WASHINGTON REAL ESTATE INVESTMENT TRUST
Form 10-K
February 20, 2018

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

FORM 10-K

---

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For fiscal year ended December 31, 2017
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
COMMISSION FILE NO. 001-06622

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

---

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES x NO o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES o NO x
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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting 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

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 June 30, 2017, the aggregate market value of such shares held by non-affiliates of the registrant was $2,436,739,462 (based on the closing price of the stock on June 30, 2017).

As of February 15, 2018, 78,497,963 common shares were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our definitive Proxy Statement relating to the 2018 Annual Meeting of Shareholders, to be filed with the Securities and Exchange Commission, are incorporated by reference in Part III, Items 10-14 of this Annual Report on Form 10-K as indicated herein.

WASHINGTON REAL ESTATE INVESTMENT TRUST
2017 FORM 10-K ANNUAL REPORT
INDEX

PART I

ITEM 1: BUSINESS

Washington REIT Overview

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

Our current strategy is to generate returns and maximize shareholder value through proactive asset management and prudent capital allocation decisions. Consistent with this strategy, we invest in additional income-producing properties through acquisitions, development and redevelopment. We invest in properties where we believe we will be able to improve the operating results and increase the value of the property. We focus 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 will seek to continue to upgrade our portfolio as opportunities arise, funding acquisitions with a combination of cash, equity, debt and proceeds from property sales.

While we have historically focused most of our investments in the greater Washington metro region, in order to maximize acquisition opportunities we also may consider opportunities to replicate our Washington-focused approach in other geographic markets which meet the criteria described above.

All of our officers and employees live and work in or near the greater Washington metro region.

Our Regional Economy and Real Estate Markets

The Washington metro region experienced moderate job growth during 2017 with approximately 48,900 net job additions, according to Delta Associates / Transwestern Commercial Services ("Delta"), a national full service real estate firm that provides market research and evaluation services for commercial property. This job growth is higher than the region's 20-year annual average of 44,100 new jobs, with growth in the private sector partially offset by net job losses of 4,200 in the Federal government. Current estimates by Delta indicate that the region's unemployment rate was 3.6% as of November 2017, unchanged from the prior year and lower than the national average of 3.9%. Delta expects the job growth in the Washington metro region to remain steady in 2018 as strong consumer spending and higher corporate profits in the private sector are offset by public sector uncertainty. Certain market statistics and information from several third party providers for the Washington metro region are set forth below:

Office

	2017	2016
Average asking rent per square foot	$42.14	$37.25
Total vacancy rate at year end	17.0 %	16.1 %
Net absorption (in millions of square feet) [1]	(0.1)	1.1
Office space under construction at year end (in millions of square feet)	11.8	10.0

Source: Jones Lang LaSalle, "JLL," a commercial real estate services firm

[1] Net absorption is defined as the change in occupied, standing inventory from one year to the next.

According to JLL, a commercial real estate firm, the increase in average asking rents in the Washington metro region was primarily due to higher demand throughout the region, particularly in areas close to Metro stations. The 2017 total vacancy rate is higher than the prior year, and above the national average of 14.9%. The higher vacancy rate is primarily due to the delivery of 3.5 million square feet of new office space, primarily in Washington, DC and Northern Virginia, over the last year. JLL projects downward pressure on occupancy and effective rents in 2018 due to the influx of new space.

Multifamily

	2017	2016
Increase in net effective rents (Class A and B)	1.3 %	1.6 %
(Decrease) increase in net effective rents (Class A)	(0.1)%	1.1 %
Increase in net effective rents (Class B)	1.8 %	2.1 %
Stabilized vacancy rate (Class A and B)	4.9 %	4.7 %
Stabilized vacancy rate (Class A)	5.2 %	4.8 %
Stabilized vacancy rate (Class B)	4.8 %	4.5 %
New apartment deliveries (# of units)	15,592	12,105

Source: MPF Research, a division of RealPage, a commercial real estate management software company that provides market research

According to MPF Research, the multifamily real estate market's low vacancy rate reflects the region's strong demand, though the large influx of new supply has kept rental rate growth below the national average. New apartment deliveries are projected to increase to approximately 16,400 units in 2018, which is expected to negatively impact occupancy and suppress rental rate growth, particularly for Class A properties.

