

**Transcript of
WashREIT
Third Quarter 2020 Earnings Conference Call
October 30, 2020**

Participants

Paul McDermott - Chairman, President & Chief Executive Officer
Stephen Riffie - Executive Vice President & Chief Financial Officer
Grant Montgomery, Vice President, Head of Research
Amy Hopkins - Vice President, Investor Relations

Analysts

Blaine Heck – Wells Fargo
Chris Lucas – Capital One
Tony Paolone – JP Morgan

Presentation

Operator

Welcome to the Washington Real Estate Investment Trust Third Quarter 2020 Earnings Conference Call. As a reminder, today's call is being recorded. Before turning over the call to the company's President and Chief Executive Officer, Paul McDermott, Amy Hopkins, Vice President of Investor Relations will provide some introductory information. Amy, please go ahead.

Amy Hopkins – Vice President of Investor Relations

Thank you. Good morning, and welcome to WashREIT's Third Quarter Earnings Conference Call. Before we begin, please note that forward-looking statements may be made during this discussion. Such statements involve known and unknown risks and uncertainties, including those related to the effects of the ongoing COVID-19 pandemic, which may cause actual results to differ materially, and we undertake no duty to update them as actual events unfold. We refer to certain of these risks in our SEC filings.

Reconciliations of the GAAP and non-GAAP financial measures discussed on this call are available in our most recent earnings press release and financial supplement, which were distributed yesterday and can be found on the Investor Relations page of our website.

Participating in today's call with me will be Paul McDermott, President and Chief Executive Officer; Steve Riffie, Executive Vice President and Chief Financial Officer; Taryn Fielder, Senior Vice President and General Counsel; Drew Hammond, Vice President, Chief Accounting Officer and Treasurer; and Grant Montgomery, Vice President and Head of Research.

Now I'd like to turn the call over to Paul.

Paul McDermott – President & Chief Executive Officer

Thank you, Amy and good morning, everyone. I hope everyone is safe and healthy and we appreciate you being with us today. We're joining you from our corporate headquarters in Washington, DC, where I've been working alongside many others from our team with social distancing and other safety protocols in place. We are all very happy to be back together on a voluntary basis and while our technology has been incredibly effective and has helped us be successful while working remotely, there is no substitute for in-person collaboration.

Last evening, we released our earnings for the third quarter of 2020. Our results were largely in line with our expectations and our portfolio continues to demonstrate strong, stable credit performance as we absorb the near-term impact of the pandemic. While uncertainty remains regarding how protracted this economic downturn will be, we remain well positioned to bolster our long-term strategic growth plans once the operating environment improves.

Ahead of the downturn, we reshaped our portfolio with a long-term vision, and this focus has proven to be prudent from a capital allocation perspective. Our multifamily collections are consistently above national averages and our suburban expansion through the Assembly portfolio acquisition is performing well.

While our operating environment has changed drastically over the past seven months, we swiftly adjusted to the demands of today's market. We have fully prepared our commercial properties for re-entry by upgrading ventilation filters, implementing enhanced cleaning protocols and installing contactless opening technology and protective shields, in addition to many other safety enhancements. We have worked diligently with tenants who had been financially impacted by COVID-19 to arrange deferral agreements that support their financial position and cashflow needs. Fortunately, these deferral arrangements have not been material and represent a cumulative impact of less than a \$0.01 per share through 2021.

While uncertainty remains regarding how protracted this eventual recovery will be, we are confident in our ability to absorb the near-term impact while preserving our long-term growth opportunities for three reasons.

First, our portfolio and local economy continue to show resilience. We attribute our strong collection performance, which Steve will discuss in detail later on this call, to the fact that the composition of our office tenants and the employers of our multifamily residents are concentrated in industry sectors that have experienced the lowest job losses. The impact of local job losses for office-using sectors in the Washington Metro region has been limited, with no office-using sector losing more than 4% of the total workforce year-over-year according to BLS data.

Forty-five percent of our multifamily residents and 56% of our office tenants are employed in Professional and Business Services, Government or Information sector jobs. Furthermore, nearly half of our Professional & Business Services tenants are government contractors, which is a key differentiator as they are "sticky" office-using tenants linked to important programs which results in significantly more stability in our region compared to other major metro areas and the US overall.

The second reason we are confident in our near-term outlook and long-term growth prospects is the continued stability demonstrated by our multifamily portfolio. Our value-oriented multifamily portfolio has held up well during the pandemic and offers favorable demand and supply fundamentals over the long term.

