WASHINGTON REAL ESTATE INVESTMENT TRUST
Form 10-Q
July 31, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For quarterly period ended June 30, 2017
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
COMMISSION FILE NO. 1-6622
WASHINGTON REAL ESTATE
INVESTMENT TRUST
(Exact name of registrant as specified in its charter)

MARYLAND	53-0261100
(State of incorporation)	(IRS Employer Identification Number)

1775 EYE STREET, NW, SUITE 1000, WASHINGTON, DC 20006
(Address of principal executive office) (Zip code)
Registrant's telephone number, including area code: (202) 774-3200

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of exchange on which registered
Shares of Beneficial Interest	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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

Indicate by checkmark 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 x NO o

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

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	o
		Emerging growth company	o

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. o

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

As of July 26, 2017, 76,926,923 common shares were outstanding.

WASHINGTON REAL ESTATE INVESTMENT TRUST
INDEX

PART I
FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

The information furnished in the accompanying unaudited Consolidated Balance Sheets, Condensed Consolidated Statements of Income, Condensed Consolidated Statements of Comprehensive Income, Consolidated Statement of Equity and Consolidated Statements of Cash Flows reflects all adjustments, consisting of normal recurring items, which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods. The accompanying financial statements and notes thereto should be read in conjunction with the financial statements and notes for the three years ended December 31, 2016 included in Washington Real Estate Investment Trust’s 2016 Annual Report on Form 10-K.

WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	June 30, 2017 (Unaudited)	December 31, 2016
Assets		
Land	$616,444	$573,315
Income producing property	2,201,846	2,112,088
	2,818,290	2,685,403
Accumulated depreciation and amortization	(691,515)	(657,425)
Net income producing property	2,126,775	2,027,978
Properties under development or held for future development	46,154	40,232
Total real estate held for investment, net	2,172,929	2,068,210
Investment in real estate sold or held for sale, net	6,983	—
Cash and cash equivalents	13,237	11,305
Restricted cash	1,506	6,317
Rents and other receivables, net of allowance for doubtful accounts of $2,274 and $2,377, respectively	72,149	64,319
Prepaid expenses and other assets	121,005	103,468
Other assets related to properties sold or held for sale	303	—
Total assets	$2,388,112	$2,253,619
Liabilities		
Notes payable, net	$893,763	$843,084
Mortgage notes payable, net	96,934	148,540
Lines of credit	228,000	120,000
Accounts payable and other liabilities	60,165	46,967
Dividend payable	—	22,414
Advance rents	11,956	11,750
Tenant security deposits	9,263	8,802
Liabilities related to properties sold or held for sale	322	—
Total liabilities	1,300,403	1,201,557
Equity		
Shareholders’ equity		
Preferred shares; $0.01 par value; 10,000 shares authorized; no shares issued or outstanding	—	—
Shares of beneficial interest, $0.01 par value; 100,000 shares authorized; 76,926 and 74,606 shares issued and outstanding, respectively	769	746
Additional paid in capital	1,435,994	1,368,636
Distributions in excess of net income	(357,308)	(326,047)
Accumulated other comprehensive income	6,857	7,611
Total shareholders’ equity	1,086,312	1,050,946
Noncontrolling interests in subsidiaries	1,397	1,116
Total equity	1,087,709	1,052,062
Total liabilities and equity	$2,388,112	$2,253,619

See accompanying notes to the consolidated financial statements.

5

WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenue				
Real estate rental revenue	$83,456	$79,405	$160,957	$156,542
Expenses				
Real estate expenses	28,691	28,175	56,554	56,909
Depreciation and amortization	29,261	25,161	55,330	51,199
Acquisition costs	—	1,024	—	1,178
General and administrative	5,759	4,968	11,385	10,479
Casualty gain	—	(676)	—	(676)
	63,711	58,652	123,269	119,089
Other operating income				
Gain on sale of real estate	—	24,112	—	24,112
Real estate operating income	19,745	44,865	37,688	61,565
Other (expense) income				
Interest expense	(12,053)	(13,820)	(23,458)	(28,180)
Other income	48	83	125	122
Income tax benefit	107	693	107	693
	(11,898)	(13,044)	(23,226)	(27,365)
Net income	7,847	31,821	14,462	34,200
Less: Net loss attributable to noncontrolling interests in subsidiaries	17	15	36	20
Net income attributable to the controlling interests	$7,864	$31,836	$14,498	$34,220
Basic net income attributable to the controlling interests per common share	$0.10	$0.44	$0.19	$0.49
Diluted net income attributable to the controlling interests per common share	$0.10	$0.44	$0.19	$0.49
Weighted average shares outstanding – basic	76,705	71,719	75,785	70,010
Weighted average shares outstanding – diluted	76,830	71,912	75,903	70,200
Dividends declared per share	$0.30	$0.30	$0.60	$0.60

See accompanying notes to the consolidated financial statements.

WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(IN THOUSANDS)
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	$7,847	$31,821	$14,462	$34,200
Other comprehensive loss:				
Unrealized loss on interest rate hedges	(1,489)	(1,384)	(754)	(5,059)
Comprehensive income	6,358	30,437	13,708	29,141
Less: Comprehensive loss attributable to noncontrolling interests	17	15	36	20
Comprehensive income attributable to the controlling interests	$6,375	$30,452	$13,744	$29,161

See accompanying notes to the consolidated financial statements.

7

WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF EQUITY
(IN THOUSANDS)
(UNAUDITED)

	Shares Issued and Out-standing	Shares of Beneficial Interest at Par Value	Additional Paid in Capital	Distributions in Excess of Net Income	Accumulated Other Comprehensive Income	Total Shareholders' Equity	Noncontrolling Interests in Subsidiaries	Total Equity
Balance, December 31, 2016	74,606	$ 746	$ 1,368,636	$ (326,047)	$ 7,611	$ 1,050,946	$ 1,116	$ 1,052,062
Net income attributable to the controlling interests	—	—	—	14,498	—	14,498	—	14,498
Net loss attributable to the noncontrolling interests	—	—	—	—	—	—	(36)	(36)
Unrealized loss on interest rate hedge	—	—	—	—	(754)	(754)	—	(754)
Distributions to noncontrolling interests	—	—	—	—	—	—	(59)	(59)
Operating partnership units issued with acquisition	—	—	—	—	—	—	376	376
Dividends	—	—	—	(45,759)	—	(45,759)	—	(45,759)
Equity issuances, net of issuance costs	2,070	21	63,885	—	—	63,906	—	63,906
Shares issued under dividend reinvestment program	56	—	1,796	—	—	1,796	—	1,796
Share grants, net of share grant amortization, forfeitures and tax withholdings	194	2	1,677	—	—	1,679	—	1,679
Balance, June 30, 2017	76,926	$ 769	$ 1,435,994	$ (357,308)	$ 6,857	$ 1,086,312	$ 1,397	$ 1,087,709

See accompanying notes to the consolidated financial statements.

WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities		
Net income	$14,462	$34,200
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	55,330	51,199
Provision for losses on accounts receivable	470	708
Casualty gain	—	(676)
Gain on sale of real estate	—	(24,112)
Share-based compensation expense	2,351	2,421
Deferred tax benefit	(107)	(732)
Amortization of debt premiums, discounts and related financing costs	948	1,604
Changes in operating other assets	(10,950)	(983)
Changes in operating other liabilities	2,846	(2,366)
Net cash provided by operating activities	65,350	61,263
Cash flows from investing activities		
Real estate acquisitions, net	(138,371)	(227,413)
Net cash received for sale of real estate	—	119,513
Capital improvements to real estate	(23,923)	(16,356)
Development in progress	(7,291)	(17,997)
Cash released from replacement reserve escrows, net	4,622	2,001
Insurance proceeds	—	883
Non-real estate capital improvements	(1,950)	(42)
Net cash used in investing activities	(166,913)	(139,411)
Cash flows from financing activities		
Line of credit borrowings, net	108,000	164,000
Dividends paid	(68,173)	(63,284)
Principal payments – mortgage notes payable	(51,075)	(166,216)
Proceeds from term loan	50,000	—
Payment of financing costs	(234)	(236)
Distributions to noncontrolling interests	(59)	(110)
Proceeds from dividend reinvestment program	1,796	—
Net proceeds from equity issuances	63,906	143,357
Payment of tax withholdings for restricted share awards	(666)	(809)
Net cash provided by financing activities	103,495	76,702
Net increase (decrease) in cash and cash equivalents	1,932	(1,446)
Cash and cash equivalents at beginning of period	11,305	23,825
Cash and cash equivalents at end of period	$13,237	$22,379
Supplemental disclosure of cash flow information:		
Cash paid for interest, net of amounts capitalized	$22,670	$27,154
Change in accrued capital improvements and development costs	1,090	3,472
Operating partnership units issued with acquisition	376	—

See accompanying notes to the consolidated financial statements.

9

WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2017
(UNAUDITED)

NOTE 1: NATURE OF BUSINESS

Washington Real Estate Investment Trust (“Washington REIT”), a Maryland real estate investment trust, is a self-administered equity real estate investment trust, successor to a trust organized in 1960. Our business consists of the ownership and operation of income-producing real estate properties in the greater Washington metro region. We own a diversified portfolio of office buildings, multifamily buildings and retail centers.

Federal Income Taxes

We believe that we qualify as a Real Estate Investment Trust (“REIT”) under Sections 856-860 of the Internal Revenue Code and intend to continue to qualify as such. To maintain our status as a REIT, we are, among other things, required to distribute 90% of our REIT taxable income (which is, generally, our ordinary taxable income, with certain modifications), excluding any net capital gains and any deductions for dividends paid to our shareholders on an annual basis. When selling a property, we generally have the option of (a) reinvesting the sales proceeds of property sold, in a way that allows us to defer recognition of some or all taxable gain realized on the sale, (b) distributing gains to the shareholders with no tax to us or (c) treating net long-term capital gains as having been distributed to our shareholders, paying the tax on the gain deemed distributed and allocating the tax paid as a credit to our shareholders.

Generally, and subject to our ongoing qualification as a REIT, no provisions for income taxes are necessary except for taxes on undistributed taxable income and taxes on the income generated by our taxable REIT subsidiaries (“TRSs”). Our TRSs are subject to corporate federal and state income tax on their taxable income at regular statutory rates, or as calculated under the alternative minimum tax, as appropriate. As of June 30, 2017 and December 31, 2016, our TRSs had deferred tax assets of $0.6 million and $0.5 million, respectively, net of valuation allowances of $2.7 million and $2.9 million, respectively. During the 2017 Quarter, we recognized a deferred tax liability of $0.6 million in connection with the acquisition of Watergate 600 (see note 3). As of June 30, 2017 and December 31, 2016, our TRSs had net deferred tax liabilities of $1.0 million and $0.4 million, respectively. The deferred tax liabilities are primarily related to temporary differences in the timing of the recognition of revenue, amortization and depreciation.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATIONS

Significant Accounting Policies

We have prepared our consolidated financial statements using the accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2016.

Pronouncements Not Yet Adopted

In May 2017, the Financial Accounting Standards Board (the “FASB”) issued ASU 2017-09, Compensation - Stock Compensation (Topic 718) - Scope of Modification Accounting, which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The new standard is effective for all entities for fiscal years beginning after December 15, 2017 and for interim periods therein. Early adoption is permitted. We do not expect the new standard to have a material impact on our consolidated financial statements.

In November 2016, the FASB issued Accounting Standards Update No. 2016-18, Statement of Cash Flows (Topic 230) - Restricted Cash, which requires that restricted cash and cash equivalents be included with cash and cash equivalents when reconciling beginning-of-period and end-of-period total amounts shown on the consolidated statements of cash flows. The new standard is effective for public entities for fiscal years beginning after December 15, 2017 and for interim periods therein, with early adoption permitted. We are currently evaluating the impact the new standard may have on Washington REIT's consolidated financial statements.

In August 2016, the FASB issued Accounting Standards Update No. 2016-15, Classification of Certain Cash Receipts and Cash Payments, which provides specific guidance on how cash receipts and payments should be presented and classified in the statement of cash flows for eight specific issues. The new standard is effective for public entities for fiscal years beginning after December

15, 2017 and for interim periods therein, with early adoption permitted. We are currently evaluating the impact the new standard may have on Washington REIT's consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, Measurement of Credit Losses on Financial Instruments, which requires financial assets measured at an amortized cost basis, including trade receivables, to be presented at the net amount expected to be collected. The new standard is effective for public entities for fiscal years beginning after December 15, 2019 and for interim periods therein with adoption one year earlier permitted. We are currently evaluating the impact the new standard may have on Washington REIT's consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842) ("ASU 2016-02"), which amends existing accounting standards for lease accounting, including by requiring lessees to recognize most leases on the balance sheet and making certain changes to lessor accounting. The new standard is effective for public entities for fiscal years beginning after December 15, 2018 and for interim periods therein with early adoption permitted. Upon adoption, for leases in which we are the lessor, the lease contract will be separated into lease and non-lease components in accordance with the provisions outlined within ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). The lease component of the contract will be recognized on a straight-line basis in accordance with ASU 2016-02, while the non-lease component will be recognized under the provisions of ASU 2014-09. For lease contracts with a duration of more than one year in which we are the lessee, the present value of future lease payments will be recognized on our balance sheet as a right-of-use asset and a corresponding lease liability. Also, only direct leasing costs may be capitalized under the new standard, while current accounting standards allow for the capitalization of indirect leasing costs. We are currently evaluating the impact ASU 2016-02 may have on Washington REIT's consolidated financial statements.

