

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

Easterly Government Properties, Inc.  
Form 10-Q  
May 08, 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 March 31, 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)

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

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post 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

(Do not check if smaller reporting company) 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 April 30, 2018, the registrant had 45,695,511 shares of common stock, par value \$0.01 per share, outstanding.

INDEX TO FINANCIAL STATEMENTS

|   | Page |
|---|------|
| Part I: Financial Information   |      |
| Item 1: Financial Statements:<br>Consolidated Financial Statements  |      |
| <u>Consolidated Balance Sheets as of March 31, 2018 and December 31, 2017 (unaudited)</u>                             | 1    |
| <u>Consolidated Statements of Operations for the Three Months Ended March 31, 2018 and 2017 (unaudited)</u>           | 2    |
| <br>  |      |
| <u>Consolidated Statements of Comprehensive Income for the Three Months Ended March 31, 2018 and 2017 (unaudited)</u> | 3    |
| <u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2018 and 2017 (unaudited)</u>           | 4    |
| <u>Notes to the Consolidated Financial Statements</u>   | 6    |
| <br>  |      |
| <u>Item 2: Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>                  | 17   |
| <u>Item 3: Quantitative and Qualitative Disclosures About Market Risk</u>   | 26   |
| <u>Item 4: Controls and Procedures</u>  | 27   |
| Part II: Other Information  |      |
| <br>  |      |
| <u>Item 1: Legal Proceedings</u>  | 28   |
| <u>Item 1A: Risk Factors</u>  | 28   |
| <u>Item 2: Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 28   |
| <u>Item 3: Defaults Upon Senior Securities</u>  | 28   |
| <u>Item 4: Mine Safety Disclosures</u>  | 28   |
| <u>Item 5: Other Information</u>  | 28   |
| <u>Item 6: Exhibits</u>   | 29   |
| <u>Signatures</u>   |      |



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

Easterly Government Properties, Inc.

Consolidated Balance Sheets (unaudited)

(Amounts in thousands, except share amounts)

|  | March 31,<br>2018   | December 31,<br>2017 |
|--|---------------------|----------------------|
| <b>Assets</b>  |                     |                      |
| Real estate properties, net  | \$ 1,232,211        | \$ 1,230,162         |
| Cash and cash equivalents  | 9,591               | 12,682               |
| Restricted cash  | 4,389               | 3,519                |
| Deposits on acquisitions   | 1,050               | 750                  |
| Rents receivable   | 13,565              | 12,751               |
| Accounts receivable  | 9,911               | 9,347                |
| Deferred financing, net  | 733                 | 945                  |
| Intangible assets, net   | 136,651             | 143,063              |
| Interest rate swaps  | 5,890               | 4,031                |
| Prepaid expenses and other assets  | 10,710              | 8,088                |
| <b>Total assets</b>  | <b>\$ 1,424,701</b> | <b>\$ 1,425,338</b>  |
| <b>Liabilities</b>   |                     |                      |
| Revolving credit facility  | 98,750              | 99,750               |
| Term loan facility, net  | 99,236              | 99,202               |
| Notes payable, net   | 173,702             | 173,692              |
| Mortgage notes payable, net  | 202,495             | 203,250              |
| Intangible liabilities, net  | 36,093              | 38,569               |
| Accounts payable and accrued liabilities   | 19,733              | 19,786               |
| <b>Total liabilities</b>   | <b>630,009</b>      | <b>634,249</b>       |
| <b>Equity</b>  |                     |                      |
| Common stock, par value \$0.01, 200,000,000 shares authorized,<br><br>45,458,706 and 44,787,040 shares issued and outstanding at March 31, 2018<br><br>and December 31, 2017, respectively | 455                 | 448                  |
| Additional paid-in capital   | 741,089             | 740,546              |
| Retained earnings  | 8,646               | 7,127                |
| Cumulative dividends   | (95,447 )           | (83,718 )            |
| Accumulated other comprehensive income   | 4,889               | 3,403                |
| <b>Total stockholders' equity</b>  | <b>659,632</b>      | <b>667,806</b>       |
| Non-controlling interest in Operating Partnership  | 135,060             | 123,283              |
| <b>Total equity</b>  | <b>794,692</b>      | <b>791,089</b>       |
| <b>Total liabilities and equity</b>  | <b>\$ 1,424,701</b> | <b>\$ 1,425,338</b>  |

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



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

Easterly Government Properties, Inc.

Consolidated Statements of Operations (unaudited)

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

|   | For the three months ended<br>March 31, |            |
|---|---|------------|
|   | 2018                                    | 2017       |
| <b>Revenues</b>                                   |   |            |
| Rental income                                     | \$32,289                                | \$26,020   |
| Tenant reimbursements                             | 3,483                                   | 3,628      |
| Other income                                      | 202                                     | 239        |
| Total revenues                                    | 35,974                                  | 29,887     |
| <b>Operating expenses</b>                         |   |            |
| Property operating                                | 6,560                                   | 6,349      |
| Real estate taxes                                 | 3,700                                   | 2,735      |
| Depreciation and amortization                     | 14,634                                  | 12,869     |
| Acquisition costs                                 | 224                                     | 532        |
| Corporate general and administrative              | 3,459                                   | 3,444      |
| Total expenses                                    | 28,577                                  | 25,929     |
| Operating income                                  | 7,397                                   | 3,958      |
| <b>Other expenses</b>                             |   |            |
| Interest expense, net                             | (5,582 )                                | (2,417 )   |
| Net income  | 1,815                                   | 1,541      |
| Non-controlling interest in Operating Partnership | (296 )                                  | (304 )     |
| Net income available to Easterly Government       |   |            |
| Properties, Inc.                                  | \$1,519                                 | \$1,237    |
| Net income available to Easterly Government       |   |            |
| Properties, Inc. per share:                       |   |            |
| Basic   | \$0.03                                  | \$0.03     |
| Diluted   | \$0.03                                  | \$0.03     |
| <b>Weighted-average common shares outstanding</b> |   |            |
| Basic   | 45,008,062                              | 36,891,595 |
| Diluted   | 46,018,040                              | 39,143,887 |
| Dividends declared per common share               | \$0.26                                  | \$0.24     |

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

Easterly Government Properties, Inc.