The Washington Metro region has a significant housing shortage that has been accumulating over many years, as well as an affordability crisis that is only getting worse as the cost of homeownership continues to rise above affordable levels for median income earners. Thus, the largest renter cohorts remain underserved by new supply.

Over 95% of the multifamily units that have been constructed over the past seven years are unaffordable for renters who earn \$75,000 per year or less, a segment which comprises 57% of the Washington metro renter base. Over 75% of WashREIT's units are affordable to those renters with a sustainable rent to income ratio of 30% or lower.

Also driving our long-term demand fundamentals is that 80% of our multifamily portfolio is located in Northern Virginia, where job growth is the strongest and job losses have been the lowest. Northern Virginia has mission critical cyber and technology jobs as government programs continue to grow and an inbound market of technology jobs compared to more expensive markets, which are losing technology jobs during the pandemic. CBRE released its annual Tech-30 market report earlier this month which ranks the nation's top tech markets in terms of resilience and potential for growth. The Washington Metro ranks second in the nation based on the presence of the best-performing large-cap tech companies and the best combination of moderate office rents with a growing high-tech labor pool. Tech sector leasing activity in Northern Virginia is expected to increase in the coming quarters with more than 1.5 million square feet of active requirements in the pipeline according to CBRE.

The third reason we are able to absorb the near-term impact of the pandemic while preserving our long-term growth opportunities is our research-driven approach to long-term capital allocation, which improved and de-risked our portfolio ahead of this downturn.

Our suburban multifamily portfolio, which we acquired last year, has performed very well as the preference for extra space, value and access to high-quality schools offered in our suburban markets combined with a reduction in the perceived benefits of city-living during the pandemic has provided the rare opportunity to continue to grow rents at our suburban assets despite challenging market conditions.

We have experienced minimal credit loss to date, largely due to the sale of 75% of our retail NOI last year including our riskiest big box retail assets. For the small amount of retail we retained, we collected 95% of contractual retail rents during the third quarter including retail tenants in our office properties.

Our retail portfolio includes a combination of assets in transit-oriented locations with strong redevelopment and mixed-use densification potential, as well as highly integrated neighborhood centers in high-net-worth neighborhoods.

Our office portfolio is also well positioned with a weighted average lease maturity of 5.2 years, no exposure to co-working, no single-tenant risk, strong and stable collection rates and limited near-term lease expirations. All of our tenants have their own private space which has become increasingly essential during the pandemic. Additionally, over half of our office portfolio is located in Northern Virginia, where commercial technology and government technology are expected to continue to fuel growth in the years ahead.

While tenant decision making remains slower than normal, we are well positioned once decision making accelerates with high quality, move-in ready space at value-oriented pricing. Many of our speculative leasing opportunities, which had excellent momentum pre-pandemic, are in our best assets including Watergate 600, Arlington Tower and Silverline Center. We believe that cost effective, healthy and adaptive space is going to win in this environment as the market recovers.

Finally, we will soon learn the results of the Federal elections, and while we are not predicting the outcome, Washington has a potential catalyst if the results bring alignment between the Executive and Legislative branches of government. Historically, if such alignment occurs, more legislation is passed which has strongly correlated to greater office absorption for Washington, DC as lobbyist and law firms ramp up for drafting and implementing changing legislation. While we are not reliant on this result, it would represent a unique catalyst for the Washington, DC office market among all other gateway markets.

All in all, we are confident in the resilience of our portfolio over the near-term, growth potential over the long-term and the opportunity for further transformation going forward.

Before I turn the call over to Steve, I'd like to briefly discuss recent ESG program developments. While we are in the midst of a pandemic, now is not the time to take our eye off of our long-term goals. The aspects of our business that define our strength as an institution over the long-term are also critical to our success over the near term. We were honored to be recently named the Best Corporate Responsibility Program in DC and Maryland by NAIOP. This award recognizes our robust ESG program - from the environmental projects that were recently implemented to WashREIT's commitment to giving back to our local communities.

Additionally, earlier this year we formed the WashREIT Diversity, Equity, Inclusion and Belonging Council to help the company continuously evolve to become an even more welcoming workplace for all individuals. We look forward to updating our stakeholders as we execute our plans to continue to promote a workplace that engages the full potential of all individuals and where equity is a core value.

Now, I'll turn it over to Steve to review our collection performance, balance sheet, third quarter results and outlook.

Steve Riffie – Executive Vice President & Chief Financial Officer

Thank you, Paul, and good morning everyone. I'll start off by discussing our cash collection performance before reviewing our third quarter results and outlook for the remainder of 2020 as well as recap our most recent steps to further strengthen our balance sheet.

