WASHINGTON REAL ESTATE INVESTMENT TRUST
Form 10-Q
August 01, 2016

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For quarterly period ended June 30, 2016
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
COMMISSION FILE NO. 1-6622
WASHINGTON REAL ESTATE
INVESTMENT TRUST
(Exact name of registrant as specified in its charter)

MARYLAND	53-0261100
(State of incorporation)	(IRS Employer Identification Number)

1775 EYE STREET, NW, SUITE 1000, WASHINGTON, DC 20006
(Address of principal executive office) (Zip code)
Registrant's telephone number, including area code: (202) 774-3200

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of exchange on which registered
Shares of Beneficial Interest	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past ninety (90) days. YES x NO o

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO x

As of July 28, 2016, 73,633,233 common shares were outstanding.

WASHINGTON REAL ESTATE INVESTMENT TRUST
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PART I
FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

The information furnished in the accompanying unaudited Consolidated Balance Sheets, Condensed Consolidated Statements of Income (Loss), Condensed Consolidated Statements of Comprehensive Income (Loss), Consolidated Statement of Equity and Consolidated Statements of Cash Flows reflects all adjustments, consisting of normal recurring items, which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods. The accompanying financial statements and notes thereto should be read in conjunction with the financial statements and notes for the three years ended December 31, 2015 included in Washington Real Estate Investment Trust’s 2015 Annual Report on Form 10-K.

WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	June 30, 2016 (Unaudited)	December 31, 2015
Assets		
Land	$573,315	$561,256
Income producing property	2,072,166	2,076,541
	2,645,481	2,637,797
Accumulated depreciation and amortization	(613,194)	(692,608)
Net income producing property	2,032,287	1,945,189
Properties under development or held for future development	35,760	36,094
Total real estate held for investment, net	2,068,047	1,981,283
Investment in real estate sold or held for sale, net	41,704	—
Cash and cash equivalents	22,379	23,825
Restricted cash	11,054	13,383
Rents and other receivables, net of allowance for doubtful accounts of $2,010 and $2,297 respectively	58,970	62,890
Prepaid expenses and other assets	99,150	109,787
Other assets related to properties sold or held for sale	5,147	—
Total assets	$2,306,451	$2,191,168
Liabilities		
Notes payable, net	$743,769	$743,181
Mortgage notes payable, net	252,044	418,052
Lines of credit	269,000	105,000
Accounts payable and other liabilities	52,722	45,367
Dividend payable	—	20,434
Advance rents	10,178	12,744
Tenant security deposits	8,290	9,378
Liabilities related to properties sold or held for sale	2,338	—
Total liabilities	1,338,341	1,354,156
Equity		
Shareholders’ equity		
Preferred shares; $0.01 par value; 10,000 shares authorized; no shares issued or outstanding	—	—
Shares of beneficial interest, $0.01 par value; 100,000 shares authorized; 73,651 and 68,191 shares issued and outstanding, respectively	737	682
Additional paid in capital	1,338,101	1,193,298
Distributions in excess of net income	(366,352)	(357,781)
Accumulated other comprehensive loss	(5,609)	(550)
Total shareholders’ equity	966,877	835,649
Noncontrolling interests in subsidiaries	1,233	1,363
Total equity	968,110	837,012
Total liabilities and equity	$2,306,451	$2,191,168

See accompanying notes to the consolidated financial statements.

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WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS)
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenue				
Real estate rental revenue	$79,405	$74,226	$156,542	$149,082
Expenses				
Real estate expenses	28,175	27,229	56,909	56,437
Depreciation and amortization	25,161	25,503	51,199	50,778
Acquisition costs	1,024	992	1,178	1,008
General and administrative	4,968	4,278	10,479	10,358
Casualty (gain) and real estate impairment loss, net	(676)	5,909	(676)	5,909
	58,652	63,911	119,089	124,490
Other operating income				
Gain on sale of real estate	24,112	1,454	24,112	31,731
Real estate operating income	44,865	11,769	61,565	56,323
Other income (expense)				
Interest expense	(13,820)	(14,700)	(28,180)	(30,048)
Loss on extinguishment of debt	—	(119)	—	(119)
Other income	83	192	122	384
Income tax benefit (expense)	693	(28)	693	(28)
	(13,044)	(14,655)	(27,365)	(29,811)
Net income (loss)	31,821	(2,886)	34,200	26,512
Less: Net loss attributable to noncontrolling interests in subsidiaries	15	340	20	448
Net income (loss) attributable to the controlling interests	$31,836	$(2,546)	$34,220	$26,960
Basic net income (loss) attributable to the controlling interests per common share	$0.44	$(0.04)	$0.49	$0.39
Diluted net income (loss) attributable to the controlling interests per common share	$0.44	$(0.04)	$0.49	$0.39
Weighted average shares outstanding – basic	71,719	68,176	70,010	68,159
Weighted average shares outstanding – diluted	71,912	68,176	70,200	68,283
Dividends declared per share	$0.30	$0.30	$0.60	$0.60

See accompanying notes to the consolidated financial statements.

WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(IN THOUSANDS)
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income (loss)	$31,821	$(2,886)	$34,200	$26,512
Other comprehensive loss:				
Unrealized loss on interest rate hedge	(1,384)	—	(5,059)	—
Comprehensive income (loss)	30,437	(2,886)	29,141	26,512
Less: Comprehensive loss attributable to noncontrolling interests	15	340	20	448
Comprehensive income (loss) attributable to the controlling interests	$30,452	$(2,546)	$29,161	$26,960

See accompanying notes to the financial statements.

WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF EQUITY
(IN THOUSANDS)
(UNAUDITED)

	Shares Issued and Out-standing	Shares of Beneficial Interest at Par Value	Additional Paid in Capital	Distributions in Excess of Net Income	Accumulated Other Comprehensive Loss	Total Shareholders' Equity	Noncontrolling Interests in Subsidiaries	Total Equity
Balance, December 31, 2015	68,191	$ 682	$ 1,193,298	$ (357,781)	$ (550)	$ 835,649	$ 1,363	$ 837,012
Net income attributable to the controlling interests	—	—	—	34,220	—	34,220	—	34,220
Net loss attributable to the noncontrolling interests	—	—	—	—	—	—	(20)	(20)
Unrealized loss on interest rate hedge	—	—	—	—	(5,059)	(5,059)	—	(5,059)
Distributions to noncontrolling interests	—	—	—	—	—	—	(110)	(110)
Dividends	—	—	—	(42,791)	—	(42,791)	—	(42,791)
Equity offerings, net of issuance costs	5,319	53	143,304	—	—	143,357	—	143,357
Share grants, net of forfeitures	141	2	1,499	—	—	1,501	—	1,501
Balance, June 30, 2016	73,651	$ 737	$ 1,338,101	$ (366,352)	$ (5,609)	$ 966,877	$ 1,233	$ 968,110

See accompanying notes to the consolidated financial statements.

WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	Six Months Ended June 30, 2016		2015	
Cash flows from operating activities				
Net income	$ 34,200		$ 26,512	
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	51,199		50,778	
Provision for losses on accounts receivable	708		1,126	
Casualty (gain) and real estate impairment loss, net	(676	)	5,909	
Gain on sale of real estate	(24,112	)	(31,731	)
Share-based compensation expense	2,421		3,073	
Deferred tax benefit	(732	)	—	
Amortization of debt premiums, discounts and related financing costs	1,604		1,854	
Loss on extinguishment of debt	—		119	
Changes in operating other assets	(983	)	(758	)
Changes in operating other liabilities	(3,175	)	(2,550	)
Net cash provided by operating activities	60,454		54,332	
Cash flows from investing activities				
Real estate acquisitions, net	(227,413	)	—	
Net cash received for sale of real estate	119,513		39,059	
Capital improvements to real estate	(16,356	)	(12,391	)
Development in progress	(17,997	)	(13,332	)
Real estate deposits, net	—		(3,000	)
	2,001		(2,392	)

Cash released from (held in) replacement reserve escrows		
Insurance proceeds	883	—
Non-real estate capital improvements	(42)	(1,836)
Net cash (used in) provided by investing activities	(139,411)	6,108
Cash flows from financing activities		
Line of credit borrowings, net	164,000	135,000
Dividends paid	(63,284)	(41,019)
Principal payments – mortgage notes payable	(166,216)	(2,266)
Borrowings under construction loan	—	3,425
Notes payable repayments	—	(150,000)
Payment of financing costs	(236)	(3,755)
Contributions from noncontrolling interests	—	5
Distributions to noncontrolling interests	(110)	—
Net proceeds from equity offering	143,357	5,121
Net cash provided by (used in) financing activities	77,511	(53,489)
Net (decrease) increase in cash and cash equivalents	(1,446)	6,951
Cash and cash equivalents at beginning of period	23,825	15,827
Cash and cash equivalents at end of period	$ 22,379	$ 22,778
Supplemental disclosure of cash flow information:		
Cash paid for interest, net of amounts capitalized	$ 27,154	$ 30,117
Change in accrued capital improvements and development costs	3,472	383

See accompanying notes to the consolidated financial statements.

WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2016
(UNAUDITED)

NOTE 1: NATURE OF BUSINESS

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

Federal Income Taxes

We believe that we qualify as a real estate investment trust (“REIT”) under Sections 856-860 of the Internal Revenue Code and intend to continue to qualify as such. To maintain our status as a REIT, we are, among other things, required to distribute 90% of our REIT taxable income (which is, generally, our ordinary taxable income, with certain modifications), excluding any net capital gains and any deductions for dividends paid to our shareholders on an annual basis. When selling a property, we generally have the option of (a) reinvesting the sales proceeds of property sold, in a way that allows us to defer recognition of some or all taxable gain realized on the sale, (b) distributing the gain to the shareholders with no tax to us or (c) retaining our net long-term capital gain but treating it as having been distributed to our shareholders, paying the tax on the gain deemed distributed and allocating the tax paid as a credit to our shareholders. During the six months ended June 30, 2016, we sold the following properties:

Disposition Date	Property Name	Segment	Gain on Sale (in thousands)
May 26, 2016	Dulles Station, Phase II [1]	Office	$ 527
June 27, 2016	Maryland Office Portfolio Transaction I [2]	Office	23,585
		Total	$ 24,112

[1] Land held for future development and an interest in a parking garage.
[2] Maryland Office Portfolio Transaction I consists of 6110 Executive Boulevard, Wayne Plaza, 600 Jefferson Plaza and West Gude Drive. Maryland Office Portfolio Transaction II, which consists of 51 Monroe Street and One Central Plaza, is scheduled to close in September 2016.

