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Transcript of Piedmont Office Realty Trust
Second Quarter 2020 Earnings Call
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Participants
Brent Smith - President & CEO
Robert Bowers - CFO

Analysts
Anthony Palione – JP Morgan
Dave Rogers – Baird
Michael Lewis – SunTrust

Presentation

Operator
Ladies and gentlemen, thank you for joining today's Piedmont Office Realty Trust, Inc., Second Quarter 2020 Earnings call. All phone lines are in a listen-only mode, but after today's prepared remarks you will be given the opportunity to ask questions.

To get us started, I am pleased to turn the floor over to Eddie Guilbert. Mr. Guilbert, good morning.

Eddie Guilbert
Thank you, Operator. Good morning, everyone. We thank you for joining us today for Piedmont's Second Quarter 2020 Earnings conference call. Last night, we filed our Form 10-Q and an 8-K that includes our earnings release and our unaudited supplemental information for the second quarter. All this information is available on our website at piedmontreit.com under the Investor Relations section.

During this call we will refer to certain non-GAAP financial measures such as FFO, core FFO, AFFO and same-store NOI. The definitions and reconciliations of these non-GAAP measures are contained in the earnings release and in the supplemental financial information.

On today's call, the company's prepared remarks and answers to your questions will contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements address matters which are subject to risks and uncertainties and, therefore, actual results may differ from those we anticipate and discuss today. The risks and uncertainties of these forward-looking statements are discussed in detail on our press release as well as our SEC filings. We encourage everyone to review the more detailed discussion related to risks associated with forward-looking statements in our SEC filings.

Examples of forward-looking statements include those related to Piedmont's future revenues, operating income, dividends and financial guidance, future leasing and investment activity. And an important factor for today's call is the potential adverse effects associated with the COVID-19 pandemic on the company's financial and operational results. The extent to which COVID-19 pandemic impacts us and our customers will depend on future developments, which are highly uncertain and cannot be predicted with confidence, including the depth, duration

and severity of the pandemic and the related economic disruption. You should not place any undue reliance on any of these forward-looking statements, and these statements speak only as of the date they are made.

At this time, our President and Chief Executive Officer Brent Smith will provide some opening comments and discuss our second quarter results and accomplishments. Brent?

Brent Smith - President & CEO
Thank you, Eddie. Good morning, everyone. We appreciate all of you taking the time to join us today for Piedmont's second quarter earnings call. In summary, our financial results for the quarter were strong and we made significant progress on a number of our strategic objectives. Of note, we completed a strategic asset recycling transaction at the end of the quarter, and we executed some important leasing, all despite the unprecedented disruption from the Coronavirus pandemic on both the national and global economies which had operational and financial consequences for our tenants and Piedmont.

In light of the challenging economic environment, we are very fortunate that most of our tenants are investment grade quality and subject to long-term leases, with an approximately six-year weighted average lease term remaining, and with very low expirations over the next two years. The strength of our tenant base is demonstrated in the fact that we collected approximately 99% of the cash rents due for the second quarter of 2020 based on current contractual lease terms. However, I would point out that this collections data is net of approximately $3.6 million of second quarter cash rents that have been deferred.

We have entered into lease modification agreements with approximately 50 of our tenants as a result of the pandemic. These agreements typically deferred an average of three months of rent to be paid later in 2020, or in some cases in 2021 with interest. Most of these workout agreements are with our retail tenants that represent approximately 1% of our annual revenues.

More importantly, during the second quarter, we continued to partner with our tenants to refine our operational procedures, cleaning standards and health protocols in all of our buildings to protect the safety and well-being of all those working at, or visiting Piedmont properties. This partnership included our publishing a "Returning to Work Tenant Guide" outlining building-specific information on operational changes such as elevator spacing, common area queuing and etiquette, janitorial schedules, enhanced maintenance and engineering programs, and improved security protocols. We have also installed a comprehensive signage program and hand-sanitizing dispensers throughout all our buildings, garages and amenity areas, and we have installed touchless equipment and automated doors in most common areas and pathways.

With all our buildings remaining open and fully operational these past few months, I could not be more proud of the hard work put forth by my Piedmont colleagues to ensure essential businesses and government agencies could continue to operate during these challenging times. I want to particularly recognize our property management personnel, who have worked compassionately with our more than 1,000 tenants while at the same time exercising vigilant financial stewardship for our stockholders.

