

Edgar Filing: Easterly Government Properties, Inc. - Form 10-Q

Easterly Government Properties, Inc.  
Form 10-Q  
November 05, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from To

Commission file number 001-36834

EASTERLY GOVERNMENT PROPERTIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland  
(State of Incorporation)

47-2047728  
(IRS Employer Identification No.)

2101 L Street NW, Suite 650, Washington, D.C.  
(Address of Principal Executive Offices)

20037  
(Zip Code)

(202) 595-9500

(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

As of October 31, 2018, the registrant had 60,818,841 shares of common stock, par value \$0.01 per share, outstanding.

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Easterly Government Properties, Inc.

Consolidated Balance Sheets (unaudited)

(Amounts in thousands, except share amounts)

|                                                                                                                                                                                                | September 30,<br>2018 | December 31,<br>2017 |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
| <b>Assets</b>                                                                                                                                                                                  |                       |                      |
| Real estate properties, net                                                                                                                                                                    | \$ 1,546,600          | \$ 1,230,162         |
| Cash and cash equivalents                                                                                                                                                                      | 6,922                 | 12,682               |
| Restricted cash                                                                                                                                                                                | 4,388                 | 3,519                |
| Deposits on acquisitions                                                                                                                                                                       | 7,225                 | 750                  |
| Rents receivable                                                                                                                                                                               | 17,394                | 12,751               |
| Accounts receivable                                                                                                                                                                            | 9,186                 | 9,347                |
| Deferred financing, net                                                                                                                                                                        | 2,636                 | 945                  |
| Intangible assets, net                                                                                                                                                                         | 167,044               | 143,063              |
| Interest rate swaps                                                                                                                                                                            | 6,958                 | 4,031                |
| Prepaid expenses and other assets                                                                                                                                                              | 10,158                | 8,088                |
| Total assets                                                                                                                                                                                   | \$ 1,778,511          | \$ 1,425,338         |
| <b>Liabilities</b>                                                                                                                                                                             |                       |                      |
| Revolving credit facility                                                                                                                                                                      | 33,000                | 99,750               |
| Term loan facilities, net                                                                                                                                                                      | 248,413               | 99,202               |
| Notes payable, net                                                                                                                                                                             | 173,752               | 173,692              |
| Mortgage notes payable, net                                                                                                                                                                    | 210,388               | 203,250              |
| Intangible liabilities, net                                                                                                                                                                    | 33,038                | 38,569               |
| Accounts payable and accrued liabilities                                                                                                                                                       | 38,618                | 19,786               |
| Total liabilities                                                                                                                                                                              | 737,209               | 634,249              |
| <b>Equity</b>                                                                                                                                                                                  |                       |                      |
| Common stock, par value \$0.01, 200,000,000 shares authorized,<br><br>60,818,841 and 44,787,040 shares issued and outstanding at September 30, 2018<br><br>and December 31, 2017, respectively | 608                   | 448                  |
| Additional paid-in capital                                                                                                                                                                     | 1,015,603             | 740,546              |
| Retained earnings                                                                                                                                                                              | 12,241                | 7,127                |
| Cumulative dividends                                                                                                                                                                           | (123,282 )            | (83,718 )            |
| Accumulated other comprehensive income                                                                                                                                                         | 6,089                 | 3,403                |
| Total stockholders' equity                                                                                                                                                                     | 911,259               | 667,806              |
| Non-controlling interest in Operating Partnership                                                                                                                                              | 130,043               | 123,283              |
| Total equity                                                                                                                                                                                   | 1,041,302             | 791,089              |
| Total liabilities and equity                                                                                                                                                                   | \$ 1,778,511          | \$ 1,425,338         |

The accompanying notes are an integral part of these consolidated financial statements.



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Easterly Government Properties, Inc.

Consolidated Statements of Operations (unaudited)

(Amounts in thousands, except share and per share amounts)

|                                                   | For the three months ended<br>September 30, |            | For the nine months ended<br>September 30, |            |
|---------------------------------------------------|---------------------------------------------|------------|--------------------------------------------|------------|
|                                                   | 2018                                        | 2017       | 2018                                       | 2017       |
| <b>Revenues</b>                                   |                                             |            |                                            |            |
| Rental income                                     | \$35,219                                    | \$30,079   | \$99,967                                   | \$83,600   |
| Tenant reimbursements                             | 4,086                                       | 3,554      | 11,658                                     | 10,156     |
| Other income                                      | 132                                         | 225        | 758                                        | 592        |
| Total revenues                                    | 39,437                                      | 33,858     | 112,383                                    | 94,348     |
| <b>Operating expenses</b>                         |                                             |            |                                            |            |
| Property operating                                | 7,780                                       | 6,718      | 21,563                                     | 18,904     |
| Real estate taxes                                 | 4,228                                       | 3,452      | 11,773                                     | 9,166      |
| Depreciation and amortization                     | 16,109                                      | 13,950     | 45,331                                     | 40,091     |
| Acquisition costs                                 | 300                                         | 206        | 1,023                                      | 1,194      |
| Corporate general and administrative              | 3,614                                       | 2,920      | 10,696                                     | 9,506      |
| Total expenses                                    | 32,031                                      | 27,246     | 90,386                                     | 78,861     |
| Operating income                                  | 7,406                                       | 6,612      | 21,997                                     | 15,487     |
| <b>Other expenses</b>                             |                                             |            |                                            |            |
| Interest expense, net                             | (4,924 )                                    | (5,495 )   | (15,981 )                                  | (11,626 )  |
| Net income                                        | 2,482                                       | 1,117      | 6,016                                      | 3,861      |
| Non-controlling interest in Operating Partnership | (327 )                                      | (175 )     | (902 )                                     | (700 )     |
| Net income available to Easterly Government       |                                             |            |                                            |            |
| Properties, Inc.                                  | \$2,155                                     | \$942      | \$5,114                                    | \$3,161    |
| Net income available to Easterly Government       |                                             |            |                                            |            |
| Properties, Inc. per share:                       |                                             |            |                                            |            |
| Basic                                             | \$0.03                                      | \$0.02     | \$0.08                                     | \$0.08     |
| Diluted                                           | \$0.03                                      | \$0.02     | \$0.08                                     | \$0.08     |
| <b>Weighted-average common shares outstanding</b> |                                             |            |                                            |            |
| Basic                                             | 60,446,199                                  | 39,962,471 | 51,051,388                                 | 38,098,805 |
| Diluted                                           | 61,978,998                                  | 41,903,977 | 52,600,858                                 | 40,012,282 |
| Dividends declared per common share               | \$0.26                                      | \$0.25     | \$0.78                                     | \$0.74     |

The accompanying notes are an integral part of these consolidated financial statements.

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Easterly Government Properties, Inc.

Consolidated Statements of Comprehensive Income (unaudited)

(Amounts in thousands)

|                                                | For the three<br>months ended<br>September 30, |         | For the nine<br>months ended<br>September 30, |         |
|------------------------------------------------|------------------------------------------------|---------|-----------------------------------------------|---------|
|                                                | 2018                                           | 2017    | 2018                                          | 2017    |
| Net income                                     | \$2,482                                        | \$1,117 | \$6,016                                       | \$3,861 |
| Other comprehensive income:                    |                                                |         |                                               |         |
| Unrealized gain (loss) on interest rate swaps, |                                                |         |                                               |         |
| net                                            | 406                                            | (111 )  | 2,927                                         | (697 )  |
| Other comprehensive income (loss)              | 406                                            | (111 )  | 2,927                                         | (697 )  |
| Comprehensive income                           | 2,888                                          | 1,006   | 8,943                                         | 3,164   |
| Non-controlling interest in Operating          |                                                |         |                                               |         |
| Partnership                                    | (327 )                                         | (175 )  | (902 )                                        | (700 )  |
| Other comprehensive income attributable to     |                                                |         |                                               |         |
| non-controlling interest                       | (9 )                                           | 77      | (241 )                                        | 286     |
| Comprehensive income attributable to Easterly  |                                                |         |                                               |         |
| Government Properties, Inc.                    | \$2,552                                        | \$908   | \$7,800                                       | \$2,750 |

The accompanying notes are an integral part of these consolidated financial statements.



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Easterly Government Properties, Inc.

Consolidated Statements of Cash Flows (unaudited)

(Amounts in thousands)

|                                                                                  | For the nine months<br>ended September 30, |           |
|----------------------------------------------------------------------------------|--------------------------------------------|-----------|
|                                                                                  | 2018                                       | 2017      |
| Cash flows from operating activities                                             |                                            |           |
| Net income                                                                       | \$6,016                                    | \$3,861   |
| Adjustments to reconcile net income to net cash provided by operating activities |                                            |           |
| Depreciation and amortization                                                    | 45,331                                     | 40,091    |
| Straight line rent                                                               | (4,253 )                                   | (1,376 )  |
| Amortization of above- / below-market leases                                     | (6,737 )                                   | (6,283 )  |
| Amortization of unearned revenue                                                 | (127 )                                     | (82 )     |
| Amortization of loan premium / discount                                          | (62 )                                      | (64 )     |
| Amortization of deferred financing costs                                         | 938                                        | 848       |
| Non-cash compensation                                                            | 2,307                                      | 2,215     |
| Net change in:                                                                   |                                            |           |
| Rents receivable                                                                 | (404 )                                     | 265       |
| Accounts receivable                                                              | 161                                        | (1,709 )  |
| Prepaid expenses and other assets                                                | (1,890 )                                   | (1,632 )  |
| Accounts payable and accrued liabilities                                         | 7,815                                      | 6,690     |
| Net cash provided by operating activities                                        | 49,095                                     | 42,824    |
| Cash flows from investing activities                                             |                                            |           |
| Real estate acquisitions and deposits                                            | (327,653)                                  | (342,566) |
| Additions to operating properties                                                | (4,064 )                                   | (2,221 )  |
| Additions to development properties                                              | (38,891 )                                  | (5,560 )  |
| Net cash used in investing activities                                            | (370,608)                                  | (350,347) |
| Cash flows from financing activities                                             |                                            |           |
| Payment of deferred financing costs                                              | (3,208 )                                   | (3,398 )  |
| Issuance of common shares                                                        | 297,805                                    | 107,190   |
| Credit facility draws                                                            | 57,500                                     | 108,000   |
| Credit facility repayments                                                       | (124,250)                                  | (260,917) |
| Term loan draws                                                                  | 150,000                                    | 100,000   |
| Issuance of notes payable                                                        | —                                          | 175,000   |
| Issuance of mortgage notes payable                                               | —                                          | 127,500   |
| Repayments of mortgage notes payable                                             | (2,363 )                                   | (2,221 )  |
| Dividends and distributions paid                                                 | (47,541 )                                  | (35,483 ) |
| Payment of offering costs                                                        | (11,321 )                                  | (4,222 )  |
| Net cash provided by financing activities                                        | 316,622                                    | 311,449   |
| Net increase in Cash and cash equivalents and Restricted cash                    | (4,891 )                                   | 3,926     |
| Cash and cash equivalents and Restricted cash, beginning of period               | 16,201                                     | 6,491     |
| Cash and cash equivalents and Restricted cash, end of period                     | \$11,310                                   | \$10,417  |

The accompanying notes are an integral part of these consolidated financial statements.



Easterly Government Properties, Inc.

Consolidated Statements of Cash Flows (unaudited)

(Amounts in thousands)

Supplemental disclosure of cash flow information is as follows:

|                                                       | For the nine<br>months ended<br>September 30, |             |
|-------------------------------------------------------|-----------------------------------------------|-------------|
|                                                       | 2018                                          | 2017        |
| Cash paid for interest, net of capitalized interest   | \$13,017                                      | \$8,236     |
| Supplemental disclosure of non-cash information       |                                               |             |
| Additions to operating properties accrued, not paid   | \$584                                         | \$819       |
| Additions to development properties accrued, not paid | 14,061                                        | 719         |
| Financing costs accrued, not paid                     | 1                                             | —           |
| Offering costs accrued, not paid                      | 8                                             | 27          |
| Deferred asset acquisition costs accrued, not paid    | 86                                            | —           |
| Unrealized gain (loss) on interest rate swaps, net    | 2,927                                         | (697 )      |
| Debt assumed on acquisition of operating property     | 9,414                                         | —           |
| Exchange of Common Units for Shares of Common Stock   |                                               |             |
| Non-controlling interest in Operating Partnership     | \$(9,846 )                                    | \$(20,401 ) |
| Common stock                                          | 6                                             | 14          |
| Additional paid-in capital                            | 9,840                                         | 20,387      |
| Total                                                 | \$—                                           | \$—         |

The accompanying notes are an integral part of these consolidated financial statements.

Easterly Government Properties, Inc.

Notes to the Consolidated Financial Statements (unaudited)

## 1. Organization and Basis of Presentation

The information contained in the following notes to the consolidated financial statements is condensed from that which would appear in the annual consolidated financial statements; accordingly, the consolidated financial statements included herein should be reviewed in conjunction with the consolidated financial statements for the fiscal year ended December 31, 2017, and related notes thereto, included in the Annual Report on Form 10-K of Easterly Government Properties, Inc. (the “Company”) for the year ended December 31, 2017 filed with the U.S. Securities and Exchange Commission (the “SEC”) on March 1, 2018.

The Company is a Maryland corporation that has elected to be taxed as a real estate investment trust (“REIT”) under the Internal Revenue Code, as amended (the “Code”) commencing with its taxable year ended December 31, 2015. The operations of the Company are carried on primarily through Easterly Government Properties LP (the “Operating Partnership”) and the wholly owned subsidiaries of the Operating Partnership. As used herein, the “Company,” “we,” “us,” or “our” refer to Easterly Government Properties, Inc. and its consolidated subsidiaries and partnerships, including the Operating Partnership, except where context otherwise requires.

We are an internally managed REIT, focused primarily on the acquisition, development, and management of Class A commercial properties that are leased to U.S. Government agencies that serve essential functions. We generate substantially all of our revenue by leasing our properties to such agencies, either directly or through the U.S. General Services Administration (“GSA”). Our objective is to generate attractive risk-adjusted returns for our stockholders over the long term through dividends and capital appreciation.

