Easterly Government Properties
Second Quarter Earnings Conference Call
August 6, 2015

Operator:

Greetings, and welcome to the Easterly Government Properties Second 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 on the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host today, Ms. 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 the forward-looking statements contained in the Private Securities Litigation Act Reform of 1995 and is making this statement for the 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 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, 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. Go ahead, Darrell.

Darrell W. Crate:

Thanks, Evelyn. Good morning, everyone. Welcome and thank you for joining us today for what is our second earnings conference call as a publicly traded company. I'm joined today by Bill Trimble, our CEO; Meghan Baivier, our COO; and Alison Bernard, our CFO.

I'd like to start off by thanking our investors for their confidence in Management and I'm pleased to report that our results and activities are consistent with the expectations that we set at the time of the IPO. We look forward to executing upon our strategy to create value for our shareholders as we continue to grow our Company.

For those of you who are new to the story, I'd like to briefly review our Company and our strategic objective. Bill will then provide more color regarding our current business activities, and Ali will follow with financial highlights for the quarter.

DEA is the only internally-managed public REIT that focuses on the United States Government leased real estate. We own 31 properties, comprising 2.2 million square feet of commercial real estate, and 96% of our leases are backed by the full faith and credit of the United States Government; 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 risk adjusted return opportunity to our investors. We've worked to be partners with the United States Government, we believe this strategy enables us to find ways to facilitate the Government's efficient delivery of its varied missions while also enhancing returns for our investors.

Our portfolio has been developed to provide a stable and secure income stream, our portfolio is 100% leased, and our buildings are early in their useful life with a weighted average age of approximately 11 years. Our most meaningful opportunity to grow earnings and dividends is through new acquisitions and development opportunities. We've honed a definable edge in the sourcing and underwriting of mission-critical federal government buildings.

We're very proud of our team at Easterly. Since our IPO, the team has been able to add two mission-critical assets to the portfolio. We are on track with our annual acquisitions outlook and maintain our goal of delivering strong growth year-over-year, which in turn will support dividend growth into the future.

Now, I will turn the call over to Bill to provide more color on the developments within Easterly that drive shareholder returns.

William C. Trimble:

Thanks, Darrell. I would like to take a few minutes to speak about our pipeline. We are gratified with the two acquisitions we've made thus far and are eager to enhance our portfolio with future acquisitions. We've been hard at work sourcing acquisitions through our deep relationships with owners and developers throughout the country. As Darrell mentioned, we're the only public REIT that solely focuses on this certain type of federally leased asset. As mentioned on our first quarter's call, we are actively tracking over $700 million in properties, and as previously indicated, we believe we will be able to purchase between $75 million and $125 million of buildings that meet our investment criteria on an annual basis. Since our IPO, we've completed approximately $34 million of acquisitions to-date.

Now, turning to our development component of the business, we have an in-house development team that remains active in sourcing development opportunities as they become available. The efforts of our development team are also helpful to our acquisition efforts as the deep relationships these individuals have with other owners have enabled us to enhance our pipeline. Additionally, I'm happy to report that the Government is in a number of discussions with us about upgrades at our existing facilities. These upgrades provide additional return opportunities for our shareholders, enhance the building's functionality, while further increasing the likelihood that the underlying agency will renew upon lease termination. It is a value-creating system for both the Government and our shareholders.

Let me give you more details related to our acquisition activity this quarter. We began the quarter with the closing of the 115,000-square foot Department of Energy's Western Area Power Administration, or WAPA, facility in Lakewood, Colorado. Located across the street from our Department of Transportation facility, we were able to quickly integrate it into our Asset Management system. As we've mentioned, this facility is located in the second largest federal enclave in the United States. More recently, we announced the acquisition of the 47,000-square foot Thad Cochran United States Bankruptcy Courthouse in Aberdeen, Mississippi. This federal courthouse handles the bankruptcy proceedings for the northern district of Mississippi and is part of the fifth circuit. This federal courthouse is leased to the General Services Administration on behalf of the Administrative Office of the Court. There are ten years remaining on the initial 20-year lease. This is the third federal courthouse that we have acquired to-date. As you know, one of our most important underwriting criteria is the mission-critical nature of the tenant agency. The Federal Judiciary resides among the most important and enduring missions of the United States Government.

Both of our new buildings are consistent with the high-quality additions that you should see from us in coming quarters. Easterly targets a specific set of buildings that have important attributes including Class A construction, scale—each are over 40,000 square feet—less than 20 years old, and where they're the result of a build-to-suit competition which makes it extremely difficult for the Government to ever leave. All of these properties are 100% leased to the United States Federal Government and on average renew 93% to 95% of the time. Our team spends their time getting that number to as close to 100% as possible. 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 United States Government.

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

Alison M. Bernard:

Thank you, Bill. I would like to take a few minutes to touch upon our current portfolio.

With the addition of our Thad Cochran U.S. Bankruptcy Courthouse in Aberdeen, Mississippi, we have 31 properties which account for over 2.2 million square feet of commercial real estate. The weighted average lease term for the portfolio is 7.6 years and our portfolio occupancy remains at 100%. As Darrell mentioned, 96% of our lease income is backed by the full faith and credit of the United States Government.

As you saw on our release earlier this week, our board of dividends—our Board of Directors declared a dividend of $0.21 per share, which represents the dividend related to our second quarter of operations. The dividend will be paid on September 3 to shareholders of record on August 18. We have included a supplement to our earnings release to provide additional information regarding our earnings 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 any one-time charges and accounting anomalies related to the changes and financial statement presentation as we transition from an SEC-registered investment adviser to a public REIT.

As you can see in both the release and the supplemental information that we furnished this morning, our pro forma second quarter FFO per share on a fully diluted basis was $0.26; and our cash available for distribution was $0.22 per share on a fully diluted basis. GAAP measures and reconciliations to GAAP measures were provided in our supplement.

We would like to clarify our guidance on a pro forma basis for the 12 months ended—ending December 31, 2015. We believe our portfolio—our existing portfolio will generate FFO, which includes non-cash charges in the range of $1.01 to $1.05 per share on a fully diluted basis. As compared to last quarter, this guidance includes the previously discussed $0.04 of non-cash charges related to grants under our long-term incentive plan. I would like to remind you that our long-term incentive plan is meaningfully aligned with shareholders and requires us to achieve both an 8% compound growth in total shareholder return, and a return that is at least 95% of the RMZ over the performance period, before management earns a dollar of incentive pay.

With respect to our guidance, we expect that G&A will remain at an annual cash run rate of $7 million. In addition, our guidance does not contemplate additional acquisitions or development.

As Bill stated, for our first year as a public company we are on track to put between $75 million and $125 million to work, but cannot provide timing or assurances of these purchases as the acquisition process is fluid and difficult to predict. Year-to-date, we acquired two properties for an aggregate purchase price of $34.3 million.

Lastly, I would like to discuss our liabilities and capital resources. We have a committed unsecured line of credit of $400 million which has an additional $250 million accordion feature. We currently have only $33.4 million outstanding on this line.

A unique opportunity for earnings accretion is our ability to buy buildings with 100% debt proceeds. Our current leverage is 14% as compared to our investment grade peers with leverage levels ranging from 40% to 55% of debt to total enterprise value.

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. At this time we will conduct 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 key. Once again, that’s star, one to ask a question at this time. One moment please while we poll for questions.

Our first question comes from Bill Crow with Raymond James. Please proceed with your question.

Andrew Banish Banners:

Yes, hi, this is Andrew Banish Banners (phon) calling in for Bill. Thank you, good morning.

William C. Trimble:

Good morning, Andrew Banish.

Andrew Banish Banners:

First of all, just Bill or Darrell, can you talk a little bit about your expectations for the impact from the development pipeline next year?

William C. Trimble:

Sure, absolutely. We're really pleased with the efforts of our in-house team, and we're pursuing the opportunities that are presented by the target agencies obviously that we deal with. These projects, I'm—not surprisingly come in a lumpy nature with the Federal Government and any wins in these areas would obviously have a material impact on our earnings and we remain incredibly engaged in sourcing and are loyal to—however are also loyal to our financial discipline. We're confident given the years of experience of our Western Devcon team, now integrated into Easterly, that we'll see a number of opportunities but it makes very difficult for us to give you a specific point in time when we think it'll be—when we'll be putting the first shovel in the ground.

Darrell W. Crate:

I would just add to that in that as we look at our acquisition pipeline and we continue to feel that that develops in a robust way, from a delivering earnings to shareholders perspective, when we look at development and acquisition you're not going to see us disappoint on earnings accretion because of the lumpiness of development or the lumpiness of acquisition. Fundamentally, we look at that as a whole but as Bill said, we've got a fantastic team searching every opportunity and I think we've got a nice edge in finding some transactions that shareholders will be pleased with over time.

Andrew Banish Banners:

Great. Thank you. My second question is, if I look at some of the recent GSA leasing taking place out in the market right now, you've got the Secret Service signing in LA, National Institutes of Health in Maryland, United States Attorney's Office in Denver, and Social Security Administration in Texas, among others, those aren't really agencies that you guys have a tremendous exposure to. Can you talk a little bit about how you see the prioritization of those agencies? Are you actively engaged with them? Do you look on sort of expanding your relationships with those agencies? Or are you sort of more confined or…

Evelyn Infurna:

Operator?

William C. Trimble:

Operator, are we still on?

Operator:

Yes, we're still on. Mr. Crow, your line is open.

Andrew Banish Banners:

Yes, I guess my second question is just on a couple of the GSA leases that I'm seeing recently in the market right now, you had Secret Service in LA, National Institutes of Health in Bethesda, United States Attorney's Office in Denver, Social Security Administration in Texas, among some others. I was just curious how you guys see the prioritization of those agencies. Are you actively engaged with them? Do you anticipate kind of bolstering relationships with them going forward?

William C. Trimble:

Well, first of all, thanks for the question. I think it's important to mention that the first criteria of our underwriting at Easterly is the importance of the mission of the underlying agency. After we get through that—and there's about 15 or 20 agencies that are at the top of our list there—we then look at the importance of the mission, the hierarchy of mission of the particular building within that agency. Once we do that, then we'll obviously go into our full and complete underwriting from a real estate standpoint. From the groups that you mentioned, we have looked at Secret Service buildings in the past, we're very familiar. Obviously Secret Service, an incredibly important agency, that basically handles not only the protection for our high Government officials but also handles counterfeit around the world of the United States currency, is a much smaller agency than a Federal Bureau of Investigation, so you will see us seeing more opportunities within the Justice Department or at Homeland Security with an FBI than we probably would see with a Social Security. We are actively engaged, however, in a large number of agencies and those are on our radar screen and we would be interested if the opportunity arose for the right building within one of those agencies, yes.

Andrew Banish Banners:

Good, thanks so much.

Operator:

Once again, ladies and gentlemen, to ask a question, that's star, one on your telephone keypad. Once again, that's star, one. One moment while we poll for more questions.

We have a question from Michael Carroll with RBC Markets. Please proceed with your question.

Michael Carroll:

Thanks. Can you guys give us some color on the actual size of your investment pipeline and what's the break-out between acquisitions and potential build-to-suit projects?

William C. Trimble:

Good morning, Michael. Thanks for calling in. From a standpoint of a pipeline as we mentioned from the beginning, we have about $700 million worth of buildings that we are actively underwriting at this time, about $200 million of that we are very engaged in. So that has not changed, it might have actually grown a little bit in the last quarter. From a standpoint of the development side, the Government basically announces the build-to-suit projects to everyone. As soon as they come up, our development team immediately goes and starts looking at the opportunities and whether they'd be of interest. There is not the lead time that you would see from the acquisition pipeline from the development side but we are confident that we've had a backlog for a number of years since the turn-down that there are a number of buildings that will be needed to be built from a build-to-suit standpoint, certainly in the coming quarters and years and we stand ready to be part of that process.

Michael Carroll:

So your pipeline's all acquisition opportunities right now?

William C. Trimble:

I would say that there are both but the super majority would be from the acquisition side.

Michael Carroll:

Okay. Then I know that you were saying that there's a lot of delay or it's hard to really predict when you would break ground on a development project, but could you expect to break ground sometime in the second half of this year or is it going to be pushed down until 2016?

William C. Trimble:

I think that 2016 would be a safer period of time to look at.

Michael Carroll:

Okay, and then what's your (inaudible) expectations, have those changed since we talked last?

William C. Trimble:

No. Ali?

Alison M. Bernard:

They have not, Michael. They're still in the 6.75% to 7.25% range.

Michael Carroll:

Okay, great, thank you.

Operator:

Once again, ladies and gentlemen, that's star, one to ask a question at this time; star, one to ask a question.

There are no further questions in queue at this time. I would like to turn the call back over to Mr. Crate for closing comments.

Darrell W. Crate:

Thank you very much for joining us for our second conference call as a public company. We look forward to continuing to deliver strong results to you and look forward to getting together with you by phone in November.

Operator:

Thank you. This does conclude today's teleconference. You may disconnect your lines at this time and have a great day.