Retail

	2017	2016
Increase (decrease) in rental rates at neighborhood centers	3.0 %	(0.1)%
Vacancy at neighborhood centers at year-end	5.6 %	5.4 %
Net absorption (in millions of square feet)	(0.3)	0.6

Source: CoStar, a provider of real estate market research and analytics

The retail real estate market in the Washington metro region was mixed in 2017, with higher rental rates offset by higher vacancy and negative absorption, according to CoStar. CoStar projects strong demand to continue in 2018 due to increasing average household income in the Washington metro region.

Our Portfolio

As of December 31, 2017, we owned a diversified portfolio of 49 properties, totaling approximately 6.4 million square feet of commercial space and 4,268 residential units, and land held for development. These 49 properties consist of 20 office properties, 13 multifamily properties and 16 retail centers. The percentage of total real estate rental revenue by segment for the years ended December 31, 2017, 2016 and 2015, and the percent leased as of December 31, 2017, were as follows:

Percent Leased December 31, 2017[(1)]		% of Total Real Estate Rental Revenue 2017	2016	2015
95%	Office	52 %	53 %	57 %
97%	Multifamily	29 %	27 %	22 %
94%	Retail	19 %	20 %	21 %
		100 %	100 %	100 %

(1) Calculated as the percentage of physical net rentable area leased, except for multifamily, which is calculated as the percentage of units leased. The net rentable area leased for office and retail properties includes temporary lease agreements.

On a combined basis, our commercial portfolio (i.e., our office and retail properties) was 95% leased at December 31, 2017, 93% leased at December 31, 2016 and 93% leased at December 31, 2015.

Total real estate rental revenue from continuing operations for each of the three years ended December 31, 2017 was $325.1 million, $313.3 million and $306.4 million, respectively. During the three years ended December 31, 2017, we acquired one office property and two multifamily properties (including parcels for development) and substantially completed major construction activities at two office redevelopment projects. During that same period, we sold six office properties, three multifamily properties, one retail property and interests in land held for development. See note 14 to the consolidated financial statements for further discussion of our operating results by segment.

The commercial lease expirations for the next ten years and thereafter are as follows:

	# of Leases	Square Feet	Gross Annual Rent (in thousands)	Percentage of Total Gross Annual Rent	
Office:					
2018	46	213,500	$ 8,508	5	%
2019	62	636,587	28,561	17	%
2020	49	428,210	20,482	12	%
2021	62	444,032	19,074	11	%
2022	37	370,262	16,758	10	%
2023	42	245,704	11,423	7	%
2024	33	192,129	9,017	5	%
2025	25	173,365	8,688	5	%
2026	20	321,856	11,547	7	%
2027	25	294,905	18,641	11	%
Thereafter	18	399,621	19,314	10	%
Total	419	3,720,171	$ 172,013	100	%
Retail:					
2018	26	236,324	$ 2,741	5	%
2019	31	118,833	3,665	7	%
2020	40	385,014	7,163	14	%
2021	23	218,039	3,892	7	%
2022	45	298,518	8,170	16	%
2023	30	224,601	6,691	13	%
2024	28	219,049	6,045	12	%
2025	20	106,811	3,163	6	%
2026	17	136,245	4,877	9	%
2027	14	98,086	3,569	6	%
Thereafter	8	29,562	2,464	5	%
Total	282	2,071,082	$ 52,440	100	%

According to Delta, the professional/business services and government sectors constituted over 40% of payroll jobs in the Washington metro area at the end of 2017. Due to our geographic concentration in the Washington metro area, a significant number of our tenants have historically been concentrated in the professional/business services and government sectors, although the exact amount will vary from time to time. As a result of this concentration, we are susceptible to business trends (both positive and negative) that affect the outlook for these sectors.

No single tenant accounted for more than 5% of real estate rental revenue in 2017, 2016 or 2015. All federal government tenants in the aggregate accounted for less than 1% of our real estate rental revenue in 2017.

