WASHINGTON REAL ESTATE INVESTMENT TRUST
Form 10-Q
August 08, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended June 30, 2008 Commission File Number: 1-6622

WASHINGTON REAL ESTATE INVESTMENT TRUST

(Exact name of registrant as specified in its charter)

MARYLAND	**53-0261100**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification Number)**

6110 EXECUTIVE BOULEVARD, SUITE 800, ROCKVILLE, MARYLAND	**20852**
(Address of principal executive office)	**(Zip code)**

Registrant s telephone number, including area code (301) 984-9400

(Former name, former address and former fiscal year, if changed since last report)

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 twelve (12) months (or such shorter period that the Registrant was required to file such report) and (2) has been subject to such filing requirements for the past ninety (90) days. YES x NO ¨

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 or smaller reporting company in Rule 12b-2 of the Exchange Act). (Check One):

Large Accelerated Filer x Accelerated Filer ¨ Non-Accelerated Filer ¨ Smaller Reporting Company ¨

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

Number of shares outstanding of common stock, as of August 7, 2008: 49,467,772

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Part I

FINANCIAL INFORMATION

The information furnished in the accompanying unaudited Consolidated Balance Sheets, Statements of Income, Statements of Cash Flows and Statement of Changes in Shareholders Equity 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, 2007 included in the Trust s 2007 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

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ITEM I. FINANCIAL STATEMENTS

WASHINGTON REAL ESTATE INVESTMENT TRUST

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

	(Unaudited) June 30, 2008	December 31, 2007
Assets		
Land	$ 337,680	$ 328,951
Income producing property	1,693,384	1,635,169
	2,031,064	1,964,120
Accumulated depreciation and amortization	(368,200)	(331,991)
Net income producing property	1,662,864	1,632,129
Development in progress	58,760	98,321
Total real estate held for investment, net	1,721,624	1,730,450
Investment in real estate held for sale, net		23,843
Cash and cash equivalents	12,724	21,488
Restricted cash	48,868	6,030
Rents and other receivables, net of allowance for doubtful accounts of $5,585 and $4,227, respectively	37,096	36,595
Prepaid expenses and other assets	85,129	78,517
Other assets related to properties held for sale		1,403
Total assets	$ 1,905,441	$ 1,898,326
Liabilities		
Notes payable	$ 918,834	$ 879,123
Mortgage notes payable	331,575	252,484
Lines of credit	15,000	192,500
Accounts payable and other liabilities	59,193	63,543
Advance rents	8,793	9,552
Tenant security deposits	10,436	10,487
Other liabilities related to properties held for sale		317
Total liabilities	1,343,831	1,408,006
Minority interest	3,791	3,776
Shareholders equity		
Shares of beneficial interest; $0.01 par value; 100,000 shares authorized: 49,461 and 46,682 shares issued and outstanding	496	468
Additional paid-in capital	653,816	561,492
Distributions in excess of net income	(96,873)	(75,416)
Accumulated other comprehensive income	380	
Total shareholders equity	557,819	486,544

Total liabilities and shareholders equity	$ 1,905,441	$ 1,898,326

See accompanying notes to the financial statements.

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WASHINGTON REAL ESTATE INVESTMENT TRUST

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Revenue				
Real estate rental revenue	$ 69,768	$ 63,255	$ 140,046	$ 123,107
Expenses				
Real estate expenses	22,803	19,542	45,936	38,248
Depreciation and amortization	21,198	16,632	41,723	32,758
General and administrative	3,111	5,367	6,191	8,250
	47,112	41,541	93,850	79,256
Real estate operating income	22,656	21,714	46,196	43,851
Other income (expense)				
Interest expense	(17,582)	(15,298)	(35,246)	(29,682)
Other income	220	420	458	1,038
Loss on extinguishment of debt			(8,449)	
Other income from life insurance proceeds				1,303
	(17,362)	(14,878)	(43,237)	(27,341)
Income from continuing operations	5,294	6,836	2,959	16,510
Discontinued operations:				
Gain on sale of real estate	15,275		15,275	
Income from operations of properties held for sale	639	1,501	1,486	2,539
Net income	$ 21,208	$ 8,337	$ 19,720	$ 19,049
Basic net income per share				
Continuing operations	$ 0.11	$ 0.15	$ 0.06	$ 0.37
Discontinued operations	0.33	0.03	0.36	0.05
Basic net income per share	$ 0.44	$ 0.18	$ 0.42	$ 0.42
Diluted net income per share				
Continuing operations	$ 0.11	$ 0.15	$ 0.06	$ 0.36
Discontinued operations	0.33	0.03	0.36	0.06
Diluted net income per share	$ 0.44	$ 0.18	$ 0.42	$ 0.42
Weighted average shares outstanding basic	47,933	45,490	47,278	45,212
Weighted average shares outstanding diluted	48,148	45,658	47,495	45,407
Dividends declared and paid per share	$ 0.4325	$ 0.4225	$ 0.8550	$ 0.8350

