Easterly Government Properties, Inc.
Form 10-Q
August 07, 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 June 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from To

Commission file number 001-36834

EASTERLY GOVERNMENT PROPERTIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland (State of Incorporation)	47-2047728 (IRS Employer Identification No.)
2101 L Street NW, Suite 650, Washington, D.C. (Address of Principal Executive Offices)	20037 (Zip Code)

(202) 595-9500

(Registrant’s telephone number, including area code)

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 July 31, 2018, the registrant had 60,384,591 shares of common stock, par value $0.01 per share, outstanding.

INDEX TO FINANCIAL STATEMENTS

Easterly Government Properties, Inc.

Consolidated Balance Sheets (unaudited)

(Amounts in thousands, except share amounts)

	June 30, 2018	December 31, 2017
Assets		
Real estate properties, net	$ 1,254,368	$ 1,230,162
Cash and cash equivalents	147,505	12,682
Restricted cash	6,330	3,519
Deposits on acquisitions	15,750	750
Rents receivable	14,074	12,751
Accounts receivable	8,198	9,347
Deferred financing, net	3,753	945
Intangible assets, net	132,477	143,063
Interest rate swaps	6,552	4,031
Prepaid expenses and other assets	10,405	8,088
Total assets	$ 1,599,412	$ 1,425,338
Liabilities		
Revolving credit facility	—	99,750
Term loan facilities, net	99,271	99,202
Notes payable, net	173,727	173,692
Mortgage notes payable, net	211,164	203,250
Intangible liabilities, net	33,937	38,569
Accounts payable and accrued liabilities	25,285	19,786
Total liabilities	543,384	634,249
Equity		
Common stock, par value $0.01, 200,000,000 shares authorized, 60,376,466 and 44,787,040 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	604	448
Additional paid-in capital	1,008,615	740,546
Retained earnings	10,086	7,127
Cumulative dividends	(107,573)	(83,718)
Accumulated other comprehensive income	5,692	3,403
Total stockholders' equity	917,424	667,806
Non-controlling interest in Operating Partnership	138,604	123,283
Total equity	1,056,028	791,089
Total liabilities and equity	$ 1,599,412	$ 1,425,338

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

Easterly Government Properties, Inc.

Consolidated Statements of Operations (unaudited)

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

	For the three months ended June 30,		For the six months ended June 30,	
	2018	2017	2018	2017
Revenues				
Rental income	$32,459	$27,501	$64,748	$53,521
Tenant reimbursements	4,089	2,974	7,572	6,602
Other income	424	128	626	367
Total revenues	36,972	30,603	72,946	60,490
Operating expenses				
Property operating	7,223	5,837	13,783	12,186
Real estate taxes	3,845	2,979	7,545	5,714
Depreciation and amortization	14,588	13,272	29,222	26,141
Acquisition costs	499	456	723	988
Corporate general and administrative	3,623	3,142	7,082	6,586
Total expenses	29,778	25,686	58,355	51,615
Operating income	7,194	4,917	14,591	8,875
Other expenses				
Interest expense, net	(5,475)	(3,714)	(11,057)	(6,131)
Net income	1,719	1,203	3,534	2,744
Non-controlling interest in Operating Partnership	(279)	(221)	(575)	(525)
Net income available to Easterly Government Properties, Inc.	$1,440	$982	$2,959	$2,219
Net income available to Easterly Government Properties, Inc. per share:				
Basic	$0.02	$0.03	$0.05	$0.06
Diluted	$0.02	$0.02	$0.05	$0.05
Weighted-average common shares outstanding				
Basic	47,531,128	37,408,603	46,276,125	37,151,527
Diluted	49,124,886	39,845,314	47,845,560	39,534,993
Dividends declared per common share	$0.26	$0.25	$0.52	$0.49

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)

	For the three months ended June 30,		For the six months ended June 30,	
	2018	2017	2018	2017
Net income	$1,719	$1,203	$3,534	$2,744
Other comprehensive income:				
Unrealized gain (loss) on interest rate swaps, net	662	(694)	2,521	(586)
Other comprehensive income (loss)	662	(694)	2,521	(586)
Comprehensive income	2,381	509	6,055	2,158
Non-controlling interest in Operating Partnership	(279)	(221)	(575)	(525)
Other comprehensive income attributable to non-controlling interest	141	221	(232)	209
Comprehensive income attributable to Easterly Government Properties, Inc.	$2,243	$509	$5,248	$1,842

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)

