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Transcript of WashREIT
Fourth Quarter 2020 Earnings Conference Call
February 12, 2021

Participants

Paul McDermott - Chairman, President & Chief Executive Officer
Stephen Riffee - 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
Dave Rodgers – Robert W. Baird

Presentation

Operator
Welcome to the Washington Real Estate Investment Trust Fourth 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, Investor Relations
Thank you and good morning everyone. 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 Riffee, 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 and good morning, everyone, and thanks for joining us today. I hope you and your families are keeping safe and well. Last evening, we released our fourth quarter earnings results, which rounded out a year dedicated to stabilizing our operating fundamentals and maintaining and preserving future growth drivers against the backdrop of one of the most challenging operating environments in recent history. Thanks to the dedication shown by the WashREIT team, the strong credit profile of our portfolio, and the resilience of the Washington Metro region, we continue to successfully navigate through the pandemic and expect to enter the vaccine-led recovery phase with a stronger balance sheet, a reaffirmed strategic direction, and a portfolio that is positioned for growth as demand returns.

With the vaccine roll-out that commenced toward the end of last year, we are seeing signs of increased activity across both our multifamily and commercial portfolios.

For multifamily, net applications were up 30% year-over-year in January for our urban properties and year-to-date trends already reflect improvement in occupancy as we head into the spring leasing season. We have focused on growing occupancy to begin reducing concessions and increasing rents. Currently, multifamily occupancy is over 95%, excluding our two rent-controlled properties, where we are not emphasizing occupancy gains as they offer limited rent growth potential in the current environment.

Multifamily credit performance continues to remain very strong at both our urban and suburban properties and has consistently outperformed the national average by a wide margin over the past year.

While multifamily lease rates declined 3.6% and 5.7% on a gross and effective blended basis during the fourth quarter, we believe that December represented the height of rental rate pressure as lease rate changes improved in January on a month-over-month basis and concessions declined. Furthermore, new and renewal lease executions with commencement dates in February and March indicate continued improvement in effective lease rate growth. Our renewal rates were strong during the fourth quarter and that strength has continued into 2021. Both urban and suburban renewal lease rate growth increased by 90 basis points during the fourth quarter to 1.7% and 3.1%, respectively, and those renewal rate increases remained stable through January.

The continued pricing power that we are experiencing at our suburban assets combined with the ability to influence lease terms with concessions has allowed us to roll more leases into future spring and summer lease maturities at our newest multifamily assets. As a result of the strategic management of our lease expiration schedule, only 20% of our leases expired during the fourth quarter and only 17% expire in the first quarter. We think December marked the low point for pricing given the improving year-to-date trends that we are seeing.

We believe the vaccine-led recovery will lead to an inflection in 2021 heading into 2022, however, it is too early to know the precise timing and extent of this benefit in 2021. Approximately two-thirds of our multifamily leases expire in the stronger spring and summer months, and we anticipate that these leases will benefit from an increased number of vaccinations. In the meantime, we plan to continue to focus on building occupancy and maximizing our retention rates, which continue to outperform our region.

Moving onto commercial, our credit performance continues to hold up very well, as Steve will discuss in greater detail, and we expect that the vast majority of our commercial credit losses are behind us. Our forecast indicates that commercial occupancy could increase by nearly 4% by year-end, although, there is still too much uncertainty to accurately forecast occupancy gains over the course of the year. However, our outlook is improving, and we are seeing signs that tenant decision making is accelerating. Leasing activity picked up significantly in January and active long-term renewal discussions with significant tenants are progressing well. For example, in January we received a signed LOI from Sunrise Senior Living to renew their space at Silverline, which currently represents approximately 1.5% of office revenue. We also have signed LOIs with B. Riley and an accredited third party at Arlington Tower. B. Riley has a termination option in December 2022 and will exercise this option on only one of its three floors, which will allow the third party to enter into a sublease of this entire floor through 2022 and then enter into a direct lease with us through 2029. B. Riley will extend the balance of their premises through 2026.

Additionally, in January we signed a 45,000 SF five-year lease renewal with Giant Food at Takoma Park, which represents our second largest retail tenant and over 6% of Other rental income. We also signed a 15,000 SF 10-year lease renewal with our grocery anchor at Montrose Shopping Center. These two lease renewals represent approximately 10% of our retail rental income.

Heading into the recovery, our office portfolio offers substantial growth potential given that much of the available space is high quality, move-in ready, and located in our best assets. We have a weighted average lease term of approximately five years, limited near-term lease expirations, and our price points and floor layouts are well positioned for our market. The average tenant size in our market and the space requirement that sees the most volume is about 4,000 SF to 6,000 SF which is both our median tenant size and the tenant size with the highest demand in the current environment. We have zero exposure to co-working operators, no co-working tenants and no single-tenant risk.

