**PSBQ420**
**John Petersen**
**PS Business Parks Incorporated**
**02/23/21**
**1:00 pm ET**

**Operator:** Good afternoon and welcome to the PS Business Parks Fourth Quarter 2020 Earnings Results Conference Call and Webcast. At this time, all participants have been placed in a 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 *1 on your touchtone phone. If at any point your question has been answered, you may remove yourself from the queue by pressing the # key. If you should require operator assistance, please press *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 Fourth Quarter 2020 PS Business Parks Investor Conference Call. This is Jeff Hedges, Chief Financial Officer. With me today is our Interim Chief Executive Officer and COO, John Peterson; and our Chief Accounting Officer, Trent Groves.

Before we begin, let me remind everyone that all statements, other than statements of historical fact 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 reports filed by the company with the Securities and Exchange Commission, including our annual report on Form 10-K and subsequent reports on Form 10-Q and Form 8-K.

We will also provide certain non-GAAP financial measures. Reconciliation of these non-GAAP financial measures to GAAP is included in our press release and earnings supplement, which can be found on our website at psbusinessparks.com.

I will now turn the call over to JP.

**John Petersen:** Thanks, Jeff. Good morning. Thank you for joining us today, and we hope each of you and your families are doing well and staying healthy. As we approach one year of dealing with this pandemic, I would like to recognize and thank our team for everything they achieved in 2020. It has been a challenging year for everyone, and we are looking forward to a 2021 that hopefully will be closer to what we all know as normal.

Today, I will discuss a few Q4 highlights, then touch on the acquisition environment, and close with our view on 2021. I'll start by taking a moment to mention that there is no update to give today on the open executive positions which we have discussed previously. We remain excited to round out our executive team and move the company forward in 2021.

Now, turning to our Q4 and full-year 2020 results, I am pleased with our performance on many fronts: leasing production, transaction costs, rent collections, and, importantly, the resiliency of our customer base. Our customers have demonstrated on many levels their ability to pivot and adapt to the challenging economic climate. Many businesses have emerged stronger and are better prepared to capture growth in 2021, and this is demonstrated by expansions of our existing customers.

In 2020, we had nearly 500,000 square feet of expansions from 141 customers, with Q4 bringing approximately 100,000 square feet of expansions from 34 customers. Additionally, as Jeff will discuss later, rent collections are essentially back to pre-pandemic levels.

We ended 2020 with strong leasing activity for the fourth quarter, totaling almost 1.9 million square feet and for the full-year 2020, we completed 7.5 million square feet, which is more total production than we achieved in 2019. As we mentioned in our earnings release, in December we signed 138,000-square-foot lease at our Wiegman building in Hayward, California with strong rent growth of over 40%. This deal is consistent with our plan to subdivide the space which was originally 460,000 square feet. We now have one unit left of approximately 140,000 square feet on which we have strong activity, and anticipate releasing it this year with rent growth consistent with this most recent deal.

Speaking of rent growth, cash rent spreads in Q4 averaged 5.3%. Industrial cash rent growth continued to lead the way at 8.8%, while flex and office rents were essentially flat.

Regarding the acquisition environment, as most of you know, competition for industrial assets remains highly competitive. Of the deals we have tracked in the last few quarters, we are seeing investors many times competing for industrial assets in our core gateway markets. Despite the heightened competition, we are encouraged by the number of deals in our pipeline, and our team is actively underwriting several opportunities. We are poised to utilize the strength of our balance sheet and put capital to work in 2021.

On the development front, we have completed our 83,000-square-foot multi-tenant industrial building in Dallas, Texas, on time and on budget. The property is attracting a strong interest we expect that it would, and we anticipate the property will fully lease in 2021.

In Seattle, we plan to commence construction next month on a similar 80,000-square-foot multi-tenant industrial building at our 212 Business Park, with delivery targeted for Q4 of this year.

