FINAL TRANSCRIPT

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FSP - Q2 2011 Franklin Street Properties Corp Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the second quarter, 2011, Franklin Street Properties Corp. earnings conference call. My name is Lisa, and I'll be your operator for today. At this time, all participants are in listen-only mode. Later, we will conduct a question and answer session.

(Operator Instructions)

I would now like to turn the conference over to your host for today, Mr. Scott Carter, General Counsel. Please proceed.

Scott Carter - *Franklin Street Properties Crop. - EVP, General Counsel*

Thanks, and good morning, everyone. Thank you for joining us this morning for our Q2 2011 earnings call. With me are George Carter, our chief executive officer, and John Demeritt, our chief financial officer.

Before I turn the call over to John, I must read the following statement. Please note that various remarks that we may make about future expectations, plans and prospects for the company may constitute forward-looking statements for purposes of the Safe Harbor provisions under the Private Securities Litigation Reform Act of 1995.

Actual results may differ materially from those indicated by these forward-looking statements as a result of various important factors, including those discussed in the Risk Factors section of our annual report on Form 10K for the year ended December 31, 2010, which is on file with the SEC.

In addition, these forward-looking statements represent the company's expectations only as of today, August 3, 2011. While the company may elect to update these forward-looking statements, it specifically disclaims any obligation to do so. Any forward-looking statements should not be relied upon as representing the company's estimates or views as of any date subsequent to today.

At times during this call, we may refer to Funds From Operations or FFO. A reconciliation of FFO to GAAP net income is contained in yesterday's press release, which is available in the investor relations section of our website at www.franklinstreetproperties.com. Now I'll turn the call over to John Demeritt. John?

John Demeritt - *Franklin Street Properties Corp. - CFO*

Thank you, Scott. Welcome to our earnings call. We're going to be talking with you about our second quarter results, and we'll start with a short overview. Afterward, George Carter, our CEO, will further discuss the quarter and FSP.

I'm going to be brief and will be referring to our earnings release, the supplemental package, and the 10-Q that were filed last night. I'd like to start with our balance sheet. During the first quarter, we closed on our $500 million unsecured credit facility. And in May, we expanded that facility for another $100 million to a new total of $600 million in availability.

We also sold a smaller industrial property in the second quarter, capturing a $2.3 million gain, and generated some cash from the sales of shares in an ongoing syndication. We used some of this cash that we raised to reduce the outstanding balance of our facility during the quarter.

As of June 30th, we had cash of $28.9 million, and $255 million in availability on our credit facility, giving us about $284 million in liquidity. We have an asset held for syndication at quarter end with a carrying value of $11.2 million. And as we sell shares in that deal, it will be converted into cash.

At quarter end, we had $345 million outstanding on our unsecured loan, and our total market cap was about $1.4 billion. So our debt to total market cap ratio was about 24.7 as of end of June. This leverage ratio continues to provide an attractive loan-to-value for our lenders and affords our shareholders a significant and more conservative equity investment in real estate.

On the income statement, we measure our performance with some key drivers that we've talked about before, and this includes FFO and gains on sale of real estate or GOS.

For the second quarter of 2011, FFO was up about $3.4 million, compared to our second quarter last year. We had the benefit of three properties that we acquired in March for the entire second quarter, which more than offset the loss of FFO on the sold properties. We also had the benefit of some new leasings signed over the last few months over leases that had expired.

Our investment banking contribution was significant this quarter, as sales of the syndication in process went very well, compared to the second quarter of 2010. George will be talking more about that.

As far as GOS is concerned, the property we sold in late June resulted in a $2.3 million gain, or $0.03 per share GOS for the quarter. During 2010, we did not sell any properties so we did not achieve any GOS in 2010.

That was a brief overview of our financial performance. The earnings release supplemental and 10-Q filing go into further detail about our results, and we can take more questions at the end if you wish to discuss anything further. This concludes the financial highlights and at this point, our CEO, George Carter, will tell you more about FSP, the results, and where we are. Thanks for listening. George?

