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Transcript of Washington REIT
Second Quarter 2017 Earnings Conference Call
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Participants

Tejal Engman - Director, IR
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Steve Riffee - EVP and CFO
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Drew Hammond - VP, CAO and Controller
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Bill Crow - Raymond James
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Presentation

Operator
Welcome to the Washington Real Estate Investment Trust Second Quarter 2017 Earnings Conference Call. As a reminder, today's call is being recorded. Before turning over the call to the company's President and Chief Executive Officer, Paul McDermott, Tejal Engman, Vice President of Investor Relations will provide some introductory information. Ms. Engman, please go ahead.

Tejal Engman - Director, IR
Thank you and good morning everyone. Please note that our conference call today will contain financial measures, such as FFO, core FFO, NOI, Core FAD and adjusted EBITDA that are non-GAAP measures as defined in Reg G. Please refer to our most recent financial supplement and to our earnings press release, both available on the Investor page of our website, and to our periodic reports furnished or filed with the SEC, for definitions and further information regarding our use of these non-GAAP financial measures, and a reconciliation of them to our GAAP results.

Please also note that some statements during this call are forward-looking statements within the Private Securities Litigation Reform Act. Forward-looking statements in the earnings press release, along with our remarks, are made as of today, and we undertake no duty to update them as actual events unfold. Such statements involve known and unknown risks, uncertainties, and other factors that may cause actual results to differ materially. We refer to certain of these risks in our SEC filings. Please refer to pages 9 – 24 of our Form 10-K for our complete risk factor disclosure.

Participating in today’s call with me will be Paul McDermott, President and Chief Executive Officer, Steve Riffee, Executive Vice President and Chief Financial Officer, Tom Bakke, Executive Vice President and Chief Operating Officer, Drew Hammond, Vice President Chief Accounting Officer and Controller, and Kelly Shiflett, Vice President Finance and Treasurer.

Now, I'd like to turn the call over to Paul.

Paul McDermott - President and CEO
Thank you Tejal and good morning everyone. Thanks for joining us on our second quarter 2017 earnings conference call.

Washington REIT raised full-year 2017 same-store NOI growth projections across all three asset classes and raised 2017 Core FFO guidance for the second time this year. Second-quarter Core FFO of $0.48 per fully diluted share grew 4.3% year-over-year, driven by strong same-store NOI growth of 8.8% year-over-year. We increased same-store economic occupancy by 470 basis points year-over-year and ended the second quarter 93.3% occupied. In addition, we drove solid leasing momentum in the second quarter, with the signing of a 131,000 square foot, 15-year lease with the United States Department of Agriculture at Braddock Metro Center. We also continued to drive high levels of activity at the Army Navy Building, which is now approximately 71% leased with an additional 10% under LOI. Finally, we received strong levels of interest for the proposed disposition of Walker House Apartments in Gaithersburg, Maryland, and expect to close on the sale of this asset in the third quarter.

We delivered robust year-over-year same-store NOI growth for the second quarter in a row, achieving 14.8%, 4.6% retail and 2.6% multifamily growth in the second quarter. While Steve will address our key performance drivers later on the call, I would like to specifically acknowledge our expense management initiatives and our continued ability to work with our tenants to drive operational improvements as key factors that have contributed to our second-quarter performance.

Beginning with our largest lease signed this quarter, we are pleased to have secured a major tenant, the USDA, in a long-term lease that is expected to commence in the second-half of 2018, contingent upon completed renovations of the asset and the leased space. The USDA is in holdover on its existing space and is working with us to stay on schedule with a desire to commence as soon as possible. For us, this lease achieves our goal of backfilling Engility's lease that expires in September 2017 with minimal downtime. Combined with our recent large long-term renewals, this new lease effectively addresses all of our large, near-term office lease expirations, while still maintaining low overall GSA exposure. Including the USDA lease on a pro-forma basis, Federal government tenants would comprise approximately 3% of our annualized base rental revenue.

Moving on to our most recent value-creation project, we closed on Watergate 600 at the beginning of the second-quarter at a going-in cash cap rate in the high 6s, which included an estimated year-one spend of approximately $10 million of the $18 million renovation program. The lobby renovation is currently underway and we are already seeing early interest for the top three floors of future vacancy from a number of significant users that place a premium on views and ease of access. Watergate 600 is one of only three waterfront office buildings in Washington DC that offers panoramic views of the Potomac and monuments. In addition to being walkable to the Foggy Bottom Metro station, the asset enjoys excellent commuter access to I-66, the Whitehurst Freeway and Rock Creek Parkway. This advantageous access enables commuters from Virginia and Maryland to shorten their commuting time relative to a CBD or an East End location. Ease of access, like amenities, is becoming a key real estate differentiator in our region as traffic congestion continues to increase.

