PSBQ319
Maria Hawthorne
PS Business Park Incorporated
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Operator: Good afternoon and welcome to the PS Business Parks Third Quarter 2019 Earnings Results Conference call and webcast.

At this time, all participants have been placed in listen-only mode and the floor will be open for your questions following the presentation. If you would like to ask a question at that time, please press star (*) and 1 on your touchtone phone. If at any point your question has been answered you may remove yourself from the queue by pressing the pound (#) key. If you should require operator assistance, please press star (*) and 0.

It is now my pleasure to turn the floor over to Jeff Hedges, PSB's chief financial officer. Sir, you may begin.

Jeff Hedges: Thank you. Good morning everyone, and thank you for joining us for the Third Quarter 2019 PS Business Parks Investor Conference Call. This is Jeff Hedges, chief financial officer. Here with me are Maria Hawthorne, CEO, John Petersen, COO and Trenton Groves, CAO.

Before we begin, let me remind everyone that all statements other than statements of historical facts included in this conference call are forward-looking statements. These forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond PS Business Parks' control which could cause actual results to differ materially from those set forth in or implied by such forward-looking statements. All forward-looking statements speak only as of the date of this conference call. PS Business Parks undertakes no obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

For additional information about risks and uncertainties that could adversely affect PS Business Parks forward-looking statements, please refer to the reports filed by the company with the Securities & Exchange Commission including our annual report on Form 10K and subsequent reports on Form 10Q and Form AK. We'll also provide certain non-GAAP financial measures. Reconciliation of these non-GAAP financial measures to GAAP is included in our press release and earning supplement which can be found on our website at psbusinessparks.com.

I will now turn the call over to Maria.

Maria Hawthorne: Thanks, Jeff. Good morning everyone and thank you for joining us today.

We have an outstanding quarter on both investments and the operation. In September, we closed on a Hathaway Industrial Park for $104.3 million. Hathaway is a 10-building, 543,000 square-foot park located in Santa Fe Springs, Los Angeles County near the intersection of three major freeways, the 5, the 105 and the 605. This market is 1.5% vacant and in place rents for the park are approximately 20% to 30% below market. There is a single user in the largest building totaling 288,000 square feet who will expire in April 2020. This space represents a near-term opportunity to add value.

On October 8, we closed on the sale of the 1.3 million square-foot office flex portfolio in Maryland. The sale totaled $148.8 million and was right in line with our expectations. At this point, there are no other assets for sale in our portfolio for 2019.

We continue to be pleased with the NOI growth at Highgate at the Mile, our multi-family asset. Compared to prior year, NOI grew 73% and weighted average occupancy was 95.6%. Last quarter, I announced that we had received full rezoning of the balance of the Mile, and that we are launching our second multi-family development called Brentford and construction will begin in mid-2020.

Continuing with development updates, we are also going to commence construction of two Class A multi-tenant industrial buildings, which are both approximately 80,000 square feet. In both cases, we are taking advantage of excess land located in existing parks. The first to start is located in our Freeport Business Park in Dallas which is a mile from DFW Airport. The other building which will start late next year is located in our 212 Business Park in Kent Valley, Washington, with close proximity to Sea-Tac Airport and the Seattle and Tacoma Port. We will give you updates on future calls.

Operationally, industrial continues to lead and customer confidence remained high. Year-to-date total cash NOI is at 5.7%. Cash rental rate change for our commercial properties is at 8.5% on 5.3 million square feet of leasing. We feel confident that our positive momentum will carry through the fourth quarter and set us up for an equally successful 2020.

With that, I turn the call over to JP.

John Peterson: Thanks, Maria. Operating fundamentals in our markets were again solid as demonstrated by 2 million square feet of production, same park occupancy of 94.7%, up 40 basis points from Q2, retention of almost 74% and overall cash rent spread of 6.5% including 13.6% rent growth on our industrial leases. Results were healthy as our customers continue to grow with us in Q3. We signed 53 expansions for a net 82,000 square feet.