Turning now to other key events in the second quarter, obviously one of the highlights was the sale of 1901 Market Street, our only asset in Philadelphia. The gross sales price was approximately $360 million, or $450 per square foot at a 5.4% cash cap rate resulting in an approximately $182 million net book gain. In addition to the very attractive economic terms, this transaction was also strategic in that it allowed us to exit the market and continue our accretive asset recycling program by successfully structuring the disposition transaction as part of a 1031 exchange, with the Dallas Galleria Office Towers, which we acquired during the first quarter of this year at an approximately 250 bps greater cap rate.

Consequently, no special distribution of the significant gain from this disposition will be required. I would note, the sale of the 100% leased, 801,000 square foot Philadelphia property did marginally impact our reported occupancy during the quarter, lowering our overall leased percentage by 1 percent to approximately 89%. As a result of this transaction, 96% of our annualized lease revenue is now generated by properties located in our seven core operating markets. Currently, no other significant developments, acquisitions or dispositions are underway.

We continue to examine Piedmont's business strategy in the context of both the near-term health crisis, as well as implications on the office sector beyond a vaccine. We believe the pandemic has accelerated two main themes which we have been incorporating into our portfolio strategy for several years, specifically, millennial family formation generating population migration to the suburbs and corporations relocating to lower-cost/pro-business cities that offer world-class education centers and highly-integrated, multimodal transportation infrastructure.

Today, we have a uniquely positioned portfolio of 57 Class A office properties comprising 17.2 million square feet primarily concentrated around urban-infill and suburban mixed-use environments or what we call "huburban", offering our customers the real estate required to attract and retain a high-caliber professional workforce, including a strong amenity base, walkability, convenient access to transportation, and closer proximity to workforce and executive housing. We were already starting to witness the impact of these population migration trends in data, collected before the pandemic. Specifically, for 2019, Cushman & Wakefield reported that nearly 70% of the Class A office absorption occurred in the suburbs with shorter commute times and walkable amenities that allow employees to accomplish more in their day than just work. Employers are more and more acknowledging these locations offer as compelling a live, work, play environment as many urban cores. We think the target millennial workforce will drive office space absorption in huburban nodes, as well as in lower cost, higher quality of life markets. And with approximately half of the Piedmont portfolio located in the Sunbelt and an additional approximately 20% located in the concentrated knowledge centers of Boston and Northern Virginia, we are uniquely positioned to capture incremental office space demand spurred on by this burgeoning demographic shift in America. Furthermore, our concentrated submarket positions, garnering significant market share in areas like Orlando's Lake Mary, Burlington in Boston, Atlanta's Northwest submarket, Dallas's Lower North Tollway, and Washington's RB Corridor give us the ability to leverage our scale and market depth to meet the flexibility today's office users demand.

Transitioning to leasing activity, the pandemic did have an impact on this area of the business with the new tenant leasing pipeline virtually coming to a halt during the second quarter due to travel and shelter-in-place restrictions. However, we did execute 271,000 square feet of leasing transactions during the quarter, almost entirely renewal activity with the most significant lease executed being Brother International's renewal of their approximately 102,000 square foot lease at 200 Bridgewater Crossing in Bridgewater, NJ. A listing of all leases greater than 10,000 square feet completed during the quarter is included in the supplemental financial information that was filed last night for your further review.

On a year-to-date basis, executed leases will have had a starting cash rollup of 4.5% and an accrual-based rollup of almost 12%. Looking ahead, we are encouraged by the amount of leasing interest that has begun to re-emerge, and we are particularly heartened by activity we currently see in our Dallas, Atlanta, Washington, D.C., and the Boston submarkets.

We continue to make progress on the one large upcoming renewal, representing 1% or more of our annualized lease revenue, the city of New York's 313,000 square feet at 60 Broad St. that is currently in holdover. While governmental leases are typically slow to complete, understandably, the city's contracting personnel have been preoccupied with more pressing issues during the pandemic. That said, communications have been ongoing and productive, and we expect to complete a long-term renewal with the city by the end of the calendar year 2021. Other than this one renewal, we have no other significant expirations until 2022.