The taxable gains for the properties sold during the three months ended June 30, 2016 will be distributed to shareholders through the quarterly dividends. The properties included in Maryland Office Portfolio Transaction II have been identified for a reverse tax deferred exchange under Section 1031 of the Internal Revenue Code. We acquired the replacement property, Riverside Apartments, during the three months ended June 30, 2016 (see note 3, under "Acquisition").

Generally, and subject to our ongoing qualification as a REIT, no provisions for income taxes are necessary except for taxes on undistributed taxable income and taxes on the income generated by our taxable REIT subsidiaries (“TRSs”). Our TRSs are subject to corporate federal and state income tax on their taxable income at regular statutory rates, or as calculated under the alternative minimum tax, as appropriate. During the second quarter of 2016, we recognized an income tax benefit of $0.7 million from a reduction of the reserve for a deferred tax asset at one of our taxable REIT subsidiaries. As of June 30, 2016, our TRSs had net deferred tax assets of $0.6 million. Our TRSs had no net deferred tax assets as of December 31, 2015. As of June 30, 2016 and December 31, 2015, our TRSs had net deferred tax liabilities of $0.5 million and $0.7 million, respectively. These deferred tax liabilities are primarily related to temporary differences in the timing of the recognition of revenue, amortization and depreciation.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATIONS

Significant Accounting Policies

We have prepared our consolidated financial statements using the accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2015.

New Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update No. 2016-13, Measurement of Credit Losses on Financial Instruments, which requires financial assets measured at an amortized cost basis, including trade receivables, to be presented at the net amount expected to be collected. The new standard is effective for public entities for fiscal years beginning after December 15, 2019 and for interim periods therein with adoption one year earlier permitted. We are currently evaluating the impact the new standard may have on Washington REIT’s consolidated financial statements.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, Improvements to Employee Share-Based Payment Accounting, which amends existing accounting standards for employee share-based payments, including by allowing an employer to make a policy election to account for forfeitures as they occur or to continue to provide for an estimate as currently required. The new standard also allows an employer to withhold shares in a net settlement in an amount that does not exceed the maximum statutory tax rate in the employees' tax jurisdiction without causing liability classification. The new standard is effective for public entities for fiscal years beginning after December 15, 2016 and for interim periods therein with early adoption permitted. We are currently evaluating the impact the new standard may have on Washington REIT’s consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-05, Derivatives and Hedging (Topic 815), which clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815, in and of itself, does not require dedesignation of that hedging relationship provided that all other hedging criteria continue to be met. The new standard is effective for public entities for fiscal years beginning after December 15, 2016 and for interim periods therein with early adoption permitted. We are currently evaluating the impact the new standard may have on Washington REIT’s consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842), which amends existing accounting standards for lease accounting, including by requiring lessees to recognize most leases on the balance sheet and making certain changes to lessor accounting. The new standard is effective for public entities for fiscal years beginning after December 15, 2018 and for interim periods therein with early adoption permitted. We are currently evaluating the impact the new standard may have on Washington REIT’s consolidated financial statements.

In February 2015, the FASB issued Accounting Standards Update No. 2015-02, Consolidation (Topic 810), which changes the analysis an entity must perform to determine whether it should consolidate certain types of legal entities. Specifically, the new standard i) modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities ("VIEs") or voting interest entities, ii) eliminates the presumption that a general partner should consolidate a limited partnership and iii) affects the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships. The new standard is effective for public entities for fiscal years beginning after December 15, 2015 and for interim periods therein. We adopted the new standard on January 1, 2016, and the provisions of the new standard did not have any impact on the consolidation of our legal entities.

In June 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which creates a single source of revenue guidance. The new standard provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other U.S. generally accepted accounting principles ("GAAP") requirements, such as the leasing literature). The guidance also provides a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate. The new standard is effective for public entities for fiscal years beginning after December 15, 2017 and for interim periods therein. Early adoption is permitted for public entities beginning after December 15, 2016. We are currently evaluating the impact the new standard may have on Washington REIT.

Principles of Consolidation and Basis of Presentation

The accompanying unaudited consolidated financial statements include the consolidated accounts of Washington REIT, our majority-owned subsidiaries and entities in which Washington REIT has a controlling interest, including where Washington REIT has been determined to be a primary beneficiary of a variable interest entity (“VIE”). See note 3 for additional information on the property for which there is a noncontrolling interest. All intercompany balances and transactions have been eliminated in consolidation.