In June 2014, the FASB issued ASU 2014-09, which creates a single source of revenue guidance. The new standard provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other U.S. generally accepted accounting principles ("GAAP") requirements, such as the leasing literature). The guidance also provides a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate. The new standard is effective for public entities for fiscal years beginning after December 15, 2017 and for interim periods therein. Early adoption is permitted for public entities beginning after December 15, 2016. We intend to adopt the new standard using the modified retrospective method. Upon adoption of ASU 2016-02, the majority of our revenue will be subject to the allocation provisions outlined within the revenue standard. We are currently evaluating the specific implementation requirements for allocating the consideration within our contracts in accordance with ASU 2014-09. We do not expect the new standard to have a material impact on the measurement and recognition of gains and losses on the sale of properties.

Principles of Consolidation and Basis of Presentation

The accompanying unaudited consolidated financial statements include the consolidated accounts of Washington REIT, our majority-owned subsidiaries and entities in which Washington REIT has a controlling interest, including where Washington REIT has been determined to be a primary beneficiary of a variable interest entity ("VIE"). See note 3 for additional information on the property for which there is a noncontrolling interest. All intercompany balances and transactions have been eliminated in consolidation.

We have prepared the accompanying unaudited financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to those rules and regulations, although we believe that the disclosures made are adequate to make the information presented not misleading. In addition, in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the results for the periods presented have been included. These unaudited financial statements should be read in conjunction with the financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2016.

Within these notes to the financial statements, we refer to the three months ended June 30, 2017 and June 30, 2016 as the “2017 Quarter” and the “2016 Quarter,” respectively and the six months ended June 30, 2017 and June 30, 2016 as the "2017 Period" and "2016 Period," respectively.

Use of Estimates in the Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 3: REAL ESTATE

Acquisition

Our current strategy is focused on properties inside the Washington metro region's Beltway, near major transportation nodes and in areas with strong employment drivers and superior growth demographics. We seek to upgrade our portfolio with acquisitions as appropriate opportunities arise. We acquired the following property during the 2017 Quarter (the "2017 acquisition"):

Acquisition Date	Property	Type	Net Rentable Square Feet	Contract Purchase Price (In thousands)
April 4, 2017	Watergate 600	Office	289,000	$ 135,000

The results of operations from the 2017 acquisition are included in the consolidated statements of income from the acquisition date and are as follows (in thousands):

	Three and Six Months Ended June 30, 2017
Real estate rental revenue	$ 4,902
Net income	964

We accounted for the acquisition of Watergate 600 as an asset acquisition. Accordingly, we capitalized $2.8 million of costs directly associated with the acquisition. We measured the value of the acquired physical assets (land and building), in-place leases (tenant origination costs, leasing commissions, absorption costs and lease intangible assets/liabilities), and any other liabilities by allocating the total cost of the acquisition on a relative fair value basis.

We have recorded the total cost of the 2017 acquisition as follows (in thousands):

Land	$45,981
Building	66,241
Tenant origination costs	12,084
Leasing commissions/absorption costs	23,161
Lease intangible assets	498
Lease intangible liabilities	(9,585)
Deferred tax liability	(560)
Total	$137,820

The weighted remaining average life for the 2017 acquisition components above, other than land, building and deferred tax liability, are 92 months for tenant origination costs, 84 months for leasing commissions/absorption costs, 19 months for net lease intangible assets and 97 months for net lease intangible liabilities.

The difference in the total contract purchase price of $135.0 million for the 2017 acquisition and cash paid for the acquisition per the consolidated statements of cash flows of $138.4 million is primarily due to capitalized acquisition-related costs ($2.8 million) and a net credit to the buyer for certain expenditures ($1.0 million), partially offset by the issuance of 12,124 operating partnership units (“Operating Partnership Units”) as part of the consideration ($0.4 million). The Operating Partnership Units are units in WashREIT Watergate 600 OP LP, a consolidated subsidiary of Washington REIT. These Operating Partnership Units may be redeemed for either cash equal to the fair market value of a share of Washington REIT common stock at the time of redemption (based on a 20-day average price) or, at the option of Washington REIT, one registered or unregistered share of Washington REIT common stock. In connection with the 2017 acquisition, we granted registration rights to the two contributors of the Watergate 600 property relating to the resale of any shares issued upon exchange of Operating Partnership Units pursuant to a shelf registration statement that we have an obligation to make available to the contributors approximately one year after the issuance of the Operating Partnership Units.

Development/Redevelopment

We have properties under development/redevelopment and held for current or future development as of June 30, 2017. In the office segment, we have a redevelopment project at the Army Navy Building, an office property in Washington, DC, to upgrade its common areas and add significant amenities in order to make the property more competitive within its sub-market. As of June 30, 2017, we had invested $4.1 million in the redevelopment and have placed $3.4 million of the project into service. We have substantially completed the additional amenities and expect to place the remainder of the project, consisting of upgrades to common areas, into service during the remainder of 2017.

In the multifamily segment, we have the Trove, a multifamily development adjacent to The Wellington, and own land held for future multifamily development adjacent to Riverside Apartments. As of June 30, 2017, we had invested $23.8 million and $18.3 million, including the costs of acquired land, in the Trove and the development adjacent to Riverside Apartments, respectively.

In the retail segment, we currently have a redevelopment project to add rentable space at Spring Valley Village. As of June 30, 2017, we had invested $1.6 million in the redevelopment.

Variable Interest Entity

In June 2011, we executed a joint venture operating agreement with a real estate development company to develop The Maxwell, a mid-rise multifamily property at 650 North Glebe Road in Arlington, Virginia. Major construction activities at The Maxwell ended during December 2014, and the building became available for occupancy during the first quarter of 2015. Washington REIT is the 90% owner of the joint venture. The real estate development company owns 10% of the joint venture and was responsible for the development and construction of the property.

We have determined that The Maxwell joint venture is a VIE primarily based on the fact that the equity investment at risk is not sufficient to permit the entity to finance its activities without additional financial support. We also determined that Washington REIT was the primary beneficiary of the VIE due to the fact that Washington REIT was determined to have a controlling financial interest in the entity. In January 2016, Washington REIT exercised its right to purchase at par The Maxwell's construction loan from the original third-party lender. Upon the purchase, the construction loan became an intercompany loan payable from the consolidated VIE to Washington REIT that is eliminated in consolidation.

