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Q2 2024 EASTERLY GOVERNMENT PROPERTIES INC EARNINGS CALL

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CORPORATE PARTICIPANTS

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- **Darrell Crate** *Easterly Government Properties Inc - Chief Executive Officer, Director*
- **Meghan Baivier** *Easterly Government Properties Inc - President, Chief Operating Officer*
- **Allison Marino** *Easterly Government Properties Inc - Chief Financial Officer, Executive Vice President, Chief Accounting Officer*

CONFERENCE CALL PARTICIPANTS

- **Operator**
- **Michael Griffin** *Citi - Analyst*
- **Michael Carroll** *RBC - Analyst*
- **Christopher Sreckovich** *Jefferies - Associate*

PRESENTATION

Operator

Welcome to the Easterly Government Properties second quarter 2024 earnings conference call.

(Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Lindsay Winterhalter, Head of Investor Relations. You may begin

Lindsay Winterhalter *Easterly Government Properties Inc - Senior Vice President, Investor Relations & Operations*

Good morning. Before the call begins, please note that certain statements made during this conference call may include statements that are not historical facts and are considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Although the company believes that its expectations as reflected in any forward-looking statements are reasonable, they can give no assurance that these expectations 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 the company's most recent Form 10-K filed with the SEC and in its other SEC filings. The company assumes no obligation to update publicly any forward-looking statements.

Additionally, on this conference call, the company may refer to certain non-GAAP financial measures such as funds from operations, core 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 its separate supplemental

information package on the Investor Relations page of the company's website at ir.easterlyreit.com.

I'd now like to turn the conference call over to Darrell Crate, CEO of Easterly Government Properties.

Darrell Crate Easterly Government Properties Inc - Chief Executive Officer, Director

Thank you, Lindsay, and good morning, everyone, and thanks for joining us for the second quarter conference call. We had a busy quarter cultivating and closing transactions, driving results at our development sites, and serving as a strategic partner to our US government agencies.

We've also spent considerable time bringing our investors into our buildings to help them appreciate the difference between our purpose-built mission critical portfolio versus the more traditional office sector. As listeners on this call may have observed, we updated our website to help viewers better understand the mission-driven specifications of the buildings in our portfolio. And just recently, certain events underscore the importance of fulfilling missions through real estate. Here's some examples.

First, the investigation following the assassination attempt at President Trump's rally in Pennsylvania has been spearheaded by FBI Pittsburgh whose field office is one of our facilities. FBI field offices are very specialized buildings and must be constructed with anti-ballistic glass, SCIF rooms equipped with national intelligence security standards, including radio frequency shieldings and duct work to prevent infiltration. We have to account for things like blast protection, security screening, and other structural requirements that are essential to agencies like the FBI being able to operate effectively in times like these.

The FBI employs approximately 35,000 people, including special agents, intelligence analysts, linguists, scientists, and information technology specialists. Whenever there is an event and our US government agencies are in proximity, they absolutely must be ready to go 24 hours a day, 7 days a week, 365 days a year.

Next, in last week's news about the apprehension of the arrest of the alleged cartel leaders, including Joaquín Guzmán López, also known as El Chapo Junior, was carried out by agents in our FBI DEA El Paso facility. The FBI and DEA in our joined El Paso facility work together with HSI to apprehend cartel leaders that boarded a plane in Mexico and then crossed the border into the US allowing law-enforcement to arrest them.

The three agencies, all Easterly Tenants, worked in tandem over the course of the next several months in order to execute this high-stakes plan. This is a clear example of what you have heard me previously say about how our specialized facilities enable these agents to work and stop cartel activities and reduce drug trafficking.

Our DEA facilities must be equipped for highly-specialized and complicated testing of synthetic drugs, some of which we have never been seen or examined before. Through drug signature programs that analyze samples to determine processing methods, geographic origins, and manufactures for heroin, cocaine, and methamphetamine.

We have machines in our facilities that can take inorganic drug and identify its origins down to a specific parcel of land where the organic substance was sourced. This isn't conceptual. It's not a sci-fi movie. Just last Thursday, in connection with the arrest of the alleged cartel leaders, Attorney General, Merrick Garland, said Fentanyl is a deadliest drug threat our country has ever faced and the Justice Department will not rest until every single cartel leader, member, and associate responsible for poisoning our communities is held accountable.

This is what the FBI and DEA agents depend on us for each day in order for them to do their mission-critical work. So much of this work can't be done outside of our specialized facilities. They are the definition of mission-critical assets.