Let me now detail our leasing progress at the Army Navy Building, where we are seeing strong levels of activity from tenants across a variety of sectors including financial services, energy, infrastructure, healthcare advocacy, government consulting and media. Tour activity remains robust and we expect to be stabilized in the first half of 2018. Leasing has met our underwriting expectations, and in a few cases, has even exceeded them. With an approximately $4 million redevelopment project, we have taken market rents at Army Navy from the mid-$50s full service to the mid-$60s on average. We are achieving a high return on cost because our market research and cost-effective design enabled us to meet demand from small and mid-size tenants for a highly amenitized product at a competitive price. Our value-add success at Army Navy follows on similar strategic office executions at 1775 Eye Street and Silverline Center. Additionally, we are also realizing our value-add strategy through ongoing multifamily unit renovations at The Wellington and Riverside.

These successes are driven by Washington REIT's core competencies of combining research with prudent capital allocation to deliver desirable space and amenities at competitive pricing levels for an underserved tenant and renter demographic. Today, we believe these combined core competencies are becoming even more critical in the DC Metro region, where we see an increasing supply of Class A office and multifamily product, alongside reduced availability of affordable leasing options for value-conscious office tenants and multifamily renters.

In the District, developers are adding high levels of new Trophy and commodity Class A office and multifamily supply despite relatively static demand from the end users of these products, which are primarily large law firms within office, and renter households earning in excess of $150,000 per year in multifamily. In Downtown DC office, the supply-demand imbalance is further amplified by the fact that over the past 24 months more than two million square feet of existing product priced in the mid-$40s to mid-$50 per foot full service has been converted into commodity Class A product priced at or above $70 per square foot, with a further 1.6 million square feet slated for conversion this year.

As a result, according to JLL, second-quarter 2017 vacancy for DC office product priced at $50 gross on average was 8.5%, while vacancy for Class A supply was approximately 16%. While the supply of affordable office product has shrunk in the Downtown core, tenants seeking more affordable offerings, which include technology, nonprofit, and professional and business services firms, are showing steady growth. As per region-wide JLL data, 71.4% of tech firms and 20% of nonprofits grew in the second quarter, while banking, consulting and professional and business services firms signed deals for a net 90,672 square feet of increased space.

Washington REIT is strategically positioned to benefit from this supply-demand imbalance as our same-store DC office portfolio offers product in a segment with below-market vacancy and rising demand, a combination that has led to greater landlord leverage. As a result, for new leases below 10,000 square feet in this portfolio, our tenant improvements per foot per year of term have fallen by approximately 17%, our free rent has dropped by approximately 10%, and our net effective rents have risen by approximately 7% for the 24 months from June 2015 to June 2017, compared to the June 2013 to June 2015 two-year period.

Similarly in multifamily, we see a supply-demand imbalance as the Class A development pipeline in the District continues to grow with more than 10,000 units projected to deliver over the next two years. Developers are adding expensive Class A multifamily product to a market where the proportion of housing-burdened renters is higher than in every major market in the country except LA, San Jose and San Diego. As per a July 2017 regional study conducted by the Fuller Institute, rental housing in the Washington region cost 69.1% above the US average and ranked second to San Francisco with New York now in third place. Moreover, the cost of living in the Washington Metro region is the third highest following San Francisco and New York. We believe our focus on product that can address this issue with quality apartments at a moderate price point is a winning formula in a market that continues to get more expensive.

We see evidence of our research-driven capital allocation strategy working in our same-store multifamily portfolio. Our second quarter same-store effective renewal rent trade out was 3.3% and new lease rent trade out was 5.6%. We attribute this strong performance to our strategic capital allocation to the right assets in the right submarkets. Approximately 71% of our overall multifamily NOI is derived from assets located in Northern Virginia and approximately 80% of our multifamily portfolio is Class B. As a result, our portfolio doesn't directly compete with the aforementioned wave of Class A deliveries that are largely hitting specific submarkets in the District, such as NoMa, and the Navy Yard and Waterfront areas of Southeast and Southwest DC.

Our growth in same-store new lease trade outs also reflects our successful unit renovation strategy at The Wellington. Today, the majority of our multifamily portfolio is located in submarkets with a wider-than-average gap between Class A and B rents. In addition to the unit renovations at The Wellington and Riverside, we have already begun smaller-scale unit renovation programs at 3801 Connecticut Avenue and the Kenmore. Finally, our rental growth is also driven by our focus on increasing pricing around stabilization benchmarks that are closely monitored for each individual asset. Our strategy is to press pricing between 94% and 96% occupancy and to thereby optimize the portfolio's rental income growth potential. Year to date, we have driven higher rent trade outs at all of our multifamily assets.

Moving onto ground-up development, our pipeline consists of two value Class A multifamily projects as well as one small retail project. We believe the size and scope of our development pipeline is appropriate given where we are in the current real estate cycle. We have commenced construction on The Trove, a 401-unit development onsite at The Wellington in South Arlington. Located at the eastern end of Columbia Pike, in a submarket with limited new supply, The Trove is designed to provide a value Class A offering. Units will be priced competitively while the asset will offer an amenity package that is unique for its submarket. We are able to offer competitive pricing at The Trove because we are developing on land that has a low cost basis given it was acquired as excess surface parking for The Wellington. We have further lowered our development costs by designing The Trove to be a wood-frame construction on a concrete podium, thereby achieving significantly lower costs than a concrete tower construction.