Now for a quick Q3 breakdown by market. There was active user demand in Northern Virginia, and we signed 107 leases for 426,000 square feet. Occupancy jumped 100 basis points to 92.8% well ahead of our peer set which is currently at 81%. A portion of this occupancy gain was generated by 13 existing customers that expanded in the quarter. We did have a negative rent growth of 8.4% in Northern Virginia primarily due to two office renewals over 20,000 square feet and one key office expansion of over 40,000 square feet. All three transactions were important wins for us as we grew occupancy and extended lease term with minimal transaction cost. Demand in Northern Virginia is being driven by technology, healthcare and government contractors.

Northern California was also active in Q3 with their team signing 490,000 square feet of deals, average deal size of 7,500 square feet generating cash rent growth of 18%. Occupancy increased 130 basis points from Q2 to 97.1% as the 130,000 square-foot vacancy we discussed in Q2 was occupied for all of Q3. Speaking of largest space in Northern California, I mentioned in the last call that we had three expirations in Q4 each over 150,000 square feet. We successfully renewed one and have solid activity with good rent growth potential on the other two.

Small users drove our leasing production in Southern California. The team in SoCal signed an amazing 149 leases in Q3 totaling 287,000 square feet for an average deal size of 1,900 square feet. This averages about two deals per workday and demonstrates our team’s ability to drive market demand. Plenty of rent growth was 6%. Orange County rent was up only 1% as we did one larger showroom lease with a rent right down.

Los Angeles is a very tight industrial market as you all know, and we increased rent in Los Angeles 10.5%. We did have one move out in Los Angeles of 52,000 square feet earlier in the year. We have since repositioned the building. We have a lot of interest in the space and expect solid rent growth upon lease up. San Diego rents improved 3.7% on the strength of our 1,400 square foot average deal size.

In Texas, solid fundamentals continue to drive business forward and our team signed over 325,000 square feet in 68 transactions. Combined rent growth in Austin and Dallas was 6.8%. Occupancy in Texas decreased 70 basis points due to 125,000 square-foot customer leaving the portfolio. We have since re-leased the space. Additionally, we signed a 30,000 square-foot lease in Las Colinas that occupies in Q1 2020.

Heading to South Florida, we're not seeing any signs of a slowdown due to trade wars or economic uncertainty. Consequently, the Miami team generated good activity in Q3 with 217,000 square feet of leases producing 13.2 % rent growth. Occupancy increased 110 basis points to 95.6 %. Finally, Seattle continues to be a top performer with rent growth of 16%, retention 91% and 188,000 square feet of production. The Seattle market is one of the tightest in the country, and we have been able to take advantage of the stellar fundamentals.

Looking into Q4, I have confidence that with 2.2 million square feet expiring, we are poised to produce solid operating metrics buoyed by strong existing customer demand, low market vacancy, and a team that knows how to produce results.

Now, I'll turn the call over to Jeff.

Jeff Hedges: Thank you, JP. As Maria mentioned in our opening remarks, we are very pleased with our third quarter financial results. Net income for the three months ended September 30th was $0.96 per diluted common share and $2.95 per diluted common share for the nine months ended September 30th. Year-to-date, funds from operation or FFO was $5.13 per share, an increase of 6.7% from a year ago while funds available for distribution or FAD increased 9.9% over the same period. The increases in both FFO and FAD were primarily attributable to growth and same park NOI, which on a cash basis increased 5.1% over the nine-month period ended September 30th compared to the prior year.

We are also very pleased that our non-same park portfolios performing as all of our recent acquisitions have to this point met or exceeded our underwritten assumptions. Additionally, our multi-family property, High Gate at the Mile, continues to perform very well as NOI reached 4.4 million for the nine months ended September 30th which is in line with our expectations.

I'd like to now provide a few additional details related to the Maryland sale. First, we want to clarify that the assets that sold are identical to those which are classified as held for sale as of and for nine months ended September 30th. Of the portfolio, which was marketed, we opted to retain one 113,000 square-foot office building which is 100% occupied by a single GSA tenant in the [past] site. Both the GSA tenanted building in [past site] had not been previously classified as held-for-sale and both remain in our same park portfolio. Turning now to the balance sheet. As you may have noticed, we are out on the line 50 million as of September 30th. With receipt of the Maryland sale proceeds, we have paid that down in full.