Our multifamily collections continue to be excellent, which as Paul outlined, is a testament to our strong portfolio credit and the resilience of the Washington Metro economy.

We collected 99% of cash and contractual rents during the third quarter and our rent collections through the first three weeks of October are in line with our quarterly trend. We have offered deferred payment programs to residents who have been financially impacted by the pandemic and only \$58,000 of deferred multifamily rent remains outstanding year-to-date.

Our monthly multifamily collection performance continues to track above National averages. As Paul highlighted, we attribute our outperformance, in part, to our high exposure to industries that have outperformed during this crisis and low relative exposure to underperforming industries. We track the industries our residents are employed in and our exposure is most heavily weighted to the most resilient economic sectors, and likewise, less weighted to the industries that have been most impacted, which has resulted in very high collection rates and stable cash flows.

The impact of COVID-19 on the Washington Metro market has been contained primarily to the Leisure and Hospitality, Education and Health and Retail sectors, which represent over 75% of Washington Metro job losses but only 55% of total job losses nationally through August. These three sectors comprise approximately 20% of our resident exposure and only 8% of our office tenant exposure, thus we are experiencing high collection rates and cash flows despite this crisis.

Turning to commercial, our office and retail collections improved during the third quarter compared to already strong performance in the second quarter, primarily due to stabilizing trends. We collected 97% of cash rents from office tenants during the third quarter, and over 99% of contractual rents, which excludes rent that has been deferred. As of October 20, our collections for October are in line with the same period in September.

Similar to our multifamily resident industry mix, our office tenants are more weighted to the stronger economic sectors than the US overall, which has helped us experience limited credit loss.

Year-to-date, we have agreed to defer a net \$1.4 million of rent for office tenants and we expect to collect 80% of that deferred rent by year-end 2021, with the balance thereafter. These amounts have not grown significantly since the second quarter when we had worked through most of these arrangements.

Retail comprised 6% of NOI year-to-date and while retail tenants have struggled the most, we collected 88% of cash rents in the third quarter. Excluding deferred rent, our collection rate was approximately 95% during the third quarter.

Year-to-date, we have agreed to defer a net \$1.0 million of rent for retail tenants and we expect to collect 50% of that rent by year-end 2021.

Overall, we have only deferred a small portion of rent and the expected cumulative cash NOI impact is less than a \$0.01 per share through year-end 2021.

To date, we have not incurred material credit losses related to COVID-19. During the third quarter we incurred approximately \$0.01 per share of bad debt expense, and it was primarily attributable to COVID-19.

Turning to the balance sheet – We are pleased to report that we have addressed upcoming debt maturity needs and further strengthened our already strong liquidity positioned by executing a \$350 million, 10-year green bond. This transaction represents our inaugural green bond and further demonstrates commitment to our sustainability goals, which now includes achieving BREEAM certifications for the Assembly portfolio, as well as LEED Silver certification for Trove. Not only are these certifications a way to elevate operations to the WashREIT sustainability standard, but we are raising the bar for the entire value-add multifamily sector, which has often lacked investment in sustainability and efficiency opportunities. We intend to be among the first in the country to achieve BREEAM certifications for existing multifamily properties.

As of September 30, we have approximately \$520 million of liquidity. Following the closing of the executed 10-year green bond this quarter, we will have no debt maturing until the fourth quarter of 2022 and a weighted average debt maturity of five years, further strengthening our liquidity.

In 2020, we have demonstrated access to long-term unsecured debt markets, term-loan markets and eliminated secured debt. We maintain investment grade credit ratings of BBB flat and Baa2 by S&P and Moody's, respectively.

We expect to continue to remain well within our bank and bond covenants and have access to the mostly undrawn Line of Credit, if needed. Again, we have no secured debt on our balance sheet, which allows us flexibility as we continue to improve our portfolio.

Our third quarter financial performance was in line with our expectations given the ongoing economic disruption.

We reported Core FFO of \$0.36 per diluted share.

Compared to the prior year, overall same-store NOI declined 4.9% and 3.6% for the third quarter and year-to-date periods on a GAAP basis and 4.1% and 2.9%, respectively, on a cash basis.

Our multifamily same-store NOI decreased by 3.8% year-over-year on a GAAP and cash basis. Overall, our multifamily fundamentals are holding up well given the operating environment that we are in. Our suburban portfolio continues to outperform on occupancy and lease rate growth due to high demand for spacious, value-oriented units. Gross lease rates for our suburban properties increased 1.1% during the third quarter on a blended basis, and effective lease rates increased 0.2% on a blended basis. Gross lease rates for our urban properties declined by 2.9% on a blended basis, and effective lease rates for our urban properties declined by 4.6% on a blended basis. In total, gross lease rates declined approximately 1.7% on a blended basis during the

third quarter, and effective lease rates declined 3.1% on a blended basis. During the quarter, average same store occupancy dipped slightly but increased back to 94% at quarter end. While urban rents were generally under more pressure, our new rent declines were modest compared to national averages and other major gateway markets.