We continue to see good traction with Space+, which is our proprietary flexible office program that is managed in-house, with spaces strategically located in our portfolio. Space+ represents approximately 3% of our office portfolio and is very well positioned once decision making picks up. Space+ is move-in ready space that is private, not co-working space, that allows tenants to control the health and safety of their environments and it offers more flexibility than traditional leases. Additionally, Space+ offers premium pricing compared to traditional leases and on average has much longer terms than co-working providers achieve, allowing us to participate in the increasing demand for flexible office space while preserving our weighted average lease term and thus, our opportunities for future portfolio transformation.

While uncertainty about the timing and pace of reopening remains, the resilience of our region provides relative stability compared to other major metropolitan areas. Since the onset of the pandemic, the Washington Metro has benefitted from fewer job losses than other major metropolitan areas and has already gained back roughly 180,000 jobs, or 56% of the jobs lost from February to May. Additionally, those jobs losses have been largely contained to non-office-using sectors as office-using sector employment in the Washington Metro market declined only 2% year-over-year in 2020 according to BLS data.

As we continue down the path toward a vaccine-driven recovery, our region has several unique catalysts to accelerate the rebound in demand. The growing high-tech labor pool, federal investments in cloud, cyber, and artificial intelligence, as well as affordable office rents continue to drive information sector leasing activity in Northern Virginia. Amazon continues to expand their regional office footprint and remains on pace with HQ2 hiring. Over the course of 2020, the tech sector contributed 36% of total leasing volume and more than 800,000 SF of occupancy growth in Northern Virginia, according to CBRE. Tech-driven leasing demand drove positive absorption for the sector in the fourth quarter, and that momentum has continued into January with the announcement of Microsoft's new 180,000 SF sales headquarters in Rosslyn, next door to Arlington Tower and strategically located at the nexus of four bridges, five major road networks and three Metro lines and offers easy access to the Pentagon and downtown, DC.

Government contractor awards should remain at record highs in 2021 and the cloud market alone is forecasted to grow 9% to 10% annually over the next three years according to JLL. Northern Virginia's diversification over the past decade – blending government contracting with direct federal leasing, technology sector growth, investments in higher education, and medicine – have set it up for a quicker-than-average office market recovery in 2021 and beyond, according to Newmark.

With the arrival of our newly aligned administration, the Washington Metro market is positioned to benefit from a surge in activity. Historically, alignment between the Executive and Legislative branches has resulted in a higher number of legislative bills passed with increased lobbying and legal presence in DC to influence, write and then implement legislation, resulting in higher absorption in the DC office market. The historical correlation to office absorption in years with aligned branches of the government is very strong.

Additionally, the election should have a positive effect on our local apartment market and may even accelerate a shift back into the city for renters. Data analyzed by CBRE over the past six Presidential elections indicates that, on average, DC Metro rent growth was more than double the U.S. average during the six months subsequent to each election. Furthermore, market-level data indicates that urban submarkets, which have underperformed suburban areas during this downturn, will likely benefit the most from the boost of activity associated with the Presidential election. Again, these are catalysts historically unique to the Washington Metro area as opposed to other Gateway metropolitan markets.

It has been an eventful and unexpected year, and alongside the challenges that we have successfully navigated, we continue to make progress on de-risking and improving our portfolio. This pandemic has re-affirmed our commitment to, and the direction of, our capital allocation strategy as part of the WashREIT transformation. Following our fourth quarter office asset sales, and including stabilized income from Trove, multifamily comprises 53% of our NOI, while office and retail comprise 41% and 6%, respectively.

And with that, I will turn it over to Steve to review our balance sheet, collection performance, fourth quarter and full year results, and our outlook.

Steve Riffee – Executive Vice President & Chief Financial Officer

Thank you Paul, and good morning everyone. I'll start off today by reviewing the balance sheet before discussing our fourth quarter and full year financial performance and future outlook.

In the midst of the uncertainty that dominated the capital markets during 2020, we took steps to strengthen our balance sheet and increase our operational flexibility which has put us in a stronger position as we head towards the recovery phase of the pandemic. First, we made sure that we had ample liquidity at the onset of the pandemic by entering into a $150 million one-year term loan with extension rights. Second, we closed and funded in December a $350 million 10-year green bond at 3.44% and used the proceeds to pay off the new $150 million term loan and our other $150 million term loan that was scheduled to expire in March of 2021. These actions addressed all of our debt maturities through the fourth quarter of 2022 and termed out our maturity ladder.

Third, we fully unencumbered the balance sheet allowing us optimal flexibility as we continue to allocate capital to further multifamily growth. Finally, we increased our balance sheet flexibility heading into 2021 with our strategic office asset sales and issued some equity through the ATM program to be ready to continue our capital allocation when visibility into the recovery is more clear. In that regard, at year end, we only had $42 million outstanding on our fully available $700 million line of credit, underscoring that, we increased our liquidity further during the pandemic. All of our covenant ratios remained strong and we have maintained our Baa2 and BBB flat Investment Grade ratings with Moody's and S&P.

Now I'll turn to our cash collection performance.

Our multifamily collections continue to be excellent, tracking well above national averages. We collected 99% of cash and contractual rents during the fourth quarter and our rent collections through January 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 a very small amount, about $15,000 of deferred multifamily rent remains outstanding.

Our office and retail collections for the fourth quarter improved sequentially, continuing the trend of steady quarterly improvement since the beginning of the pandemic. We collected 99% of cash rents from office tenants during the fourth quarter and over 99% of contractual rents, which excludes rent that has been deferred. Net deferred rent associated with office tenants was $1 million as of January 31, 2021, and we expect to collect approximately 75% of that deferred rent by year-end, with the balance thereafter.

We collected 94% of retail cash rents in the fourth quarter. Excluding deferred rent, our collection rate was approximately 97%. Net deferred rent associated with retail tenants was $1 million as of January 31, 2021, and we expect to collect 40% of that rent by year-end. Overall, we have only deferred a small portion of rent, and the expected cumulative cash NOI impact is less than $0.01 per share through year-end 2021.

Now turning to our financial performance, net loss for 2020 was $15.7 million, or $0.20 per diluted share, compared to net income of $383.6 million, or $4.75 per diluted share the prior year. The largest decrease is primarily due to the net gains on asset sales that were executed during 2019 compared to small losses recorded on sales in 2020.

Core FFO of $1.45 per diluted share for full year 2020 was in line with the mid-point of our guidance range. On a year-over-year basis, Core FFO per share declined by $0.26 due to the strategic transactions completed during 2019, as well as the impact of the pandemic on leasing activity, parking income, and credit losses.

Overall, same-store NOI declined 5.4% year-over-year on a GAAP basis and 4.9% on a cash basis for the full year 2020.

Multifamily same-store NOI declined 0.9% and 1% on a GAAP and cash basis for the year and 7.2% and 7.3% on a GAAP and cash basis for the fourth quarter. The full-year and fourth quarter declines were primarily driven by year-over-year new lease rate declines at our urban assets, which comprised 100% of our same-store portfolio during 2020. The impact of lease rate declines had an outsized impact on our same-store results during the fourth quarter as the impact of urban flight on overall demand levels had a greater impact on lease rates during the weaker winter months. Our suburban properties, where lease rate performance has been the best, will be included in same-store results in 2021. During the fourth quarter we focused on maintaining occupancy and it ended at 94.3% excluding Trove.

Office same-store NOI declined 7.1% and 6.4% on a GAAP and cash basis for the year and 12.7% on a GAAP and cash basis for the fourth quarter. The full-year and fourth quarter declines were primarily driven by lower parking income, known move-outs, and increased credit loss reflected in the write-off of two isolated and specific receivables and their more significant lease intangibles related to COVID-19.

Same-store GAAP NOI decreased at our remaining retail centers, which we report as Other, by $2.1 million and $1.8 million on a GAAP and cash basis for the year and $0.7 million on a GAAP and cash basis for the fourth quarter. The full year and fourth quarter declines were primarily driven by credit losses related to COVID-19, which increased in the fourth quarter primarily due to the write-off of intangibles related to two leases.

Overall, commercial credit losses reduced our Core FFO by approximately $0.02 per share this quarter, which is higher than the third quarter impact and in line with the second quarter. However, the sequential increase this quarter was primarily driven by the write-off of intangibles related to the aforementioned leases, which are not indicative of a change in the credit performance of our overall portfolio, which remains very strong and stable. Over 60% of the credit losses related to these leases were non-cash straight line rent write-offs as our cash losses were relatively flat on a sequential basis. We believe that we've addressed the credit risks that are apparent at this point in time and we anticipate steady improvement in credit performance over the coming year.

Turning to leasing activity for the fourth quarter and full year. We signed approximately 9,000 SF of new office leases and 22,000 SF of office renewals in the fourth quarter. Office rental rates declined 5% on a GAAP basis and 9% on a cash basis for new office leases but increased 22% on a GAAP basis and 8% on a cash basis for office renewals. More importantly in December, the exchange of proposals and the negotiation of lease renewals picked up substantially and that momentum has carried into January. Earlier, Paul gave color on two of our largest renewal and extensions at Silverline Center and Arlington Tower, for example.

Retail signed approximately 8,000 SF of new leases and 3,000 SF of renewal leases during the quarter, and achieved rental rate increases of 13% on a GAAP basis for new retail leases and 3% on a GAAP basis for retail renewals. As Paul referenced, we've signed approximately 60,000 SF of retail leases, representing 10% of our retail portfolio revenues, since year end.

Now turning to our outlook. With the development and rollout of vaccine programs, our growth prospects heading into 2021 have improved but the timing of when we will reach an inflection point is still unknown. Therefore, the extent that vaccine rollouts will offset the pandemic impact in 2021 prior to that inflection is uncertain. We do, however, believe we will see rapid improvement once we reach that point and that it will carry over into 2022 given that the embedded growth drivers that we had prior to the pandemic are still intact. While we believe that the most disruptive part of the pandemic is behind us, the timing and pace of the economy re-opening still remains uncertain, and we are not ready to forecast, with a sufficient degree of accuracy, the timing and extent of the recovery over the course of the full year.

This close to quarter-end, we have enough visibility to provide FFO guidance for the first quarter, however, we do not have enough visibility to provide FFO guidance for the full year.

We are, however, providing full-year guidance ranges for the financial performance metrics that we believe we are able to forecast with a reasonable degree of accuracy. While we are not calling the timing of and therefore the full impact of the pandemic prior to the anticipated inflection point, we will discuss the areas of our portfolio that we would expect to be the most responsive, and to offer the most upside growth potential once the economy resumes.

Starting with multifamily, total operating portfolio occupancy ended the year at 94.3%, which is in line with our expectations and represents a relatively stable trend since the end of the second quarter. On a positive note, as Paul mentioned, we've gained occupancy since year end and leading indicators point toward steady improvement in occupancy as we head into the strong leasing seasons. We have increased occupancy to slightly over 95% excluding our two rent-controlled assets and we are seeing effective lease rates trending in the right direction. Additionally, net application volumes have increased significantly on a year-over-year basis for our urban properties.

Overall, we had previously expected significant multifamily growth in 2020 and that growth is likely now going to be deferred until the economic recovery led by the greater vaccination takes hold. While we do expect a seasonal lift in the second quarter, we expect the broader inflection to occur at some point in 2021 heading into 2022 and for it to have a greater impact on 2022. We have a five-year pipeline of value-add renovations ready to resume once conditions improve and we still expect future NOI growth from the Trove, which I will cover next.

In terms of our renovation pipeline, we are constantly evaluating the health of each of our submarkets for rent growth and renovation potential and we are encouraged by the metrics that we are seeing, especially in our newly acquired suburban portfolio. Certain submarkets in the Metro area are seeing the rent gap between Class A and Class B rents widen, which is an early indicator of renovation potential, while other submarkets continue to see rent gaps tightening. We are monitoring these trends and we will resume renovations when the submarket fundamentals allow for rent increases to deliver the appropriate ROI and we know the capital allocation is accretive.

Trove delivered its final phase in the fourth quarter and leasing momentum continues to increase. While our lease-up had just begun when social distancing measures drew on-site touring to a halt in April, we continued to make substantial progress on lease-up and have maintained a monthly lease-up rate that is above the long-term regional average against an extremely challenging back drop. We reached breakeven in December and remain on track to reach stabilization in early 2022. We expect Trove to add $100,000 of income in the first quarter, ramping up each quarter to approximately $1 million by the fourth quarter of 2021 with significantly greater growth in 2022 over 2021 levels.

Now moving on to commercial. As expected, occupancy remained relatively flat through year end and while we only have a small amount, approximately 20,000 SF, of signed new leases that have not yet rent commenced, and approximately 20,000 SF of signed LOIs for new leases that are expected to rent commence during 2021, we have minimal lease expirations during 2021. Our 2021 office lease expirations represent less than 3% of our overall revenue, and we believe that a renewal is likely, or we are under negotiation for renewal for over 60% of that space.

We do not have enough visibility on the timing of the inflection point for new office leasing, but it will be driven by a combination of wide spread vaccination rollout, schools reopening and the general community returning to more normalized activities. When that occurs, it will impact the timing of new lease commencements. We have a forecast that can result in occupancy growth of up to 4%, but that forecast is at risk if new leasing is delayed. For example, that forecast includes a little over $3 million of new leasing revenue in the fourth quarter that would be at risk if the inflection does not happen soon enough. So, we are not ready to provide a guidance range yet without more visibility.

Following the two retail renewals which were executed in January, which represent 10% of our retail NOI, we have less than 3% of retail revenue expiring in 2021.

While we are seeing recent signs of and experiencing increased activity across our office portfolio, one of the most challenging calls for us to make is when sentiment will turn, and decision making will pick-up to even higher levels again and when those additional lease commencements will begin. With that said, we believe that we are positioned well once activity improves, and we expect our office portfolio to be highly responsive to the economy reopening. The majority of our vacancy is in high quality space, some of which is move-in ready stages, nearly 60% of our current vacancy is in Northern Virginia where job growth and absorption rates are the strongest and where we are seeing the most touring and leasing activity.

Parking revenue improved slightly over the course of 2020 driven by an increase in transient parking but remains below normalized levels. Compared to other major metropolitan areas, our parking coverage is higher, which allows more of our tenants to choose to drive instead of taking public transportation. Our parking garages capacity can serve over 50% of our building population prior to the pandemic, on average, and we still currently have at least 50% parking capacity available, which provides an option for companies that want to encourage employees to return to the office before sentiment improves towards public transportation.

We are guiding to a Core FFO per share range of $0.29 to $0.32 per share for the first quarter. We expect multifamily NOI to range from $20.25 to $20.75 million, office NOI to range from $17.75 to $18.5 million and other NOI of approximately $3 million. G&A is projected to range from $6 to $6.25 million, interest expense is expected to range from $10 to $10.25 million, and development expenditures are expected to range from $5 to $7.5 million.

We expect NOI to bottom in the first quarter, driven primarily by our year-end asset sales. Following the first quarter, and absent any major setbacks to the current gradual pace of reopening, we expect sequential growth throughout the year to be driven by the lease-up of Trove, the benefit of the more favorable multifamily leasing season coming off of the winter months, the phased resumption of unit renovations, and commercial rent commencements. Therefore, we expect our full year results for 2021 to be higher than the first quarter annualized results.

Since our last earnings call, we sold two office assets and issued approximately two million shares through our ATM program at an average price of $23.86 per share to improve our balance sheet and position us to further strengthen our capital allocation once visibility aligns with opportunity to increase multifamily. Currently, we are not planning on reinvesting those proceeds in the near-term thus we estimate at this time, that these two initiatives net of their interest expense impact will further strengthen our balance sheet and lower full year 2021 Core FFO by approximately $0.09 per share.

For the full year, we expect G&A to range from $22.25 to $23.25 million and interest expense to range from approximately $41.5 to $42.5 million. These ranges do not assume any acquisitions are completed during the year. Additionally, assuming that leasing activity and utilization continue to increase and we achieve occupancy growth by year-end, we would expect commercial operating expenses to increase by approximately $1 million by the fourth quarter from the first quarter expected range $11.75 to $12.25 million.

We believe that during 2021 the vaccine distribution should create a positive recovery inflection point, and from that point forward, we should see improvement with more to follow in 2022.

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

Paul McDermott – President & Chief Executive Officer

During what was a challenging and unexpected year, we supported and protected our residents and tenants, stabilized our operating fundamentals, strengthened our balance sheet, and preserved long-term growth opportunities. While the timing of when we will reach an inflection remains uncertain, we believe that it will happen at some time in the second half of 2021 and that we are positioned for rapid improvement once we reach that point. Our region has several unique catalysts to accelerate the rebound in demand, including a strong economy and favorable demographics. Historically, we have seen Washington office absorption increase significantly when the White House and both branches of Congress are aligned with one party correlating with increased legislation, lobbying and law implementation. That is a promising opportunity that we will be monitoring. We also expect the apartment market in the region to receive a relative boost compared to other markets over six months based on historical patterns following Presidential elections which should coincide with our strongest seasonal leasing months. Long-term, our research indicates that we should expect sustained growth in Northern Virginia driven by government contracting, technology sector growth, and investments in higher education. While we certainly have not emerged from the pandemic at this point, we are seeing signs of our multifamily occupancy strengthening, concessions starting to decline and improvement in effective lease rates, all of which are positive trends heading into our stronger seasonal leasing months.

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. [Operator instructions]. Our first question comes from Tony Paolone with JP Morgan.

Q: First question for Paul, just from a bigger-picture point of view, can you talk about how you're thinking about capital allocation and the push to multifamily in an environment where it seems like cap rates have compressed, and gone to like 4% in apartments? And how are you thinking about potentially making that trade, and if that's still a push that you want to make here?

Paul McDermott – President & Chief Executive Officer

In terms of capital allocation, we are going to continue to look for multifamily opportunities. Right now, when we look at the markets and what we're seeing out there, I do question the sustainability of those cap rates. Just anecdotally, some color on that.

Agency borrowing costs have increased over 50 basis points since last summer. And even the new lending from the life companies and the debt funds, they're pushing back and they're really gravitating towards in kind of trailing 1s and trailing 3s. I think the folks that we are competing against are probably core-plus and value-add folks, really essentially competing for the same deals, but with different leverage strategies.

When I look around, where would we allocate capital right now, in DC, with TOPA and the restrictions, DC. probably had its lowest sales volume. The numbers I'm hearing is around $30 million for 2020 in, basically, a multibillion-dollar region.

But I do think there are going to be opportunities in terms of looking at potentially some unstabilized deals in decent submarkets. We always preach research around here. And we follow jobs, and we track the rents and the income demographics and there are decent submarkets. When we're looking at potentially an unstabilized property, those aren't going to have agency debt on those.

There's an opportunity for us to jump in and make a basis bet. But we're definitely committed to continuing our capital allocation to multifamily. We look at what's taking place in the market right now, just in terms of our operating fundamentals. We look at how we drove occupancy and how other operators drive the occupancy using concessions, DC as a region has held up pretty well. We had kind of a tough fourth quarter. But candidly, we like what we're seeing in January, and we think that the traffic has picked up, and hoping that bodes well for the spring season.

Just some other observations, I've been reading the same things other people are about multifamily and how we're going to perform entering into a recovery phase and a reentry phase. We still believe the Class B strategy is the appropriate strategy and has really only been amplified in these times.

People look at DC and they question the supply that's going to deliver over the next couple of years. I'm looking at units that are supposed to deliver in '23. There were 11,000 units forecasted to deliver in '23. On our math and the things that we're tracking, only about 3,300 of those units have been capitalized. And those units are delivering at price points -- Class A price points with a rent gap between our average -- and this is a net effect of our average Class Bs and the net effect of Class As. There's still a $650 gap there. We're through the move-home-to-mom-and-dad phase. We think people are planning on a reentry in 2021, whether it's summer or fall, and that's really driving a lot of the traffic right now.

And with the growth that we've seen in rents in the suburbs, we think that some of the urban and DC. deals are looking, on a relative basis, kind of inexpensive. There are going to be opportunities out there. I never would say it's not going to be competitive. They're all competitive. But it gets back to knowing what markets you want to be in and what price points you want to be at. As you know, we don't really typically utilize debt, while I think the first quarter is going to be slow, we do think we're going to be presented with some multifamily opportunities for the balance of the year.

Q: I appreciate all that color. Were you all active in some of the bidding contests in the 4Q deal flow? And did you find yourselves, if so, far behind? Or it just didn't line up and it wasn't stuff you wanted? Or how did that work?

Paul McDermott - President & Chief Executive Officer

I hate to keep going back to research. But we have a good handle on the markets. Steve basically touched upon this in his remarks. We have an idea of the markets we think are out in front and are going to recover quicker, and that will probably reactivate our renovation pipeline. We have market observations, we're seeing negative rent trade-outs. I'm seeing folks that are winning these deals, growing rents simultaneously at 1% to 3%. We wish them well, we want to be pragmatic about our underwriting. We looked at deals certainly in the fourth quarter. We always look at deals. We were very comfortable when we saw some of the price per pounds that were being ponied up. We were comfortable passing and maintaining discipline and being shot selective.

Q: On the comment about potentially 400 basis points of occupancy pickup, just what's behind that? Is there a set of leases that may or may not go your way? Is there a specific asset that you've got some traction on? Just curious what's behind the 400?

Steve Riffee Executive Vice President & Chief Financial Officer

That's really looking at all our leasing. If you think about what we're experiencing, we're having really good traction on renewals. Renewals are showing that there's conviction, and people are ready to move on that. That's happening already. To get our occupancy gains, it's got to be our new leasing.

We're very confident in terms of the space that we have. It's some of the very best space and assets that we had going into the call. And that's our normal lease-up, including just looking at market color and activity. The question is really for new leasing, will people have the conviction soon enough, that the workforce is ready to return to work and all? We see the conviction happening actively on the renewal front. That's basically reflecting our new leasing assumptions. And for us, it's a when, not an if question. The when is really driven by when schools open, when the vaccine has more widely distributed, when activities return and really companies feeling like they got to get ahead of it. We're seeing it in the apartment side.

We're seeing people now starting to move back in. Our applications are up, getting closer to where they want to work. We're seeing it on the renewal side where companies are saying, we're ready to make our long-term decisions. We just need to see the inflection help with new leasing a little bit. That's the risk for us. It's really a timing risk in terms of whether that will happen soon enough in '21 for us to get the benefit to grow that occupancy. That's the call we weren't ready to make.

Operator

Our next question comes from the line of Blaine Heck with Wells Fargo.

Q: Paul, you touched a little bit on the 60,000 SF of retail leasing you signed in January. First, is there any detail you can give on the rent spreads on that leasing? And second, now that you have longer-term renewals signed on that 10% of the retail portfolio, does that maybe change the pricing profile and make you any more willing to look to sell your remaining retail assets?

Paul McDermott - President & Chief Executive Officer

I don't have the rent spreads right in front of me, but I'm happy to follow up with you after the call. Those were two critical anchors at their respective centers. In terms of changing it, certainly, it changes the risk profile. Both of those centers are in that potential redevelopment bucket. As you know, the Giant at Takoma not only is in an opportunity zone, but it's literally right on the purple line. So that does represent a redevelopment opportunity. Going back to Tony's earlier question, we want to allocate capital. Most of it is, do the rents that we're seeing right now justify new development in that respective submarket, or don't they? Right now, I don't believe the rents are there for Takoma.

I probably said the same for the Montrose Shopping Center. Suburban Maryland still has a couple of bumps, as we're all well aware of. There are people that are starting to put the pen to paper right now, looking at new return-on-cost metrics, looking at forward rents two years from now, and obviously, looking at their land basis. We've always said, these were covered land plays. And I think the optionality that Washington REIT has is does it do it itself or does it sell the dream? That's still where we are. Steve, do you have those rent spreads?

Steve Riffee Executive Vice President & Chief Financial Officer

Yes, I do, pretty much flat in terms of initial cash rent, but we've got bumps in it. So the gap increase is about 15% lease-over-lease.

Q: I know we've talked about this in the past, but just for an update in light of the recent office sales. Just wanted to get a sense of how you guys are thinking about the dividend going forward. Your payout ratio was between 90% and 95% this quarter. You've also talked about recycling more capital out of office and into multifamily, which is likely to be dilutive going forward. So just updated thoughts on the dividend would be helpful.

Steve Riffee Executive Vice President & Chief Financial Officer

We obviously provide our forecast and guidance in the boardroom. We discuss the dividend every quarter, as the Board thinks along with us. We're expecting to cover the forecast -- to cover the dividend in our forecast for the year. The Board is confident that we should keep paying it. We do believe that once we get to a point of inflection, assuming we're going forward through this pandemic and coming out the other side, our coverage ratio should strengthen. There's been no thought or discussion of cutting the dividend, honestly, in our Board discussions.

Operator

Our next question comes from the line of Dave Rodgers with Robert W. Baird.

Q: I wanted to talk about the Class B rent gap. I think it came up maybe a couple of times in a variety of the comments. But can you maybe dive down a little bit deeper? And maybe this is for Grant as well, in terms of kind of the Class B rent gap. I think you said it's getting wider. And I would think that given the decline in rents and kind of the pandemic, we would see compression in those numbers. I wanted to give you the chance to clarify, maybe both on the multifamily side and then within the office component as well.

Grant Montgomery – Vice President, Head of Research

The comments in the note or our script said that we had some compression market-wide throughout 2020 that had started to flatten out in the fourth quarter. There was no longer compression at the market level. At the submarket level, which we are watching very closely as part of our ongoing analysis of when it will be the right time to turn renovations back on, there is quite a bit of variety in terms of the rent gap so that some submarkets are widening, and that gap is growing because we are getting rent growth in those, particularly in some suburban locations.

Some of the submarkets, that's actually sort of how we chose our submarkets to begin with, and that we chose submarkets that had a greater-than-average rent gap. So even the ones that we've had some compression in, we have 350 basis points greater gap in some of our submarkets like Columbia Pike, where The Wellington and Trove are located, than you would have in market-wide. We're watching that closely. It's flattening out at the market level and is not compressing further as it had. In some markets, we are seeing it go the other way in a positive direction.

Q: Maybe just a quick follow-up on that before talking office, is just suburban versus the urban component of where that compression has been. Is there a way to generalize between the two of those without going each submarket by submarket?

Grant Montgomery – Vice President, Head of Research

I don't have the exact number in front of me, but if the average for the region is around 20%, I would say it's wider in the submarkets in the suburbs, where there has been less decline in Class A than there is Class B. I think over the course of the pandemic, B has outperformed A by about 230, 240 basis points. That would probably back into the difference there between those rent gap levels.

Q: Thoughts on the office component, how the rent delta is compressing within and around the district?

Paul McDermott - President & Chief Executive Officer

I'd like to look at it pre-pandemic and what we're currently seeing, if I were to look at large deals in the Class A space, probably pre-pandemic, a TI package was let's say, $110 a foot. Today, it could be anywhere from $130 to $140. Free rent probably was right on top of a month per year. Today, it's probably 1.25 to 1.5 months per year term. You have your unused TI conversion, which has probably gone from 10%, maybe upwards to 20%. We're not really seeing those types of lifts. I think we've seen less slippage in the Class B space.

More importantly, just like in the multifamily space, it's about retention. Just reading with JLL, their deck in retention renewals in Northern Virginia were up 1/3. It can be more economically viable for both the tenant and certainly for the landlord. We're really focused on renewals especially in the B space and looking at our portfolio, we're playing in that 4,000 to 6,000 SF range. We're not really competing for those hefty TI packages and big free rent packages. I think tenants are very savvy, and they're going to obviously try to negotiate the best deal possible. But there's definitely a spread for the big, renovated A's and trophies that have to achieve occupancy and what they're willing to do to buy occupancy in the Class B's. We have an adequate delta between Class A rents and Class B rents in the region.

Q: You mentioned the two renewals, B. Riley and Sunrise. Can you talk about the tone of those conversations? It sounds like some flexibility was important in at least one of those deals. But talk about maybe the economics and how those shook out at the end.

Paul McDermott - President & Chief Executive Officer

Sunrise, we've been talking about pre-pandemic. We applaud them in terms of their decision-makers coming back, having a workforce strategy and putting the pen to the paper. It was a competitive bid situation. Flexibility. When we talk about flexibility, we see tenants that are operating in the space that are recognizing that it's a tenant's market right now, making workforce strategy decisions. In terms of flexibility, we're seeing more folks requesting a partial termination option in a future lease. Not that they're going to exercise it, but that they definitely want that at their disposal in case their model requires some type of shift in operating expenses.

B. Riley is committed to the space. But looked at their model and said, we have an option to give back a floor. That's what they've done. Fortunately, not that there are bad floors, but there was a good floor in Arlington Tower. It was immediately picked up by a full-floor user. The situation we have with B. Riley is that user will do their sublease to the point of the termination option, which I believe is December '22. That user will have a primary lease with WashREIT through 2029. Again, we're not seeing tenants saying, they want to get back half of their space. What they're looking for is optionality going forward based on how protracted or not a recovery can be. Those have been the discussions. We haven't seen huge redesigns, we have not experienced that in our portfolio to date.

Q: Steve, you mentioned using the ATM. Can you talk about when and how you're looking at using that going forward in terms of adding capital to the balance sheet?

Steve Riffee Executive Vice President & Chief Financial Officer

We looked at the opportunity to continue our capital allocation. First of all, we wanted to strengthen the balance sheet. We can't time everything at the same time so we wanted to get the office sales executed that we felt were good and could get executed. We did just a little bit of ATM, I think somewhere around 2%. It's just a small sliver of capital. But we wanted to go into 2021 with a strong balance sheet as we could until we had more visibility for the inflection that we think we have spring leasing seasons. The pandemic is going to give us a lift.

We wanted to be as strong as possible when we finally have that visibility. We're not planning on using it or going to the ATM at this point. We wanted to go into '21 and decide how much conviction we had on visibility. We're also monitoring what's happening. We like the multifamily business. I'll make a comment or two in terms of what we were observing. We did have some investor meetings on the road at the end of the year. October and November were good months for us still. I would say the leasing season extended a little bit into the September, October months. For us, it looks like December was the bottom from a multifamily standpoint -- it's the winter months.

Fortunately, we only had about 20% of our portfolio expiring at that time, and we have about 2/3 in the summer. But we saw December was tough, and our focus was on maintaining and then starting to push occupancy. That really helped us. We commented on it in our prepared remarks. But we didn't think it made sense to push our two rent-controlled assets. For everything else, since year-end, we've got it up to about 95%. And that is getting to the point where we can start to burn off concessions, start improving effective rents. We saw in the month of January, a 300- basis-point improvement in effective rents for new leases, which is the right trend. As we look at our early indicators, renewals and the leases getting signed in early February, it looks like February, March are improving in the right direction, both from an effective rent standpoint and as I've said, we've improved our occupancy, we feel good about that.

When I think about January versus the fourth quarter, if December was our toughest month, and I look at January, it's better than December. And in fact, January is already kind of to the average of the fourth quarter, which had two better months. And if February and March are truly trending as they seem to be trending, then hopefully, the first quarter will be better in all. About our guidance, we saw the winter coming and we outperformed our fourth quarter multifamily guidance from a same-store standpoint and from an NOI standpoint. And hopefully, we'll prove to be conservative in the first quarter. But we're just going to have to see. In terms of the other inflection points, as I said earlier, it's when will things happen soon enough and how much will they benefit '21.

Operator
Our next question comes from the line of Chris Lucas with Capital One Securities.

Q: On the Sunrise renewal, did you provide the duration of that renewal?

Paul McDermott – President & Chief Executive Officer
It's 7 years.

Q: The one sort of nearer-term lease that you haven't talked about is the Capital One expiration, which I guess is first quarter of '22. Any movement or conversation there? And what do you see as sort of things that you need to see in order to get a response out of them?

Paul McDermott – President & Chief Executive Officer
We are having dialogue and broker to broker and head of real estate to WashREIT. The only thing tangible, that I think has happened in the last 90 to 120-plus days is just them executing. They're in three buildings, as you know, in Tysons outside of their main campus and them executing a short-term extension at one of the buildings. We are hearing that same type of activity may be coming our way. But that's obviously one we've all got our eye on. But to date, we have not traded paper since the beginning of the year.

Operator
And if there are no further questions, I'd like to turn the floor back over to management for any closing comments.

Paul McDermott – President & Chief Executive Officer
Thank you. Again, I would like to thank everyone for your time today, and we look forward to seeing many of you at the upcoming conferences over the next several weeks.