth opportunities.

In the first quarter of 2021, the Company issued approximately 1.56 million shares of its common stock through the Company's ATM program, raising net proceeds to the Company of approximately $40 million. At a net weighted average price of $25.69 per share, this highly attractive cost of capital delivers meaningful accretion to shareholders.

Today, the Company has approximately 2.9 million shares which are subject to unsettled forward sales transactions under the Company's ATM program. Assuming these shares are physically settled in full at a net weighted average initial forward sales price of $24.43 per share, the Company expects to receive net proceeds of approximately $72.1 million.

Turning to our earnings guidance, the Company is maintaining its previously issued 2021 FFO per share on a fully diluted basis guidance in a range of $1.28 to $1.30. The midpoint of this guidance is predicated upon completing $200 million in acquisitions and $25 million in growth development-related investment in 2021. Easterly remains on track to deliver 2% to 3% FFO growth per share year-over-year, a percentage we are proud to provide to our shareholders through underlying U.S. government cash flows.

Finally, as Bill previously mentioned, we've had a successful quarter of re-leasing activity and with nearly 550,000 square feet and 11 leases expiring through the end of 2021, we are pleased to report we are making meaningful progress with the GSA and are in active discussions regarding all properties at this time. We feel good about the long-term mission and tenancy of these upcoming expirations and we'll continue to keep you apprised of future renewals in the coming quarters.

As always, we thank you for your commitment to our thesis and continued partnership.

With that, I will turn the call back to Chemaley.

Operator

Thank you. At this time we will be conducting a question-and-answer session.

One moment, please, while we poll for questions.

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

Michael Carroll

Yes, thanks. Bill or Meghan, could you talk a little bit about the renewals that you completed in the first quarter? I guess what's the cash lease spread and can you provide color on the base rent and how the TI buildouts kind of will roll in the numbers in the rent streams over the next few quarters?

Meghan G. Baivier

Sure. Good morning, Michael.

As Bill mentioned, there were four renewals in the quarter, the buildings we refer to as Treasury Parkersburg, DEA Bakersfield, ICE Pittsburgh and DEA Sterling. It's an interesting cross-section of the portfolio. Those four leases we are expecting, two of them do have tenant improvement allowances included in the renewal, but we are again expecting—because these are not completed TIs—an average of approximately 8.5% and the rent spread with an average $30 to $35 of TI. Treasury Parkersburg and ICE Pittsburgh had no TI budgeted and so that brought down the average for the quarter.

There you go.

Michael Carroll

Can you talk to us about the TI budgeted and maybe explain how that rolls into the rent stream? I guess once you build out those spaces that's going to add rent to the base rents over the next few quarters, and how long will that take to complete those TIs?

Meghan G. Baivier

Sure. As I said, Treasury Parkersburg and ICE Pittsburgh do not have any TI allowances, so those spreads would kick in on Day 1. We don't have a perfectly clear crystal ball but it's our expectation that in Bakersfield and Sterling that we would also be able to have the tenant improvement completed prior to the commencement of those new leases. Sterling asset will commence in the third quarter of 2022 and Bakersfield in January of 2022, so it should provide us sufficient time this year.

Michael Carroll

Okay, great. Then I guess, Bill, can you talk a little bit about your FBI field offices? I think you highlighted that there's 12 that Easterly owns today. Does that provide you incremental synergies with that agency and the ability maybe to complete more deals or sign leases with them? I guess what type of advantages does that have, having 12 field offices?

William C. Trimble

Yes, good morning, Michael.

I think it does. I think that at the point we're now at 12, the FBI certainly knows who we are. I think they're very pleased with how we run their buildings. And what I think we're beginning to see, as I mentioned before, is there's a number of projects that we'll do at one building at the government expense that we will then do at another one of our facilities. I think it also smooths out our renewals because I think they understand that we have a very good handle on what these buildings are worth, what they would cost to develop, and so I think that's going to only enure to our benefit going forward.

I am very pleased to get to this scale. As you know, that's the best group of buildings I think we can possibly own within the federal government and I think we have a terrific relationship with the agency, so I'm looking forward to owning more. Look forward to the next 12.

Michael Carroll

Okay, great. Then I guess last question, can you talk a little bit about the deals that Mike Ibe is pursuing with the GSA build-to-suits? I think that you highlighted in your prepared remarks that he's pursuing—I don't know if you put a qualifier on that, if it was multiple or several, but is there an expectation on how many GSA build-to-suits you could potentially announce this year, or how many are even out there?

William C. Trimble

What I would say Michael is it really hasn't changed. As you can imagine, the federal government does move at a glacial pace when it comes to a lot of these opportunities, but I would continue to say that this FDA laboratory program, which was slow during COVID—luckily we got everything we needed to get done before the sort of shut down—I think (inaudible) here. Whether it starts in the fall or in the next winter, I think there's going to be some terrific opportunities there. Those are very expensive buildings and we have a real expertise, especially Mike and Mark, on delivering to the FDA. I think we're going to see some more FEMA projects. I think that's a very popular agency with the current administration. I think you're going to see more opportunities there.