Operating portfolio occupancy, which excludes Trove, our recently delivered property that is in initial lease-up, was 94.6% at September 30, up from 94.3% at the end of the second quarter.

Same store office NOI declined 4.9% on a GAAP basis and 3.7% on a cash basis, driven by an expected decline in parking income, a couple of known and expected move-outs and credit loss related to COVID-19. While parking income increased by about 24% compared to the second quarter as transient parking increased, we have experienced monthly parking contract cancellations as full re-entry has been delayed. Excluding the decline in parking income and credit loss related to COVID-19, third quarter same-store office NOI would have increased slightly on a year-over-year basis.

Same-store NOI decreased at our residual retail centers, which we report as 'Other', by approximately \$300,000 on a GAAP basis and \$270,000 on a cash basis, driven primarily by higher credit loss, which included receivables due from retail tenants impacted by COVID-19 deemed uncollectible. The combined write-off for all office and retail tenants was less than \$0.01 per share and was primarily related to COVID-19.

Turning to leasing activity, while velocity and touring was hit by the economic shut down, we signed approximately 40,000 SF of office renewals and approximately 8,000 SF of retail renewals, and 19,000 SF of new office leases and 6,000 SF of new retail leases during the quarter.

We achieved rental rate increases of 17.6% on a GAAP basis and 3.4% on a cash basis for office renewals and 10% on a GAAP basis and negative 3.9% on a cash basis for new office leases. Rental rates increased 16.4% on a GAAP basis and 3.3% on a cash basis for retail renewals and remained relatively flat on a GAAP and cash basis for new retail leases.

The impact of operational cost saving initiatives at our commercial properties reduced operating costs by approximately \$680,000 net of tenant recoveries during the third quarter. The step down in cost savings compared to the \$850,000 of cost saving recognized during the second quarter was primarily related to higher cleaning expenses due to an increase in the number of spaces being utilized at our office properties. Today, approximately 50% of our office spaces are being utilized by some of the tenants' personnel. Even though utilization by headcount remains lower, our protocols require us to clean the entire office space even if only a few employees are using it. We expect to continue to benefit from operational cost savings until office spaces return to normalized utilization, however, we anticipate operational cost savings will stabilize ahead of hitting normal, pre-pandemic utilization levels.

Now I'd like to discuss our financial outlook. As reiterated in our earnings release last evening, we withdrew our previously issued 2020 outlook in April due to the volatile macro environment and continued uncertainty related to

COVID-19. While uncertainty remains surrounding the magnitude of the pandemic and durability of recovery – we are now seven months into the pandemic and feel better about our ability to forecast the impact of COVID-19 for the balance of 2020. The historical economic stability of the Washington Metro region during downturns has been further demonstrated during 2020, however the duration and extent of economic disruption in 2021 remains uncertain. While we are not providing guidance for 2021 today, we believe the growth in quarterly FFO that was originally expected in 2020 will resume in sequential quarters in 2021 from a low in the first quarter of 2021 in terms of cadence. However, we are still uncertain overall about the extent, impact and duration of the pandemic disruption.

We are reinstating full year 2020 guidance with a Core FFO per share range of \$1.44 per share to \$1.46 per share.

We expect our multifamily NOI to range from \$59.25 million to \$59.75 million, non-same store NOI, which includes Trove, to range from \$26.75 to \$27.25 million, office NOI to range from \$81.5 million to \$82 million, Other NOI to range from \$11.5 million to \$12 million.

We had previously expected significant multifamily growth in 2020 but growth is now likely going to be deferred until the second half of 2021 and thereafter.

Multifamily occupancy increased by 30 basis points during the quarter supported by strong demand for our suburban properties, which allowed us to maintain occupancy while growing rents and preserving our seasonal rent roll.

We continue to outperform the Washington Metro market on resident retention, as more of our residents are choosing to stay with us relative to other multifamily operators in the region. Our suburban retention was very strong at 63% during the third quarter compared to the Washington Metro suburban average of 58%. Our urban retention was 55% during the third quarter, well above the Washington Metro urban average of 46%. Total portfolio retention was 58% during the third quarter compared to the Washington Metro overall average of 54% according to RealPage.