Consolidated Statements of Comprehensive Income (unaudited)

(Amounts in thousands, except share amounts)

|  | For the three<br>months ended<br>March 31, |         |
|--|--|---------|
|  | 2018                                       | 2017    |
| Net income   | \$1,815                                    | \$1,541 |
| Other comprehensive income:  |  |         |
| Unrealized gain on interest rate swaps, net                                  | 1,859                                      | 108     |
| Other comprehensive income   | 1,859                                      | 108     |
| Comprehensive income   | 3,674                                      | 1,649   |
| Non-controlling interest in Operating Partnership                            | (296 )                                     | (304 )  |
| Other comprehensive income attributable to                                   |  |         |
| non-controlling interest   | (373 )                                     | (12 )   |
| Comprehensive income attributable to Easterly<br>Government Properties, Inc. | \$3,005                                    | \$1,333 |

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



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

Easterly Government Properties, Inc.

Consolidated Statements of Cash Flows (unaudited)

(Amounts in thousands)

|  | For the three months ended March 31, |           |
|--|--------------------------------------|-----------|
|  | 2018                                 | 2017      |
| Cash flows from operating activities   |                                      |           |
| Net income   | \$ 1,815                             | \$ 1,541  |
| Adjustments to reconcile net income to net cash provided by operating activities |                                      |           |
| Depreciation and amortization  | 14,634                               | 12,869    |
| Straight line rent   | (1,807 )                             | (143 )    |
| Amortization of above- / below-market leases                                     | (2,279 )                             | (2,112 )  |
| Amortization of unearned revenue   | (26 )                                | (27 )     |
| Amortization of loan premium / discount  | (21 )                                | (21 )     |
| Amortization of deferred financing costs   | 285                                  | 251       |
| Non-cash compensation  | 864                                  | 727       |
| Net change in:   |                                      |           |
| Rents receivable   | 991                                  | 775       |
| Accounts receivable  | (564 )                               | 83        |
| Prepaid expenses and other assets  | (2,613 )                             | (1,905 )  |
| Accounts payable and accrued liabilities   | 834                                  | (1,313 )  |
| Net cash provided by operating activities  | 12,113                               | 10,725    |
| Cash flows from investing activities   |                                      |           |
| Real estate acquisitions and deposits  | (326 )                               | (43,968 ) |
| Additions to operating properties  | (890 )                               | (124 )    |
| Additions to development properties  | (10,410 )                            | (79 )     |

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

|  |           |            |
|--|-----------|------------|
| Net cash (used in) investing activities                                  | (11,626 ) | (44,171 )  |
| Cash flows from financing activities                                     |           |            |
| Payment of deferred financing costs                                      | —         | (18 )      |
| Issuance of common shares  | 13,669    | —          |
| Credit facility draws  | 4,000     | 65,750     |
| Credit facility repayments   | (5,000 )  | (119,750 ) |
| Term loan draws  | —         | 100,000    |
| Repayments of mortgage notes payable                                     | (763 )    | (732 )     |
| Dividends and distributions paid   | (14,424 ) | (11,049 )  |
| Payment of offering costs  | (190 )    | —          |
| Net cash provided by (used in) financing activities                      | (2,708 )  | 34,201     |
| Net increase (decrease) in Cash and cash equivalents and Restricted cash | (2,221 )  | 755        |
| Cash and cash equivalents and Restricted cash, beginning of period       | 16,201    | 6,491      |
| Cash and cash equivalents and Restricted cash, end of period             | \$ 13,980 | \$ 7,246   |

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 three<br>months ended<br>March 31, |           |
|---|--|-----------|
|   | 2018                                       | 2017      |
| Cash paid for interest, net of capitalized interest   | \$3,497                                    | \$2,190   |
| Supplemental disclosure of non-cash information       |  |           |
| Additions to operating properties accrued, not paid   | \$183                                      | \$102     |
| Additions to development properties accrued, not paid | 2,532                                      | 92        |
| Offering costs accrued, not paid                      | 17   | —         |
| Deferred asset acquisition costs accrued, not paid    | 8  | —         |
| Unrealized loss on interest rate swaps, net           | 1,859                                      | 108       |
| Exchange of Common Units for Shares of Common Stock   |  |           |
| Non-controlling interest in Operating Partnership     | \$—  | \$(1,727) |
| Common stock  | —  | 1         |
| Additional paid-in capital                            | —  | 1,726     |
| Total   | \$—  | \$—       |

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

5

---

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. (which may be referred to in these financial statements as the “Company,” “we,” “us,” or “our”) 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.

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 March 31, 2018, we wholly owned 46 operating properties in the United States, including 44 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 3.7 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 our business. The Company is the sole general partner of the Operating Partnership. The Company owned approximately 83.0% of the aggregate limited partnership interests in the Operating Partnership (“common units”) at March 31, 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 March 31, 2018, and the consolidated results of operations for the three months ended March 31, 2018 and 2017 and the consolidated cash flows for the three months ended March 31, 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 March 31, 2017                               |                              |            |               |
| Total revenues   | \$ 29,887                    | \$ —       | \$ 29,887     |
| Depreciation and amortization  | 13,060                       | (191 )     | 12,869        |
| Total expenses   | 26,120                       | (191 )     | 25,929        |
| Net income   | 1,350                        | 191        | 1,541         |
| Net income available to Easterly Government Properties, Inc.                               | 1,084                        | 153        | 1,237         |
| Net income available to Easterly Government Properties, Inc. per share (basic and diluted) | 0.03                         | —          | 0.03          |
| Comprehensive income   | 1,458                        | 191        | 1,649         |

### 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 guidance should be applied retrospectively, however 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.

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 guidance should be applied prospectively to an award modified on or after the adoption date, however, 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 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 March 31, 2018, the Company had a sublease for office space in Washington D.C. 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 \$1.7 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.

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.

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. 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 three months ended March 31, 2018, we incurred \$0.2 million of acquisition-related expenses including \$0.2 million of internal costs associated with property acquisitions.

#### Consolidated Real Estate and Intangibles

Real estate and intangibles consisted of the following as of March 31, 2018 (dollars in thousands):

|                                   | Total        |
|-----------------------------------|--------------|
| Real estate properties, net       |              |
| Land                              | \$ 134,163   |
| Building                          | 1,099,949    |
| Acquired tenant improvements      | 47,503       |
| Construction in progress          | 27,395       |
| Accumulated amortization          | (76,799 )    |
| Total Real estate properties, net | \$ 1,232,211 |
| Intangible assets, net            |              |
| In-place leases                   | \$ 160,119   |
| Acquired leasing commissions      | 38,464       |
| Above market leases               | 9,455        |
| Accumulated amortization          | (71,387 )    |
| Total Intangible assets, net      | \$ 136,651   |
| Intangible liabilities, net       |              |
| Below market leases               | \$(62,856 )  |
| Accumulated amortization          | 26,763       |
| Total Intangible liabilities, net | \$(36,093 )  |