We are in the design development phase on our second multifamily ground-up development at Riverside Apartments in Alexandria, Virginia, where we plan to add approximately 550 units of additional density. Riverside is located in a submarket with limited Class A supply and among the widest affordability gaps between Class A and B rents in our region. Furthermore, major employers such as the National Science Foundation, MGM National Harbor Resort and the Patent and Trade Organization combined are bringing thousands of new jobs within a three mile radius of the property. We expect to commence construction on the Riverside's new development in the fourth quarter of 2018, contingent upon our validating continued positive market conditions.

Finally, we have also commenced construction at Spring Valley Village for 14,000 additional square feet and have signed LOI's with a high-quality regional restauranteur and a café operator for the ground floor of the new construction. We expect construction to be complete in the first quarter of 2018 and for the new space to lease during the remainder of the year. We expect to generate approximately $500,000 of incremental, annualized NOI from the new construction.

Touching on the rest of the retail portfolio, we are at LOI for the HHGregg vacancy at Frederick Crossing at higher rents, and are seeing good activity on the HHGregg vacancy at Hagerstown. Our watch list has remained stable after some watch list tenants, such as HHGregg, materialized at the beginning of the year.

Despite the general negative sentiment around the retail sector, our retail portfolio is well-positioned in one of the nation's more resilient retail markets. We don't own any malls and approximately 88% of our second quarter NOI was driven by community and neighborhood shopping centers as well as Class A power centers. Furthermore, our neighborhood and community shopping centers are high-performing, well-located centers with an average population density of approximately 156,000 and average annual household income of approximately $122,000 within a three mile radius. Based on second quarter NOI, approximately 80% of these centers have a grocery anchor that drives strong levels of traffic. Perhaps as importantly, many of these centers have been a part of their communities for decades and have adapted over time to serve their communities' evolved needs. Today, they offer an array of food, grocery, medical and personal care services, all of which tend to be relatively less impacted by the growth of e-commerce.

Retail in the DC Metro area continues to benefit from solid supply-demand fundamentals and has been the most consistent performer of any property type in the DC region over the last five years. According to CoStar data, the average market vacancy rate is 4.1% for all retail types and supply growth as a percentage of inventory is about half of the metro's historical average. Asking rents have increased 8.2% over the past 12 months and are up 5.4% over the previous quarter. Retail in our region benefits from high average household income levels that exceed the national average by 61%. Buying power in most of DC proper's submarkets has increased by at least 25% since 2000.

Now let me conclude with some observations on the Washington Metro Region, where job growth rebounded in May and accelerated further in June, adding 59,400 jobs on a trailing 12 month basis. This growth represents a 35% increase over the region's 20-year average job growth between 1990 and 2010, a period that excludes the impact of sequestration. Moreover, forward-looking indicators are pointing to stronger economic growth in the second half of this year and into 2018. The Washington Leading Index, developed in 1990 by George Mason University and the Greater Washington Board of Trade, is designed to forecast the performance of the Metro region's economy six to eight months in advance. The index measures changes in forward-looking indicators such as durable goods retail sales and consumer expectations among others, and has achieved five strong increases over the past six months. These gains represent the strongest sustained performance for the leading index over the past three years and present a signal that the economy is poised for stronger future growth than it is currently experiencing. According to regional economists that track the Index, our regional economy appears positioned to accelerate over the balance of this year and to generate a strong economic performance in 2018.

Finally, I would like to highlight that the Washington region is a knowledge-based economy dominated by high-skill jobs and a highly educated population. Washington ranks first among the country's largest metropolitan areas by educational attainment, with 49% of the population age 25 and over holding a college degree and nearly 24% with an advanced degree. It is therefore not surprising that the Washington Region has emerged as one of the top three destinations in the nation for technology. Cushman and Wakefield ranks the Washington Metro Region as the third most tech-centric market in the US, after San Jose's Silicon Valley and San Francisco. Their research methodology ranks each market on a variety of metrics such as institutions of higher learning, capital, tech workers, educated workers and growth entrepreneurship. Our region ranks first on the index for growth entrepreneurship by Metro area.

Now I would like to turn the call over to Steve to discuss our financial and operating performance in the second quarter.

Steve Riffee - EVP and CFO
Thanks Paul. Good morning everyone. Net income of $7.8 million or $0.10 per diluted share in the second quarter of 2017 was below net income of $31.8 or $0.44 per diluted share in the second quarter of 2016, which had included the recognition of a $24 million gain from the first sale transaction of the suburban Maryland office portfolio.

We reported second quarter core FFO of $0.48 per diluted share versus $0.46 in the same prior year period, driven by revenue-led year-over-year same-store NOI growth of 8.8%.

Second quarter core funds available for distribution, or Core FAD was approximately $33.8 million and we continue to target a full-year Core FAD payout ratio in the mid-80s.