Finally, I'll wrap up by pointing out that we paid a dividend of $1.05 to common shareholders in the third quarter, and our board recently declared a dividend of $1.05 to be paid to shareholders in the fourth quarter payable on December 30th to shareholders of record on December 13th.

With that, we'll now open the call for questions. Operator?

Operator: At this time, if you would like to ask a question, please press star (*) and 1 on your touchtone phone. You can remove yourself from the queue by pressing the pound (#) key. Again, that's star (*) and 1. We'll, take our first question from Craig Mailman with KeyBanc Capital Markets.

Craig Mailman: Hey, everyone. Just starting on Hathaway here, you mentioned that almost half the property has an expiration in 2020. Are you guys planning on that tenant moving out and going in with your typical PSB demise program and getting just more tenants or is that a market where you feel like you want to keep a larger space for bigger tenants? What's the capital that you think would have to go if you decide to do your typical program?

John Petersen: Yes, Craig, it's JP here. Good question. Right now, we're real confident – well, first of all we're negotiating with the customer to renew. We're real confident, if we're unable to come to a renewal, that the market supports a full building user. The rest of the park, as you can imagine, is small multi-tenant industrial. There's one big building in LA. It's very marketable. We expect that there'll be good demand if we're unable to renew the tenant. Either way, we're confident that there's really good rent growth there and small amount of capital to lease the space up. We like our position with that expiration.

Craig Mailman: Okay. Then what's the timing to get to the rest of the leases to capture that 20% or 30% mark-to-market?

Maria Hawthorne: Hey, Craig, so in the first two years, first 24 months of ownership, 76% of the park is turning. As you know, 288 of 543 is over 50% as this one deal. Then as JP said, the other spaces are pretty small industrially speaking so we're confident about what's going on there and the rent increases that we'll see throughout the Park.

Craig Mailman: I'm sorry. I knew you guys typically don't want to talk about yields, but from - you're going into where this thing could stabilize in two years, I mean what do you think the uplift could be on a yield?

Maria Hawthorne: Craig, we don't like to give yield information like that. That's skirting the edge of guidance there, but this was definitely a market deal. It was expensive. What we loved about it was that it was a 10-building park of various sizes, and we have a great operating team in LA. We're very confident that we will be very successful moving this asset forward and bringing it at market rate. Craig, with the big expiration coming, you'll see it happen next year.

Craig Mailman: Right. I'm just trying to get a sense of the dollar uplift on it. Is there any way to say what the in-place rents are on a per month basis? I'm just trying to get a sense of how to model the uplift as it seems like there could be a pretty big upper swing, and it doesn't take much to move your FFO a couple of pennies.

Maria Hawthorne: Yes. Craig, it would be hard to say for 2019 just because with this big customer, if they renew, that will be a big increase immediately, but then of course if it goes dark, then it does take one or two or three quarters to lease that size space up. I wouldn't want to be forecasting FFO for the space, and we will certainly give a better update in February when we talk again.

Craig Mailman: I guess moving on, outside of this 288, what other big expirations you guys have in ‘20? Any chunk you [want]?

John Petersen: Yes, I mentioned we’ve got a couple in Northern California that are expiring this quarter. Again, much like the one in LA at Hathaway, there’s a market for big expirations. Our plan is not to slice and dice those, but we could have – I mean, just to be clear, we could have some vacancy in Northern California as we head in to ‘20. Other than that, we don’t have any big one in SoCal and nothing that’s material really in the rest of the country. I’d say primarily, Northern California, we got these two big ones. We got a couple of others midyear, but again I like our position there in renewing those and pushing rents as those leases mark-to-market.

Craig Mailman: Right.

John Petersen: We do have – sorry Craig, we have a bigger one in Seattle there at 212 Business Park that we’re pretty sure it’s going to come back to market with this midyear next. That’s really it.

Craig Mailman: How big is that?

John Petersen: It’s over 100,000 square feet up in Seattle.

Craig Mailman: Okay. You guys are building another 80,000 square-foot facility there. I guess you feel really good about the demand at that park.