See accompanying notes to the financial statements.

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WASHINGTON REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

(In thousands)

(UNAUDITED)

	Shares	Shares of Beneficial Interest at Par Value	Additional Paid in Capital	Distributions In Excess of Net Income	Accumulated Other Comprehensive Income	Shareholders Equity
Balance, December 31, 2007	46,682	$ 468	$ 561,492	$ (75,416)	$	$ 486,544
Comprehensive income:						
Net income				19,720		19,720
Change in fair value of interest rate hedge					380	380
Total comprehensive income						20,100
Dividends				(41,177)		(41,177)
Equity offering	2,600	26	86,657			86,683
Shares issued under Dividend Reinvestment Program	80	1	2,559			2,560
Share options exercised	99	1	2,136			2,137
Share grants, net of share grant amortization and forfeitures			972			972
Balance, June 30, 2008	49,461	$ 496	$ 653,816	$ (96,873)	$ 380	$ 557,819

See accompanying notes to the financial statements.

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WASHINGTON REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(UNAUDITED)

	Six Months Ended June 30,	
	2008	2007
Cash flows from operating activities		
Net income	$ 19,720	$ 19,049
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, including amounts in discontinued operations	41,723	33,655
Provision for losses on accounts receivable	1,679	948
Amortization of share grants	1,031	1,598
Gain on sale of real estate	(15,275)	
Loss on extinguishment of debt	8,449	
Changes in operating other assets	(2,182)	(3,500)
Changes in operating other liabilities	3,314	14,406
Net cash provided by operating activities	58,459	66,156
Cash flows from investing activities		
Real estate acquisitions, net	(16,842)	(200,123)
Net cash received for sale of real estate	40,231	
Restricted cash tax free exchange escrow	(40,231)	
Capital improvements to real estate	(18,016)	(20,341)
Development in progress	(13,556)	(34,359)
Non-real estate capital improvements	(224)	(2,359)
Net cash used in investing activities	(48,638)	(257,182)
Cash flows from financing activities		
Line of credit borrowings		161,200
Line of credit repayments	(177,500)	(126,700)
Dividends paid	(41,177)	(38,402)
Proceeds from equity offering under Dividend Reinvestment Program	2,560	
Proceeds from mortgage notes payable	81,029	
Principal payments mortgage notes payable	(1,938)	(9,548)
Proceeds from debt offering	100,076	150,809
Financing costs	(1,640)	(4,887)
Net proceeds from equity offering	86,683	57,790
Note repayments	(60,366)	
Loss on extinguishment	(8,449)	
Net proceeds from the exercise of share options	2,137	176
Net cash provided by (used in) financing activities	(18,585)	190,438
Net (decrease) in cash and cash equivalents	(8,764)	(588)
Cash and cash equivalents, beginning of period	21,488	8,721
Cash and cash equivalents, end of period	$ 12,724	$ 8,133

Supplemental disclosure of cash flow information:		
Cash paid for interest, net of amounts capitalized	$ 35,248	$ 26,765

See accompanying notes to the financial statements.