## 4. Debt

At March 31, 2018, our consolidated borrowings consisted of the following (dollars in thousands):

| Loan  | Principal<br>Outstanding<br>March 31,<br>2018 | Interest<br>Rate <sup>(1)</sup> | Current<br>Maturity          |
|---|---|---------------------------------|------------------------------|
| <b>Revolving credit facility:</b>                         |   |                                 |                              |
| Senior unsecured revolving credit facility <sup>(2)</sup> | \$ 98,750                                     | L +<br>150bps                   | February 2019 <sup>(3)</sup> |
| <b>Total revolving credit facility</b>                    | <b>98,750</b>                                 |                                 |                              |
| <b>Term loan facility:</b>                                |   |                                 |                              |
| Senior unsecured term loan facility                       | 100,000                                       | 3.17%<br><sup>(4)</sup>         | September 2023               |
| <b>Total term loan facility</b>                           | <b>100,000</b>                                |                                 |                              |
| Less: Total unamortized deferred financing fees           | (764 )  |                                 |                              |
| <b>Total term loan facility, net</b>                      | <b>99,236</b>                                 |                                 |                              |
| <b>Notes payable:</b>                                     |   |                                 |                              |
| 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                     |
| <b>Total notes payable</b>                                | <b>175,000</b>                                |                                 |                              |
| Less: Total unamortized deferred financing fees           | (1,298 )                                      |                                 |                              |
| <b>Total notes payable, net</b>                           | <b>173,702</b>                                |                                 |                              |
| <b>Mortgage notes payable:</b>                            |   |                                 |                              |
| CBP - Savannah  | 14,035  | 3.40%<br><sup>(5)</sup>         | July 2033                    |
| ICE - Charleston  | 19,517  | 4.21%<br><sup>(5)</sup>         | January 2027                 |
| MEPCOM - Jacksonville                                     | 10,574  | 4.41%<br><sup>(5)</sup>         | October 2025                 |
| USFS II - Albuquerque                                     | 16,816  | 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                    |
| <b>Total mortgage notes payable</b>                       | <b>204,142</b>                                |                                 |                              |
| Less: Total unamortized deferred financing fees           | (2,002 )                                      |                                 |                              |
| Less: Total unamortized premium/discount                  | 355   |                                 |                              |
| <b>Total mortgage notes payable, net</b>                  | <b>202,495</b>                                |                                 |                              |
| <b>Total debt</b>   | <b>\$ 574,183</b>                             |                                 |                              |

(1) At March 31, 2018, the one-month LIBOR ("L") was 1.88%. 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 Company's senior unsecured revolving credit

facility and senior unsecured term loan facility is based on the Company's consolidated leverage ratio, as defined in the respective loan agreements.

- (2) Available capacity of \$301.2 million at March 31, 2018 with an accordion feature that provides additional capacity of up to \$250.0 million, for a total facility size of not more than \$650.0 million.
- (3) Our senior unsecured 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 effective date of March 29, 2017 with an aggregate notional value of \$100.0 million, which effectively fix the interest rate at 3.17% annually, based on the Company's consolidated leverage ratio, as defined in the senior unsecured 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%.

#### Financial Covenant Considerations

The Company was in compliance with all financial and other covenants as of March 31, 2018 related to its senior unsecured revolving credit facility, senior unsecured term loan facility, senior unsecured notes payable and secured mortgage notes payable.

## Fair Value of Debt

As of March 31, 2018, the carrying value of our senior unsecured 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 senior unsecured revolving credit facility as a Level 3 measurement.

As of March 31, 2018, the carrying value of our senior unsecured 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 senior unsecured term loan facility as a Level 3 measurement.

At March 31, 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 March 31, 2018, the fair value of our notes payable was \$172.9 million.

At March 31, 2018, the fair value of our mortgage debt was determined by discounting future contractual principal and interest payments using prevailing market rates. We deem the fair value measurement of our mortgage debt instruments as a Level 3 measurement. At March 31, 2018, the fair value of our mortgage debt was \$198.2 million.

## 5. Derivatives and Hedging Activities

As of March 31, 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 senior unsecured term loan facility on September 29, 2023. The swaps effectively fix the interest rate under our senior unsecured term loan facility at 3.17% 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 March 31, 2018 our swaps were classified as an asset on our consolidated balance sheet at \$5.9 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 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 months ended March 31, 2018 and March 31, 2017 the amount of unrealized gains recognized in accumulated other comprehensive income on interest rate swaps was \$1.9 million and \$0.1 million, respectively. For the three months ended March 31, 2018 the amount of gain reclassified from accumulated other comprehensive income into interest expense was less than \$0.1 million. For the three months ended March 31, 2017 the amount of loss reclassified from accumulated other comprehensive income into interest expense was less than \$0.1 million. Additionally, during the three months ended March 31, 2018 and March 31, 2017, there Company did not record any hedge ineffectiveness.

The Company estimates that \$0.7 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 March 31, 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 March 31, 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 unsecured senior revolving credit facility based on the short term maturity, variable interest rates and credit spreads (categorized within Level 3 of the fair value hierarchy), estimated the fair value of our senior unsecured 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 prudent management decision.

The table below presents the Company's assets and liabilities measured at fair value on a recurring basis as of March 31, 2018, aggregated by the level in the fair value hierarchy within which those measurements fall.

| Balance Sheet Line Item | As of March 31,<br>2018     |         |         |
|-------------------------|-----------------------------|---------|---------|
|                         | Level 1                     | Level 2 | Level 3 |
|                         | Interest rate swaps - Asset | \$—     | \$5,890 |

## 7. Equity

The following table summarizes the changes in our stockholders' equity for the three months ended March 31, 2018 and 2017 (dollars in thousands):

|   |            | Common          |                            |                             | Non-controlling      |  |                                   |              |
|---|------------|-----------------|----------------------------|-----------------------------|----------------------|--|-----------------------------------|--------------|
|   | Shares     | Stock Par Value | Additional Paid-in Capital | Retained Earnings (Deficit) | Cumulative Dividends | Accumulated Other Comprehensive Income | Interest in Operating Partnership | Total Equity |
| <b>Three months ended March 31, 2018</b>                        |            |                 |                            |                             |                      |  |                                   |              |
| Balance at December 31, 2017                                    | 44,787,040 | \$ 448          | \$ 740,546                 | \$ 7,127                    | \$(83,718 )          | \$ 3,403                               | \$ 123,283                        | \$ 791,089   |
| Stock based compensation  |            | —               | 81                         | —                           | —                    | —                                      | 783                               | 864          |
| Dividends and distributions paid                                |            | —               | —                          | —                           | (11,729 )            | —                                      | (2,695 )                          | (14,424 )    |
| Issuance of common stock  | 671,666    | 7               | 13,482                     | —                           | —                    | —                                      | —                                 | 13,489       |
| Unrealized gain (loss) on interest rate swaps                   |            | —               | —                          | —                           | —                    | 1,486                                  | 373                               | 1,859        |
| Net income  |            | —               | —                          | 1,519                       | —                    | —                                      | 296                               | 1,815        |
| Allocation of non-controlling interest in Operating Partnership |            | —               | (13,020 )                  | —                           | —                    | —                                      | 13,020                            | —            |
| Balance at March 31, 2018                                       | 45,458,706 | \$ 455          | \$ 741,089                 | \$ 8,646                    | \$(95,447 )          | \$ 4,889                               | \$ 135,060                        | \$ 794,692   |
| <b>Three months ended March 31, 2017</b>                        |            |                 |                            |                             |                      |  |                                   |              |
| Balance at December 31, 2016                                    | 36,874,810 | \$ 369          | \$ 597,164                 | \$ 2,679                    | \$(42,794 )          | \$ 3,038                               | \$ 137,844                        | \$ 698,300   |
| Stock based compensation  |            | —               | 74                         | —                           | —                    | —                                      | 653                               | 727          |
| Dividends and distributions paid                                |            | —               | —                          | —                           | (8,877 )             | —                                      | (2,172 )                          | (11,049 )    |
| Grant of unvested restricted stock                              | 2,692      | —               | —                          | —                           | —                    | —                                      | —                                 | —            |
| Redemption of common units for shares of common stock           | 113,928    | 1               | 1,726                      | —                           | —                    | —                                      | (1,727 )                          | —            |
| Unrealized gain on interest rate swaps                          |            | —               | —                          | —                           | —                    | 96                                     | 12                                | 108          |

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

|   |            |        |            |          |            |          |            |
|---|------------|--------|------------|----------|------------|----------|------------|
| Net income  | —          | —      | 1,237      | —        | —          | 304      | 1,541      |
| Allocation of non-controlling interest in Operating Partnership | —          | 466    | —          | —        | —          | (466)    | —          |
| Balance at March 31, 2017                                       | 36,991,430 | \$ 370 | \$ 599,430 | \$ 3,916 | \$(51,671) | \$ 3,134 | \$ 134,448 |
|   |            |        |            |          |            |          | \$ 689,627 |

The Company granted 891,000 long term incentive plan units in our 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, 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 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.

On January 4, 2018, the Company granted an aggregate of 173,381 performance-based LTIP units to members of management, 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.

A summary of our shares of restricted common stock and LTIP unit awards at March 31, 2018 is as follows:

|                                | Restricted Shares | Weighted Average Grant Date Fair Value Per Share | LTIP Units | Weighted Average Grant Date Fair Value Per Share |
|--------------------------------|-------------------|--|------------|--|
| Outstanding, December 31, 2017 | 17,912            | \$ 19.72   | 926,000    | \$ 8.91  |
| Granted                        | —                 | —  | 173,381    | \$ 18.31   |
| Vested                         | —                 | —  | (463,000)  | \$ 8.91  |
| Forfeited                      | —                 | —  | —          | —  |
| Outstanding, March 31, 2018    | 17,912            | \$ 19.72   | 636,381    | \$ 11.47   |



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

We recognized \$0.9 million in compensation expense related to our shares of restricted common stock and the LTIP unit awards for the three months ended March 31, 2018. As of March 31, 2018, unrecognized compensation expense for both sets of awards was \$3.9 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         |

(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. The following table sets forth certain information with respect to the ATM program as of March 31, 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          |
|   | 2,241,180                   | \$ 46,795       |

We have used the proceeds from such sales for general corporate purposes. As of March 31, 2018, we had approximately \$52.7 million of gross sales of our common stock available under our ATM program.

### 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 months ended March 31, 2018 and 2017 (amounts in thousands, except per share amounts):

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

|   | For the three months ended<br>March 31, |            |
|---|---|------------|
|   | 2018                                    | 2017       |
| Numerator   |   |            |
| Net income  | \$1,815                                 | \$1,541    |
| Less: Non-controlling interest in Operating Partnership           | (296 )                                  | (304 )     |
| Net income available to Easterly Government<br>Properties, Inc.   | 1,519                                   | 1,237      |
| Less: Dividends on participating securities                       | (279 )                                  | (26 )      |
| Net income available to common stockholders                       | \$1,240                                 | \$1,211    |
| Denominator for basic EPS   | 45,008,062                              | 36,891,595 |
| Dilutive effect of share-based compensation awards                | 12,803                                  | 11,815     |
| Dilutive effect of LTIP units                                     | 997,175                                 | 1,818,392  |
| Dilutive effect of shares issuable under forward sales agreements | —                                       | 422,085    |
| Denominator for diluted EPS                                       | 46,018,040                              | 39,143,887 |
| Basic EPS   | \$0.03                                  | \$0.03     |
| Diluted EPS   | \$0.03                                  | \$0.03     |

## 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 March 31, 2018, future non-cancelable minimum contractual rent payments are as follows (dollars in thousands):

|                         | Payments due by period |        |        |        |        |        | Thereafter |
|-------------------------|------------------------|--------|--------|--------|--------|--------|------------|
|                         | Total                  | 2018   | 2019   | 2020   | 2021   | 2022   |            |
| <b>Operating Leases</b> |                        |        |        |        |        |        |            |
| Minimum lease payments  | \$850,806              | 76,506 | 96,333 | 90,704 | 79,985 | 68,225 | 439,053    |

The Company's consolidated operating properties were 100% occupied by 24 tenants at March 31, 2018.

For the three months ended March 31, 2018 we recognized \$28.2 million in rental income attributable to base rent, \$2.3 million in rental income attributable to the amortization of our above- and below-market leases and a straight-line adjustment of \$1.8 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 March 31, 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 \$0.2 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 months ended March 31, 2018 (in thousands).

|  | Tenant<br>Construction |
|--|------------------------|
| Tenant   | Project<br>Income      |
| Administrative Office of the U.S. Courts (“AOC”) | \$ 100                 |
| Drug Enforcement Administration (“DEA”)          | 23                     |
| Federal Bureau of Investigation (“FBI”)          | 58                     |
| Immigration and Customs Enforcement (“ICE”)      | 9                      |
| National Park Service (“NPS”)                    | 31                     |
| U.S. Coast Guard (“USCG”)                        | 6                      |
| U.S. Forest Service (“USFS”)                     | 29                     |
| Department of Veteran Affairs (“VA”)             | 787                    |
|  | \$ 1,043               |

The balance in Accounts receivable related to tenant construction projects was \$3.5 million as of March 31, 2018 and \$3.0 million as of December 31, 2017. There were no contract assets or liabilities as of March 31, 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

15

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 March 31, 2018, the U.S Government accounted for approximately 99.2% of rental income and non-governmental tenants accounted for the remaining approximately 0.8%.

Fourteen of our 46 operating properties are located in California, accounting for approximately 25.8% of our total rentable square feet and approximately 33.3% of our total annualized lease income as of March 31, 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 March 31, 2018, the Company evaluated subsequent events and noted no significant events.

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;
- 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;
- 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 March 31, 2018, we wholly owned 46 operating properties in the United States, including 44 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 3.7 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 March 31, 2018, we owned approximately 83.0% 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.

## Operating Properties

As of March 31, 2018, our 46 operating properties were 100% leased with a weighted average annualized lease income per leased square foot of \$35.79 and a weighted average age of approximately 12.3 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.



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

Information about our operating properties as of March 31, 2018 is set forth in the table below:

| Property Name                   | Location             | Type <sup>(1)</sup> | Tenant Lease Expiration Year <sup>(2)</sup> | Rentable Square Feet | Annualized Lease Income | Annualized Lease Income per Square Foot |   |
|---------------------------------|----------------------|---------------------|---|----------------------|-------------------------|---|---|
|                                 |                      |                     |   |                      |                         | Annualized Lease Income                 | Percentage of Total Annualized Lease Income |
| U.S. Government Leased          |                      |                     |   |                      |                         |   |   |
| VA - Loma Linda                 | Loma Linda, CA       | OC                  | 2036  | 327,614              | \$16,015,434            | 12.2                                    | % \$ 48.89                                  |
| IRS - Fresno                    | Fresno, CA           | O                   | 2018  | 180,481              | 7,578,831               | 5.8                                     | % 41.99                                     |
| FBI - Salt Lake                 | Salt Lake City, UT   | O                   | 2032  | 169,542              | 6,746,595               | 5.1                                     | % 39.79                                     |
| PTO - Arlington                 | Arlington, VA        | O                   | 2019 / 2020                                 | 189,871              | 6,519,811               | 5.0                                     | % 34.34                                     |
| FBI - San Antonio               | San Antonio, TX      | O                   | 2021  | 148,584              | 5,132,896               | 3.9                                     | % 34.55                                     |
| FBI - Omaha                     | Omaha, NE            | O                   | 2024  | 112,196              | 4,437,584               | 3.4                                     | % 39.55                                     |
| EPA - Kansas City               | Kansas City, KS      | L                   | 2023  | 71,979               | 4,171,384               | 3.2                                     | % 57.95                                     |
| VA - South Bend                 | Mishakawa, IN        | OC                  | 2032  | 86,363               | 3,985,799               | 3.0                                     | % 46.15                                     |
| ICE - Charleston <sup>(4)</sup> | North Charleston, SC | O                   | 2021 / 2027                                 | 86,733               | 3,772,210               | 2.9                                     | % 43.49                                     |
| DOT - Lakewood                  | Lakewood, CO         | O                   | 2024  | 122,225              | 3,382,692               | 2.7                                     | % 27.68                                     |
| USCIS - Lincoln                 | Lincoln, NE          | O                   | 2020  | 137,671              | 3,298,565               | 2.5                                     | % 23.96                                     |
| FBI - Birmingham                | Birmingham, AL       | O                   | 2020  | 96,278               | 3,285,723               | 2.5                                     | % 34.13                                     |
| AOC - El Centro <sup>(6)</sup>  | El Centro, CA        | C/O                 | 2019  | 46,813               | 3,099,437               | 2.4                                     | % 66.21                                     |
| OSHA - Sandy                    | Sandy, UT            | L                   | 2024 <sup>(7)</sup>                         | 75,000               | 2,979,790               | 2.3                                     | % 39.73                                     |
| USFS II - Albuquerque           | Albuquerque, NM      | O                   | 2026 <sup>(8)</sup>                         | 98,720               | 2,856,835               | 2.2                                     | % 28.94                                     |
| ICE - Albuquerque               | Albuquerque, NM      | O                   | 2027  | 71,100               | 2,804,426               | 2.1                                     | % 39.44                                     |
| DEA - Vista                     | Vista, CA            | L                   | 2020  | 54,119               | 2,777,302               | 2.1                                     | % 51.32                                     |
| DEA - Pleasanton                | Pleasanton, CA       | L                   | 2035  | 42,480               | 2,770,028               | 2.1                                     | % 65.21                                     |
| FBI - Richmond                  | Richmond, VA         | O                   | 2021  | 96,607               | 2,737,803               | 2.1                                     | % 28.34                                     |
| USFS I - Albuquerque            | Albuquerque, NM      | O                   | 2021 <sup>(8)</sup>                         | 92,455               | 2,737,373               | 2.1                                     | % 29.61                                     |
| AOC - Del Rio <sup>(6)</sup>    | Del Rio, TX          | C/O                 | 2024  | 89,880               | 2,667,861               | 2.0                                     | % 29.68                                     |
| DEA - Dallas Lab                | Dallas, TX           | L                   | 2021  | 49,723               | 2,414,114               | 1.8                                     | % 48.55                                     |
| FBI - Little Rock               | Little Rock, AR      | O                   | 2021  | 101,977              | 2,206,381               | 1.7                                     | % 21.64                                     |
| MEPCOM - Jacksonville           | Jacksonville, FL     | O                   | 2025  | 30,000               | 2,183,870               | 1.7                                     | % 72.80                                     |
| CBP - Savannah                  | Savannah, GA         | L                   | 2033  | 35,000               | 2,118,784               | 1.6                                     | % 60.54                                     |
| FBI - Albany                    | Albany, NY           | O                   | 2018  | 98,184               | 2,098,811               | 1.6                                     | % 21.38                                     |
| DEA - Santa Ana                 | Santa Ana, CA        | O                   | 2024  | 39,905               | 2,078,323               | 1.6                                     | % 52.08                                     |
| DOE - Lakewood                  | Lakewood, CO         | O                   | 2029  | 115,650              | 2,068,524               | 1.6                                     | % 17.89                                     |
| DEA - Dallas                    | Dallas, TX           | O                   | 2021  | 71,827               | 1,830,279               | 1.4                                     | % 25.48                                     |
| NPS - Omaha                     | Omaha, NE            | O                   | 2024  | 62,772               | 1,751,754               | 1.3                                     | % 27.91                                     |