John Petersen: We feel great about demand at Kent Valley. Our park has been – when space becomes vacant, we re-lease it very quickly. We’ve operated it in the high ‘90s for the last, I don’t know, several years. We are also – that’s why we’re building this new building as Maria pointed out and we’re building multi-tenant industrial. That’s what the park is and that’s what – even though there’s this is one expiration, more than likely you’ll see us slice and dice that like we always do with our bigger blocks or like we mostly do with our bigger blocks. Does that answer your question?

Craig Mailman: It does. Just on the developments, are you guys going to spend an aggregate, it's like $10 to $50 million? Do you think of spend that you could fund just through cash flow or is the cost bigger depending on what you're building?

Maria Hawthorne: No, no. Yes. Craig, even though these are multi-tenant industrial buildings they're still industrial building. What will make them unique is that they're hyper infill. Dallas is not a place we would ordinarily develop, but the part that I'm talking about is about 1 mile from the freight access into DFW. It'll have 28-foot clear height, 10,000-foot units, and that is just something that will be unique that is close to the airport. It's the same thing with the Kent Valley. That is a completely built-up market in Seattle. We're putting 30-foot clear height, which – and again we're going small tenant. We don't have a lot of 10,000, 12,000 square-foot spaces at 212 Business Park. The ones we have usually have a waiting list. We're very confident that these will be as successful as the development that we did in Miami a few years ago.

Jeff Hedges: [Crosstalk] Yes. We won't have to do anything out of the ordinary to finance these developments. You're directionally accurate in your thought in terms of the cost of development.

Craig Mailman: Okay. It's like $60.00 a foot [of land] basically, roughly.

John Petersen: Yes.

Maria Hawthorne: Costs have gone up [Laughter], and it is Seattle. I would target more $100.00 to $115.00.

Craig Mailman: Even [ex] land because you guys already have the land, right? That's just in this [Crosstalk].

Maria Hawthorne: Right. That's correct

Craig Mailman: Okay. Just one last from me…

Maria Hawthorne: Right. Craig, we're still getting bids. Those are good numbers to model. Seattle, a little more expensive, about 20% more expensive than Dallas.

Craig Mailman: Okay. Then just one last one. Anything in the same store expenses? Cash rents were pretty consistent grower, but expenses were up a bit this quarter.

Jeff Hedges: Yes. Craig, as we talked about a little bit last quarter, our business is somewhat seasonal and also is impacted by weather patterns or other events that are out of our control. Quarter to quarter there could be little timing differences. We probably benefitted a little bit from some timing items in Q2 that came into normalization in Q3. What I always remind people is while it's important to look at quarterly results for directional indications, it's equally or more important to look at the year-to-date results. I would say our nine months ended year-to-date results are a better reflection of how our portfolio is trending from an opex perspective.

Craig Mailman: Great. Thanks, guys.

Maria Hawthorne: Thank you.

Operator: Our next question will come from Manny Courtman with Citi. Please go ahead.

Manny Courtman: Hey, guys. Just as we think about the two new developments you're starting, are there other places in the portfolio that we should expect announcements of new development or is this it for now?

Maria Hawthorne: Manny, that's a good question. For now, that's it. I mean there will definitely be opportunities in the future for redevelopment, but nothing for 2020.

Manny Courtman: Thanks, Maria. Then, JP, on the large leases you spoke about in SoCal, are those going to require repositioning assets or a bunch of capital or is it just simply trying to match the right tenant to the right space there?

John Petersen: There are two. The one at the Hathaway Park we just bought won't require much capital. That's a 280,000 square-foot expiration is coming up. The one that we just repositioned 52,000 square feet I mentioned, that required more capital. That tenant had been in the building basically for 30 years. We had repositioned that building. Now, we have it back, and we're marketing it. We are real excited about rent uptick there.

Manny Cordman: There's no timing delay or capital need from here forward. That's all been done for both of those spaces essentially.

John Petersen: That's correct. That's correct.

Manny Cordman: Perfect. Thanks guys.

Operator: Our next question will come from Blaine Heck with Wells Fargo. Please go ahead.

Blaine Heck: Thanks. Just a follow-up on the development. How do you guys think about the economics? Is there a yield hurdle that you guys are targeting or any other target you use to I guess determine whether or not to go ahead with construction?

Maria Hawthorne: Yes. Hey, Blaine. That's a good question, too. I can tell you that stabilized returns will probably be at least 200 points higher than what you can buy in new product these days once it's stabilized.