Finally, I'll give you one more example. Let's talk about the Veterans Administration, which is our top tenant. Over half of all veterans used at least one VA benefit or service in 2021. And of those 9.8 million users, approximately 51% used multiple benefits, up from 36% in 2010. Our VA properties include community based outpatient clinics that are designed to be a one-stop shop for veteran care.

These regionally focused centers and have a specialized mix of departments from radiology, dental, and optometry to mental health, physical therapy, prosthetics, and phlebotomy, and each department has its own set of physical requirements. For example, radiology has its own baseline for humidity and temperature control while pharmaceutical requires specialized security systems.

In VA Phoenix, we have a customized kitchen, and these models are built directly into the walls of certain rooms so that care providers can assist veterans with various disabilities with self-sufficiency and reacclimate to their homes. This is our definable edge.

If we take one thing -- if you take one thing away from this call today, I hope is that you understand how essential the infrastructure we provide is to these US government agencies. We are meaningfully differentiated from an office portfolio, and this provides our shareholders with greater stability and lower volatility of cash flow.

Real estate markets have suffered, but our portfolio continues to perform well. And during this time, we've taken the opportunity to expand on our strength and broaden our strategy to provide attractive returns to our shareholders. Rather than remaining idle, we are focused on cultivating opportunity.

For institutional investors, revisiting this space with an eye towards easing interest rates, it's important to remember that these three key truths: We're focused on growth, we believe we have the resources to execute, and we anticipate our core strategy will have additional tailwinds in a declining rate environment. Given the strategy we laid out and the growth opportunities we have in front of us, we see a path to achieving a payout ratio in the next 24 months that is consistent with our historical levels.

We have a development pipeline that's significant and we are working not only with US government agencies, but also with high credit government adjacent companies like those in the defense industry, which have government contracts and need customized facilities similar to the ones that we have owned and developed to support their own missions alongside their US government partners. We're focused on being a chosen partner to the organizations we work with by building and developing properties that help them meet and facilitate their critical missions.

Thank you again for taking the time to join us this morning. And now I'll hand things over to Meghan Baivier, our President and Chief Operating Officer.

Meghan Baivier Easterly Government Properties Inc - President, Chief Operating Officer

Thanks, Darrell, and good morning.

We are excited to have you join us this morning and I echo Darrell's enthusiasm for the opportunities on the horizon. While the REIT sector has faced outflows over the past several years, Easterly has been working hard to harvest an incredible pipeline of long-term growth opportunities. The missions of our tenant agencies continue to grow, both in terms of scale and criticality and they have an ongoing need for specialized facilities.

The same is true for the government adjacent tenants on which we focus. We are seeing large scale net lease projects with contractual escalators that fulfill our strict definition of mission-critical real estate. We believe Easterly has the platform, balance sheet, and access to capital to uniquely pursue these types of opportunities and further enhance shareholder returns.

An increasingly favorable cost of equity aligns with our growth strategy and allows us to target strategic assets that not only complement our existing business lines, but also have the potential to drive long-term earnings growth. Our goal is not just to acquire assets but to integrate them seamlessly into our operations, thereby maximizing synergies and operational efficiencies. By leveraging this opportunity, we aim to strengthen our market position and deliver sustainable value to our shareholders.

Since the time of our last call, we have capitalized on our growth strategy and acquired two additional assets, both in Orlando, Florida, and both critical to the safety, security, and infrastructure of our country. We have successfully transacted on three accretive deals in 2024 despite a backdrop of lower market volumes, highlighting our ability to source and execute in challenging environments.

In addition to acquisitions, we continue investing in our assets to further bolster our strong partnership with our important tenants. This is part of our competitive edge relative to other owners of mission-critical government-leased real estate and is an important component of our ability to consistently deliver stable cash flows to shareholders.

Looking forward, we see an outsized pipeline of opportunities that we believe will further our ability to meet our stated goal of delivering 2% to 3% core FFO per share growth year over year for years to come. We are making progress with an opportunity to serve as a lender and then buyer of mission-critical assets that we believe will further change the growth trajectory of this organization. We look forward to keeping you apprised as this develops.

With that, thank you for your time this morning. I encourage attendees on this call to spend some time digging into the Easterly model to understand our opportunity for getting on a path for outsized growth over the next several years.

I will now hand the call over to Allison.

Allison Marino Easterly Government Properties Inc - Chief Financial Officer, Executive Vice President, Chief Accounting Officer

Thanks, Megan. Good morning, everyone.