George Carter - *Franklin Street Properties Corp. - Chairman, CEO*

Thanks, John. Thanks, Scott. And thank you, everyone, for taking the time to listen to FSP's second quarter earnings call. As usual, I will follow my written comments in yesterday's earnings release, trying to expand and put more detail to them.

For the second quarter of 2011, FSP's profits, as represented by FFO plus GOS, totaled approximately $22.5 million or $0.28 a share, a decrease of $0.16 per share compared to the first quarter of 2011. Dividend distributions declared for the second quarter of 2011, which are payable on August 19th, will be approximately $15.5 million, or $0.19 a share. As some of you know that followed our earnings releases, I tend to comment in the first paragraph of my comments, in a sort of consecutive quarter look at profits, analyzing those profits both by FFO plus GOS.

We use that metric here as one of our metrics, because we are a cyclical acquirer and seller, manager of properties and believe in the suburban office market that gain on sale as well as FFO is an important overall rate of return metric. And so it's just a little different view. And again, I've used it in the past and will continue to use it in the future as something a little different than the normal comparison of profits.

The second quarter of 2011 did not measure up to the first quarter under that metric, primarily because in the first quarter, we had sold, for us, a very large property, the Fairview Park property in Falls Church, Virginia, which produced a large gain on sale. We did not have that size gain on sale in the second quarter, even though our FFO was higher.

Our directly owned real estate portfolio of 34 properties, totaling about 6.7 million square feet, was approximately 86.9% leased as of June 30, 2011. That's down from approximately 88.4% which was leased as of March 31st.

Most of the rental and leasing markets where our properties are located have stabilized, but they have stabilized at lower levels, both in terms of occupancy and rental levels than they were before the recent downturn.

It is our objective to move overall occupancy levels in the portfolio back up to the 90%-plus range, and we think we have a very good opportunity to do that by the end of 2011. We have a lot of leasing activity going on in the portfolio and are very, very optimistic.

If you look at the quarter, first quarter to second quarter, you'll know, again for those that look closely at the end of the first quarter, that one of our last big, big lease-rolls that we talked about for two years prior, this is Ober Kaler tenant in our East Baltimore property. Ober Kaler is a law firm. We knew they were going to leave, and they actually were a tenant as of the last day of the first quarter so they were involved in that 88.4% lease number as of the end of the quarter.

But on the first day of the second quarter, they were technically not a tenant anymore and so we really were about 86% leased as of the start of the second quarter and have actually moved that up a little bit in the second quarter. And again, as I said, we are very optimistic about the balance of the year and our leasing activity that's going on.

We also are very optimistic about our percentage of lease-roll over the next three or four years, which is quite low. Again, over the previous two to three years, really at the height of the recession, we had a lot of lease-roll in our portfolio. We've gotten through that now. I think we're headed back up into the 90%-plus range over time. And the wind's at our back in the coming years relative to percentage lease-roll in our portfolio. And even when we look into that percentage lease-roll, we think there's a very good opportunity to retain many of those tenants.

Under property acquisitions, there were none that were completed in the second quarter, but we continue to have acquisitions as a major objective for our growth profile, and we do expect to acquire additional properties during the balance of this year.

We have several that we're very active on right now, one that is under purchase and sale agreement and we're active in due diligence on. So hopefully, we will be making some acquisitions that we'll be able to announce in the coming weeks and months.

During the second quarter of 2011, our investment banking group raised about $42.5 million. That's out of a $62 million private placement offering that we began in March of this year. There remains approximately $16.7 million of that offering to complete, and we are actively working on that.

The total equity raised during the first half of 2011 has been about $50 million. And again, we see our typical investors' confidence and interest in commercial real estate to be generally increasing, but it is very changeable and very dependent upon broader capital market and stock market activity. It clearly still is sensitive relative to the bigger capital market picture, which I think you would expect when you're looking at high net worth individual investors, which are our primary investor type.

On June 24th of this year, we sold our Bollman Place industrial property, which was located in Savage, Maryland, for approximately $7.5 million. The sale produced a gain of approximately $2.3 million, or $0.03 a share. The property was our only remaining industrial asset from our early days, totaling approximately 99,000 square feet.

