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Easterly Government Properties

Second Quarter 2022 Earnings Conference Call

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CORPORATE PARTICIPANTS

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Darrell Crate, *Chairman*

Bill Trimble, *Chief Executive Officer*

Meghan Baivier, *Chief Financial Officer and Chief Operating Officer*

CONFERENCE CALL PARTICIPANTS

Michael Griffin, *Citi*

Michael Carroll, *RBC Capital Markets*

John Kim, *BMO Capital Markets*

Peter Abramowitz, *Jefferies*

Michael Lewis, *Truist*

Bill Crow, *Raymond James*

PRESENTATION

Operator

Greetings. Welcome to Easterly Government Properties' Second Quarter 2022 Earnings Conference Call.

As a reminder, this conference is being recorded.

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

Lindsay 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 Reform Act of 1995 and is making the 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 in its Annual Report on Form 10-K for the year ended December 31, 2021, which was filed with the SEC on February 28, 2022, and its Quarterly Report on Form 10-Q for the quarter ended June 30, 2022, to be filed with the SEC on August 2, 2022, 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 Crate

Good morning, everyone, and thank you for joining us for this second 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 had another strong quarter at Easterly Government Properties. We continue to add high quality, mission critical assets to grow and diversify our portfolio. Like others, we are seeing a shift in the market. It seems we are entering a period of price discovery for our assets. We're optimistic about the effect this market dynamic will have on our business, particularly in the medium and long term.

We're seeing marginal buyers exit the market, and we believe that there are developers in our space that have bid on projects with the expectation that cap rates would continue to decline. They may find themselves overextended as these projects approach completion. We expect both of these dynamics will have a positive effect on our ability to gain bullseye assets over the next 24 months.

Further, during times of uncertainty, we believe our strategy delivers predictable results to investors. We concentrate on mission critical assets that serve enduring missions. During challenging times, our assets become more relevant and valuable. The gun-toters can't work from home, critical response functions can't be executed from home offices, and if a recession is near, the crime business will be up. These agencies that we serve will be called to action. Our facilities will be serving their occupants effectively.

While the asset side of our balance sheet is well curated, our liability structure also provides investors with confidence. Meghan has done a great job terming out our debt. Additionally, we have limited rollovers in the next several years.

We do hear questions about the effects of inflation on the value of our assets. As many of you know, our leases have provisions that protect our investors from accelerating operating costs. Inflation also improves the value creation related to renewal activity. Meghan will further describe some of the positive effects that inflation has in our portfolio.

We're pleased with how the Company is positioned as we look forward, and we'll continue to execute our business strategy with the intent to deliver safety and stability to our investors. The goal is to deliver an attractive risk adjusted return to our shareholders that is backed by tenants that represent the full faith and credit of the United States Government.

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

Bill Trimble

Thanks, Darrell.

Good morning. Thank you for joining us for our second quarter earnings call.

Starting with acquisitions during the second quarter, Easterly through our joint venture acquired the fifth and sixth brand new VA facilities located in Birmingham, Alabama, and Marietta, Georgia. They are part of our previously announced 10-building portfolio. Subsequent to quarter end, we were pleased to add the seventh facility to the portfolio, VA Columbus, a brand-new VA facility located in Columbus, Georgia. Currently, the remainder of the assets in the VA portfolio continue to deliver as planned, and we expect the JV to close on approximately $145 million of this portfolio throughout 2022.

In addition to the VA properties, Easterly had two wholly owned acquisitions during the second quarter. The first was the National Archives and Records Administration warehouse in Broomfield, Colorado. NARA Broomfield is a build-to-suit warehouse constructed in 2012, and is 100% leased to the General Services Administration on behalf of NARA, pursuant to a 20-year lease, which does not expire until May of 2032. NARA Broomfield is one of 18 facilities strategically located throughout the country that holds permanent and temporary records created by federal agencies and courts across seven states.