As of June 30, 2017 and December 31, 2016, The Maxwell's assets were as follows (in thousands):

	June 30, 2017	December 31, 2016
Land	$12,851	$ 12,851
Income producing property	37,955	37,949
Accumulated depreciation and amortization	(5,689)	(4,571)
Other assets	536	456
	$45,653	$ 46,685

As of June 30, 2017 and December 31, 2016, The Maxwell's liabilities were as follows (in thousands):

	June 30, 2017	December 31, 2016
Mortgage notes payable [(1)]	$31,690	$ 31,869
Accounts payable and other liabilities	199	186

Tenant security deposits	89	99
	$31,978	$ 32,154

(1) The mortgage notes payable balances as of June 30, 2017 and December 31, 2016 are eliminated in consolidation due to the purchase of the loan by Washington REIT in January 2016.

Properties Sold and Held for Sale

We intend to hold our properties for investment with a view to long-term appreciation, to engage in the business of acquiring, developing and owning our properties, and to make occasional sales of the properties that no longer meet our long-term strategy or return objectives and where market conditions for sale are favorable. The proceeds from the sales may be reinvested into other properties, used to fund development operations or to support other corporate needs, or distributed to our shareholders. Depreciation on these properties is discontinued when classified as held for sale, but operating revenues, other operating expenses and interest continue to be recognized until the date of sale.

During the 2017 Quarter, we executed a purchase and sale agreement for the sale of Walker House, a multifamily property in Gaithersburg, Maryland. We expect to close on this sale during 2017. We determined Walker House met the criteria for classification as held for sale as of June 30, 2017. There can be no assurances that this purchase and sale agreement will close on time or at all.

We sold the following properties in 2016:

Disposition Date	Property Name	Segment	Number of Units/ Rentable Square Feet	Contract Sales Price (in thousands)	Gain on Sale (in thousands)
May 26, 2016	Dulles Station II [1]	Office	N/A	$ 12,100	$ 527
June 27, 2016	Maryland Office Portfolio Transaction I [2]	Office	692,000	111,500	23,585
September 22, 2016	Maryland Office Portfolio Transaction II [3]	Office	491,000	128,500	77,592
	Total 2016		1,183,000	$ 252,100	$ 101,704

(1) Land held for future development and an interest in a parking garage.

(2) Maryland Office Portfolio Transaction I consists of 6110 Executive Boulevard, 600 Jefferson Plaza, Wayne Plaza and West Gude Drive.

(3) Maryland Office Portfolio Transaction II consists of 51 Monroe Street and One Central Plaza.

While the sale of the Maryland Office Portfolio, in the aggregate, constituted an individually significant disposition, the Maryland Office Portfolio does not qualify for presentation and disclosure as a discontinued operation as it does not represent a strategic shift in our operations. Real estate rental revenue and net income for the Maryland Office Portfolio for the three and six months ended June 30, 2017 and 2016 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Real estate rental revenue	$ —	$ 8,147	$ —	$ 16,577
Net income	—	4,176	—	6,902

We do not have significant continuing involvement in the operations of the disposed properties.

NOTE 4: MORTGAGE NOTES PAYABLE

In February 2017, we prepaid without penalty the remaining $49.6 million of the mortgage note secured by the Army Navy Building.

NOTE 5: UNSECURED LINES OF CREDIT PAYABLE

We have a $600.0 million unsecured revolving credit agreement (“Revolving Credit Facility”) that matures in June 2019, unless extended pursuant to one or both of the two six months extension options. The Revolving Credit Facility has an accordion feature, which we utilized a portion of in September 2015, as described below, that allows us to increase the facility to $1.0 billion, subject to the extent the lenders agree to provide additional revolving loan commitments or term loans. In September 2015, we entered into a $150.0 million unsecured term loan (“2015 Term Loan”) by executing a portion of the accordion feature under the Revolving Credit Facility. The 2015 Term Loan has a 5.5 year term and currently has an interest rate of one month LIBOR plus 110 basis points, based on Washington REIT’s current unsecured debt ratings. We entered into two interest rate swaps to effectively fix the interest rate at 2.7% (see note 7).

The Revolving Credit Facility bears interest at a rate of either one month LIBOR plus a margin ranging from 0.875% to 1.55% or the base rate plus a margin ranging from 0.0% to 0.55% (in each case depending upon Washington REIT’s credit rating). The base rate is the highest of the administrative agent’s prime rate, the federal funds rate plus 0.50% and the LIBOR market index rate plus 1.0%. In addition, the Revolving Credit Facility requires the payment of a facility fee ranging from 0.125% to 0.30% (depending on Washington REIT’s credit rating) on the $600.0 million committed capacity, without regard to usage. As of June 30, 2017, the interest rate on the facility is one month LIBOR plus 1.00% and the facility fee is 0.20%.

The amount of the Revolving Credit Facility’s unsecured line of credit unused and available at June 30, 2017 is as follows (in thousands):

Committed capacity	$600,000
Borrowings outstanding	(228,000)
Unused and available	$372,000

We executed borrowings and repayments on the Revolving Credit Facility during the 2017 Period as follows (in thousands):

	Revolving Credit Facility
Balance at December 31, 2016	$120,000
Borrowings	239,000
Repayments	(131,000)
Balance at June 30, 2017	$228,000

NOTE 6: NOTES PAYABLE

During 2016, we entered into a seven year, $150.0 million unsecured term loan ("2016 Term Loan") maturing on July 21, 2023 with a deferred draw period of up to six months commencing on July 22, 2016. The 2016 Term Loan bears interest at a rate of either LIBOR plus a margin ranging from 1.50% to 2.45% or the base rate plus a margin ranging from 0.5% to 1.45% (in each case depending upon Washington REIT's credit rating). The base rate is the highest of the administrative agent's prime rate, the federal funds rate plus 0.50% and one-month LIBOR plus 1.0%. The 2016 Term Loan currently has an interest rate of one month LIBOR plus 165 basis points, based on Washington REIT's current unsecured debt ratings. We borrowed $100.0 million on the term loan in the fourth quarter of 2016, and borrowed the remaining $50.0 million during the first quarter of 2017. We have also previously entered into forward interest rate swaps commencing on March 31, 2017 to effectively fix the interest rate on the 2016 Term Loan at 2.9% (see note 7).

NOTE 7: DERIVATIVE INSTRUMENTS

On September 15, 2015, we entered into two interest rate swap arrangements with a total notional amount of $150.0 million to swap the floating interest rate under the 2015 Term Loan (see note 5) to an all-in fixed interest rate of 2.7% starting on October 15, 2015 and extending until the maturity of the 2015 Term Loan on March 15, 2021. On July 22, 2016, we entered into two forward interest rate swap arrangements with a total notional amount of $150.0 million to swap the floating interest rate under the 2016 Term Loan (see note 6) to an all-in fixed interest rate of 2.9% starting on March 31, 2017 and extending until the maturity of the 2016 Term Loan on July 21, 2023.