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WASHINGTON REAL ESTATE INVESTMENT TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(UNAUDITED)

NOTE 1: NATURE OF BUSINESS

Washington Real Estate Investment Trust (WRIT, the Company or the Trust), 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 development of income-producing real estate properties in the greater Washington metro region. We own a diversified portfolio of office buildings, medical office buildings, industrial/flex centers, multifamily properties 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 required to distribute at least 90% of our ordinary taxable income to our shareholders. When selling properties, we have the option of (i) reinvesting the sale price of properties sold, allowing for a deferral of income taxes on the sale, (ii) paying out capital gains to the shareholders with no tax to the company or (iii) treating the capital gains as having been distributed to the shareholders, paying the tax on the gain deemed distributed and allocating the tax paid as a credit to the shareholders. In June 2008, two industrial properties, Sullyfield Center and The Earhart Building, were sold for a gain of $15.3 million. The proceeds from the sale are expected to be reinvested in a replacement property.

NOTE 2: ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited financial statements have been prepared 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 U.S. generally accepted accounting principles 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 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, 2007.

Within these notes to the financial statements, we refer to the three and six months ended June 30, 2008 as the 2008 Quarter and the 2008 Period , respectively, and the three and six months ended June 30, 2007 as the 2007 Quarter and the 2007 Period , respectively.

New Accounting Pronouncements

In September 2006, the FASB issued FASB Statement No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. On February 12, 2007, the FASB issued FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157* (the FSP). The FSP amends SFAS No. 157 to delay the effective date for all non-financial assets and non-financial liabilities, except for those that are recognized or disclosed at fair value in the financial statements on a recurring basis (i.e. at least annually). The FSP defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of the proposed FSP. The effective date of the statement related to those items not covered by the deferral (all financial assets and liabilities or non-financial assets and liabilities recorded at fair value on a recurring basis) is for fiscal years beginning after November 15, 2007. We do not have significant assets or liabilities recorded at fair value on a recurring basis, and therefore the adoption of this statement on January 1, 2008 did not have a material impact on our financial statements. However, this statement requires us to provide expanded disclosures of our valuation techniques.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We have not elected the fair value option for any assets or liabilities, and therefore the adoption of the statement did not have a material impact on our financial statements.

WASHINGTON REAL ESTATE INVESTMENT TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(UNAUDITED)

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations, a revision of SFAS No. 141. This statement changes the accounting for acquisitions by specifically eliminating the step acquisition model, changing the recognition of contingent consideration from being recognized when it is probable to being recognized at the time of acquisition, disallowing the capitalization of transaction costs, and delaying when restructuring related to acquisitions can be recognized. The standard is effective for fiscal years beginning after December 15, 2008, and will only impact the accounting for acquisitions we make after our adoption. Accordingly, upon our adoption of this standard on January 1, 2009, there will not be any impact on our historical financial statements.

Also in December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, which clarifies the classification of noncontrolling interests in consolidated statements of financial position and the accounting for and reporting of transactions between the reporting entity and holders of such noncontrolling interests. Under the new standard noncontrolling interests are considered equity and should be reported as an element of consolidated equity. Net income will encompass the total income of all consolidated subsidiaries and there will be a separate disclosure on the face of the income statement of the attribution of that income between the controlling and noncontrolling interests. Increases and decreases in the noncontrolling ownership interest amount will be accounted for as equity transactions. The standard is effective for fiscal years beginning after December 15, 2008. The statement will require us to change the presentation only of minority interest on our financial statements.

In March 2008 the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133 (FAS 161). This statement requires entities to provide greater transparency about how and why an entity uses derivative instruments, and how derivative instruments and related hedged items affect an entity s financial position, results of operations, and cash flows. To meet these objectives, FAS 161 requires (1) qualitative disclosures about objectives for using derivatives by primary underlying risk exposure and by purpose or strategy, (2) information about the volume of derivative activity, (3) tabular disclosures about balance sheet location and gross fair value amounts of derivative instruments, income statement and other comprehensive income location and amounts of gains and losses on derivative instruments by type of contract, and (4) disclosures about credit risk-related contingent features in derivative agreements. FAS 161 is effective for financial statements issued for fiscal years beginning after November 15, 2008. This statement will require us to provide expanded disclosures only of our interest rate hedge contract.

On May 9, 2008, the FASB issued FASB Staff Position APB 14-a (the FSP). This guidance clarifies the accounting for convertible debt instruments that may be settled in cash (including partial cash settlement) upon conversion. This guidance will significantly impact the accounting of the Company s convertible debt by requiring bifurcation of a component of the debt, classification of that component in stockholders equity, and then accretion of the resulting discount on the debt to result in interest expense equal to the issuer s nonconvertible debt borrowing rate. The calculation of earnings-per-share will not be affected, other than the impact on net income from the debt discount amortization. The FSP will be effective for fiscal years beginning after December 15, 2008. We believe that the adoption of the proposed FSP will have a significant impact on our financial statements due to our convertible debt outstanding and are in the process of quantifying the impact.