Then from a purchasing standpoint, as you know, we've been really terrific buying some of these brand VA facilities; again, not overnight stays but the new face for the VA, and I think you're seeing a lot of other developers executing on those plans, so I think we're going to see a lot of upside certainly from them as well.

All in all, I think yes, we will see some new opportunities. Look forward to announcing them, but I think we're still waiting to get out of the barn a little bit with the COVID world, but it isn't going to slow down our team. They're traveling around, they're looking at opportunities, and fingers crossed but I think that will continue to be a strong driver of FFO growth for us into the future.

Michael Carroll

Okay, great. Thanks.

Operator

Our next question is from Merrill Ross with Compass Point. Please proceed with your question.

Merrill Ross

Hi, good morning.

I'm wondering if you can—you described that you've already underwritten the assets that are bullseye in the GSA inventory, so the pace of acquisition or the fulsomeness, actionability of your pipeline kind of depends on the sellers being willing to sell. Do you see anything sort of globally that makes people more willing to sell in 2021 or 2022 than you had seen in the previous six years?

William C. Trimble

Good morning, Merrill. That's a great question and I think absolutely is the answer.

I think you've got a number of factors. I think first, as you know, most of our buildings are owned by individuals and I think it's no secret out there that we're going to see some sort of change in the capital gains rate. There might be some 1031 exchange change. There might be a lot of things happening within the Tax Code that will make a lot of these owners make that decision sooner rather than later. I think that's an important factor.

Obviously, we are the only group out there that really can also offer units for tax efficiency to these owners, so there's a big advantage over anybody else in our space. I think that another thing that's happening is a lot of these newer facilities were build sort of 2006/2007; they're rolling, they've just been renewed, and a lot of these owners are in their 60s and 70s and I think they're going to be taking advantage from an estate planning or whatever it might be, or maybe to take advantage of the world restarting to need that equity to put out some fires in their hotels—not literally—or to come up with some new opportunities.

I think everything out there is putting a tailwind to us in this market. I think the—and Meghan will go into it, but I think the attractive cost of capital allows us to make accretive acquisitions. Everybody knows who we are and I think we execute very quickly. I think our relationship with the brokers are very strong. So, I am very gratified to see what we see out there going forward for this year and am very excited to exceed that $200 million as soon as possible.

Merrill Ross

Thank you.

Operator

Our next question is from Frank Lee with BMO. Please proceed with your questions.

Frank Lee

Hi. Good morning everyone. If we annualize the $0.33 you reported in the first quarter and considering that you could exceed your $200 million in acquisitions target, you talk about the pace of activity so far, that gets you to the top end of the guidance range or even above it. Just wondering if there's anything else we should consider that could be a drag on earnings this year, aside from maybe some more ATM issuances? What prevented you from raising guidance this quarter? Thanks.

Meghan G. Baivier

Good morning, Frank.

Obviously, I'm very proud of the strong quarter we put out. I think as we look at the remainder of the year we continue to work on the pipeline and we've never saw from COVID-19, a pandemic before, and so it's just the approach that I took in terms of approaching our Board and getting approvals for the guidance that we project. It's our preference at this time to stay with the current range. We look forward to the opportunity to exceed that and hopefully look to higher levels as the year progresses.

Frank Lee

Okay, great.

Then just want to touch on the leases that expired in 2020. There were three of them from last quarter; it looks like 2 and 3 were renewed on a shorter-term basis. Just curious what happened with the last lease and your (inaudible) to renew the other two on a longer-term basis.

Meghan G. Baivier

Last quarter, those three, one was DEA Vista, one was DEA Birmingham. You'll note that the GSA, if you're sort of nearing the end of a renewal process, they can oftentimes get into what's called a holdover position where they'll just stay in a month-to-month situation while they're waiting to get paperwork signed or through their queues. The both of those are, we believe, in that stage. We don't want to preannounce any renewals before they happen, but that's the status of those two.

The third was a very small deli in our Buffalo asset.

William C. Trimble

Great sandwiches.

Meghan G. Baivier

Almost 1,100 square feet. Yes, unfortunately you won't be able to get one in the future.

Frank Lee

Okay. Then just one last one for me. On your Atlanta FDA development project, it looks like the completion date got pushed back by a quarter and costs were slightly up. Maybe it's just a minor detail but is there any additional color on what drove this?

Meghan G. Baivier

They're in the design phase. They're working out the final set of requirements and drawings and so it pushed a little. It doesn't change the future trajectory.

William C. Trimble

We're always happy to let the government figure out how they can spend more money with us to build a better building. We're patient.

Frank Lee

Okay. Then still no additional clarity on the timing on the lump sum, right?

Meghan G. Baivier

That's correct. It's still our strong desire and we do believe we'll be successful as we were in the past in FDA Lenexa on receiving progress payments from the government, but no finality there yet.

Frank Lee

Okay, great. Thank you.

Operator

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

Darrell Crate

Great. Thank you everyone for joining the Easterly Government Properties First Quarter 2021 Conference Call. We appreciate your time this morning and we look forward to keeping you posted on our developments as we strive to build and enhance our portfolio of pristine assets backed by the full faith and credit of the U.S. government.

Operator

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