Our strong second-quarter year-over-year same-store NOI growth was driven by same-store economic occupancy gains of 470 basis points in office and retail, as well as higher rental growth in multifamily and retail. Office also benefited from higher periodic settlements of tenant recoveries as well as increased lease termination fees.

Starting with office, same-store NOI grew 14.8% over second quarter 2016, driven by 870 basis points of economic occupancy gains. Approximately 60% of our year-over-year economic occupancy gains were driven by the Silverline Center, with the remainder spread across the portfolio with new lease commencements at 1776 G Street, 1775 Eye Street and Fairgate at Ballston as well as a tenant expansion at 1600 Wilson Boulevard. Office economic occupancy also improved 80 basis points sequentially due to new lease commencements by tech and healthcare related users at the Silverline Center, 1600 Wilson Boulevard, Fairgate and 2000 M Street. Office ending occupancy declined by 10 basis points sequentially due to a tenant move out at Monument II in Herndon, Virginia that has been backfilled by a cyber-security company, and its lease is expected to commence in the third quarter. With regard to office expenses, although real estate taxes have increased, as Paul mentioned, we have driven operational improvements across the office portfolio that have resulted in lower utility costs.

We leased approximately 214,000 square feet of office space in the second quarter, with new leases rolling down 14.2% on a GAAP basis and 20% on a cash basis largely due to the 131,000 square foot, 15-year new lease signed with the USDA. Large leases are not very common for our office portfolio, where the average new lease deal size for the twelve-months ended June 2017, excluding the USDA lease, was approximately 4,900 square feet. Our objective in signing the USDA lease was to minimize the downtime at the asset and to de-risk our cash flows by a signing a long-term lease with the US government. That said, when we factored in the term we received on this lease, the tenant improvements and leasing commissions for all new office leases were a reasonable $6.67 per foot per year of term, the lowest in several quarters. As a result of this lease and our recent large office renewals, we have now addressed all of our large, near-term office lease expirations. Office renewals were 14.8% higher on a GAAP basis and 7.3% higher on a cash basis, with modest tenant improvements and leasing commissions of $21.65 per foot. We believe these are representative office lease economics for quarters where we don’t have large tenants rolling and are renewing small and mid-size tenants, who represent the majority of our tenant base. Office tenant retention in the second-quarter was approximately 63%.

We continue to generate leasing momentum in our office portfolio where we have activity and prospects for 3 ½ times the total square footage of our current vacancies and 2017 lease expirations. Our same-store Washington DC office portfolio continues to outperform the region with occupancy approximately 7% above overall DC market occupancy. Our office portfolio is also significantly outperforming in Northern Virginia, where our same-store occupancy is over 13% higher than the market’s.

Moving onto Retail, same-store NOI grew by approximately 4.6% on a year-over-year basis, primarily driven by 110 basis points of year-over-year occupancy gains and 90 basis points of year-over-year rental growth. Although occupancy declined on a sequential basis due to HHGregg, one move out was related to Office Max leaving Gateway Overlook, which is being replaced by Aldi. Aldi has taken possession subsequent to quarter-end and at rents that are rolling up significantly. Our retail portfolio was 93% leased at quarter-end with good activity on vacancies and the opportunity to grow occupancy in 2018.

We leased approximately 152,000 square feet of retail space predominantly through renewal leases, which achieved an average rental rate increase of 11.1% on a GAAP basis and 8.7% on a cash basis. New leases were 66% higher on a GAAP basis and 57% higher on a cash basis.

Finally, multifamily same-store NOI was up 2.6% over second quarter 2016 driven by 180 basis points of rent growth. On a per unit basis, the same-store portfolio ended the second quarter 95.4% occupied with overall occupancy at 95.1%. Paul detailed the key drivers of our strong rental growth in multifamily and I would like to provide you with further detail on our unit renovation programs at The Wellington and Riverside. In the second quarter, we renovated 49 units at The Wellington and 97 units at Riverside. In total, we have renovated 313 out of 680 planned units at The Wellington and 275 out of 850 planned units at Riverside. We continue to generate a mid-to-high teen return on cost on the renovation dollars that have been invested at these two assets to date and expect these programs to continue through the end of 2018.

Now turning to guidance, we are raising the mid-point of our 2017 Core FFO guidance range by $0.02 for the second time this year and tightening the guidance range to $1.80 to one $1.84, from a previous range of $1.76 to $1.84. Our 2017 acquisition and disposition assumptions continue to reflect the acquisition of Watergate 600 and to assume asset dispositions of $70 to $100 million, which includes the sale of Walker House in the third quarter. We expect to bring another office asset to market after Labor Day and close in the fourth quarter. We continue to look for further value-add opportunities and will update you on future calls to the extent that we execute on such opportunities.