Revenue Recognition

Residential properties (our multifamily segment) are leased under operating leases with terms of generally one year or less, and commercial properties (our office, medical office, retail and industrial segments) are leased under operating leases with average terms of three to seven years. We recognize rental income and rental abatements from our residential and commercial leases when earned on a straight-line basis in accordance with SFAS No. 13 Accounting for Leases. Recognition of rental income commences when control of the facility has been given to the tenant. We record a provision for losses on accounts receivable equal to the estimated uncollectible amounts. This estimate is based on our historical experience and a review of the current status of the Company s receivables. Percentage rents, which represent additional rents based on gross tenant sales, are recognized when tenants sales exceed specified thresholds.

In accordance with SFAS No. 66, Accounting for Sales of Real Estate, sales are recognized at closing only when sufficient down payments have been obtained, possession and other attributes of ownership have been transferred to the buyer and we have no significant continuing involvement.

WASHINGTON REAL ESTATE INVESTMENT TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(UNAUDITED)

We recognize cost reimbursement income from pass-through expenses on an accrual basis over the periods in which the expenses were incurred. Pass-through expenses are comprised of real estate taxes, operating expenses and common area maintenance costs which are reimbursed by tenants in accordance with specific allowable costs per tenant lease agreements.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable primarily represents amounts accrued and unpaid from tenants in accordance with the terms of the respective leases, subject to our revenue recognition policy. Receivables are reviewed monthly and reserves are established when, in the opinion of management, collection of the receivable is doubtful. When the collection of a receivable is deemed doubtful in the same quarter that the receivable was established, then the allowance for that receivable is recognized as an offset to real estate revenues. When a receivable that was initially established in a prior quarter is deemed doubtful, then the allowance is recognized as an operating expense. In addition to rents due currently, accounts receivable include amounts representing minimal rental income accrued on a straight-line basis to be paid by tenants over the remaining term of their respective leases. Reserves are established for tenants whose rent payment history or financial condition casts doubt upon the tenant s ability to perform under its lease obligation.

Minority Interest

We entered into an operating agreement with a member of the entity that previously owned Northern Virginia Industrial Park in conjunction with the acquisition of this property in May 1998. This resulted in a minority ownership interest in this property based upon defined company ownership units at the date of purchase. The operating agreement was amended and restated in 2002 resulting in a reduced minority ownership percentage interest. We account for this activity by recording minority interest expense by applying the minority owner s percentage ownership interest to the net income of the property and including such amount in our general and administrative expenses, thereby reducing net income.

In August 2007 we acquired a 0.8 acre parcel of land located at 4661 Kenmore Avenue, Alexandria, Virginia for future medical office development. The acquisition was funded by issuing operating units in a consolidated subsidiary of WRIT. This resulted in a minority ownership interest in this property based upon defined company ownership units at the date of purchase. We account for this activity by recording minority interest expense by applying the minority owner s percentage ownership interest to the net income of the property and including such amount in our general and administrative expenses, thereby reducing net income.

Minority interest expense was $52,800 and $110,200 for the 2008 Quarter and 2008 Period, respectively, and $52,900 and $105,200 for the 2007 Quarter and 2007 Period, respectively. Quarterly distributions are made to the minority owners equal to the quarterly dividend per share for each ownership unit.

Deferred Financing Costs

External costs associated with the issuance or assumption of mortgages, notes payable and fees associated with the lines of credit are capitalized and amortized using the effective interest rate method or the straight-line method which approximates the effective interest rate method over the term of the related debt. As of June 30, 2008 and December 31, 2007, deferred financing costs of $21.4 million and $23.9 million, respectively, net of accumulated amortization of $5.0 million and $7.9 million, were included in Prepaid Expenses and Other Assets on the balance sheets. The amortization is included in Interest Expense in the accompanying statements of income. The amortization of debt costs included in Interest Expense totaled $0.6 million and $1.3 million for the 2008 Quarter and 2008 Period, respectively, and $0.6 million and $1.1 million for the 2007 Quarter and the 2007 Period, respectively.

