**PSBQ220**
**John Petersen**
**PS Business Parks Incorporated**
**08/05/20**
**1:00 pm ET**

**Operator:** Good afternoon and welcome to the PS Business Parks Second 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 Second 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 Petersen; and our Chief Accounting Officer, Trenton 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 the 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 psbusiness parks.com.

I will now turn the call over to JP.

**John Petersen:** Thanks, Jeff. Good morning and thank you for joining us today. Before we get into Q2 results, I wanted to give everyone an update on our President and CEO, Maria Hawthorne. Maria has been out on non-COVID medical leave since April. She's recovering and remains on leave for the time being. Our team wishes her well and we are hoping for her full recovery soon.

Speaking of our team, I want to take a minute and thank each and every member of the PSB family for their tremendous efforts over the last several months. In spite of the many challenges presented by this unprecedented pandemic, our team delivered solid results, including impressive leasing production, low transaction costs, and steadily improving collections, and all of our parks have remained open and functional throughout.

Our leasing team led us to an impressive 1.8 million square feet of production and first half 2020 leasing volume was almost 400,000 square feet more than the same period in 2019. Retention during the quarter was 54.8%. However, this metric was impacted by the planned move-out of a

288,000-square-foot single-tenant customer at our Hathaway Business Park. Excluding this move-out, retention was 64.4%.

Included in our Q2 production was a 180,000-square-foot lease in our Hayward Business Park to a Fortune 100 customer. This lease represents approximately 40% of the 460,000-square-foot vacancy I have been discussing the last couple of quarters. We still have 280,000 square feet vacant in that building on which we have good activity.

Regarding our other large vacancy of 288,000 square feet in Santa Fe Springs here in Southern California, activity level is high and we are optimistic we will be able to lease this space in the near term. The effects of the government-ordered shutdowns in Q2 did have an impact on our ability to push rents as we prioritized production in the midst of the pandemic. Cash rent growth was 2.5% in Q2. Industrial rent growth was highest at 4.4%, while office rents declined by 6% in Q2 as demand for office space slowed as the economic shutdowns in our markets took hold.

I would like to point out that although rent growth on the nearly 1.8 million square feet in leasing production in Q2 was lower than what we have reported in recent quarters, we achieved this production with near record low transaction costs for PSB of $2.28 per square foot for the total portfolio. Our strategy has always been and continues to be keeping our buildings well occupied while preserving capital.

Next, I would like to provide an update on Brentford at the Mile, our 411-unit multifamily development in Tysons, Virginia. On our last call, I mentioned we were pressing the pause button to evaluate market fundamentals and pricing. Over the last few months, we have worked hard with our JV partner and our contractor to secure improved pricing and we will commence construction this week. Not only are we pleased with our lower cost basis, but we also believe that demand for these high-quality, well-located multifamily units will be strong when we plan to deliver Brentford in the summer of 2022.

Also on the development front, our 80,000-square-foot, $8-million multi-tenant industrial development in Dallas is on track for completion in Q4 this year. In Seattle, we are anticipating securing permits this fall for a similar 80,000-square-foot multi-tenant industrial building and we are targeting delivery in Q4 of 2021.

Finally, the investment market has been quiet but we are starting to see some deals surface in our core markets. Initial pricing guidance on these offerings is essentially the same as it was pre-COVID. We will actively pursue deals that we like, but we'll also remain disciplined as the markets reopen.

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 second quarter. Net income for the three months ended June 30th was $25.5 million or $0.93 per share, while FFO was $55.4 million or $1.59 per share. Second quarter FFO includes $1.2 million of accounts receivable write-offs and an additional $2.4 million of noncash deferred rent receivable write off, which represent reductions in FFO of $0.03 and $0.07 per share, respectively.

