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Easterly Government Properties, Inc.

First Quarter 2016 Earnings Conference Call

May 9, 2016

C O R P O R A T E   P A R T I C I P A N T S

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

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

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

C O N F E R E N C E   C A L L   P A R T I C I P A N T S

Emmanuel Korchman, *Citigroup*

Michael Carroll, *RBC Capital Markets*

Bill Crow, *Raymond James Financial, Inc.*

P R E S E N T A T I O N

Operator:

Greetings and welcome to the Easterly Government Properties First Quarter 2016 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 would now like to turn the conference over to Meghan Baivier, Chief Financial and Operating Officer. Thank you; please go ahead.

Meghan Baivier:

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 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, 2015, filed with the SEC on March 2, 2016, 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 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, Meghan. Good morning, everyone. Welcome and thank you for joining us for our first quarter conference call. Today, I'm joined by Bill Trimble, our CEO; and Meghan Baivier, our CFO and COO.

DA (phon) remains the only internally-managed public REIT focused on United States government-leased real estate. Our portfolio is young, generally a generation younger than other REITs, and our leases are backed by the full faith and credit of the United States government, which provides a foundation for strong recurring cash flow. Our acquisition strategy is executing above the expectations that we set during the IPO.

Turning to the quarter, we were pleased with the first quarter acquisition of ICE Albuquerque. Our Team is strong and we have the resources to execute. Our Internal Management Team has a meaningful expertise in originating, underwriting, and servicing our target assets. We believe our balance sheet supports our earnings growth strategy with low leverage and limited exposure to interest rate fluctuation, with our assets and liabilities generally matched in terms of duration.

We're focused on containing costs with our general and administrative expenses and they are well-positioned to grow more slowly than our NOI after financing costs.

Lastly, our incentive structures are designed to meaningfully align us with Shareholders with emphasis on longer-term incentive compensation tied in large part to our performance and Shareholder appreciation.

We're very proud of our Team at Easterly. We look forward to delivering between $75 million and $125 million in acquisitions in 2016 and are already well on our way following our first acquisition of the year. We continue to execute upon our goal of delivering strong earnings growth year-over-year.

Lastly, I would like to post you on other good news. In addition to our Annual Meeting this week, we will welcome over 60 institutional limited partners to our list of public Shareholders as we extinguish the private equity funds in which we're established. These Investors are stable, long-term Shareholders from some of the largest pensions and endowment. Some have been invested in this portfolio since 2010 under the exact investment discipline we are executing each day. They understand that our dividend yield and growth opportunities are very attractive, particularly on a risk-adjusted basis.

When they originally invested with us, the Investor expectation was for no opportunity for liquidity until the year 2020. While we've gone public, little about their investment thesis has changed. The transformation into a REIT last February preserved to their cash flow stream while also delivering them double the property diversification and access to additional attractive capital, as well as lower Management fees. They are happy, stable Shareholders.

Today, the Company has a market capitalization of approximately $750 million, and float of approximately $255 million. This float can be expected to increase by at least $200 million. We believe this event and our growth will continue to reduce the cost of entry and exit into our common equity and further enable us to broaden our Shareholder base. With our objectives of consistent dividend growth and long-term compound FFO as adjusted growth of approximately 7%, we believe we will continue to attract and curate a strong set of equity partners that will be part of our Shareholder value creation journey. We target the long-term return profile of the Russell with far less risk like. We're very enthusiastic about the next chapter of our growth.

Now I'll turn the call over to Bill to provide more color on the developments within Easterly that drive Shareholder return.

William C. Trimble:

Thanks, Darrell, and good morning. I would like to spend a few minutes discussing our first quarter of 2016.

We were very pleased to acquire the 71,100 square foot Albuquerque, New Mexico Immigration and Customs Enforcement facility, which, combined with our other properties, represents a portfolio of 37 buildings, from which 96% of its rental income is derived from the full faith and credit of the United States federal government. ICE Albuquerque represents well our focused investment discipline as a new facility built in 2011, it serves a critical mission for an important agency of the federal government. The building's hierarchy of mission makes it an integral part of ICE's ability to provide enforcement in the busy southwest border region.