Deferred Leasing Costs

Costs associated with the successful negotiation of leases, both external commissions and internal direct costs, are capitalized and amortized on a straight-line basis over the terms of the respective leases. If an applicable lease terminates prior to the expiration of its initial lease term, the carrying amount of the costs are written-off to amortization expense. As of June 30, 2008 and December 31, 2007 deferred leasing costs of $26.1 million and $23.8 million, respectively, net of accumulated amortization of $9.3 million and $8.3 million, were included in Prepaid Expenses and Other Assets on the balance sheets. The amortization of deferred leasing costs included in Amortization Expense for properties classified as continuing operations totaled $0.8 million and $1.7 million for the 2008 Quarter and the 2008 Period, respectively, and $0.7 million and $1.5 million for the 2007 Quarter and the 2007 Period, respectively.

WASHINGTON REAL ESTATE INVESTMENT TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(UNAUDITED)

Real Estate and Depreciation

Buildings are depreciated on a straight-line basis over estimated useful lives ranging from 28 to 50 years. All capital improvement expenditures associated with replacements, improvements, or major repairs to real property that extend its useful life are capitalized and depreciated using the straight-line method over their estimated useful lives ranging from 3 to 30 years. We also capitalize costs incurred in connection with our development projects, including capitalizing interest and other internal costs during periods in which development projects are in progress. In addition, we capitalize tenant leasehold improvements when certain criteria are met, including when we supervise construction and will own the improvements. All tenant improvements are amortized over the shorter of the useful life of the improvements or the term of the related tenant lease. Real estate depreciation expense from continuing operations was $17.2 million and $34.0 million for the 2008 Quarter and Period, respectively, and $13.6 million and $26.1 million for the 2007 Quarter and Period, respectively. Maintenance and repair costs that do not extend an asset s life are charged to expense as incurred.

We capitalize interest costs incurred on borrowing obligations while qualifying assets are being readied for their intended use in accordance with SFAS No. 34, Capitalization of Interest Cost. Total interest expense capitalized to real estate assets related to development and major renovation activities was $0.7 million and $1.4 million for the 2008 Quarter and Period, respectively, and $1.6 million and $2.9 million for the 2007 Quarter and Period, respectively. Interest capitalized is amortized over the useful life of the related underlying assets upon those assets being placed into service.

We recognize impairment losses on long-lived assets used in operations and held for sale, development assets or land held for future development, if indicators of impairment are present and the net undiscounted cash flows estimated to be generated by those assets are less than the assets carrying amount and estimated undiscounted cash flows associated with future development expenditures. If such carrying amount is in excess of the estimated cash flows from the operation and disposal of the property, we would recognize an impairment loss equivalent to an amount required to adjust the carrying amount to the estimated fair value. There were no property impairments recognized during 2008 and 2007 Quarters and 2008 and 2007 Periods.

We allocate the purchase price of acquired properties to the related physical assets and in-place leases based on their fair values, in accordance with SFAS No. 141, Business Combinations. The fair values of acquired buildings are determined on an as-if-vacant basis considering a variety of factors, including the physical condition and quality of the buildings, estimated rental and absorption rates, estimated future cash flows and valuation assumptions consistent with current market conditions. The as-if-vacant fair value is allocated to land, building and tenant improvements based on property tax assessments and other relevant information obtained in connection with the acquisition of the property. No goodwill was recorded on our acquisitions for the 2008 and 2007 Quarters and 2008 and 2007 Periods.

The fair value of in-place leases consists of the following components (1) the estimated cost to us to replace the leases, including foregone rents during the period of finding a new tenant and foregone recovery of tenant pass-throughs (referred to as Absorption Cost), (2) the estimated cost of tenant improvements, and other direct costs associated with obtaining a new tenant (referred to as Tenant Origination Cost); (3) estimated leasing commissions associated with obtaining a new tenant (referred to as Leasing Commissions); (4) the above/below market cash flow of the leases, determined by comparing the projected cash flows of the leases in place to projected cash flows of comparable market-rate leases (referred to as Net Lease Intangible); and (5) the value, if any, of customer relationships, determined based on our evaluation of the specific characteristics of each tenant s lease and our overall relationship with the tenant (referred to as Customer Relationship Value).

The amounts used to calculate Net Lease Intangible are discounted using an interest rate which reflects the risks associated with the leases acquired. Tenant Origination Costs are included in Real Estate Assets on our balance sheet and are amortized as depreciation expense on a straight-line basis over the remaining life of the underlying leases. Leasing Commissions and Absorption Costs are classified as Other Assets and are amortized as amortization expense on a straight-line basis over the remaining life of the underlying leases. Net Lease Intangible Assets are classified as Other Assets and are amortized on a straight-line basis as a decrease to Real Estate Rental Revenue over the remaining term of the underlying leases. Net Lease Intangible Liabilities are classified as Other Liabilities and are amortized on a straight-line basis as an increase

to Real Estate Rental Revenue over the remaining term of the underlying leases. Should a tenant terminate its lease, the unamortized portion of the Tenant Origination Cost, Leasing Commissions, Absorption Costs and Net Lease Intangible associated with that lease are written off to depreciation expense, amortization expense, and rental revenue, respectively.

WASHINGTON REAL ESTATE INVESTMENT TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(UNAUDITED)

Balances, net of accumulated depreciation or amortization, as appropriate, of the components of the fair value of in-place leases at June 30, 2008 and December 31, 2007 are as follows (in millions):

	June 30, 2008			December 31, 2007		
	Gross Carrying Value	Accumulated Amortization	Net	Gross Carrying Value	Accumulated Amortization	Net
Tenant Origination Costs	$ 31.3	$ 13.5	$ 17.8	$ 31.3	$ 10.9	$ 20.4
Leasing Commissions/Absorption Costs	$ 34.1	$ 12.0	$ 22.1	$ 33.8	$ 8.8	$ 25.0
Net Lease Intangible Assets	$ 8.8	$ 5.0	$ 3.8	$ 8.9	$ 4.3	$ 4.6
Net Lease Intangible Liabilities	$ 22.8	$ 8.2	$ 14.6	$ 23.5	$ 6.3	$ 17.2

Amortization of these components combined was $2.5 million and $4.7 million for the 2008 Quarter and Period, respectively, and $2.0 million and $4.2 million for the 2007 Quarter and Period, respectively. In addition, we have a below-market ground lease intangible asset from a 2007 acquisition with a gross carrying value of $12.1 million as of June 30, 2008. No value had been assigned to Customer Relationship Value at June 30, 2008 or December 31, 2007.

Discontinued Operations

We classify properties as held for sale when they meet the necessary criteria specified by SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets and EITF 03-13, Applying the Conditions in Paragraph 42 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* in Determining Whether to Report Discontinued Operations. These include: senior management commits to and actively embarks upon a plan to sell the assets, the sale is expected to be completed within one year under terms usual and customary for such sales and actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. Depreciation on these properties is discontinued, but operating revenues, operating expenses and interest expense continue to be recognized until the date of sale.

Under SFAS No. 144, revenues and expenses of properties that are either sold or classified as held for sale are presented as discontinued operations for all periods presented in the Statements of Income. Interest on debt that can be identified as specifically attributed to these properties is included in discontinued operations. We do not have significant continuing involvement in the operations of any of our disposed properties.

Cash and Cash Equivalents

Cash and cash equivalents include investments readily convertible to known amounts of cash with original maturities of 90 days or less.

Restricted Cash

Restricted cash at June 30, 2008 and December 31, 2007 consisted of $48.9 million and $6.0 million, respectively, in funds escrowed for tenant security deposits for certain tenants, real estate tax, insurance and mortgage escrows and escrow deposits required by lenders on certain of our properties to be used for future building renovations or tenant improvements. The balance at June 30, 2008 includes proceeds from the sale of real estate of $40.2 million escrowed in a tax free property exchange account (see Note 3).

