

Easterly Government Properties(Q4 2024 Earnings)

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Corporate Speakers:

- Lindsay Winterhalter; Easterly Government Properties; Head of Investor Relations
- Darrell Crate; Easterly Government Properties; President and Chief Executive Officer
- Allison Marino; Easterly Government Properties; Chief Financial and Chief Accounting Officer

Participants:

- Michael Griffin; Citi; Analyst
- John Kim; BMO Capital Markets; Analyst
- Aditi Balachandran; RBC Capital Markets; Analyst

PRESENTATION

Operator[^] Greetings. Welcome to Easterly Government Properties' Fourth 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. Please go ahead.

Lindsay Winterhalter[^] 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 are as reflected in any forward-looking statements are reasonable, it 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 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, President and CEO of Easterly Government Properties.

Darrell Crate[^] Thank you, Lindsay. Good morning, everyone, and thanks for joining us for this fourth quarter 2024 conference call. We are in the midst of a shift in how government will function.

Some of the headlines are dramatic, the actions we see show us that the change is real, and we're pleased to say that we have been underwriting to DOGE before DOGE since we founded the company.

What I mean is that we have been focused on truly mission-critical facilities in agencies that align with what the American people would imagine their government does well. Law enforcement, care for veterans, protecting the food and legal drug supply just to name a few.

We're pleased to share the progress we've made in strengthening our partnerships with the government's mission-critical agencies.

The Department of Government Efficiency, or DOGE, has made speedy progress in cutting wasteful spending across federal agencies and optimizing expenditures on its real estate portfolio. DOGE's message to the American people is clear. taxpayer funds must be utilized on government functions critical to the safety and well-being of the country. Its real estate portfolio is no exception.

As a private sector specialist, we have a long time proven track record of delivering cost efficiencies to the agencies that we serve. Through the GSA, the federal government owns over 1,500 buildings. The average age of its owned facilities is over 50 years, and it holds over \$80 billion in deferred maintenance and repair liabilities as of fiscal year 2022.

This is a remarkable 57% increase from just five years earlier. This exists in stark contrast to our portfolio of state-of-the-art Class A assets, which hold a weighted average age of 15.7 years. These figures underscore the importance of the GSA's outlook as published on February 12 of this year.

The GSA states in its press release, "optimizing the GSA's real estate portfolio prioritizes reducing our deferred maintenance liabilities, supporting the return to office of federal employees and taking advantage of a stronger private government partnership in managing the workforce in the future."

As a private sector partner to the GSA, we have championed government efficiency long before DOGE was created. Take our development projects at the FDA, for example, we estimate we can deliver a laboratory to the government 3x cheaper and notably faster than it would cost for the government to develop and own it itself.

The GSA and DOGE have recognized the value in federally leased real estate as a source of cost efficiency for taxpayers, and we are uniquely positioned to help them deliver quickly.

Thomas Shed, the GSA's Deputy Federal Acquisition Service Commissioner and Director of Technology Transformation Services recently echoed this sentiment directly to his staffers stating, "the intention of the GSA and the whole federal government is to reduce the number of old buildings that are owned with high liabilities in favor of newer leased buildings, which can be more flexible and are more modern."

While we see DOGE in the headlines, as we've said, we believe mission-critical properties will continue to be an important and ongoing component of the government real estate portfolio.

As evidenced by that, just last week, we renewed a 33,000 square foot firm term noncancelable lease for the U.S. Army Corps of Engineers in Portland, Oregon. While typically immaterial to our investors, we believe this execution is significant given the renewed emphasis on government efficiency.

Allison will go into this later on our call, but 95% of our portfolio today is comprised of firm term leases, and we look forward to strengthening its weighted average lease term under this new administration.

A second emerging theme with DOGE is the redistribution of government spending away from Washington. Recently confirmed FBI Director, Kash Patel, stated that he will relocate 1,500 agents from the DC headquarters to field offices like ours across the country.

This should help the FBI fulfill its essential role in tackling high-profile crime from homicides to terror threats drug enforcement, gang violence and more. From Salt Lake City, Utah, to Albany, New York our FBI field offices have been housing these operations all along, and we look forward to supporting the agency as it increases its footprint across the country.