The Development Team remains active in responding to all opportunities that would fit within the strict criteria of our portfolio metrics. While there has been very little in the way of projects that we would consider, we are actively engaged in several opportunities. Additionally, our Asset Management and Development Teams are currently engaged in a number of value-added projects to our existing portfolio. Twenty-two of our 37 properties have seen mission-enhancing projects by the government, at government expense, which serves in keeping our tenants able to performance mission while keeping our already young building updated.

Our acquisition pipeline remains robust and we are looking at a number of single-facility and multi-facility portfolios. These buildings are very similar to our existing portfolio of properties: they're leased to a single tenant of the US federal government, are the result of a Design Build Award, and are usually over 40,000 square feet in size. It is important to note that we underwrite the agency and the hierarchy of mission of the perspective building before performing the deep dive on the actual bricks and mortar.

We see a number of opportunities, over 200 million, that are actionable in the near- to midterm, and will continue to maintain a rigorous underwriting standards so as to do as well or even better than the current 93% to 95% renewal for this class of federally leased buildings.

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

Meghan Baivier:

Thank you, Bill. Today I will touch upon our current portfolio, discuss our first quarter results, provide an update on our balance sheet, and review our 2016 guidance. Additional details regarding our first quarter results can be found in the Company's earnings release and supplemental information package.

As of March 31, we own 37 properties comprising nearly 2.7 million square feet of commercial real estate. The weighted average lease term for the portfolio is 6.9 years and our portfolio occupancy remains at 100%. In addition, 96% of our annualized leased income is backed by the full faith and credit of the United States government.

For the first quarter, FFO per share in a fully diluted basis was $0.30, FFO as adjusted per share on a fully diluted basis was $0.29, and our cash available for distribution was $0.26 per share on a fully diluted basis. GAAP measures and reconciliations to GAAP measures have been provided in our supplemental information package.

For the 12 months ending December 31, 2016, the Company is reiterating its guidance for FFO per share on a fully diluted basis of $1.19 to $1.23 per share. This guidance assumes acquisitions of $75 million in 2016, including the ICE Albuquerque acquisition we completed in the first quarter, spread evenly throughout the year. This guidance does not contemplate dispositions or additional capital market activities.

Let me walk you through this guidance in more detail. As of December 31, 2015, given acquisitions that were completed through 2015, run rate FFO on a fully diluted basis was approximately a $1.17 per share. This increase to $1.17 already included approximately $9 million of cash general and administrative expenses for the year. This amount provides the resources which we believe will support robust growth for the Company this year. A portion of this increase is compensation for our Team, based on Easterly meeting or exceeding our communicated growth targets. As you know, a disproportionate amount of Management's total compensation is incentive-based.

To be clear, if we do not meet our growth targets, our cash G&A expense will be lower.

As I said, the run rate FFO for the business at year-end was approximately $1.17 per share. We would expect to be (phon) impact from $75 million of acquisitions, spread equally across the year in 2016, to add $0.08 per share to our run rate FFO on a fully diluted basis, bringing run rate FFO to $1.25 by the end of 2016 and FFO for the year to a range with a midpoint of $1.21.

Now turning to the balance sheet, at quarter-end we had $184 million outstanding on our revolving line of credit and total debt of $267 million. Availability on our line of credit stood at $216 million. In terms of leverage, net debt to total enterprise value was 26.3%.

Finally, as previously announced this week, our Board of Directors declared a dividend related to our first quarter of operations of $0.23 per share. This dividend will be paid on June 23 to Shareholders of record on June 8. When we came public, our first full quarter dividend was $0.21 per share. We increased our dividend to $0.22 per share one quarter later, and now two quarters after that we have increased it further to $0.23 per share. This is in line with our outlined expectation of consistent dividend growth.

I'll now turn the call back to the Operator for questions.

Operator:

Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate that 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 pickup your handset before pressing the star keys. Once again, it is star, one to ask a question at this time.

Our first question comes from the line of Manny (phon) Korchman with Citigroup. Please go ahead with your question.

Emmanuel Korchman:

Good morning, everyone.

Darrell W. Crate:

Morning, Emmanuel.

Meghan Baivier:

Morning.

William C. Trimble:

Morning.

Emmanuel Korchman:

Bill, in your prepared remarks you spoke about some multi-facility portfolio that you guys are looking at. Are any of those included in the $200 million near-term opportunities? I guess, whether they are or not, it doesn't really matter—the next question—but sort of what would the size of one of these multi-facility portfolios look like?