While we are experiencing more pricing power and occupancy growth in our suburban submarkets, our urban submarkets showed responsiveness to pricing strategies during the quarter. Urban application volumes rebounded from March lows and trended 40% above prior year levels during the third quarter and remained above prior year levels through October. Going forward we will focus on keeping occupancy as strong as possible throughout the winter months in advance of the expected lift from the spring leasing season.

Trove continues to lease-up and is on pace to add growth in 2021 and additional growth in 2022. The pace of lease-up continues to be in-line with our post-onset of the pandemic expectations and we just delivered phase two this month. Trove lease-up had just begun when social distancing measures drew on-site touring to a halt, and while we had much success converting virtual tours into signed leases during the early summer months, we have pushed our expectations for stabilization to the first quarter of 2022 from the fourth quarter of 2021. We now

expect to incur a loss of between \$400,000 to \$500,000 in 2020 and continue to expect to reach breakeven occupancy near year end.

Now moving on to commercial. Tenant improvement buildouts for near-term lease commencements have continued to progress uninterrupted. We still have approximately 39,000 SF of signed leases that have not yet rent commenced and expect 16,000 SF of those signed leases to commence by year end. Although physical tours had paused, they resumed toward the end of the second quarter and while traffic continued to increase throughout the third quarter it remains well below pre-pandemic levels. Overall, decision making continues to be slow and the pace of phased re-entry is slower than originally anticipated but has picked up in recent weeks as some tenants have reassessed re-opening strategies and are signaling a near-term phased approach to re-entry. Daycares and some local schools have re-opened and if the trend continues, we expect office utilization to continue to increase at a current gradual pace.

Our initial revenue expectations for 2020 included speculative office lease commencements that have been impacted by the current economic disruption. As Paul mentioned, the majority of this leasing was expected to occur during the second half of 2020 at high-quality space where leasing momentum had been the strongest.

We expect lower speculative leasing assumptions to continue to be somewhat offset by higher revenue from lease renewals and extensions and we have minimal commercial lease expirations for the remainder of 2020, limiting the downside risk of our internal leasing estimates. We expect occupancy to remain stable through year end.

Currently we expect to achieve additional operating cost savings of approximately \$525,000 during the fourth quarter. This amount is net of expenses associated with preparing our buildings for re-entry and the cost savings that we expect to pass along to our tenants.

We expect G&A, including leasing expenses, to range from \$23.5 million to \$24.0 million and interest expense to range from \$37.5 million to \$37.75 million.

As mentioned on previous calls, we have lowered our initial capital expenditure expectations including lowering development spending. We now expect development expenditures to range from \$30 to \$35 million.

While our future multifamily renovation pipeline remains intact, the program remains suspended until the market allows for rent increases to deliver the appropriate ROI. We are pleased that nearly all of our future renovation potential is at our strongest performing suburban assets, which will likely recover sooner than urban submarkets post-pandemic.

While market conditions remain highly uncertain, we feel confident in our ability to navigate these uncertain times over the near-term while retaining the operational flexibility necessary to bolster our long-term goals once operating conditions improve.

And with that I will now turn the call back over to Paul.

Paul McDermott – President & Chief Executive Officer

Thanks, Steve.

In closing, while we are operating in a challenging environment, we remain confident in our ability to effectively manage through this period of uncertainty while preserving the embedded growth of our assets. While we, like others, are dealing with an unprecedented pandemic, we have kept our eye on executing, diligently strengthening the balance sheet, maintaining value as well as preserving long term growth opportunities. At our current stock price, we believe we offer a compelling value proposition for investors, with a 7% dividend yield on a dividend that we are covering, a strong liquidity position, a development and renovation pipeline that can and will be reactivated once conditions improve and a solid long-term growth story.

Now we would like to open the call to answer your questions.

Operator

At this time we will be conducting a question and answer session. Our first question comes of the line of Anthony Paolone with JP Morgan. Please say your question.

Q: Thanks, good morning. Paul, I think last quarter or maybe the quarter before I asked about the investment sales market, you talked about how the transaction side of things is still relatively slow. Are you seeing any signs of an increase in transactional volume? And if so, is there enough to figure out what the effect on pricing has been both in multifamily and office?

Paul McDermott - President and Chief Executive Officer

Let's start with multifamily. I would bifurcate the markets between urban and suburban. I'll start with D.C. proper. Occupancy, obviously, there's been some deceleration downtown. But the big challenge really has been TOPA. It's still hurting downtown investment sales for those who wanted to close by year end, it's become the Achilles' heel to that execution.

In the suburban markets and multifamily that seems to be the hottest product right now, particularly in Northern Virginia. Our observation, and let's go back to the end of the fourth quarter of 2019, where we thought it was a very hot market. We definitely saw tremendous activity and some cap rate compression, probably in January and February this year.