We do continue to witness generally improving pricing and liquidity for quality properties in certain markets. And consequently, I think you should expect to see us to continue selective property dispositions in the future.

This property was, as I said, our last remaining industrial property. An affiliate, actually, of FSP originally purchased this 12 years ago in 1999. The property was originally built 27 years ago, in '84, and this was the property that had as our main tenant, Maines Food Services. That lease with Maines was coming up for renewal or expiration within a couple of years.

Interesting to sort of see why properties trade, who's buyers, who's sellers. Buyer in that area owned a number of industrial properties of various sizes, and it's pretty clear that even though there was a fairly near term lease expiration, the buyer felt that having different size properties would allow tenants upsizing and downsizing and moving amongst properties and felt that that kind of sort of critical mass in different sizes, different types of properties in that area, would reduce the risk to them versus us that had, you know, one main tenant that, again, was coming up for renewal.

Just looking at the balance of 2011, we continue to be, I believe, in a very good environment. We are very optimistic about continuing our leasing progress and expect occupancy to rise. We have a number of acquisitions in the pipeline, and I would say on the acquisitions front that one of the sort of key things that has really changed a little bit over the last quarter or two is because some of the pricing and some of the sales have been so visible and good relative to pricing, low caps, higher prices per square foot, etc., it has brought out a slew of sellers. There's a lot of property on the market right now, a lot of brokers brokering property for sellers.

Now, some of the prices that are being asked, you know, we believe are rich. But they clearly have, you know, sort of drafted off of some of these other sales that occurred earlier in the year and later last year. Some of these properties just are not getting those prices. There's a little bit of oversupply of properties on the market now. Sellers are either pulling back and not selling the property because they can't get their price or they're having to lower price and sell.

In that scenario, where there's sort of this flood of supply coming on a market which is still not at nearly as robust as it was a few years ago, I think there's opportunity, and we are certainly pursuing some of those opportunities.

And again, we have some properties that we have held for some time that we think are in an advantageous position to potentially sell ourselves. So we're, again -- we feel we've got a little bit of the wind at our back. We're watching the macroeconomics scenario going on just like everybody else is, and, you know, at the end of the day, we need employment growth in this country to get going. That's what's going to lift all ships, particularly in the office arena.

But in terms of the microeconomic picture; i.e., FSP's picture inside it, again we continue to be very, very optimistic with, we believe, the wind at our back. With that, I'll open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

David AuBuchon with R.W. Baird.

David AuBuchon - *Robert W. Baird - Analyst*

George, just curious about your comments. You seem still fairly bullish. And over the last couple months, the economic data clearly getting a lot weaker in the equity markets discounting a slowing of the economy in the second half of this year. Just any sort of read from your people on the ground in the markets about what the leasing velocity and investment interest is over the last month or so?

George Carter - *Franklin Street Properties Corp. - Chairman, CEO*

Well, I'll separate the two, investment interest and leasing velocity. And again, I'm just -- I'm inside of FSP, who, as you know from leasing velocity and roll over the last few years, has more than taken a few hits.

Our reports from the field, people on the ground, are good relative to our properties. We have a lot of activity at our properties and more activity than we had in the previous quarter and, certainly, last year. So there is real, genuine optimism for our specific properties and our specific markets. And again, that's on the leasing side. But on the investing side, properties trading side, we have noticed in our acquisition, people have noticed some distress by sellers who -- and brokers -- who have really overreached in terms of prices that their properties can trade at.

And so when you sort of wrap the sales side or investment side along with the leasing side together and look at the sort of deteriorating -- and clearly, it has been deteriorating macroeconomics -- you know, the whole picture sort of makes you want to be cautious about the future and careful. I mean, on the leasing side, we clearly are going to make deals and not wait around for, you know, the next best one to come down the road. There are deals to be made now. We're going to make them, because the macroeconomic picture is so uncertain.

On the investment side, I think what that leads us to, Dave, is just being real tough on price. And we say no on so many deals, and brokers and sellers tell us, well, you won't be in the game. And a month later or two months later, they're calling us back and saying, you know, do you want to be in the game.