I'm pleased to report the financial results for the second quarter. Both on a fully diluted basis, net income per share was \$0.04 and core FFO per share was \$0.29. Our cash available for distribution was \$24.8 million. We maintain our focus on growing the enterprise through the acquisition, development, and renewal of mission-critical assets leased primarily to the US government as well as [its adjacent] partners. While calm on the surface, behind the scenes, our team is working at a rapid pace to execute on the roughly \$1.5 billion to \$2 billion worth of pipeline opportunities we see today.

As a company with a \$1.4 billion market cap, this outsized growth opportunity is extremely exciting for the company and hopefully our prospective shareholders. The Easterly team has done a great job of getting the balance sheet poised and ready to absorb the anticipated capital needs to fund this unique opportunity.

First, we are once again met with great success in the private placement market with the execution of \$200 million of fixed rate senior unsecured notes with nine-year maturities. This is our fourth entry into this market, and we were pleased with the oversubscribed interest from new and existing investors alike.

We believe the credit quality of our underlying US government tenant is a significant draw in this market, and our BBB stable rating from Kroll provides third-party validation of that. As of today, we have closed the first \$150-million tranche of Series A notes, and we remain on track to close the second \$50-million tranche of Series B notes on August 14, subject to customary closing conditions.

Second, we were pleased to partner with our premier syndicate of banks and execute a new \$400-million revolving credit facility with an accordion feature that allows for a total borrowing capacity of up to \$700 million. With an initial maturity date of June 2028 and due six month as-of-right extension options, we are pleased to extend the term of lender commitments and secured the liquidity necessary to pursue accretive capital deployment opportunities.

I would like to thank our capital partners and the successful execution of both transactions and a special thanks to Citi, PNC, Truist, and Wells Fargo for serving as joint lead arrangers on our revolver. In total, we believe this success highlights our unique strategy, superior credit quality, and attractive platform relative to other REITs.

Turning to guidance after a recent raise subsequent to last quarter's call, I'm happy to share that we are maintaining our full-year core FFO per share guidance for 2024 in a range of \$1.15 to \$1.17 on a fully diluted basis. This guidance assumes the closing of VA Jacksonville through the company's joint venture at a pro rata acquisition price of \$41 million, approximately \$50 million in wholly owned acquisitions throughout 2024 and \$100 million to \$110 million of gross development related investment during the year.

At its midpoint, this sets a path for Easterly to deliver strong core FFO per share earnings growth to shareholders this year. And as we start to execute on the outsized pipeline of opportunities that we have identified, we expect an outsized growth opportunity for our shareholders will then follow.

With that, we thank you for your time this morning and appreciate your partnership. I will now turn the call back to Towanda.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Michael Griffin, Citi.

Michael Griffin Citi - Analyst

Great, thanks. Appreciate the color in the opening remarks.

Just wondering if you could expand a bit kind of on the acquisition opportunities you're seeing. I think we've seen the transaction market [saw] somewhat. So maybe an expectation about when they could pick up and then if you could give us a sense on where investment spreads are relative to your current cost of capital.

Darrell Crate *Easterly Government Properties Inc - Chief Executive Officer, Director*

Yeah. Maybe just to start at the top, we talked in the last quarter, the bid-ask spread was wide and we obviously see that shrinking. We are in a place today where especially buildings where folks have debt that's maturing. Time is a little bit on our side as we move forward and that's having a powerful impact on, again, taking that bid-ask spread and shrinking that a bit.

For or us, our cost of capital today is just about [7.25] and stepping back when we talked about our growth strategy and 2% to 3% growth going forward and you know how we were continuing to build out our growth strategy, the stock was at \$12. So, as we've seen the stock appreciate almost 10%, a little bit more since then, that only means more accretion, better cost of capital, and all those things that make REITs go around. We have a robust pipeline. As I said, we're working not only on US government agencies as well as state and local, but also those high credit government adjacent tenants. And we feel very excited about the growth prospects as we go forward.

Michael Griffin *Citi - Analyst*

Appreciate that, Darrell.

And then maybe just one broad comment around the upcoming election and if there's any chance potential change in administration could impact various aspects of your business?

Darrell Crate *Easterly Government Properties Inc - Chief Executive Officer, Director*

I mean, our core strategy of US government assets we've always pick agencies that really aren't swayed by the political wins. So, VA, FBI, DEA, I think both parties agree that each of those serve a very important critical mission. We're not -- the Department of Education is not on our list. And so most of the folks who you hear are vulnerable to one party's preference over the other are not our major tenants.

Operator

Michael Carroll, RBC.