	For the six months ended June 30, 2018	2017
Cash flows from operating activities		
Net income	$3,534	$2,744
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	29,222	26,141
Straight line rent	(3,073)	(493)
Amortization of above- / below-market leases	(4,518)	(4,218)
Amortization of unearned revenue	(52)	(55)
Amortization of loan premium / discount	(42)	(42)
Amortization of deferred financing costs	605	516
Non-cash compensation	1,576	1,467
Net change in:		
Rents receivable	1,742	787
Accounts receivable	1,149	(923)
Prepaid expenses and other assets	(1,988)	(1,698)
Accounts payable and accrued liabilities	459	318
Net cash provided by operating activities	28,614	24,544
Cash flows from investing activities		
Real estate acquisitions and deposits	(20,576)	(249,492)
Additions to operating properties	(2,425)	(901)
Additions to development properties	(21,125)	(3,911)
Net cash used in investing activities	(44,126)	(254,304)
Cash flows from financing activities		
Payment of deferred financing costs	(3,070)	(3,225)
Issuance of common shares	297,805	1,886
Credit facility draws	19,000	108,000
Credit facility repayments	(118,750)	(252,167)
Term loan draws	—	100,000
Issuance of notes payable	—	175,000
Issuance of mortgage notes payable	—	127,500
Repayments of mortgage notes payable	(1,560)	(1,473)
Dividends and distributions paid	(29,196)	(22,564)
Payment of offering costs	(11,083)	(24)
Net cash provided by financing activities	153,146	232,933
Net increase in Cash and cash equivalents and Restricted cash	137,634	3,173
Cash and cash equivalents and Restricted cash, beginning of period	16,201	6,491
Cash and cash equivalents and Restricted cash, end of period	$153,835	$9,664

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

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Easterly Government Properties, Inc.

Consolidated Statements of Cash Flows (unaudited)

(Amounts in thousands)

Supplemental disclosure of cash flow information is as follows:

	For the six months ended June 30,	
	2018	2017
Cash paid for interest, net of capitalized interest	$10,766	$5,149
Supplemental disclosure of non-cash information		
Additions to operating properties accrued, not paid	$652	$229
Additions to development properties accrued, not paid	7,419	11
Financing costs accrued, not paid	137	173
Offering costs accrued, not paid	246	—
Deferred asset acquisition costs accrued, not paid	256	—
Unrealized gain (loss) on interest rate swaps, net	2,521	(586)
Debt assumed on acquisition of operating property	9,414	—
Exchange of Common Units for Shares of Common Stock		
Non-controlling interest in Operating Partnership	$(3,039)	$(19,866)
Common stock	2	13
Additional paid-in capital	3,037	19,853
Total	$—	$—

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

Easterly Government Properties, Inc.

Notes to the Consolidated Financial Statements (unaudited)

1. Organization and Basis of Presentation

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

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

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

As of June 30, 2018, we wholly owned 47 operating properties in the United States, including 45 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 86.9% of the aggregate limited partnership interests in the Operating Partnership (“common units”) at June 30, 2018. We believe that we have operated and have been organized in conformity with the requirements for qualification and taxation as a REIT for U.S federal income tax purposes commencing with our taxable year ended December 31, 2015.

Principles of Consolidation

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

Basis of Presentation

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

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

2. Summary of Significant Accounting Policies

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

Revision of Previously Reported Consolidated Financial Statements

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

Effect of Revision For the Three Months Ended June 30, 2017	As Previously Reported	Adjustment	As Revised
Total revenues	$ 30,603	$ —	$ 30,603
Depreciation and amortization	13,462	(190)	13,272
Total expenses	25,876	(190)	25,686
Net income	1,013	190	1,203
Net income available to Easterly Government Properties, Inc.	827	155	982
Net income available to Easterly Government Properties, Inc. per share (basic)	0.02	0.01	0.03
Net income available to Easterly Government Properties, Inc. per share (diluted)	0.02	—	0.02
Comprehensive income	319	190	509

Effect of Revision For the Six Months Ended June 30, 2017	As Previously Reported	Adjustment	As Revised
Depreciation and amortization	$ 26,522	$ (381)	$ 26,141
Total expenses	51,996	(381)	51,615
Net income	2,363	381	2,744
Net income available to Easterly Government Properties, Inc.	1,911	308	2,219
Net income available to Easterly Government Properties, Inc. per share (basic)	0.05	0.01	0.06
Net income available to Easterly Government Properties, Inc. per share (diluted)	0.05	—	0.05
Comprehensive income	1,777	381	2,158