And then, obviously, in March, there was a static period. I would say that it is back with a vengeance right now. Thanks to agency lending we have seen some cap rate compression. I don't like to put all my eggs in the cap rate basket just because – are they based on actual occupancy, actual collections, tax adjusted, are you T-12ing, T-3ing, T-1ing.

But we've definitely seen underwriting. I'd say since Labor Day it's become more aggressive. And I'm really looking at a year-2 growth assumption in the multifamily space. When we talk in the second quarter, some folks

still probably had zero to negative growth. and that growth rate has now translated to, just in the underwriting feedback, between 1% and 3%.

Just in terms of capital, we talked about the Odyssey Index, the core funds are kind of gone. But we're definitely seeing 1031 activity with cash flows with good collections, value-add core plus money. Debt is the real supercharger here. Folks are really looking in the multifamily space for what I'd say 6% on levered IRRs, 11% to 12% levered. And that's predicated on just over 2% debt, but it's clearly all about levered yields in the multifamily space.

Office, obviously, a bit of a different story. I'll start in the suburbs. The activity that we're seeing out there is really from the core plus capital, looking for longer-dated vaults or shorter dates with a retention story. That capital is probably solving for an 11% to 13% or a 12% to 14% levered.

They're trying to get 60% to 65% loan to value, but under the prep and promote structures they're looking for about a 6% prep, with an overall 12% target. Core capital, we just don't see it in the mainstream right now.

The bigger deals, even downtown, are falling short on pricing. I don't believe folks are underwriting a tremendous amount of growth for the next two years in the commercial sector. They're probably taking face rates and discounting them 10%-plus and that's leading to a continued bid-ask gap like we talked about last time.

In D.C. proper, lots of confidentiality agreements, lots of folks kicking tires, lots of fact finding. We just see a lot of portfolio managers in discovery mode, but not a lot of serious capital chasing. I think size is very relevant, because it looks like the capital markets, especially the local, and regional banks are capping those loans in that \$25 million to \$50 million total loan value.

Life companies are only lending on the best of the best CMBS are out there. But I think borrowers are gun shy. Debt funds at 4% to 5% rates are not terribly accretive to folks. I just started to see seller financing creep back into the marketplace right now. And that's from sellers that have cues, and probably needed to get the product traded sooner rather than later.

My final comment would be just foreign capital, definitely seeing a lot of foreign capital back bidding, looking around. They think D.C. is on sale. They're looking at – they're also looking for longer-term vaults, but they're probably doing it through a local operating partner. I think you're going to see that foreign capital pick-up post-election.

Q: That's great commentary. Very helpful. Maybe just a couple of follow-ups, focusing on the multifamily side, are you seeing more core deals on the market? Or are there also value-add deals? And if so, what's the pricing differential between the two? And then, assuming you guys are looking at deals, are you mostly focused on Northern Virginia? Are you looking at properties in D.C. proper and Maryland as well?

Paul McDermott - President and Chief Executive Officer

Let me start with the last and I'll work my way backwards. The district right now is really only 13% of our NOI stream. We're not seeing any transactions in the District, like I said in my earlier comments, because of TOPA. If you're looking for certainty of execution on closing, DC's pushed out their restrictions to year end. There's nothing to say that that won't become more protracted once we get to December 31.

Given some of the occupancy and concessionary issues that we are dealing with in the District right now, you're probably having a little bit wider than normal bid ask. If I go back into suburbs right now. I think Northern Virginia, just because of the resiliency of the job market with tech and the government contracting, they are definitely seeing more deals and more value-add deals.

I remember talking to you last year, at this time when we were signed and sealed and executed on the Assembly portfolio, and people were asking about suburban, a garden style walk up. That is one of the hottest products out there right now. It's being priced well above replacement cost and that is clearly value-add capital when they're going to grow rents. They've brought that rent's growth curve inward more than some folks that have been operating out there for some time, like I said, they're growing rents, probably to win these deals at the beginning of year two, so have not seen a lot of core capital sniffing around those deals that right now.

Q: Okay, that's great. And last one on the transaction side. At this point, would you guys be comfortable taking on more development risk through the acquisition of land or maybe an asset that's still under construction?

Paul McDermott - President and Chief Executive Officer

Let's look at our development pipeline right now. We have 767 units shovel-ready in a market we know very well. We've got our litmus test that has been the excellent renovation work that we've done. That is what we'd look at first and foremost, as you know, we have covered land plays that we don't have to go out and seek already embedded in our portfolio, as well as some multifamily assets that have additional FAR. As far as broken construction deals right now, that's probably just too broad. That would be sub-market by sub-market. There are markets we really still try to play and draft off of our affordability gaps.