In conclusion, in light of the pandemic, we feel that we are well positioned to withstand the effects of the economic slowdown associated with COVID-19 and in good financial position to take advantage of growth opportunities should they present themselves. I want to also add, considering the public discussion surrounding equality in our country, I want to take this opportunity to reiterate that all of us at Piedmont will continue to support the non-violent efforts to eliminate prejudice and discrimination, wherever it exists. We proudly joined other Georgia employers this past quarter in urging our legislature's passage of a new hate crime bill in our state. Piedmont is committed to demonstrating to each other and our communities the compassion, kindness and strength required to bring about positive and lasting change.

With that, I along with the rest of the senior management team will be available to address any questions you have after Bobby walks us through the financial highlights of the quarter and outlook for the rest of 2020. Bobby?

Robert Bowers – CFO
Thanks, Brent. While I'll discuss some of our financial highlights for the quarter, I encourage you to please review the earnings release and supplemental financial information which were filed last night for more complete details.

For the second quarter of 2020, we reported $0.49 per diluted share of Core FFO, a 14% increase compared to second quarter of 2019, reflecting rental rate growth throughout the portfolio and accretive capital recycling activity since the second quarter of last year.

AFFO was approximately $45 million for the second quarter, well in excess of our second quarter dividend, and same-store NOI was up approximately 2% on a cash basis and up over 5% on an accrual basis for the second quarter of 2020, before deducting an approximate $5 million general reserve.

Our general and administrative expenses decreased $6.5 million during the second quarter of 2020 when compared to the same period in 2019. This decrease is due to lower accruals for stock-based compensation in the current year, and $3.2 million of retirement expenses included in 2019 results related to the senior management transition that occurred on June 30, 2019.

Turning to the balance sheet, our average net debt to Core EBITDA ratio for the second quarter of 2020 was slightly elevated at 6.2x because of the increased balance on the company's line of credit due to the purchase of the Dallas Galleria Office Towers during the first quarter of 2020. This metric is anticipated to return to a more normalized range of around 5.6x in the 3rd quarter, benefiting from a full quarter's impact of the sale of 1901 Market Street and the resulting pay down of debt. Our debt to gross asset ratio was approximately 34% at the end of the quarter.

As the duration and severity of the COVID-19 pandemic and the longer-term consequences on the economy and our tenants continue to be unknown, we are not providing guidance for 2020 currently. Notwithstanding this economic backdrop, Piedmont has a strong, diversified tenant base, a majority of which is investment grade quality. Additionally, Piedmont has a prudent balance sheet that we've discussed with excellent liquidity, including approximately $30 million in cash and full availability of our $500 million line of credit at June 30th, with no debt maturities until late 2021. Despite the widespread impacts of the COVID-19 pandemic on the global economy, we currently anticipate that our overall leased percentage and expected 2020 financial performance will be only modestly impacted by the pandemic.

While not providing guidance, we want to offer some additional information regarding performance year-to-date and our current expectations for how the pandemic could impact our financial performance for the year when compared to the previous year and to the original expectations we had for 2020.

First, as Brent indicated, new tenant leasing activity slowed during the second quarter. Although new tenant prospects have begun to increase, particularly in our Sunbelt markets, Washington D.C. and Boston, we believe this slowing new tenant leasing trend will continue throughout the third quarter, likely pushing out "new tenant" leasing goals several months, which will modestly lower our originally anticipated accrual NOI for 2020 by approximately $5 million, and lower our estimated year end lease percentage.

Also, much of Piedmont's typical transient parking income for the third quarter of 2020 will not occur and will be similar to the second quarter's results; NOI from transient parking is estimated to be lower by approximately $2 million for the year.

Further, with respect to retail tenant income, which is about 1% of the Company's total 2020 revenues, overall retail NOI expectations are estimated to decline by approximately $2 million on an accrual basis for the year.

As I just mentioned, the Company took an additional charge this quarter of approximately $1.8 million against rental revenue in recognition of the increase in rental collectability risks. This charge is a specific reserve against individual accounts. Also, as a precautionary measure, we established an approximately $5 million general reserve or roughly 1% of our Annualized Lease Revenues for potential future losses.

Offsetting these reductions in earnings are approximately $5 million of interest expense savings due to lower Libor and treasury rates than we originally budgeted, and approximately $1 million to 2 million of operating cost savings associated with the landlord portions of various operating expenses, such as utilities and janitorial costs, due to lower active utilization at the properties.