Blaine Heck: Okay. That's helpful. Then you guys seemed to have several different options for funding between the low-cost of [debt] out there, potential preferred issuance, your low-costed equity and potential disposition proceeds. I guess maybe for, Jeff, can you just tell us how you're thinking about maybe the relative attractiveness of funding sources for spend on both the development pipeline and potential additional acquisitions out there.

Jeff Hedges: Yes. Great questions. Obviously, we keep a close eye on all the capital markets, and you're right in identifying that. All three come in preferred and potentially issuing debt are attractive to us right now. At this point in time, we don't have a funding need that would require us to tap into those markets for new acquisitions or for growth capital. We hope to have something to raise capital around here in the near future. At that point in time, we'll assess what the right avenue is for us at that given point in time.

What you've heard us say for the last couple of quarters is that even though we historically have not utilized debt, at least not significantly, that is something we will explore potentially. Of course, our cost of common and preferred equity remains attractive to us as well. We're going to keep a close eye on all of that. We'll provide guidance on this topic once we have something to actually raise capital around.

Blaine Heck: Great. That's helpful. Last one maybe for JP. Rent spreads have been negative for your office portfolio this year. Do you anticipate those turning positive in the near future or do you think we'll see negative spreads? Are those negative spreads mostly attributable to the greater DC portfolio or are there maybe any other pockets of weakness out there?

John Petersen: Yes. Blaine, this is not new for DC office, as you well know. When we assess doing a lease or a renewal and some of the ones I talked about in my remarks, it's far better for us to do a renewal especially ones that I mentioned. One of which was a large expansion. We're really happy with those renewals even though they came with the rent right down. In terms of looking forward, all of the office rent issues are in DC, not anywhere else because we don't have much office anywhere else for that matter.

I do think we're seeing more strength in DC to be honest. We're seeing more activity from government contractors. One of the expansions I mentioned was a government contractor and they're taking more space and extending term. That's a good sign that we're seeing. We do have parks where from time to time we can keep rents flat. It's hard to grow when the market is 20% vacant, grow rent that is. I do think our goal is to start reducing that office rent decline. It's really tough to do in a market that's, again, 20% vacant, but from time to time and park to park, we do have opportunities in our office portfolio in DC to either hold the line on rents that expire or occasionally, believe it or not, we can grow rents in some of our parks here.

It really is isolated to DC. Again, our view on DC is we've had a really good view there, production-wise. We're seeing more activity frankly in '19 than we have in a long time from the sectors that I mentioned, technology, government contractors. We're not seeing anything directly from the Amazon effect. No direct deals from that or anything so I don't want you to read into that, but the economy is active. Unemployment is 3% in DC. The Nationals are in the World Series and things are good there. [Laughter]

Blaine Heck: Yes, that's helpful. Thanks, everyone.

Maria Hawthorne: Thanks, Blaine.

Operator: Our next question will come from Eric Frankel with Green Street Advisors. Please go ahead.

Eric Frankel: Thank you. Can you remind me on the dispositions, what the occupancy was of the portfolio that's sold? I know there was a tenant move up. I wasn't sure if that occurred late in the quarter or early in the quarter. I just want to get a bare sense of the cap rate and what that entails.

Maria Hawthorne: Yes. Eric, the big tenant that moved out was about 160,000 square feet and that did occur in the first quarter. We were around 80% occupied upon the sale.

Eric Frankel: Okay. It seems like a pretty negative read-through for overall property, guys, for that office flex properties in Maryland and Virginia. Can you comment on whether that valuation that you experienced, is that appropriate to extend to the rest of your portfolio there or is there special circumstances that gave this portfolio a bit of a discount?

Maria Hawthorne: Okay, yes. There are special circumstances. First off, Maryland and Virginia are two different markets. We break it out that way. Virginia is a right-to-work state. It's very pro-business. In fact, Montgomery County did a survey on – and Montgomery County is where we had these assets, did a survey on why Fairfax County was getting more business than Montgomery. It came out the issue is pro-business, lower taxes. Maryland is a very high-tax state. Virginia is a lower-tax state. Don't ascribe the Maryland asset sales to Northern Virginia.