I haven't seen any broken construction deals right now in Northern Virginia that we would look at. But I think we'd be in line with a number of other hungry capital potential participants.

Q: Okay. That's great color. Last one for me, and maybe sticking with your call, or maybe even for Grant. Paul, you mentioned this a little bit in your prepared remarks. I'm thinking back four years ago, when we were looking at a pretty subdued office environment in DC, and I think the hope was that alignment of the White House and Congress would spur more bills being passed and thus drive demand for office. I think for a bunch of different reasons that didn't really pan out like it has in past elections. Now, who knows what happens in this election, but if we do see alignment of the White House and Congress, do you think there's an argument that we actually could see a surge in office demand this time around? And if so, what's the difference between now and four years ago?

Grant Montgomery – Vice President and Head of Research

You've sort of zeroed in on the point of that the last four years have been different for a variety of reasons in terms of prior trends and so our thought is if we do reach alignment, there is the opportunity for more of a typical relationship between the branches of government in terms of legislative and executive within the party that really hasn't existed over the last four years.

And a more cooperative stance may allow that to revert back more to the historical pattern, which we point out, typically does relate to a higher number of legislative bills that are passed, and then increase lobbying and legal precedent that DC that results in higher absorption.

Operator

Our next question is from Anthony Paolone with JP Morgan. Please proceed.

Q: When I think about your markets, you've got on the office side with law firms and government and some companies as the big space users, and then you have this smaller folks like foundations and lobbyists and consultants. Just wondering if you have a sense as to the smaller tenants, any initial thoughts as to whether you see them trying to give up space or work in a more remote world going forward? Or just what you're seeing in terms of their thought process right now?

Paul McDermott - President and Chief Executive Officer

I would just use our portfolio and our own experience as kind of litmus test. Smaller tenants are the ones that are back in the office right now. That makes sense to me, because for a 12 to 15-person firm, everyone is essential number one, and a lot of them don't necessarily have the technology infrastructure to support working from home. If you look at our portfolio, we average roughly in the 5,500 square foot range on that smaller tenant scale. Some of them, yes, we've worked with, but I think a lot of them are very focused on making it work in the footprint that they have.

Larger tenants for either liability purposes or other reasons are the ones we're not seeing back into spaces actively. The larger ones, within our discussions, are folks that are actively trying to put together a workforce strategy.

We're starting to see some folks, I wouldn't say it's a trend, but we're definitely seeing some looking at longer term deals, because they're taking advantage of current market conditions and realize they can probably capitalize on free rent clauses, parking clauses, et cetera. I wouldn't call them visionaries, but definitely opportunistically looking at their workforce strategy, with probably a longer vision than some of the smaller tenants that we're dealing with.

Q: What's happening in your Space+ and what's the leasing or just utilization there?

Paul McDermott - President and Chief Executive Officer

We've had good traction, like everybody else, we have experienced a lot of folks looking for shorter duration leases with flexibility, and that does neatly fit into the Space+ box, which is roughly 3% of our NOI right now. We're going to continue to see, as more decision makers come back, our Space+ inquiries grow. Our first deal, literally, that we did during the pandemic were folks moving out of WeWork and co-working, where they could come into Space+, and get their own identity. More importantly, control the safety protocols within their own environment.

We think that that's still going to get traction throughout the balance of 2020 and going into 2021, and looking forward to reporting on that further as we progress through this.

Q: Last question, for me, you talked a lot about and gave a lot of color on the transaction environment, anything specific to you all on the disposition side that that could make sense or that you're contemplating now that could be used to find capital to redeploy elsewhere?

Paul McDermott - President and Chief Executive Officer

I'm not trying to dodge your question, but as you know, we're always trying to be opportunistic in how we allocate capital. If we see an opportunity to monetize an asset, we will probably take advantage of it. But we're always looking at recycling, we've tried to be good stewards of our investors' capital. We're on top of the market. We see what's being bought and what's being sold. We're dealing with a bifurcation between multifamily and office, obviously, a lot of that sales market is being driven by the lending community. We'd have to have some kind of a glass slipper. Of course, we would look at it if it opportunistically made sense for us.

Operator

Our next question is from Chris Lucas with Capital One Securities. Please proceed.