To ensure the preservation of these important documents, the facility was specifically constructed to the exact needs of the National Archives, providing for optimal environmental controls and to maintain certain set points for both temperature and humidity. Aside from its important building attributes, it is also worth noting that our acquisitions team funded part of this acquisition through the issuance of operating partnership units at an accretive price of approximately $21 per unit, once again demonstrating the strength of an UPREIT structure.

Our second wholly owned acquisition in the quarter was an FBI field office located in Tampa, Florida. Remaining true to our original pieces of owning Class A mission critical facilities, FBI Tampa defined this investment criteria with an in-place lease that does not expire until November of 2040. This 138,000 square foot trophy asset is enhanced by a number of important security features, including but not limited to perimeter fencing, controlled access, blast protection, security setbacks, vehicle barriers, magnetometers, and SCIF space.

With this acquisition, Easterly now owns 13, or just under a quarter, of the 56 FBI field offices located throughout the country. We continue to monitor the acquisition pipeline, as we believe we are now seeing cap rates backing up from the bottom as the markets' cost of capital has shifted. We continue to see potential CAD accretive NAV enhancing transactions, and we'll remain focused on only the best opportunities within our niche market.

As discussed last quarter, private equity understands the unique nature of the GSA lease structure that protects us as landlords from inflation-induced operating cost increases and have gotten more active in the space. We believe this heightened interest drives value in the Easterly portfolio and introduces the potential to recycle capital in the back half of 2022.

Turning to leasing updates, our asset management team continues to secure renewals that lengthen the duration of our government backed cash flows and enhance the portfolio's NAV. In the second quarter, we renewed the ICE facility located in Louisville, Kentucky, for a new 15-year non-cancelable lease term. This renewal, coupled with the FBI Birmingham and EPA Kansas City executions from the first quarter, represent three successful re-leasing exercises in the first half of 2022.

The remaining renewals for 2022 include the DEA laboratory in Dallas, and the FBI field office in Little Rock, both of which we are considering strong bullseye assets in the Easterly portfolio. As of quarter end, negotiations on both leases are well underway and we look forward to providing updates in future quarters.

Finally, our FDA laboratory is now in the final stages of design drawings, which should lead to a restart in the near term. We estimate this facility will be delivered in the second quarter of 2025.

In closing, we had a strong first half of the year and expect the trajectory to continue in the second half of 2022. The Easterly team will continue to execute on its discipline strategy of acquiring the most important assets leased to the Federal Government. We will work with the GSA and underlying tenant agencies on upcoming renewals and look to non-speculative development opportunities that can provide attractive returns.

With that, I thank you for your time this morning. I'll turn the call over to Meghan to discuss the quarterly financial results and capital markets executions.

Meghan Baivier

Thank you, Bill.

Good morning, everyone. It was another strong quarter for Easterly and we are pleased to share our results and how we view the Company's positioning in the current market environment.

As of June 30, we owned 93 operating properties comprising approximately 9 million leased square feet, either wholly owned, or through our joint venture, with one additional development project in design, totaling approximately 162,000 square feet. Through the acquisition of newer facilities, the weighted average age of our portfolio remains young at 13.9 years. Successful long-term renewal of existing properties have also allowed us to sustain a lengthy weighted average remaining lease term of 9.9 years.

As previously mentioned, maintaining a young portfolio age and a long weighted average remaining lease term is reflective of our strategy of owning relatively new build-to-suit assets within enduring mission. We believe 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 accretive acquisition and development project pipeline.

Turning to our second quarter results, all on a fully diluted basis, net income per share was $0.08, FFO per share was $0.33, and FFO adjusted per share was $0.33. Our cash available for distribution was $29.5 million.

Turning to the balance sheet, at quarter end, the Company had total indebtedness of approximately $1.3 billion, with approximately $307 million available on our line of credit for future acquisitions and development related expenses. As of June 30, Easterly's net debt to total enterprise value was 40.5% and our adjusted net debt to annualized quarterly pro forma EBITDA ratio was 7.2 times. With a weighted average debt maturity of six years and over 88% of all outstanding debt fixed at attractive levels, I am pleased with our Company's positioning as we navigate a rising rate environment.