The interest rate swaps qualify as cash flow hedges and are recorded at fair value in accordance with GAAP, based on discounted cash flow methodologies and observable inputs. We record the effective portion of changes in fair value of the cash flow hedges in other comprehensive income (loss). The resulting unrealized gain (loss) on the effective portions of the cash flow hedges was the only activity in other comprehensive income (loss) during the periods presented in our consolidated financial statements. We assess the effectiveness of our cash flow hedges both at inception and on an ongoing basis. The cash flow hedges were effective for the 2017 Quarter and 2017 Period and 2016 Quarter and 2016 Period, and therefore hedge ineffectiveness did not impact earnings during the 2017 Quarter and 2017 Period and 2016 Quarter and 2016 Period.

The fair values of the interest rate swaps as of June 30, 2017 and December 31, 2016, are as follows (in thousands):

				Fair Value Asset Derivatives	
Derivative Instrument	Aggregate Notional	Effective Date	Maturity Date	June 30, 2017	December 31, 2016

	Amount				
Interest rate swaps	$ 150,000	October 15, 2015	March 15, 2021	$ 578	$ 417
Interest rate swaps	150,000	March 31, 2017	July 21, 2023	6,279	7,194
	$ 300,000			$ 6,857	$ 7,611

We record interest rate swaps on our consolidated balance sheets with prepaid expenses and other assets when in a net asset position and with accounts payable and other liabilities when in a net liability position. The interest rate swaps have been effective since inception. The net gains or losses on the effective swaps are recognized in other comprehensive income (loss), as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Unrealized loss on interest rate hedges	$(1,489)	$(1,384)	$(754)	$(5,059)

Amounts reported in accumulated other comprehensive loss related to derivatives will be reclassified to interest expense as interest payments are made on our variable-rate debt. During the next twelve months, we estimate that an additional $0.2 million will be reclassified as an increase to interest expense.

We have agreements with each of our derivative counterparties that contain a provision whereby we could be declared in default on our derivative obligations if repayment of the underlying indebtedness is accelerated by the lender due to our default on the indebtedness. As of June 30, 2017, the fair value of derivatives is in a net asset position of $6.9 million, which includes accrued interest but excludes any adjustment for nonperformance risk. As of June 30, 2017, we have not posted any collateral related to these agreements.

Derivative instruments expose us to credit risk in the event of non-performance by the counterparty under the terms of the interest rate hedge agreement. We believe that we minimize our credit risk on these transactions by dealing with major, creditworthy financial institutions. We monitor the credit ratings of counterparties and our exposure to any single entity, thus minimizing our credit risk concentration.

NOTE 8: FAIR VALUE DISCLOSURES

Assets and Liabilities Measured at Fair Value

For assets and liabilities measured at fair value on a recurring basis, quantitative disclosures about the fair value measurements are required to be disclosed separately for each major category of assets and liabilities, as follows:

Level 1: Quoted prices in active markets for identical assets
Level 2: Significant other observable inputs
Level 3: Significant unobservable inputs

The only assets or liabilities we had at June 30, 2017 and December 31, 2016 that are recorded at fair value on a recurring basis are the assets held in the Supplemental Executive Retirement Plan (“SERP”), which primarily consist of investments in mutual funds, and the interest rate swaps (see note 7).

We base the valuations related to the SERP on assumptions derived from significant other observable inputs and accordingly these valuations fall into Level 2 in the fair value hierarchy.

The valuation of the interest rate swaps is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each interest rate swap. This analysis reflects the contractual terms of the interest rate swaps, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments). The variable cash payments (or receipts) are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves. To comply with the provisions of ASC 820, we incorporate credit valuation adjustments in the fair value measurements to appropriately reflect both our own nonperformance risk and the respective counterparty’s nonperformance risk. These credit valuation adjustments were concluded to not be significant inputs for the fair value calculations for the periods presented. In adjusting the fair value of our derivative contracts for the effect of nonperformance risk, we have considered the impact of netting and any applicable credit enhancements, such as the posting of collateral, thresholds, mutual puts and guarantees. The valuation of interest rate swaps fall into Level 2 in the fair value hierarchy.

The fair values of these assets and liabilities at June 30, 2017 and December 31, 2016 were as follows (in thousands):

	June 30, 2017				December 31, 2016			
	Fair Value	Level 1	Level 2	Level 3	Fair Value	Level 1	Level 2	Level 3
Assets:								
SERP	$1,593	$ —	$1,593	$ —	$1,407	$ —	$1,407	$ —
Interest rate swaps	$6,857	$ —	$6,857	$ —	$7,611	$ —	$7,611	$ —

Financial Assets and Liabilities Not Measured at Fair Value

The following disclosures of estimated fair value were determined by management using available market information and established valuation methodologies, including discounted cash flow. Many of these estimates involve significant judgment. The estimated fair value disclosed may not necessarily be indicative of the amounts we could realize on disposition of the financial instruments. The use of different market assumptions or estimation methodologies could have an effect on the estimated fair value amounts. In addition, fair value estimates are made at a point in time and thus, estimates of fair value subsequent to June 30, 2017 may differ significantly from the amounts presented.

Following is a summary of significant methodologies used in estimating fair values and a schedule of fair values at June 30, 2017 and December 31, 2016.

Cash and Cash Equivalents and Restricted Cash

Cash and cash equivalents and restricted cash include cash and commercial paper with original maturities of less than 90 days, which are valued at the carrying value, which approximates fair value due to the short maturity of these instruments (Level 1 inputs).

Notes Receivable

We acquired a note receivable (“2445 M Street note”) in 2008 with the purchase of 2445 M Street. We estimate the fair value of the 2445 M Street note based on a discounted cash flow methodology using market discount rates (Level 3 inputs).

Debt

Mortgage notes payable consist of instruments in which certain of our real estate assets are used for collateral. We estimate the fair value of the mortgage notes payable by discounting the contractual cash flows at a rate equal to the relevant treasury rates (with respect to the timing of each cash flow) plus credit spreads estimated through independent comparisons to real estate assets or loans with similar characteristics. Lines of credit payable consist of our bank facility which we use for various purposes including working capital, acquisition funding and capital improvements. The lines of credit advances and term loans with floating interest rates are priced at a specified rate plus a spread. We estimate the market value based on a comparison of the spreads of the advances to market given the adjustable base rate. We estimate the fair value of the notes payable by discounting the contractual cash flows at a rate equal to the relevant treasury rates (with respect to the timing of each cash flow) plus credit spreads derived using the relevant securities’ market prices. We classify these fair value measurements as Level 3 as we use significant unobservable inputs and management judgment due to the absence of quoted market prices.