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 June 30, 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 $1.6 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 six months ended June 30, 2018, we acquired one operating property, VA – Golden, in an asset acquisition for a purchase price of $14.9 million. We allocated the purchase price of the acquisition based on the estimated fair values of the acquired assets and assumed liabilities as follows (amounts in thousands):

	Total
Real estate	
Land	$4,080
Building	7,718
Acquired tenant improvements	1,215
Total real estate	13,013
Intangible assets	
In-place leases	1,752
Acquired leasing commissions	383
Total intangible assets	2,135
Intangible liabilities	
Below-market leases	(280)
Total intangible liabilities	(280)
Purchase price	14,868
Less: Mortgage note assumed	(9,414)
Net assets acquired	$5,454

The intangible assets and liabilities of VA – Golden has a weighted average amortization period of 8.24 years as of June 30, 2018. During the six months ended June 30, 2018, we included $0.2 million of revenues and less than $0.1 million of net income in our consolidated statement of operations related to VA – Golden.

During the six months ended June 30, 2018, we agreed to acquire a 1,479,762-square foot portfolio of 14 properties (the “Acquisition Portfolio”) for a purchase price of approximately $430.0 million, including a $15.0 million non-refundable deposit paid in connection with the execution of the purchase agreement and the end of the due diligence period. The completion of the portfolio acquisition is subject to customary closing conditions.

During the six months ended June 30, 2018, we incurred $0.7 million of acquisition-related expenses including $0.5 million of internal costs associated with property acquisitions.

Consolidated Real Estate and Intangibles

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

	Total
Real estate properties, net	
Land	$138,243
Building	1,109,671
Acquired tenant improvements	48,718
Construction in progress	42,997
Accumulated amortization	(85,261)

Total Real estate properties, net	$1,254,368
Intangible assets, net	
In-place leases	$161,872
Acquired leasing commissions	38,847
Above market leases	9,455
Accumulated amortization	(77,697)
Total Intangible assets, net	$132,477
Intangible liabilities, net	
Below market leases	$(63,136)
Accumulated amortization	29,199
Total Intangible liabilities, net	$(33,937)

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

	Acquired Above-Market Lease Intangibles	Acquired Below-Market Lease Intangibles
2018	$ 394	$ 4,494
2019	743	6,905
2020	609	6,208
2021	608	4,385
2022	608	2,850

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

4. Debt

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

Loan	Principal Outstanding June 30, 2018	Interest Rate (1)	Current Maturity
Revolving credit facility:			
Revolving credit facility (2)	$ —	L + 130bps	June 2022 (3)
Total revolving credit facility	—		
Term loan facilities:			
2016 term loan facility	100,000	3.17% (4)	September 2023
2018 term loan facility	—	L + 125bps	June 2023
Total term loan facility	100,000		
Less: Total unamortized deferred financing fees	(729)		
Total term loan facilities, net	99,271		
Notes payable:			
Senior unsecured notes payable, series A	95,000	4.05%	May 2027
Senior unsecured notes payable, series B	50,000	4.15%	May 2029
Senior unsecured notes payable, series C	30,000	4.30%	May 2032

Total notes payable	175,000		
Less: Total unamortized deferred financing fees	(1,273)		
Total notes payable, net	173,727		
Mortgage notes payable:			
CBP - Savannah	13,856	3.40% (5)	July 2033
ICE - Charleston	19,227	4.21% (5)	January 2027
MEPCOM - Jacksonville	10,349	4.41% (5)	October 2025
USFS II - Albuquerque	16,739	4.46% (5)	July 2026
DEA - Pleasanton	15,700	L + 150bps (5)	October 2023
VA - Loma Linda	127,500	3.59% (5)	July 2027
VA - Golden	9,404	5.00% (5)	April 2024
Total mortgage notes payable	212,775		
Less: Total unamortized deferred financing fees	(1,930)		
Less: Total unamortized premium/discount	319		
Total mortgage notes payable, net	211,164		
Total debt	$ 484,162		

(1) At June 30, 2018, the one-month LIBOR (“L”) was 2.09%. 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 $450.0 million at June 30, 2018 with an accordion feature that provides additional capacity of up to $250.0 million, for a total facility size of not more than $700.0 million.
(3) Our revolving credit facility has two six-month as-of-right extension options subject to certain conditions and the payment of an extension fee.
(4) The interest rate is calculated based on two interest rate swaps with an aggregate notional value of $100.0 million, which effectively fix the interest rate at 3.17% annually, based on the Company's consolidated leverage ratio, as defined in the 2016 term loan facility agreement.
(5) Effective interest rates are as follows: CBP - Savannah 4.12%, ICE - Charleston 3.93%, MEPCOM - Jacksonville 3.89%, USFS II - Albuquerque 3.92%, DEA - Pleasanton 1.8%, VA – Loma Linda 3.78%, VA – Golden 5.03%.

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

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

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

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

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

The 2018 term loan facility has a 364-day delayed draw period and is prepayable without penalty for the entire term of the loan. As of June 30, 2018, we had not drawn any funds under our 2018 term loan facility.

In addition, on June 18, 2018, we entered into a second amendment to our existing $100 million senior unsecured term loan facility (the "2016 term loan facility"). The second amendment amends certain covenants and other provisions in the 2016 term loan facility to conform to changes made to such covenants and other provisions in our amended senior unsecured credit facility.

Financial Covenant Considerations

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

Fair Value of Debt

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

At June 30, 2018, the fair value of our notes payable was determined by discounting future contractual principal and interest payments using prevailing market rates. We deem the fair value measurement of our notes payable instruments as a Level 3 measurement. At June 30, 2018, the fair value of our notes payable was $171.5 million.

At June 30, 2018, the fair value of our mortgage notes payable was determined by discounting future contractual principal and interest payments using prevailing market rates. We deem the fair value measurement of our mortgage notes payable as a Level 3 measurement. At June 30, 2018, the fair value of our mortgage notes payable was $205.7 million.

5. Derivatives and Hedging Activities

As of June 30, 2018, the Company had two outstanding interest rate swaps with an aggregate notional value of $100.0 million that were designated as cash flow hedges. The swaps had an effective date of March 29, 2017 and extend until the maturity of our 2016 term loan facility on September 29, 2023. The swaps effectively fix the interest rate under our 2016 term loan facility at 3.17% 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 June 30, 2018 our swaps were classified as an asset on our consolidated balance sheet at $6.6 million. The effective portion of changes in the fair value of derivatives designated and qualified as cash flow hedges is recorded in accumulated other comprehensive income and will be reclassified to interest expense in the period that the hedged forecasted transactions affect earnings on the Company's consolidated variable rate debt. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings into interest expense. For the three and six months ended June 30, 2018 the amount of unrealized gains recognized in accumulated other comprehensive income on interest rate swaps was $0.8 million and $2.7 million, respectively. For the three and six months ended June 30, 2018 the amount of gain reclassified from accumulated other comprehensive income into interest expense was $0.1 million and $0.2 million, respectively. Additionally, during the three and six months ended June 30, 2018, the Company did not record any hedge ineffectiveness. For the three and six months ended June 30, 2017 the amount of unrealized loss recognized in accumulated other comprehensive income on interest rate swaps was $0.8 million and $0.7 million, respectively. For the three and six months ended June 30, 2017 the amount of loss reclassified from accumulated other comprehensive income into interest expense was $0.1 million and $0.1 million, respectively. Additionally, during the three and six months ended June 30, 2017, the Company did not record any hedge ineffectiveness.

The Company estimates that $1.0 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 June 30, 2018, the Company did not have any derivatives in a net liability position.

6. Fair Value Measurements

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

Recurring fair value measurements

The fair values of our interest rate swaps are determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities in such interest rates. While the Company determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Company and its counterparties. The Company has determined that the significance of the impact of the credit valuation adjustments made to its derivative contracts, which determination was based on the fair value of each individual contract, was not significant to the overall valuation. As a result, all of the Company’s derivatives held as of June 30, 2018 were classified as Level 2 of the fair value hierarchy.

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

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

	As of June 30, 2018		
Balance Sheet Line Item	Level 1	Level 2	Level 3
Interest rate swaps - Asset	$—	$6,552	$ —

7. Equity

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

	Shares	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings (Deficit)	Cumulative Dividends	Accumulated Other Comprehensive Income	Non-controlling Interest in Operating Partnership	Total Equity
Six months ended June 30, 2018								
Balance at December 31, 2017	44,787,040	$ 448	$ 740,546	$ 7,127	$ (83,718)	$ 3,403	$ 123,283	$ 791,089
Stock based compensation		—	181	—	—	—	1,395	1,576
Dividends and distributions paid		—						