As DOGE addresses the inefficiencies that exist in the thicket of the federal bureaucracy, we've continued to execute accretive acquisitions with a renewed emphasis on the cost savings value proposition we deliver to our government agency partner. We closed 10 new assets, either wholly owned or through our joint venture in 2024.

We also materially expanded our total addressable market through leasing to investment-grade government adjacent tenants like Northrop Grumman and we expect our exposure in the sector to expand as defense-focused corporations demonstrate a consistent demand for secure facilities to fulfill their government contracts.

We remain focused on growing the portfolio, executing accretive lease renewals and acquiring buildings that add value to our shareholders.

We believe we're well positioned to execute these stated priorities. Thank you again for taking the time to join us this morning. And with that, I'll turn the call over to Allison Marino, our Chief Financial and Chief Accounting Officer.

Allison Marino[^] Thanks, Darrell. Good morning, everyone. I'm pleased to report the financial results for the fourth quarter and full year 2024. For the quarter, both on a fully diluted basis, Net income per share was \$0.05 and core FFO per share grew 3% year-over-year and was \$0.29. Our cash available for distribution was \$25.1 million.

For the year, also both on a fully diluted basis, net income per share was \$0.19 and core FFO met the upper end of our raised guidance at \$1.17. Our cash available for distribution was \$100.9 million.

In 2024, we successfully delivered 3% earnings growth, a direct result of cultivating a robust pipeline of opportunities. A critical element of this success has been our ability to expand our total addressable market, opening new avenues for growth in the state and local and government adjacent space while maintaining our disciplined approach to portfolio management.

This expansion not only enhances our near-term prospects, but positions us strongly for continued long-term value creation.

As Darrell mentioned, a cornerstone of our strategy is the recognition that our current portfolio of assets is considered mission-critical. Many of the government operations we serve are dependent on the continued functionality of our real estate with key tenants relying on these spaces to perform essential work.

This unique characteristic further solidifies the resilience of our business as the demand for our mission-critical properties continues to outperform commodity government office. Subsequent to quarter end, we amended our \$100 million senior unsecured term loan agreement originally executed in 2016.

By doing this, we have successfully extended the maturity date of the loan from 2025 to 2028. Additionally, we have secured two 1-year extension options, which could extend the maturity date to 2030, subject to certain conditions.

We also increased the borrowing capacity available through the accordion feature, providing us with greater flexibility moving forward. We believe this amendment underscores the strength of our banking relationships and the stability of our balance sheet.

Thanks to these favorable terms, we can now focus even more intently on executing our disciplined investment strategy and continuing to drive long-term growth for our shareholders.

Additionally, in connection with the amended term loan, we entered into an interest rate swap that provides greater certainty around our rate exposure. These moves will strengthen our ability to pursue our strategic goals.

Further, as is customary on our fourth quarter earnings call we'd like to discuss our re-leasing successes as of year-end.

But before doing so, I'd like to remind the audience of the underlying fundamentals behind the GSA or a VA lease within the U.S. government. There have been a lot of questions circulating in the news about the government's ability to cancel a lease.

So here are the facts as it relates to our leases. This is not necessarily true for a defense lease, so please keep that in mind. A GSA or a VA lease can be structured in one of two ways.

First, it can be a firm term lease or non-cancelable for the entirety of the term. Or second, it can be a combination of firm term and soft term. A typical example you'll see is a 20-year lease with a 15-year firm term.

If the lease is in firm term, the GSA cannot unilaterally cancel the lease. To do so unilaterally would be the equivalent of a government default.

When a lease is in soft term, the government is allowed to terminate its lease but because our assets are so young and important to key government agencies, the company believes this does not pose a significant risk to the portfolio.

As of quarter end, roughly 5% of the portfolio's annualized lease income is in soft term, and we feel comfortable with the ongoing need for those facilities. The weighted average remaining lease term of the entire portfolio is exactly 10 years.

If you back out the portions of the portfolio that have soft term, the weighted average remaining lease term is still a healthy 8.6 years.

We have curated a portfolio where no more than roughly 6% of our annualized lease income rolls in any given year, and we remain committed to our high credit leases with the U.S. government.

With that, as a reminder, due to the unique nature of the leases, final renewal rents cannot be ascertained until the exact amount of TI dollars required by the government at renewal is known and that TI work is complete.