As of June 30, 2017 and December 31, 2016, the carrying values and estimated fair values of our financial instruments were as follows (in thousands):

	June 30, 2017		December 31, 2016	
		Fair Value		Fair Value

	Carrying Value		Carrying Value	
Cash and cash equivalents	$13,237	$ 13,237	$11,305	$ 11,305
Restricted cash	1,506	1,506	6,317	6,317
2445 M Street note receivable	2,096	2,324	2,089	2,173
Mortgage notes payable, net	96,934	100,130	148,540	149,997
Lines of credit	228,000	228,000	120,000	120,000
Notes payable, net	893,763	925,915	843,084	873,516

NOTE 9: STOCK BASED COMPENSATION

Washington REIT maintains short-term (“STIP”) and long-term (“LTIP”) incentive plans that allow for stock-based awards to officers and non-officer employees. Stock based awards are provided to officers and non-officer employees, as well as trustees, under the Washington Real Estate Investment Trust 2016 Omnibus Incentive Plan which allows for awards in the form of restricted shares, restricted share units, options and other awards up to an aggregate of 2,400,000 shares over the ten-year period in which the plan will be in effect. Restricted share units are converted into shares of our stock upon full vesting through the issuance of new shares.

Total Compensation Expense

Total compensation expense recognized in the consolidated financial statements for all outstanding share based awards was $1.2 million and $0.9 million for the 2017 Quarter and 2016 Quarter, respectively, and $2.4 million and $2.4 million for the 2017 Period and 2016 Period, respectively.

Restricted Share Awards

The total fair values of restricted share awards vested was $2.0 million and $2.5 million for the 2017 Period and 2016 Period, respectively.

The total unvested restricted share awards at June 30, 2017 was 356,093 shares, which had a weighted average grant date fair value of $30.85 per share. As of June 30, 2017, the total compensation cost related to unvested restricted share awards was $8.3 million, which we expect to recognize over a weighted average period of 39 months.

NOTE 10: EARNINGS PER COMMON SHARE

We determine “Basic earnings per share” using the two-class method as our unvested restricted share awards and units have non-forfeitable rights to dividends, and are therefore considered participating securities. We compute basic earnings per share by dividing net income attributable to the controlling interest less the allocation of undistributed earnings to unvested restricted share awards and units by the weighted-average number of common shares outstanding for the period.

We also determine “Diluted earnings per share” as the more dilutive of the two-class method or the treasury stock method with respect to the unvested restricted share awards. We further evaluate any other potentially dilutive securities at the end of the period and adjust the basic earnings per share calculation for the impact of those securities that are dilutive. Our diluted earnings per share calculation includes the dilutive impact of our share based awards with performance conditions prior to the grant date and awards with market conditions under the contingently issuable method. The dilutive earnings per share calculation also considers the Operating Partnership Units issued in connection with the 2017 acquisition, which were not dilutive for any of the periods presented.

The computations of basic and diluted earnings per share for the three and six months ended June 30, 2017 and 2016 were as follows (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Numerator:				
Net income	$7,847	$31,821	$14,462	$34,200
Net loss attributable to noncontrolling interests in subsidiaries	17	15	36	20
Allocation of earnings to unvested restricted share awards	(107)	(99)	(184)	(155)
Adjusted net income attributable to the controlling interests	$7,757	$31,737	$14,314	$34,065
Denominator:				
Weighted average shares outstanding – basic	76,705	71,719	75,785	70,010
Effect of dilutive securities:				
Operating partnership units	11	—	6	—
Employee restricted share awards	114	193	112	190
Weighted average shares outstanding – diluted	76,830	71,912	75,903	70,200
Basic net income attributable to the controlling interests per common share	$0.10	$0.44	$0.19	$0.49
Diluted net income attributable to the controlling interests per common share	$0.10	$0.44	$0.19	$0.49

NOTE 11: SEGMENT INFORMATION

We have three reportable segments: office, multifamily and retail. Office properties provide office space for various types of businesses and professions. Multifamily properties provide rental housing for individuals and families throughout the greater Washington metro region. Retail properties are typically grocery store-anchored neighborhood centers that include other small shop tenants or regional power centers with several junior box tenants.

We evaluate performance based upon net operating income from the combined properties in each segment. Our reportable operating segments are consolidations of similar properties. GAAP requires that segment disclosures present the measure(s) used by the chief operating decision maker for purposes of assessing segments' performance. Net operating income is a key measurement of our segment profit and loss. Net operating income is defined as segment real estate rental revenue less segment real estate expenses.

The following tables present revenues, net operating income, capital expenditures and total assets for the three and six months ended June 30, 2017 and 2016 from these segments, and reconcile net operating income of reportable segments to net income attributable to the controlling interests as reported (in thousands):

	Three Months Ended June 30, 2017				
	Office	Retail	Multifamily	Corporate and Other	Consolidated
Real estate rental revenue	$44,109	$15,512	$ 23,835	$ —	$83,456
Real estate expenses	15,853	3,597	9,241	—	28,691
Net operating income	$28,256	$11,915	$ 14,594	$ —	$54,765
Depreciation and amortization					(29,261)
General and administrative					(5,759)
Interest expense					(12,053)
Other income					48
Income tax benefit					107
Net income					7,847
Less: Net loss attributable to noncontrolling interests in subsidiaries					17
Net income attributable to the controlling interests					$7,864
Capital expenditures	$5,864	$62	$ 6,561	$ 1,375	$13,862
Total assets	$1,241,618	$344,523	$ 766,972	$ 34,999	$2,388,112

	Three Months Ended June 30, 2016				
	Office	Retail	Multifamily	Corporate and Other	Consolidated
Real estate rental revenue	$43,737	$15,080	$ 20,588	$ —	$79,405
Real estate expenses	16,594	3,684	7,897	—	28,175
Net operating income	$27,143	$11,396	$ 12,691	$ —	$51,230
Depreciation and amortization					(25,161)
Acquisition costs					(1,024)
General and administrative					(4,968)
Interest expense					(13,820)
Other income					83
Gain on sale of real estate					24,112
Income tax benefit					693
Casualty gain					676
Net income					31,821
Less: Net loss attributable to noncontrolling interests in subsidiaries					15
Net income attributable to the controlling interests					$31,836
Capital expenditures	$5,854	$3,588	$ 2,198	$ 29	$11,669
Total assets	$1,151,041	$352,094	$ 769,592	$ 33,724	$2,306,451