With a focus on leverage, I would like to touch on how we view our balance sheet positioning as we enter the second half of 2022. As Bill noted, we believe now's a good time to actively look at recycling capital. There is strong embedded value in the portfolio that we believe is being recognized by private players in our market. We ended the quarter with leverage of 7.2 times, a level that was a deliberate decision by the Company, as we have approximately $92.5 million in proceeds of unsettled foreign equity available to us. Consistent with standard practice, we will inform the market if and when deals are completed.

We like how the balance sheet is positioned and we are watching the market evolve. We believe Easterly is armed with the right set of tools to navigate the second half of the year and beyond. This quarter, our Board approved an inaugural stock repurchase plan of up to 5%, or approximately 4.5 million shares of the Company's outstanding shares.

The stock repurchase plan, the previously mentioned unsettled forward equity, and our strong banking relationships will ensure we remain aligned with our consistent commitment to allocating capital in a way that drives the greatest value for shareholders. The Company and its shareholders view Easterly as a Steady Eddy REIT, and we intend to continue being the consistent and dependable segment of the real estate sector we have always been.

Finally, as Darryl and Bill mentioned, an inflationary environment serves as a real strategic benefit for Easterly, compared to other REITs. Due to the build-to-suit nature of our assets, the cost of constructing another facility, upon lease expiration, is increasingly less desirable for the government, and our existing asset is further distinguished as the natural cost-effective renewal option for the GSA and the underlying tenant agency.

Further, the unique nature of our leases allows for NOI protection. While shell rent in most of our leases is flat, GSA leases generally contain an operating expense base which grows uncapped with increases in urban CPI, thus protecting us against NOI degradation in an inflationary environment. To be clear, the relevant urban CPI index as of June 30 2022 was 9.8% higher than one year ago.

Turning to our earnings guidance, the Company's maintaining its FFO guidance per share in a fully diluted basis in a range of $1.34 to $1.36. This guidance is predicated upon $200 million to $250 million of wholly owned acquisitions, the closing of properties in the VA portfolio totaling approximately $145 million at the Company's pro rata share, and up to $10 million in gross development related investment during 2022. At its midpoint, Easterly remains on track to continue our record of steady FFO growth year over year.

With that, we thank you for your commitment to our thesis and appreciate your partnership. I will now turn the call back to Doug.

Operator

Thank you. Ladies and gentlemen, at this time, we will be conducting a question-and-answer session.

Our first question comes from the line of Michael Griffin with Citi. Please proceed with your question.

Michael Griffin

Hi. Thanks.

Darrell and Bill, you talked a little bit in your prepared remarks about cap rates and how you're seeing them maybe expand a little bit. Could you expand on that a bit? Have you seen any assets trades, quantifying where you're seeing cap rates, and maybe where you expect it to trend in the near term?

Bill Trimble

Well, I think we've certainly seen 25 basis points of movement. I think, Michael, the thing is it's sort of an uncertain time. Things are moving right now. We did see the FBI Baltimore transaction fall apart earlier this year, so I think what we really are trying to do is figure out when we get, I think, a real balance and can figure out what the actual pricing should be.

I think, as Darrell mentioned, we see a lot of opportunities out there. Our acquisitions team is doing all of their work; but I think until things settle down, I think we want to make sure that we are not the elephant in the swimming pool making a lot of splashing out there. I think the bid ask is probably a bigger range than we've seen in a very long time.

Michael Griffin

Great. That's helpful. Just maybe a quick question on office utilization. I know you mentioned that it's maybe not affecting you as much relative to other traditional office peers, but I feel that every other—you may see some headlines around the Federal Government trying to bring people back in the office, and this might be starting—going in fits and starts. So, kind of curious. Can you maybe quantify the percentage of your portfolio that might kind of be impacted in sort of that delayed return to the office area?