As such, there can be a lag in providing releasing data relative to the point at which we have signed a renewal lease.

As we scale and grow over the coming years, we remain focused on attractive tenant retention rates, ensuring that no single asset erodes value as a priority as we balance expansion with careful stewardship of our existing properties.

As of December 31, 2024, we have renewed 34 leases since IPO. Of that 34, 22 are renewals for which there was no associated renewal TI work or renewal TI work has been complete and accepted by the government.

There are 12 other renewals with pending TI projects. This combined 2.3 million square feet across 34 renewals, it includes PTO Arlington, IRS Fresno and various smaller leases at Buffalo. When we exclude these assets, the average rent spread achieved on the remaining renewals is anticipated to be 16% including an estimated amount of \$41.55 a square foot of TI utilized by the government. The weighted average total remaining renewal term for these leases was 17.4 years.

Stepping back, we achieved our 2024 objectives, and we are on track to continue our strong execution in 2025 and beyond. Our long-term vision remains clear.

We have a strong pipeline, a disciplined growth strategy and a continued focus on operational excellence as we look to the future. I remain optimistic about the opportunities ahead and look forward to keeping you informed on our continued progress.

Before handing the call back to our operator, I'm pleased to report that we're bringing up the bottom end of our core FFO guidance for 2025 to a range of \$1.18 to \$1.21 on a fully diluted basis. This guidance assumes \$100 million in wholly owned acquisitions and \$25 million to \$75 million of gross development-related investment during 2025.

This is consistent with our established goal of delivering 2% to 3% core FFO growth for shareholders. With that, we thank you for your time this morning and for your ongoing support and commitment to our shared goals. I will now turn the call back to Shannon.

QUESTIONS AND ANSWERS

Operator[^] (Operator Instructions) Our first question is from Michael Griffin of Citi.

Michael Griffin[^] Appreciate all the commentary there. Maybe just going and starting off with the acquisition pipeline and the opportunity set that you're seeing.

If I recall you're looking at deals around the mid 8s versus your cost of capital, which on an implied cap rate basis, probably in the mid-7s. How are you viewing the accretion of these deals now just given it seems like we're going to be at higher interest rates for longer than previously expected?

Darrell Crate[^] Maybe Allison, I will just ham and egg the answer to this a bit which is we have a really strong pipeline, I mean both in acquisitions as well as development opportunities. The broad context, while we spend a lot of time talking about DOGE on investor calls and with the media.

But the background is banks are still not lending to particularly developers. And that being the case, having capital puts you in a very strong position.

And we've seen for a set of sellers that are either facing maturities or it's just time for them to sell an asset, and they're looking and saying interest rates are going to be longer - higher for longer, that now is an appropriate time to sell. So the pipeline continues to grow, I think, with opportunities that are very attractive.

As you know, Michael, I view our business principally as a net lease business in that we look at cost of capital, we look at the spread, we look at the risk of where we're underwriting. So I think we have plenty of accretive acquisitions.

We've been conservative, I think, in our guidance. I mean in that, as you heard, we have about \$100 million of acquisitions in the guidance range.

Obviously as we think about targeting a midpoint when we give parameters around what the company is going to do, having a 2.5% growth rate is what we're targeting, and really the course that we're setting ourselves on for the next set of years.

And so what we've got in our pipeline and harvesting that gets us to those levels. If we're in a space where we can announce more acquisitions in any year, we probably bring up the lower end of the guidance range, unless it's a robust amount.

And that positions us very well for our earnings growth in 2026, which again doesn't seem like a terribly high hurdle as we've increased our TAM and continue to build what we build and Allison is doing a terrific job on the capital structure.

And we've had some good news regarding debt that's been in our past and how we're modifying that in the future. As you know REITs, generally as debt has rolled over, face a headwind in their earnings. But I think we have plenty of opportunities and creativity in ways for us to get cheaper cost of capital. What's your thought, Allison?

Allison Marino[^] Yes. So what I would add there is we are looking to an incremental cost of capital as we spread invest to the portfolio of acquisition and opportunity we see.

So we are looking to generate that 50 to 100 basis points spread range on the next deals or the broader pipeline, and that will allow us to achieve our growth goals. But that certainly accounts for where interest rates are and are expected to be over the next few years.