As we look ahead, we fully realize that pandemic is not behind us yet. However, we are encouraged by positive trends with our customers, our markets, and overall industrial operating fundamentals we have seen early in 2021. Demand for both new and renewal leases is healthy and rent collections are essentially back to normal.

Starting the year with occupancy at 92.9% and no single scheduled expiration greater than 90,000 square feet during the year, the PSB team is poised to capture occupancy upside in 2021. Building upon the momentum from the second half of 2020, I am confident that PSB is well positioned for a strong year in 2021.

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

**Jeff Hedges:** Thank you, JP. I'll begin with an overview of our financial results for the quarter and year-ended December 31, 2020. Net income allocable to common shareholders for the three months ended December 31st was $26.9 million or $0.98 per diluted common share, and for the 12 months ended was $124.6 million or $4.52 per diluted common share. Core FFO was $57.9 million or $1.66 per share for the quarter, and $229.5 million or $6.57 per share for the year.

In Q4, cash net operating income attributable to our Same Park portfolio was $69.2 million, a decrease of 0.5% from the prior year. This decrease was primarily a result of lower Same Park weighted average occupancy which was 92.0% in Q4 2020 versus 94.4% in the prior year. However, the decrease in occupancy was mostly offset by increased cash rental income from the occupied portion of our Same Park portfolio as cash rental income per occupied square foot increased 3.6% in Q4 versus Q4 of 2019.

For the year, Same Park cash NOI was $267.4 million, a decrease of 0.9% from the prior year. Similar to Q4, the decrease for the year was primarily driven by lower weighted average occupancy in 2020, which was 92.4% versus 94.5% in 2019, while cash rental income per occupied square foot increased 2.4%. Excluding the effect of COVID-related rent deferrals and abatements, the increase in Same Park cash rental income per occupied square foot was 3.4%.

As JP mentioned previously, this increase in net income generated by the occupied portion of our portfolio provides momentum as we look to recapture occupancy in 2021. FAD was $48.0 million for the three months ended December 31, 2020, representing an increase of 6.7% from Q4 2019. For the year, FAD was $190.1 million, a decrease of 2.4% from the prior year. Relative to core FFO, the change in FAD for both the three- and 12-month periods benefited from efficient use of capital as our teams were able to generate significant lease production with minimal transaction costs. For the year, Same Park recurring capital, which includes both transaction and maintenance capital, was 11.5% of NOI versus 12.3% in 2019.

I'll now take a moment to provide some commentary on rent collections and rent relief. As presented in our earnings release and 10-K filed last night, there was very little new rent deferral or abatement activity in Q4. Further, we have collected 97.1% of deferral repayments scheduled to be repaid to date. In 2020, we granted $5.7 million of COVID-related rent deferral, of which $3.2 million was repaid through December 31 and an additional $1.9 million is scheduled to be repaid in 2021.

Regarding AR, Q4 was effectively a normal quarter for rent collections. We ended the year with an AR balance almost identical to the balance in the prior year, and AR write-offs were $0.2 million, our second straight quarter of normal AR write-off volume.

California remains more challenging for rent collection than any of our other markets due to the continued moratoriums and the state and local orders that remain in place. However, our teams have done a terrific job of managing our list of delinquent tenants down to a small number of holdouts.

Turning now to the balance sheet, we ended the quarter with roughly $69.1 million of unrestricted cash, and our credit facility remains undrawn and we have no debt outstanding. We are funding our current and planned development projects with cash on hand and will utilize our credit facility as necessary as acquisition opportunities present themselves.

Lastly, I'll point out that we paid a dividend of $1.05 per share to common shareholders in the fourth quarter, and our board recently declared a dividend of $1.05 per share to be paid in the first quarter of 2021 on March 31st to shareholders of record on March 16th.

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

**Operator:** The floor is now open for questions. At this time, if you have a question or a comment, please press *1 on your touchtone phone. If at any point your question is answered, you may remove yourself from the queue by pressing the # key. We do ask that while you pose your question that you pick up your handset to provide optimal sound quality. Thank you.

Our first question is coming from Emmanuel Korchman with Citi. Please go ahead. Your line is open.

**Emmanuel Korchman:** Hey, everyone. Jeff, just wondering - or maybe this one's for JP - on the shorter leases and your trends and run rate this quarter, is that on you making that choice? Is that the tenants wanting some flexibility with the lease or something in between?

**John Petersen:** Yes. Hey, Manny. It depends on the situation, but maybe a little bit of both. We think that in Q4, the market wasn't fully recovered yet, and we think there are better things ahead, as you can tell. We may have wanted to keep lease term shorter and in some cases, the customers weren't sure of their business going forward, and so they decided to do that. The way our teams work the lease deals is on a situation, case-by-case basis, and so

I would say it's a mixture there but certainly, at times, we have made that decision.

**Emmanuel Korchman:** Then on the acquisition pipeline that you wrapped up with, what does that pipeline look like right now if we had to guess how much you might transact in 2021? Could you help us ballpark that?

**John Petersen:** I can't put a number to it, Manny, but what I can tell you is with each succeeding week, every couple of weeks we're starting to see more activity, which is encouraging in our core markets and even we're starting to see activity in markets that we're not in, and we're actively underwriting, like I said before, a number of these transactions. It's starting to build momentum and, as you know, kind of midyear in 2020 with COVID, the acquisition market went silent for several months, but now we're encouraged by what we're seeing out there in terms of deals coming to market. I don't have a number for you, but we are encouraged that we're going to be able to put our capital to work here in 2021.

**Emmanuel Korchman:** That's it for me. Thank you.

**John Petersen:** Yes.

**Operator:** We will move next with Craig Mailman with KeyBanc. Please go ahead.

**Craig Mailman:** Hey, guys. Jeff, appreciate you giving us what the deferred rents to be paid back in 2021 are. Of that $1.9 million, is that all in the same store?

**Jeff Hedges:** It's not all in the same store but as you would expect, given how much of our portfolio is comprised by our same-store portfolio, it's primarily coming from that.

**Craig Mailman:** Okay. I apologize, I can look it up, but what's the same-store as a percent of the total pool right now?

**Jeff Hedges:** It's roughly just under 96%.

**Craig Mailman:** Okay. I know you guys don't give guidance here but clearly, the pressure is kind of ebbing here from COVID. I don't know if there's a way you could give us some building blocks to look at. Some of these pieces you guys have in the bank, so to speak, versus what your ending 2020 NOI is for the same-store pool. It seems like you get most of this $1.9 million, maybe the $1.3 million of abatements likely doesn't recur. Then you have this lease that you guys just did in Hayward and maybe some free rents and from some of the other bigger leases that you guys have completed in 2020 may be burning off. I'm not trying to get the guidance, but just could you give us some pieces of the building blocks of same store from what's in the bag already and maybe include like what rent bumps are on average?

**Jeff Hedges:** Sure. We'll try and address at least some of that, Craig. I wouldn't describe anything necessarily as in the bag but as you've pointed out, there are certain things that we have laid out in our press release in terms of the components of revenue or items that are going against revenues, such as the abatements that as we sit here today, we would expect in 2021 we would have lower abatement volume than we did in 2020. Similarly, deferral volume has dropped off significantly in Q4 and if that trend continues to hold, deferral repayments would become a tailwind for us in 2021.

I would point you to what we've included in our press release, specifically for the Same Park portfolio on those components of revenue, and you can make your own assumptions in terms of how those will trend for us in 2021.

Then as it relates to just rent bumps, generally, our average rent bump in multiyear leases is roughly about 3%. That has been the case for some time and remains the case today and of the new leases that we've been signing recently, that trend continues. On average, multiyear leases tend to increase, at least on the base year component by about 3% per year.

**Craig Mailman:** Okay. Then on the 140,000 lease you guys did in Hayward, was any of that in 4Q or is that all going to be recognized in 2021 in terms of the benefit?

**Jeff Hedges:** You're talking about the large lease that we announced, the 140,000 square feet in Q4?

**Craig Mailman:** Correct.

**Jeff Hedges:** Yes. That lease was signed at the very end of the year, so the cash flow benefit of that lease will be entirely recognized in 2021.

**Craig Mailman:** Could you give a sense of what quarterly or annually the uplift is from that or just the total rent?

**Jeff Hedges:** Craig, I don't have that specific data available to give here today, but I can tell you that with leases of that nature, typically we will give some free rent concessions on those leases. In this particular lease, the free rent period is actually relatively short, so we would expect to benefit from cash flow from that particular lease transaction for most of 2021.

**Craig Mailman:** Is that like at $8.00 or $9.00 per square foot lease or is it in that ballpark?

**Jeff Hedges:** Go ahead, JP.

**John Petersen:** Yes. Yes, that's in that ballpark and like I said in my prepared comments, Craig, we're excited about getting the next vacancy lease as well. I can't tell you when because I don't know, but we are seeing good activity in that neighborhood of rents and fortunately, there's good demand. Our hope is to get that thing put to bed here over the next couple of quarters. As I said before in previous calls, we are being selective in credit. We're being selective with the user. We want to do the right deal for long term, so we are going to be patient there but there's enough activity that we're confident that we can get something done this year.

**Craig Mailman:** Okay. Then just on the financing, I know you guys have the Series W that comes in October. Where do you guys think you could price right now for preferreds, or is this the time to maybe mix in some 10-year unsecured debt to give you guys a little bit more lift as you do acquisitions on the refinancing?

**Jeff Hedges:** Yes. As you pointed out, we do have the opportunity later this year to potentially refinance that series of preferred. As we've said numerous times over the past few quarters, for the right deployment opportunity, we will take a very serious look at senior unsecured debt as a means of financing those acquisition opportunities or those growth opportunities.

JP spent a little time earlier talking about our pipeline. If we are able to acquire a meaningful amount of real estate this year, debt will be considered as a potential means of financing those growth opportunities. As it relates to the preferreds specifically, preferred is a - we like it and we continue to like it. We'll evaluate what, if anything, to do with the potential refinancing opportunity of those preferreds when they come due later this year but for right now, there's no commitment either way on that.

**Craig Mailman:** Where do you think you could price today on preferreds?

**Jeff Hedges:** It's a hard question to answer specifically because of the lack of comps in the market. I would say based on what we saw transpire at the end of last year in Q4 and just what we're seeing in terms of where our strip yields are trading on our existing series, probably in the low- to mid-four area. Certainly, we would expect or hope that we would price inside the last issuance that we did which was 4.78% but again, that's subject to market movement and could change. Without actually being in the market on an offering, it's really hard for us to pinpoint that with any precision.

**Craig Mailman:** I agree. Thank you, guys.

**John Petersen:** Thanks, Craig.

**Operator:** Next, we have Blaine Heck with Wells Fargo. Please go ahead.

**Blaine Heck:** Thanks, Craig. Good morning out there. Just to continue along those same lines of Craig's questioning, and I'm sorry if I missed it, but it didn't sound like you guys talked about dispositions as a source of capital. Do you guys see sales as a viable source of funds, or is it maybe because of office pricing and the lack of visibility that we should assume that you guys are looking more toward debt and other sources of capital this year?

**John Petersen:** Yes, Blaine. Good question. As we've done from time to time in the past, we've strategically moved out of some office assets that we don't see as redevelopment opportunities, and we'll continue to evaluate some of those parks as the market recovers from the COVID situation. To your point, and as Jeff just talked about, we would certainly look if we can find some deals to put some debt potentially on the balance sheet to be acquisitive here, but I think it could be a combination. Of course, we have cash, too, that we're ready to put to work. It could be a mixture of each, and we'll see how the office market recovers and what's in play for some of our office portfolio that we don't think we can redevelop moving forward.

Does that answer your question?

**Blaine Heck:** Yes, that makes sense, very helpful. Then second question for me. Can you just talk about any shift in demand you guys have seen as a result of the pandemic? I'm just thinking about office, especially there has been a bit of a movement we've seen from coastal, high-cost, high-density markets to more Sun Belt or even fringes, maybe some more suburban markets. Given that you guys have exposure on both sides of the equation, I wanted to see if you had any insight or we're seeing any noticeable differences in demand throughout your markets?

**John Petersen:** Yes, Blaine. We monitor that very closely and on a weekly basis, and so what we're starting to see on the office side first is in the last, let's call it, four to six weeks, we're starting to see - and as you know, Blaine, our office portfolio is primarily in Washington, D.C. area, and it's all suburban. Frankly, we're seeing more office demand than you might expect. We're seeing where that's coming from, we've done a deal most recently with traditional suburban office space with a homebuilder. We did a deal with the government for office. We did a deal with a government contractor. Surprisingly, we're able - and as I pointed out earlier, our rent growth was essentially flat for office which, again, is another positive surprise. The suburban office market is probably better than you would expect coming - while we're still in the pandemic, but in this environment.

Then shifting to the other side of the coin, yes, there has been some outmigration from California, as it has been well documented. As our stats would point out, we haven't seen any of that yet. Anecdotally, sure, there are companies that are moving to other Sun Belt markets as we've seen, but there still is good demand in Southern California. In Northern California, as I touched on, we're seeing good demand, but yes, I think there's some outmigration from California, but I think there's still a lot of innovation and growth to be realized in our California markets. We're capturing that, as you saw in our rent growth stats for California and the activity we're getting. We were a little bit concerned about it and we're still monitoring it really closely, Blaine, but we're encouraged by the level of activity, especially I would say maybe as we got mid-January, maybe this COVID - that surge has died down a little bit. Maybe we're seeing more activity and that shows in some of our touring activity and things like that in California, specifically, so I don't know if that helps.

**Blaine Heck:** Yes. I appreciate the commentary. Thanks.

**John Petersen:** Sure. Thanks, Blaine.

**Operator:** Next question from Vince Tibone with Green Street. Please go ahead.

**Vince Tibone:** Hi, good morning. I have a follow-up. Do you expect shorter average lease terms to persist moving forward due to tenant preferences, or do you think 2020 was more of an outlier year due to the pandemic?

**John Petersen:** Well, certainly 2020, Vince, to your point, was an outlier year as I think any user of industrial space was trying to figure out what to do and what was going to happen with the pandemic, but I think industrial rates are still strong. Vacancy is very low still in all of our markets. There is rent pressure. I think we'll start to return here for our product type and our core customer base, and then how do customers and what do we want and how do we want to position our properties. Like I said earlier in the call, we're going to look park by park, deal by deal on how long do we want lease terms and if we can find the right space and the right credit and the right rent, we're going to push for a longer lease term.

In certain situations, we may keep it short, so it's really a push-pull on every situation, but I do think that leases were shorter in 2020 because of the uncertainty of the pandemic and demand going forward. Does that answer your question?

**Vince Tibone:** Yes. Thank you, makes sense. One more for me. Could you discuss the differences in leasing CAPEX between new leases and renewals? It looks like transaction costs were executed but were right around $3.00 in 2020. Could you maybe split that out between new leases and renewals? Just trying to get a sense if lease terms are shorter, for example, and you're renewing more frequently, could that have an impact on the CAPEX profile of the business?

**Jeff Hedges:** Yes. Hi, Vince, and good to have you on the call here today. Certainly, we've always been more efficient with transaction capital on our renewal leases than new leases, and that has not changed in 2020. We haven't broken that out in anything that we've released to date, but I can tell you that - and I'm just looking at the stats here - we're roughly around $1.00 a square foot. I'll call it $1.11 per square foot on transaction costs on our renewal leases that were for renewals that were signed in the fourth quarter. Hopefully, that gives you some context in terms of the difference between the efficiency we've been able to achieve on the renewals versus new leases.

**Vince Tibone:** Yes, that's perfect. Thank you.

**Operator:** Next question from Anthony Paolone with J.P. Morgan. Please go ahead.

**Anthony Paolone:** Thanks. Just in terms of the core portfolio, I think if I look at your occupancy in 2018 and 2019, it seemed to be in the 94.5% or so range on balance. Should we think about that as being - what sort of the return to normal looks like for you guys?

**John Petersen:** Hey, Tony, yes. I think that's where we need to be. Where our sweet spot is, is 95%. If we're in the 95%, there's a good balance there between rent growth and occupancy. If you get too high, maybe you're not pushing rents enough, right? With our rollover, we're keenly focused on that balance. There are certain parks, as you well know, that it's full and highly leased and we can push rents higher, and there are other parks where we may have a vacancy and we need to be a little more aggressive. Yes, and even if you think about the big deal in Hayward that became vacant last year, that's what, a little over 1.5 of full occupancy. Once we get that thing leased, we're pushing - you're back kind of to 95% or close to the 95%, not quite there.

Yes. Our goal is to get to that 95%, maybe push it beyond that. Look, if the momentum that we're seeing early on in 2021 continues, I think there's a chance to get there later in 2021, but we're going to have to benefit from the pandemic going away and other improving fundamentals, but that's where our sweet spot is.

**Anthony Paolone:** Okay. Yes, because I mean that was going to be my next question, like any other impediments to getting there in 2021, because it seems like Hayward is getting backfilled and you talked about, I think, 140,000 square feet of expansion space from existing tenants in the fourth quarter alone, plus just business getting back to a bit normal. It just sounds like a timing issue?

**John Petersen:** Yes, it's going to take some time. As we sit here with our masks on, right, we're still not through this and there's still some uncertainty with business, but we think that trends are favorable, as I mentioned. We do have a vacancy in Texas, in Las Colinas, that's we need to backfill. I'm confident we'll get some of these other leases that I mentioned backfilled but yes, it will take some time here but I don't think there's any major impediment so long as we continue to see the improvement in macroeconomic conditions across the country. I think we can get there towards the end of the year.

**Anthony Paolone:** Okay. Then just last question, you may have mentioned this with Manny's question, but just on the deals you're considering on the acquisition side and the stuff you're seeing in the market, any color on just where initial yields would be and just where the market is going in on transactions?

**John Petersen:** Yes. Well, Tony, the initial yields are lower than we'd like, but as you know and as you've heard from others, yields are getting compressed in the 4's, for sure, for quality industrial and gateway markets and in many cases, if you've seen from some of our peers below 4 for initial yields, and so how do you underwrite growth? How do you underwrite what the future looks like? That's the question. Certainly, for core markets like ours and even what used to be known as secondary markets, those are getting even more compressed these days as well. I think initial yields for sure, too, are in 4's, potentially low 4's.

Does that help?

**Anthony Paolone:** Okay. Thanks for the help. Yes.

**John Petersen:** Okay. Thank you, Tony.

**Operator:** If you do have a question, you may press *1 on your touchtone phone at this time. One moment while we queue.

Once again, it is * and 1.

There appear to be no further questions at this time. I would now like to turn the floor back over to Jeff Hedges for any additional or closing remarks.

**Jeff Hedges:** Thank you, everyone, for joining us today. We look forward to talking with you again soon and hope you enjoy the rest of your day. Take care.

**John Petersen:** Thank you.

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