William C. Trimble:

Good morning, Manny. First of all, the answer is of course, and we have been looking at multi-building portfolios since we went public. Our overall pipeline remains at about $700 million, but $200 million, as I've said, is sort of what we like to have from an active standpoint.

Emmanuel Korchman:

So the $200 million…

William C. Trimble:

Maybe, Manny, to bite-size, for us, a portfolio can be $50 million to $100 million. It's a way to think about it. It's a couple of buildings rather than the building a quarter to a tempo that we've tried to establish since going public.

Emmanuel Korchman:

Got it. Meghan, just on G&A, sort of what's going to be the cadence of that over the rest of the year? It looked a little bit high in 1Q compared to the guidance for the year.

Meghan Baivier:

Yes. The first quarter, if you were to annualize that number, you would see it come in a little higher than our communicated $9 million rate. That's due to just the Corporate activity associated with the business in the first order. But you would—you can expect that to peter out and grow consistently from a run rate basis over the remainder of the year.

Emmanuel Korchman:

Great. Thanks.

Operator:

Thank you. Once again, as a reminder, you may press star, one to ask a question at this time.

Our next question comes from the line of Michael Carroll with RBC. Please proceed with questions.

Michael Carroll:

Thanks. Bill, can you kind of give us some additional color on the investment pipeline? I know you mentioned you have numerous activities that are actionable in the near- and midterm. What do you consider the midterm? Is that sometime in 2016 or '17?

William C. Trimble:

Good morning, Michael. I think the message is that the Company continues to do what we said we're going to do. It continues to grow. We see a very actionable pipeline going forward and I can just reiterate that we have a terrific Team here that are able to mine wonderful opportunities from a big list of properties, and I think you can expect us to do just what we've done in the past and we're looking forward, as we've said, to acquiring $75 million to $125 million in properties this year.

Michael Carroll:

All right. Have you noticed any changes with the competition in the market? Who are you mainly competing against, and has that activity picked up recently?

William C. Trimble:

No. As I said before, we really have not seen any change in the competition, as I mentioned I think last quarter. We continue to do what we do. We think the middle sector of this market is a good place to play and I would say there are no changes.

Michael Carroll:

Okay. Then I believe you touched on this earlier, but has there been any improvements in the GSA build-to-suit activity? What do you think will be the callus that will drive that activity higher for the government?

William C. Trimble:

I think that there has not been any change. We came off a 2007, 2008 when we saw a lot of activity. Obviously the federal government is not doing as much development today and changes would be as these buildings become older—not our buildings because we're some of the newest in the federal government inventory—but as some of those buildings need to be replaced, the government will be forced to start building again.

Michael Carroll:

Do think after the election, that the activity will pick up? Is that a good, I guess, marker in the future that could change that type of level?

William C. Trimble:

I mean, I think that the bottom line is that spending is due to the Congress of the United States and if you can tell me what they're going to do, I'll be very gratified. But I don't think there'll be much change at this point.

Michael Carroll:

Okay. Great. Thank you.

Operator:

Thank you. Again, as a reminder, you may press star, one to ask a question at this time.

Our next question comes from the line of Helen Crowe with The Crowe Family Trust. Please proceed with your questions.

Bill Crow:

Yes. I understand that very soon now the quiet period will be changed for initial Investors, and I understand that the partnership is doing a very good job of managing the flow of any of these funds into the market. But I don't have any information yet on units. Is that information coming soon?

Darrell W. Crate:

Bill, if you're a limited partner, then, yes. On May 11 you'll get your specific unit amount.

Bill Crow:

All right. Thank you.

Operator:

Thank you. We have no further questions at this time. I'd like to turn the floor back over to Management for closing remarks.

Darrell W. Crate:

Well, again, thank you everyone for today, spending time with us. We're very excited about our growth strategy. You know, as we look back to February of last year, going public always has a set of challenges. The Company functioned very well as a private Company. This year we've demonstrated that it functions in an extraordinary way as a public Company. We continue to attract outstanding talent. We are the recipient of inbound phone calls for folks who own buildings and we believe with the capital formation exercises that we have and the Team we have to execute, that we continue to exceed expectations as we move forward.

Operator:

Thank you. Ladies and gentlemen, this concludes today's teleconference. You may disconnect your lines at this time and thank you for your participation.