Our guidance is supported by the following assumptions. Overall same-store NOI growth expectations are raised to a range of 5.75% to 6.25%, from a previous range of 4.75% to 5.25%. We assume office same-store NOI growth is now higher at approximately 9% to 9.5%, from a previous range of 7.25% to 7.75%. We are raising our assumptions for retail same-store NOI growth, which is now expected to range between 2.5% to 3% from a previous range of 2% to 2.5%. Stronger retail growth despite absorbing the impact of the previously-disclosed HHGregg and Offenbachers bankruptcies reflects our stable tenant watch list as well as our region’s resilient retail fundamentals. Our office non same-store NOI range now includes Watergate 600 and has been revised to $18.5 to $19.5 million from a previous range of $9 to $10 million. Multifamily non same-store NOI is expected to range between $13 to $13.5 million from a previous range of $13 to $13.75 million.

Our interest expense is expected to range from $47.5 to $48 million considering the acquisition of Watergate 600 and the anticipated timing of the assumed dispositions. G and A is projected to range from $22 to $22.5 million.

Our capital plan for 2017 continues to focus on maintaining our balance sheet strength and flexibility to realize our development and redevelopment plans and to pursue further value-add growth opportunities. As already mentioned on our last call, this year we have opportunistically raised approximately $65 million of gross proceeds through our ATM program at an average price of $31.44. As a reminder, we have unencumbered our assets and now have approximately 3% secured debt to total assets, and have no debt maturing this year or next year. We expect our net debt to adjusted EBIDTA to end the year within our target range of 6 to 6.5 times.

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

Paul McDermott - President and CEO
Thank you, Steve.

Our same-store NOI and Core FFO growth in the first half of this year is the result of our research-based strategic capital allocation to those submarkets and product types in our region that have strong rental growth prospects. While our growth is apparent in our quarterly operational performance, the relatively low risk that underpins it is also a key differentiator for Washington REIT and one that we work hard to maintain. Over the past three years, we have strategically allocated capital out of low-barrier, suburban office assets and into urban-infill, Metro-centric assets in locations with strong demographics and walkable amenities. We have focused on targeting small to mid-size office tenants, and have further minimized our risk by offering spec-suite solutions that reduce downtime and leasing capital. Moreover, we have allocated capital to value-add multifamily assets, thereby increasing the stability of our cash flows while decreasing overall portfolio risk. In addition, we have a resilient retail portfolio with a large majority of neighborhood and community shopping centers. Our overall operating portfolio has low submarket and tenant concentration risk and therefore low cash flow volatility.

On the development front, given where we are in the cycle, we have built a small and manageable pipeline that enables us to increase density at existing NOI-producing assets located in submarkets with limited new supply. And finally, we have strong financial metrics and a deleveraged and unencumbered balance sheet, providing us with greater capacity and flexibility to capitalize on future growth opportunities.

Now I would like to open the call to answer your questions. Operator, please go ahead.

Question-and-Answer Session

Operator
Thank you. We will now be conducting a question-and-answer session. Our first question is from Bill Crow with Raymond James. Please go ahead.

Q: Couple of questions. You have in the past indicated that you would be happy to add more retail to your portfolio if you could find it. Has that perspective changed given some of the dynamics in the retail space?

Paul McDermott - President and CEO
I think it has, candidly, probably tempered a lot of people's enthusiasm, both from a buying and a selling standpoint. We still have not seen a tremendous amount of retail product come to the table, although, there are two opportunities right now on the market that we think are going to be a good litmus test for updated retail pricing in mid-2017.

Q: Two more quickies. Just on the economic growth, and I appreciate your comments about the leading indicators, but we have heard reports the job growth did stall with some of the early failures of the Trump efforts. You didn't see any of that or it did and then it's reaccelerated? Just talk about job growth itself.

Paul McDermott - President and CEO
Sure, we came out of the block pretty strong at the beginning of the year in January and February, had good job growth. Admittedly, it cooled in March and April with April being a low point. It rebounded sharply in May and then we just got new June numbers. As I said, we are in excess of 59,000 for the trailing 12 months. That is a 35% increase over the 20-year average of 1990 to 2010. And the reason we stop 2010 because that was kind of bellwether movement for this region where sequestration kicked in. If you added sequestration that 35% increased number would only accelerate. So at this point and in midyear, we feel pretty good about the jobs numbers.

Q: Great. And then finally for me, Paul, we have seen some really high profile asset sales or transactions in the DC office market. Can you talk about any change in competition in your type of assets?

Paul McDermott - President and CEO
Let's start with what you are seeing. I definitely agree that there has been a bit of an overzealous underwriting approach to the super core. As you've seen, Bill, we set records recently at 1,250 a foot for downtown core assets. I think that people will continue to pay up for that uber quality in the CBD. We haven't seen that really change.

In terms of the value-add product that we would like to go after targeting affordability gaps on multifamily or targeting repositioning opportunities like 1775, we want to make sure that we lead with research and we want to make sure that demand is going to be there. Right now the multifamily opportunities that we are executing on currently are probably a little bit more prevalent than the office opportunities that we're seeing. I'd say people are pushing through underwriting on the vacancy, and I think there's a bit of risk rationalization going on, but I also think that there's a tremendous amount of capital out there, and some people have a gun to their head to try to push the value-add envelope.