	Six Months Ended June 30, 2017				
	Office	Retail	Multifamily	Corporate and Other	Consolidated
Real estate rental revenue	$82,136	$31,217	$ 47,604	$ —	$ 160,957
Real estate expenses	30,267	7,460	18,827	—	56,554
Net operating income	$51,869	$23,757	$ 28,777	$ —	$ 104,403
Depreciation and amortization					(55,330)
General and administrative					(11,385)
Interest expense					(23,458)
Other income					125
Income tax benefit					107
Net income					14,462
Less: Net loss attributable to noncontrolling interests in subsidiaries					36
Net income attributable to the controlling interests					$ 14,498
Capital expenditures	$10,819	$246	$ 12,858	$ 1,950	$ 25,873

	Six Months Ended June 30, 2016				
	Office	Retail	Multifamily	Corporate and Other	Consolidated
Real estate rental revenue	$87,555	30,460	$ 38,527	$ —	$ 156,542
Real estate expenses	33,669	8,090	15,150	—	56,909
Net operating income	53,886	$22,370	$ 23,377	$ —	$ 99,633
Depreciation and amortization					(51,199)
Acquisition costs					(1,178)
General and administrative					(10,479)
Interest expense					(28,180)
Other income					122
Gain on sale of real estate					24,112
Income tax benefit					693
Casualty gain					676
Net income					34,200
Less: Net loss attributable to noncontrolling interests in subsidiaries					20
Net income attributable to the controlling interests					$ 34,220
Capital expenditures	$8,025	$4,131	$ 4,200	$ 42	$ 16,398

NOTE 12: SHAREHOLDERS' EQUITY

On June 23, 2015, we entered into four separate equity distribution agreements (collectively, the "Equity Distribution Agreements") with each of Wells Fargo Securities, LLC, BNY Mellon Capital Markets, LLC, Citigroup Global Markets Inc. and RBC Capital Markets, LLC relating to the issuance of up to $200.0 million of our common shares from time to time. Issuances of our common shares are made at market prices prevailing at the time of issuance. We may use net proceeds from the issuance of common shares under this program for general corporate purposes, including, without limitation, working capital, the acquisition, renovation, expansion, improvement, development or redevelopment of income producing properties or the repayment of debt. During the 2017 Quarter, we issued 1.1 million common shares under the Equity Distribution Agreements at an average price of $31.55 per share, raising $33.9 million in net proceeds. During the 2017 Period, we issued 2.1 million common shares under the Equity Distribution Agreements at an average price of $31.44 per share, raising $63.9 million in net proceeds.

We have a dividend reinvestment program, whereby shareholders may use their dividends and optional cash payments to purchase common shares. The common shares sold under this program may either be common shares issued by us or common shares purchased in the open market. During the 2017 Quarter, we issued 21,499 common shares under this program at a weighted average price of $31.95 per share, raising $0.7 million in net proceeds. During the 2017 Period, we issued 0.1 million common shares under the dividend reinvestment program at a weighted average price of $32.03 per share, raising $1.8 million in net proceeds.

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our consolidated financial statements and the notes thereto appearing in Item 1 of this report and the more detailed information contained in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the Securities and Exchange Commission on February 21, 2017.

We refer to the three months ended June 30, 2017 and June 30, 2016 as the "2017 Quarter" and the "2016 Quarter," respectively, and the six months ended June 30, 2017 and June 30, 2016 as the "2017 Period" and "2016 Period," respectively.

Forward-Looking Statements

This Form 10-Q contains forward-looking statements which involve risks and uncertainties. Forward-looking statements include statements in this report preceded by, followed by or that include the words "believe," "expect," "intend," "anticipate," "potential," "project," "will" and other similar expressions. We claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 for these statements. The following important factors, in addition to those discussed elsewhere in this Form 10-Q, could affect our future results and could cause those results to differ materially from those expressed in the forward-looking statements: (a) the effect of credit and financial market conditions; (b) the availability and cost of capital; (c) fluctuations in interest rates; (d) the economic health of our tenants; (e) the timing and pricing of lease transactions; (f) the economic health of the greater Washington metro region, or other markets we may enter; (g) the risks associated with ownership of real estate in general and our real estate assets in particular; (h) the effects of changes in federal government spending; (i) the supply of competing properties; (j) the ability to maintain an effective system of internal controls; (k) compliance with applicable laws, including those concerning the environment and access by persons with disabilities; (l) governmental or regulatory actions and initiatives; (m) terrorist attacks or actions; (n) weather conditions and natural disasters; (o) failure to qualify as a REIT; (p) the availability of and our ability to attract and retain qualified personnel; (q) uncertainty in our ability to continue to pay dividends at the current rates; and (r) other factors discussed under the caption "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the Securities and Exchange Commission on February 21, 2017. We undertake no obligation to update our forward-looking statements or risk factors to reflect new information, future events, or otherwise.

General

Introductory Matters

We provide our Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") in addition to the accompanying consolidated financial statements and notes to assist readers in understanding our results of operations and financial condition. We organize the MD&A as follows:

- Overview. Discussion of our business outlook, operating results, investment activity, financing activity and capital requirements to provide context for the remainder of MD&A.
- Results of Operations. Discussion of our financial results comparing the 2017 Quarter to the 2016 Quarter and the 2017 Period to the 2016 Period.
- Liquidity and Capital Resources. Discussion of our financial condition and analysis of changes in our capital structure and cash flows.
- Funds From Operations. Calculation of NAREIT Funds From Operations ("NAREIT FFO"), a non-GAAP supplemental measure to net income.
-

Critical Accounting Policies and Estimates. Descriptions of accounting policies that reflect significant judgments and estimates used in the preparation of our consolidated financial statements.

When evaluating our financial condition and operating performance, we focus on the following financial and non-financial indicators:

- Net operating income ("NOI"), calculated as real estate rental revenue less real estate expenses excluding depreciation and amortization and general and administrative expenses. NOI is a non-GAAP supplemental measure to net income.
- NAREIT FFO, calculated as set forth below under the caption "Funds from Operations."
- Ending occupancy, calculated as occupied square footage as a percentage of total square footage as of the last day of that period.
- Leased percentage, calculated as the percentage of available physical net rentable area leased for our office and retail segments and percentage of apartments leased for our multifamily segment.

- Rental rates.
- Leasing activity, including new leases, renewals and expirations.

For purposes of evaluating comparative operating performance, we categorize our properties as "same-store", "non-same-store" or discontinued operations. A "same-store" property is one that was owned for the entirety of 2017 and the prior year, and excludes properties under redevelopment or development and properties purchased or sold at any time during 2017 or the prior year. A "non-same-store" property is one that was acquired, under redevelopment or development, or placed into service during 2017 or the prior year. We define redevelopment properties as those for which we expect to spend significant development and construction costs on existing or acquired buildings pursuant to a formal plan which has a current impact on operating results, occupancy and the ability to lease space with the intended result of a higher economic return on the property. Properties under redevelopment or development are included with the non-same-store properties beginning in the period during which redevelopment or development activities commence. We consider properties to no longer be under redevelopment or development upon substantial completion of redevelopment or development activities, and the earlier of achieving 90% occupancy or two years after substantial completion.

Overview

Business Outlook

Our revenues are derived primarily from the ownership and operation of income-producing properties in the greater Washington metro region. As of June 30, 2017, we owned a diversified portfolio of 50 properties, totaling approximately 6.3 million square feet of commercial space and 4,480 multifamily units, and land held for development. These 50 properties consisted of 20 office properties, 16 retail centers and 14 multifamily properties.

Operating Results

Net income attributable to the controlling interests, NOI and NAREIT FFO for the three months ended June 30, 2017 and 2016 were as follows (in thousands):

	Three Months Ended June 30,			
	2017	2016	$ Change	% Change
Net income attributable to the controlling interests	$7,864	$31,836	$(23,972)	(75.3)%
NOI [1]	$54,765	$51,230	$3,535	6.9 %
NAREIT FFO [2]	$37,108	$32,870	$4,238	12.9 %

[1] See page 26 of the MD&A for a reconciliation of NOI to net income.
[2] See page 36 of the MD&A for a reconciliation of NAREIT FFO to net income.

The lower net income attributable to the controlling interests is primarily due to gains on sale of real estate during the 2016 Quarter ($24.1 million); higher depreciation and amortization expenses ($4.1 million) and higher general and administrative expenses ($0.8 million); a casualty gain ($0.7 million) in the 2016 Quarter; and a higher income tax benefit ($0.6 million) in the 2016 Quarter, partially offset by higher NOI ($3.5 million), lower interest expense ($1.8 million) and lower acquisition costs ($1.0 million).

The increase in NOI is primarily due to higher NOI from same-store properties ($3.7 million) and the Watergate 600 ($3.4 million) and Riverside Apartments ($1.6 million) acquisitions, partially offset by the property sales during 2016 ($5.0 million). The higher same-store NOI is explained in further detail beginning on page 26 (Results of Operations - 2017 Quarter Compared to 2016 Quarter). Same-store ending occupancy increased to 93.3% as of June 30, 2017, from

90.8% one year ago, primarily due to higher occupancy in the office segment.

The higher NAREIT FFO is primarily attributable to the higher NOI ($3.5 million), lower interest expense ($1.8 million) and lower acquisition costs ($1.0 million), partially offset by higher general and administrative expenses ($0.8 million), a casualty gain ($0.7 million) in the 2016 Quarter and a higher income tax benefit ($0.6 million) in the 2016 Quarter.

Investment Activity

Significant investment transactions during the 2017 Period included the following:

- The acquisition of Watergate 600, which we refer to as the 2017 acquisition, a 289,000 net rentable square foot office building in Washington, DC, for a contract purchase price of $135.0 million in a transaction that was structured to include the issuance of 12,124 operating partnership units in WashREIT Watergate 600 OP LP, a consolidated subsidiary of Washington REIT ("Operating Partnership Units"), representing $0.4 million of the purchase price. We incurred $2.8 million of acquisition costs related to this transaction.

Financing Activity

Significant financing transactions during the 2017 Period included the following:

- The prepayment at par of the remaining $49.6 million of the mortgage note secured by the Army Navy Building in February 2017.
- The draw of the remaining $50.0 million on the seven year, $150 million unsecured term loan agreement maturing on July 21, 2023. We used the borrowing to refinance maturing secured debt.
- The issuance of approximately 2.1 million common shares under our ATM program at an average price to the public of $31.44 per share, for net proceeds of approximately $63.9 million.

As of June 30, 2017, the interest rate on the Revolving Credit Facility was one month LIBOR plus 1.00% and the facility fee was 0.20%. As of July 26, 2017, our Revolving Credit Facility has a borrowing capacity of $376.0 million.

Capital Requirements

We do not have any other debt maturities during 2017. We expect to have additional capital requirements as set forth on page 33 (Liquidity and Capital Resources - Capital Requirements).

Results of Operations

The discussion that follows is based on our consolidated results of operations for the 2017 Quarter and 2017 Period and 2016 Quarter and 2016 Period. The ability to compare one period to another is significantly affected by acquisitions completed and dispositions made during 2016 and 2017 (see note 3 to the consolidated financial statements).

Net Operating Income

NOI is a non-GAAP measure calculated as real estate rental revenue less real estate expenses excluding depreciation and amortization and general and administrative expenses. NOI is the primary performance measure we use to assess the results of our operations at the property level. We believe that NOI is useful as a performance measure because, when compared across periods, NOI reflects the impact on operations of trends in occupancy rates, rental rates and operating costs on an unleveraged basis, providing perspective not immediately apparent from net income. NOI excludes certain components from net income in order to provide results more closely related to a property's results of operations. For example, interest expense is not necessarily linked to the operating performance of a real estate asset. In addition, depreciation and amortization, because of historical cost accounting and useful life estimates, may distort operating performance at the property level. As a result of the foregoing, we provide NOI as a supplement to net income, calculated in accordance with GAAP. NOI does not represent net income or income from continuing operations, in either case calculated in accordance with GAAP. As such, it should not be considered an alternative to these measures as an indication of our operating performance. A reconciliation of NOI to net income follows.

2017 Quarter Compared to 2016 Quarter

The following tables reconcile NOI to net income (loss) attributable to the controlling interests and provide the basis for our discussion of our consolidated results of operations and NOI in the 2017 Quarter compared to the 2016 Quarter. All amounts are in thousands, except percentage amounts.

	Same-Store				Non-Same-Store Acquisitions [1]		Development/Redevelopment [2]		Dispositions [3]		All Properties			
	2017	2016	$ Change	% Change	2017	2016	2017	2016	2017	2016	2017	2016	$ Change	% Change
Real estate rental revenue	$69,097	$64,633	$4,464	6.9%	$10,333	$2,485	$4,026	$4,140	$—	$8,147	$83,456	$79,405	$4,051	5.1 %
Real estate expenses	23,340	22,581	759	3.4%	3,702	868	1,649	1,621	—	3,105	28,691	28,175	516	1.8 %
NOI	$45,757	$42,052	$3,705	8.8%	$6,631	$1,617	$2,377	$2,519	$—	$5,042	$54,765	$51,230	$3,535	6.9 %
Reconciliation to net income attributable to the controlling interests:														
Depreciation and amortization											(29,261)	(25,161)	(4,100)	16.3 %
Acquisition costs														