As of September 30, 2018, we wholly owned 56 operating properties in the United States, including 54 operating properties that were leased primarily to U.S. Government tenant agencies and two operating properties that were entirely leased to private tenants, encompassing approximately 4.8 million square feet in the aggregate. In addition, we wholly owned three properties under development that we expect will encompass approximately 0.3 million square feet upon completion. We focus on acquiring, developing, and managing U.S. Government leased properties that are essential to supporting the mission of the tenant agency and strive to be a partner of choice for the U.S. Government, working with the tenant agency to meet its needs and objectives.

The Operating Partnership holds substantially all of our assets and conducts substantially all of our business. The Company is the sole general partner of the Operating Partnership. The Company owned approximately 87.5% of the aggregate limited partnership interests in the Operating Partnership (“common units”) at September 30, 2018. We believe that we have operated and have been organized in conformity with the requirements for qualification and taxation as a REIT for U.S. federal income tax purposes commencing with our taxable year ended December 31, 2015.

## Principles of Consolidation

The accompanying consolidated financial statements are presented on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and include the accounts of the Company, Easterly Government Properties TRS, LLC, Easterly Government Services, LLC, the Operating Partnership and its other subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

## Basis of Presentation

The condensed consolidated financial statements included herein are unaudited; however, they include all adjustments (consisting only of normal recurring adjustments) which, in the opinion of management, are necessary to state fairly the consolidated financial position of the Company at September 30, 2018, and the consolidated results of operations for the three and nine months ended September 30, 2018 and 2017 and the consolidated cash flows for the nine months ended September 30, 2018 and 2017. Certain prior year amounts have been reclassified to conform to the current year presentation. The year-end condensed consolidated balance sheet data was derived from audited financial statements but does not include all disclosures required by GAAP. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year.

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the balance sheet and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## 2. Summary of Significant Accounting Policies

The significant accounting policies used in the preparation of the Company's condensed consolidated financial statements are disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

### Revision of Previously Reported Consolidated Financial Statements

In connection with the preparation of the Company's consolidated financial statements for the year ended December 31, 2017, the Company identified an error in the estimated useful life utilized to amortize certain assets associated with three properties contributed at the time of the Company's initial public offering in the first quarter of 2015. As a result of the error, Depreciation and amortization expense had been overstated and thereby Real estate properties, net, Intangible assets, net and Equity were understated. The Company concluded that the amounts are not material to any of its previously issued consolidated financial statements. However, to maintain proper comparability between our financial statements we have elected to revise prior periods. Accordingly, the Company revised these balances in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017. The effects of this revision to the consolidated financial statements are as follows (in thousands, except for per share data).

|                                                                                            | As<br>Previously<br>Reported | Adjustment | As<br>Revised |
|--------------------------------------------------------------------------------------------|------------------------------|------------|---------------|
| Effect of Revision For the Three Months Ended September 30, 2017                           |                              |            |               |
| Total revenues                                                                             | \$ 33,858                    | \$ —       | \$ 33,858     |
| Depreciation and amortization                                                              | 14,141                       | (191 )     | 13,950        |
| Total expenses                                                                             | 27,437                       | (191 )     | 27,246        |
| Net income                                                                                 | 926                          | 191        | 1,117         |
| Net income available to Easterly Government Properties, Inc.                               | 782                          | 160        | 942           |
| Net income available to Easterly Government Properties, Inc. per share (basic and diluted) | 0.02                         | —          | 0.02          |
| Comprehensive income                                                                       | 815                          | 191        | 1,006         |

|                                                                                            | As<br>Previously<br>Reported | Adjustment | As<br>Revised |
|--------------------------------------------------------------------------------------------|------------------------------|------------|---------------|
| Effect of Revision For the Nine Months Ended September 30, 2017                            |                              |            |               |
| Depreciation and amortization                                                              | \$ 40,663                    | \$ (572 )  | \$ 40,091     |
| Total expenses                                                                             | 79,433                       | (572 )     | 78,861        |
| Net income                                                                                 | 3,289                        | 572        | 3,861         |
| Net income available to Easterly Government Properties, Inc.                               | 2,693                        | 468        | 3,161         |
| Net income available to Easterly Government Properties, Inc. per share (basic and diluted) | 0.07                         | 0.01       | 0.08          |
| Comprehensive income                                                                       | 2,592                        | 572        | 3,164         |

### Recently Adopted Accounting Pronouncements

On January 1, 2018, the Company adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). Please refer to Note 10 for more information pertaining to our adoption of this guidance.

On January 1, 2018, the Company adopted ASU No. 2016-15, Statement of Cash Flows (Topic 230), which provides classification guidance for certain cash receipts and cash payments including payment of debt extinguishment costs, settlement of zero-coupon debt instruments, insurance claim payments and distributions from equity method investees. The Company adopted this ASU using the retrospective method and the implementation of this update did not have a

material impact on our consolidated financial statements.

On January 1, 2018, the Company adopted and retrospectively applied ASU No. 2016-18, Statement of Cash Flows (Topic 230), which requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The Company now reconciles both cash and cash equivalents and restricted cash in the accompanying Statements of Cash Flows for all periods, whereas under the prior guidance the Company explained the changes during the period for cash and cash equivalents only.

On January 1, 2018, the Company adopted ASU No. 2017-05, Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. This ASU clarifies the scope and accounting of a financial asset that meets the definition of an “in-substance nonfinancial asset” and defines the term “in-substance nonfinancial asset.” This ASU also adds guidance for partial sales of nonfinancial assets. The Company adopted this ASU using the modified retrospective method and the implementation of this update did not have a material impact on our consolidated financial statements.

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On January 1, 2018, the Company adopted ASU 2017-09, Stock Compensation (Topic 718): Scope of Modification Accounting, which provides updated guidance about which changes to the terms or conditions of a share-based payment award would require an entity to apply modification accounting under the topic. The Company adopted this ASU using the prospective method to an award modified on or after the adoption date, however, the implementation of this update did not have a material impact on our consolidated financial statements.

### Recent Accounting Pronouncements Not Yet Adopted

In February 2016, the Financial Accounting Standards Board (the “FASB”) issued ASU No. 2016-02, Leases, which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase of the leased asset by the lessee. This classification will determine whether the lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for in the same manner as operating leases today. As of September 30, 2018, the Company had a sublease for office space in Washington, DC expiring in June 2021 and a lease for office space in San Diego, CA expiring in April 2022. The remaining contractual payments under the Company’s lease and sublease for office space aggregate \$1.5 million.

The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. In connection with the new revenue guidance, we believe that the new revenue standard may apply to executory costs and other components of revenue deemed to be non-lease components, even when the revenue for such activities is not separately stipulated in the lease. In that case, we would need to separate the lease components of revenue due under leases from the non-lease components. Under the new guidance, we would continue to recognize the lease components of lease revenue on a straight-line basis over our respective lease terms as we do under prior guidance. However, we would recognize the non-lease components under the new revenue guidance as the related services are delivered. As a result, while the total revenue recognized over time would not differ under the new guidance, the recognition pattern could be different. The Company is currently in the process of evaluating the significance of the difference in the recognition pattern that would result from this change.

In July 2018, the FASB issued ASU 2018-11, Targeted Improvements to Topic 842 Leases. The improvements in ASU 2018-11 provide for (a) an optional new transition method for adoption that results in initial recognition of a cumulative effect adjustment to retained earnings in the year of adoption and (b) a practical expedient for lessors, under certain circumstances, to combine the lease and non-lease components of revenues for presentation purposes.

Additionally, ASU 2016-02 will require that lessees and lessors capitalize, as initial direct costs, only those costs that are incurred due to the execution of a lease. Under ASU 2016-02, allocated payroll costs and other costs that are incurred regardless of whether the lease is obtained will no longer be capitalized as initial direct costs and instead will be expensed as incurred.

In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases, which clarifies, corrects, or consolidates authoritative guidance issued in ASU 2016-02 and is effective upon adoption of ASU 2016-02.

ASU No. 2016-02 is effective for reporting periods beginning January 1, 2019, with modified retrospective application for each reporting period presented at the time of adoption or utilizing the optional transition method under ASU 2018-11. Early adoption is also permitted for this guidance. The Company is in the process of evaluating the impact of this new guidance.



In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities. The purpose of this updated guidance is to better align a company's financial reporting for hedging activities with the economic objectives of those activities. The transition guidance provides companies with the option of either adopting the new standard early using a modified retrospective transition method in any interim period after issuance of the update, or alternatively adopting the new standard for fiscal years beginning after December 15, 2018. This adoption method may require the Company to recognize the cumulative effect of initially applying the ASU as an adjustment to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings as of the beginning of the fiscal year that an entity adopts the update. While the Company continues to assess all potential impacts of the standard, we do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

### 3. Real Estate and Intangibles

During the nine months ended September 30, 2018, we acquired ten operating properties in asset acquisitions, consisting of VA – Golden, VA – San Jose, and the First Closing Properties (as defined below) for an aggregate purchase price of \$321.0 million. We allocated the aggregate purchase price based on the estimated fair values of the acquired assets and assumed liabilities as follows (amounts in thousands):

|                              | Total      |
|------------------------------|------------|
| Real estate                  |            |
| Land                         | \$ 18,835  |
| Building                     | 261,883    |
| Acquired tenant improvements | 7,798      |
| Total real estate            | 288,516    |
| Intangible assets            |            |
| In-place leases              | 38,263     |
| Acquired leasing commissions | 4,198      |
| Above-market leases          | 1,307      |
| Total intangible assets      | 43,768     |
| Intangible liabilities       |            |
| Below-market leases          | (1,827 )   |
| Total intangible liabilities | (1,827 )   |
| Purchase price               | 330,457    |
| Less: Mortgage note assumed  | (9,414 )   |
| Net assets acquired          | \$ 321,043 |

The intangible assets and liabilities of operating properties acquired during the nine months ended September 30, 2018 has a weighted average amortization period of 6.39 years as of September 30, 2018. During the nine months ended September 30, 2018, we included \$3.0 million of revenues and \$0.5 million of net income in our consolidated statement of operations related to VA – Golden, VA – San Jose, and the First Closing Properties (as defined below).

On June 15, 2018, we entered into a purchase and sale agreement to acquire a 1,479,762-square foot portfolio of 14 properties (the “Portfolio Properties”) for an aggregate purchase price of approximately \$430.0 million. On September 13, 2018, we closed on the acquisition of eight of the Portfolio Properties (the “First Closing”). The eight properties acquired in the First Closing, consisting of an aggregate of 1,024,036 square feet, include the following (listed by primary tenant agency, if applicable, and location): Various GSA – Buffalo, NY, Various GSA – Chicago, IL, TREAS – Parkersburg, WV, SSA – Charleston, WV, FBI – Pittsburgh, PA, GSA – Clarksburg, WV, ICE – Pittsburgh, PA and SSA – Dallas, TX (collectively, the “First Closing Properties”). Please refer to Note 12 for information regarding the six remaining Portfolio Properties.

During the nine months ended September 30, 2018, we incurred \$1.0 million of acquisition-related expenses including \$0.8 million of internal costs associated with property acquisitions.

# Consolidated Real Estate and Intangibles

Real estate and intangibles consisted of the following as of September 30, 2018 (amounts in thousands):

|                                   | Total       |
|-----------------------------------|-------------|
| Real estate properties, net       |             |
| Land                              | \$ 152,999  |
| Building                          | 1,364,862   |
| Acquired tenant improvements      | 55,301      |
| Construction in progress          | 67,950      |
| Accumulated depreciation          | (94,512 )   |
| Total Real estate properties, net | 1,546,600   |
| Intangible assets, net            |             |
| In-place leases                   | 198,383     |
| Acquired leasing commissions      | 42,664      |
| Above market leases               | 10,762      |
| Accumulated amortization          | (84,765 )   |
| Total Intangible assets, net      | 167,044     |
| Intangible liabilities, net       |             |
| Below market leases               | (64,682 )   |
| Accumulated amortization          | 31,644      |
| Total Intangible liabilities, net | \$(33,038 ) |

The following table summarizes the scheduled amortization of the Company's acquired above- and below-market lease intangibles for each of the five succeeding years as of September 30, 2018 (amounts in thousands):

|      | Acquired<br>Above-Market<br>Lease<br>Intangibles | Acquired<br>Below-Market<br>Lease<br>Intangibles |
|------|--------------------------------------------------|--------------------------------------------------|
| 2018 | \$ 342                                           | \$ 2,213                                         |
| 2019 | 1,318                                            | 7,379                                            |
| 2020 | 1,081                                            | 6,550                                            |
| 2021 | 683                                              | 4,589                                            |
| 2022 | 618                                              | 2,982                                            |

Above-market lease amortization reduces Rental income on our Consolidated Statements of Operations and below-market lease amortization increases Rental income on our Consolidated Statements of Operations.



## 4. Debt

At September 30, 2018, our consolidated borrowings consisted of the following (amounts in thousands):

| Loan                                            | Principal<br>Outstanding<br>September 30,<br>2018 | Interest<br>Rate <sup>(1)</sup> | Current<br>Maturity      |
|-------------------------------------------------|---------------------------------------------------|---------------------------------|--------------------------|
| Revolving credit facility:                      |                                                   |                                 |                          |
| Revolving credit facility <sup>(2)</sup>        | \$ 33,000                                         | L +<br>125bps                   | June 2022 <sup>(3)</sup> |
| Total revolving credit facility                 | 33,000                                            |                                 |                          |
| Term loan facilities:                           |                                                   |                                 |                          |
| 2016 term loan facility                         | 100,000                                           | 3.12%<br><sup>(4)</sup>         | September 2023           |
| 2018 term loan facility                         | 150,000                                           | L +<br>120bps                   | June 2023                |
| Total term loan facilities                      | 250,000                                           |                                 |                          |
| Less: Total unamortized deferred financing fees | (1,587 )                                          |                                 |                          |
| Total term loan facilities, net                 | 248,413                                           |                                 |                          |
| Notes payable:                                  |                                                   |                                 |                          |
| Senior unsecured notes payable, series A        | 95,000                                            | 4.05%                           | May 2027                 |
| Senior unsecured notes payable, series B        | 50,000                                            | 4.15%                           | May 2029                 |
| Senior unsecured notes payable, series C        | 30,000                                            | 4.30%                           | May 2032                 |
| Total notes payable                             | 175,000                                           |                                 |                          |
| Less: Total unamortized deferred financing fees | (1,248 )                                          |                                 |                          |
| Total notes payable, net                        | 173,752                                           |                                 |                          |
| Mortgage notes payable:                         |                                                   |                                 |                          |
| CBP - Savannah                                  | 13,676                                            | 3.40%<br><sup>(5)</sup>         | July 2033                |
| ICE - Charleston                                | 18,934                                            | 4.21%<br><sup>(5)</sup>         | January 2027             |
| MEPCOM - Jacksonville                           | 10,121                                            | 4.41%<br><sup>(5)</sup>         | October 2025             |
| USFS II - Albuquerque                           | 16,660                                            | 4.46%<br><sup>(5)</sup>         | July 2026                |
| DEA - Pleasanton                                | 15,700                                            | L +<br>150bps<br><sup>(5)</sup> | October 2023             |
| VA - Loma Linda                                 | 127,500                                           | 3.59%<br><sup>(5)</sup>         | July 2027                |
| VA - Golden                                     | 9,380                                             | 5.00%<br><sup>(5)</sup>         | April 2024               |
| Total mortgage notes payable                    | 211,971                                           |                                 |                          |
| Less: Total unamortized deferred financing fees | (1,882 )                                          |                                 |                          |
| Less: Total unamortized premium/discount        | 299                                               |                                 |                          |

|                                   |         |
|-----------------------------------|---------|
| Total mortgage notes payable, net | 210,388 |
|-----------------------------------|---------|

|            |            |
|------------|------------|
| Total debt | \$ 665,553 |
|------------|------------|

- (1) At September 30, 2018, the one-month LIBOR (“L”) was 2.26%. The current interest rate is not adjusted to include the amortization of deferred financing fees or debt issuance costs incurred in obtaining debt or any unamortized fair market value premiums. The spread over the applicable rate for our revolving credit facility and term loan facilities is based on the Company’s consolidated leverage ratio, as defined in the respective loan agreements.
  - (2) Available capacity of \$417.0 million at September 30, 2018 with an accordion feature that provides additional capacity of up to \$250.0 million, subject to the satisfaction of customary terms and conditions.
  - (3) Our revolving credit facility has two six-month as-of-right extension options subject to certain conditions and the payment of an extension fee.
  - (4) The interest rate is calculated based on two interest rate swaps with an aggregate notional value of \$100.0 million, which effectively fix the interest rate at 3.12% annually, based on the Company’s consolidated leverage ratio, as defined in the 2016 term loan facility agreement.
  - (5) Effective interest rates are as follows: CBP – Savannah 4.12%, ICE – Charleston 3.93%, MEPCOM – Jacksonville 3.89%, USFS II – Albuquerque 3.92%, DEA – Pleasanton 1.8%, VA – Loma Linda 3.78%, VA – Golden 5.03%.
- On June 18, 2018, we entered into an amended and restated senior unsecured credit facility (our “amended senior unsecured credit facility”). Our amended senior unsecured credit facility increased the total borrowing capacity of our existing senior unsecured credit facility by \$200.0 million for a total credit facility size of \$600.0 million, consisting of two components: (i) a \$450.0 million senior unsecured revolving credit facility (the “revolving credit facility”), and (ii) a \$150.0 million senior unsecured term loan facility (the “2018 term loan facility”). The revolving credit facility also includes an accordion feature that will provide us with additional capacity, subject to the satisfaction of customary terms and conditions, of up to \$250.0 million.

The Operating Partnership is the borrower, and we and certain of our subsidiaries that directly own certain of our properties are guarantors under our amended senior unsecured credit facility. The revolving credit facility matures in four years and the 2018 term loan facility matures in five years. In addition, the revolving credit facility has two six-month as-of-right extension options subject to certain conditions and the payment of an extension fee.

Our amended senior unsecured credit facility bears interest, at our option, either at:

- a Eurodollar rate equal to a periodic fixed rate equal to LIBOR plus, a margin ranging from 1.25% to 1.80% for advances under the revolving credit facility and a margin ranging from 1.20% to 1.75% for advances under the 2018 term loan facility; or

- a fluctuating rate equal to the sum of (a) the highest of (x) Citibank, N.A.'s base rate, (y) the federal funds effective rate plus 0.50% and (z) the one-month Eurodollar rate plus 1.00% plus (b) a margin ranging from 0.25% to 0.80% for advances under the revolving credit facility and a margin ranging from 0.20% to 0.75% for advances under the 2018 term loan facility, in each case with a margin based on our leverage ratio.

The 2018 term loan facility had a 364-day delayed draw period and is prepayable without penalty for the entire term of the loan. On September 10, 2018, we fully drew \$150.0 million on our 2018 term loan facility.

In addition, on June 18, 2018, we entered into a second amendment to our existing \$100.0 million senior unsecured term loan facility (the "2016 term loan facility"). The second amendment amends certain covenants and other provisions in the 2016 term loan facility to conform to changes made to such covenants and other provisions in our amended senior unsecured credit facility.

#### Financial Covenant Considerations

The Company was in compliance with all financial and other covenants as of September 30, 2018 related to its revolving credit facility, 2016 term loan facility, 2018 term loan facility, notes payable and mortgage notes payable.

#### Fair Value of Debt

As of September 30, 2018, the carrying value of our revolving credit facility approximated fair value. In determining the fair value we considered the short term maturity, variable interest rate and credit spreads. We deem the fair value of our credit facility as a Level 3 measurement.

As of September 30, 2018, the carrying value of our 2016 term loan facility approximated fair value. In determining the fair value we considered the variable interest rate and credit spreads. We deem the fair value of our 2016 term loan facility as a Level 3 measurement.

As of September 30, 2018, the carrying value of our 2018 term loan facility approximated fair value. In determining the fair value we considered the variable interest rate and credit spreads. We deem the fair value of our 2018 term loan facility as a Level 3 measurement.

At September 30, 2018, the fair value of our notes payable was determined by discounting future contractual principal and interest payments using prevailing market rates. We deem the fair value measurement of our notes payable instruments as a Level 3 measurement. At September 30, 2018, the fair value of our notes payable was \$168.9 million.

At September 30, 2018, the fair value of our mortgage notes payable was determined by discounting future contractual principal and interest payments using prevailing market rates. We deem the fair value measurement of our mortgage notes payable as a Level 3 measurement. At September 30, 2018, the fair value of our mortgage notes payable was \$202.8 million.

## 5. Derivatives and Hedging Activities

As of September 30, 2018, the Company had two outstanding interest rate swaps with an aggregate notional value of \$100.0 million that were designated as cash flow hedges. The swaps had an effective date of March 29, 2017 and extend until the maturity of our 2016 term loan facility on September 29, 2023. The swaps effectively fix the interest rate under our 2016 term loan facility at 3.12% annually based on the Company's current consolidated leverage ratio and a variable interest rate of one-month LIBOR.

### Cash Flow Hedges of Interest Rate Risk

As of September 30, 2018 our swaps were classified as an asset on our consolidated balance sheet at \$7.0 million. The effective portion of changes in the fair value of derivatives designated and qualified as cash flow hedges is recorded in accumulated other



comprehensive income and will be reclassified to interest expense in the period that the hedged forecasted transactions affect earnings on the Company's consolidated variable rate debt. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings into interest expense. For the three and nine months ended September 30, 2018 the amount of unrealized gains recognized in accumulated other comprehensive income on interest rate swaps was \$0.6 million and \$3.3 million, respectively. For the three and nine months ended September 30, 2018 the amount of gain reclassified from accumulated other comprehensive income into interest expense was \$0.2 million and \$0.3 million, respectively. Additionally, during the three and nine months ended September 30, 2018, the Company did not record any hedge ineffectiveness. For the three and nine months ended September 30, 2017 the amount of unrealized loss recognized in accumulated other comprehensive income on interest rate swaps was \$0.2 million and \$0.8 million, respectively. For the three and nine months ended September 30, 2017 the amount of loss reclassified from accumulated other comprehensive income into interest expense was \$0.1 million and \$0.2 million, respectively. Additionally, during the three and nine months ended September 30, 2017, the Company did not record any hedge ineffectiveness.

The Company estimates that \$1.2 million will be reclassified from accumulated other comprehensive income as a decrease to interest expense over the next 12 months.

#### Credit-Risk-Related Contingent Features

The Company has agreements with each of its derivative counterparties that contain a provision where the Company could be declared in default on its derivative obligations if repayment of the underlying indebtedness is accelerated by the lender due to the Company's default on such indebtedness. As of September 30, 2018, the Company did not have any derivatives in a net liability position.

#### 6. Fair Value Measurements

Accounting standards define fair value as the exit price, or the amount that would be received upon sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The standards also establish a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability developed based on market data obtained from sources independent of us. Unobservable inputs are inputs that reflect our assumptions about the factors market participants would use in valuing the asset or liability developed based upon the best information available in the circumstances. The hierarchy of these inputs is broken down into three levels: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. Categorization within the valuation hierarchy is based upon the lowest level of input that is most significant to the fair value measurement.

#### Recurring fair value measurements

The fair values of our interest rate swaps are determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities in such interest rates. While the Company determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments

associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Company and its counterparties. The Company has determined that the significance of the impact of the credit valuation adjustments made to its derivative contracts, which determination was based on the fair value of each individual contract, was not significant to the overall valuation. As a result, all of the Company's derivatives held as of September 30, 2018 were classified as Level 2 of the fair value hierarchy.

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, other assets and accounts payable and accrued expenses are reasonable estimates of fair values because of the short maturities of these instruments. For our disclosure of debt fair values in Note 4, we estimated the fair value of our 2016 and 2018 term loan facility based on the variable interest rate and credit spreads (categorized within Level 3 of the fair value hierarchy) and estimated the fair value of our other debt based on the discounted estimated future cash payments to be made on such debt (categorized within Level 3 of the fair value hierarchy); the discount rates used approximate current market rates for loans, or groups of loans, with similar maturities and credit quality, and the estimated future payments included scheduled principal and interest payments. Fair value estimates are made as of a specific point in time, are subjective in nature and involve uncertainties and matters of significant judgment. Settlement at such fair value amounts may not be possible and may not be a prudent management decision.

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The table below presents the Company's assets and liabilities measured at fair value on a recurring basis as of September 30, 2018, aggregated by the level in the fair value hierarchy within which those measurements fall.

| Balance Sheet Line Item     | As of September 30,<br>2018 |          |       |
|-----------------------------|-----------------------------|----------|-------|
|                             | Level                       |          | Level |
|                             | 1                           | Level 2  | 3     |
| Interest rate swaps - Asset | \$ —                        | \$ 6,958 | \$ —  |

## 7. Equity

The following table summarizes the changes in our stockholders' equity for the nine months ended September 30, 2018 and 2017 (amounts in thousands, except share amounts):

|                                                       | Shares     | Common |            | Retained Earnings | Cumulative Dividends | Non-Controlling      |             | Total      |
|-------------------------------------------------------|------------|--------|------------|-------------------|----------------------|----------------------|-------------|------------|
|                                                       |            | Stock  | Additional |                   |                      | Accumulated          | Interest in |            |
|                                                       |            | Par    | Paid-in    |                   |                      | Other                | Operating   |            |
|                                                       |            | Value  | Capital    | (Deficit)         |                      | Comprehensive Income | Partnership | Equity     |
| Nine months ended September 30, 2018                  |            |        |            |                   |                      |                      |             |            |
| Balance at December 31, 2017                          | 44,787,040 | \$ 448 | \$ 740,546 | \$ 7,127          | \$(83,718 )          | \$ 3,403             | \$ 123,283  | \$ 791,089 |
| Stock based compensation                              |            | —      | 294        | —                 | —                    | —                    | 2,013       | 2,307      |
| Dividends and distributions paid                      |            | —      | —          | —                 | (39,564 )            | —                    | (7,977 )    | (47,541 )  |
| Grant of unvested restricted stock                    | 21,328     | —      | —          | —                 | —                    | —                    | —           | —          |
| Redemption of common units for shares of common stock | 628,436    | 6      | 9,840      | —                 | —                    | —                    | (9,846 )    | —          |
| Issuance of common stock                              | 15,382,037 | 154    | 286,350    | —                 | —                    | —                    | —           | 286,504    |
| Unrealized gain on interest rate swaps, net           |            | —      | —          | —                 | —                    | 2,686                | 241         | 2,927      |
| Net income                                            |            | —      | —          | 5,114             | —                    | —                    | 902         | 6,016      |
| Allocation of non-controlling                         |            | —      | (21,427 )  | —                 | —                    | —                    | 21,427      | —          |

interest

in Operating

Partnership

Balance at

|                    |            |        |             |          |              |          |           |             |
|--------------------|------------|--------|-------------|----------|--------------|----------|-----------|-------------|
| September 30, 2018 | 60,818,841 | \$ 608 | \$1,015,603 | \$12,241 | \$(123,282 ) | \$ 6,089 | \$130,043 | \$1,041,302 |
|--------------------|------------|--------|-------------|----------|--------------|----------|-----------|-------------|

Nine months ended September 30, 2017

Balance at

|                   |            |        |           |         |             |          |           |           |
|-------------------|------------|--------|-----------|---------|-------------|----------|-----------|-----------|
| December 31, 2016 | 36,874,810 | \$ 369 | \$597,164 | \$2,679 | \$(42,794 ) | \$ 3,038 | \$137,844 | \$698,300 |
|-------------------|------------|--------|-----------|---------|-------------|----------|-----------|-----------|

Stock based

compensation

|   |     |   |   |   |       |       |
|---|-----|---|---|---|-------|-------|
| — | 240 | — | — | — | 1,975 | 2,215 |
|---|-----|---|---|---|-------|-------|

Dividends and

distributions paid

|   |   |   |           |   |          |           |
|---|---|---|-----------|---|----------|-----------|
| — | — | — | (29,401 ) | — | (6,082 ) | (35,483 ) |
|---|---|---|-----------|---|----------|-----------|

Grant of unvested

restricted stock

|        |   |   |   |   |   |   |
|--------|---|---|---|---|---|---|
| 17,912 | — | — | — | — | — | — |
|--------|---|---|---|---|---|---|

Redemption of

common units for

shares of common

stock

|           |    |        |   |   |   |           |   |
|-----------|----|--------|---|---|---|-----------|---|
| 1,361,594 | 14 | 20,387 | — | — | — | (20,401 ) | — |
|-----------|----|--------|---|---|---|-----------|---|

Issuance of

common stock

|           |    |         |   |   |   |   |         |
|-----------|----|---------|---|---|---|---|---------|
| 5,619,480 | 56 | 102,885 | — | — | — | — | 102,941 |
|-----------|----|---------|---|---|---|---|---------|

Unrealized loss on

interest rate swaps,

|     |   |   |   |   |        |        |        |
|-----|---|---|---|---|--------|--------|--------|
| net | — | — | — | — | (411 ) | (286 ) | (697 ) |
|-----|---|---|---|---|--------|--------|--------|

Net income

|   |   |       |   |   |     |       |
|---|---|-------|---|---|-----|-------|
| — | — | 3,161 | — | — | 700 | 3,861 |
|---|---|-------|---|---|-----|-------|

Allocation of

non-controlling

interest

in Operating

Partnership

|   |          |   |   |   |       |   |
|---|----------|---|---|---|-------|---|
| — | (1,516 ) | — | — | — | 1,516 | — |
|---|----------|---|---|---|-------|---|

Balance at

|                    |            |        |           |         |             |          |           |           |
|--------------------|------------|--------|-----------|---------|-------------|----------|-----------|-----------|
| September 30, 2017 | 43,873,796 | \$ 439 | \$719,160 | \$5,840 | \$(72,195 ) | \$ 2,627 | \$115,266 | \$771,137 |
|--------------------|------------|--------|-----------|---------|-------------|----------|-----------|-----------|

The Company granted 891,000 long term incentive plan units in the Operating Partnership ("LTIP units") on May 6, 2015 and 40,000 LTIP units on February 26, 2016 to members of management as long-term incentive compensation under the 2015 Equity Incentive Plan, as amended (the "2015 Equity Incentive Plan") subject to the Company achieving certain absolute and relative total shareholder returns through the performance period, which ended on December 31, 2017. Based on the Company's absolute and relative total shareholder return performance through the end of the performance period, the compensation committee of the Company's board of directors determined that an aggregate of 2,079,297 LTIP units were earned. Under the terms of the awards, earned awards vested 50% on February 15, 2018 with the remaining 50% vesting on February 6, 2019, subject to the grantee's continued employment.