Operator
Thank you. Our next question comes from the line of Jed Reagan with Green Street Advisors. Please proceed with your question.

Q: Maybe just following up on Bill's retail question, would you say, you feel like all your retail assets are a longer term holds at this point? Or could you see a looking to maybe monetize some of the more outlying stuff in the coming years?

Paul McDermott - President and CEO

Jed, we're comfortable with the position that we have in retail. As you know we did have two HHGregg, two of the outliers. We feel pretty good right now, one we're working on an LOI. I think that our biggest thing is making sure that we're shoring up the cash flows on some of what you term are the outliers, but the infill product we think not only offers good diversification for our portfolio, but as you know, probably three or four of them offer good redevelopment and repositioning opportunities.

Q: Are there any other major roll-downs in the coming years similar to the USDA, and where would you say your office portfolio in place rents are relative to market kind of overall at this point?

Tom Bakke - EVP and COO
We don't have any other significant roll-downs. I think we're sort of looking at our rollover as being fairly manageable, and it's rolling generally flat to slightly up on a cash basis and rolling up on a GAAP basis and pretty much across the board.

Q: So, maybe the last of the kind of the larger roll downs for a while?

Tom Bakke - EVP and COO
Yes.

Q: And that's a kind of a second half '18 sort of commencement and impact?

Tom Bakke - EVP and COO
Yes, that's correct.

Q: And I guess any update on the Advisory Board expiration? I guess we're a couple of years out on that now, less than a couple of years. I am just curious if you can give any update on how the plans are coming there, if you're getting any traction on the marketing campaign and then maybe how much base building capital you might be looking to spend there.

Tom Bakke - EVP and COO
So, as we've discussed on previous calls, we've looked at several redevelopment options, scenarios there at 2445. The multifamily was of interest early on. I don't think the city has been able to push through a significant incentive package for that conversion. That's still out there. I think it's becoming a bit more remote. And so we have gone aggressively with an office redevelopment marketing approach and one that has been a little more open to what the users would pay for. We do have some fairly sizeable prospects that want full Class A rental, and so we are looking at that. We have some others that are looking for more modest. I think a lot of its going to depend here on who bites first in significant size that drives how this plays out.

Q: Is it realistic to think you might have that space recommitted by the time the Advisory Board expires?

Tom Bakke - EVP and COO
I would like to think we would have all committed, but that might be optimistic, certainly a big chunk of it.

Q:.Generally, how is the tempo of office leasing feeling in the District and in Northern Virginia? So far this year, are you seeing any uptick in velocity and then are you seeing any noticeable changes in the asking rents or the concession environment?

Tom Bakke - EVP and COO
DC Class B is still active. Fortunately that's the bread and butter for us. The large tenant market in DC feels about the same. Northern Virginia, you had that initial defense surge going on out in the Northern Virginia

suburbs. That is not affecting us that much, and seems to have faded a little bit recently. We've seen activity in Rosslyn with the Nestle deal, and there is another 100,000 deals circling around in Rosslyn. So, Rosslyn's picked up a little bit.

Yes, I just think the activity feels about flat to me, and concessions feel flat. Nothing seems to really be changing significantly now. We talked on previous calls about Silverline. Most 65% of the deal activity is hitting along with Silverline and major beneficiary has been Tysons. We have seen a rent growth there. So I think that is the one bright spot where, rents, frankly, on the product right along the four metro stops and Tysons, especially on the two primary ones, has moved $5 to $10 depending on the asset. So that's probably the biggest bright spot on Northern Virginia.

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

Q: Just to follow up on that, for Paul or Tom, can you just talk about whether or not you think the high Class A vacancy you're seeing in DC office, is it going to have a dampening effect on rent growth in the Class B market? Or in other words, do you think Class A landlords are going to have to decrease asking rents to the extent that Class B space might have to compete with them to attract kind of the same tenant?

Tom Bakke - EVP and COO
The gap is little bit too wide for the huge spillover effect on B. If you talk about the glass box redevelopment model, it's about mid-to-low 70s gross rents and in some cases higher.

The new development phase is 80s, and we're in the $50 for B. That's a big gap, and I don't think we're going to have to drop rents. We may see our effective rent growth, which we've seen some nice growth there as concessions have squeezed down, that might slow down a little bit as we move up, but that just a big gap. I don't see it affecting us too much.

Paul McDermott - President and CEO
The only thing I'd add to Tom's spot-on comments would be you really need to keep going back to, especially when you look at other firms that do build to suits and everything, you really need to go back to the size of the tenants in the marketplace. I don't see somebody that's asking $72 dropping to $55 for a 5,000 or 10,000 square foot tenant. That just really doesn't move the needle on the big risk projects that they have taken on. And if you look at the B caliber tenants and look at the average deal size, our portfolio is well within that particular rental demographic. It's kind of 5,000 to 6,000 square feet. These Class A landlords have made big bets on the repositionings of getting into mid-70s and having substantial preleasing. That's a lot of work to chop adding up a bunch or 5,000 and 6,000 square foot tenants.

