

Company Update

Maryland Athletes Win Twenty Olympic Medals While WRE Happy to Exit Maryland Office Market. NDR Recap. Hold.

- As the summer draws to a close, we accompanied Washington REIT on an NDR; reviewing their core portfolio and -- now that they have an attractive cost of capital -- growth opportunities.
- We note that while Maryland athletes won [20 Olympic medals](#), the WRE management noted that there is zero correlation between Maryland athletic prowess and Suburban MD office market dynamics. Hence, exiting their suburban MD office assets for \$240mm and a very high \$200/SF was Olympic gold for WRE.

- Key take-aways included: 1) proforma the suburban office asset sales the portfolio NOI will be comprised of 46% office, 30% apartment and 24% retail, 2) deleveraging is occurring with net debt/EBITDA falling from 6.6x at 4Q15 to an expected 6.1x-6.3x by YE16, 3) strong job growth in the DC MSA is sustaining demand for apartments and retail sales, 4) the affordability gap between Class A and Class B apartments appears to be increasing, improving WRE's ability to raise rents in its Class B apartments, despite all the recent new supply delivered in the DC MSA, and 5) the appeal of METRO accessible office properties is apparent as net office absorption in Northern Virginia between 1/1/15 and 6/30/16 in assets within 1/2 mile of METRO stations is positive 1.8mm SF. For those assets further away, net absorption was negative 1.3mm SF for the same period. Sixteen of WRE's proforma eighteen office properties are within half a mile of a METRO.

- One of the few REITs we cover that has an internal research team and focuses on only one market, we are always interested in the WRE perspective on the multiple asset classes and the ability to create value primarily through acquisition and redevelopment in the Washington, D.C. MSA.

- Based on recent transactions and forward expectations, it appears that WRE is much more interested in spending capital on inside the Beltway Virginia-centric apartment development and redevelopment than 'office capex hogs'.

- Per our 2Q16 Office Fundamentals wire here: [Houston Free Fall. San Francisco and Boston Solid, Los Angeles Hype Not in Numbers. 2Q16 Office Fundamentals Update](#). we are not at all surprised. Although there are some rays of sunshine in the greater Washington, D.C. office market, landlords are still expected to provide turnkey office space.

- Additionally, please see our Washington, D.C. update wire ([here](#)). The greater D.C. office market is recognized as one of the most expensive markets in the country for re-leasing office space.

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Changes	Previous	Current
Rating	—	Hold
Target Price	—	NA
FY16E FFO	—	\$1.77
FY17E FFO	\$1.80	\$1.81
FY16E FAD	—	1.28
FY17E FAD	—	1.30

Price (08/26/16):	\$32.06
52-Week Range:	\$35 – \$24
Market Cap.(mm):	2,367.3
Shr.O/S-Diluted (mm):	73.8
Enterprise Val. (mm):	\$3,692.1
Avg Daily Vol (3 Mo):	441,522
LT Debt/Total Cap.:	34.7%
Dividend(\$ / %)	\$1.20 / 3.7%
S&P Index	2,161.94

Prices are intraday.

FFO	2015A	2016E	2017E
Q1	\$0.38	\$0.42A	\$0.43
Q2	0.42	0.46A	0.46
Q3	0.45	0.44	0.45
Q4	0.46	0.45	0.47
FY Dec	\$1.71A	\$1.77	\$1.81
P/FFO	18.7x	18.1x	17.7x

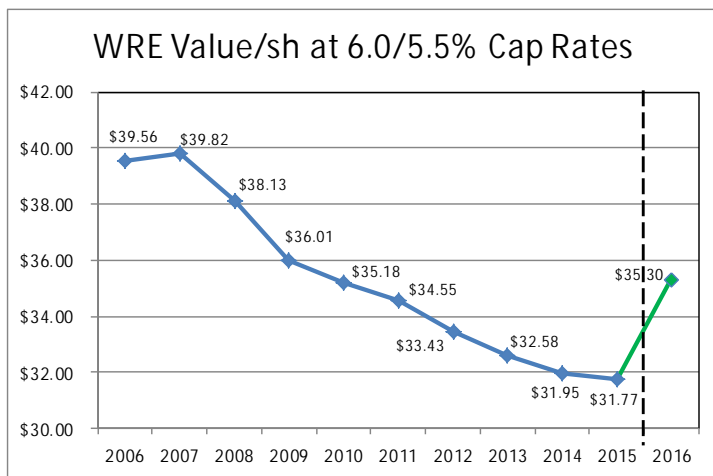
FAD	2015A	2016E	2017E
Q1	0.32	0.38A	0.30
Q2	0.28	0.30A	0.34
Q3	0.33	0.27	0.32
Q4	0.30	0.33	0.34
FY Dec	1.23A	1.28	1.30
P/FAD	26.1x	25.0x	24.7x



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- We estimate WRE currently trades at 5.9%/4.7%/4.2% implied cap rates for NOI/cash flow/CF less G&A. This equates to (9.0%)/3.0% discount/premium to our NAV estimate of \$35/\$31/sh using our just reduced NAV cap rate range of 5.5%-6.0%.
- We adjusted our NAV cap rate range as a result of the cumulative efforts to reposition the office portfolio while reducing its overall percentage of NOI. Once the suburban office asset sales are completed in 3Q16, WRE's NOI will be composed of 46% office, 30% apartments and 24% retail. We believe this is an improvement from the 4Q15 composition of 55% office, 20% apartments and 25% retail.
- In addition to adjusting our NAV cap rate range, we are also adjusting our NAV static cap rate analysis to reflect the portfolio's improving quality.



Sources: Company data and Stifel estimates

- This adjustment creates a one-time pop to NAV. Where the value goes hereafter will once again depend upon management's ability to create value in a still challenging Washington, D.C. environment. WRE's improved cost of capital, should help in this respect.
- It appears as if all REITs (all sectors) that are generating reasonable (5%+) FFO/FAD growth, can grow the dividend and own institutional quality assets are trading sub 5.3%. As WRE clearly owns institutional quality assets, share price appreciation appears likely if the portfolio starts generating earnings and dividend growth.
- We think the post suburban office portfolio sale TEV for office space of \$455/SF is fair relative to our recently updated \$592/\$433/SF estimates for gross/adjusted replacement cost.
- Other positive aspects include 1) improved balance sheet, 2) improved portfolio, 3) while the Washington, D.C. economic recovery lagged the U.S. 2011-2015, it is now exceeding the U.S., 4) Washington, D.C. leads the nation in millennial as a percentage of the population, and 5) WRE has internal redevelopment opportunities for both office and apartment assets.
- Negatives include 1) there is not a shortage of talented developers in the Washington, D.C. MSA, 2) land is available near a large number of METRO stops, 3) significant apartment supply, 4) surprising continued office development in select markets.
- We are adjusting our 2016 FFO/FAD/sh estimates to \$1.77/\$1.28 from \$1.77/\$1.32 and our 2017 FFO/FAD/sh estimates to \$1.81/\$1.30 from \$1.80/\$1.29. This equates to normalized FFO/FAD 2015-2017 growth of 2.9%/2.8%.

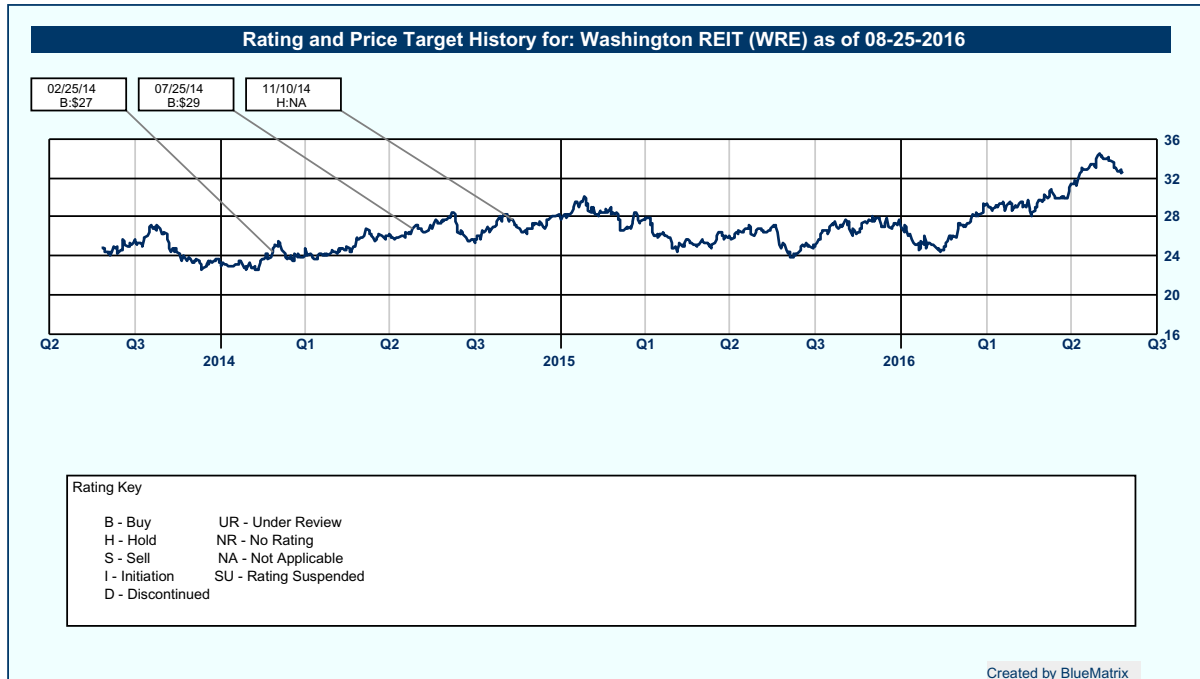
Company Description

Washington Real Estate Investment Trust is an equity REIT that has been engaged in acquiring and managing

properties since 1960. The Trust owns a diversified portfolio of 51 properties consisting of 16 retail centers, 21 office properties, and 14 multi-family properties, all in the Washington, D.C. metro area.

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For a price chart with our ratings and any applicable target price changes for WRE go to <http://sf.bluematrix.com/bluematrix/Disclosure?ticker=WRE>

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