Michael Carroll *RBC - Analyst*

Thank you- I guess, Meghan, can you give us an update on your leasing activity? I know it looks like the lease expiration schedule hasn't really changed much. So I'm assuming nothing has really signed for this quarter. I know last quarter you're pretty optimistic by some of those progresses, so maybe can you give us an idea of the timing of when you can satisfy the 2024 leases? And what's the outlook for the 2025 expirations?

Meghan Baivier *Easterly Government Properties Inc - President, Chief Operating Officer*

Yeah. Happy to do that.

As we look at the remainder of 2024 and the two largest, one is outsized as FBI in Omaha and then we have an FBI tenancy in our Portland asset as well as two other small tenancies. And I would say certainly the FBI Omaha, I wish I could have had positive commentary for you today, but we feel very good about that as we do about the others.

Looking to 2025, as those become more firmly in view, we've got a handful of FBIs and a courthouse in Aberdeen. I'd say the same sentiment applies. Therefore, positive news on the horizon, those procurements being estaguous and in a position where we

appreciate the progress and look to see a positive outcome.

Michael Carroll RBC - Analyst

Okay. And then with these being the, I guess, a lot of the expirations being in the center of your bullseye that you're typically targeting. Can we assume cash lease spreads are these in the 15% to 20% range? Or is there something unique that we should be thinking about?

Meghan Baivier Easterly Government Properties Inc - President, Chief Operating Officer

FBI Omaha is subject to a prospectus, we've known that. So that renewal likely looks more like a flat renewal. But as we look to the two FBIs and the courthouse in 2025, yes, Mike, I would tell you those are -- our expectations are squarely in that high-teens range from a net effective.

Michael Carroll RBC - Analyst

Okay, great.

And then just two I guess modeling type questions, but on the JV deal, like what's the timing of completing the JV acquisition, the last acquisition from that transaction?

Meghan Baivier Easterly Government Properties Inc - President, Chief Operating Officer

Yeah. That last -- the Jacksonville VA, it is our expectation that, that is teed up to close in the quarter and that would be the last transaction.

Michael Carroll RBC - Analyst

Okay. And then final one for me.

I know there was a small -- I don't know -- [I don't know you learnt about it]. It's so small I'm not sure if we're talking about, but there is a loan provision for credit losses that was added back to FFO. Can you explain what that is? And should we expect any additional credit loss provisions to be recorded over the next few quarters?

Allison Marino Easterly Government Properties Inc - Chief Financial Officer, Executive Vice President, Chief Accounting Officer

Sure. I can take that one.

So as we've shared, there's an opportunity in the market for us to partner with developers on projects and act in a lender position. We have a small pre-leased award loan out to a developer. And while that loan is not experiencing actual loss or default, accounting rules require us to estimate a credit loss probability for this asset for the term it's outstanding, so that will continue to get tweaked through its maturity date.

Operator

(Operator Instructions)

Christopher (inaudible), Jefferies.

Christopher Sreckovich Jefferies - Associate

Stepping in here for Peter.

Just wanted to touch on maintenance CapEx. It was a little bit higher this quarter. Can you talk about expected run rate going forward and any items we should look out for the rest of the year from a AFFO perspective?

Thanks.

Allison Marino Easterly Government Properties Inc - Chief Financial Officer, Executive Vice President, Chief Accounting Officer

As you can probably expect, there's always timing as projects kick off and complete throughout the year. So, I would say there's no changes to our run rate expectations on that line.

Christopher Sreckovich Jefferies - Associate

Okay, great. Thanks.

And then I guess more generally on the acquisition front, we touched on it a little bit, but as rates come down generally, you get a different pool of buyers looking at these assets. Do you think you'll see more competition for the assets you're targeting and how will that impact pricing?

Meghan Baivier Easterly Government Properties Inc - President, Chief Operating Officer

I'll take that.

I mean, I think -- we are excited for the cost of -- our cost of capital to be normalizing and really presenting increased opportunities to acquire at a healthy 50- to 100-basis point spread. That cost of capital is still leading in the industry, right? Our ability to access the private placement market in the way we did the equity cost today of the stock rate, so our blended cost of capital is still a competitive advantage as we go into the marketplace. It's spend -- it's really more about meeting sellers' expectations.

Christopher Sreckovich Jefferies - Associate

Great. That's helpful. Thank you.

Operator

I'm showing no further questions in the queue. I would now like to turn the call back to Darrell Crate, Chairman of Easterly Government Properties, for closing remarks.

Darrell Crate Easterly Government Properties Inc - Chief Executive Officer, Director

Thank you, everyone, and thanks for joining the Easterly Government Properties second quarter 2024 conference call. We look forward to keeping you posted on the coming quarters and as we make progress on our pipeline of growth opportunities.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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