Prices are moving. Cap rates are generally moving back up in markets and properties that we're looking at, and so I think that creates opportunity. So right now, sitting here looking at this big macro picture, it makes us take action on the leasing front. We have the opportunities to take action on. We're going to. It makes us be very tough on the acquisition front, and I think we'll get some better pricing on some deals that we're working on.

David AuBuchon - *Robert W. Baird - Analyst*

And you did mention the acquisition. Care to sort of quantify what you're looking at right now on the acquisition side and, alternatively, on the sales side; and to sort of, on a net basis for this year, do you anticipate being sort of flat on an incremental investment basis, or do you really foresee the opportunity to gain some market share in the investment side?

George Carter - *Franklin Street Properties Corp. - Chairman, CEO*

Yeah, to comment on the potential acquisition or potential sale specifically would be inappropriate. They're pretty competitive markets. It's a competition thing. And hopefully, we'll be making some announcements, particularly on the acquisition front, sooner rather than later.

I would say that we anticipate at this point looking at properties that we're working on acquiring and properties that are potential candidates for sale.

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I think net, we will have grown this year, and maybe by a lot in terms of square footage, equity, total properties owned, substantially potentially over last year. So I think net acquisitions will exceed, and maybe substantially, net sales.

David AuBuchon - *Robert W. Baird - Analyst*

Last question for me. Are you looking more toward stabilized or value add deals?

George Carter - *Franklin Street Properties Corp. - Chairman, CEO*

I would say generally stabilized, Dave, still. And I think that does reflect still some concern about what this recovery looks like and the timing of it.

Now, again, when I say stabilized, we have some opportunity in some of these properties to definitely add NOI and not pay for that add up front. What some of these, quote, value add deals are trying to sell is they're trying to sell the value add play but making the buyer pay for it up front. And those are a lot of the deals that are running into trouble and are not trading.

So on a number of our transactions, we're paying cap rates as prices per square foot for stabilized NOI in place with some good tenants and some longer-term leases. And yet, with some opportunity to do some leasing on top of that acquisition, 10%, 15%, 20% vacancy in a property that we might be able to add some value on without risk of big vacancy in the near term.

David AuBuchon - *Robert W. Baird - Analyst*

Thanks. And actually one more question. John, latest conversations with lenders? What's been the tone?

John Demeritt - *Franklin Street Properties Corp. - CFO*

Well, we did the $100 million accordion feature in mid-May, and that went very well. No change in pricing compared to the deal we have now. Conversations we've had with the banks, we've met with, you know, most of them over the last few months as we worked on this deal. And the tenor is they're looking for ancillary income in all the different segments of business that they do. But generally, I've found capital to be pretty available in the REITs sector.

David AuBuchon - *Robert W. Baird - Analyst*

Okay. Thank you.

Operator

John Guinee with Stifel.

John Guinee - *Stifel Nicolaus - Analyst*

Hello, thank you. Couple questions. I guess John probably. If I look at the real estate FFO, it's about $16.8 million, $0.21 a share. And then I take out what I think is the TI leasing commission base building dollars of about $6.6 million, and then it looks like about $2.9 million in straight line rents, I get down to a sort of a traditional FAD number of $7.2 million or $0.09 a share, sort of an industry standard way of looking at it. Are those the correct numbers?

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John Demeritt - *Franklin Street Properties Corp. - CFO*

I think you do it a little differently than we do, John, but it sounds like you're pretty close to the way you look at it.

John Guinee - *Stifel Nicolaus - Analyst*

Okay. Do you guys think that the run rate on straight line rents is going to be about $2 million quarter in and quarter out, and do you think the TIs, lease and commissions, base building CapEx will run in the $6.5 million to $7 million for the next handful of quarters?

John Demeritt - *Franklin Street Properties Corp. - CFO*

I think that's probably a little hard to predict because it's so tied back to the leasing that we've been doing, and we've got a significant amount done. We're 86%, 87% leased right now. So until we get more leases put in place, I don't think you'd see the TI dollars run up all that high, and that would drive some of the straight line rent component. You know, if we gave a few months of free rent on some of the leases we signed recently, you probably see that number go down as opposed to up. But as we do more leasing, that number would be changing.