We have prepared the accompanying unaudited financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to those rules and regulations, although we believe that the disclosures made are adequate to make the information presented not misleading. In addition, in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the results for the periods presented have been included. These unaudited financial statements should be read in conjunction with the financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2015.

Within these notes to the financial statements, we refer to the three months ended June 30, 2016 and June 30, 2015 as the “2016 Quarter” and the “2015 Quarter,” respectively, and the six months ended June 30, 2016 and June 30, 2015 as the "2016 Period" and "2015 Period," respectively.

Use of Estimates in the Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 3: REAL ESTATE

Acquisition

Our current strategy is focused on properties inside the Washington metro region’s Beltway, near major transportation nodes and in areas with strong employment drivers and superior growth demographics. We seek to upgrade our portfolio with acquisitions as opportunities arise. Properties and land for development acquired during the 2016 Period were as follows:

Acquisition Date	Property	Type	# of units (unaudited)	Contract Purchase Price (In thousands)
May 20, 2016	Riverside Apartments	Multifamily	1,222	$ 244,750

Riverside Apartments consists of apartment buildings and an adjacent parcel of land for potential future multifamily development. The purchase of Riverside Apartments was structured as a reverse exchange under Section 1031 of the Internal Revenue Code in a manner such that legal title is held by a Qualified Intermediary until certain identified properties are sold and the reverse exchange transaction is completed. We retain essentially all of the legal and economic benefits and obligations related to Riverside Apartments. As such, Riverside Apartments is considered to be a VIE until legal title is transferred to us upon completion of the 1031 exchange, which is expected during the third quarter of 2016. We have consolidated the assets and liabilities of Riverside Apartments because we have determined that Washington REIT is the primary beneficiary of the VIE. The results of operations from the acquired operating property are included in the consolidated statements of income (loss) as of the acquisition date and are as follows (in thousands):

	Three and Six Months Ended June 30, 2016
Real estate rental revenue	$ 2,484
Net income	583

We record the acquired physical assets (land, building and tenant improvements), in-place leases (absorption, tenant origination costs, leasing commissions, and net lease intangible assets/liabilities), and any other liabilities at their fair values.

We have recorded the total purchase price of the above acquisition as follows (in thousands):

Land	$38,922
Land for development	15,969
Buildings	184,855
Leasing commissions/absorption costs	4,992
Net lease intangible assets	22
Net lease intangible liabilities	(10)
Total	$244,750

The weighted remaining average life for the 2016 acquisition components above, other than land and building, are 47 months for leasing commissions/absorption costs, 93 months for net lease intangible assets and 49 months for net lease intangible liabilities.

The difference in the total contract price of $244.8 million for the acquisition and the acquisition cost per the consolidated statements of cash flows of $243.4 million is primarily due to credits received at settlement totaling $1.4 million. The portion of the acquisition cost allocated to land for development is reported on the consolidated statements of cash flows as Development in progress.

The following unaudited pro-forma combined condensed statements of operations set forth the consolidated results of operations for the three and six months ended June 30, 2016 and 2015 as if the above-described acquisition in 2016 had occurred on January 1, 2015. The pro forma adjustments include reclassifying costs related to the above-described acquisition to 2015. The unaudited pro-forma information does not purport to be indicative of the results that actually would have occurred if the acquisitions had been in effect for the three and six months ended June 30, 2016 and 2015. The unaudited data presented is in thousands, except per share data.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Real estate rental revenue	$82,304	$79,609	$164,823	$159,789
Net income (loss)	32,595	(1,136)	36,389	29,765
Diluted net income (loss) per share	0.45	(0.02)	0.52	0.43

Development/Redevelopment

In the office segment, we had a redevelopment project to renovate Silverline Center, an office property in Tysons, Virginia. As of June 30, 2016, we had invested $36.1 million in the renovation. We completed major construction activities on this project during the second quarter of 2015, and placed into service substantially completed portions of the project at that time totaling $25.9 million. The remaining components of the redevelopment project were placed into service as of March 31, 2016, one year from completion of major construction activities. We also currently have a redevelopment project to renovate the common areas and add amenities to the Army Navy Club Building, an office property in Washington, DC. As of June 30, 2016, we had invested $0.6 million in the redevelopment.

We have also begun predevelopment activities for the construction of a multifamily building on land adjacent to The Wellington in Arlington, Virginia. As of June 30, 2016, we had invested $16.7 million in the development.

Variable Interest Entities

In June 2011, we executed a joint venture operating agreement with a real estate development company to develop The Maxwell, a mid-rise multifamily property at 650 North Glebe Road in Arlington, Virginia. Major construction activities at The Maxwell ended during December 2014, and the building became available for occupancy during the first quarter of 2015. Washington REIT is the 90% owner of the joint venture. The real estate development company owns 10% of the joint venture and was responsible for the development and construction of the property.