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Assets and Liabilities Measured at Fair Value

For assets and liabilities measured at fair value on a recurring basis, SFAS No. 157, *Fair Value Measurements*, requires quantitative disclosures about the fair value measurements separately for each major category of assets and liabilities. The only assets or liabilities the Company has at June 30, 2008 that are recorded at fair value on a recurring basis are the assets held in the Supplemental Executive Retirement Program (SERP) and an interest rate hedge contract. The Company s valuations related to these items are based on assumptions derived from significant other observable inputs and accordingly fall into Level 2 in the fair value hierarchy. The fair value of these assets and liabilities at June 30, 2008 is as follows (in millions):

	June 30, 2008			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
SERP	$ 0.8	$	$ 0.8	$
Derivatives	$ 0.4	$	$ 0.4	$

Derivative Instruments

In February 2008, we entered into an interest rate swap with a notional amount of $100 million that qualifies as a cash flow hedge under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (see Note 6 for further details). We enter into interest rate swaps to manage our exposure to variable rate interest risk. We do not purchase derivatives for speculation. Our cash flow hedges are recorded at fair value. The effective portion of changes in fair value of cash flow hedges is recorded in other comprehensive income. The ineffective portion of changes in fair value of cash flow hedges is recorded in earnings in the period affected. We assess effectiveness of our cash flow hedges both at inception and on an ongoing basis. The hedge was deemed effective in the 2008 Quarter and Period. We did not have any cash flow hedges during 2007.

Stock Based Compensation

We maintained a Share Grant Plan and Incentive Stock Option Plans as described in Note 7, and pursuant to those plans we made restricted share grants and granted share options to officers, eligible employees and trustees. Officer share grants vesting over five years vest in annual installments commencing one year after the date of grant, and share grants vesting over three years vest twenty-five percent from date of grant in years one and two and fifty percent in year three. Officer performance share units, granted under an amendment to the Share Grant Plan, cliff vest at the end of a three year performance period. Officer and non-officer employee restricted share units, granted under an amendment to the Share Grant Plan, vest over five years. Trustee share grants are fully vested immediately upon date of share grant and are restricted from transferability for the period of the trustee s service.

In March 2007, the WRIT Board of Trustees adopted, and in July 2007 WRIT shareholders approved, the Washington Real Estate Investment Trust 2007 Omnibus Long-Term Incentive Plan (2007 Plan). This plan replaced the Share Grant Plan, which expired on December 15, 2007, as well as the 2001 Stock Option Plan and Stock Option Plan for Trustees. As described above, the shares and options granted pursuant to the above plans are not affected by the adoption of the 2007 Plan. However, if an award under the Share Grant Plan is forfeited or an award of options granted under the Option Plans expires without being exercised, the shares covered by those awards will not be available for issuance under the 2007 Plan.

The 2007 Plan provides for the award to WRIT s trustees, officers and non-officer employees of restricted shares, restricted share units, options and other awards to acquire up to an aggregate of 2,000,000 shares over the ten year period in which the plan will be in effect. If an award under the 2007 Plan of restricted shares or restricted share units is forfeited or an award of options or any other rights granted under the 2007 Plan expires without being exercised, the shares covered by any such award would again become available for issuance under new awards.

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Compensation expense is recognized for share grants over the vesting period equal to the fair market value of the shares on the date of issuance. Compensation expense for the trustee grants, which fully vest immediately, is fully recognized upon issuance based upon the fair market value of the shares on the date of grant. The unvested portion of officer and non-officer employee share grants is recognized in compensation cost over the vesting period.

Unvested shares are forfeited upon an employee s termination except for employees eligible for retirement whose unvested shares fully vest upon retirement. For shares granted to employees who are eligible for retirement or will become eligible for retirement during the vesting period, compensation cost is recognized over the explicit service period with acceleration of expense upon the date of actual retirement for these employees. The Company will continue this practice for awards granted prior to January 1, 2006, when SFAS No. 123R was adopted, and for shares granted after the adoption of SFAS No. 123R the Company will recognize compensation expense through the date that the employee is no longer required to provide service to earn the award (e.g. the date the employee is eligible to retire).

Stock options were historically issued annually to officers, non-officer key employees and trustees under the Incentive Stock Option Plans. They were last issued to officers in 2002, to non-officer key employees in 2003 and to trustees in 2004. The options vested over a 2-year period in annual installments commencing one year after the date of grant, except for trustee options which vested immediately upon the date of grant. Stock options issued prior to the adoption of SFAS No. 123R are accounted for in accordance with APB No. 25, whereby if options are priced at fair market value or above at the date of grant and if other requirements are met then the plans are considered fixed and no compensation expense is recognized. Accordingly, we have recognized no compensation cost for stock options.