Secondly, the portfolio that we sold when we say flex, this was large tenants flex that was really 95% built-out as commodity office. The office portfolio in Maryland was larger tenant office than what we have in Northern Virginia. With the market as well as the type of product, that was the difference. If you think about like what we bought in Northern Virginia last year, that 1.1 million square-foot acquisition, that was pure and plain industrial, which is seeing rent growth, seeing occupancy growth, and we're very, very happy. That should have industrial cap rates on it. Suburban Maryland office quite frankly right now just has a black eye.

Eric Frankel: Right. Would you spread that to suburban Virginia? Because I understand that the fundamentals are better there, a little bit better business environment, but the occupancy between your two portfolios isn't all that different. The rent spread hasn't been all that meaningfully different over time, too. I just want to have an investor review of cash flow in North Virginia office or flex versus Maryland. I understand last year's purchase of the industrial portfolio, that's a different tenant profile and different economic driver. It seemed obvious that office is heading in one direction and industrial is heading in another direction. I'm just trying to understand where were think about valuation.

Maria Hawthorne: Yes. Okay. Eric, a lot of the Virginia office, a lot of it is at the Mile. We're going to eventually redevelop that entire 45 acres. We've only redeveloped five of it. Then on the slate, we'll have two more phases coming which will be about another 10, 12 acres. If you think about that, that will be a redevelopment opportunity. Our other office and a bigger piece of office in Northern Virginia is Herndon and that was one of our original parks to have one of our lowest basis. The Metro literally was being built and is being opened next year across the street. We feel really good. That will also be a future redevelopment opportunity.

Then we have a big flex office park in Merrifield and again down the street eighth of a mile away from the Metro. Our Virginia office portfolio is very well located for future development, has higher occupancy than Maryland, and that's because the demographics and the economic dynamics in Northern Virginia are stronger than suburban Maryland.

Eric Frankel: Okay. It sounds like Maryland is in need of a train line, too. [Laughter] I have a couple of other questions, if you don't mind. These kinds of developments, it only makes sense for you to get started on building on some excess [land] in a good market, but why haven't you developed those assets a little bit sooner? Those markets haven't been in great shape for a few years now.

Maria Hawthorne: They have. First off, the space that we're going to be able to build the Seattle office – I'm sorry, not office, industrial building, is currently yard space for the big tenant expiration that JP referenced in an earlier question. We don't have access to it until that tenant moves out next year. Then quite frankly, the freeport, our park there is more of a flex park though not a high-finish flex park. It really hit us as we were thinking about it starting last year. We explored the idea, could we build the industrial building, and we can. We've been working on that, but we didn't want to announce anything until we knew we could build it.

Eric Frankel: Okay. That's helpful.

Maria Hawthorne: Yes.

Eric Frankel: Follow-up questions related to the acquisition. It seems obviously you have to disclose the yield, but certainly it seems it has good fundamentals and that market is in great shape. I know you're also recycling some proceeds from the Maryland office flex sale? Why not significantly increase your appetite for those types of transactions? It seems like they're out there. I understand that they're not easy to find. It's super competitive, but you guys certainly have a pretty durable competitive advantage in operating small tenant assets. In the market that you traffic in, there are still a fair amount of assets now that are trading. Do you have any appetite for being a little bit more aggressive going forward?

Maria Hawthorne: Eric, I would love to come back in February and announce 10 more Hathaways. There would be nothing that would please me more. The problem is that while there's been a lot of industrial that's come on the market and some parks, they're in Illinois, farmland in Pennsylvania, lots of stuff for sale in Las Vegas, Reno, what I would consider secondary markets, but at cap rates that are now - because of cap rate compression, approaching primary market rates. If we're going to pay for retail, it will be in our core market. Quite frankly, it's hard to find these very attractive business parks in our core infill markets. When we see them, as we did with Hathaway, we got very aggressive.

Eric Frankel: Okay. Sounds good. We'll discuss again. Thank you.

Maria Hawthorne: Thanks, Eric.

Operator: Once again, if you do have a question, you may press star (*) and 1 on your touchtone phone. At this time, we'll take our next from Tony Paolone with JPMorgan. Please go ahead.