We have determined that The Maxwell joint venture is a VIE primarily based on the fact that the equity investment at risk is not sufficient to permit the entity to finance its activities without additional financial support. As of December 31, 2015, $32.2 million was outstanding on The Maxwell's construction loan. In January 2016, Washington REIT exercised its right to purchase at par The Maxwell's construction loan from the original third-party lender. Upon the purchase, the loan became an intercompany payable from the consolidated VIE to Washington REIT that is eliminated in consolidation. We also determined that Washington REIT was the primary beneficiary of the VIE due to the fact that Washington REIT was determined to have a controlling financial interest in the entity.

We include joint venture land acquisitions and related capitalized development costs on our consolidated balance sheets in properties under development or held for future development until placed in service or sold. As of June 30, 2016 and December 31, 2015, The Maxwell's assets were as follows (in thousands):

	June 30, 2016	December 31, 2015
Land	$12,851	$ 12,851
Income producing property	37,915	37,791
Accumulated depreciation and amortization	(3,457)	(2,347)
Other assets	823	1,188
	$48,132	$ 49,483

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As of June 30, 2016 and December 31, 2015, The Maxwell's liabilities were as follows (in thousands):

	June 30, 2016	December 31, 2015
Mortgage notes payable	$32,113 (1)	$ 32,214
Accounts payable and other liabilities	175	256
Tenant security deposits	86	82
	$32,374	$ 32,552

(1) The mortgage notes payable balance as of June 30, 2016 is eliminated in consolidation due to the purchase of the loan by Washington REIT in January 2016.

Properties Sold and Held for Sale

We intend to hold our properties for investment with a view to long-term appreciation, to engage in the business of acquiring, developing and owning our properties, and to make occasional sales of the properties that no longer meet our long-term strategy or return objectives and where market conditions for sale are favorable. The proceeds from the sales may be reinvested into other properties, used to fund development operations or to support other corporate needs, or distributed to our shareholders. Depreciation on these properties is discontinued when classified as held for sale, but operating revenues, other operating expenses and interest continue to be recognized until the date of sale.

During the 2016 Quarter, we sold Dulles Station, Phase II, which consists of land held for future development and an interest in a parking garage in Herndon, Virginia, for $12.1 million. Also during the 2016 Quarter, we executed two purchase and sale agreements with a single buyer for the sale of a portfolio of six office properties located in Maryland: 6110 Executive Boulevard, Wayne Plaza, 600 Jefferson Plaza, West Gude Drive, 51 Monroe Street and One Central Plaza (collectively, the "Maryland Office Portfolio") for an aggregate contract sales price of $240.0 million. The buyer paid non-refundable deposits of $9.0 million and $1.0 million under the purchase and sale agreements for the first and second sale transactions, respectively. We closed on the first sale transaction in June 2016 and expect to close on the second sale transaction in September 2016. The properties in Maryland Office Portfolio Transaction II met the criteria for classification as held for sale as of June 30, 2016.

We sold or classified as held for sale the following properties in 2016 and 2015:

Disposition Date	Property Name	Segment	# of units	Rentable Square Feet	Contract Sales Price (in thousands)	Gain on Sale (in thousands)
May 26, 2016	Dulles Station, Phase II (1)	Office	N/A	N/A	$ 12,100	$ 527
June 27, 2016	Maryland Office Portfolio Transaction I (2)	Office	N/A	692,000	111,500	23,585
N/A	Maryland Office Portfolio Transaction II (3)	Office	N/A	491,000	128,500	N/A
		Total 2016		1,183,000	$ 252,100	$ 24,112
March 20, 2015	Country Club Towers	Multifamily	227	N/A	$ 37,800	$ 30,277
September 9, 2015	1225 First Street (4)	Multifamily	N/A	N/A	14,500	—
October 21, 2015	Munson Hill Towers	Multifamily	279	N/A	57,050	51,395
December 14, 2015	Montgomery Village Center	Retail	N/A	197,000	27,750	7,981
		Total 2015	506	197,000	$ 137,100	$ 89,653

(1) Land held for future development and an interest in a parking garage.

(2) Maryland Office Portfolio Transaction I consists of 6110 Executive Boulevard, 600 Jefferson Plaza, Wayne Plaza and West Gude Drive.

(3) Maryland Office Portfolio Transaction II consists of 51 Monroe Street and One Central Plaza, and is scheduled to close in September 2016.

(4) Interest in land held for future development.

The Maryland Office Portfolio, in the aggregate, constitutes an individually significant disposition that does not qualify for presentation and disclosure as a discontinued operation as it does not represent a strategic shift in our operations. Real estate rental revenue and net income for the Maryland Office Portfolio for the three and six months ended June 30, 2016 and 2015 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Real estate rental revenue	$8,147	$8,288	$16,577	$15,882
Net income	4,176	2,719	6,902	4,437

We do not have significant continuing involvement in the operations of the disposed properties.