Q: Good morning, guys. Sort of a follow-up to Tony's question, Paul, which is just counterintuitive, but you do have a couple of really nice infill retail properties we've heard, while there's not a lot of retail that's traded, the stuff that has traded, that is considered high quality infill in major markets is really trading at sort of pre-COVID cap rates or even lower, particularly if you adjust for NOI risk. Just curious as to whether or not a couple of the assets that you have to come apart, Takoma Park, Spring Valley, in particular would be something you'd look to monetize in this environment.

Paul McDermott - President and Chief Executive Officer

Not at the risk of repeating myself, we're always open for business as any real estate investor should be. I look at a couple of those assets, and one that you mentioned Takoma that's directly on the purple line. We have some what I would consider good cash flowing covered land plays. But if somebody thinks that they are worth more fully developed as a mixed-use asset, of course, we would take a look at it.

Spring Valley, as you know, we did an addition on that, and wanted to make sure that that leasing was complete. We're doing well there on a relative basis. We have not tested the market, for us, just in terms of pre-pandemic cap rates. We were, as you know, pretty comfortable with the high fixed cap rate that we achieved on our portfolio, of the 75% of our retail portfolio NOI last year.

We haven't really tested the waters, I'm not saying that if someone didn't come in with a compelling offer that we wouldn't take a hard look at it.

Q: Okay, great. And then, Steve, just on the guidance, the implied fourth quarter guidance sort of declines from third quarter and your NOI guides were sort of generally at the midpoint down a few percent. Just kind of curious as to what is embedded in guidance and if there's something specific that I'm either not missing or that you're aware of, that we should be aware of that is driving that.

Stephen Riffie - Chief Financial Officer

I think when you were looking at total NOI guidance, and trying to find all the pieces, there's something you're probably missing, because we did not update guidance on JM II because we sold it midyear, but it did contribute about \$1.3 million to NOI before the sale and when I think you were looking at total numbers you put that in there.

Q: We took that out.

Stephen Riffie - Chief Financial Officer

Okay. It looks like you may have missed that. In terms of our own thoughts about the fourth quarter, this is the first time that we have given guidance in the COVID world. When we look at the office sector, I would say the two things that imply a little lower in, say, commercial or office is anticipating less recoveries of operating expenses in the quarter than what we just experienced.

We're probably being a little conservative. We're a little nervous about projecting bad debt. So we're a little heavier on our bad debt projections, probably for commercial and multifamily, honestly, than what we've experienced so far.

On the multifamily side, our trade-outs and our rents we started to feel some slippage in September relative to the rest of the quarter. But when we look at what's happening in other gateway markets, a blended down of gross rents of 1.7%, or even effective rents at negative 3% isn't bad, as we're looking at all the data in all the gateway markets.

We are going into the winter months and we're being a little bit conservative going through there. We're really happy that we've managed our lease maturity ladder, so that it's really heavily weighted to the spring and summer months. So we're maybe a little bit conservative in that front, obviously, it maybe just for some perspective for a second too, in terms of our original guidance – we finally reestablished it.

If you recall, we talked about a lot of things that we're going to be building up throughout 2020 sequentially, so that we would end very strong in 2020 and have a lot of momentum going into 2021. Well, what would that be? We had this bucket of lease commencements that have now been pushed out till – and even those that were being under negotiation pushed out probably into 2021.

Because we went without rent increases during the strong spring months into the summer, as we were freezing multifamily rents, we would have had a lot of that growing by the fourth quarter. We also suspended our value-add renovation program, which we would have build up by then. So here's an interesting perspective, when we look at our original guidance to the new guidance, the midpoint, we're only \$0.02 a share behind year to date through September 30, from where we originally plan to be.

All that growth was supposed to build for the fourth quarter. So in our mind, we can't predict the extent and ongoing duration of the pandemic. But for us, it's a question of when not if that growth is coming, because the spaces that we have to lease in our office portfolio are still at our best assets where there is interest.

And when we look at our multifamily, we're going to get a chance to go back through the strong leasing seasons. And hopefully, have rental increases this year, and hopefully, again, start to resume our renovation program. There's the Trove which delivered right before the pandemic. So, it's slower on lease up, but we've got pretty good growth in 2021, just as that continues to lease up and then even a lot more growth than that in 2022, considering when it got started. That's our perspective in terms of looking into the fourth quarter, into the early winter in terms of guidance.

Operator

Okay, with no questions coming into queue, I would like to turn it back over to Paul for closing comments.

Paul McDermott - President and Chief Executive Officer

Thank you. Again, I'd like to thank everyone for taking the time to join us today. We appreciate your continued support. And we look forward to talking with you at NAREIT and over the coming weeks and months. So thank you, please stay healthy and positive and have a good day.

Operator

This does conclude today's conference. You may disconnect your lines at this time and thank you for your participation.