Bill Trimble

Well, I think the great news is our folks have always been working throughout the pandemic, so not really a factor for us. I will say about 85% of our buildings are those build-to-suit facilities that have very heavy usage like the FBIs that Darrell alluded to, the DEA laboratories that have really necessitated the folks being there the whole time.

As you know, more of our plain vanilla missions are about 15% of the overall portfolio, and they are occupied as well. I think though that as you heard President Biden mentioned in the State of the Union address last winter that the efficiency of the Federal Government may be compromised by working from home and that there's been a huge backlog over the last years of COVID and that the Government does do a better job in their office space, which I think is probably not a great surprise to all of us.

We are not particularly impacted. Luckily, those buildings that we say are more plain vanilla in our portfolio—the vast majority have been renewed for substantial 15-year terms just in the last several years.

We're pretty happy to be where we are right now, and those build-to-suit facilities are humming along all the time as they have been throughout the entire pandemic.

Michael Griffin

Okay. That's it for me. Thanks for the time.

Bill Trimble

Thank you.

Operator

Our next question comes from the line of Michael Carroll with RBC Capital Markets. Please proceed with your question.

Michael Carroll

Yes. Thanks.

Bill, with your comment that cap rates are kind of up about 25 basis points and you're still trying to figure out the right valuations are, should we expect that investment activity for DEA is going to slow, at least in the third quarter. Is that fair? Will it pick back up in the fourth quarter to hit your guidance?

Bill Trimble

Well, I think that the question is when things—we don't know yet. I mean, I don't know if we aren't going to see something in a couple of weeks. I don't see if we're going to see something in a month. I do see a lot of activity out there, and it's going to be these sellers realizing that now is a better time to sell than probably later. I think you can rest assured that we're going to be very careful and not do anything that isn't at least FFO neutral or positive or CAD accretive. From that standpoint, we are going to maintain our course.

There are plenty of opportunities out there, but I think we really do need to see some sort of certainty in clarifying of the market before we're going to jump in wholesale. So, more to come.

Michael Carroll

Okay. Is there, I guess, risk to the investment guidance? I think you have about another $110 million to (audio interference) that? Is that something that you're willing to (inaudible) into 2023 if the market valuations don't settle out by then?

Bill Trimble

Well, I can't comment now what's going to happen next year, except for the fact that I think we're seeing plenty of opportunities, and so far it's steady as you go from our standpoint. There's a lot of uncertain factors out there, and I think that we're probably the most certain of the—probably of the REITs that you're following right now into what we're seeing.

Darrell Crate

Yes, this is Darrell.

Something I'd add is this is really where market position favors the folks who sort of occupy a dominant position, and that's us. You do have these developers who—I mean, they all have Excel spreadsheets. Folks are beginning to look at interest rates, understand where the water gets kind of above their head, and where we've had more calls with folks offering us an opportunity or a partnership to be involved in their projects. As we've seen in the past, that ultimately translates into people needing help in ways that can be very accretive to our shareholders. None of that's going to abate soon, so I think we really could see some activity, as again, our acquisitions, you can't predict by week or month. They are few in numbers, so they're lumpy.

But that said, the conversations that are happening are productive, and I think we're—as I said, we're very confident in the medium to long term about the change in these dynamics and what it means for shareholders.

Michael Carroll

Okay. Great. Can I come back to the transaction market. I know Bill and Meghan both mentioned that you're looking to potentially recycle capital now. What type of assets are you looking to sell, and what are the valuations on those specific properties? I'm assuming that you've already (audio interference) having discussions on those given that (audio interference) implied that something could happen in the back half of the year.

Bill Trimble

Well, I think in the market environment we're in, and we've mentioned before, that's another tool in our toolbox, and that's something that we could do. I think that it would not be surprising to folks that as we acquire wonderful portfolios and buildings over the years, there are buildings in those portfolios that are not essential to our bullseye or mission as others. That would be terrific properties for other owners in the government space, but maybe not adhering to all the disciplined points that we have.

I think that's just a natural opportunity for us, and we would avail ourselves of it if the correct pricing and market conditions warrant it. Without saying anything, I think that would be on our radar screen, and we'll be sure to talk about it when there would be any certainty to that.

Obviously, those properties would probably not be, if we were looking to sell something in the FBI zone, but maybe something—and Michael, you know us very well, probably the buildings that are more plain vanilla or would have missions, or geographically challenged for us as a REIT.

Michael Carroll

Okay. Great. Then just last one for me. Could we get an update on the FDA Atlanta? I guess, Bill, as you know that's been kind of in the design phase for a little while now. Is there expectation that that can kind of break ground soon.

Bill Trimble

Yes. I'll start and then give it to Meghan.

Yes, the answer is finally. I think the wonderful thing, as folks on this call I think should be reminded, we do nonspeculative development. So, that's certainly very important in general, and particularly important right now.

This project was off and running as our third FDA laboratory just before COVID broke out. The government basically had a lot of things on their mind and a lot of people working from home, and I think got sidetracked a little bit, which obviously wasn't terrific for anyone. But now we are, thanks to our team, Mark Bauer and Mike Ibe, have worked very hard on getting this back on track with the Federal Government, and so I think we'll be in future quarters talking about the renewal of people on site and building this amazing laboratory for the FDA.

Yes, I think we're finally there. It's been a lot of work. It certainly hasn't been from our side, the issues, but I think the government now realizes that they better get going. So, we're confident. This is the first time I've said that in a little while that this will be underway in the near future.

Michael Carroll

Thank you.

Operator

Our next question comes from the line of John Kim with BMO Capital Markets. Please proceed with your question.

John Kim

Thank you.

You had mentioned price discovery and cap rate expansion back in your last call at June Nareit. Since that time, comparing it to the June, but the 10-Year has come down 70 basis points. I was wondering if your appetite is more tied to 10-Year than typical office assets, or is it purely based on funding costs?

Meghan Baivier

(Multiple speakers). John, good morning, it's Meghan.

Obviously, there is definitely a correlation to 10-Year. I think we also see a little more tying in the private market participants to something more in the 5% to 7% range in terms of how they think about their financing today. So, absolutely, everybody in our market is looking to those base rates spreads as well as we settle in here to where cap rates are starting to normalize.

Darrell Crate

And again, it's not a precise science. But as we've looked over time and we think about a 100 basis point movement in the 10-Year. As we correlated cap rate to over time, think of that as being sort of 14 basis points to 17 basis points in cap rate. I mean, that's in the classroom, and the real world is different, but if your brand regressions and other things, that's the kind of the level of correlation that you can imagine.

John Kim

Okay. Given the price discovery and increased acquisition opportunities that you're seeing or foreshadowing, are you less inclined to buy back shares on your share repurchase program than when you first instituted it?

Darrell Crate

The answer is no. I think it's a tool that's in our toolbox, and as we talk about potential dispositions and we look at the environment that we're going to move into, we're going to have every corporate finance tool available to maximize return for our shareholders.

John Kim

Just to clarify on capital recycling, are these purely going to be third-party sales? Or is there an opportunity to sell assets into your joint venture?

Meghan Baivier

Yes. Currently, we'd be considering third-party sales. Obviously, we do have a joint venture partner who is very eager to continue to deploy capital into this space, and we're always looking for opportunities to continue that relationship as well, but outside of the scope of this potential capital recycling.

John Kim

As you identified these opportunities, do you any components of your bullseye target change and that's the reason for the sales at this time?

Bill Trimble

No, I think that's one thing that we're trying to adhere to, and I would say absolutely no changes in that area. I think that one thing that—just to sort of reiterate, and Darrell mentioned this, is the competitive environment for buying these properties. There are a couple of folks out there that we have happily sparred with for the last 10 or 12 years that are knowledgeable, there were a whole lot of new players we saw in the last 12 to 18 months that simply cannot get financed in this market.

I think from the standpoint of our acquisitions going forward, we are very pleased that a number of these players have dropped out on the fringes, and I think it just bodes for a terrific opportunity, as Darrell mentioned. So, from our standpoint, we're pretty excited about the prospects for being able to manage this market much more effectively than we've been able to for the last 18 months.

John Kim

That’s very helpful. Thank you.

Operator

Our next question comes from the line of Peter Abramowitz with Jefferies. Please proceed with your question.

Peter Abramowitz

Yes. Thank you.

I just wanted to ask, within the acquisition markets, are there any portfolio deals that are out there that you've been looking at? And even if one that you're not considering is—have you observed kind of a difference in pricing between those and kind of one-off single assets?

Darrell Crate

Well, I think that we've always said there are a number of larger portfolios out there. This is not probably the time you're seeing a lot of that occurring, but I think that people do value portfolios more, in that it's difficult to put some great buildings together right now, obviously.

Always, I think there's a premium on the portfolio acquisitions, we've enjoyed several of them, as you noted, and of course, our JV opportunity that we're still purchasing now. But I think there is a premium to portfolios for sure.

Peter Abramowitz

Okay. Then on the development side, I know it's a fair amount of leg work here with FDA Atlanta, as you mentioned earlier. Just wondering if you could go into a little bit more detail on kind of the broader opportunity set kind of what we could expect potentially over the next year.

Bill Trimble

Well, I think I'll let Meghan step in as well.

I think this is going to be a really exciting year. You've got a couple of things going on. As Darrell mentioned, some of the smaller regional developers in this space are having troubles getting financing, the government has been slow, and so initial indications of what they need in a new development project can change. These smaller developers cannot figure out what pricing is going to be for the next one, two, three, or whenever the—you've seen it in Atlanta, imagine if you were a small developer out on the line with a construction loan, trying to get that building done.

I think that the government understands that pricing is only going up, inflation is not their friend, and so they're going to want to move quicker on some of these development projects in the next several years. I think there's going to be more room, certainly, for the more successful developers that we know, including ourselves for opportunities. We're certainly going to avail ourselves of that.

Just like I mentioned in the space of acquisitions, I think this is a good spot for the larger, more seasoned and well-capitalized folks within this business to see some great opportunities. A lot of those smaller developers, I think, are going to be selling to some of these larger players like us. We will be standing by with a life ring and ready to help out. We've done this in the past, as you recall, the FEMA Tracy was a wonderful, wonderful opportunity that our development team took on from another developer.

From that standpoint, I'm pretty excited about what we might see in the next several years.

Peter Abramowitz

Got it. That’s all for me. Thank you.

Operator

Our next question comes from the line of Michael Lewis with Truist. Please proceed with your question.

Michael Lewis

Great. Thank you.

Your cash flow growth the last handful of quarters has been quite strong. It looks like a lot of that is due to capital expenditures going down on a year-over-year basis. I might have expected the opposite, given inflationary pressures and growth in the portfolio. Could you just talk a little bit about what's happening on the Capex front and on your cash flow growth?

Meghan Baivier

Hi, Mike. Good morning.

Absolutely. The dynamic you're seeing over the last couple of quarters in terms of FFO conversion down to FFO adjusted and CAD is coming from a couple of places. One, obviously, as we've worked through some renewals over the course of last year, our free rent burden has lifted a bit in the first half of the year. That's to the tune of about $2 million.

We've talked about this for years, but the effect of the amortization of above- and below-market leases continues to be that burn off, as well a headwind, to FFO growth. Obviously, creates more conversion to cash. That's contributing about another $1 million when you think about sort of the six-month year-to-date year-over-year comparison.

From a Capex perspective, that's always one where we really look to think about over a more medium-term arc and trying to live in that $1.00 to $1.50 per foot. We will, obviously, oftentimes wait for renewals to occur to ensure that we are fully up to speed on some of our maintenance capital items, so that could ebb and flow; but over the longer term, medium to longer term, you are going to still see that $1 to $1.50 per foot range.