Net operating income attributable to our Same Park portfolio was $65.7 million, decreasing 3.6% from the prior year due primarily to the same AR and noncash deferred rent receivable write-offs mentioned above. Same Park cash NOI was $63.1 million, a 6.6% decrease from the prior year. The noncash write-offs of deferred rent receivable did not impact cash NOI.

However, we did exclude $4.5 million of deferred and abated rents from our computation of Same Park cash NOI and will recognize the collection of deferred rents for cash NOI purposes in the period in which they are received. Similarly, deferred and abated rents are excluded in our computation of funds available for distribution, which was $44.6 million for the quarter.

I'll now provide an update on rent collections. To date, 94% of second quarter rents have been collected and less than 1% remain uncollected after given effect to amounts that were deferred or abated. Our rent collection experience has progressively improved each month since April and as of today, approximately 4% of July's rent remains uncollected. In addition to the steadily improving rent collection activity, the volume of rent relief requests has slowed significantly over the past several weeks. Subsequent to quarter end, we did defer an additional $1 million of July rent. However, the majority of those agreements either were in progress at the end of the quarter or had already been agreed to in a prior month.

Turning now to the balance sheet, we ended the quarter with roughly $100 million of unrestricted cash and our corporate credit facility remains undrawn, meaning we have no debt outstanding. As JP mentioned, we are excited to commence development on Brentford at the Mile and we intend to finance the development with retained cash and cash on hand and if necessary, we'll draw on our credit facility depending on net acquisition volume over the development period.

Lastly, before I turn it back to JP, I'll point out that we paid a dividend of $1.05 per share to common shareholders in the second quarter, and our board recently declared a dividend of $1.05 per share to be paid in the third quarter on September 30th to shareholders of record on September 15th.

With that, I'll turn the call back to JP.

**John Petersen:** Thanks, Jeff. Before we open the call for questions and as we look towards the second half of 2020, I would like to again acknowledge the extraordinary efforts of our team and their dedication to serving our customers. I am confident in the resiliency of small business America whom we are proud to serve as our core customer base, and I am pleased with our current momentum which sets the stage for the second half of the year.

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

**Operator:** The floor is now open for questions. At this time, if you have a question or 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 comes from Craig Mailman, KeyBanc Capital. Mr. Mailman, your line is open. Please check your mute switch.

We'll move next to Blaine Heck, your line is open, of Wells Fargo.

**Blaine Heck:** Great, thanks. I just wanted to start on retention. As you noted, JP, the first and second quarter figures were probably pretty skewed by the larger known move-outs that you've had but as I'm looking out between now and the end of 2022, you have over 50% of your leases expiring. I'm just trying to get a sense for what the retention expectation is for you guys over that time period and whether you have any more large chunks of space that might be on the fence or known move-outs during that period of time.

**John Petersen:** Yes, Blaine. As you pointed out, if you pull out that Hathaway expiration, we were at 64% and there were two other or three other over 40,000-square-foot customers that vacated during the quarter. If you pull those out, we're in the low 70%. I would expect as we look into 2020 and even 2021 and where our expirations are, which we have a good portion in California, our retention would get back to those normalized numbers, especially if economies continue to reopen. Look, that's what we're relying on so if we get some momentum with the economy, I expect our retention to be in the mid-60s to low 70s going forward. Does that answer your question?

**Blaine Heck:** Okay. Yes, that's helpful. Then just any large move-outs that you can talk about that might be coming up in the next couple of years?

**John Petersen:** Nothing on the magnitude which is what we've been discussing today. We do have one in Dallas coming up later this year which we're looking at extending, but nothing on the magnitude of what we've been talking about.

**Blaine Heck:** Okay, great. That's helpful. Then so you noted in your press release that you plan to or maybe you said expect to grant additional rent relief requests going forward. Can you just give a little color on that? Could you comment on how many of these rent relief discussions you're having for the future? How much relief are we talking about and what periods those might apply to?

**Jeff Hedges:** Yes, Blaine, this is Jeff. As of right now, we have a little less or right around 1% of our customer base on a revenue basis has open rent relief requests in our evaluation queue. Can't really say what percentage of those will or will not be approved but certainly, that is quite a bit lower than what we were evaluating a month or two or three months ago. As we look forward, it's hard for us to predict how many additional requests will come in. That's going to be dependent on the environment in which we find ourselves in from a macroeconomic perspective in Q3, Q4 beyond. Right now, as I said in my prepared remarks, the volume of requests that have come in have decreased significantly from where they were a few months ago and absent any other changes in the economy, we expect to see that kind of declining activity.

**Blaine Heck:** Okay, great. That's helpful, Jeff. Then maybe one more for you. It sounds like you guys were able to negotiate the cost of construction down at the Brentford at the Mile, which is great. Obviously, those costs are one of the most important inputs as you're looking at pro forma yields. I'm wondering if you guys can give us your targeted yield on that development now that that cost has been reset.

**John Petersen:** Yes, Blaine. We were real pleased with our ability, as you touched on, to lower our basis in Brentford, and our partners in this project realized that we were ready to go if we could demonstrate some savings and we've done that. As I mentioned in my remarks, we're starting work here this week, so that's very exciting.

In terms of the returns, I think we're going to be in the high 5's, low 6's range on Brentford and realizing this cost savings, so real pleased with our efforts there. We do expect that when we deliver the thing in two years that there will be good demand in that submarket, so we're excited with our execution so far in getting Brentford started. Does that answer your question?

**Blaine Heck:** Absolutely. Thanks, guys.

**John Petersen:** Thanks, Blaine.

**Operator:** Our next question is from Eric Frankel of Green Street.

**Eric Frankel:** Thank you. Would you mind just giving a bit of more color or detail on the breakout of the types of tenants or industries that have been either offered rental abatements where rents were written off in the second quarter and where deferrals occurred in July and where they might going forward, just to get a sense of what we might be looking at depending on the shape of the economic recovery?

**Jeff Hedges:** Yes. Hi, Eric. This is Jeff. As it relates to the deferrals that were granted, it really ranged across a number of industries and geographic locations. Certainly, some segments of our customer base performed better or were less impacted by the shutdowns than others, but our customers that rely on in-person foot traffic, so the gyms, the restaurant locations that we have, the showroom retail that we have at some of our parks were impacted more than others. They got a disproportionate amount of the deferrals and certainly the abatements, but, as I said, the deferrals ranged across a number of industries and geographic locations, so it’s hard to pinpoint a specific segment of our customer base that was predominantly attributable to the rent relief requests that were granted.

**Eric Frankel:** Okay, so is it fair to say then that based on just what the virus is telling us of how we can live and operate for a while that gyms and restaurants were closed by health officials, were recommended to be closed for the next six months to a year or so, we should continue to deduct rental revenue by 1% to 2% per month or 1% to 2% during that time period? Is that generally the right way to think about it?

**Jeff Hedges:** I think in general, the way you’re thinking about it is logical, but I don’t know that we could extrapolate that percentage exactly going forward because a lot of these customers have pivoted. They have changed their revenue model. For instance, we have some restaurants that have embraced the delivery model or the curbside pickup and have been able to return to revenue generation. I would hesitate on saying use that extrapolation but certainly, yes, the segment of our portfolio that does remain on that in-person commerce is going to continue to be affected, probably more so than the e-commerce-related tenants as the effects of the pandemic continue on.

**Eric Frankel:** Okay. Then would you mind sharing what your rent collection stats, including your - [or the offered] deferrals for July 2020? How does that compare? I understand that it's progressing relative to the last few months. How does that compare to last year though, [like July] 2019?

**Jeff Hedges:** I don't have the exact percentage of collection as of July 30, 2019, Eric, but it is at 4% uncollected, that would be significantly higher than where we would typically end a month. We're usually around 1% to 2% uncollected at the end of a given month in normal times.

**Eric Frankel:** Okay, that's helpful. Final question, and I'll just get back in the queue. I'm sure there's somebody after this, somebody else that wants to ask questions, but obviously, negotiating the cost decrease for the Brentford project is obviously a win, but it looks like fundamentals or [its] occupancy deteriorated meaningfully for the first project at the Mile. Can you talk about apartment fundamentals there and whether - obviously, I'm sure the fact that the mall is not operating at full capacity is affecting demand in that region, but can you just talk about what the near-term outlook looks like there to just get a sense of whether the fundamental view of apartments in that area have changed?

**John Petersen:** Sure, Eric. As you can imagine, when the pandemic hit in March and then held for March then we - over April, May, we had a lot of move-outs and to generate activity, we had to drop rent, so we did that. Then in late June, early July, move-outs moderated and in fact, over the last few weeks, we're pushing occupancy back up towards 92% or so, so we made progress.

We think the worst of it is behind us and the outlook for the near term is choppy for multifamily in Tysons, but we really like the demographics of that submarket for Highgate and Brentford as we look ahead two years out when we're delivering Brentford. I think overall, it's going to be choppy. We've been able to reverse the decline in occupancy at Highgate and it's trending nicely this month. Our anticipation is the rest of the summer and early fall, we should continue that trend. Then Brentford, like I said, we like where we're going to be in two years' time. Does that help?

**Eric Frankel:** Yes, it does. Thank you.

**Operator:** Once again, that is *1 to ask a question. Our next question comes from Manny Korchman of Citi. Your line is open.

**Manny Korchman:** Hey, everyone. Thank you. Just wondering if you guys have looked at or thought about how PPP is either impacting the rents you have been able to collect or as that burns off, how it might impact people coming in for more rent abatement or deferral requests.

**John Petersen:** Manny, I'll start and then turn it over to Jeff, but when you say how PPE is impacting our ability to collect rents, is that what – is that right?

**Manny Korchman:** Sorry, the PPP loans, not PPE as in masks and gloves. Sorry.

**John Petersen:** Okay. Well, we wear our gloves and masks when we collect rent but yes, it's a good question. It's going to be interesting to see what happens as the PPP rolls off and then if the economies continued to roll open, which maybe we're going to see here in the second half of the year although it certainly will be choppy, we think that our customer base is stabilizing with each passing week so the effects of the PPP I think will be minimal to our customer base. Jeff, did you want to add anything there?

**Jeff Hedges:** Yes. I think just a couple of things regarding the PPP loan program and the other government-sponsored stimulus programs that are out there. As we've mentioned before, our process that we developed for evaluating rent relief requests, we required and we verified that customers who came to us looking for relief were exploring and applying for all the government-sponsored relief programs that were available to them, including the PPP loans. Certainly, a large number of our customers were eligible for those loans and benefited from those. In general, what we've seen is that those loans for our customer base have worked as intended, which was to create a bridge to allow them to keep headcount on staff or rehire headcount and, as I mentioned on an earlier question, in some cases, pivot their business model to adapt to the current environment. As JP just said, we've seen that our customer base has been pretty resilient and, in many cases, their businesses have returned. In some cases, I think that the effects of the shutdowns and the environment we find ourselves in has drawn out further than what was originally anticipated.

We have seen a very select few return relief requests and I suppose that has something to do with the PPP funds that those customers received being depleted but certainly, we feel good about where our customer base stands right now. We think that, as I mentioned before, the relief requests that are coming in today are quite a bit lower than what they were earlier in the year a few months ago and we hope to see that continued positive momentum.

**Manny Korchman:** Right, and Jeff, I think earlier in call, maybe it was you or JP, you talked about the retail uses and showrooming uses in your portfolio being most impacted. Do you happen to have stats available as to how much your portfolio is, is that retail or showroom or similar use?

**Jeff Hedges:** Yes. We don't have those exact stats that I think you're referring to there, Manny, but we do have in our earnings supplement a breakout of our portfolio that's defined by SIC code. We will look into trying to make some of those more detailed stats available in the future but as of right now, we don't have those exact percentages to provide.

**Manny Korchman:** I think your point is you have it by tenant type, so the type of tenants that signed a lease but not necessarily their use within your portfolio?

**Jeff Hedges:** That's correct.

**Manny Korchman:** Perfect. Thanks, guys.

**John Petersen:** Thanks, Manny.

**Operator:** Once again, to ask a question, that is *1 on your touchtone phone. We have a follow-up from Eric Frankel of Green Street.

**Eric Frankel:** Yes. Just to break, just to get into trends in terms of market rents, rents have seemed to have decelerated or rent changes on recent lease rollover seem to have decelerated a little bit. Maybe if you provide a little more color on July activity and whether just, obviously, the lack of foot traffic and the inability to actually transact and to do business in the second quarter, maybe that has abated a little bit.

**John Petersen:** Sure, Eric. Let me take a stab at that. As we go through each of our markets, not all markets are created equal in terms of pushing rents. Certainly, in our office portfolio, you can imagine there's not a high demand for office, so we have to be more aggressive with rents there. If you look towards some of our other markets, we've still had some positive rent upside in Northern California and even in certain submarkets in Southern California. Especially, in the last, call it 30 days, maybe to your point, we have the ability in certain submarkets and in certain properties to push back.

When this thing started early on in the second quarter, we didn't know where it was going, notwithstanding the increase in cases around the country. We've been operating fairly, I wouldn't call it normally, but we've been doing tours, social distance tours, virtual tours. We've been able to, as you saw in our production, get to normal numbers there and we expect to the extent we can keep that velocity, we will have better pricing power, not a ton, but we'll have better pricing power in certain submarkets, in certain product types, as we head into the summer and the fall. Does that help?

**Eric Frankel:** It does. Maybe you could touch upon some of the markets where you had a real significant deceleration and cash run rate change from the first quarter to the second quarter. It looks like Seattle, Orange County, to a lesser extent San Diego, whether it has turned negative there, so any other color for those markets would be appreciated.

**John Petersen:** Yes, sure. For San Diego specifically, that portfolio was really impacted initially by some businesses that just couldn't make it and that we didn't feel were viable going forward. To push back up occupancy, we did drop rents and you'll notice occupancy in San Diego was almost 96%. For these small - sometimes the target, if you think back to April, May, even parts of June when there was a lot more and not that there's not uncertainty, but businesses looking for space, there were not a lot of small companies out looking for space as this pandemic started. Some didn't make it, as I said, but in order to attract that activity to our parks, we had to drop rents and we did that, and we were able to keep San Diego. It's almost 96% lease in the quarter. Real happy with that. Same thing with Orange County, not a lot of activity in the second quarter in Orange County, but we're able to keep occupancy over 93% there.

If you're a small business looking for space in a pandemic and there's availability, we want to get that prospect to our space, so we're going to, where appropriate, be aggressive. Then certain parks of ours are still 100% leased and still fine or still well leased, and we're not having to drop rents there, so it's really a park-by-park situation. The last market you asked about was – I'm sorry?

**Eric Frankel:** Seattle.

**John Petersen:** Yes, Seattle. Let me just look here real quick. Yes, Seattle, we've had really good rent growth, as you know, over the last several quarters. I expect that in most of our exploration up there, we should get back to positive growth in Seattle here as we push into the remainder of the year. Seattle is still pretty well occupied for us at 97%.

**Eric Frankel:** Okay, thank you. Appreciate it.

**John Petersen:** Thanks, Eric.

**Operator:** This concludes our question-and-answer session. I'd be happy to return the call to Mr. Jeff Hedges for any concluding remarks.

**Jeff Hedges:** All right. Thank you, everyone. We hope you all stay safe and look forward to talking with you again soon. Have a good afternoon.

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