These identified impacts of the COVID-19 pandemic during 2020 equate to approximately $10 to 12 million dollars of identified NOI reductions from our original expectations for the year, half of which is a prudent estimated general reserve provision. And despite this, we will still be outperforming our 2019 results. I will note, the estimated effects of COVID-19 on the Company's financial performance are based upon the premise that the economic impacts from the pandemic will subside during the fourth quarter of 2020. We will reevaluate providing guidance once the longer-term consequences of the pandemic on the economy and on our tenant-base are known, or at least a minimum can more thoroughly be considered.

With that, I will now ask our operator to provide our listeners with instructions on how they can submit their questions. We will attempt to answer all your questions now, or we will make appropriate later public disclosure if necessary. Operator?

Operator
Gentlemen, thank you for your remarks. [Operator instructions]. We'll hear first from Anthony Palione [ph] with JP Morgan.

Q: Thank you. I guess the first question is for Bobby just to maybe help with a little bit of a walk on the NOI and some of these write-offs and reserves. So if we think about what you recorded for 2Q and think about rolling that into 3Q, I want to make sure I understand this. So the $1.8 million, that effectively took either a tenant or a variety of tenants to cash based recognition, it would seem, and so we can I guess make an assumption of what happens from here, but then the $5 million, is that just a general straight line write-off where we add that back as we start to roll into 3Q?

Robert Bowers – CFO
Thanks for the question. Let me see if I can address it.

First, let me sort of give you a little background. We've had very little losses for as long as I've been here, maybe a few thousand dollars a year related to any sort of bad debt, but certainly we're living a period of time that's very different right now. So for the second quarter our tenant reserves consisted of really two components. You mentioned the first one, it's a specific reserve of $1.8 million and that is recorded, as you've indicated, against individual tenant accounts. That was done after a thorough review of all of our tenant billings and it includes related balance sheet accounts. I think this is a piece many people don't realize, it includes the write-off of straight line rent receivables and tangibles. And yes, it does take it to a cash basis.

There was a second component that we have typically never done that was included in the second quarter this year. I'll tell you what was driving that. Obviously, we don't know fully all the impacts of the pandemic on the balances that we have on our balance sheet that include straight line rents again and intangibles as it relates to every tenant, including those tenants that are currently, well, presently current on their payables and those tenants that have been granted deferrals. So I think the uncertainty that's there is what's the impact that the pandemic is going to have in due duration on all of these tenants, and nobody knows that.

I will tell you this, after a lot of discussion we believe it's prudent to establish and I would say an adequate second general reserve for these potential and yet unidentifiable losses. The question is, how do you get there when you don't have an historical perspective on how do you estimate this? In our particular case we have a very clear trend of 99% of our tenants have been paying their billed receivables; therefore, we just simply recorded a 1% reserve of this annualized lease revenues that we have that was approximately $5 million and that equates to a $0.04 impact that ran through our financials in the second quarter. Again, we think it was a conservative, prudent thing to do.

Now I can't assure you that the reserve will be entirely used later, but I do believe it's unrealistic to assume that all potential losses on our balance sheet are known and have been identified at this time, but I think that's true for anyone. Does that address your question, Tony?

Q: Yes, I think that's really helpful context in terms of how you got there and all. From a short term, just quarter to quarter basis, if nothing really happened in the third quarter, you wouldn't, that $5 million comes back, right? Like you've reserved for it already and so if there was some incremental losses in say the third quarter, you could tap into that $5 million and use some of it, I guess. So in that regard, like when we think about the run rate, we would just add the $5 million back as we roll into 3Q?

Robert Bowers – CFO
That's absolutely correct. Any unused balance will come back to benefit us.

Q: Okay. Got it. And then on [indiscernible] in Orlando as they kind of push out the completion of that, does it change when actual cash rent is due on that space or is the cash rent due whenever the lease actually commences and so that gets pushed out too?

Brent Smith - President & CEO
Hi, Tony. Appreciate you taking the time with us today. So I guess on the topic of [indiscernible], first let us say that they are current on all the rental obligations and they continue to be a great performing tenant. On the specific location in Orlando, as we have noted previously, they have pushed back construction given some of the issues first initially around fire code and now around COVID, but we do still believe that that will be a 2021 commencement. As we've noted before, we did not include any of that income in our 2020 numbers. But when it comes to specifics in a lease, we don't like to get too much in detail, but there is a firm date in which rent payments will have to begin, so we feel like we're protected and not just continuing to get kicked further and further out.