Michael Lewis

Okay. Do you expect cash flow growth to be better than FFO growth as far as we could see, or is it tough to determine that at this point?

Meghan Baivier

Yes. When I look out over the next two years to five years, that dynamic on the above-below burning off, as well as the effect of continuing to buy younger assets, which require less in terms of maintenance capital, yes, that's an expectation I have for the portfolio.

Michael Lewis

Okay. Great. Just last for me, a clarification on how the expense reimbursements work. I think you, Meghan, said something about the CPI. I understand CPI escalators when they're applied to rent. But for expenses, don't you just get expense reimbursement based on what the actual expenses are over the pace here? I'm not sure what the CPI has to do with that. Maybe I heard wrong, or I misunderstood.

Meghan Baivier

No, I appreciate the question. Let's set the record straight on that. Inherent to our rent is an agreed upon Opex base. And so every year, starting from the first year, that base, let's call it $8 a foot, accretes or grows on a compounded basis annually with urban CPI, so at the end of the lease year, the year-over-year index comparison is made, and that increase is added to the Opex space for the ensuing year. So no, it's not actually tied to actual operating expenses, but I will say that we are well matched in terms of our current base in accumulated reimbursement above that base to our actual operating expenses.

We do have that nice sort of insulation from NOI degradation by virtue of being well matched.

Michael Lewis

Okay. I understand. I guess it's possible how property say their taxes, or their utilities don't go up as much as the CPI. It still would be CPI applied to that base here. So, to your point, you're kind of protected from an overall inflation standpoint.

Meghan Baivier

Yes, that's right. It's a broad CPI index and has proven, certainly to date, to be providing the protection that we would expect it to.

Michael Lewis

Okay. I got it. Thanks a lot.

Operator

Our next question comes from the line of Bill Crow with Raymond James. Please proceed with your question.

Bill Crow

Great. Good morning.

Question for you. Based on your comments on competitors kind of pulling back in the marketplace and price discovery, just given your dominance in the space, I'm wondering if it doesn't make sense for you to pull back further and for longer, and maybe help push rate yields on acquisitions up even further.

Bill Trimble

Well, Bill, I think that we are definitely not going to be the last group standing to validate expensive prices. So, you can figure that we have the foot on the brake and the accelerator. We are not going to keep marking the market all the way as the cap rates increase, so we're going to be very careful there. We agree that there is absolutely no reason to shoot ourselves in the foot by playing ridiculous prices in the market. So, you're dead on.

As to the timing, when the turnaround occurs, there's a whole lot of reasons as you might be heading into a recession that opportunities can move quicker than we even see. So, rest assured, and we have got to use the term correctly, we are not on the sidelines, not watching the game; we are eagerly watching, and not running in until we see the right plays being called.

Bill Crow

Great. Can you remind me when the forward equity sale has to be complete?

Meghan Baivier

We have 12 months from the end of the quarter to settle our forward equity.

Bill Crow

Great. Great. This is not really a comment on Easterly, but it's amazing how the last couple of decades, in times like this where stocks are going down, it helps management to identify noncore assets. I'm just curious whether you had thought about capital recycling last year or the year before as a viable source of financing instead of just hitting the equity markets?

Bill Trimble

I think we've always thought of it. Boy, don't we wish we all thought of this on maybe December 15 or something, or executed on December 15. But I think that we balance a lot of different things, and there's new knowledge coming in all the time. I think that you're correct, that during these period's turndowns it's a wonderful opportunity to really go through and figure out what's core and noncore to our particular business, and that's what we're doing right now.

Bill Crow

Okay. That's all for me. Thank you.

Bill Trimble

Thank you.

Operator

There are no further questions in the queue. I'd like to hand the call back over to Darrell Crate for closing remarks.

Darrell Crate

Thanks.

Thank you, everyone, and thanks for joining the Easterly Government Properties Second Quarter 2022 Conference Call. We appreciate your time this morning, and we look forward to keeping you appraised of future developments as they occur.

Operator

Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation.