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Modest core FFO Beat, Guidance Maintained

Buy

Price: \$18.60

Net-net: We think the stock could modestly outperform this morning, as core FFO results were a penny ahead of the consensus and our estimate. In addition, DEA reiterated its 2016 guidance (at the \$1.21 midpoint), which remained slightly higher the street and our estimate. In short, DEA delivered what we had expected and we will look for additional details on the conference call at 10am (1-877-705-6003).

Core FFO Beats Consensus: Third-quarter FFO was \$0.30 per share versus our estimate of \$0.29ps and the consensus of \$0.30. Excluding acquisition costs, **normalized FFO of \$0.32ps was \$0.01 ahead of our estimate and the consensus (each \$0.31ps). The \$0.01 per share normalized FFO beat versus our estimate was driven by higher NOI and lower interest expense.** Normalized FFO of \$0.32ps was up 20.5% year-over year, driven by higher NOI and was partially offset by higher interest expense.

Figure 1: STRH FFO Estimate versus Consensus 2016-2017

	STRH	Cons.	STRH vs. Cons. (%)	Act./ Guid. vs. Cons. (%)
3Q16			Actual	
3Q16 NAREIT FFO	\$0.29	\$0.30	\$0.30	0.0%
3Q16 Norm. FFO	\$0.31	\$0.29	\$0.32	
2016E			Guidance	
2016E NAREIT FFO	\$1.19	\$1.20	\$1.19 - \$1.23	0.9%
2016E Norm. FFO	\$1.23	1.23		
2017E				
2017E NAREIT FFO	\$1.22	\$1.25		
2017E Norm. FFO	\$1.24			

Source: Company Reports, Factset, STRH

2016 Guidance Unchanged: Management maintained its 2016 FFO guidance at **\$1.19-\$1.23 per share**. The \$1.21 per share midpoint remained unchanged and implies 16.8% growth year-over-year. Our current estimate, which is not yet updated to reflect 3Q16 results, is \$1.19ps and the consensus is \$1.20ps. DEA now assumes \$160 million in 2016 acquisitions, down slightly from the previous \$175 million estimate.

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Operating Results: Total NOI increased **36.3% YOY (+31.3% cash)** compared with last quarter's +25.1% YOY (+31.6% cash; vs 2Q15 pro-forma), driven by acquisition activity. Occupancy remained at 100%

Acquisitions: During the quarter, DEA completed 3 previously announced acquisitions, including:

- FBI – Birmingham, a 96,000 sf built-to-suit property that is 100% leased through 2020 to the GSA, on behalf of the FBI
- DEA – Birmingham, a 36,000 sf build-to-suit that is 100% leased through 2020 to the GSA on behalf of the DEA
- EPA – Kansas City, a 72,000 sf build-to-suit laboratory that is 100% leased through 2023 to the GSA on behalf of the EPA

Subsequent to 3Q, DEA expects to close the remaining acquisition of the 98,000 sf FBI- Albany property. The property is 100% leased through 2018 to the GSA on behalf of the FBI.

We wrote in extensive detail about these acquisitions in our [initiation report](#) on October 18.

Balance Sheet: During 3Q, DEA closed on a 7-year \$100 million unsecured term loan, which matures September 2023. Subsequent to the quarter, DEA entered into 2 interest rate swaps with an aggregate notional value of \$100 million, which effectively fixed the interest rate of future draw-downs of the term loan at 3.12% annually, based on the DEA's current leverage ratio.

DEA had total liquidity of ~\$197 million including \$4.4 million in cash on hand and \$193 million in availability under its revolving credit facility.

Companies Mentioned in This Note

Easterly Government Properties, Inc. (DEA, \$18.60, Buy, Michael Lewis)

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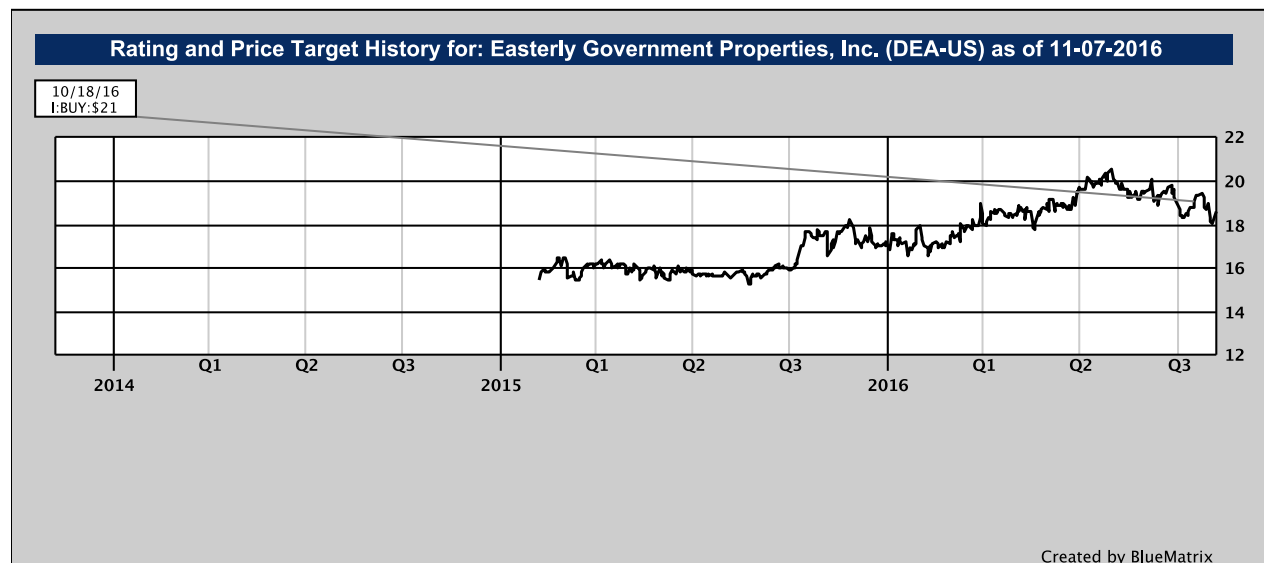
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