Q4 2023 Earnings Call *(Corrected version)*

Event Details

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Company: Alexandria Real Estate Equities, Inc.
Ticker: ARE-US

Company Participants

Paula Schwartz - Rx Communications Group LLC, Managing Director
Joel S. Marcus - Alexandria Real Estate Equities, Inc., Executive Chairman & Founder
Peter M. Moglia - Alexandria Real Estate Equities, Inc., Chief Executive Officer & Chief Investment Officer
Hallie Kuhn - Alexandria Real Estate Equities, Inc., Senior Vice President-Science & Technology & Capital Markets
Marc E. Binda - Alexandria Real Estate Equities, Inc., Chief Financial Officer & Treasurer

Other Participants

Joshua Dennerlein - Analyst
Anthony Paolone - Analyst
Vikram Malhotra - Analyst
Richard Anderson - Analyst
Michael A. Griffin - Analyst
James Kammert - Analyst
Thomas Catherwood - Analyst
James Feldman - Analyst
Michael Carroll - Analyst
Dylan Robert Burzinski - Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon and welcome to the Alexandria Real Estate Equities 2023 Fourth Quarter and Year-End Conference Call. All participants will be in listen-only mode. After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

I would now like to turn the conference over to Paula Schwartz, Investor Relations. Please go ahead.

Paula Schwartz

Thank you and good afternoon, everyone. This conference call contains forward-looking statements within the meaning of the federal securities laws. The company's actual results might differ materially from those projected in the forward-looking statements. Additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements is contained in the company's periodic reports filed with the Securities and Exchange Commission.

And now, I'd like to turn the call over to Joel Marcus, Executive Chairman and Founder. Please go ahead, Joel.

Joel S. Marcus

Thanks, Paula, and welcome, everybody. Consistent with Alexandria's building the future of life-changing innovation in medicine and at the vanguard and the heart of the $5 trillion secularly growing industry, want to wish everyone a safe and healthy 2024.

On the cover of our press release and supplemental package, we've included the great Jim Collins quote about

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Alexandria. "Alexandria has achieved the three outputs that define a great company: superior results, distinctive impact, and lasting endurance."

On superior results, we're very proud to say that we've had a very strong total shareholder return since IPO of over 1,500%, beating all of the benchmark REIT indices and also almost every other health care REIT.

On distinctive impact, Alexandria's tenants, whom we have supported, are responsible for an astounding 50% of the novel FDA-approved therapies over the last decade, truly amazing. And our unique, one-of-a-kind full continuum of care OneFifteen project, in Dayton, Ohio has treated more than 7,500 patients afflicted by opioid addiction and other substance abuses, and has made a dramatic and positive impact on the lives of thousands of people, and we're very proud of that accomplishment.

And then moving to lasting endurance, want to congratulate the Alexandria family team on the significant 30-year anniversary milestone of our founding on January 5, 1994. And who would or could have imagined in 1994 that this fledgling garage startup would have created an entirely new class of real estate at the vanguard and the heart of the life science industry, combating many of the illnesses which afflict our family and friends.

So moving on to my take on fourth quarter and year-end 2023, I'd say we have witnessed the unprecedented eight-year bull run of a life science capital markets 2014 through 2021, the longest on record coupled with the rocket ship funding during COVID. And the market in 2023 has clearly reflected the rationalization of the past decade.

With respect to Alexandria in 2023, I would say I would characterize our 2023 overall operating and financial performance as highly resilient. Notable achievements include 11%-plus NOI growth year-over-year, 2023 to 2022, very, very strong. We delivered a record $265 million of incremental NOI in 2023 with our development capabilities moving that to fruition, which are first-in-class. We've continued very solid leasing in 2023 with over 4 million-plus rentable square feet leased with very respectable GAAP and cash numbers.

Two key leases in fourth quarter, which are noted in the supplemental, the lease to Novo Nordisk and the lease to CARGO Therapeutics. 2023, we had a remarkable 76% of leasing with existing tenants and we look forward to a strong 2024 leasing effort and expect a handful of significant leases to mature soon. We expect to make significant progress on our lease expirations and filling vacant space while achieving positive rent growth.

2023, we did a highly competent job of self-funding our growth and we'll continue to do so in 2024. Our balance sheet and liquidity are in the best shape in the company's history and we're very proud of that accomplishment.

We have given and reconfirmed very solid detailed guidance for 2024 and we believe that the life science industry will continue to benefit, most importantly, from some key macro tailwinds in 2024, including positive M&A activity, declining interest rates, increased innovation, and some great key data readouts.

And finally, before I turn it over to Peter to comment on a range of critical issues, I want to comment on the sale of our 42nd Street asset in New York City, leased to Pfizer through mid-year 2024. They previously vacated and moved their headquarters to another site in New York City. We made a strategic decision not to go forward with the contemplated redevelopment of that building due, in part, to challenging state and local governmental policies.

We also had a somewhat similar but not on the scale reaction back a number of years ago in our successful reduction in our footprint in the city of San Francisco. We've created and grown the commercial life science lab space market in New York City where we delivered our East Tower and our ACLS mega campus. Back in 2010, there were only essentially two companies of any significance that were doing commercial life science research in New York City. Many academics, but virtually no commercial.

Today, there are over 100, but New York City, the life science market there remains here 14 years later still a small startup market and we believe that by focusing on our ACLS New York City mega campus, that's the best way for us to continue to be successful. And we have taken this disciplined action out of an abundance of prudence.

And with that, let me turn the commentary over to Peter.

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Peter M. Moglia

Thanks, Joel. In Flagship Pioneering's 2024 annual letter, Founder and CEO, Noubar Afeyan, described 2023 as a polycrisis encompassing the confluence of economic turbulence, climate change, deeply fractured politics, two global wars, threats to democracy, loss of trust in institutions, and continuing dislocations triggered by the COVID epidemic. Alexandria's solid 2023 performance within such a dismal backdrop is nothing less than extraordinary. I don't want to steal too much of Marc's thunder, but leasing close to our average volume since 2018 ex the rocket ship years and maintaining strong earnings growth while navigating through this polycrisis is a testament to Alexandria's competitive advantage and the power of our brand that Joel and Dan eloquently articulated at Investor Day.

Heading into 2024, the polycrisis remains, but so does our resiliency. Our balance sheet is as strong as ever, and in 2023, we proved that we can self-fund our investments and still maintain our lowest leverage level in history.

Thus, with our unique business model, highly skilled and experienced talent, impeccable execution and a healthy underlying industry poised to advance human and planetary health, we've created the fertile industrial ecosystem Mr. Afeyan postulated can generate value while defending against any coming vulnerabilities. We aim to prove that thesis right. I'm going to discuss our development pipeline, leasing, supply, and asset sales and hand it over to Hallie.

In the fourth quarter, we delivered 1,228,604 square feet into our high barrier to entry sub-markets, bringing total deliveries for the year to 3,271,170 square feet covering 15 projects. The annual incremental NOI delivered during the year of approximately $265 million and the incremental NOI delivered during the quarter of $145 million are both the highest totals in company history. The initial weighted average stabilized yield for 2023 deliveries was 7%, supported by a strong stabilized yield on cost up to 7.7% from our fourth quarter deliveries.

Development and redevelopment leasing activity of approximately 234,000 square feet was higher quarter-over-quarter for the third reporting period in a row, and the positive momentum is expected to continue as we signed 270,000 square feet of LOIs during the quarter. At quarter end, our pipeline of current and near-term projects are 60% leased or under negotiations, which include executed LOIs.

From the first quarter of 2024 through the end of 2027, we expect to deliver approximately 90% of the $495 million of stabilized NOI the current pipeline is expected to generate. Demand from our highly innovative credit tenant base looking to leverage the placemaking and scale of our mega campus model is expected to drive future opportunities such as the Novo Nordisk lease executed during the quarter for 165,000 square feet at the Alexandria Center for Life Science Waltham mega campus in Greater Boston.

Transitioning to leasing and supply, we leased 4,306,072 square feet during the year and 889,737 square feet during the quarter. To put some context to that, it's roughly half of the average of the rocket ship years of 2021 and 2022, but very close to the average volume we leased in the three years prior from 2018 through 2020. We've returned to the fundamentals which were trending positively before 2021 and 2022 so we feel really good about the near and long-term prospects for our business.

We spoke a lot about the competitive advantages that our mega campus model affords us during Investor Day. 63% of the total leasing we did during the year was completed in our highly curated Class A mega campuses located in high-barrier-to-entry life science clusters and they are the key reason we continue to post strong cash and GAAP rent increases, which came in at 15.8% and 29.4%, respectively for the year.

We believe the beginning of 2023 was the low point for demand and are pleased to see that demand for Greater Boston, San Francisco Bay, and San Diego are all up year-over-year, a good sign since this does not include a number of projects that are on hold as management teams and boards remain cautious. However, that should change soon. As you will hear from Hallie, the trajectory of the industry has turned positive. In the meantime, we continue to win the majority of the current high-quality demand due to tenants' prioritizing location, placemaking experience, ability to scale, proven operational excellence, reliability, and trustworthiness.

Our teams continue to closely track supply building by building in our proprietary databases. As we turn the page on 2023, we expect 2024 to be the peak year for new deliveries then begin to dissipate in 2025.

In Greater Boston, unleased competitive supply estimated to be delivered in 2024 is 7% of market inventory, a 0.9% increase over last quarter not due to new projects but because of project deliveries being pushed from 2023 to 2024.

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In 2025, the unleased competitive supply will increase market inventory by another 2.5%, an expected slowdown from 2024 levels.

In San Francisco Bay, unleased competitive supply estimated to be delivered in 2024 is 10.7% of market inventory, which is a 2.7% increase. Like Greater Boston, this increase is driven by projects that were expected to deliver in 2023, but are taking longer than expected. In 2025, the unleased competitive supply will increase market inventory by much less at 2.2%, a good sign but still a 1% increase over last quarter due to a new project breaking ground in Menlo Park.

In San Diego, unleased competitive supply estimated to be delivered in 2024 is 6.8% of market inventory, a slight decrease from last quarter due to an increase in supply from projects being pushed from 2023 to 2024, offset by leasing in those projects. In 2025, the unleased competitive supply will decelerate to 2.7% of market inventory.

A quick update on direct and sub-leased vacancy. Direct vacancy in Greater Boston is up 258 basis points to 7.05%, still mid-single digits despite a number of deliveries in late 2023. It has climbed 270 basis points to 12.36% in our San Francisco Bay markets due to unleased new deliveries. And in San Diego, the increase has been more modest, rising 121 basis points to 7.97%, driven primarily by Sorrento Therapeutics vacating all of their leases in the region. They are not an Alexandria tenant. Sub-lease vacancy has remained stable, ranging from 5.4% in San Diego to 5.9% in Boston.

I'll conclude with an update on our value-harvesting asset recycling program. Continued demand for our assets enabled us to self-fund our investments as we presented at Investor Day. Page 6 of the supplemental summarizes the material transaction closed during the year. What can be taken away from the partial interest sales at 15 Necco and 9625 Towne Centre Drive and the sale of 11119 North Torrey Pines Road is that well-located and stabilized assets located in Alexandria's primary submarkets continue to command a premium valuation.

Others in solid locations but in need of material CapEx for repositioning such as the Second Avenue and Memorial portfolio in Greater Boston completed in the second quarter and the Memorial Drive, Beaver Street, and Roselle Street portfolio completed in the fourth quarter delivered solid per square foot valuations due to their solid historical performance. Due to the unstabilized nature of these portfolio sales, the cap rates will not provide any meaningful insights to return expectations on stabilized properties. However, I can point you to Healthpeak's 65% sale of 3020 and 3030 Callan Ridge Road and Torrey Pines as a directional comp.

The building is fully leased long-term to a credit tenant, but is not expected to be occupied by said tenant. The purchase price yielded a 5.3% cap rate despite that change or despite that challenge. As we presented at Investor Day, our strategies that continue to widen the moat with competitive advantages our mega campus model provides by recycling our non-campus assets into our current and future mega campuses.

With that, I'll pass the call over to Hallie.

Hallie Kuhn

Thank you, Peter, and good afternoon, everyone. This is Hallie Kuhn, SVP of Science and Technology and Capital Markets. Today, I will provide a recap of the life science industry in 2023 and an overview of the health and demand drivers of each of our life science tenant segments as we kick off 2024.

John Templeton wisely wrote that bull markets are born on pessimism, grow on skepticism, mature on optimism, and die of euphoria. While the reset of the life science industry from euphoric 2021 highs has been rocky, healthy pessimism is seeding renewed momentum underscored by rational valuations and capital flowing to the strongest technologies and experienced management teams.

Fundamentally, the staggering unmet medical need that drives a $5 trillion secularly growing life science industry has not abated, and the opportunity for companies and investors in the life science sector to positively impact human health and disease is massive. Through the ups and downs, the trajectory of the industry is positive, translating long-term into a healthy and expanding tenant base.

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This sentiment is reflected in the numbers. The XBI, a weighted index of small and mid-cap biotech, ended 2023 up 8%. Large biopharma performance, which had an exceptional 2022 while the rest of the market generally languished, ended flat. Two notable exceptions were Alexandria tenants, Eli Lilly and Novo Nordisk, both of which ended the year up over 50% as the market for their novel diabetes and obesity medicines accelerated. And as Peter mentioned, in December, we announced a significant lease with Novo Nordisk for their new US R&D headquarters on our Waltham mega campus in Greater Boston.

Another 2023 biopharma trend was M&A. Excluding mega mergers over $50 billion, 2023 set a new high watermark with $159 billion in acquisitions. These were largely sub-$10 billion deals driven by pharma's need to bolster pipelines as they face steep revenue loss due to patent expirations. As M&A dollars are recycled back into the industry, it creates a positive cycle of innovation as scientists and entrepreneurs start their next new venture. Altogether, the M&A life cycle is an important driver of demand across our regions.

With respect to the FDA, 55 novel medicines were approved in 2023, the second highest year on record and double the average number of annual approvals 20 years ago. There were also eight advanced cell and gene therapies approved. Tenant Vertex received FDA approval of CASGEVY this December, a potentially curative therapy for severe sickle cell disease and the first approved treatment utilizing a novel genome editing technology known as CRISPR. The takeaway is that the industry's model is working. Novel scientific discoveries such as CRISPR, which was elucidated just over a decade ago are translating into impactful medicines for patients.

Now, let's take a closer look at the health and demand across each of our life science tenant segments. First, large pharma, which makes up 19% of our ARR, continues to deploy substantial capital towards internal and external R&D, equating to over $270 billion in R&D spend. Commitment to R&D is an imperative for pharma. Over the next decade, the top 20 pharma are staring down approximately $200 billion of lost revenue, as patents expire, new competitors enter the market and a subset of medicines becomes subject to potential price setting by Medicare through the recently enacted IRA legislation. And where does pharma look to offset this gap in revenue? To smaller and nimbler biotechs.

Currently, $3 out of every $5 of top 20 pharma revenue stem from medicines acquired through M&A and partnerships. Fortunately, this segment is well-positioned, with strong balance sheets and an estimated $1 trillion in available firepower to leverage. All told, we expect healthy levels of internal research and M&A to continue through 2024 and beyond.

Importantly, innovation requires people and a critical component of the pharma equation is stellar talent. Recruiting and retaining scientists is more important than ever. Cancer can't be cured from the couch and expectations of a scientific workforce, where working from home is not an option, are high, requiring amenities and community that the scale of Alexandria's mega campuses are uniquely positioned to provide. This need is driving several large pharma requirements across our clusters.

Transitioning to public biotechnology, our ARR from biotechs with marketed products increased to 17% compared to 14% in 3Q. This increase is due to the delivery of Moderna's new headquarters at 325 Binney Street on our One Kendall Square mega campus, as well as several clinical stage companies transitioning to commercial stage after receiving marketing approval for new therapies. This segment continues to mature, with tenants such as Vertex eclipsing a market cap of $100 billion in 2023.

Next up are our pre-commercial public biotech companies, which represent 8% of our ARR. For this segment, data trumps all. Companies that meet expected milestones have executed significant follow-on financings and stock prices have responded positively. In total, nearly $20 billion in follow-on financing was raised on U.S. stock exchanges in 2023, a quarter of which was raised by Alexandria tenants. Companies have also tapped alternative financing structures such as pipes and royalty deals, providing additional access to liquidity.

Our San Francisco-based tenant BridgeBio has raised over $900 million in the past 12 months from a combination of these sources, driven by clinical data for a novel medicine treating transthyretin amyloid cardiomyopathy, a potential fatal disease of the heart muscle. As the IPO market cracks open in 2024, companies with the right clinical pedigree will be able to access additional liquidity. Last week, the first IPO of the year by SF-based CG Oncology priced above their target range and raised $380 million.

On to private biotechnology, which encompasses 10% of our ARR. While life science venture investments slowed in 2023 relative to the highs of 2021 and 2022, it still exceeds pre-COVID levels and came in at approximately $40

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billion. Series A, B and C rounds are predominantly being led by outside investors, speaking to healthy levels of new investments, with the caveat that valuations have come down and deals often take longer to close.

Funds have been conservative deploying the capital raised in the past several years and have ample dry powder. As the markets warm, we expect venture activity to remain strong through 2024. One counterbalance is that we may see less later stage financings as a subset of companies go public instead of raising another round of private capital.

Next are our life science product, service and device tenants, which represent 21% of our ARR. This segment includes contract manufacturers, diagnostic firms and research tool companies, all of which are critical and complementary to companies developing new medicines. For example, research tool companies are creating the next generation of advanced life science technologies such as super resolution microscopes and DNA sequencers that can process an entire genome in half a day. These technologies often require large, specialized footprints, complex infrastructure and highly trained scientific talent. As the trusted brand for life science real estate, our tenants look to Alexandria to safeguard the billions of dollars of equipment, intellectual property and assets housed within their lab.

Last are our institutional tenants, totaling 11% ARR. As well funded often credit tenants, institutions continue to be an engine of innovation within our ecosystems. One pioneering institutional tenant that came out of stealth this month is Cambridge-based Arena BioWorks. With $500 million in funding, Arena hired scientific luminaries from around the country, with the goal to combine and accelerate academic research and venture-backed drug development under one roof.

Returning to where we started, the life science industry is squarely in the realm of healthy skepticism, seeding the very early innings of the next bull run. We are not completely out of the woods yet, with question marks around interest rates and 2024 elections looming. However, accelerating pace of scientific innovation, access to significant capital from multiple sources and enormous unmet need for lifesaving therapies will propel the industry forward and translate into healthy demand and increasing long-term revenue.

With that, I will pass it over to Marc.

Marc E. Binda

Thank you, Hallie. This is Marc Binda here. Hello and good afternoon, everyone. Congratulations to our entire team for an outstanding execution this past year in a very challenging macroeconomic environment. I'll start with our solid financial results. Total revenues and NOI for 2023 were up 11.5% and 12.2%, respectively, over 2022, primarily driven by solid same property performance and record high development and redevelopment projects placed into service in 2023, with incremental annual NOI of $265 million. FFO per share diluted as adjusted was $8.97, up a solid 6.5% over 2022. We're very proud to report solid operating results for the year, driven by disciplined execution of our mega campus strategy. Our tenants continue to appreciate our brand, collaborative mega campuses and our operational excellence by our team.

We have high-quality cash flows, with 52% of our annual rental revenue as of 4Q 2023 from investment-grade and publicly traded large cap tenants, up 3% from the prior quarter, and we have one of the highest quality client rosters in the REIT industry. 75% of our annual rental revenue comes from our collaborative mega campuses. Collections remained very high at 99.9%, adjusted EBITDA margins remained strong at 69%, and 96% of our leases contain annual rent escalations approximating 3%.

Now, solid rental rate growth and leasing volume drove same property NOI growth in 2023 of 3.4% and 4.6% on a cash basis. These results were in line with our previous guidance and very solid results, especially considering the macro environment. As expected, our fourth quarter same property results took some pressure due to some temporary vacancy at four properties spread across Boston, San Francisco and San Diego, comprising about 330,000 square feet that is 64% leased or negotiating.

We expect same property results to accelerate in the second half of 2024, driven by anticipated solid rental rate growth, occupancy growth in the second half of the year, coupled with the four properties I just mentioned, as well as contractual rent increases and the burn-off of contractual free rent from executed leases. We expect solid same property growth for 2024, consistent with what we provided at our Investor Day in December of 1.5% and 4% on a cash basis at the midpoint of our guidance range.

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Leasing volume in the fourth quarter was solid at 890,000 square feet for the quarter and 4.3 million for the year, which is in line with our general historical average from 2013 to 2020. We continue to benefit from our longstanding tenant relationships and brand loyalty, with 76% of our leasing completed in 2023 coming from existing tenant relationships. Rental rate growth for lease renewals and re-leasing space in 2023 was very strong at 29.4% and 15.8% on a cash basis. These are very solid results and are the third highest annual amounts compared to the 10 years preceding the rocket ship years of 2021 and 2022.

4Q 2023 rental rate growth for lease renewals and re-leasing of space was 9.2% and 5.5% on a cash basis. Due to the incredible execution by our team, we were able to backfill the roughly 100,000 square foot former Atreca space in San Carlos with a very exciting clinical stage biotech company called CARGO Therapeutics during the quarter, add solid economics, including no TIs and limited downtime. The starting cash rent on that deal was slightly negative at about negative 4% compared to the most recent in-place rents from Atreca that was 3 years into a 10-year lease. Given the quarterly results are driven by a relatively small amount of square feet, the relatively flat results from this transaction had a meaningful impact on the quarterly rental rate increases. Excluding this transaction, rental rate increases for the quarter would have been 21.4% and 9.7% on a cash basis.

We expect solid rental rate growth on lease renewals and re-leasing of space for 2024 at a midpoint of 15% and 9% on a cash basis, with some variation from quarter-to-quarter. The overall mark-to-market for cash rental rates in our – related to our in-place leases for the entire asset base remains solid at 14%. Our non-revenue enhancing expenditures, including TIs and leasing commissions on second-generation space, have averaged 15% of NOI over the last five years and remained low during 2023 in the 12% to 13% range.

Year-end occupancy was solid at 94.6%, up 90 basis points from the prior quarter, and the primary driver of the increase from the third quarter was space that was delivered in San Diego. The midpoint of our guidance range for occupancy for year-end 2024 is 95.1%. So we do expect some modest growth in occupancy through the year, as well as growth in same property occupancy in the second half of the year.

Transitioning to the balance sheet, we have one of the strongest balance sheets in the company's history as of 4Q 2023. Our corporate credit rankings rank in the top 10% of all publicly traded U.S. public REITs. We met our goal for a year-end leverage of 5.1 times for net debt to adjusted EBITDA on a quarterly annualized basis, and we ended the year with tremendous liquidity of $5.8 billion fixed rate debt comprising 98.1% of our total debt, a weighted average remaining term of debt of 12.8 years and no debt maturities until 2025. Only 20% of our debt matures in the next five years and 29% of our debt matures in 2049 and beyond with an attractive rate of 3.91%.

We continue to focus on the enhancement of our overall asset base and the recycling of capital through outright dispositions of assets that are not integral to our mega campus strategy. We recognized that these types of assets will likely have a higher cost of capital than our core assets located in our mega campuses, but this will allow us to recycle these proceeds into our highly leased development and redevelopment pipeline and to continue to enhance our mega campus strategy.

For 2023, we completed dispositions and partial interest sales of $1.3 billion, including $439 million of dispositions completed in the fourth quarter. Importantly, during 2023, we did not issue any new common equity other than the settlement of our outstanding forward equity contracts from 2022, which raised $104 million, and we're very proud of our strong execution capability.

The team is laser focused on the execution of our capital plan headed into 2024, and we have pending dispositions subject to letters of intent or sales agreements for another $142 million that we expect to close in 2024. Based upon our current outlook, we expect our asset recycling program to be more heavily weighted towards outright dispositions of non-core assets rather than partial interest sales in 2024.

In the fourth quarter, we recognized impairments aggregating $271.9 million, which included two significant items. First was the $94.8 million charge related to the sale of 380 and 420 E Street located in the Seaport, which had been announced last quarter and subsequently closed during the fourth quarter. And then, second, as Joel mentioned, that $93.5 million of a charge related to an office property located in Manhattan, which was classified as held for sale this quarter. The New York project Joel mentioned was acquired in 2018 as a covered land project with a leaseback and in-place cash flows, but in the fourth quarter, we elected not to proceed with the conversion project and this is now under contract and expected to be sold next year.

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Cash flows from operating activities after dividends for 2024 is expected to be very strong at $450 million at the midpoint of our guidance and will continue to support growth in our annual common stock dividends per share. We had a low and conservative FFO payout ratio of 56% for the quarter with a 6% average per share dividend increase over the last five years. And at this pace of retained cash flows over the next three years, cash flows from operating activities after dividends should generate close to $1.4 billion of efficient capital for reinvestment.

Now, I'll turn to a couple important highlights on the external growth side. 2023 and 4Q 2023 were both record years in terms of the amount of incremental annual NOI onboarded, with $265 million and $145 million, respectively. Importantly, about 80% of the annual rental revenue delivered in the fourth quarter was to investment-grade or publicly-traded large cap tenants, including Moderna and Eli Lilly. With a very large amount of deliveries around mid-quarter on average in the fourth quarter, we expect a significant earnings benefit headed into 1Q 2024. We expect tremendous growth in incremental annual net operating income on a cash basis of $114 million upon the burn-off of initial free rent related to recently delivered projects, with a weighted average burn-off period of about 10 months.

And as Peter highlighted, we have 5.7 million rentable square feet of projects that are 60% leased or negotiating and projects that will generate $495 million of incremental annual net operating income over the next four years. A key item to highlight here is that we had strong leasing activity in the pipeline, with over 500,000 square feet either leased or added to the negotiating bucket through signed LOIs during the quarter, which was the most we've had since 2Q 2022.

Next on capitalized interest, our outlook for capitalized interest for 2024 is consistent with our previous guidance. And as a reminder, we expect capitalized interest for 2024 to be impacted by the following. First, an overall decline in average real estate basis, subject to capitalization, compared to 2023, which was driven in part by the large basis placed into service in the fourth quarter of 2023. And second, we expect an offsetting increase caused by an uptick in our weighted average interest rate on borrowings used in the calculation of capitalization of interest in 2024 compared to 2023.

I'll turn next to venture investments. Realized gains from venture investments included in FFO per share as adjusted for the quarter was $12.3 million, which was below our recent run rate, in part due to a large realized loss on one of our investments that occurred late in the quarter. FFO per share as adjusted over the last three years has included on average $96 million of realized gains in each year from venture investments or approximately $24 million per quarter. Our outlook for quarterly realized gains from venture investments in 2024 is $95 million to $125 million, which is modestly above our three-year annual average of $96 million. Gross unrealized gains in our venture investments as of the end of the quarter were $320 million on a cost basis of just under $1.2 billion.

Turning to guidance, we have reaffirmed our solid guidance for 2024 that was initially provided in connection with our annual Investor Day on November 29, with a few minor changes at as outlined in our supplemental package on page 4. Our range for guidance for EPS is $3.49 to $3.69 and our range for FFO per share diluted as adjusted is $9.37 to $9.57, with no change in the midpoint of $9.47, which represents a solid 5.6% growth in FFO per share, following excellent growth last year of 6.5%. Lastly, our ATM program expired in early January of this year upon the expiration of our shelf registration. So, we do expect to file a new program here in the near future.

With that, let me turn it over to Joel.

Joel S. Marcus

So please open it up for questions, operator.

QUESTION AND ANSWER SECTION

Operator

We will now begin the question-and-answer session. And our first question will come from Josh Dennerlein of Bank of America Merrill Lynch. Please go ahead.

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Analyst: Joshua Dennerlein

Question – Joshua Dennerlein: Yeah. Hey, guys. Thanks for the time. Just want to explore the occupancy uplift that you're assuming in guide. How much of that occupancy uplift is just driven by leases you've already signed versus leasing that you're assuming that still has to get done?

Answer – Joel S. Marcus: Yeah. So Marc, comment?

Answer – Marc E. Binda: Yeah, sure. Hi, Josh. So, we do have about 300,000 square feet of leases that we've already signed that have not commenced that will commence next year. So, we have a good head start headed into 2024. I think to put things into perspective, we've got about 3.4 million of lease rolls next year. But after you back out the space that we've anticipated will go dark that go into redevelopment or development, that only leaves you with about 1.8 million square feet that's not resolved. So, I think that number feels pretty manageable relative to our historical run rate on leasing.

Answer – Joel S. Marcus: Yeah. So when Marc says next year, we're in 2024, but the next year from 2023, which we're reporting, just so we're clear.

Question – Joshua Dennerlein: Appreciate that. And then, it looks like supply is going to peak this year. Just kind of what's your latest thoughts on timing for net effective rents bottoming, and any kind of variation across your three core markets?

Answer – Joel S. Marcus: Yeah. So, Marc, Peter, you guys want to comment?

Answer – Peter M. Moglia: Yeah. I'll take it. Hey, Josh. Hard to predict, but certainly, the effects of 2023 supply has been seen, net effective rents. So, we've seen TIs increase remarkably. We've talked about that before. TIs aren't going to go any further up because they're already pretty high. I'd say there's some pricing power to the tenant if they've got a very large requirement, but outside of that, I think things have been holding relatively well.

Question – Joshua Dennerlein: Okay. Appreciate that. Thank you.

Answer – Joel S. Marcus: Yeah. Thank you.

Operator

The next question comes from Anthony Paolone of JPMorgan. Please go ahead.

Analyst: Anthony Paolone

Question – Anthony Paolone: Yeah. Thanks. First question is, it's early in the year and it seems like you're approaching the midpoint of your acquisition guide. So just curious if these were transactions that were in process when you were setting up the guidance or if you just are seeing a lot of stuff that's attractive or you feel like it's a time to play more offense?

Answer – Joel S. Marcus: Yeah. The former, Tony.

Question – Anthony Paolone: Okay. So, there's no like anticipation that you want to pick up...

Answer – Joel S. Marcus: No.

Question – Anthony Paolone: Yeah. Okay.

Answer – Joel S. Marcus: No.

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Answer – Joel S. Marcus: No.

Question – Anthony Paolone: And then, just on the disposition side, you talked about some of the non-core stuff like having New York under contract. But like when you look at the rest of the dispositions that you're thinking about for the rest of this year, do you think you'll have better execution on non-core sales or do you think selling stakes in more core higher quality stuff is where you might get either more capital or better execution at this point?

Answer – Joel S. Marcus: Yeah. I think we're – I think as Marc and Peter have indicated, we're focused on really non-core, non-campus assets. So, we feel pretty good about that.

Question – Anthony Paolone: Okay. That's all I have. Thanks.

Answer – Joel S. Marcus: Yes. Thank you.

Operator

The next question comes from Vikram Malhotra of Mizuho. Please go ahead.

Analyst: Vikram Malhotra

Question – Vikram Malhotra: Good afternoon. Thanks for taking the questions. Just wanted to get some maybe more color on the pipeline that you're kind of looking at today to deal with sort of expirations over the next 12 to 18 months, but also the developments, particularly what's delivering in sort of 2025, 2026 where maybe more lease-up is expected. So, I don't know if you could give us some sort of wide range of like what is the pipeline square footage-wise of tenants who are at some stage of discussion with, or if not that, at least give us a sense of the composition of these large, small, by market. And any color there would be helpful just to sort of bridge the lease-up that you have to do in terms of expirations and developments.

Answer – Joel S. Marcus: Yeah. So I don't think we would want to talk about pipeline that, I think, is pretty confidential stuff, Vikram. But I think you can assume, every lease is somewhat different and every market is somewhat different. I mean, if you go back and look at the CARGO Therapeutics, that was a very unique lease in a very unique set of circumstances. So, it isn't like this is not a commodity product. This is a generally a premium priced non-commodity product. So, it's not like you have the same bunch of folks waiting for the same amount of space and the same kind of market-type place. It's just not that kind of a business.

Question – Vikram Malhotra: Okay. And then, just maybe one other topic, Biogen announced sort of rationalization of its office space. And I'm wondering if, in your conversations with tenants across the portfolio, can you give us a sense of the latest thoughts on how they're thinking about office versus lab or office needs, whether it's remote work or just they took on too much space? Just how are the tenants thinking about office space they may have in their lab portfolios?

Answer – Joel S. Marcus: It's always asked. Hallie, do you want to kind of comment on that?

Answer – Hallie Kuhn: Sure. And hi, Vikram, this is Hallie. I think we need to separate out the components of non-technical space adjacent to the labs. These are desks largely for the researchers that are moving in and out of the labs through the day. And just there's no rationalization of that space. That space is needed. You – it's part of the workflow that scientists, day in and day out, are utilizing. Surely, there are larger office requirements that as companies grow, that they will lease up. If it's further clinical or sales and marketing, that's a different set of questions. That is not who we are catering, by and large.

So when it comes to the lab space infrastructure, that space is not going to go away. And we even have examples right now where that lab to non-technical space ratio is shifting. Look (00:48:52), we need more desking, right? Like we have more scientists going in and out, right? People don't like to share the same space. They like their own desks. So just to make that clear, you really have to distinguish the two.

Answer – Peter M. Moglia: Yeah. This is Peter. Just to be clear, Biogen's rationalizing their pure office space,

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nothing to do with their lab space.

Answer – Joel S. Marcus: Yeah. And remember, they're a big cap company. So like big pharma, they have kind of dedicated legions of people doing things in traditional office, if you will. So, it's not a typical case.

(00:49:37)

Question – Vikram Malhotra: That's helpful. Thank you.

Answer – Joel S. Marcus: Yes. Next question, operator?

Operator

The next question comes from Rich Anderson of Wedbush. Please go ahead.

Analyst: Richard Anderson

Question – Richard Anderson: Hey. Thanks. Good afternoon. Just wanted to ask about the impairment, and specifically, it's behind you now, but as a function of taking on what may be called kind of a creative approach to development in a different macro environment. And I'm curious if you can – we can expect to see more in the way of an impairment type of model in 2024 as you part ways with non-core assets. Is this something that we might see repeat itself as the year progresses?

Answer – Joel S. Marcus: Yeah. Marc, do you want to comment on that?

Answer – Marc E. Binda: Yeah, sure. Hi, Rich. Yeah. So under the accounting rules, these – you can – the common way where you could have an impairment is at the point where you designate an asset as held for sale. So as we get closer to potentially committing to certain sales, it's definitely possible that we could have additional impairments, but it's really hard to say at this point as we're still refining our approach in which assets to sell. So, hard to say at this point.

Question – Richard Anderson: Okay. And then, second question, on the $114 million of free rent burn, that's good in the sense that you've got new cash flow coming in, but it's also – free rent is what it is. It's not necessarily a good thing. Where does that compare to – if you can quantify it to the past and how much of it is a reflection of the current difficult headwinds that are facing you? And how do you expect that free rent sort of exposure to trend on a go-forward basis?

Answer – Joel S. Marcus: Yeah. So, Marc?

Answer – Marc E. Binda: Yeah. Yeah, yeah. Hi, Rich. Yeah. So, we did – we had $114 million of free rent that we'll be burning off. I guess just to put that into perspective, we delivered $265 million of NOI this year. That's annual NOI. And a lot of those leases are very long term in nature. So it's not a direct correlation, one for one, but if you just do the simple math there, it's less than half a year on what it is. Generally, on average, those types of leases are 10 years and longer. So, I don't I think it's something that we're super concerned with. But to be fair, free rent has trickled up a little bit as we've seen.

Question – Richard Anderson: But not – just not glaringly higher or anything like that over the past few years. Is that correct?

Answer – Marc E. Binda: I mean, we published our free rent statistics, Rich, and I think it was about 3.3 months per year of rent at the end of last year, and I think we're at 0.6. So, it's ticked up a little bit this year but still relatively modest compared to the length of leases.

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Question – Richard Anderson: Fair enough. Thank you.

Answer – Peter M. Moglia: Yeah. Hey, Rich, it's Peter. In the great financial crisis, it was more like 1 month. So, we're still pretty healthy considering the market dynamics.

Question – Richard Anderson: Great. Thanks, Peter. Thanks, everyone.

Answer – Joel S. Marcus: Thank you, Rich.

Operator

The next question comes from Michael Griffin of Citi. Please go ahead.

Analyst: Michael A. Griffin

Question – Michael A. Griffin: Great. Thanks. I want to go back to the CARGO Therapeutics lease at 835 Industrial. Joel, I know you mentioned that it was something specific driving that. But just wondering if you can give anymore color on what drove the decline in rents. Was it a function of CARGO willing to take occupancy pretty quickly or are there more worries about supply and where rental rates are going?

Answer – Joel S. Marcus: Well, I think the key is – it's a good question – is it's one of those situations where you're trying to find the right key to fit the right lock, an exact amount of space that comes vacant that one would not have wanted to be vacant due to Atreca and finding the exact user of that space with literally very little downtime, and as I think Marc said, we had no TIs. So, you don't want to just let that kind of a tenant go into the market and choose from some assorted number of spaces that might be available now or in the future. And so, you try to make the deal because it's the perfect lock fitting, the perfect – the perfect key fitting the right lock. And so, that's kind of the story.

Question – Michael A. Griffin: Got you. That's helpful. And then, I was wondering if you could provide any additional color on the recent asset sales, the one in – ones in Greater Boston and San Diego. It seems like they're aggregated in the supplemental, and given there, it seems like they're kind of lowly occupied. I'd be curious if you can kind of give us pricing, particularly on the asset in Cambridge, maybe what a yield would be on a stabilized basis.

Answer – Joel S. Marcus: Yeah. So Peter, do you want to give some commentary?

Answer – Peter M. Moglia: Yeah. I mean, that speculating of what the Cambridge asset would be on a stabilized basis, I'd just kind of point to where we've seen stabilized things in Boston trade, ourselves in the low to mid-5s with the Necco transaction we had a couple quarters ago. Boston Properties last quarter did something in the high-5s, but it's about two or three years from cash flowing. So, I pointed to in my commentary a 5.3% cap rate in Torrey Pines for a building that's fully leased long term to a credit tenant, but that tenant decided not to move in. So I've said it before, we speculate that good – well-located assets with good credit and good lease term are going to be in that low-5s. The sub-5 cap rates are no longer with us due to rates. Hopefully, that's helpful.

Question – Michael A. Griffin: Yes. That's it for me. Appreciate the time.

Answer – Joel S. Marcus: Yes. Thank you.

Operator

The next question comes from Jim Kammert of Evercore ISI. Please go ahead.

Analyst: James Kammert

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Question – James Kammert: Thank you. Good afternoon. Thematically, in Alexandria's experience, Hallie mentioned a lot of this positive M&A activity, has that historically in your experience translated to a net incremental (00:57:14) space demand across your portfolio, meaning or is it more of a credit upgrade? I'm just trying to understand if the acquirers really tend over time expand their lab footprint or they already have kind of an underutilized space.

Answer – Joel S. Marcus: Yeah. Hey, Jim. The way to think about that is every case is different. If it's a smaller company with a specific product, it's sometimes just bolted on and the space isn't necessarily utilized and maybe sub-leased or terminated. But oftentimes, you find a strategic acquisition and they could be on the larger, medium or even smaller side where companies, I can think of the Bristol Myers-Juno in Seattle back a number of years ago where BMS wanted really to get into the self-therapy issue and that led not only to the acquisition but a fairly big expansion. So if they're buying, if it's a strategic technology platform and vulnerable product shots on goal, usually those end up with very, very good expansion results. If it's a smaller bolt-on, sometimes those don't, but everyone is honestly different.

Question – James Kammert: All right. Fair enough. And then a technical question, I'm sorry. You note that the fourth quarter sort of same-store progression in the first half of this year will be a little repressed by the vacancy associated with four properties. What would have to happen at those properties from a leasing perspective from where they are today to get to 3% same-store NOI guide at the bottom end of your range? I mean, does anything have to happen? Or I'm just trying to understand the order of magnitude what might turn incremental leasing for that portfolio to get you and your bench in your range.

Answer – Joel S. Marcus: Yeah. So, Marc?

Answer – Marc E. Binda: Yeah. So we gave the leased negotiating stat. I think it was about half of that, 64% was leased and the other half was negotiation. And that stuff's expected to benefit that last half of the year. We do need to continue to make progress on that but then we do have a significant amount of free rent that's contractual that is already been leased that will also contribute to the numbers in the back half of the year.

Question – James Kammert: Fair enough. Thank you.

Operator

The next question comes from Tom Catherwood of BTIG. Please go ahead.

Analyst: Thomas Catherwood

Question – Thomas Catherwood: Thanks and good afternoon, everyone. Peter, you'd commented in past quarters on tenant space planning trending towards more just-in-time leasing. Is that still a fair characterization across your portfolio or are you seeing some markets where tenants are getting ahead of their expirations to lock in space?

Answer – Peter M. Moglia: Yeah. Decision-making has been slow and I mean, I guess what I've talked about is that and tenants not wanting to invest in space so their preference has been to go into available built space, things that are vacant or rolling or sub-leased rather than plan ahead and move in 12 months later into a development project. A lot of that has to do with a lot of the requirements over the past year and a half have been small versus a larger requirement that might not be easy to find and you need to put into a newer building.

But I don't think anybody is waiting to the last minute. It's really a function of the size of the company. If you're under 15,000 square feet or even under 20,000 square feet, you probably have options. If you're above that, you definitely need to plan ahead because there's a lot less inventory and not in those sizes.

Answer – Joel S. Marcus: Yeah. I think the other way to think about that is the just-in-time inventory issue is really focused on primarily biotech companies' clinical stage that hit a milestone and they need to move pretty rapidly to scale because of that milestone, which also yields funding, and that's where you get probably the most kick on the just-in-time space.

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Question – Thomas Catherwood: Appreciate that. And that actually kind of leads into second question which is, Peter, you had mentioned elevated concessions and we hear about that kind of across the market yet if we look at your second generation leasing costs in 2023, they were a good bit lower than in 2022, especially if we do it on a kind of per year average basis. So can you speak maybe about how concessions are trending for new and renewal leases at existing properties as compared to leases at new developments and maybe where the economics are different on that side?

Answer – Peter M. Moglia: Yeah. I mean, the large increase in tenant improvement concessions has really been almost exclusively in new development space where you would traditionally give somebody $200 a foot plus or minus depending on the market with their rental rate and then expect them to invest into the rest of the space. That, as we've talked about, has gone to $300 a square foot.

If you look at the operating portfolio and you pointed out that the numbers prove this, that concession isn't needed because that is already built out. And one of the beautiful things about our business is how the tenants or how the TIs are recyclable. So we build something out first generation. It's very rare that we have to put a material amount of money into it the next time around. And given that it's probably got a large investment from a tenant, the first generation tenant, we don't have to bump the rents much to make up for that additional investment, right, because we didn't make it.

So it becomes a very valuable thing to a tenant to be able to move into something that's already built out and so they aren't seeking the type of concessions that they are for new space. Now, it ties to what I said before. If you're in a smaller set of space needs, 25,000 square feet or less, you might have some options to find, but once you get above that, it becomes tougher to find existing space. So you might end up going more towards new development where you would seek the concessions of higher TIs but you're also paying higher rents.

Question – Thomas Catherwood: Appreciate the color. Thanks, everyone.

Answer – Joel S. Marcus: Yeah. Thank you, Tom.

Operator

The next question comes from Jamie Feldman of Wells Fargo. Please go ahead.

Analyst: James Feldman

Question – James Feldman: Great. Thanks for taking my question. So if you look at your 2024 expiration schedule, the amount of expirations moving into redevelopment declined 30% (01:05:06) in the supplemental from 41% when you initially gave guidance. Do you think that's a number that's going to continue to trend lower as the year moves on or is that more driven by dispositions? Maybe just talk about what changed and what may change going forward.

Answer – Joel S. Marcus: Yeah. Marc, you want to comment on that?

Answer – Marc E. Binda: Yeah, sure. I think last quarter, we or at least as of Investor Day, we did have the 219 East 42nd Street asset in there as something that we thought that we would redevelop or develop. It turned out that we've decided to sell that asset. Aside from that, it's been pretty consistent from the last quarter. I think a lot of those redevelopment assets are in great locations in places that we'd like to be. But certainly, as we go through our process to look at non-core assets, it's always possible that we find things in there that could potentially be sold.

Question – James Feldman: Okay. Thanks for that. And then the $95 million to $125 million of investment gains that you plan to include in earnings, you said you took an impairment recently. I mean, what gives you conviction that you can hit those numbers and do you think you'll see more impairments netting that out?

Answer – Marc E. Binda: Yeah. We did have some impairments during the quarter here, Jamie, but I think when we look back over three years, we've averaged like $96 million over the last three years per year. And so over a longer period, when we look back, the impairments have been pretty modest relative to the size of those gains. So I think

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we're thinking about the things that Hallie mentioned upfront just with some renewed excitement around M&A that we feel pretty comfortable with that number headed into next year.

Question – James Feldman: Do you mean that you think you'll see some increase in values and take gains on that or based on where values are today, you still can deliver that $95 million to $125 million?

Answer – Marc E. Binda: Yeah. Hard to say where values go. Yeah. No, I think we're talking about the values today. I think if you look on balance sheet, we've got something like north of $300 million of unrealized gains that we could tap. And part of it, too, to be fair, Jamie, a lot of it is outside of our control, whether it's an M&A event or an acquisition by a big pharma or so forth. So some of it's hard to predict because these things kind of happen when they happen.

Question – James Feldman: Okay.

Answer – Joel S. Marcus: But the fact that we've reiterated guidance here, I think, Jamie, should give you comfort that we think we can hit those numbers pretty comfortably. Otherwise, we wouldn't stick with it.

Question – James Feldman: Yeah. Okay. That makes sense. Thank you.

Operator

The next question comes from Michael Carroll of RBC Capital Markets. Please go ahead.

Analyst: Michael Carroll

Question – Michael Carroll: Yeah, thanks. I believe you touched on this earlier, but I wanted to see if I can ask it a different way. Just regarding overall leasing activity, I know that some tenants have been delaying decisions just given the uncertain environment. I mean, are there any examples of this starting to loosen up just given the prospect of interest rates that could continue to drop? I mean, is that activity or urgency for tenants? Is that starting to pick up here?

Answer – Joel S. Marcus: Well, I think, again, if you go back to Hallie's comments and think about the different sectors, each sector is kind of driven by different issues when it comes to, say, big pharma or big cap bio, those are dependent upon their needs and not on the vicissitudes of the capital markets today or whatever. But then you contrast those to clinical stage biotech who are waiting to hit a clinical milestone or not than those that's where – and Peter's re-emphasized this a number of times, boards want to be really careful not to get ahead of their skis. So it really depends on the sector that you're looking at. It's not a one-size-shoe-fits-all, if you will.

Question – Michael Carroll: Okay. And then on the five projects that are scheduled to be stabilized in 2025, I mean, how are the leasing prospects on those specific buildings? And I know that we're still a year out from the expected stabilization, but when should we start to see leases getting signed in those projects? What are going to be done here in the next few quarters? Is that a good way to think about it?

Answer – Joel S. Marcus: Yeah. So maybe let's do this since we're doing fourth quarter and year-end 2023. Let us and Peter make a note of this. We'll specifically address that on our first quarter call, if you don't mind.

Question – Michael Carroll: Okay. Great. Thanks, Joel.

Answer – Joel S. Marcus: Okay. Thank you.

Operator

Our last question comes from Dylan Burzinski of Green Street. Please go ahead.

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Analyst: Dylan Robert Burzinski

Question – Dylan Robert Burzinski: Hi, guys. Thanks for taking the question. Peter, just wanted to go back to one of the comments you made regarding one of the questions asked a little bit earlier on $200 a square foot for new development leases for TIs being the norm last year versus $300 a square foot today. Would you attribute that to solely the imbalance between supply and demand today or do you expect that to sort of be the new normal moving forward?

Answer – Peter M. Moglia: I think it's the new normal going forward. I mean, it's driven certainly by more competition in the market, but it's also driven by the higher cost to build out space. That's been a considerable increase in construction costs, as you guys all know, and I used to comment on. So that alone, I mean, the availability numbers will eventually resolve themselves, but the costs are what they are and the tenants are willing to invest in the space, but only to a certain degree. So I think that that number's here to stay.

Answer – Joel S. Marcus: Yeah. And again, I think you have to distinguish different sectors have different tolerances for investing in space, and they can be pretty dramatically different. And as Peter said, the structural inflation that we have brought on ourselves over the last number of years as a country and really as a world is pretty much here to stay. So – and that's true across all real estate classes.

Question – Dylan Robert Burzinski: Okay. Appreciate the details on that. And then one more on sort of the dispositions. You mentioned focusing on non-core, non-campus like assets. Could you just talk about sort of the typical buyer profile on who's in bidding tents (01:12:28) when you go to market with those types of assets?

Answer – Joel S. Marcus: Yeah. I think we'd rather not get into that issue and just let it be at this moment. I don't think we want to discuss that on a earnings call. Sorry.

Question – Dylan Robert Burzinski: Okay. Well, that's all I had. Thanks, guys.

Answer – Joel S. Marcus: Yeah.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Joel Marcus for any closing remarks.

Thank you, everybody, and look forward to our call for first quarter. And again, safe and healthy new year.

Operator

The conference is now concluded. Thank you for attending today's presentation and you may now disconnect.

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