Earnings per Common Share

We calculate basic and diluted earnings per share in accordance with SFAS No. 128, Earnings per Share. Basic earnings per share excludes dilution and is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted into common shares, and then shared in our earnings. Sources of potentially dilutive common shares are our share based payment plans, operating partnership units and senior convertible notes. The senior convertible notes were not dilutive for the three and six months ended June 30, 2008 or June 30, 2007.

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The following table sets forth the computation of basic and diluted earnings per share (dollars in thousands; except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Numerator for basic and diluted per share calculations:				
Income from continuing operations	$ 5,294	$ 6,836	$ 2,959	$ 16,510
Discontinued operations including gain on sale of real estate	15,914	1,501	16,761	2,539
Net income	$ 21,208	$ 8,337	$ 19,720	$ 19,049
Denominator for basic and diluted per share calculations:				
Denominator for basic per share amounts weighted average shares	47,933	45,490	47,278	45,212
Effect of dilutive securities:				
Employee stock options/restricted share awards and units	133	168	135	195
Operating partnership units	82		82	
Denominator for diluted per share amounts	48,148	45,658	47,495	45,407
Income from continuing operations per share				
Basic	$ 0.11	$ 0.15	$ 0.06	$ 0.37
Diluted	$ 0.11	$ 0.15	$ 0.06	$ 0.36
Discontinued operations including gain on disposal				
Basic	$ 0.33	$ 0.03	$ 0.36	$ 0.05
Diluted	$ 0.33	$ 0.03	$ 0.36	$ 0.06
Net income per share				
Basic	$ 0.44	$ 0.18	$ 0.42	$ 0.42
Diluted	$ 0.44	$ 0.18	$ 0.42	$ 0.42

Use of Estimates in the Financial Statements

The preparation of financial statements in conformity with U. S. generally accepted accounting principles 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.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

Other Comprehensive Income (Loss)

We recorded other comprehensive income of $0.4 million for the period ended June 30, 2008 to account for the change in valuation of an interest rate swap agreement that qualifies as a cash flow hedge under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. We recorded no other comprehensive income or loss for 2007.

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NOTE 3: REAL ESTATE INVESTMENTS

Our real estate investment portfolio, at cost, consists of properties located in Maryland, Washington, D.C. and Virginia as follows (in thousands):

	June 30, 2008	December 31, 2007
Office buildings	$ 817,110	$ 817,508
Medical office buildings	363,885	354,485
Retail centers	265,734	257,966
Multifamily properties	267,051	229,241
Industrial/Flex properties	317,284	304,920
	$ 2,031,064	$ 1,964,120

The amounts above reflect properties classified as continuing operations, which means they are to be held and used in rental operations (income producing property).

We have several properties in development in our office and multifamily sectors. In the multifamily sector, Bennett Park was substantially completed in the fourth quarter of 2007, and The Clayborne Apartments were substantially completed in the first quarter of 2008. The cost of our real estate portfolio in development is illustrated below (in thousands):

	June 30, 2008	December 31, 2007
Office buildings	$ 53,758	$ 56,311
Medical office buildings	4,289	4,016
Retail centers	159	74
Multifamily	301	37,920
Industrial/Flex properties	253	
	$ 58,760	$ 98,321

We dispose of assets (sometimes using tax-deferred exchanges) that are inconsistent with our long-term strategic or return objectives and when market conditions for sale are favorable. The proceeds from the sales may be redeployed into other properties, used to fund development operations or to support other corporate needs, or distributed to our shareholders. Two office properties, Maryland Trade Centers I and II, were sold as of September 30, 2007 and initially classified as held for sale as of March 31, 2007. Two industrial properties, Sullyfield Center and The Earhart Building, were sold on June 6, 2008 and initially classified as held for sale in November 2007. They were sold for a contract sales price of $41.1 million that resulted in a gain on sale of $15.3 million.

Operating results of the properties classified as discontinued operations are summarized as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Revenues	$ 832	$ 2,777	$ 1,930	$ 5,519
Property expenses	(193)	(1,028)	(444)	(2,083)
Depreciation and amortization		(248)		(897)
	$ 639			