Q: Steve, obviously, you guys did a great job on same-store basis during the quarter, but I did notice the same-store expenses were up at about 7% year-over-year. Is that just increased taxes or expenses associated with Silverline occupancy? Or was it something else? I guess how long should we expect that year-over-year expense growth to continue?

Steve Riffee - EVP and CFO
Your biggest driver is we are now fully occupied at the Silverline Center. So this time a year ago that space wasn't fully occupied and therefore we weren't incurring all the expenses. I mean you have natural increases in real estate taxes but we also talked about some great work that's been done to drive down the utility cost. So I think they moved in and we started recognizing income in the third quarter. They weren't fully occupying because

they were still building out their space, so I think the comparison for the expense at Silverline will begin to normalize over the next couple quarters.

Operator
Our next question comes from the line of John Guinee with Stifel. Please proceed with your question.

Q: Just as an educational exercise, can you walk through how it is to work with the GSA on, for example, the USDA lease at Braddock Place—aligned RFP process, ability to negotiate, who else was in the fray? Would they consider a non-Metro location such as Skyline? Did they go up as far as Rosslyn Ballston or Crystal City? Or was it primarily an Alexandria requirement?

Tom Bakke - EVP and COO
Good questions. Like you said, it it's an education process anytime you do your GSA deal. I think it's an educational process for our team as well. We had an experienced GSA brokerage team on the assignment, and when we knew Englity was going to depart, we knew that being on Metro and in Alexandria, it is a generally a highly scrutinized GSA type of asset for the price point. And so we had a good team that they got us plugged into the RFP process. Yes, there is in general very specific defined geography, Metro correct, and a lot of it has to do with the workers and commuting patterns and things like that that go into how they write the RFP. And so USDA fit our asset well, and I think that's why we were successful in winning the deal.

Q: I mean it looks like its maybe a $30 gross rent, $18 net rent deal. Is that a good way to look at it? And what did you have to pay in terms of base building dollars in addition to the TI package?

Tom Bakke - EVP and COO
So, your economic picture is plus or minus in the ballpark. I think the typical GSA deal requires a fairly standard TI package, but they also needed some additional security type requirements, but when we total all the concessions up, they were totally in line with the typical large deal even in the commercial market. The one thing you don't get on a GSA deal is the rent bumps. Other than that, the deal lined up very competitively in the marketplace.

Q: Switching a little bit to The Wellington, when you look at that deal and essentially you have to build a lot of structured parking to replace the surface parking and that essentially provides your land basis, Paul, what do you think your all in cost per unit is going to be to develop that? And then refresh our memory, what's the closest Metro stop? Is it Pentagon City, and how far away is it?

Paul McDermott - President and CEO
I'll start with the construction costs. So, as you know, we contributed that land, John, and I think that land was in the mid-30s a door and dirt. At the end of the day we're probably in the 325-ish range per door for construction. In terms of Metro stop, I believe Pentagon City is closest. We're running a shuttle and it's one mile.

Q: So, 325,000 per door all in including land and cost for parking?

Paul McDermott - President and CEO
Including land. That's correct.

Operator
Thank you. Our next question comes from the line of Dave Rodgers with Robert W. Baird. Please proceed with our question.

Q: I wanted to ask really quickly on multifamily, clearly this is the time seasonally where you'd expect to see the lease percentage up and rents up, and so not to take anything away from the strategy which you guys have evolved and done a good job executing, but do we expect that to continue or would we expect kind of two steps forward, one step back as you still see more construction coming online and maybe more pressure in the B market? How do you feel that unfolds here over the next 12 months or so?

Paul McDermott - President and CEO
I'll start first and ask Steve or Tom to jump in. In the region B rents increased 1.5% in the second quarter. Vacancy rate for B is 2% region-wide in 2Q. I look at where a lot of the supply is delivering and it's DC-based NoMA, Southeast and Southwest Waterfront in DC. So, I don't really feel like we're competing with those projects head on. When I look at where our capital is allocated, we still have pretty wide gaps between the new Class A that's delivering and the B that we have right now. That's why, quite frankly, we're adding additional renovation programs like at 3801 Connecticut in the Kenmore because we can capture more value there. We still see enough of an affordability gap to capitalize on it. But I don't see the $2,500, $2,700 a door cannibalizing the B space at $1,850 a door.

Steve Riffee - EVP and CFO
Dave, you mentioned how we've done so far. In our other answers and our prepared remarks we talked about our ability to focus on driving and maximizing cash flows by focusing on a pricing strategy when we get to the 94% to 96% range asset by asset. So the first half of the year I would say we've really focused on pricing, and you've seen the good rent increases and the trade-outs in our portfolio. I think it shifts just a little bit because we've now got a really strong occupancy when you start to go into the lower seasonal part of the year.