Tony Paolone: Yes. Thank you. I guess first question on the developments. I think the last one you did was residential and you had a partner. Do you guys have the team and staff to do this or do you need to make changes there?

Maria Hawthorne: We do. With the thought that we're going to be thinking about redevelopment not just at the Mile but other locations in the future, we are going to be adding an executive of development to make sure that we have appropriate oversight. We're very happy with our joint venture partner. In the next development, we're going to be working with them again. We're very happy with them, but we realize as this will continue in the future, we do also need that in-house expertise. Just as a reminder, too, we did also add to our board a multi-family development expert. We have that expertise on the board. Of course, the industrial development we have in-house. That's JP's background, and he's developed millions of square feet of industrial so we're good there.

Tony Paolone: Okay. How do we think about then more specifically with G&A particularly in a quarter, which was a bit higher? How should we roll that as we think ahead?

Jeff Hedges: You shouldn't expect anything with regard to the to-be-named, the new hire that Maria referenced a minute ago for 2019. We're hoping to have somebody join our team in that role in early to mid-2020. You could expect a midlevel salary attributable to that person. You're right in assuming that that would run through – that would be G&A position. Tony, as that search progresses and we have something to announce, of course, we will make that announcement.

Tony Paolone: What about just the third-quarter you just reported in terms of that number being a bit higher. Does that come back down in near term or…?

Jeff Hedges: Yes. As we try to highlight in the press release, there was what we're referring to as one-time events related to the change in the direct-to-retirement share policy. For accounting purposes, the stock-based comp expense related to that change was about $1.1 million. That's a one-time effect. The one rate stock-based comp will be marginally higher attributable to that change, but very de minimis in terms of the run rate effect of that. That one $1.1 million charge is truly a one-time event related to the change. We expect Q4 to come back in line with what we experienced in the first six months of the year.

Tony Paolone: Okay. Then for JP. You touched on this a number of different ways. I just want to make sure I understand. The three larger expirations in 4Q, one's renewed, but in terms of the other two, should we anticipate some level of downtime or gaps such that occupancy is down in 4Q before coming back up or how should we think about that just near-term?

John Petersen: Yes, Tony. Look, what we're trying to do here is secure really good credit, really long terms at really higher rent. [Laughter] We want it all. Yes, there is a chance that there will be some downtime because I think we're at a point in time now in that particular market in Northern California where we can try, and we've been successful in getting good credit at higher rents for long-term leases. That's what we're trying to do here. As a result, we may not be able to make the deals that we're interested in. There could be some downtime. My goal is to keep those spaces full that if we're unable to come to an agreement quickly, but yes, we're fine with going forward on the market fundamentals there. The demand for those types of spaces is very strong. We could realize some downtime, yes. I hope we don't, but we could. I'm fine with it if we do. Does that make sense?

Tony Paolone: Yes. No. I'm just trying to understand near term since you've had very good occupancy terms. If we do see that, step back before continuing on. Okay. We'll work it out. Last question, I guess I know Craig I think probably tried to ask by the ways on the modeling side with Hathaway. Just order of magnitude in terms of things about how you're thinking about returns, if you're going in a market return that's probably got a poor handle on it, thinking three to five years out, for it to be interesting to you, does that need to go to five? Does it need to go to eight? What is an interesting return for you all these days for a core type property in your portfolio?

Maria Hawthorne: We always like to get high returns, and we are accustomed to that. One of the things that happened and I think Jeff referenced this is an earlier remark is that interest rates have never been more attractive. They've been attractive for a long time. We are open to tapping into that. That allows us to keep historic spreads for our returns. They will be materially lower than what we required in the past which was in the 7% to 8% range. For industrial right now in these core markets, we're happy to get a 5.5% to a 6%.

Tony Paolone: That 5.5% to 6% being something a few years out after you've stabilized and moved the rents up and that sort of thing.

Maria Hawthorne: Exactly.

Tony Paolone: Okay. That's helpful. Thank you.

Maria Hawthorne: Okay. Sure.

Operator: There appear to be no further questions at this time. I'll turn it back to Jeff for closing remarks.

Jeff Hedges: All right. Thank you everyone. We look forward to seeing many of you maybe in a few weeks. Have a good afternoon.

END