Michael Griffin[^] Appreciate all the context there. And then, Darrell just going back to kind of the DOGE initiatives. Obviously I think you guys have done a good job highlighting the difference of Easter lease portfolio relative to what the market might consider traditional government office space.

But as you look to kind of the idea of austerity, whether it's the Pentagon potentially looking to cut its budgets or requisitions getting delayed for new projects.

I mean could that impact the external growth side, whether it's being awarded new developments or some of these government adjacent properties maybe not being as attractive given worries about defense spending. Any commentary there would be helpful.

Darrell Crate[^] Yes. I mean I think in the short term, I guess the metaphor that I've used internally is we're going to have some like a light chop turbulence here as everybody figures out what is going on in the government.

But we are all set for a very smooth landing because -- if you squint at our company, we've spent over a decade dedicating ourselves to be a specialist in helping and creating a private partnership with the U.S. government.

We have terrific relationships with the folks that we've built buildings with or with our leasing officers.

I think we try to be very creative in suggesting ways in which they can improve those facilities. And what that really means is improved mission. And I'll tell you, when you step back, maybe this is a little too detaily, but when we speak to folks who work at the GSA, they cared deeply about housing folks in the government to satisfy their mission.

And candidly, what I see from the outside and being somebody who works in private business, is that they spend just as much time figuring out the right solution for the facilities that create mission as they do navigating the bureaucracy.

I mean -- and it's not irrational because example, we would come to the GSA and have a couple of million bucks that we could save and the reality is they think that's a great idea.

These agents and folks who work for the government are terribly hard working and sincere and respect the taxpayers. But they would say, the minimum amount of time that we could redo this procurement is eight months, and the reality is it will probably take closer to three years.

So our choice is hey, we can take three years and save a couple of million dollars, but we know that facility that they're housed in today is not adequate and we need for this mission to be accomplished in a way that would make the American People proud. We need a new facility.

And it's that process that really needs to get fixed, and that's what we call the ticket of bureaucracy. And there is no GSA number that I've ever met that's excited to become professional in navigating the bureaucracy.

They want to do the right thing for the American people. They want to get these facilities to be operating and operating quickly. And that's why I really applaud their efforts and the DOGE efforts to look to have greater lease portfolio.

We're good at real estate. They're good at mission. We can't catch criminals, but we certainly can replace paint, carpet, and make sure the roof doesn't leak. And that partnership will serve the government very well over time.

And so when we look forward to getting out of this just little short-term period, I think we're one of the very best positioned to help them find savings. And as the example, that FDA building that I'm mentioning that's in Denver, there are still people who are doing some work on that for reasons that are unaccountable to me because we can deliver it for a third of the cost that they're planning on.

So that is what will get fixed. And I know -- I feel 100% aligned with the GSA to help them achieve their objectives. So maybe more than you're asking, but.

Michael Griffin[^] No. I really appreciate that, Darrell.

Operator[^] Our next question is from John Kim of BMO Capital Markets.

John Kim[^] Question on office utilization, which is typically a gauge of how much potential access is in leased real estate. And historically, I know you've been commenting that it's hard to measure within your portfolio.

But I'm wondering if you find that that's an important measure for the DOGE leadership and if it's something that you could take a more proactive approach in engaging?

Darrell Crate[^] Yes. I mean it's a great question. It's -- we're trying to ask ourselves a version of that question almost every day. And I think here, I would draw the distinction between offices that are in Washington, where we have incredibly limited exposure.

I think those are the places where they look at square feet, they look at utilization, and they're trying to navigate low utilization, return to work and trying to get it figured out.

But there will be a reduction in federal office footprint in Washington if they -- when all of these things balance out. A bunch of our facilities, you think about the lab down in -- I mean let's just take like the lab in Pleasanton. There's a room that is very stable.

It houses a \$600,000 machine in that machine, you can take any organic drug, put it in that machine, go get yourself a nice little Nespresso and come back. And it will tell you

the exact -- think if Colombia had ZIP codes, it would tell you the ZIP code that, that drug came from.