John Guinee - *Stifel Nicolaus - Analyst*

Okay. Second question, and this goes to your syndication business. I'm just looking at the page 12 on the supplemental, and is it fair to say that you did about $50 million worth of syndication sales in the first half of the year, and your syndication fees plus transaction fees totaled about, I guess $6.8 million? That's about a 13.5%, 14% load. And then it looks like commissions and selling expenses resulted in about a 50% profit margin. Do we look at the business as about a 13.5% to 14% load and a 50% profit margin?

John Demeritt - *Franklin Street Properties Corp. - CFO*

That's reasonably close. I mean, I use a little different rule of thumb on it. I generally take about 8% of gross syndication proceeds, and that usually equates to the FFO or pretty close to that. But I think if I do the math that you just did, I think that's pretty close to the same thing.

John Guinee - *Stifel Nicolaus - Analyst*

Okay. And then the next question, I guess, George, you've always been sort of anti-leverage. You've been, you know, sort of the pitch was we're going to be one of the lower levered, if not the lowest levered REIT out there. And with the credit facility up to $600 million, how do you think we should look at your overall debt to total market cap quarter in and quarter out?

George Carter - *Franklin Street Properties Corp. - Chairman, CEO*

I think, John, our long-term vision is still to be a fairly low-levered REIT. As we sort of got critical mass and the downturn occurred, we thought adding some leverage would make some sense, and we believe it has.

But I don't think you're ever going to see us, you know, be levered between debt and preferreds and so on up in the 45%, 50%, or 60% level. We're going to be moderately levered, I think, long-term. I think quarter to quarter, though, you might see a spike up and down. But if you wanted to look at us over the next ten years, I think we'll be a moderately leveraged REIT, and I think we'll stay very simple relative to our leverage, where we won't have converts and preferreds.

I think we'll try to keep all of our debt -- even though we will likely try to extend term --I think we'll try to keep basically all of our debt unsecured, you know, in effect over the whole portfolio, which not only from percentage debt basis but from a flexibility and a sort of a net risk. Because all debt is backed effectively by the whole portfolio, I think, does keep us in that lower risk in terms of leverage category. So I think that's the way you should think about us.

John Guinee - *Stifel Nicolaus - Analyst*

Do you want to put a percentage on that?

George Carter - *Franklin Street Properties Corp. - Chairman, CEO*

No.

John Guinee - *Stifel Nicolaus - Analyst*

Okay.

John Demeritt - *Franklin Street Properties Corp. - CFO*

I think it's fairly fluid, John. I think our line of credit enables us to go to 60% on the value of our properties, which, you know, after some haircuts is probably at most, say, 50%. And so we could go as high up on that depending on where we are with acquisitions and other capital transactions. But I don't think we could hang a percentage on it over a period of time, like George had said.

John Guinee - *Stifel Nicolaus - Analyst*

Got you.

George Carter - *Franklin Street Properties Corp. - Chairman, CEO*

I think it will vary a lot quarter to quarter. That's the point. And so if you see it go down one quarter a lot because we pay off the line from a property sale or we do an equity raise, or you see it spike up one quarter because we've done a couple of acquisitions without property sales or equity raises, you know, I think that will be normal. But again, trying to look at us over the long haul, like you have over the last number of years, John, I think you'll still look at us as basically a lower levered REIT.

John Guinee - *Stifel Nicolaus - Analyst*

Okay. Thank you very much.

John Demeritt - *Franklin Street Properties Corp. - CFO*

Thanks, John.

George Carter - *Franklin Street Properties Corp. - Chairman, CEO*

You're welcome.

Operator

There are no additional questions at this time. I would now like to turn the presentation back over to Mr. George Carter for closing remarks.

George Carter - *Franklin Street Properties Corp. - Chairman, CEO*

Just want to thank everybody again for tuning into the call. We look forward to talking to you next quarter.

Operator

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect. Have a great day.