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

|                                  |                   |     |                |      |           |                |       |   |          |
|----------------------------------|-------------------|-----|----------------|------|-----------|----------------|-------|---|----------|
| ICE - Otay                       | San Diego, CA     | O   | 2022 /<br>2026 | (9)  | 52,881    | 1,735,240      | 1.3   | % | 35.09    |
| DEA - North Highlands            | Sacramento, CA    | O   | 2018           |      | 37,975    | 1,721,698      | 1.3   | % | 45.34    |
| CBP - Chula Vista                | Chula Vista, CA   | O   | 2018           |      | 59,397    | 1,710,248      | 1.3   | % | 28.79    |
| CBP - Sunburst                   | Sunburst, MT      | O   | 2028           |      | 33,000    | 1,597,758      | 1.2   | % | 48.42    |
| USCG - Martinsburg               | Martinsburg, WV   | O   | 2027           |      | 59,547    | 1,582,249      | 1.2   | % | 26.57    |
| DEA - Birmingham <sup>(10)</sup> | Birmingham, AL    | O   | 2020           |      | 35,616    | 1,533,079      | 1.2   | % | 43.04    |
| DEA - Otay <sup>(11)</sup>       | San Diego, CA     | O   | 2018           |      | 32,560    | 1,482,682      | 1.1   | % | 45.54    |
| AOC - Aberdeen <sup>(6)</sup>    | Aberdeen, MS      | C/O | 2025           |      | 46,979    | 1,465,665      | 1.1   | % | 31.20    |
| DEA - Albany                     | Albany, NY        | O   | 2025           |      | 31,976    | 1,422,021      | 1.1   | % | 44.47    |
| DEA - Riverside                  | Riverside, CA     | O   | 2032           |      | 34,354    | 1,235,147      | 0.9   | % | 35.95    |
| AOC - South Bend <sup>(6)</sup>  | South Bend, IN    | C/O | 2027           |      | 30,119    | 823,889        | 0.6   | % | 27.35    |
| DEA - San Diego                  | San Diego, CA     | W   | 2032           |      | 16,100    | 530,404        | 0.4   | % | 32.94    |
| SSA - Mission Viejo              | Mission Viejo, CA | O   | 2020           |      | 11,590    | 467,296        | 0.4   | % | 40.32    |
| SSA - San Diego                  | San Diego, CA     | O   | 2032           |      | 10,856    | 327,423        | 0.2   | % | 32.55    |
| Subtotal                         |                   |     |                |      | 3,494,699 | \$ 130,144,018 | 99.2  | % | \$ 37.29 |
| Privately Leased                 |                   |     |                |      |           |                |       |   |          |
| 5998 Osceola Court -             |                   |     |                |      |           |                |       |   |          |
| United Technologies              | Midland, GA       | W/M | 2023           | (12) | 105,641   | 544,405        | 0.4   | % | 5.15     |
| 501 East Hunter Street           |                   |     |                |      |           |                |       |   |          |
| -                                |                   |     |                |      |           |                |       |   |          |
| Lummus Corporation               | Lubbock, TX       | W/D | 2028           | (7)  | 70,078    | 527,804        | 0.4   | % | 7.53     |
| Subtotal                         |                   |     |                |      | 175,719   | \$ 1,072,209   | 0.8   | % | \$ 6.10  |
| Total / Weighted Average         |                   |     |                |      | 3,670,418 | \$ 131,216,227 | 100.0 | % | \$ 35.79 |

(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) 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.

(4) This property is only partially leased to the U.S. Government. We Are Sharing Hope SC (formerly known as LifePoint, Inc.) occupies 21,609 rentable square feet.

(5) 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.

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

- (6) 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.
- (7) Lease contains two five-year renewal options.
- (8) Lease contains one five-year renewal option.
- (9) 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 Department of Agriculture (DOA) will expire on January 1, 2026.
- (10) The Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) occupies 8,680 rentable square feet.
- (11) ICE occupies 5,813 rentable square feet.
- (12) 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 15.6 years as of March 31, 2018), the mission-critical focus of the properties subject to the leases and the current level of operations at such properties.

The following table sets forth a schedule of lease expirations for leases in place as of March 31, 2018.

| Year of Lease Expiration<br>(1) | Number of Square |           | Percentage of               |                          | Percentage               |                          | Annualized Lease<br>Income per<br>Leased Square |
|---------------------------------|------------------|-----------|-----------------------------|--------------------------|--------------------------|--------------------------|---|
|                                 | Leases           | Footage   | Portfolio Square<br>Footage | Annualized               | Annualized               | of Total                 |   |
|                                 | Expiring         | Expiring  | Expiring                    | Lease Income<br>Expiring | Lease Income<br>Expiring | Lease Income<br>Expiring | Foot Expiring                                   |
| 2018                            | 6                | 408,597   | 11.1                        | % 14,592,270             | 11.1                     | %                        | 35.71   |
| 2019                            | 2                | 215,281   | 5.9                         | % 8,849,543              | 6.7                      | %                        | 41.11   |
| 2020                            | 7                | 356,677   | 9.7                         | % 12,131,670             | 9.2                      | %                        | 34.01   |
| 2021                            | 7                | 582,782   | 15.9                        | % 17,670,978             | 13.5                     | %                        | 30.32   |
| 2022                            | 2                | 47,919    | 1.3                         | % 1,680,241              | 1.3                      | %                        | 35.06   |
| 2023                            | 2                | 177,620   | 4.8                         | % 4,715,789              | 3.6                      | %                        | 26.55   |
| 2024                            | 6                | 501,978   | 13.7                        | % 17,298,004             | 13.2                     | %                        | 34.46   |
| 2025                            | 3                | 108,955   | 3.0                         | % 5,071,556              | 3.9                      | %                        | 46.55   |
| 2026                            | 2                | 100,258   | 2.7                         | % 2,911,834              | 2.2                      | %                        | 29.04   |
| 2027                            | 6                | 225,890   | 6.2                         | % 8,370,642              | 6.4                      | %                        | 37.06   |
| Thereafter                      | 7                | 940,240   | 25.7                        | % 37,923,700             | 28.9                     | %                        | 40.33   |
| Total / Weighted Average        | 50               | 3,666,197 | 100.0                       | % \$ 131,216,227         | 100.0                    | %                        | \$ 35.79  |

(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 March 31, 2018, six tenants occupying approximately 12.8% of our rentable square feet and contributing approximately 11.5% 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 March 31, 2018 and 2017

The financial information presented below summarizes the results of operations of the Company for the three months ended March 31, 2018 and 2017 (dollars in thousands).

|                                      | For the three months ended<br>March 31, |          |         |
|--------------------------------------|---|----------|---------|
|                                      | 2018                                    | 2017     | Change  |
| <b>Revenues</b>                      |   |          |         |
| Rental income                        | \$32,289                                | \$26,020 | \$6,269 |
| Tenant reimbursements                | 3,483                                   | 3,628    | (145 )  |
| Other income                         | 202                                     | 239      | (37 )   |
| Total revenues                       | 35,974                                  | 29,887   | 6,087   |
| <b>Operating Expenses</b>            |   |          |         |
| Property operating                   | 6,560                                   | 6,349    | 211     |
| Real estate taxes                    | 3,700                                   | 2,735    | 965     |
| Depreciation and amortization        | 14,634                                  | 12,869   | 1,765   |
| Acquisition costs                    | 224                                     | 532      | (308 )  |
| Corporate general and administrative | 3,459                                   | 3,444    | 15      |
| Total expenses                       | 28,577                                  | 25,929   | 2,648   |
| Operating income                     | 7,397                                   | 3,958    | 3,439   |
| Other (expenses) / income            |   |          |         |
| Interest expense                     | (5,582 )                                | (2,417 ) | (3,165) |
| Net income (loss)                    | \$1,815                                 | \$1,541  | \$274   |

## 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 \$6.1 million to \$36.0 million for the three months ended March 31, 2018 compared to \$29.9 million for the three months ended March 31, 2017. The increase is primarily attributable to an additional \$6.6 million of revenue from the three operating properties acquired since March 31, 2017 as well as a full period of operations from the one operating property acquired during the three months ended March 31, 2017 offset by one property disposed of since March 31, 2017. This was offset by a \$0.7 million decrease in tenant project reimbursements and the associated project management income.

## Operating Expenses

Total expenses increased by \$2.6 million to \$28.6 million for the three months ended March 31, 2018 compared to \$25.9 million for the three months ended March 31, 2017. The increase is attributable to \$4.0 million in property operating expenses, real estate taxes, and depreciation and amortization associated with the three operating properties acquired since March 31, 2017 as well as a full period of operations from the one operating property acquired during the three months ended March 31, 2017 offset by one property disposed of since March 31, 2017. This was offset by \$0.6 million decrease in expenses associated with projects and other services that were fully reimbursed by the tenant and a \$0.7 million decrease in depreciation related to the timing of intangible asset amortization.

## Interest Expense

Interest expense increased \$3.2 million to \$5.6 million for three months ended March 31, 2018 compared to \$2.4 million for the three months ended March 31, 2017. The increase is primarily due to \$1.8 million associated with interest on the senior unsecured notes and \$1.2 million associated with interest on the mortgage loan secured by VA – Loma Linda, which were both entered into after March 31, 2017, and \$0.7 million attributable to interest on our \$100 million senior unsecured term loan facility and interest rate swap which we drew on March 20, 2017, offset by a \$0.3 million decrease in interest on the credit facility due to a decrease in the weighted average borrowings from \$230.6 million to \$99.9 million quarter over quarter offset by an increase in weighted average interest rate from of 2.2% to 3.1% quarter over quarter.

21

---

## 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 March 31, 2018, we had \$9.6 million available in cash and cash equivalents and there was \$301.2 million available under our senior unsecured revolving credit facility.

Our primary expected sources of capital are as follows:

- cash and cash equivalents;
- operating cash flow;
- available borrowings under our senior unsecured 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.

## 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.

## 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.

22

---



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

The following table sets forth certain information with respect to the ATM program as of March 31, 2018 (dollars in thousands):

|   | 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          |
|   | 2,241,180                   | \$ 46,795       |

We have used the proceeds from such sales for general corporate purposes. As of March 31, 2018, we had approximately \$52.7 million of gross sales of our common stock available under on our ATM program.

Debt

The following table sets forth certain information with respect to our outstanding indebtedness as of March 31, 2018 (dollars in thousands):

| Loan  | Principal<br>Outstanding<br>March 31,<br>2018 | Interest<br>Rate <sup>(1)</sup> | Current<br>Maturity          |
|---|---|---------------------------------|------------------------------|
| <b>Revolving credit facility:</b>                         |   |                                 |                              |
| Senior unsecured revolving credit facility <sup>(2)</sup> | \$ 98,750                                     | L +<br>150bps                   | February 2019 <sup>(3)</sup> |
| <b>Total revolving credit facility</b>                    | <b>98,750</b>                                 |                                 |                              |
| <b>Term loan facility:</b>                                |   |                                 |                              |
| Senior unsecured term loan facility                       | 100,000                                       | 3.17%<br><sup>(4)</sup>         | September 2023               |
| <b>Total term loan facility</b>                           | <b>100,000</b>                                |                                 |                              |
| Less: Total unamortized deferred financing fees           | (764 )  |                                 |                              |
| <b>Total term loan facility, net</b>                      | <b>99,236</b>                                 |                                 |                              |
| <b>Notes payable:</b>                                     |   |                                 |                              |
| 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                     |
| <b>Total notes payable</b>                                | <b>175,000</b>                                |                                 |                              |
| Less: Total unamortized deferred financing fees           | (1,298 )                                      |                                 |                              |
| <b>Total notes payable, net</b>                           | <b>173,702</b>                                |                                 |                              |
| <b>Mortgage notes payable:</b>                            |   |                                 |                              |
| CBP - Savannah  | 14,035  | 3.40%<br><sup>(5)</sup>         | July 2033                    |
| ICE - Charleston  | 19,517  | 4.21%<br><sup>(5)</sup>         | January 2027                 |
| MEPCOM - Jacksonville                                     | 10,574  | 4.41%<br><sup>(5)</sup>         | October 2025                 |
| USFS II - Albuquerque                                     | 16,816  |                                 | July 2026                    |

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

|   |            |        |              |
|---|------------|--------|--------------|
|   |            | 4.46%  |              |
|   |            | (5)    |              |
| DEA - Pleasanton                                |            | L +    | October 2023 |
|   | 15,700     | 150bps |              |
|   |            | (5)    |              |
| VA - Loma Linda                                 | 127,500    | 3.59%  | July 2027    |
|   |            | (5)    |              |
| Total mortgage notes payable                    | 204,142    |        |              |
| Less: Total unamortized deferred financing fees | (2,002 )   |        |              |
| Less: Total unamortized premium/discount        | 355        |        |              |
| Total mortgage notes payable, net               | 202,495    |        |              |
| <br>  |            |        |              |
| Total debt                                      | \$ 574,183 |        |              |

(1) At March 31, 2018, the one-month LIBOR (“L”) was 1.88%. 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 Company’s senior unsecured revolving credit facility and senior unsecured term loan facility is based on the Company’s consolidated leverage ratio, as defined in the respective loan agreements.

(2) Available capacity of \$301.2 million at March 31, 2018 with an accordion feature that provides additional capacity of up to \$250.0 million, for a total facility size of not more than \$650.0 million.

23

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

- (3) Our senior unsecured 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 effective date of March 29, 2017 with an aggregate notional value of \$100.0 million, which effectively fix the interest rate at 3.17% annually, based on the Company's consolidated leverage ratio, as defined in the senior unsecured 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%.

Our unsecured credit facility, unsecured term loans, unsecured notes, and mortgage notes are subject to ongoing compliance with a number of financial and other covenants. As of March 31, 2018, we were in compliance with the applicable financial covenants.

The chart below details our debt capital structure as of March 31, 2018 (dollars in thousands):

| Debt Capital Structure         | March 31, 2018 |
|--------------------------------|----------------|
| Total principal outstanding    | \$ 577,892     |
| Weighted average maturity      | 7.6 years      |
| Weighted average interest rate | 3.7 %          |
| % Variable debt                | 19.8 %         |
| % Fixed debt <sup>(1)</sup>    | 80.2 %         |
| % Secured debt                 | 35.3 %         |

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

#### Contractual Obligations

The following table summarizes our contractual obligations as of March 31, 2018 (dollars in thousands):

|   | Payments due by period |        |        |        |        |        |            |
|---|------------------------|--------|--------|--------|--------|--------|------------|
|   | Total                  | 2018   | 2019   | 2020   | 2021   | 2022   | Thereafter |
| Mortgage principal and interest                                   | \$265,787              | 8,008  | 10,656 | 10,700 | 11,199 | 12,059 | 213,165    |
| Senior unsecured revolving credit facility principal and interest | 102,446                | 3,212  | 99,234 | —      | —      | —      | —          |
| Senior unsecured term loan facility principal and interest        | 117,501                | 2,389  | 3,185  | 3,185  | 3,185  | 3,185  | 102,372    |
| Senior unsecured notes payable principal and interest             | 251,600                | 5,409  | 7,213  | 7,213  | 7,213  | 7,213  | 217,339    |
| Development property obligations <sup>(1)</sup>                   | 39,135                 | 30,373 | 8,762  | —      | —      | —      | —          |
| Corporate office leases   | 1,742                  | 350    | 479    | 496    | 352    | 65     | —          |

- (1) Due to the long-term nature of certain construction and development contracts included in this line, the amounts reported in the table represent our estimate of the timing for the related obligations being paid.

#### 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.

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

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         |

(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 March 31, 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 three months ended March 31, 2018 and 2017:

|                                 | For the three<br>months ended<br>March 31,<br>2018      2017<br>(amounts in<br>thousands) |          |
|---------------------------------|---|----------|
| Net cash (used in) provided by: |   |          |
| Operating activities            | \$12,113  | \$10,725 |
| Investing activities            | (11,626)  | (44,171) |
| Financing activities            | (2,708 )  | 34,201   |

### Operating Activities

The Company generated \$12.1 million and \$10.7 million of cash from operating activities during the three months ended March 31, 2018 and 2017, respectively. Net cash provided by operating activities for the three months ended March 31, 2018 includes \$13.5 million in net cash from rental activities net of expenses offset by \$1.4 million related to the change in rents receivable, accounts receivable, prepaid and other assets, and accounts payable and accrued liabilities. Net cash from operating activities for the three months ended March 31, 2017 includes \$13.1 million in net cash from rental activities net of expenses offset by \$2.4 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 \$11.6 million and \$44.2 million in cash for investing activities during the three months ended March 31, 2018 and 2017, respectively. Net cash used in investing activities for the three months ended March 31, 2018 includes \$10.4 million in additions to development properties, \$0.9 million in additions to operating properties and a \$0.3 million increase in deposits on acquisitions. Net cash used in investing activities for the three months ended March 31, 2017 includes \$37.0 million in real estate acquisitions related to the purchase of OSHA – Sandy and \$7.0 million in deposits on acquisitions.

#### Financing Activities

The Company used \$2.7 million and generated \$34.2 million in cash from financing activities during the three months ended March 31, 2018 and 2017, respectively. Net cash used by financing activities for the three months ended March 31, 2018 includes \$14.4 million in dividend payments, \$1.0 million in net pay downs under our senior unsecured revolving credit facility and \$0.8 million in mortgage debt repayment offset by \$13.5 million in net proceeds from issuance of shares of our common stock. Net cash provided by financing activities for the three months ended March 31, 2017 includes \$100.0 million in term loan draws offset by \$54.0 million in net credit facility pay downs, \$11.0 million in dividends and \$0.7 million in mortgage debt 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 and non-cash compensation. By excluding income and expense items such as straight-line rent, above-/below-market leases, non-cash interest expense, non-cash compensation and other non-cash items including amortization of lease inducements from FFO, as Adjusted, we believe we provide useful information as these items have no cash impact. In addition, by excluding 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 months ended March 31, 2018 and 2017 (dollars in thousands):

|                               | For the three months ended |         |
|-------------------------------|----------------------------|---------|
|                               | March 31,                  |         |
|                               | 2018                       | 2017    |
| Net income                    | \$1,815                    | \$1,541 |
| Depreciation and amortization | 14,634                     | 12,869  |
| Funds From Operations         | 16,449                     | 14,410  |

|   |          |          |
|---|----------|----------|
| Adjustments to FFO:                               |          |          |
| Acquisition costs                                 | 224      | 532      |
| Straight-line rent and other non-cash adjustments | (1,794 ) | (143 )   |
| Above-/below-market leases                        | (2,279 ) | (2,112 ) |
| Non-cash interest expense                         | 264      | 230      |
| Non-cash compensation                             | 864      | 727      |
| Funds from Operations, as Adjusted                | \$13,728 | \$13,644 |

### 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 March 31, 2018, \$463.4 million, or 80.2% of our debt, excluding unamortized premiums and discounts, had fixed interest rates and \$114.5 million, or 19.8% 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 \$0.3 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 March 31, 2018. Based on this evaluation, our principal executive officer and principal financial officer concluded that, as of March 31, 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 March 31, 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

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 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)
- 3.2 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)
- 4.1 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)
- 31.1\* Certification of Chief Executive Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
- 31.2\* Certification of Chief Financial Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
- 32.1\*\* Certification of Chief Executive Officer and Chief Financial Officer Required by Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended
- 101\* The following materials from Easterly Government Properties, Inc.'s Quarterly Report on Form 10-Q for three months ended March 31, 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: May 8, 2018

/s/ William C. Trimble, III  
William C. Trimble, III  
Chief Executive Officer and President

(Principal Executive Officer)

Date: May 8, 2018

/s/ Meghan G. Baivier  
Meghan G. Baivier  
Executive Vice President, Chief Financial Officer and Chief Operating Officer

(Principal Financial Officer)