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On January 4, 2018, the Company granted an aggregate of 173,381 performance-based LTIP units to members of management under the 2015 Equity Incentive Plan, subject to the Company achieving certain absolute and relative total shareholder returns through the performance period. The awards consist of three separate tranches of 32,448 LTIP units, 55,463 LTIP units and 85,470 LTIP units with performance periods ending on December 31, 2018, December 31, 2019 and December 31, 2020, respectively. The performance criteria for each tranche is based 75% on the Company's absolute total shareholder return performance and 25% on the Company's relative total shareholder return performance during the relevant performance period, with 50% of the LTIP Units vesting when earned following the end of the applicable performance period and 50% of the earned award subject to an additional one year of vesting.

On April 3, 2018, the Company issued an aggregate of 2,236 shares of restricted common stock to certain employees pursuant to our 2015 Equity Incentive Plan. The restricted common stock grants will vest upon the second anniversary of the grant date so long as the grantee remains an employee of the Company on such date.

In connection with our 2018 annual meeting of stockholders, we issued an aggregate of 19,092 shares of restricted common stock to our non-employee directors pursuant to our 2015 Equity Incentive Plan. The restricted common stock grants will vest upon the earlier of the anniversary of the date of the grant or the next annual stockholder meeting.

In connection with the liquidation of certain private investment funds that contributed assets in our initial public offering, we issued 628,436 shares of our common stock between January 1, 2018 and September 30, 2018 upon redemption of 628,436 common units in accordance with the terms of the partnership agreement of the Operating Partnership.

A summary of our shares of restricted common stock and LTIP unit awards at September 30, 2018 is as follows:

|                                 | Restricted |           | LTIP      |           |
|---------------------------------|------------|-----------|-----------|-----------|
|                                 | Shares     |           | Units     |           |
|                                 | Weighted   |           | Weighted  |           |
|                                 | Average    |           | Average   |           |
|                                 | Grant      |           | Grant     |           |
|                                 | Date Fair  |           | Date Fair |           |
|                                 | Value      |           | Value     |           |
|                                 | Restricted |           | LTIP      |           |
|                                 | Shares     | Per Share | Units     | Per Share |
| Outstanding, December 31, 2017  | 17,912     | \$ 19.72  | 926,000   | \$ 8.91   |
| Granted                         | 21,328     | 20.87     | 173,381   | 18.31     |
| Vested                          | (15,220 )  | 19.71     | (463,000) | 8.91      |
| Forfeited                       | —          | —         | —         | —         |
| Outstanding, September 30, 2018 | 24,020     | \$ 20.74  | 636,381   | \$ 11.47  |

We recognized \$2.3 million in compensation expense related to our shares of restricted common stock and the LTIP unit awards for the nine months ended September 30, 2018. As of September 30, 2018, unrecognized compensation expense for both sets of awards was \$2.9 million, which will be amortized over the vesting period.

A summary of dividends declared by the board of directors per share of common stock and per common unit at the date of record is as follows:

| Quarter | Declaration Date | Record Date        | Pay Date           | Dividend<br>(1) |
|---------|------------------|--------------------|--------------------|-----------------|
| Q1 2018 | May 3, 2018      | June 11, 2018      | June 28, 2018      | \$ 0.26         |
| Q2 2018 | August 1, 2018   | September 13, 2018 | September 27, 2018 | \$ 0.26         |
| Q3 2018 | October 29, 2018 | December 13, 2018  | December 27, 2018  | \$ 0.26         |

(1) Prior to the end of the performance period as set forth in the applicable LTIP unit award, holders of LTIP units are entitled to receive dividends per LTIP unit equal to 10% of the dividend paid per common unit. After the end of the performance period, the number of LTIP units, both vested and unvested, that LTIP award recipients have earned, if any, are entitled to receive dividends in an amount per LTIP unit equal to dividends, both regular and special, payable per common unit.

On March 3, 2017, we entered into separate equity distribution agreements with each of Citigroup Global Markets Inc., BTIG, LLC, Jefferies LLC, Raymond James & Associates, Inc., RBC Capital Markets, LLC and SunTrust Robinson Humphrey, Inc. (collectively, the “managers”), pursuant to which we may issue and sell the shares of our common stock having an aggregate offering price of up to \$100.0 million from time to time through the managers, acting as sales agents and/or principals (the “ATM program”). The sales of shares of our common stock under the equity distribution agreements may be made in negotiated transactions or transactions that are deemed to be “at the market” offerings as defined in Rule 415 under the Securities Act of 1933, as amended.

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The following table sets forth certain information with respect to the ATM program as of September 30, 2018:

|                                               | Number of<br>Shares<br>Sold | Net<br>Proceeds |
|-----------------------------------------------|-----------------------------|-----------------|
| For the year ended December 31, 2017          | 1,569,514                   | \$ 33,263       |
| For the three months ended March 31, 2018     | 671,666                     | 13,532          |
| For the three months ended June 30, 2018      | 1,010,371                   | 20,208          |
| For the three months ended September 30, 2018 | —                           | —               |
| Total                                         | 3,251,551                   | \$ 67,003       |

We have used the proceeds from such sales for general corporate purposes. As of September 30, 2018, we had approximately \$32.3 million of gross sales of our common stock available under the ATM program.

On June 21, 2018, we completed an underwritten public offering of an aggregate of 20,700,000 shares of our common stock, consisting of (i) 13,700,000 shares sold by us to the underwriters (including 2,700,000 shares pursuant to the underwriters' exercise of their option to purchase additional shares) and (ii) 7,000,000 shares offered and sold on a forward basis in connection with forward sales agreements entered into with certain financial institutions, acting as forward purchasers. We received approximately \$252.9 million in net proceeds from the sale of shares offered by us in the offering, after deducting underwriting discounts and commissions and our offering expenses. Subject to the Company's right to elect cash or net share settlement, we expect to physically settle the forward sales agreements no later than December 21, 2018. Assuming the forward sales agreements are physically settled in full, we expect to receive an additional \$129.3 million of net proceeds, after deducting underwriting discounts, commissions and estimated offering expenses.

### 8. Earnings Per Share

Basic earnings or loss per share of common stock ("EPS") is calculated by dividing net income attributable to common stockholders by the weighted average shares of common stock outstanding for the periods presented. Diluted EPS is computed after adjusting the basic EPS computation for the effect of dilutive common equivalent shares outstanding during the periods presented. Unvested restricted shares and unvested LTIP units are considered participating securities, which require the use of the two-class method for the computation of basic and diluted earnings per share.

The following table sets forth the computation of the Company's basic and diluted earnings per share of common stock for the three and nine months ended September 30, 2018 and 2017 (amounts in thousands, except per share amounts):

|           | For the three months ended<br>September 30, |      | For the nine months ended<br>September 30, |      |
|-----------|---------------------------------------------|------|--------------------------------------------|------|
|           | 2018                                        | 2017 | 2018                                       | 2017 |
| Numerator |                                             |      |                                            |      |

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|                                                                   |            |            |            |            |
|-------------------------------------------------------------------|------------|------------|------------|------------|
| Net income                                                        | \$2,482    | \$1,117    | \$6,016    | \$3,861    |
| Less: Non-controlling interest in Operating Partnership           | (327)      | (175)      | (902)      | (700)      |
| Net income available to Easterly Government Properties, Inc.      | 2,155      | 942        | 5,114      | 3,161      |
| Less: Dividends on participating securities                       | (281)      | (28)       | (842)      | (81)       |
| Net income available to common stockholders                       | \$1,874    | \$914      | \$4,272    | \$3,080    |
| Denominator for basic EPS                                         | 60,446,199 | 39,962,471 | 51,051,388 | 38,098,805 |
| Dilutive effect of share-based compensation awards                | 6,204      | 4,673      | 8,867      | 9,193      |
| Dilutive effect of LTIP units <sup>(1)</sup>                      | 1,012,448  | 1,936,833  | 1,172,676  | 1,904,284  |
| Dilutive effect of shares issuable under forward sales agreements | 514,147    | —          | 367,927    | —          |
| Denominator for diluted EPS                                       | 61,978,998 | 41,903,977 | 52,600,858 | 40,012,282 |
| Basic EPS                                                         | \$0.03     | \$0.02     | \$0.08     | \$0.08     |
| Diluted EPS                                                       | \$0.03     | \$0.02     | \$0.08     | \$0.08     |

(1) During the three and nine months ended September 30, 2018, there were approximately 173,381 unvested performance-based LTIP units that were not included in the computation of diluted earnings per share because to do so would have been antidilutive for the period.



## 9. Operating Leases

Our rental properties are subject to generally non-cancelable operating leases generating future minimum contractual rent payments due from tenants. As of September 30, 2018, future non-cancelable minimum contractual rent payments are as follows (amounts in thousands):

|                        | Payments due by period |        |         |         |         |        |            |
|------------------------|------------------------|--------|---------|---------|---------|--------|------------|
|                        | Total                  | 2018   | 2019    | 2020    | 2021    | 2022   | Thereafter |
| Operating Leases       |                        |        |         |         |         |        |            |
| Minimum lease payments | \$1,075,191            | 33,971 | 137,136 | 126,906 | 102,989 | 87,492 | 586,697    |

The Company's consolidated operating properties were 100% occupied by 37 tenants at September 30, 2018.

For the nine months ended September 30, 2018 we recognized \$88.9 million in rental income attributable to base rent, \$6.7 million in rental income attributable to the amortization of our above- and below-market leases and a straight-line adjustment of \$4.2 million.

## 10. Revenue

On January 1, 2018, the Company adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) using the modified retrospective method and applied it to all contracts that were not completed as of January 1, 2018. The new guidance requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers and replaced the existing revenue recognition guidance.

The adoption of Topic 606 did not have an impact on the Company's historical financial statements as the revenue that falls under the scope of this guidance is limited to tenant construction projects and the associated management fee, the recognition of which did not change from how the Company has historically accounted for these projects upon adoption of the new guidance. Tenant construction project reimbursements consist primarily of subcontracted costs that are reimbursed to the Company by the tenant.

Historically, the Company has accounted for tenant construction project reimbursement arrangements using the percentage of completion method and will continue to recognize revenue from tenant construction projects using the percentage of completion method when the revenue and costs for such projects can be estimated with reasonable accuracy; when these criteria do not apply to a project, the Company recognizes revenue from that project using the completed contract method. Under the percentage of completion method, the Company recognizes a percentage of the total revenue on a project based on the cost of services provided on the project as of a point in time relative to the total costs on the project. The duration of the majority of tenant construction project reimbursement arrangements are less than a year and payment is typically due once a project is complete and work has been accepted by the tenant. For those projects ongoing as of September 30, 2018 and with a duration of greater than one year, the aggregate amount of transaction price allocated to remaining performance obligations at the end of the reporting period was \$0.1 million, which will be recognized as revenue prior to the end of 2018 using the percentage of completion method as discussed above.

The table below sets forth revenue from tenant construction projects disaggregated by tenant agency for the three and nine months ended September 30, 2018 (in thousands).

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| Tenant                                              | For the three<br>months ended<br>September 30,<br>2018 | For the nine<br>months ended<br>September 30,<br>2018 |
|-----------------------------------------------------|--------------------------------------------------------|-------------------------------------------------------|
| Administrative Office of the U.S. Courts ("AOC")    | \$ 26                                                  | \$ 138                                                |
| Drug Enforcement Administration ("DEA")             | 17                                                     | 203                                                   |
| Federal Bureau of Investigation ("FBI")             | 204                                                    | 329                                                   |
| Immigration and Customs Enforcement ("ICE")         | —                                                      | 9                                                     |
| National Park Service ("NPS")                       | —                                                      | 31                                                    |
| Social Security Administration ("SSA")              | 17                                                     | 31                                                    |
| U.S. Coast Guard ("USCG")                           | —                                                      | 6                                                     |
| U.S. Citizenship and Immigration Services ("USCIS") | —                                                      | 39                                                    |
| U.S. Forest Service ("USFS")                        | 342                                                    | 432                                                   |
| Department of Veteran Affairs ("VA")                | 572                                                    | 2,605                                                 |
|                                                     | \$ 1,178                                               | \$ 3,823                                              |

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The balance in Accounts receivable related to tenant construction projects was \$2.0 million as of September 30, 2018 and \$3.0 million as of December 31, 2017. There were no contract assets or liabilities as of September 30, 2018.