Casualty Gains

We recorded a net casualty gain of $0.7 million during the 2016 Quarter associated with a fire at Bethesda Hill Towers that damaged four units, which is included in casualty (gain) and real estate impairment loss, net on our Condensed Consolidated Statements of Income (Loss). The net casualty gain is comprised of $0.9 million in third-party insurance proceeds received by us, which were partially offset by casualty charges of $0.2 million to write off the net book value of the damaged units at Bethesda Hill Towers.

NOTE 4: MORTGAGE NOTES PAYABLE

In January 2016, we exercised our right to purchase the construction loan in the amount of $32.2 million secured by The Maxwell without penalty from the lender (see note 3, under "Variable Interest Entities").

In February 2016, we prepaid without penalty the remaining $50.9 million of the mortgage note secured by John Marshall II.

In June 2016, we repaid without penalty the remaining $81.0 million of mortgage notes secured by 3801 Connecticut Avenue, Bethesda Hill Apartments and Walker House Apartments.

NOTE 5: UNSECURED LINES OF CREDIT PAYABLE

We have a $600.0 million unsecured revolving credit agreement ("Revolving Credit Facility") that matures in June 2019, unless extended pursuant to one or both of the two six months extension options. The Revolving Credit Facility has an accordion feature, which we utilized a portion of in September 2015, as described below, that allows us to increase the facility to $1.0 billion, subject to the extent the lenders agree to provide additional revolving loan commitments or term loans. In September 2015, we entered into a $150.0 million unsecured term loan by executing a portion of the accordion feature under the Revolving Credit Facility. The term loan has a 5.5 year term and currently has an interest rate of one month LIBOR plus 110 basis points, based on Washington REIT's current unsecured debt ratings. We entered into two interest rate swaps to effectively fix the interest rate at 2.7% (see note 6).

The Revolving Credit Facility bears interest at a rate of either one month LIBOR plus a margin ranging from 0.875% to 1.55% or the base rate plus a margin ranging from 0.0% to 0.55% (in each case depending upon Washington REIT’s credit rating). The base rate is the highest of the administrative agent's prime rate, the federal funds rate plus 0.50% and the LIBOR market index rate plus 1.0%. In addition, the Revolving Credit Facility requires the payment of a facility fee ranging from 0.125% to 0.30% (depending on Washington REIT’s credit rating) on the $600.0 million committed capacity, without regard to usage. As of June 30, 2016, the interest rate on the facility is one month LIBOR plus 1.00% and the facility fee is 0.20%.

The amount of the Revolving Credit Facility's unsecured line of credit unused and available at June 30, 2016 is as follows (in thousands):

Committed capacity	$600,000
Borrowings outstanding	(269,000)
Letters of credit issued	—
Unused and available	$331,000

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We executed borrowings and repayments on the Revolving Credit Facility during the 2016 Period as follows (in thousands):

	Revolving Credit Facility
Balance at December 31, 2015	$105,000
Borrowings	398,000
Repayments	(234,000)
Balance at June 30, 2016	$269,000

NOTE 6: DERIVATIVE INSTRUMENTS

On September 15, 2015, we entered into two interest rate swap arrangements with a total notional amount of $150.0 million to swap the floating interest rate under our term loan (see note 5) to an all-in fixed interest rate of 2.7% starting on October 15, 2015 and extending until the maturity of the term loan on March 15, 2021. The interest rate swaps qualify as cash flow hedges and are recorded at fair value in accordance with GAAP, based on discounted cash flow methodologies and observable inputs. We record the effective portion of changes in fair value of the cash flow hedge in other comprehensive loss. The resulting unrealized loss on the effective portions of the cash flow hedges was the only activity in other comprehensive loss during the periods presented in our consolidated financial statements. We assess the effectiveness of our cash flow hedges both at inception and on an ongoing basis. The cash flow hedges were effective for the 2016 Quarter and hedge ineffectiveness did not impact earnings during the 2016 Quarter or 2016 Period. We had no derivative instruments outstanding during the 2015 Quarter or 2015 Period.

The fair value and balance sheet locations of the interest rate swap as of June 30, 2016 and December 31, 2015, are as follows (in thousands):

	June 30, 2016	December 31, 2015
Accounts payable and other liabilities	$5,609	$ 550

The interest rate swaps have been effective since inception. The gain or loss on the effective swap is recognized in other comprehensive loss, as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Unrealized loss on interest rate hedge	$(1,384)	$ —	$(5,059)	$ —

Amounts reported in accumulated other comprehensive loss related to derivatives will be reclassified to interest expense as interest payments are made on our variable-rate debt. During the next twelve months, we estimate that an additional $1.7 million will be reclassified as an increase to interest expense.

We have agreements with each of our derivative counterparties that contain a provision whereby we could be declared in default on our derivative obligations if repayment of the underlying indebtedness is accelerated by the lender due to our default on the indebtedness. As of June 30, 2016, the fair value of derivatives is in a net liability position of $5.6 million, which includes accrued interest but excludes any adjustment for nonperformance risk. As of June 30, 2016, we have not posted any collateral related to these agreements. If we had breached any of these provisions at June 30, 2016, we could have been required to settle our obligations under the agreements at their termination value of $5.6 million.

Derivative instruments expose us to credit risk in the event of non-performance by the counterparty under the terms of the interest rate hedge agreement. We believe that we minimize our credit risk on these transactions by dealing with major, creditworthy financial institutions. We monitor the credit ratings of counterparties and our exposure to any single entity, thus minimizing our credit risk concentration.

NOTE 7: FAIR VALUE DISCLOSURES

Assets and Liabilities Measured at Fair Value

For assets and liabilities measured at fair value on a recurring basis, quantitative disclosures about the fair value measurements are required to be disclosed separately for each major category of assets and liabilities, as follows:

Level 1: Quoted prices in active markets for identical assets

Level 2: Significant other observable inputs
Level 3: Significant unobservable inputs

The only assets or liabilities we had at June 30, 2016 and December 31, 2015 that are recorded at fair value on a recurring basis are the assets held in the Supplemental Executive Retirement Plan ("SERP"), which primarily consists of investments in mutual funds, and the interest rate swaps (see note 6).

We base the valuations related to the SERP on assumptions derived from significant other observable inputs and accordingly these valuations fall into Level 2 in the fair value hierarchy.

The valuation of the interest rate swaps is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each interest rate swap. This analysis reflects the contractual terms of the interest rate swaps, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments). The variable cash payments (or receipts) are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves. To comply with the provisions of ASC 820, we incorporate credit valuation adjustments in the fair value measurements to appropriately reflect both our own nonperformance risk and the respective counterparty's nonperformance risk. These credit valuation adjustments were concluded to not be significant inputs for the fair value calculations for the periods presented. In adjusting the fair value of our derivative contracts for the effect of nonperformance risk, we have considered the impact of netting and any applicable credit enhancements, such as the posting of collateral, thresholds, mutual puts and guarantees. The valuation of interest rate swaps fall into Level 2 in the fair value hierarchy.

The fair values of these assets and liabilities at June 30, 2016 and December 31, 2015 were as follows (in thousands):

	June 30, 2016				December 31, 2015			
	Fair Value	Level 1	Level 2	Level 3	Fair Value	Level 1	Level 2	Level 3
Assets:								
SERP	$1,556	$ —	$1,556	$ —	$1,408	$ —	$1,408	$ —
Liabilities:								
Interest rate swaps	$5,609	$ —	$5,609	$ —	$550	$ —	$550	$ —

Financial Assets and Liabilities Not Measured at Fair Value

The following disclosures of estimated fair value were determined by management using available market information and established valuation methodologies, including discounted cash flow. Many of these estimates involve significant judgment. The estimated fair value disclosed may not necessarily be indicative of the amounts we could realize on disposition of the financial instruments. The use of different market assumptions or estimation methodologies could have an effect on the estimated fair value amounts. In addition, fair value estimates are made at a point in time and thus, estimates of fair value subsequent to June 30, 2016 may differ significantly from the amounts presented.

Following is a summary of significant methodologies used in estimating fair values and a schedule of fair values at June 30, 2016 and December 31, 2015.

Cash and Cash Equivalents and Restricted Cash

Cash and cash equivalents and restricted cash include cash and commercial paper with original maturities of less than 90 days, which are valued at the carrying value, which approximates fair value due to the short maturity of these instruments (Level 1 inputs).

Notes Receivable

We acquired a note receivable ("2445 M Street note") in 2008 with the purchase of 2445 M Street. We estimate the fair value of the 2445 M Street note based on a discounted cash flow methodology using market discount rates (Level 3 inputs).

Debt

Mortgage notes payable consist of instruments in which certain of our real estate assets are used for collateral. We estimate the fair value of the mortgage notes payable by discounting the contractual cash flows at a rate equal to the relevant treasury rates (with respect to the timing of each cash flow) plus credit spreads estimated through independent comparisons to real estate assets or loans with similar characteristics. Lines of credit payable consist of our bank facility which we use for various purposes including working capital, acquisition funding and capital improvements. The lines of credit advances are priced at a specified rate plus a spread. We estimate the market value based on a comparison of the spreads of the advances to market given the adjustable base rate. We estimate the fair value of the notes payable by discounting the contractual cash flows at a rate equal to the relevant treasury rates (with respect to the timing of each cash flow) plus credit spreads derived using the relevant securities' market prices. We classify these fair value measurements as Level 3 as we use significant unobservable inputs and management judgment due to the absence of quoted market prices.

As of June 30, 2016 and December 31, 2015, the carrying values and estimated fair values of our financial instruments were as follows (in thousands):

	June 30, 2016		December 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	$22,379	$ 22,379	$23,825	$ 23,825
Restricted cash	11,054	11,054	13,383	13,383
2445 M Street note receivable	3,539	3,655	3,849	4,275
Mortgage notes payable, net	252,044	259,779	418,052	426,693
Lines of credit	269,000	269,000	105,000	105,000
Notes payable, net	743,769	784,582	743,181	753,816

NOTE 8: STOCK BASED COMPENSATION

Washington REIT maintains short-term ("STIP") and long-term ("LTIP") incentive plans that allow for stock-based awards to officers and non-officer employees. Stock based awards are provided to officers and non-officer employees, as well as trustees, under the Washington Real Estate Investment Trust 2007 Omnibus Long-Term Incentive Plan which allows for awards in the form of restricted shares, restricted share units, options and other awards up to an aggregate of 2,000,000 shares over the ten-year period in which the plan will be in effect. Restricted share units are converted into shares of our stock upon full vesting through the issuance of new shares.

In February 2016, we adopted a revised long-term incentive plan ("New LTIP") for non-executive officers and other employees that replaced the previous long-term incentive plan for non-executive officers and other employees. The New LTIP is effective January 1, 2016 for performance years beginning on or after that date. Non-executive officers and other employees earn restricted share unit awards under the New LTIP based upon various percentages of their salaries and annual performance calculations. The restricted share unit awards vest ratably over three years beginning on the grant date based upon continued employment. We initially measure compensation expense for awards under the New LTIP based on the fair value at the grant date, and recognize compensation expense for these awards according to a graded vesting schedule over the three-year requisite service period.

Total Compensation Expense

Total compensation expense recognized in the consolidated financial statements for all outstanding share based awards was $0.9 million and $1.2 million for the 2016 Quarter and 2015 Quarter, respectively, and $2.4 million and $3.1 million for the 2016 Period and 2015 Period, respectively.

Restricted Share Awards

The total fair values of restricted share awards vested was $2.5 million and $2.3 million for the 2016 Period and 2015 Period, respectively.

The total unvested restricted share awards at June 30, 2016 was 237,919 shares, which had a weighted average grant date fair value of $26.38 per share. As of June 30, 2016, the total compensation cost related to unvested restricted share awards was $3.3 million, which we expect to recognize over a weighted average period of 23 months.

NOTE 9: EARNINGS PER COMMON SHARE

We determine “Basic earnings per share” using the two-class method as our unvested restricted share awards and units have non-forfeitable rights to dividends, and are therefore considered participating securities. We compute basic earnings per share by dividing net income attributable to the controlling interest less the allocation of undistributed earnings to unvested restricted share awards and units by the weighted-average number of common shares outstanding for the period.

We also determine “Diluted earnings per share” as the more dilutive of the two-class method or the treasury stock method with respect to the unvested restricted share awards. We further evaluate any other potentially dilutive securities at the end of the period and adjust the basic earnings per share calculation for the impact of those securities that are dilutive. Our diluted earnings per share calculation includes the dilutive impact of our share based awards with performance conditions prior to the grant date and all market condition awards under the contingently issuable method.

The computations of basic and diluted earnings per share for the three and six months ended June 30, 2016 and 2015 were as follows (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Numerator:				
Net income (loss)	$31,821	$(2,886)	$34,200	$26,512
Net loss attributable to noncontrolling interests in subsidiaries	15	340	20	448
Allocation of earnings to unvested restricted share awards	(99)	(80)	(155)	(165)
Adjusted net income (loss) attributable to the controlling interests	$31,737	$(2,626)	$34,065	$26,795
Denominator:				
Weighted average shares outstanding – basic	71,719	68,176	70,010	68,159
Effect of dilutive securities:				
Employee restricted share awards	193	—	190	124
Weighted average shares outstanding – diluted	71,912	68,176	70,200	68,283
Basic net income (loss) attributable to the controlling interests per common share	$0.44	$(0.04)	$0.49	$0.39
Diluted net income (loss) attributable to the controlling interests per common share	$0.44	$(0.04)	$0.49	$0.39

NOTE 10: SEGMENT INFORMATION

We have three reportable segments: office, multifamily and retail. Office properties provide office space for various types of businesses and professions. Multifamily properties provide rental housing for individuals and families throughout the Washington metro region. Retail properties are typically grocery store-anchored neighborhood centers that include other small shop tenants or regional power centers with several junior box tenants.

We evaluate performance based upon net operating income from the combined properties in each segment. Our reportable operating segments are consolidations of similar properties. GAAP requires that segment disclosures present the measure(s) used by the chief operating decision maker for purposes of assessing segments’ performance. Net operating income is a key measurement of our segment profit and loss. Net operating income is defined as segment real estate rental revenue less segment real estate expenses.

The following tables present revenues, net operating income, capital expenditures and total assets for the three and six months ended June 30, 2016 and 2015 from these segments, and reconcile net operating income of reportable segments to net income attributable to the controlling interests as reported (in thousands):

	Three Months Ended June 30, 2016				
	Office	Retail	Multifamily	Corporate and Other	Consolidated
Real estate rental revenue	$43,737	$15,080	$ 20,588	$ —	$ 79,405
Real estate expenses	16,594	3,684	7,897	—	28,175
Net operating income	$27,143	$11,396	$ 12,691	$ —	$ 51,230
Depreciation and amortization					(25,161)
General and administrative					(4,968)
Acquisition costs					(1,024)
Interest expense					(13,820)
Other income					