Q: Okay, got it. And last question on DC just generally, where you have a bit more vacancy and I know things are slow, but is it a matter of you need a certain sized tenant and that's not where the market is or the traffic is just not there? Just wondering if you could give some color on the environment there and prospects for addressing some of that vacancy.

Brent Smith - President & CEO
Yes. So I guess as I would point out, we really headed into the year with really limited role, almost no role in DC for the next call it four or five years with really great runway. And I would also say it was probably the best leasing pipeline we've seen there in probably three years from a number of different, whether it be government, defense and/or technology related as we were starting to see some of the benefit of the Amazon [audio skip], if you will.

As we headed into the pandemic, I'd say DC as a market held up, actually, the pipeline of activity, the best out of all of our markets and we do hope to have good news to share on that front as we kind of head through the rest of the year and I think that will prove, the durability of that market will prove out. So as we've now alluded to in the prepared remarks, we started to see the pipeline build across the portfolio. DC is one of those markets that it wasn't beat up as bad and the pipeline is also starting to grow a little bit more in the RD corridor than the District in that front, and again, that's generally been contractor and technology related.

So we are seeing a pickup in activity there and I think we're hopeful that it will become as robust as it was pre-COVID crisis were we had a number of kind of 15,000 square foot deals that we thought we had a really good chance of landing. So I'd say it's picking back up, not quite as much as our Atlanta and Dallas markets where we're seeing really good activity, but still starting to rebuild that pipeline. And I'd say we're still constructive, particularly in our RD positions.

Q: Great. Thank you for the color.

Operator
Thank you. Next we'll hear from Dave Rogers at Baird.

Q: Good morning, everybody. Brent, I think in the comment you made earlier in the press release you talked about walkable amenities, non-public transit oriented locations really starting to see a pick-up in demand. And I think you guys also quoted about 30% utilization of office overall kind of back up from where it had been. I'm wondering if you could give us maybe some anecdotal information on these kind of walkable and non-public transit oriented assets. That's what you own, obviously, but the demand that you're starting to see the conversations you're having, is that from tenants wanting to leave a bucket, for instance? Is that from tenants that are looking to establish new presence in the suburbs and closer to the employee base? Any color that you can have, and I realize it's early, but it would be really helpful.

Brent Smith - President & CEO
Dave, appreciate you taking the time to join us this morning. I think as we think about it and see some of the activity around demand that we noted before, really seeing good activity in Dallas and Atlanta, and DC to some extent, I think when you come to this concept of the hub and spoke, which we've heard discussed a lot, there's a thesis that it may be within market and a firm takes a location -- we'll use Atlanta as an example – and midtown. You know, they've had a millennial workforce, they're used to a newer, walkable urban environment with mixed use. That age cohort, as we've seen, is now at the precipice of family formation and children are starting to go to school. The first Miillenials are really now reaching 40 and that is driving a suburban push, but also a push out of California and the northeast to these lower cost markets, a little bit higher quality of life. You layer on the effects of salt, which we think will continue to drive a secular shift in the American population towards more of these lower cost, high quality of life markets which do predominantly exist in the Sunbelt, but do include other cities within the middle of the US as well. So, as that focus comes into play, we're seeing some of our tenants within a

market think about the hub and spoke concept and maybe they have a location, Atlanta, and they decide to take a location in the Galleria because it is a dense, walkable environment to the Battery, to a Brave's game and all the lunch and dinner options that are available at the base of that building.

So their experience and use of this urban core and they want to replicate that experience in the suburbs, drive to their office and be able to accomplish a lot more within their day than they just do going into the office, whether it be kind of every day errands, meeting someone for lunch or a nice dinner in the evening or an activity with friends at the ball park, it provides that experience, but the better school systems that usually typically exist in the suburbs as well as greater proximity to where they live. And we are seeing the Millennials now being the largest buyers of homes and that is now in the suburbs. So we think all those trends play to that location, as I mentioned in my remarks, not just the Atlanta Galleria, but Burlington in Boston, Lake Marion in Orlando, our positions in the lower tollway there in Dallas. While they are in urban cores like in Orlando and Minneapolis, our towers there, we still have two per thousand parking and it is very much a car driven market not reliant on mass transit. And as we talk to a lot of our tenants, that's been their focus or concern is I feel comfortable once I get to the office, but getting to the office, particularly when you're reliant 100% on mass transit has been a problem. So in these markets like Orlando and Minneapolis, before a lot of the office population left, we actually saw an uptick in parking as more and more of the individuals who would have normally taken mass transit were parking now in the CVD.

So we think all this continues to add to a dynamic that makes these walkable huburbs, if you've heard me use that term, really where we think the office market is going to see the greatest demand in the near and medium term.

Q: And maybe just to follow up on that point, I guess the long term trend, I guess I'm trying to gauge how much of that has been driven by COVID and how much of this resumed activity that you're seeing is COVID related versus just a continuation in a long term trend?

Brent Smith - President & CEO
I think it's a continuation of a long term trend. What may be more COVID related or accelerated, and I meant to add this point back from my prior remark, on this hub and spoke concept we're not seeing it materialize within a market yet. I think tenants are still saying if I'm in midtown right now, maybe I'm thinking about going to the Galleria. But what we have seen in Atlanta and Dallas in particular are locations outside of that market looking to bring 40,000 to 60,000 square feet into the market. Maybe it's a division, maybe it's a group. I'm seeing more of that in the hub and spoke concept, and Dallas and Atlanta as being a spoke and maybe like a New York or a San Francisco being the hub more so than within market right now. I'll keep you abreast as we start to see that within market, but right now it's more driving it from some of these higher cost markets to some of our Sunbelt markets.

Q: Great. Second question for me on the New York City negotiations, I realize they're still going on, but is there a risk or has there been any changes in scope in terms of the overall size of the requirement or how they might be moving different groups into that building.

Brent Smith - President & CEO
As we mentioned in our remarks, the pandemic has delayed things pretty considerably. Like New York State, I expect we'll do a shorter term renewal more near term and do the longer term lease, as I mentioned, toward the latter part of next year. It is still a very unique building and is well suited for the agencies that occupy it, so we feel very good about keeping their "eyes on the prize" and getting a lease done and over the goal line.

The terms really still are generally in line with what we previously shared overall from an economic standpoint. I think right now they are still trying to decide what is the ultimate agency group that will reside in the building and that is being reviewed, so we continue to make progress overall. But again, no material change in what we previously shared.

I would add that means a meaningful cash roll up to market, which right now was generally in line with where the holdover rate is. And of course that gap rollup, that will be really significant is not going to be realized, unfortunately, until that long term deal is signed. But again, everything is still perceived as you would expect it given a government agency in the middle of a national crisis.

Q: Great. Thank you. Last for me, Bobby, you talked about $10 million to $12 million NOI impact for the full year relative to initial guidance, and I realize you're not giving guidance, but you'd said that all of this assumes a 4Q '20 kind of rebound in activity and kind of the opening of the economy. What's still at risk if that doesn't happen? Is it really just parking at this point maybe offset by some opex costs? How do you look at 4Q since that was your expectation for an opening?

Robert Bowers – CFO
If you look at the guidance that we provided and we indicated that it was $10 million to $12 million impact, half of that was related to the bad debt charges that all ran through as reserve here in the second quarter. Really, the other significant item is new leasing. That's where you see the impact of COVID really taking its effect. Not executing those new leases delays the commencement of those leases and revenue recognition, so you really have two major factors. First, the reserve charge in the second quarter and then the impact late in this year that comes from delayed leasing.

The other stuff, as you've indicated, largely offsets each other. The parking, the retail offset by opex savings and G&A savings.

Brent Smith - President & CEO
I think that's exactly in line with what you describe. We pushed leasing out and it will not benefit this year, it will be a 2021 impact. And of course we won't give guidance on 2021 until January.

Q: Thank you.

Operator
Thank you for your question. [Operator instructions]. We'll move next to Mr. Michael Lewis at SunTrust.

Q: Thank you. I know this is a tough question to answer now about asset pricing when there's not a lot going on, but I wanted to ask the question about particularly between core stabilized assets that you might be selling and then the types of assets that you might still be willing to buy. So maybe it's a longer term question about what kind of risks you're willing to take at this point and then if maybe those spreads widen out even further, maybe that's helpful to you if you are willing to take on some of those leasing risks and others that you've done in the past.