## 11. Concentrations Risk

Concentrations of credit risk arise for the Company when multiple tenants of the Company are engaged in similar business activities, are located in the same geographic region or have similar economic features that impact in a similar manner their ability to meet contractual obligations, including those to the Company. The Company regularly monitors its tenant base to assess potential concentrations of credit risk.

As stated in Note 1 above, the Company leases commercial space to the U.S. Government or nongovernmental tenants. At September 30, 2018, the U.S Government accounted for approximately 98.7% of rental income and non-governmental tenants accounted for the remaining approximately 1.3%.

Fifteen of our 56 operating properties are located in California, accounting for approximately 21.5% of our total rentable square feet and approximately 29.7% of our total annualized lease income as of September 30, 2018. In addition, we owned two properties under development located in California. To the extent that weak economic or real estate conditions or natural disasters affect California more severely than other areas of the country, our business, financial condition and results of operations could be significantly impacted.

## 12. Subsequent Events

For its consolidated financial statements as of September 30, 2018, the Company evaluated subsequent events and noted the following significant events:

On October 1, 2018, the FEMA – Tracy development project was substantially completed and a 20-year non-cancelable lease commenced with the GSA for the beneficial use of the Federal Emergency Management Agency (“FEMA”).

On October 3, 2018, we entered into a third letter amendment (the “Third Amendment”) to the 2016 term loan facility. The Third Amendment reduced the interest rate margin applicable to borrowings under the 2016 term loan facility and extended the maturity date by six months to March 29, 2024.

On October 16, 2018, we completed the acquisition of three of the 14 Portfolio Properties (the “Second Closing”). The three properties acquired in the Second Closing consist of an aggregate of 100,300 square feet and include the following (listed by primary tenant agency and location): AOC – Charleston, SC, VA – Baton Rouge, LA and DEA – Bakersfield, CA. As a result of the First Closing and the Second Closing, we have completed the acquisition of 11 of the 14 Portfolio Properties. We expect to close on the remaining three Portfolio Properties prior to December 31, 2018, subject to the satisfaction of customary closing conditions.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations  
Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We caution investors that forward-looking statements are based on management's beliefs and on assumptions made by, and information currently available to, management. When used, the words "anticipate", "believe", "estimate", "expect", "intend", "may", "might", "plan", "project", "result", "should", "will", and similar expressions which do not relate solely to historical matters are intended to identify forward-looking statements. These statements are subject to risks, uncertainties, and assumptions and are not guarantees of future performance, which may be affected by known and unknown risks, trends, uncertainties, and factors that are beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected. We expressly disclaim any responsibility to update our forward-looking statements, whether as a result of new information, future events, or otherwise. Accordingly, investors should use caution in relying on forward-looking statements, which are based on results and trends at the time they are made, to anticipate future results or trends.

Some of the risks and uncertainties that may cause our actual results, performance, or achievements to differ materially from those expressed or implied by forward-looking statements include, among others, the following:

- the factors included under the heading "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 and the factors included under the heading "Risk Factors" in the Company's other public filings;
- risks associated with our dependence on the U.S. Government and its agencies for substantially all of our revenues, including credit risk and risk that the U.S. Government reduces its spending on real estate or that it changes its preference away from leased properties;
- risks associated with ownership and development of real estate;
- the risk of decreased rental rates or increased vacancy rates;
- loss of key personnel;
- general volatility of the capital and credit markets and the market price of our common stock;
- the risk we may lose one or more major tenants;
- difficulties in completing and successfully integrating acquisitions;
- failure of acquisitions or development projects to occur at anticipated levels or yield anticipated results;
- risks associated with actual or threatened terrorist attacks;
- intense competition in the real estate market that may limit our ability to attract or retain tenants or re-lease space;
- insufficient amounts of insurance or exposure to events that are either uninsured or underinsured;
- uncertainties and risks related to adverse weather conditions, natural disasters and climate change;
- exposure to liability relating to environmental and health and safety matters;
- limited ability to dispose of assets because of the relative illiquidity of real estate investments and the nature of our assets;
- exposure to litigation or other claims;
- risks associated with breaches of our data security;
- risks associated with our indebtedness, including failure to refinance current or future indebtedness on favorable terms, or at all; failure to meet the restrictive covenants and requirements in our existing and new debt agreements; fluctuations in interest rates and increased costs to refinance or issue new debt;
- risks associated with derivatives or hedging activity; and
- risks associated with mortgage debt or unsecured financing or the unavailability thereof, which could make it difficult to finance or refinance properties and could subject us to foreclosure.

For a further discussion of these and other factors, see the section entitled "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017.



## Overview

References to “we,” “our,” “us” and “the Company” refer to Easterly Government Properties, Inc., a Maryland corporation, together with our consolidated subsidiaries including Easterly Government Properties LP, a Delaware limited partnership, which we refer to herein as our operating partnership.

We are an internally managed real estate investment trust, or REIT, focused primarily on the acquisition, development and management of Class A commercial properties that are leased to U.S. Government agencies that serve essential functions. We generate substantially all of our revenue by leasing our properties to such agencies, either directly or through the U.S. General Services Administration, or GSA. Our objective is to generate attractive risk-adjusted returns for our stockholders over the long term through dividends and capital appreciation.

As of September 30, 2018, we wholly owned 56 operating properties in the United States, including 54 operating properties that were leased primarily to U.S. Government tenant agencies and two operating properties that were entirely leased to private tenants, encompassing approximately 4.8 million square feet in the aggregate. In addition, we wholly owned three properties under development that we expect to encompass approximately 0.3 million square feet upon completion. We focus on acquiring, developing and managing U.S. Government leased properties that are essential to supporting the mission of the tenant agency and strive to be a partner of choice for the U.S. Government, working with the tenant agency to meet its needs and objectives.

Our operating partnership holds substantially all of our assets and conducts substantially all of our business. As of September 30, 2018, we owned approximately 87.5% of the aggregate limited partnership interests in our operating partnership, or common units. We have elected to be taxed as a REIT and operate in a manner that we believe allows us to continue to qualify as a REIT for federal income tax purposes commencing with our taxable year ended December 31, 2015.

## Recent Acquisitions

On May 24, 2018, we acquired a 56,753 square foot Department of Veteran Affairs (VA) facility in Golden, CO. The building was originally constructed in 1996 and fully renovated in 2011 to meet the specific design needs of the VA. The facility is leased to the VA for an initial 15-year lease term, which expires in September 2026.

On July 11, 2018, we acquired a 90,085 square foot VA facility in San Jose, CA. The building was constructed in 2018 and is 100% leased to the VA for an initial, non-cancelable lease term of 20 years through February 2038.

On June 15, 2018, we entered into a purchase and sale agreement to acquire a 1,479,762-square foot portfolio of 14 properties, which we refer to as the portfolio acquisition properties, for an aggregate purchase price of approximately \$430.0 million. On September 13, 2018, we closed on the acquisition of eight of the 14 portfolio acquisition properties, consisting of an aggregate of 1,024,036 square feet and including the following (listed by primary tenant agency, if applicable, and location): Various GSA – Buffalo, NY, Various GSA – Chicago, IL, TREAS – Parkersburg, WV, SSA – Charleston, WV, FBI – Pittsburgh, PA, GSA – Clarksburg, WV, ICE – Pittsburgh, PA and SSA – Dallas, TX. On October 16, 2018, we completed the acquisition of three of the remaining six portfolio acquisition properties, consisting of an aggregate of 100,300 square feet and including the following (listed by primary tenant agency and location): AOC – Charleston, SC, VA – Baton Rouge, LA and DEA – Bakersfield, CA. We expect to close on the remaining three portfolio acquisition properties prior to December 31, 2018, subject to the satisfaction of customary closing conditions.

## Operating Properties

As of September 30, 2018, our 56 operating properties were 100% leased with a weighted average annualized lease income per leased square foot of \$34.75 and a weighted average age of approximately 15.8 years. We calculate

annualized lease income as annualized contractual base rent for the last month in a specified period, plus the annualized straight-line rent adjustments for the last month in such period and the annualized expense reimbursements earned by us for the last month in such period.

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Information about our operating properties as of September 30, 2018 is set forth in the table below:

| Property Name                        | Location             | Type <sup>(1)</sup> | Tenant<br>Lease<br>Expiration<br>Year <sup>(2)</sup> | Rentable<br>Square<br>Feet | Annualized<br>Lease<br>Income | Annualized             |                        |          |
|--------------------------------------|----------------------|---------------------|------------------------------------------------------|----------------------------|-------------------------------|------------------------|------------------------|----------|
|                                      |                      |                     |                                                      |                            |                               | Percentage<br>of Total | Lease<br>Income<br>per | Leased   |
|                                      |                      |                     |                                                      |                            |                               |                        |                        |          |
| Property Name                        | Location             | Type <sup>(1)</sup> | Year <sup>(2)</sup>                                  | Feet                       | Income                        | Income                 | Foot                   |          |
| U.S Government Leased                |                      |                     |                                                      |                            |                               |                        |                        |          |
| VA - Loma Linda                      | Loma Linda, CA       | OC                  | 2036                                                 | 327,614                    | \$16,053,017                  | 9.6                    | %                      | \$ 49.00 |
| Various GSA - Buffalo <sup>(3)</sup> | Buffalo, NY          | O                   | 2018 - <sup>(4)</sup><br>2025                        | 267,766                    | 8,461,644                     | 5.0                    | %                      | 31.60    |
| IRS - Fresno                         | Fresno, CA           | O                   | 2033                                                 | 180,481                    | 7,499,545                     | 4.4                    | %                      | 41.55    |
| FBI - Salt Lake                      | Salt Lake City, UT   | O                   | 2032                                                 | 169,542                    | 6,803,228                     | 4.1                    | %                      | 40.13    |
| PTO - Arlington                      | Arlington, VA        | O                   | 2019 / 2020                                          | 189,871                    | 6,617,464                     | 4.0                    | %                      | 34.85    |
| Various GSA - Chicago <sup>(6)</sup> | Des Plaines, IL      | O                   | 2020 / <sup>(7)</sup><br>2022                        | 232,759                    | 6,395,004                     | 3.8                    | %                      | 28.52    |
| VA - San Jose                        | San Jose, CA         | OC                  | 2038                                                 | 90,085                     | 5,781,091                     | 3.5                    | %                      | 64.17    |
| FBI - San Antonio                    | San Antonio, TX      | O                   | 2021                                                 | 148,584                    | 5,129,841                     | 3.1                    | %                      | 34.52    |
| TREAS - Parkersburg                  | Parkersburg, WV      | O                   | 2021                                                 | 182,500                    | 4,619,514                     | 2.8                    | %                      | 25.31    |
| FBI - Omaha                          | Omaha, NE            | O                   | 2024                                                 | 112,196                    | 4,449,165                     | 2.7                    | %                      | 39.66    |
| EPA - Kansas City                    | Kansas City, KS      | L                   | 2023                                                 | 71,979                     | 4,183,838                     | 2.5                    | %                      | 58.13    |
| VA - South Bend                      | Mishakawa, IN        | OC                  | 2032                                                 | 86,363                     | 3,985,309                     | 2.4                    | %                      | 46.15    |
| ICE - Charleston <sup>(8)</sup>      | North Charleston, SC | O                   | 2021 / 2027                                          | 86,733                     | 3,788,417                     | 2.3                    | %                      | 43.68    |
| DOT - Lakewood                       | Lakewood, CO         | O                   | 2024                                                 | 122,225                    | 3,408,756                     | 2.0                    | %                      | 27.89    |
| FBI - Pittsburgh                     | Pittsburgh, PA       | O                   | 2027                                                 | 100,054                    | 3,386,688                     | 2.0                    | %                      | 33.85    |
| USCIS - Lincoln                      | Lincoln, NE          | O                   | 2020                                                 | 137,671                    | 3,310,841                     | 2.0                    | %                      | 24.05    |
| FBI - Birmingham                     | Birmingham, AL       | O                   | 2020                                                 | 96,278                     | 3,148,764                     | 1.9                    | %                      | 32.70    |
| AOC - El Centro <sup>(10)</sup>      | El Centro, CA        | C/O                 | 2019                                                 | 46,813                     | 3,097,404                     | 1.9                    | %                      | 66.17    |
| OSHA - Sandy                         | Sandy, UT            | L                   | 2024 <sup>(11)</sup>                                 | 75,000                     | 2,982,868                     | 1.8                    | %                      | 39.77    |
| USFS II - Albuquerque                | Albuquerque, NM      | O                   | 2026 <sup>(12)</sup>                                 | 98,720                     | 2,870,004                     | 1.7                    | %                      | 29.07    |
| ICE - Albuquerque                    | Albuquerque, NM      | O                   | 2027                                                 | 71,100                     | 2,804,426                     | 1.7                    | %                      | 39.44    |
| DEA - Pleasanton                     | Pleasanton, CA       | L                   | 2035                                                 | 42,480                     | 2,785,682                     | 1.7                    | %                      | 65.58    |
| DEA - Vista                          | Vista, CA            | L                   | 2020                                                 | 54,119                     | 2,777,302                     | 1.7                    | %                      | 51.32    |
| USFS I - Albuquerque                 | Albuquerque, NM      | O                   | 2021 <sup>(12)</sup>                                 | 92,455                     | 2,749,070                     | 1.6                    | %                      | 29.73    |
| FBI - Richmond                       | Richmond, VA         | O                   | 2021                                                 | 96,607                     | 2,740,032                     | 1.6                    | %                      | 28.36    |
| AOC - Del Rio <sup>(10)</sup>        | Del Rio, TX          | C/O                 | 2024                                                 | 89,880                     | 2,695,482                     | 1.6                    | %                      | 29.99    |
| DEA - Dallas Lab                     | Dallas, TX           | L                   | 2021                                                 | 49,723                     | 2,424,579                     | 1.4                    | %                      | 48.76    |
| SSA - Charleston                     | Charleston, WV       | O                   | 2019 <sup>(13)</sup>                                 | 110,000                    | 2,273,040                     | 1.4                    | %                      | 20.66    |
| FBI - Little Rock                    | Little Rock, AR      | O                   | 2021                                                 | 101,977                    | 2,206,381                     | 1.3                    | %                      | 21.64    |
|                                      | Jacksonville, FL     | O                   | 2025                                                 | 30,000                     | 2,183,945                     | 1.3                    | %                      | 72.80    |



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|                       |                   |     |                     |           |                |      |   |          |
|-----------------------|-------------------|-----|---------------------|-----------|----------------|------|---|----------|
| MEPCOM - Jacksonville |                   |     |                     |           |                |      |   |          |
| CBP - Savannah        | Savannah, GA      | L   | 2033                | 35,000    | 2,137,168      | 1.3  | % | 61.06    |
| FBI - Albany          | Albany, NY        | O   | 2019                | 98,184    | 2,092,524      | 1.3  | % | 21.31    |
| DEA - Santa Ana       | Santa Ana, CA     | O   | 2024                | 39,905    | 2,090,935      | 1.2  | % | 52.40    |
| CBP - Chula Vista     | Chula Vista, CA   | O   | 2028                | 59,322    | 2,080,111      | 1.2  | % | 35.06    |
| DOE - Lakewood        | Lakewood, CO      | O   | 2029                | 115,650   | 2,068,524      | 1.2  | % | 17.89    |
| NPS - Omaha           | Omaha, NE         | O   | 2024                | 62,772    | 1,772,276      | 1.1  | % | 28.23    |
| DEA - Dallas          | Dallas, TX        | O   | 2021                | 71,827    | 1,769,575      | 1.1  | % | 24.64    |
| ICE - Otay            | San Diego, CA     | O   | 2022 / (14)<br>2026 | 52,881    | 1,746,593      | 1.0  | % | 35.32    |
| VA - Golden           | Golden, CO        | O/W | 2026                | 56,753    | 1,686,982      | 1.0  | % | 29.72    |
| CBP - Sunburst        | Sunburst, MT      | O   | 2028                | 33,000    | 1,597,758      | 1.0  | % | 48.42    |
| USCG - Martinsburg    | Martinsburg, WV   | O   | 2027                | 59,547    | 1,585,903      | 0.9  | % | 26.63    |
| DEA - Otay (15)       | San Diego, CA     | O   | 2018                | 32,560    | 1,492,827      | 0.9  | % | 45.85    |
| AOC - Aberdeen (10)   | Aberdeen, MS      | C/O | 2025                | 46,979    | 1,465,665      | 0.9  | % | 31.20    |
| DEA - Birmingham (16) | Birmingham, AL    | O   | 2020                | 35,616    | 1,460,619      | 0.9  | % | 41.01    |
| DEA - North           | Sacramento, CA    | O   | 2033                | 37,975    | 1,435,217      | 0.9  | % | 37.79    |
| Highlands             |                   |     |                     |           |                |      |   |          |
| GSA - Clarksburg (17) | Clarksburg, WV    | O   | 2024 (12)           | 63,750    | 1,381,968      | 0.8  | % | 21.68    |
| DEA - Albany          | Albany, NY        | O   | 2025                | 31,976    | 1,349,054      | 0.8  | % | 42.19    |
| DEA - Riverside       | Riverside, CA     | O   | 2032                | 34,354    | 1,246,594      | 0.7  | % | 36.29    |
| SSA - Dallas          | Dallas, TX        | O   | 2020                | 27,200    | 1,087,236      | 0.6  | % | 39.97    |
| ICE - Pittsburgh (18) | Pittsburgh, PA    | O   | 2022 / (19)<br>2023 | 33,425    | 839,772        | 0.5  | % | 33.26    |
| AOC - South Bend (10) | South Bend, IN    | C/O | 2027                | 30,119    | 820,347        | 0.5  | % | 27.24    |
| DEA - San Diego       | San Diego, CA     | W   | 2032                | 16,100    | 556,358        | 0.3  | % | 34.56    |
| SSA - Mission Viejo   | Mission Viejo, CA | O   | 2020                | 11,590    | 529,616        | 0.3  | % | 45.70    |
| SSA - San Diego       | San Diego, CA     | O   | 2032                | 10,856    | 327,423        | 0.2  | % | 32.55    |
| Subtotal              |                   |     |                     | 4,658,916 | \$ 166,233,386 | 99.4 | % | \$ 35.84 |

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| Property Name            | Location    | Type <sup>(1)</sup> | Year <sup>(2)</sup>  | Feet      | Income        | Annualized |            |
|--------------------------|-------------|---------------------|----------------------|-----------|---------------|------------|------------|
|                          |             |                     |                      |           |               | Percentage | Lease      |
|                          |             |                     |                      |           |               | of Total   | Income per |
|                          |             |                     |                      |           |               | Annualized | Leased     |
| Property Name            | Location    | Type <sup>(1)</sup> | Year <sup>(2)</sup>  | Feet      | Income        | Income     | Foot       |
| <b>Privately Leased</b>  |             |                     |                      |           |               |            |            |
| 5998 Osceola Court -     |             |                     |                      |           |               |            |            |
| United Technologies      | Midland, GA | W/M                 | 2023 <sup>(20)</sup> | 105,641   | 544,330       | 0.3        | % 5.15     |
| 501 East Hunter Street - |             |                     |                      |           |               |            |            |
| Lummus Corporation       | Lubbock, TX | W/D                 | 2028 <sup>(11)</sup> | 70,078    | 520,918       | 0.3        | % 7.43     |
| Subtotal                 |             |                     |                      | 175,719   | \$1,065,248   | 0.6        | % \$ 6.06  |
| Total / Weighted Average |             |                     |                      | 4,834,635 | \$167,298,634 | 100.0      | % \$ 34.75 |

(1) OC=Outpatient Clinic; O=Office; C=Courthouse; L=Laboratory; W=Warehouse; D=Distribution; M=Manufacturing.

(2) The year of lease expiration does not include renewal options. All leases with renewal options are noted in the following footnotes to this table.

(3) Private tenants occupy 15,374 rentable square feet.

(4) 93,130 rentable square feet leased to the VA will expire on January 13, 2021, 61,334 rentable square feet leased to the IRS will expire on December 12, 2020, 36,640 rentable square feet leased to the National Labor Relations Board (NLRB) will expire on September 19, 2025, 32,000 rentable square feet leased to the Small Business Administration (SBA) will expire on December 14, 2021 and 44,662 rentable square feet leased to various other tenants and will expire between 2018-2021.

(5) 168,468 rentable square feet leased to the PTO will expire on March 31, 2019, and 21,403 rentable square feet leased to the PTO will expire on January 7, 2020.

(6) Private tenants occupy 2,987 rentable square feet.

(7) 209,970 rentable square feet leased to the Federal Aviation Administration (FAA) will expire on October 20, 2020 and 14,223 rentable square feet leased to various other tenants will expire between 2020-2022.

(8) We Are Sharing Hope SC (formerly known as LifePoint, Inc.) occupies 21,609 rentable square feet.

(9) 21,609 rentable square feet leased to We Are Sharing Hope SC will expire on September 30, 2021, and 54,872 rentable square feet leased to ICE, 9,198 rentable square feet leased to DEA, and 1,054 rentable square feet leased to U.S. Marshals Service will expire on January 31, 2027.

(10) A portion of this property is occupied by the U.S. Marshals Service to provide security and otherwise support the mission of the Administrative Office of the Courts. Because of the interrelated nature of the U.S. Marshals Service and the Administrative Office of the Courts, we have not separately addressed occupancy by the U.S. Marshals Service.

(11) Lease contains two five-year renewal options.

(12) Lease contains one five-year renewal option.

(13) Lease contains two five-year renewal options or one ten-year renewal option.

(14) 40,485 rentable square feet leased to ICE will expire on November 27, 2022, 7,434 rentable square feet leased to the DOT will expire on June 4, 2022 and 1,538 rentable square feet leased to the USDA will expire on January 1, 2026.

- (15) ICE occupies 5,813 rentable square feet.
- (16) The ATF occupies 8,680 rentable square feet.
- (17) SSA occupies 42,017 rentable square feet and the remaining 21,733 rentable square feet are leased to various other government tenants.
- (18) A private tenant occupies 3,854 rentable square feet.
- (19) 21,391 rentable square feet leased to ICE will expire on February 28, 2022 and contains one three-year renewal option. 3,854 rentable square feet leased to a private tenant will expire June 3, 2023.
- (20) Lease contains three five-year renewal options.

Certain of our leases are currently in the “soft-term” period of the lease, meaning that the U.S. Government tenant agency has the right to terminate the lease prior to its stated lease end date. We believe that, from the U.S.

Government’s perspective, leases with such provisions are helpful for budgetary purposes. While some of our leases are contractually subject to early termination, we do not believe that our tenant agencies are likely to terminate these leases early given the build-to-suit features at the properties subject to the leases, the average age of these properties (approximately 16.7 years as of September 30, 2018), the mission-critical focus of the properties subject to the leases and the current level of operations at such properties.

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The following table sets forth a schedule of lease expirations for leases in place as of September 30, 2018.

|                                         |                     |                   |                                              |   |                            |                            |   | Annualized |
|-----------------------------------------|---------------------|-------------------|----------------------------------------------|---|----------------------------|----------------------------|---|------------|
|                                         |                     |                   |                                              |   |                            |                            |   | Lease      |
|                                         |                     |                   |                                              |   |                            |                            |   | Income     |
|                                         |                     |                   |                                              |   |                            |                            |   | per Leased |
|                                         |                     |                   |                                              |   |                            |                            |   | Square     |
|                                         |                     |                   |                                              |   |                            |                            |   | Foot       |
| Year of Lease Expiration <sup>(1)</sup> | Number of<br>Leases | Square<br>Footage | Percentage of<br>Portfolio Square<br>Footage |   | Annualized<br>Lease Income | Annualized<br>Lease Income |   | Expiring   |
|                                         | Expiring            | Expiring          | Expiring                                     |   | Expiring                   | Expiring                   |   | Expiring   |
| 2018                                    | 3                   | 49,795            | 1.0                                          | % | 2,236,707                  | 1.3                        | % | 44.92      |
| 2019                                    | 5                   | 435,518           | 9.0                                          | % | 13,598,057                 | 8.1                        | % | 31.22      |
| 2020                                    | 14                  | 668,669           | 13.9                                         | % | 21,397,897                 | 12.8                       | % | 32.00      |
| 2021                                    | 11                  | 904,686           | 18.8                                         | % | 26,736,336                 | 16.0                       | % | 29.55      |
| 2022                                    | 4                   | 71,145            | 1.5                                          | % | 2,415,086                  | 1.4                        | % | 33.95      |
| 2023                                    | 3                   | 181,474           | 3.8                                          | % | 4,851,324                  | 2.9                        | % | 26.73      |
| 2024                                    | 13                  | 565,728           | 11.8                                         | % | 18,781,450                 | 11.2                       | % | 33.20      |
| 2025                                    | 4                   | 145,595           | 3.0                                          | % | 6,009,832                  | 3.6                        | % | 41.28      |
| 2026                                    | 3                   | 157,011           | 3.3                                          | % | 4,611,985                  | 2.8                        | % | 29.37      |
| 2027                                    | 7                   | 325,944           | 6.8                                          | % | 11,782,017                 | 7.0                        | % | 36.15      |
| Thereafter                              | 5                   | 1,308,103         | 27.1                                         | % | 54,877,943                 | 32.9                       | % | 41.95      |
| Total / Weighted Average                | 72                  | 4,813,668         | 100.0                                        | % | \$167,298,634              | 100.0                      | % | \$ 34.75   |

(1) The year of lease expirations is pursuant to current contract terms. Some tenants have the right to vacate their space during a specified period, or “soft term,” before the stated terms of their leases expire. As of September 30, 2018, six tenants occupying approximately 6.3% of our rentable square feet and contributing approximately 4.5% of our annualized lease income have exercisable rights to terminate their leases before the stated term of their lease expires.

## Results of Operations

### Comparison of Results of Operations for the three months ended September 30, 2018 and 2017

The financial information presented below summarizes the results of operations of the Company for the three months ended September 30, 2018 and 2017 (amounts in thousands).

|                           | For the three months ended<br>September 30, |               |              |
|---------------------------|---------------------------------------------|---------------|--------------|
|                           | 2018                                        | 2017          | Change       |
| <b>Revenues</b>           |                                             |               |              |
| Rental income             | \$35,219                                    | \$30,079      | \$5,140      |
| Tenant reimbursements     | 4,086                                       | 3,554         | 532          |
| Other income              | 132                                         | 225           | (93 )        |
| <b>Total revenues</b>     | <b>39,437</b>                               | <b>33,858</b> | <b>5,579</b> |
| <b>Operating Expenses</b> |                                             |               |              |
| Property operating        | 7,780                                       | 6,718         | 1,062        |

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|                                      |          |          |         |
|--------------------------------------|----------|----------|---------|
| Real estate taxes                    | 4,228    | 3,452    | 776     |
| Depreciation and amortization        | 16,109   | 13,950   | 2,159   |
| Acquisition costs                    | 300      | 206      | 94      |
| Corporate general and administrative | 3,614    | 2,920    | 694     |
| Total expenses                       | 32,031   | 27,246   | 4,785   |
| Operating income                     | 7,406    | 6,612    | 794     |
| Other expenses                       |          |          |         |
| Interest expense                     | (4,924 ) | (5,495 ) | 571     |
| Net income                           | \$2,482  | \$1,117  | \$1,365 |

Revenues

Total revenue consists primarily of rental income from our properties, tenant reimbursements for real estate taxes and certain other expenses, and project management income.

Total revenue increased by \$5.6 million to \$39.4 million for the three months ended September 30, 2018 compared to \$33.9 million for the three months ended September 30, 2017. The increase is primarily attributable to an additional \$5.4 million of revenue from the eleven operating properties acquired since September 30, 2017 as well as a full period of operations from one operating property acquired during the three months ended September 30, 2017 offset by one property disposed of since September 30, 2017.

## Operating Expenses

Total expenses increased by \$4.8 million to \$32.0 million for the three months ended September 30, 2018 compared to \$27.2 million for the three months ended September 30, 2017. The increase is primarily attributable to \$4.0 million in property operating expenses, real estate taxes, and depreciation and amortization associated with the eleven operating properties acquired since September 30, 2017 as well as a full period of operations from one operating property acquired during the three months ended September 30, 2017, offset by one property disposed of since September 30, 2017. Additionally, corporate and general administrative costs increased by \$0.7 million primarily due to an increase in employee costs.

## Interest Expense

Interest expense decreased by \$0.6 million to \$4.9 million for the three months ended September 30, 2018 compared to \$5.5 million for the three months ended September 30, 2017. The decrease is primarily due to a \$0.9 million decrease attributable to an increase in capitalized interest associated with properties under development and a decrease in interest on our \$450.0 million senior unsecured revolving credit facility, which we refer to as the revolving credit facility, due to a decrease in weighted average borrowings from \$63.1 million during the three months ended September 30, 2017 to \$4.7 million for the three months ended September 30, 2018. The decrease in interest was partially offset by a \$0.3 million increase attributable to interest incurred on our \$150.0 million senior unsecured term loan facility, which we refer to as the 2018 term loan facility, which was fully drawn on September 10, 2018.

## Comparison of Results of Operations for the nine months ended September 30, 2018 and 2017

The financial information presented below summarizes the results of operations of the Company for the nine months ended September 30, 2018 and 2017 (amounts in thousands).

|                                      | For the nine months ended<br>September 30, |          |          |
|--------------------------------------|--------------------------------------------|----------|----------|
|                                      | 2018                                       | 2017     | Change   |
| Revenues                             |                                            |          |          |
| Rental income                        | \$99,967                                   | \$83,600 | \$16,367 |
| Tenant reimbursements                | 11,658                                     | 10,156   | 1,502    |
| Other income                         | 758                                        | 592      | 166      |
| Total revenues                       | 112,383                                    | 94,348   | 18,035   |
| Operating Expenses                   |                                            |          |          |
| Property operating                   | 21,563                                     | 18,904   | 2,659    |
| Real estate taxes                    | 11,773                                     | 9,166    | 2,607    |
| Depreciation and amortization        | 45,331                                     | 40,091   | 5,240    |
| Acquisition costs                    | 1,023                                      | 1,194    | (171 )   |
| Corporate general and administrative | 10,696                                     | 9,506    | 1,190    |
| Total expenses                       | 90,386                                     | 78,861   | 11,525   |
| Operating income                     | 21,997                                     | 15,487   | 6,510    |
| Other (expenses) / income            |                                            |          |          |
| Interest expense                     | (15,981 )                                  | (11,626) | (4,355 ) |
| Net income (loss)                    | \$6,016                                    | \$3,861  | \$2,155  |

## Revenues

Total revenue consists primarily of rental income from our properties, tenant reimbursements for real estate taxes and certain other expenses, and project management income.

Total revenue increased by \$18.0 million to \$112.4 million for the nine months ended September 30, 2018 compared to \$94.3 million for the nine months ended September 30, 2017. The increase is primarily attributable to an additional \$17.1 million of revenue from the eleven operating properties acquired since September 30, 2017 as well as a full period of operations from the three operating properties acquired during the nine months ended September 30, 2017, offset by one property disposed of since September 30, 2017.

#### Operating Expenses

Total expenses increased by \$11.5 million to \$90.4 million for the nine months ended September 30, 2018 compared to \$78.9 million for the nine months ended September 30, 2017. The increase is primarily attributable to \$11.2 million in property operating expenses, real estate taxes, and depreciation and amortization associated with the eleven operating properties acquired since September 30, 2017 as well as a full period of operations from the three operating properties acquired during the nine months ended

September 30, 2017, offset by one property disposed of since September 30, 2017 and by a \$1.3 million decrease in depreciation related to the timing of intangible asset amortization. Additionally, corporate and general administrative costs increased by \$1.2 million primarily due to an increase in employee costs.

### Interest Expense

Interest expense increased \$4.4 million to \$16.0 million for the nine months ended September 30, 2018 compared to \$11.6 million for the nine months ended September 30, 2017. The increase is primarily due to a \$6.3 million increase associated with interest on the senior unsecured notes and mortgage loan secured by VA – Loma Linda, both of which were entered into during the nine months ended September 30, 2017, and interest on our \$100.0 million senior unsecured term loan facility, which we refer to as the 2016 term loan facility and the 2018 term loan facility, which were amended and entered into, respectively, during the nine months ended September 30, 2018. This increase in interest was partially offset by a \$2.0 million decrease in interest due to an increase in capitalized interest associated with properties under development and a decrease in interest on the revolving credit facility due to a decrease in the weighted average borrowings from \$154.2 million during the nine months ended September 30, 2017 to \$67.9 million for the nine months ended September 30, 2018.

### Liquidity and Capital Resources

We anticipate that our cash flows from the sources listed below will provide adequate capital for the next 12 months for all anticipated uses, including all scheduled principal and interest payments on our outstanding indebtedness, current and anticipated tenant improvements, stockholder distributions to maintain our qualification as a REIT and other capital obligations associated with conducting our business. At September 30, 2018, we had \$6.9 million available in cash and cash equivalents and there was \$417.0 million available under our revolving credit facility (as defined below).

Our primary expected sources of capital are as follows:

- cash and cash equivalents;
- operating cash flow;
- available borrowings under our revolving credit facility;
- secured loans collateralized by individual properties;
- issuance of long-term debt;
- issuance of equity, including under our ATM program (as described below); and
- asset sales.

Our short-term liquidity requirements consist primarily of funds to pay for the following:

- development and redevelopment activities, including major redevelopment, renovation or expansion programs at individual properties;
- property acquisitions under contract;
- tenant improvements allowances and leasing costs;
- recurring maintenance capital expenditures;
- debt repayment requirements;
- corporate and administrative costs;
- interest swap payments; and
- distribution payments.

Our long-term liquidity needs, in addition to recurring short-term liquidity needs as discussed above, consist primarily of funds necessary to pay for acquisitions, non-recurring capital expenditures, and scheduled debt maturities.

Although we may be able to anticipate and plan for certain of our liquidity needs, unexpected increases in uses of cash that are beyond our control and which affect our financial condition and results of operations may arise, or our sources of liquidity may be fewer than, and the funds available from such sources may be less than, anticipated or required. As



of the date of this filing, there were no known commitments or events that would have a material impact on our liquidity.

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## Equity

## Shelf Registration Statement on Form S-3

On March 16, 2018, we filed an automatic universal shelf registration statement on Form S-3 with the Securities and Exchange Commission, or SEC, which was deemed automatically effective and which provides for the registration of unspecified amounts of securities. However, there can be no assurance that we will be able to complete any such offerings of securities in the future.

## Underwritten Public Offering of Common Stock

On June 21, 2018, we completed an underwritten public offering of an aggregate of 20,700,000 shares of our common stock, consisting of (i) 13,700,000 shares sold by us to the underwriters (including 2,700,000 shares pursuant to the underwriters' exercise of their option to purchase additional shares) and (ii) 7,000,000 shares offered and sold on a forward basis in connection with forward sales agreements entered into with certain financial institutions, acting as forward purchasers. We received approximately \$252.9 million in net proceeds from the sale of shares offered by us in the offering, after deducting underwriting discounts and commissions and our offering expenses. Subject to the Company's right to elect cash or net share settlement, we expect to physically settle the forward sales agreements no later than December 21, 2018. Assuming the forward sales agreements are physically settled in full, we expect to receive an additional \$129.3 million of net proceeds, after deducting underwriting discounts, commissions and estimated offering expenses.

## ATM Program

On March 3, 2017, we entered into equity distribution agreements with each of Citigroup Global Markets Inc., BTIG, LLC, Jefferies LLC, Raymond James & Associates, Inc., RBC Capital Markets, LLC and SunTrust Robinson Humphrey, Inc., whom we refer to collectively as the managers, pursuant to which we may issue and sell the shares of our common stock having an aggregate offering price of up to \$100.0 million from time to time through the managers, acting as sales agents and/or principals, which we refer to as our ATM program. The sales of shares of our common stock under the equity distribution agreements may be made in negotiated transactions or transactions that are deemed to be "at the market" offerings as defined in Rule 415 under the Securities Act.

The following table sets forth certain information with respect to our ATM program as of September 30, 2018 (amounts in thousands, except share amounts):

|                                               | Number of<br>Shares<br>Sold | Net<br>Proceeds  |
|-----------------------------------------------|-----------------------------|------------------|
| For the year ended December 31, 2017          | 1,569,514                   | \$ 33,263        |
| For the three months ended March 31, 2018     | 671,666                     | 13,532           |
| For the three months ended June 30, 2018      | 1,010,371                   | 20,208           |
| For the three months ended September 30, 2018 | —                           | —                |
| <b>Total</b>                                  | <b>3,251,551</b>            | <b>\$ 67,003</b> |

We have used the proceeds from such sales for general corporate purposes. As of September 30, 2018, we had approximately \$32.3 million of gross sales of our common stock available under our ATM program.

## Debt

## Amended and Restated Credit Facility

On June 18, 2018, we entered into an amended and restated senior unsecured credit facility, which we refer to as our amended senior unsecured credit facility. Our amended senior unsecured credit facility increased the total borrowing capacity of our existing senior unsecured credit facility by \$200.0 million for a total credit facility size of \$600.0 million, consisting of two components: (i) the \$450.0 million revolving credit facility, and (ii) the \$150.0 million 2018 term loan facility, which we refer to as the 2018 term loan facility. The revolving credit facility also includes an accordion feature that will provide us with additional capacity, subject to the satisfaction of customary terms and conditions, of up to \$250.0 million.

Our operating partnership is the borrower, and we and certain of our subsidiaries that directly own certain of our properties are guarantors under our amended senior unsecured credit facility. The revolving credit facility matures in four years and the 2018 term loan facility matures in five years. In addition, the revolving credit facility has two six-month as-of-right extension options subject to certain conditions and the payment of an extension fee.

Our amended senior unsecured credit facility bears interest, at our option, either at:

- Eurodollar rate equal to a periodic fixed rate equal to LIBOR plus, a margin ranging from 1.25% to 1.80% for advances under the revolving credit facility and a margin ranging from 1.20% to 1.75% for advances under the 2018 term loan facility; or
- fluctuating rate equal to the sum of (a) the highest of (x) Citibank, N.A.'s base rate, (y) the federal funds effective rate plus 0.50% and (z) the one-month Eurodollar rate plus 1.00% plus (b) a margin ranging from 0.25% to 0.80% for advances under the revolving credit facility and a margin ranging from 0.20% to 0.75% for advances under the 2018 term loan facility, in each case with a margin based on our leverage ratio.

The 2018 term loan facility had a 364-day delayed draw period and is prepayable without penalty for the entire term of the loan. As of September 30, 2018, we fully drew \$150.0 million on our 2018 term loan facility.

#### Amendments to Term Loan Facility

On June 18, 2018, we entered into a second amendment to the 2016 term loan facility. The second amendment amends certain covenants and other provisions in the 2016 term loan facility to conform to changes made to such covenants and other provisions in our amended senior unsecured credit facility.

On October 3, 2018, we entered into a third letter amendment to the 2016 term loan facility. The third letter amendment reduces the interest rate margin applicable to borrowings under the 2016 term loan facility and extends the maturity date by six months to March 29, 2024.

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## Indebtedness Outstanding

The following table sets forth certain information with respect to our outstanding indebtedness as of September 30, 2018 (amounts in thousands):

| Loan                                            | Principal<br>Outstanding<br>September 30,<br>2018 | Interest<br>Rate <sup>(1)</sup> | Current<br>Maturity      |
|-------------------------------------------------|---------------------------------------------------|---------------------------------|--------------------------|
| Revolving credit facility:                      |                                                   |                                 |                          |
| Revolving credit facility <sup>(2)</sup>        | \$ 33,000                                         | L +<br>125bps                   | June 2022 <sup>(3)</sup> |
| Total revolving credit facility                 | 33,000                                            |                                 |                          |
| Term loan facilities:                           |                                                   |                                 |                          |
| 2016 term loan facility                         | 100,000                                           | 3.12%<br><sup>(4)</sup>         | September 2023           |
| 2018 term loan facility                         | 150,000                                           | L +<br>120bps                   | June 2023                |
| Total term loan facilities                      | 250,000                                           |                                 |                          |
| Less: Total unamortized deferred financing fees | (1,587 )                                          |                                 |                          |
| Total term loan facilities, net                 | 248,413                                           |                                 |                          |
| Notes payable:                                  |                                                   |                                 |                          |
| Senior unsecured notes payable, series A        | 95,000                                            | 4.05%                           | May 2027                 |
| Senior unsecured notes payable, series B        | 50,000                                            | 4.15%                           | May 2029                 |
| Senior unsecured notes payable, series C        | 30,000                                            | 4.30%                           | May 2032                 |
| Total notes payable                             | 175,000                                           |                                 |                          |
| Less: Total unamortized deferred financing fees | (1,248 )                                          |                                 |                          |
| Total notes payable, net                        | 173,752                                           |                                 |                          |
| Mortgage notes payable:                         |                                                   |                                 |                          |
| CBP - Savannah                                  | 13,676                                            | 3.40%<br><sup>(5)</sup>         | July 2033                |
| ICE - Charleston                                | 18,934                                            | 4.21%<br><sup>(5)</sup>         | January 2027             |
| MEPCOM - Jacksonville                           | 10,121                                            | 4.41%<br><sup>(5)</sup>         | October 2025             |
| USFS II - Albuquerque                           | 16,660                                            | 4.46%<br><sup>(5)</sup>         | July 2026                |
| DEA - Pleasanton                                | 15,700                                            | L +<br>150bps<br><sup>(5)</sup> | October 2023             |
| VA - Loma Linda                                 | 127,500                                           | 3.59%<br><sup>(5)</sup>         | July 2027                |
| VA - Golden                                     | 9,380                                             | 5.00%<br><sup>(5)</sup>         | April 2024               |
| Total mortgage notes payable                    | 211,971                                           |                                 |                          |
| Less: Total unamortized deferred financing fees | (1,882 )                                          |                                 |                          |

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|                                          |         |
|------------------------------------------|---------|
| Less: Total unamortized premium/discount | 299     |
| Total mortgage notes payable, net        | 210,388 |

|            |            |
|------------|------------|
| Total debt | \$ 665,553 |
|------------|------------|

- (1) At September 30, 2018, the one-month LIBOR (“L”) was 2.26%. The current interest rate is not adjusted to include the amortization of deferred financing fees or debt issuance costs incurred in obtaining debt or any unamortized fair market value premiums. The spread over the applicable rate for the revolving credit facility and the term loan facilities is based on the Company’s consolidated leverage ratio, as defined in the respective loan agreements.
- (2) Available capacity of \$417.0 million at September 30, 2018 with an accordion feature that provides additional capacity of up to \$250.0 million, subject to the satisfaction of customary terms and conditions.
- (3) Our revolving credit facility has two six-month as-of-right extension options subject to certain conditions and the payment of an extension fee.
- (4) The interest rate is calculated based on two interest rate swaps with an aggregate notional value of \$100.0 million, which effectively fix the interest rate at 3.12% annually, based on the Company’s consolidated leverage ratio, as defined in the 2016 term loan facility agreement.
- (5) Effective interest rates are as follows: CBP – Savannah 4.12%, ICE – Charleston 3.93%, MEPCOM – Jacksonville 3.89%, USFS II – Albuquerque 3.92%, DEA – Pleasanton 1.8%, VA – Loma Linda 3.78%, VA – Golden 5.03%. Our revolving credit facility, term loan facilities, unsecured notes, and mortgage notes payable are subject to ongoing compliance with a number of financial and other covenants. As of September 30, 2018, we were in compliance with all applicable financial covenants.

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The chart below details our debt capital structure as of September 30, 2018 (dollar amounts in thousands):

| Debt Capital Structure         | September 30,<br>2018 |   |
|--------------------------------|-----------------------|---|
| Total principal outstanding    | \$ 669,971            |   |
| Weighted average maturity      | 7 years               |   |
| Weighted average interest rate | 3.7                   | % |
| % Variable debt                | 29.7                  | % |
| % Fixed debt <sup>(1)</sup>    | 70.3                  | % |
| % Secured debt                 | 31.6                  | % |

(1) Our 2016 term loan facility is swapped to be fixed and as such is included as fixed rate debt in the table above.

### Dividend Policy

In order to qualify as a REIT, we are required to distribute to our stockholders, on an annual basis, at least 90% of our REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gains. We anticipate distributing all of our taxable income. We expect to make quarterly distributions to our stockholders in a manner intended to satisfy this requirement. Prior to making any distributions for U.S. federal tax purposes or otherwise, we must first satisfy our operating and debt service obligations. It is possible that it would be necessary to utilize cash reserves, liquidate assets at unfavorable prices or incur additional indebtedness in order to make required distributions. It is also possible that our board of directors could decide to make required distributions in part by using shares of our common stock.

A summary of dividends declared by the board of directors per share of common stock and per common unit of our operating partnership at the date of record is as follows:

| Quarter | Declaration Date | Record Date        | Pay Date           | Dividend<br>(1) |
|---------|------------------|--------------------|--------------------|-----------------|
| Q1 2018 | May 3, 2018      | June 11, 2018      | June 28, 2018      | \$ 0.26         |
| Q2 2018 | August 1, 2018   | September 13, 2018 | September 27, 2018 | \$ 0.26         |
| Q3 2018 | October 29, 2018 | December 13, 2018  | December 27, 2018  | \$ 0.26         |

(1) Prior to the end of the performance period as set forth in the applicable LTIP unit award, holders of LTIP units are entitled to receive dividends per LTIP unit equal to 10% of the dividend paid per common unit. After the end of the performance period, the number of LTIP units, both vested and unvested, that LTIP award recipients have earned, if any, are entitled to receive dividends in an amount per LTIP unit equal to dividends, both regular and special, payable per common unit.

### Off-balance Sheet Arrangements

We had no material off-balance sheet arrangements as of September 30, 2018.

### Inflation

Substantially all of our leases provide for operating expense escalations. We believe inflationary increases in expenses may be at least partially offset by the operating expenses that are passed through to our tenants and by contractual rent increases. We do not believe inflation has had a material impact on our historical financial position or results of operations.

### Cash Flows

The following table sets forth a summary of cash flows for the nine months ended September 30, 2018 and 2017 (amounts in thousands):

|                                 | For the nine months<br>ended September 30, |           |
|---------------------------------|--------------------------------------------|-----------|
|                                 | 2018                                       | 2017      |
| Net cash (used in) provided by: |                                            |           |
| Operating activities            | \$49,095                                   | \$42,824  |
| Investing activities            | (370,608)                                  | (350,347) |
| Financing activities            | 316,622                                    | 311,449   |



## Operating Activities

The Company generated \$49.1 million and \$42.8 million of cash from operating activities during the nine months ended September 30, 2018 and 2017, respectively. Net cash provided by operating activities for the nine months ended September 30, 2018 includes \$43.4 million in net cash from rental activities net of expenses and \$5.7 million related to the change in rents receivable, accounts receivable, prepaid and other assets, and accounts payable and accrued liabilities. Net cash provided by operating activities for the nine months ended September 30, 2017 includes a \$39.2 million increase in net cash from rental activities net of expenses and \$3.6 million related to the change in rents receivable, accounts receivable, prepaid and other assets, and accounts payable and accrued liabilities.

## Investing Activities

The Company used \$370.6 million and \$350.3 million in cash for investing activities during the nine months ended September 30, 2018 and 2017, respectively. Net cash used in investing activities for the nine months ended September 30, 2018 includes \$321.0 million in real estate acquisitions related to the purchase of VA – Golden, VA – San Jose and the closing of the first eight portfolio acquisition properties, \$38.9 million in additions to development properties, \$4.1 million in additions to operating properties and a \$6.5 million increase in deposits on acquisitions. Net cash used in investing activities for the nine months ended September 30, 2017 includes \$337.6 million in real estate acquisitions related to the purchase of OSHA – Sandy, VA – Loma Linda, FDA – Lenexa and FBI – Salt Lake, \$5.6 million in additions to development properties, a \$5.0 million note receivable and \$2.2 million in additions to operating properties offset by a \$0.7 million decrease in deposits on acquisitions.

## Financing Activities

The Company generated \$316.6 million and \$311.4 million in cash from financing activities during the nine months ended September 30, 2018 and 2017, respectively. Net cash generated by financing activities for the nine months ended September 30, 2018 includes \$297.8 million in gross proceeds from issuance of shares of our common stock, \$150.0 million in draws under our 2018 term loan facility and \$57.5 million in draws under our revolving credit facility, offset by \$124.3 million in net pay downs under our revolving credit facility, \$47.5 million in dividends, \$11.3 million in payment of offering costs, \$3.2 million in payment of deferred financing costs and \$2.4 million in mortgage notes payable repayment. Net cash provided by financing activities for the nine months ended September 30, 2017 includes \$100.0 million in draws under our 2016 term loan facility, \$175.0 million in proceeds from the issuance of senior unsecured notes, \$127.5 million in mortgage notes payable, \$107.2 million in gross proceeds from issuance of shares of our common stock, offset by \$152.9 million in net pay downs under our revolving credit facility, \$35.5 million in dividends, \$3.4 million in payment of deferred financing costs, \$4.2 million in payment of deferred offering costs and \$2.2 million in mortgage notes payable repayment.

## Non-GAAP Financial Measures

We use and present funds from operations, or FFO, and FFO, as Adjusted as supplemental measures of our performance. The summary below describes our use of FFO and FFO, as Adjusted, provides information regarding why we believe these measures are meaningful supplemental measures of our performance and reconciles these measures from net income (loss), presented in accordance with GAAP.

### Funds From Operations and Funds From Operations, as Adjusted

Funds From Operations, or FFO, is a supplemental measure of our performance. We present FFO calculated in accordance with the current National Association of Real Estate Investment Trusts, or NAREIT, definition. In addition, we present FFO, as Adjusted for certain other adjustments that we believe enhance the comparability of our FFO across periods and to the FFO reported by other publicly traded REITs. FFO is a supplemental performance measure that is commonly used in the real estate industry to assist investors and analysts in comparing results of

REITs.

FFO is defined by NAREIT as net income (loss), calculated in accordance with GAAP, excluding gains or losses from sales of property and impairment losses on depreciable real estate, plus real estate depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. We present FFO because we consider it an important supplemental measure of our operating performance, and we believe it is frequently used by securities analysts, investors and other interested parties in the evaluation of REITs, many of which present FFO when reporting results.

We adjust FFO to present FFO, as Adjusted as an alternative measure of our operating performance, which, when applicable, excludes the impact of acquisition costs, straight-line rent, above-/below-market leases, non-cash interest expense, non-cash compensation and other non-cash items including amortization of lease inducements. By excluding these income and expense items from FFO, as Adjusted, we believe we provide useful information as these items have no cash impact. In addition, by excluding

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acquisition related costs we believe FFO, as Adjusted provides useful information that is comparable across periods and more accurately reflects the operating performance of our properties.

FFO and FFO, as Adjusted are presented as supplemental financial measures and do not fully represent our operating performance. Other REITs may use different methodologies for calculating FFO and FFO, as Adjusted or use other definitions of FFO and FFO, as Adjusted and, accordingly, our presentation of these measures may not be comparable to other REITs. Neither FFO nor FFO, as Adjusted is intended to be a measure of cash flow or liquidity. Please refer to our financial statements, prepared in accordance with GAAP, for purposes of evaluating our financial condition, results of operations and cash flows.

The following table sets forth a reconciliation of our net income to FFO and FFO, as Adjusted for the three and nine months ended September 30, 2018 and 2017 (amounts in thousands):

|                                        | For the three<br>months ended<br>September 30, |          | For the nine<br>months ended<br>September 30, |          |
|----------------------------------------|------------------------------------------------|----------|-----------------------------------------------|----------|
|                                        | 2018                                           | 2017     | 2018                                          | 2017     |
| Net income                             | \$2,482                                        | \$1,117  | \$6,016                                       | \$3,861  |
| Depreciation and amortization          | 16,109                                         | 13,950   | 45,331                                        | 40,091   |
| Funds From Operations                  | 18,591                                         | 15,067   | 51,347                                        | 43,952   |
| Adjustments to FFO:                    |                                                |          |                                               |          |
| Acquisition costs                      | 300                                            | 206      | 1,023                                         | 1,194    |
| Straight-line rent and amortization of |                                                |          |                                               |          |
| lease inducements                      | (1,209 )                                       | (883 )   | (4,256 )                                      | (1,376 ) |
| Above-/below-market leases             | (2,219 )                                       | (2,065 ) | (6,737 )                                      | (6,283 ) |
| Non-cash interest expense              | 313                                            | 310      | 876                                           | 784      |
| Non-cash compensation                  | 731                                            | 748      | 2,307                                         | 2,215    |
| Funds from Operations, as Adjusted     | \$16,507                                       | \$13,383 | \$44,560                                      | \$40,486 |

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of loss from adverse changes in market prices and interest rates. Our future earnings, cash flows and fair values relevant to financial instruments are dependent upon prevailing market interest rates. Our primary market risk results from our indebtedness, which bears interest at both fixed and variable rates. We manage and may continue to manage our market risk on variable rate debt by entering into swap arrangements to, in effect, fix the rate on all or a portion of the debt for varying periods up to maturity. This in turn, reduces the risks of variability of cash flows created by variable rate debt and mitigates the risk of increases in interest rates. Our objective when undertaking such arrangements is to reduce our floating rate exposure and we do not intend to enter into hedging arrangements for speculative purposes.

As of September 30, 2018, \$471.3 million, or 70.3% of our debt, excluding unamortized premiums and discounts, had fixed interest rates and \$198.7 million, or 29.7% had variable interest rates. If market rates of interest on our variable rate debt fluctuate by 25 basis points, interest expense would increase or decrease, depending on rate movement, future earnings and cash flows, by \$0.5 million annually.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation required by the Exchange Act, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) and Rule 15d-15 of the Exchange Act, as of September 30, 2018. Based on this evaluation, our principal executive officer and principal financial officer concluded that, as of September 30, 2018, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2018 that have materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II

Item 1. Legal  
Proceedings

We are not currently involved in any material litigation nor, to our knowledge, is any material litigation currently threatened against us.

Item 1A. Risk Factors

There have been no material changes to the risk factors included in our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

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Item 6. Exhibits

The following exhibits are included, or incorporated by reference, in this Quarterly Report on Form 10-Q:

| Exhibit | Exhibit Description |
|---------|---------------------|
|---------|---------------------|

- |        |                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|--------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1    | <u>Amended and Restated Articles of Amendment and Restatement of Easterly Government Properties, Inc. (previously filed as Exhibit 3.1 to Amendment No. 2 to the Company's Registration Statement on Form S-11 on January 30, 2015 and incorporated herein by reference)</u>                                                                                                                                                                                 |
| 3.2    | <u>Amended and Restated Bylaws of Easterly Government Properties, Inc. (previously filed as Exhibit 3.2 to Amendment No. 2 to the Company's Registration Statement on Form S-11 on January 30, 2015 and incorporated herein by reference)</u>                                                                                                                                                                                                                |
| 4.1    | <u>Specimen Certificate of Common Stock of Easterly Government Properties, Inc. (previously filed as Exhibit 4.1 to Amendment No. 2 to the Company's Registration Statement on Form S-11 on January 30, 2015 and incorporated herein by reference)</u>                                                                                                                                                                                                       |
| 10.1*  | <u>Third Letter Amendment to Term Loan Agreement, dated as of October 3, 2018, by and among Easterly Government Properties, Inc., as Parent Guarantor, Easterly Government Properties LP, as Borrower, the Subsidiary Guarantors named therein, PNC Bank, National Association, as Administrative Agent and U.S. Bank National Association and SunTrust Bank, as Lenders</u>                                                                                 |
| 31.1*  | <u>Certification of Chief Executive Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended</u>                                                                                                                                                                                                                                                                                                                                |
| 31.2*  | <u>Certification of Chief Financial Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended</u>                                                                                                                                                                                                                                                                                                                                |
| 32.1** | <u>Certification of Chief Executive Officer and Chief Financial Officer Required by Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended</u>                                                                                                                                                                                                                                                                                                    |
| 101*   | The following materials from Easterly Government Properties, Inc.'s Quarterly Report on Form 10-Q for nine months ended September 30, 2018 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Equity, (iv) the Consolidated Statements of Cash Flows and (v) the related notes to these consolidated financial statements |

\* Filed herewith

\*\* Furnished herewith



SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Easterly Government Properties, Inc.

Date: November 5, 2018                      /s/ William C. Trimble, III  
William C. Trimble, III  
Chief Executive Officer and President

(Principal Executive Officer)

Date: November 5, 2018                      /s/ Meghan G. Baivier  
Meghan G. Baivier  
Executive Vice President, Chief Financial Officer and Chief Operating Officer

(Principal Financial Officer)