And what's the utilization in that room? I don't know but it has to exist. And so when we look at these mission-critical facilities, they have facilities that help them execute mission and we fully know that they're -- they've been using a lot of utilities all through COVID, and I don't think COVID solved the illegal drug problem. And when we think about the buildings that we're trying to maintain and deliver for the U.S. government, they have those kinds of functions.

And I could go on about romaine lettuce to the cotton that we import to the drugs that get filled for the veterans all of that is happening. And so I see on the other end, the mission delivery is very strong, and we see that happening in our buildings when we go and visit, and we see it in the numbers that the government publishes about what they're up to and what they're doing.

John Kim[^] Can you provide any commentary on the \$100 million of acquisitions that you now have in guidance, whether they will be GSA leases that were in your bulls eye historically? Or are there going to be the non-GSA leases that you've been requiring more recently?

Darrell Crate[^] Yes. I mean I think we'll look probably to the state and local as well as nonadjacent for that bit that's in the guidance.

John Kim[^] Okay. And then a final question on AFFO or CAD growth. I was wondering if you could provide some commentary on where you think that goes just given there's higher CapEx and TIs in some of these government adjacent leases?

Darrell Crate[^] Great question.

Allison Marino[^] Sure. So we are committed to the path of growth that we've been talking about for the last year. And growth in CAD comes through a combination of successful lease renewals, improved operating margins and managing capital levels to an effective place.

And they are also driven by opportunities that Darrell mentioned that we're seeing in the market on an acquisition basis. So we're evaluating CAD impact as we look at new deals as well and trying to do accretive deals on that end.

John Kim[^] But is it going to be in line with your FFO growth? Or will it lag in the initial phases go forward?

Darrell Crate[^] Yes. Yes. Yes. I mean -- and as we've looked at it, as we said, trying to get our CAD generation and dividend within striking distance by the end of 2026 is what we're focused on.

I think we'll have some good news as we look to next year. And -- but that said, our stock price at \$11 provides -- the paradox of this business is at \$11, we've got the guidance that we put forward here.

At \$12, we're in a place where we're going to see incremental activity because our cost of capital is going down and the price of buildings is staying the same. And at \$13 or \$14 we can kind of clean up the market. So it's -- that's where we find ourselves.

We think we're super excited about the projects and like leaning into what we're doing. -- if -- maybe I'm not allowed to say stuff like this, but if the stock was at \$13, covering the dividend is no problem. I mean that's from where we stand today.

Operator[^] Our next question is from Aditi Balachandran of RBC Capital Markets.

Aditi Balachandran[^] I know touching on CapEx that we previously spoke about. It was a little higher than a quarter. So is that a good run rate going forward?

Allison Marino[^] Yes. So Q4 does have what I would call the impact of seasonality. So typically, there are a lot of projects that ramp up in Q4. On a run rate basis, I would expect to share that we're in that \$1.75 to \$2 per square foot range going forward.

Typically, Q1 capital tends to be a little bit lighter as we hit the winter months and then spread more evenly throughout the year. That's not to say at zero, it just seasonality tends to put things in the last three months of the quarter -- three quarters of the year.

Aditi Balachandran[^] All right. Got it. And then what's your plan for the SAA Chicago building post the exploration? Do you plan on releasing the facility? Or should we think about this being a sale?

Allison Marino[^] Yes. So we acquired that building as part of a portfolio a number of years ago at a 20% cap rate. So this is certainly a victory in terms of the property itself. It's outperformed our underwriting by 3x in both term and performance.

Our goal would be to -- we are not expecting the GSA to remain in that building, and we would look to a disposition outcome following the expiration whenever that might be.

Darrell Crate[^] I mean if anything, I mean just a little detail on that building, which is -- I mean the deed which DOGE today is examining what they're doing next and how they're moving things forward. The tenancy in that building will either be where we expect it to be or be something a little bit longer.

And if you were to go visit the place, you'd see that the market will give us a price that I think investors will be pleased by when the FAA moves to their new facility.

Operator[^] Thank you. I would now like to turn the conference back to Darrell Crate, President and CEO of Easterly Government Properties for closing remarks.

Darrell Crate^ Thank you, everybody, for joining us for our yearend 2024 conference call. We really look forward to posting you on DOGE and all the events that we have to move the company forward in the coming quarter, and we'll be back to chat with you in three months. All the best.

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