I think our strategy has been tactically planned out for season of the year, so I think we will focus on occupancy when we get towards the last quarter of the year. And then when you think about our same-store growth, so year-to-date it's been 3.3% growth in multifamily, and we talked about a lot of that being pricing. We think we're starting the second half of the year at a really good strong occupancy point, and we've upped our guidance for the year to 3% to 3.5%. So we're basically saying we're expecting our same-store performance to be just as strong in the second half of the year it has been year-to-date.

Q: Shifting gears a little bit for Watergate, I know you're underway with a pretty substantial renovation there. And Paul, you said activity was good on the space. But how do you view the desire to lease that up or the ability to lease that up pretty quickly versus getting through some of the renovation and taking some time over the next year to two to put the right tenant in?

Tom Bakke - EVP and COO
It typically requires a prospective user to touch and feel the final product to make a big commitment, but in this case because of the unique nature of the views, the access, those are the two main selling points. I think we set up a very nice marketing presentation on site that the tenants are able to visualize how the final lobby renovation is going to look and feel and the amenity package. You get them up on the roof to the views, and that's generally been effective so far. That's why the activity has been robust, and we feel we will be able to get some commitments even before we're done with the renovation.

Q: Sticking with you on the USDA and the replacement of Engility, it sounded like they wanted to be in as soon as possible. Are you still going forward with the redevelopment of the asset in total? Can you talk about the scope of that work? The downtime between Engility and USDA, which it sounds like could be as much as nine months or more, is that just due to tenant work or is there some more going on?

Steve Riffee - EVP and CFO

So as we started the process we were really going through two approaches. One was a potential multitenant scope, and one was a single tenant. We were working with the USDA but also getting the other option ready. Fortunately, this deal progressed fast enough that we were able to alter the scope to meet more of their requirements. We still have building work to do. They have some security requirements and there are still some common area things that we need to do. But we were able to tailor it more to them, for instance, how they want to access the conference room versus how we would have to do it in the lobby for a multitenant. So we have work to do, but it will be a little bit cheaper than if we had multi-tenant. I would say it's brought the base building cost down a little bit. I think we are estimating it to be a little over $5 million for the base building cost. It would have been more if we had gone the multi-tenant route.

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

Q: Just a few questions here. But on the transaction market, Paul, you guys have been really successful since your arrival at doing off-market deals. And obviously 600 Watergate was a limited viewing, and you had success doing OP unit placements with that particular seller. Are you finding any traction in the off market sort of private owned non-institutional where OP units would be helpful in the transaction market? Are you finding that 600 Watergate transaction is opening some doors for you? And are you getting some traction on those kinds of opportunities?

Paul McDermott - President and CEO
Good question, yes, we are seeing more deals. We have actually been contacted about deals. I think our biggest challenge is where we are in the cycle, number one; and number two, we preach it until people are nauseous around here about research, and we file research into the submarkets. Not all of the families that we talk to have always placed some of the best bets. We want to be cognizant that we are not changing our strategy for an asset, and so we are trying to lead with research and go into those markets that we are comfortable with.

We got presented an office deal down at the Waterfront that we just decided to take a pass on. I think that we are continuing to talk to folks about more than just a one-off deal and trying to involve something that has scale and duration. So, we think that those opportunities are going to continue to present themselves, but the Watergate was a special deal for us. We would like to see that translate to more. We're seeing more of the family type deals on the multifamily side. And so we are going to continue to push on that.

Q: Shifting over to the multifamily side, on the unit renovation process that you have been doing at both Riverside and The Wellington, returns certainly sound like they are within your underwriting. As you guys look at those units going through the first churn, what sort of returns you are getting, sort of rent pumps are you getting at that point after sort of a full year? And what kind of renewal rates are you getting with those tenants as it relates to sort of maybe the project overall? How has that driven the business at The Wellington and Riverside?

Tom Bakke - EVP and COO
So, Chris, to understand your question you're saying after we've renovated and we've turned it over or come around for a renewal and/or a release, after a year after a renovated unit?

Q: Right.

Tom Bakke - EVP and COO
We're seeing renewal trends or trade-outs in those units consistent with all of the trade-outs across the board. I think, again, the quality there of the renovation is what's driving both the rent and the trade-out on whether it's a renewal or a new lease.

Q: On the USDA lease, you talked about GAAP rent commencement second half of '18. Cash rent commencement would be roughly when after that?

Paul McDermott - President and CEO
I think we gave them 18 months of free rent. Fifteen-year deal.

Q: You guys jumped the G&A midpoint of guidance a fair amount. What's the driver behind that?

Steve Riffee - EVP and CFO
Most of it would be incentive comp. This is the second time that we've raised guidance for the year. So that's a pretty good indication that we're ahead of the plan for the year. It's not all of it, but that would be the biggest change.

Operator
Thank you. I'll now turn the floor back over to Mr. McDermott for any final remarks.

Paul McDermott - President and CEO
Thank you, operator. Again, I would like to thank everyone for your time today. And we hope that you enjoy the remainder of your summer. We look forward to seeing many of you on our upcoming non-deal road shows in the very near future. Thank you, everyone.

Operator
Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.