Our ten largest tenants, in terms of real estate rental revenue for 2017, are as follows:
1. Advisory Board Company
2. World Bank
3. Booz Allen Hamilton, Inc.
4. Atlantic Media, Inc.
5. Capital One, N.A.
6. Blank Rome LLP
7. Engility Corporation
8. Hughes Hubbard & Reed LLP
9. Epstein Becker & Green, P.C.
10. Morgan Stanley, Smith Barney

We enter into arrangements from time to time by which various service providers conduct day-to-day property management and/or leasing activities at our properties. Bozzuto Management Company ("Bozzuto") began conducting property management and leasing services at our multifamily properties in 2014. Bozzuto provides such services under individual property management agreements for each property, each of which is separately terminable by us or Bozzuto. Although they vary by property, on average, the fees charged by Bozzuto under each agreement are approximately 3% of revenues at the property.

We expect to continue investing in additional income-producing properties through acquisitions, development and redevelopment. We invest in properties where we believe we will be able to improve the operating results and increase the value of the property. Our properties typically compete for tenants with other properties on the basis of location, quality and rental rates.

We make capital improvements to our properties on an ongoing basis for the purpose of maintaining and increasing their value and income. Major improvements and/or renovations to the properties during the three years ended December 31, 2017 are discussed in Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations, under the heading “Capital Improvements and Development Costs.”

Further description of the property groups is contained in Item 2, Properties, and Note 14 to the consolidated financial statements, Segment Information, and in Schedule III. Reference is also made to Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations.

On February 15, 2018, we had 149 employees including 74 persons engaged in property management functions and 75 persons engaged in corporate, financial, leasing, asset management and other functions.

REIT Tax Status

We believe that we qualify as a REIT under Sections 856-860 of the Internal Revenue Code of 1986, as amended (the "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 (determined before the deduction for dividends paid and excluding net capital gains), 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 U.S. federal, state and local income tax on their taxable income at regular statutory rates (see note 1 to the consolidated financial statements for further disclosure).

Tax Treatment of Recent Disposition Activity

We sold our interests in the following properties during the three years ended December 31, 2017:

Property	Type	# of units	Rentable Square Feet	Contract Sales Price (in thousands)	Gain on Sale (in thousands)
2017:					
Walker House Apartments	Multifamily	212	N/A	$ 32,200	$ 23,838
2016:					
Dulles Station, Phase II (1)	Office	N/A	N/A	$ 12,100	$ 527
Maryland Office Portfolio Transaction I (2)	Office	N/A	692,000	111,500	23,585
Maryland Office Portfolio Transaction II (3)	Office	N/A	491,000	128,500	77,592
	Total 2016		1,183,000	$ 252,100	$ 101,704
2015:					
Country Club Towers	Multifamily	227	N/A	$ 37,800	$ 30,277
1225 First Street (4)	Multifamily	N/A	N/A	14,500	—
Munson Hill Towers	Multifamily	279	N/A	57,050	51,395
Montgomery Village Center	Retail	N/A	197,000	27,750	7,981
	Total 2015	506	197,000	$ 137,100	$ 89,653

(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.

(4) 95% interest in land held for future development.

All disclosed gains on sale are calculated in accordance with U.S. generally accepted accounting principles ("GAAP"). We reinvested a portion of the Maryland Office Portfolio, Medical Office Portfolio, Country Club Towers, Munson Hill Towers and Montgomery Village Center sales proceeds in replacement properties through deferred tax exchanges.

We distributed all of our ordinary taxable income and capital gains for the three years ended December 31, 2017 to our shareholders.

Availability of Reports

Copies of this Annual Report on Form 10-K, as well as our Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to such reports are available, free of charge, on the Internet on our website www.washreit.com. All required reports are made available on the website as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission. The reference to our website address does not constitute incorporation by reference of the information contained in the website and such information should not be considered part of this document.

ITEM 1A: RISK FACTORS

Set forth below are the risks that we believe are material to our shareholders. We refer to the shares of beneficial interest in Washington REIT as our “common shares,” and the investors who own shares as our “shareholders.” This section includes or refers to certain forward-looking statements. You should refer to the explanation of the qualifications and limitations on such forward-looking statements beginning on page 47.

Risks Related to our Business and Operations

Our performance and value are subject to risks associated with our real estate assets and with the real estate industry, which could adversely affect our cash flow and ability to pay distributions to our shareholders.

Our financial performance and the value of our real estate assets are subject to the risk that if our office, retail and multifamily properties do not generate revenues sufficient to meet our operating expenses, debt service and capital expenditures, our cash flow and ability to pay distributions to our shareholders will be adversely affected. The following factors, among others, may adversely affect the cash flow generated by our commercial and multifamily properties: