

**Transcript of
Washington REIT
Second Quarter 2020 Earnings Conference Call
July 29, 2020**

Participants

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

Analysts

Bill Crow – Raymond James
Blaine Heck – Wells Fargo
Tony Paolone – JP Morgan
Dave Rodgers – RW Baird

Presentation

Operator:

Welcome to the Washington Real Estate Investment Trust Second Quarter 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 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, that 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 Riffée, 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. Thanks for joining us on our second quarter earnings call.

We delivered strong second quarter financial performance against the backdrop of the ongoing economic disruption, highlighting the resilience of our portfolio. As our local economy gradually reopens, our primary focus continues to center around the health and safety of our residents, tenants, employees and their families. Over the past several months, WashREIT created and implemented a comprehensive re-entry plan to mitigate the spread of COVID-19 at our properties. We connected with our office tenants through personalized outreach to understand their needs and discuss our approach to make sure that they are comfortable with the protocols that we have implemented. We are fortunate to have not experienced material bad debts to-date, yet alongside re-entry planning, we've been diligently working with tenants who have been financially impacted by the economic shutdown to discuss and finalize deferral arrangements. As of today, we are pleased to report that we have substantially completed that effort.

There is no doubt that these are trying times. However, we have adjusted to the new demands of today's operating environment and have taken swift and deliberate action to protect and support our residents and tenants. I could not be more proud of the dedication shown by the WashREIT team during this challenging period. Furthermore, these times have highlighted the importance of social fairness, equity and justice and our company has responded with a re-focused commitment to improving diversity, inclusion, and belonging within our company and our community and creating long-lasting, positive change.

As we enter the second half of the year, we are increasingly confident in the resilience of our region, and likewise, our portfolio. Our Washington Metro focus provides economic stability compared to other major metropolitan areas. This is true both historically and during the current downturn, as the Washington Metro area continues to experience fewer job losses since the pandemic hit than other large metro areas and the US overall. Washington Metro employment declined 9% during the second quarter compared to over 11% for the US overall.

A recent analysis completed by Delta Associates determined that the Washington multifamily market is better positioned to weather a down cycle than nearly all of the nation's other large metropolitan areas. This is due, in large part, to the presence of the Federal Government and the corresponding stability of the Professional/Business Services sector, which together comprise 46% of the DC Metro economy compared to 25% for the 30 largest metro areas. Furthermore, our Professional/Business Services sector is more heavily weighted toward the Professional, Scientific and Technical subsector, which has fared very well during this crisis and generated year-over-year job growth of 1.6% in June. This sector is expected to bounce back much quicker than other sectors and continues to be the primary private job creation source in the region over the long-term, according to Delta Associates.

Unsurprisingly, the Federal Government sector has been the least negatively impacted by the pandemic thus far. Many Federal agencies actually received a funding boost which could lead to additional hiring, especially at critical agencies such as the SBA, NIH and FDA. Government contractors have seen \$1.2 billion in contracts awarded year-to-date that are directly tied to the COVID-19 response, according to JLL.

Employment trends for the regional Information sector reflect limited disruption, and major tech industry investments— including Amazon’s HQ2 campus construction and Virginia Tech’s Potomac Yard campus— continue without disruption.

The Washington Metro area led the country in Q2 leasing activity driven by 1.6 million SF of positive net absorption in Northern Virginia. Despite the stay-at-home orders, office leasing activity in Northern Virginia declined only 12% in the second quarter compared to the five-year trailing quarterly average, according to CBRE. Over half of the leasing activity in Northern Virginia was driven by government contracting services. Government contractor awards are up 4% year-over-year due to the government’s response to COVID-19. Tech and government contracting drove 60% of our office leasing volume in Northern Virginia last year, and looking forward, we expect demand from these sectors to continue to grow.

Unsurprisingly, Washington DC office leasing activity has slowed more than it did in Northern Virginia due to lower momentum leading into this downturn. However, the impact of local job losses for office-using sectors in DC has been limited, with no office-using sector losing more than 5% of the total workforce during the second quarter according to BLS data. Additionally, the number of tours increased substantially in July. We expect our DC office portfolio to act defensively against this backdrop.

Maryland, Virginia and DC each took a phased approach to re-entry, beginning at the end of May. DC and Maryland are currently in Phase 2 with limited re-openings of shops and restaurants and Virginia is in Phase 3, which has allowed all retail and public services to resume with social distancing measures in place.

With the implementation of phased re-entry protocols, we are seeing increased activity across all of our asset classes.

Multifamily touring and application volumes have increased threefold from early April for both our same-store and non-same-store assets and same-store applications are trending above prior year levels.

Following the closure of our leasing offices, we took advantage of our virtual touring capabilities to continue leasing in April and May, and once social distancing requirements were eased locally, we began offering self-guided tours in June. Just recently we have opened our multifamily amenities and common areas and started offering in-person tours with additional safety precautions.

The lease-up of Trove continues to progress and is expected to reach stabilized occupancy in the fourth quarter of 2021. While the economic shutdown has impacted the original expected pace of lease-up, we averaged approximately 16 leases per month during the second quarter and expect to reach breakeven levels of occupancy by year-end followed by steady quarterly NOI growth thereafter.

Our total lease rate growth for the quarter was a positive 40 basis points, which combined with our sequential decline in ending occupancy of less than 80 basis points for our stabilized properties, demonstrates the resilience of our value-oriented multifamily portfolio. Lease rates for our non-same store portfolio, which include strong

performance from our Class B suburban communities, grew over 2% during the quarter on a blended basis, comprised of 2.6% of renewal lease rate growth and 1% of new lease rate growth. Our suburban garden-style apartments offer larger unit sizes, open-air hallways, and less density compared to mid or high-rise buildings, allowing us to participate in the increasing demand for these qualities over the near-term in the wake of the pandemic. Over the long-term, the expansion of our multifamily portfolio to growing suburban markets in the DC Metro suburbs positions us to capture an increasing share of regional household formation and job growth.

We began to experience an uptick in utilization at all of our office properties toward the end of the quarter, although, most notably at our Northern Virginia office assets, as Northern Virginia is now in Phase 3 of re-opening.

In preparation for the repopulation of our properties, we prepared a detailed property re-entry plan that emphasizes employee and tenant health and well-being as top priorities. We have reached out to our tenants to discuss the plans and protocols that we have put in place. The feedback regarding our collaborative approach has been very positive, and in many cases, we've strengthened our relationships with our tenants.

We have upgraded our office buildings to MERV-13 ventilation filters, which is the standard for superior commercial office buildings, installed directional safety practice signage, contactless opening technology and protective shields around front office desks, in addition to a variety of other measures taken to facilitate safe re-entry. We have also established enhanced cleaning protocols that include more frequent cleaning and the use of electrostatic cleaning machines and have developed elevator and common area safety protocols designed to mitigate the risk of virus transmission.

Our tenant experience app, "&You," which we began rolling out in January, has kept us connected with many of our tenants despite working remotely. The concierge program has continued to provide a wide range of on-demand services and partnered with local vendors and farmers to provide grocery and other essential deliveries. We could not have picked a more critical time to roll out this technology to assist our tenants both professionally and personally during this challenging time.

Our Space+ program has allowed us to meet changing tenant needs more efficiently with flexible lease terms. Our spaces offer tenants quick move-ins, all in pricing, flexibility for short- and long-term planning, as well as privacy and independence – not just for brand building but now, more importantly than ever, for control over the health of the tenants' office. All of our Space+ tenants have control over their own private space which is becoming increasingly important in this COVID-19 environment.

In an environment where many tenants are moving slower on larger and longer requirements, flexibility is key, and Space+ is playing a crucial role in meeting tenant needs.

We entered 2020 expecting to see sequential quarterly growth driven by renovation-led value creation and commercial lease commencements. While the pandemic has disrupted the timing of that growth, our key growth drivers remain intact.

In multifamily, we have positioned our portfolio to retain the growth drivers so we may capture that value for our shareholders as normal activities and opportunities return. We've allocated capital to Class B properties in submarkets with wider than average gaps between Class A and Class B rents and limited competitive supply, which sets us up for a quick recovery and preserves the value-add rent growth from renovations for the future. Through our 2019 strategic allocation, we have increased our renovation pipeline to over 3,000 units which represents five years of growth at compelling return on costs.

While most of our portfolio does not directly compete with new supply, deliveries in Northern Virginia, where 80% of our multifamily portfolio is located, are expected to decrease by 24% over the next 12 months. Furthermore, the pandemic will likely cause delays in projected construction starts in the second half of 2020, which will reduce the number of deliveries in 2022 and into 2023. Overall, there is an acute housing shortage in the Washington Metro region and our in-house research affirms our confidence that growth opportunities are still ahead of us.

We also have a tremendous opportunity for growth having substantially made the capital outlay for the Trove with Phase 2 delivering in a couple of months. While the disruption certainly changed the initial pace of lease-up, we expect to reach a break-even occupancy level in the fourth quarter and thereafter achieve quarterly sequential NOI growth through stabilization in 2021 and into 2022.

In the office portfolio, our embedded growth is comprised of future commencements for high quality space at value-oriented pricing and move-in ready space with flexible lease terms. We expect signed leases to continue to occupy, and we expect to benefit from higher occupancy in the fourth quarter and throughout 2021. Many of our speculative leasing opportunities, for which we had excellent momentum before the pandemic hit, are located in our best assets including Watergate 600, Arlington Tower and Silverline Center, as well as, our Space+ program which is positioned well to meet demand in these early, cautious transition months.

While physical touring did pause, it is now resuming, although, decision making remains slower than normal while re-entry is being worked through by prospective tenants. We believe those leasing opportunities are a matter of when, not if, they will commence.

And with that, I will turn it over to Steve to review our collection performance, balance sheet, second quarter results and our 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 second quarter results and outlook for the remainder of 2020.

Our multifamily collections continue to be very strong, which is a testament to the resilience of our submarkets and industry mix, and low average rent to income ratio of 26%.

We collected over 99% of cash rents during the second quarter, and over 99% of contractual rents, and our rent collections through the first three weeks of July have been strong also.

While we are offering deferred payment programs to residents who have been financially impacted by the pandemic, to date, deferrals have been relatively low, representing less than 0.4% of total monthly rental income on average.

Our monthly multifamily collection performance continues to track above National averages. We collected 99% of cash rents in June compared to 96% per NMHC.

We attribute our outperformance, in part, to high exposure to industries that have outperformed during this crisis and lower relative exposure to underperforming industries.

The impact of COVID-19 on the Washington Metro market has been contained primarily to three sectors, representing approximately 75% of Washington Metro job losses, while the impact has been more broadly spread across a wider range of sectors in the US overall, as those same three sectors represented less than 60% of total losses nationally through June. Thus, the US overall is experiencing job losses that are spread across more industries than our region.

The Washington Metro market's relative strength reflects the stability in business revenue provided by technology and federal contracting. 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.

Turning to office, we collected 97% of cash rents during the second quarter, and over 99% of contractual rents, which excludes rent that has been deferred. As of July 22, our collections for July are in line with the same period in June.

Similar to our multifamily resident industry mix, our office tenants are relatively weighted to the stronger economic sectors than the US overall which has helped us experience limited bad debt thus far.

We have agreed to defer \$1.2 million of rent for office tenants and we expect to collect over 85% of that deferred rent by year-end 2021, with the balance thereafter.

We believe our efforts to substantially de-risk our portfolio by selling all single-tenant office assets and 75% of our prior retail exposure including all of the power centers, and re-allocating that capital to our multifamily portfolio is certainly proving its value in these economic times. Retail now comprises just 6% of NOI and while retail tenants have struggled the most, we collected 72% of retail rents in the second quarter. Excluding deferred rent, our collection rate was approximately 90% during the second quarter, and 91% during the first three weeks of July.

Year-to-date, we have only incurred approximately \$770,000 of bad debt expense related to retail tenants, and \$638,000 of that amount was related to COVID-19. We will continue to monitor their strength and ability as the economy progresses.

We have agreed to defer approximately \$1 million of rent for retail tenants and we expect to collect over 50% of that rent by year-end 2021. This assumes that our region continues to gradually reopen through year-end.

To date, we have not incurred material bad debts related to COVID-19. Overall, we have only deferred a small portion of rent and the expected cash NOI impact is less than a penny per share through year-end 2021.

While we have possibly experienced the most disruptive part of the pandemic, uncertainty regarding its duration and future impact remains. We currently believe the second quarter represented the most challenging quarter; however, future and ongoing economic disruption could result in bad debts greater than what we have incurred to date. We will continue to monitor future developments and proactively address them as they occur.

Turning to the balance sheet – we have a strong liquidity position with approximately \$530 million of available liquidity as of June 30 and no significant capital commitments for the balance of the year and no remaining maturities in 2020.

As of June 30, our net debt to EBITDA ratio was 6.1x, at the lower end of our targeted range. We prepaid our \$250 million 4.95% bonds in early April and we can go to the capital markets to further term out debt when it makes sense to do so. We expect to remain well within our bank and bond covenants and have access to our mostly undrawn line of credit if needed.

Based on our current projections, we have reduced 2020 assumed capital expenditures for the year by approximately \$40 million compared to our initial 2020 guidance. Included in this amount is almost \$30 million of lower assumed capital expenditures and \$11 million less in development spending as we no longer expect to break ground on the Riverside development this year. Our capital expenditure reductions include non-essential building improvements, tenant improvements and leasing costs for speculative leasing, as well as lower multifamily renovation CapEx.

Our future multifamily renovation pipeline remains intact, although, we are suspending the program until after the market disruption subsides. We plan to allocate the renovation capital at a later date when the market allows for rent increases to deliver the appropriate ROI.

As we navigate through the second half of the year, we will continue to explore opportunities to further reduce non-essential CapEx spending to further bolster our liquidity. Looking forward, we feel confident in our ability to execute on our short-term goals of providing payment flexibility to residents and tenants in need while retaining the operational flexibility necessary to execute on our long-term goals.

As Paul mentioned, we posted a solid second quarter despite the challenging operating environment. I will discuss those results before addressing our future outlook.

We reported Core FFO of \$0.39 per diluted share.

Overall same-store NOI declined 4.5% year-over-year on a GAAP basis and 3.5% on a cash basis due to a same store office NOI decline of 4.8% on a GAAP basis and 3.7% on a cash basis, as well as, bad debt expenses related to COVID-19 of approximately \$720,000. The same-store office NOI decline was driven by expected decline in parking income, as well, an increase in bad debt expenses related to COVID-19. Excluding the decline in parking income and increase in bad debt expenses compared to our prior 2020 expectations, same-store office NOI would have increased slightly on a year-over-year basis.

Our multifamily same-store NOI increased by 0.7% year-over-year on a GAAP basis and 0.8% year-over-year on a cash basis. The Company achieved 40 basis points of blended year-over-year lease rate growth driven by strong performance from our suburban assets in our non-same store portfolio. Same store new lease rates declined by just under 4% while renewal rates increased by over 1.4%, reflecting blended lease rate decline of approximately 40 basis points. Non same store lease rates grew over 2% during the quarter on a blended basis, comprised of 2.6% of renewal lease rate growth and 1% of new lease rate growth. Our same-store multifamily portfolio is currently approximately 94% occupied and our total stabilized portfolio is over 94% occupied and 97% leased.

Same-store NOI decreased at our residual retail centers, which we report as 'Other', by 24.6% on a GAAP basis and 22.1% on a cash basis driven primarily by higher credit losses which included amounts due from tenants impacted by COVID-19 deemed not likely collectible and lower recoveries compared to the prior year period. The combined write-off impact of COVID-19 in the quarter was approximately \$560,000 which included straight line rents and lease intangibles and the cash impact was approximately \$335,000.

Turning to leasing activity for the quarter, while velocity and touring was hit by the economic shut down, we signed approximately 20,000 SF of new office leases and 15,000 SF of office renewals in the second quarter.

We achieved rental rate increases of 0.8% on a GAAP basis and negative 2.3% on a cash basis for new leases and 19.4% on a GAAP basis and 1.9% on a cash basis for renewals.

The impact of operational cost saving initiatives reduced operating costs by approximately \$848,000 during the second quarter net of tenant recoveries and expenses related to preparing our office buildings for re-entry. Second quarter operational cost savings primarily included reduced utility consumption, lower R&M, security expenses, and lower tenant event and amenity expenses relative to our original forecast.

Now I'd like to discuss our financial outlook. We are now four months into the pandemic and while we are not in a position to predict the ongoing magnitude of the pandemic or durability of the recovery – we believe that we are

able to forecast, subject to certain caveats, the impact of COVID-19 for the balance of 2020 on our NOI and interest expense exclusive of future bad debt.

Today, I will describe the impacts that we are experiencing on various financial performance metrics. Our expectations are based on the assumption that the gradual reopening will continue, uninterrupted, through year-end.

Multifamily occupancy dipped to 94% in June and has remained stable through July. With the easing of confinement measures and increased staffing in our leasing offices, we've seen touring and application volumes increase substantially. Total application volumes have increased by 3x from early April lows and same store-applications have trended over 30% above prior year levels since the end of May. We expect the continual increase in leasing volume to drive a gradual increase in occupancy to 95% by year-end.

We did not increase rents on 12 plus month renewals for the second quarter which impacted our NOI growth as we normally would be achieving significant rent increases during the strong second quarter leasing season, especially since we had such strong lease rate growth in March. As a result, we experienced an increase in renewal retention to 60%. While this higher renewal retention has helped to maintain occupancy and preserve our seasonal rent roll during these uncertain times, it did not fully offset the impact on occupancy from lower new leasing volumes.

Lower new and renewal lease rate growth, as well as, lower move-in and other fee income were partially offset by operating expense saving initiatives during the second quarter. The majority of the expected full-year impact of operating expense savings related to COVID-19 was recognized in the second quarter.

Excluding the impact of bad debt, we expect the impact of COVID-19 on our multifamily NOI to translate to a reduction of approximately \$0.03 per share relative to our initial Core FFO guidance for 2020.

Overall, we had previously expected significant multifamily growth in 2020 and that growth is likely now going to be deferred until 2021 and thereafter. As Paul said, we have a five-year pipeline of value-add renovations once conditions improve and it is appropriate to resume such growth, and we still expect future NOI growth from Trove, which I will cover next.

Trove is on pace to deliver Phase 2 in the fourth quarter. Our lease-up had just begun when social distancing measures drew on-site touring to a halt, however, we have been successfully converting virtual tours into signed leases. While virtual touring is having continued success, we expect lease-up to take longer than we had originally guided and are likely to incur a loss of between \$600,000 to \$700,000 in 2020, which translates to a negative impact on Core FFO relative to our initial guidance of approximately \$.01 per share. As Paul also said, we expect to reach breakeven occupancy near this year-end and to reach stabilization in the fourth quarter of 2021. Therefore, the Trove should not only provide substantial growth in 2021 but also further year-over-year growth in 2022.

Now moving on to commercial. Tenant improvement buildouts for near-term lease commencements are expected to continue uninterrupted. We have over 55,000 SF, representing approximately 150 basis points of future increase to occupancy, of signed leases that have not yet rent commenced. Although physical tours had stopped, they resumed toward the end of the quarter and have substantially increased through July to just below pre-COVID-19 levels. Overall decision making has been slower as the pace of phased re-entry has, in many cases, allowed prospective tenants more time. Additionally, we are in lease extension negotiations with a handful of tenants who were previously expected to vacate.

Our previous revenue expectations for 2020 included speculative office lease commencements that have been impacted by the current economic disruption and are now likely to be substantially executed in 2021 for leases not signed as of today. The majority of this leasing was expected to occur during the third and fourth quarters at high-quality space across Watergate 600, Silverline Center, Arlington Tower and Space+, where leasing momentum had been the strongest.

We expect the impact of lower speculative leasing to be only partially 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 to our internal leasing estimates. Office lease expirations represent approximately 4% of our office revenue and less than 2% of our overall revenue, and as many tenants are opting to delay long-term decisions, short-term lease extension and renewal activity could trend higher as the year progresses.

Parking revenue is down as people are not driving to their offices. Our current projection is that that parking revenue will decline by over \$1.3 million over the remainder of the year, however, that estimate could change if the shutdown is more protracted than we have assumed. Likewise, once the economy returns, we could experience an increase in parking income from higher utilization as tenant transportation preferences shift away from public transportation. We are already seeing signs of increased transient parking at many of our properties.

Currently we are assuming that we may achieve additional operating cost savings of approximately \$750,000 for the balance of the year assuming a gradual increase in office utilization over the remainder of the year. 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.

Excluding future bad debt, we expect the impact of COVID-19 on our office and other NOI to translate to a negative impact of approximately \$0.08 per share relative to our initial Core FFO guidance for 2020. Most of that impact will occur during the second half of the year as we previously expected a ramp up in that time frame that we now expect to occur throughout 2021.

Offsetting a part of the negative impact of COVID-19 on our business is a reduction in our expectations for interest expense by \$0.04 per share relative to our initial Core FFO 2020 guidance excluding any future re-financings to further term out debt.

On a combined basis, we expect the impact of COVID-19 on NOI and interest expense to translate to a negative impact of approximately \$0.08 per share relative to our initial guidance for 2020. We are not updating other guidance assumptions at this time. The majority of the impact will occur during the second half of the year as we previously expected a ramp up in that time frame that we now expect to occur throughout 2021.

Overall, we are actually slightly ahead of our original budget for the first six months of 2020 despite going through a historically challenging four-month period. As we have just explained, much of the growth we had planned for the second half of 2020 appears to be deferred but we believe still intact for the future.

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 are confident in our ability to effectively manage through this period of uncertainty while preserving the embedded growth of our assets. Our value-oriented portfolio has demonstrated resilience as we absorb the near-term impact, which is further underscored by our strong rent collection performance and the proven stability of the Washington Metro economy. Furthermore, our sustained multifamily lease rate growth and stabilizing occupancy trends highlight the value of our research-driven capital allocation strategy, which has led us to invest in well-located residential units that will be in the path of growth once the economy resumes.

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. If you would like to ask a question, please press star one on your telephone key pad. A confirmation tone will indicate your line is in the question queue.

You may press star two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys.

Our first question comes of the line of Anthony Paolone with JPMorgan. Please say your question.

Q: Thank you and good morning. My first question is with regards to the multifamily portfolio. Can you give us a sense as to what happened to market rents in the last say month or two or where your new lease spreads are trending right now?

Paul McDermott - President and Chief Executive Officer:

In the overall portfolio we're seeing concessions rise in the market but not materially. The market has become more concessionary as properties open up, and I'll just give you an example.

Throughout our portfolio depending on the respective submarket we've seen concessions range from \$250 to one month, and the largest concessions we're seeing are really at Trove and the markets move from one month to two months free.

We're also offering up to three months for a 24-month deal at the Trove. I don't see that materially changing in the future, and in terms of spreads?

Steve Riffie – Executive Vice President and Chief Financial Officer:

We did well in the second quarter. We've now started in August increasing rates of renewals for 12-month plus leases that we were holding flat.

We're doing OK on new lease rates in recent weeks although I will say for us we're going to emphasize holding occupancy and keeping our lease maturity ladder intact, so we might have a little bit of trade off on new leases. So maybe in the most current month they blend a slightly negative of new renewals, but we feel they're holding very well and when we look on a relative basis we think things are going well.

Q: On the office side – I know there's not a ton of volume, but any color on what's happening there with net effective rents or how those tenants that may be in the market are paying in terms of what they'd like to see to get a deal done?

Paul McDermott - President and Chief Executive Officer:

A better fact pattern to really articulate the second quarter overall what we're seeing in the market in terms of leasing are a lot of short-term, a lot of two to three-year deals with extensions. Definitely seeing a bit of an outmigration from coworking.

DC proper activity probably dropped 50% in the second quarter in terms of leasing volume. I can't really provide you a great track record there. I think the thing we were probably most impressed about in this region was Northern Virginia leading the US with 1.6 million SF absorbed.

I would also comment that in July both in downtown and in Northern Virginia our traffic and our velocity picked up notably, and we hope that a lot of that will crystallize for us.

I'd say realistically, it's probably post-Labor day, that's what we're getting from a lot of our tenants when we think there's going to be a lot more decision makers wading back in, but we're optimistic about the balance of the year.

Q: I know it's early, but just anything on the investment sale side or any commentary on early indications of price discovery or anything being brought to market?

Paul McDermott - President and Chief Executive Officer:

Let me split that between about office and multifamily. On the office side, very low volume, obviously interestingly, I've seen some single tenant credit deals where we see some investors trying to play the spread to fixed income.

Seeing a lot of recaps versus selling into this market right now, the key for investors and lenders in the capital market's execution has to be there, but it's just the weighted average lease term, and what we're hearing both from lenders and equity folks, they're looking for seven-plus years on that.

I think the big challenge right now, we haven't really seen a lot of multi-tenanted buildings come to the market, it's the lack of traditional A-note buyers. I think the good thing I would observe over the last 90 days and especially talking with the lenders is there hasn't been any motivation on the lender's part to take any of these assets back.

They are working with deferral plans for their borrowers to try to do some type of bridge. Multifamily, a bit of a different story, obviously, with Fannie and Freddie being aggressively open for business. I think the biggest challenge – and we have seen definitely more multifamily deals hit the market in the last 60 days, and just talking to folks, a definite notable pickup in BOV activity, probably with the top three brokerage firms in this region.

The feedback we get is really the first two years are the challenging underwriting, and people are always trying to make up for those first two years, and then people are incorporating I'd say 2023, '24, '25, we're seeing rent spike being implemented between 5% and 8%, but the convergence really over the last 30 to 60 days has been around a five-cap.

We've seen old deals that probably withered away pre-COVID, being dusted off and relooked at, and seeing some small off-market activity. But like I said, the debt some of these folks are getting sub-three, so investors are clipping an 8.

In DC, I think the biggest challenge you're going to see as far as turnover in product is, we have to go through a TOPA process and you can't submit TOPA until October 12, which is where the mayor extended the state of emergency to, so that's really – tap the breaks there.

In Northern Virginia, not seeing any slowdown in the appetite for people with investors still looking at that long-term bet that like the Amazon renter changes the footprint. But both on the commercial side and on the multifamily side, we've gotten plenty of feedback that there'll be a lot more product moving to the market post Labor Day.

Operator:

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

Q: Just a follow-up on my last question, do you think the fallout from the pandemic ultimately increases the spread between office cap rates that you'll be selling at and the multi-family cap rates that you'll be buying?

Paul McDermott - President and Chief Executive Officer:

I think to monetize assets in this environment, especially office environment, people are good – both lenders and investors are going to be looking for duration. I think we're fortunate to have that at a number of our assets if we choose to do that execution. I do think when the dust does settle that you will definitely be seeing more activity in the multifamily space.

There's still a lot of capital out there that was on the sidelines prior to COVID-19, and just recently over the last 30 days I've seen activity and pricing, people definitely becoming a little bit more aggressive. It's really the separation gate is how you're underwriting years one and two in multifamily. But I would expect it to be, again with the assistance of Fannie and Freddie, I would expect to see a competitive fall for multifamily product in the region.

Q: Your retail and other allocation has decreased a lot over the years, down to I think 6% of NOI now, but it continues to be a little bit of a drag on the rest of the portfolio and results seem to be getting worse as COVID disrupts those businesses even more.

Can you just talk about your plan for that portfolio, does it make sense to try to dispose of the risk as soon as possible or do you think it's best to hold onto what you have in the hopes that you can backfill any sort of moveouts that you have and maybe get better pricing after the crisis?

Steve Riffie – Executive Vice President and Chief Financial Officer:

It is 6%, and we've had less than a penny share of bad debts, and when we look at what we contractually looked at, we've collected 90% there so it's really not that big a drag and it's some of our best retail assets.

There's probably not much of a market right now, I'll let Paul comment on that in terms of trading retail assets, but these assets we kept because they also have the ability to be eventually converted into multifamily and other mixed uses. So there's more than one path to some of those assets.

Paul McDermott - President and Chief Executive Officer:

I'd say that the thing that's probably changed is obviously a pretty small pipeline of retail investors out there right now, and we're obviously sensitive to a delusion. I think first and foremost we're happy we got rid of our riskiest assets with the most lease turnover last year.

As Steve said, over half of the assets inside of that 6% had redevelopment potential, i.e. Randolph, Montrose, Takoma and Chevy Chase Metro and in very good locations and I think that we're comfortable with that. We're actually working pretty well with our retail tenants right now and I'm comfortable of some of the programs that we've implemented with them.

But also due to the quality of the locations if we did have some move-outs I'm also equally comfortable with our ability to backfill the space. So retail given that it's only 6% is a manageable situation.

Operator:

Our next question comes from the line of Dave Rodgers with Baird. Please proceed with your question.

Q: Maybe two on office. The first is it sounds like Northern Virginia is recovering a little bit faster by parking or any of your internal systems are you able to determine what percentage of employees are back in the office or where utilization has gone to? What has been your experience with Space+ in the current environment with collections, renewals if you have any that are far enough along? New demand for that product?

Paul McDermott - President and Chief Executive Officer:

First in terms of Northern Virginia and occupancy levels. Northern Virginia, you know we obviously through our fobs we track activity. I think Northern Virginia got up over 20% first. We've seen that dial back a little bit and I attribute a lot of that to we're in the month of August and I think some folks are candidly just kicking the can until past Labor Day.

DC a little bit different, DC probably peaked in the 12% to 15% – we think that is probably going to remain at a lower occupancy level than Northern Virginia. I'm comfortable saying that the activity in terms of that people coming back we want that to translate into leasing activity. And two of the three assets that we're focusing on are Arlington Tower and Silverline Center, some of our best assets with some of our best space.

We're optimistic that that will turn into something post Labor Day just in terms of execution. The second part of your question was Space+. We've talked to a lot of tenant reps and a lot of the larger shops both on the agency side and the tenant rep side here. Definitely seeing a bit of out-migration out of the co-working space.

Folks looking for their own identity. As I made comments on earlier on leasing, Space+ really is kind of a slipper fit for people looking for two to three year terms with flexible leasing. Not only that but they also get to create their own identity and most importantly in this environment they get to control the protocols in their own space.

The first deal that we did at 2000 M Street was this Space+ execution that I believe was coming out of WeWork and we expect that trend to continue. I don't believe we've had any real material rent hiccups in the Space+space.

Steve Riffie – Executive Vice President and Chief Financial Officer:

Not at all. The key words are flexibility. People are slow to make longer term decisions, so Space+ fits it really well.

It fits for those that are worried about the health of the environment that they've been in, so they can have their own independence sweep and it can be healthy; and they don't have to interact like in co-working with others and it allows people who have longer term needs to get started on the short term basis.

The fact that we have Space+ in some of our best assets available is actually helping and it might even see longer term lease decisions after that.

Q: One on the multifamily side. The 3,000 units over 5 years, I understand taking a pause here; but as you talked about starting to push rent a little bit here into August as you guys talk about the confidence just in the broader economy with not having as many deliveries maybe over the next couple of years. When will we expect you to be more aggressive on the apartment renovations that would seem like that trade up today might make sense especially as you get a little bit more vacancy in the apartment portfolio just to kind of continue through with that product. So I guess ultimately what would you want to see to get more aggressive there and get back on track?

Paul McDermott - President and Chief Executive Officer:

The renovation pipeline is based on the affordability gap, and we still see good affordability gaps. A and B – it's not like there's been a wide divergence like A has come in and B's dropped.

We've seen them move lock step and I'll defer to Grant Montgomery – our head of research – but we're going to evaluate it on a sub-market by sub-market basis Dave. As you're aware, we had achieved mid-teens return on cost metrics. I think we're going to re-evaluate that.

Is that still appropriate in this environment? And then what type of movements are we seeing particularly in the B space. I think we've been pretty pleased with the B space and how it's performed – not only on the collections, but on some rent movements – both on the renewal side of it; but we're going to look at each one of those properties.

We're doing it on a monthly basis right now, and I would tell you that if we saw an opportunity where we thought that the affordability gap was intact and we could achieve a suitable return on cost. We would move forward in the sub-market, and again – I'll defer to Grant.

Grant Montgomery – Head of Research:

We have seen very similar paths with A and B through April. It's really been within 30 to 40 basis points in terms of their tracking – in terms of the over rent growth, so that mid 20% rent gap that we have between A and B region wide is still intact; and it really speaks to how B has held up during this time. It speaks to sort of the exposure of our residents to the stronger industries, which we've talked about in the script last quarter.

Yes, the majority of job losses in our region have been really concentrated in a couple of three industries; particularly retail and leisure and hospitality were almost 60% of the job losses but we only have about 13.5% percent exposure to that industry.

That's really spoken to the strength of our Class B assets, in light of what's going on broadly and has really held up quite well relative to what's going on in the market.

Paul McDermott - President and Chief Executive Officer:

The only other thing I'd add, and we've told you this before, we're very sensitive to the income to rent metric. And our average renter, I believe, is at 26%. So we want to keep that intact.

We think that's important given the economic disruption we're going through. So I'm comfortable with that and we'll monitor that as we move forward and look at reactivating our renovation program.

Operator: Our next question comes from the line of Bill Crow with Raymond James. Proceed with your question.

Q: On the multifamily front, if we see a big reduction on the unemployment benefits, would you anticipate your collection rate to decline in the next few quarters?

Steve Riffie – Executive Vice President and Chief Financial Officer:

One of the things that we're really pleased with, obviously we've collected 99% of our rents and there's a lot of information in our materials that we've put out as we met with investors about the strength of the sectors that our residents are employed by and how they've held up so well on a relative basis to the US overall.

One of the things that we noticed, broadly speaking in terms of the large Metro areas, the DC rent income is better than say New York or Los Angeles or the Bay area.

So for instance, the CARES Act is really just bearing less of the burden here in D.C. And again, that's not really effecting that much – many of our tenants are collecting 99%.

But I think it also speaks to just our region. Grant, if you want to add a little to that or Paul.

Grant Montgomery – Head of Research:

I can add so to echo - sort of the way I answered the previous question is it really does get down to how our portfolio is somewhat insulated based on the employment distribution of our residents.

Looking at it another way, within the Washington region; professional business services, government and finance all on average declined less than 2.5% during the period we're going through.

Those industries comprise approximately 60% of our tenant base in Class B which really speaks to how DC's Class B is somewhat different than perhaps some of the pressures that might occur in other markets as Steve mentioned that have higher rent to income ratios or alternatively a different employment base that make up their economy.

Q: I know it's early and I know one of the tenants are tied to the government in one way or another, but any buzz among the tenant reps that some of the CBD tenants may be looking for the suburbs either to avoid mass transit or in reaction to some of the protest activities or anything like that?

Paul McDermott - President and Chief Executive Officer:

I haven't seen that per se with an executed lease. Do I think that some folks, just given the remote working paradigm that we are going through, I do think you're going to see a hub and spoke approach. I know a number of companies that have downtown presences are also going to be employing satellite offices in Virginia, or in Maryland.

If you look at our same-store numbers in multifamily, I know you asked about office – people are definitely moving out there and I think that folks want to live close to where they work. I would anticipate some of that follow-on activity. I don't think there's some massive trend we're observing over the last 90 days, Bill, but that's clearly something that we're going to keep our eye on moving forward.

Steve Riffie – Executive Vice President and Chief Financial Officer:

Grant, you can correct me if I'm wrong, 70% of the job growth for the last period of time has been in Northern Virginia, it's been really the growth engine for our region for a while.

Tech is a huge part of it and the government contracting has increased, it hasn't decreased. Many of the big tech firms that are moving in in big ways, HQ2, Microsoft, Facebook, even Walmart Labs – people like that. So I just think there's just more jobs, there's just more growth coming in to Northern Virginia.

Operator:

And if there are no further questions left in the Q&A, I would like to pass the floor back over to management for any closing remarks.

Paul McDermott - President and Chief Executive Officer:

I'd like to thank everyone again for taking time to join us this morning. We appreciate your continued support during these challenging times, and we look forward to talking with you over the coming weeks and months. Thank you, and have a good day.

OPERATOR:

This concludes today's teleconference. You may now disconnect your lines at this time. Thank you for your participation. Have a wonderful day.