Brent Smith - President & CEO
Hi, Michael. Appreciate you taking the time and joining us today.

We have been very effective at continuing to recycle capital prior to the pandemic. Obviously, given the slowdown in the capital markets, that's going to be a little muted here more near-term, but we still feel like we have a nice "pipeline" of potential disposition candidates through our regular way of business. Now, I'm very happy we're not 96% now in our core markets and it's just regular way recycling and continuing to enhance what we have within the markets, so we've got a number of candidates that we think we can push into the markets that are well leased, long term, good credit and that could be sold.

We could also get creative and look at an opportunity to sell something that was maybe really we felt was long term leased, high credit and doesn't require a significant mortgage, or if it does it's easy to put on to the asset. So, those would be what we think we could sell.

In terms of the buys and taking more risk, I think we view it as a time to be patient. If it's a logical, strategic bolt-on, you'd see us do it. But really, I find it an opportunity to maybe find something that is very high quality but might have a value add component to it. So in some regards it's risky because it has that value add, but we think it's of such high quality that it fits well within our pipeline and upgrades the overall portfolio.

I don't see anything right now in the pipeline that fits that. And again, we'll be patient. We're fortunate to have $30 million in cash on the balance sheet and a full line of credit available. We're talking to various parties as well, given the sense of destruction may be coming, whether it be other groups if there are larger opportunity that we could take down something with and/or get creative if we needed to raise additional capital quickly, but we felt like our stock price might not afford that, so we're being "creative" about building a war chest. But you're going to continue to see us leverage that kind of 200 basis point spread between the buys and the sells for the foreseeable future. I just hope that now that spread will garner us something that's of even higher quality than it would have before, if that helps put it into context.

Q: That's great. Then my second question, I kind of circled three themes I wanted to ask you about. One was the hub and spoke, which you already gave good detail on and was helpful. The second I wanted to ask if you've had any tenants suggest significant work from home where they might be reducing their space materially because they're shifting to, you know, they think they might do this long term? And then the third one was the opposite of that, I suppose, which would be the need to social distance, are there any tenants that are coming to you and saying we need more space or we need to do this differently and kind of go the other way?

Brent Smith - President & CEO
First on the absorption side and social distancing, we have seen a number of tenants who have either, we approached them and they occupy say 90% of a floor, there's a vacant suite and we go to them and say, "Wouldn't you like to control all the floor? Take the last remaining kind of portion of the floor, have your own bathrooms, etc." We have seen a few of those.

In addition, we've seen a number of tenants who anticipated pre-pandemic to downsize maybe 15% to 20% and go 180 and renew on the full amount. So we have seen the social distancing lead to some absorption.

On the significant work from home pulling tenancy out, on a few select situations where the tenancy was a pretty small tenant and could basically kind of pick up their things and not come back to the office, we've had maybe one or two of those instances with a 2000 type square foot tenant who basically said, "I can't structure my business and pay for real estate any more. I'm taking my entire company and everybody's working from home." But we've not really seen that widespread. And again, it's been a very limited number of cases.

So for the most part, for our type of tenancy that work from home is now more of a situation where every 10 to 15 years the concept of how an office is used to create that collaboration in culture is reevaluated and redesigned. It keeps a lot of people in the American economy going – construction and design, etc., and I think we're at the precipice of one of those situations where companies are now just trying to, they feel like they've stabilized the ship from the reaction of the pandemic and now they're just starting to evaluate the real commercial real estate needs and what that means for the future. I think you're going to continue to see them utilize roughly the same amount of space, but reconfigure it overall. And so the work from home component will play into that, but I think it will be offset by the densification and you're going to see offices really be more focused for that collaboration, teamwork and culture building component. The densification will still kind of offset that work from home. That's our view at least.

Q: Thanks.

Operator
With no further questions in the queue, I will turn it back to Mr. Brent Smith for any additional or closing remarks.

Brent Smith - President & CEO
Thank you. Appreciate everyone giving us the time today. We look forward to continuing the dialogue. Hopefully we'll get a chance to meet many of you at NIRI in November, but if we don't have a chance to connect, again, wish everybody a great rest of the summer. We appreciate the time and have a good day.