

WASHINGTON REAL ESTATE INVESTMENT TRUST  
Form 10-K  
March 01, 2007

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

**x ANNUAL 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 fiscal year ended December 31, 2006

COMMISSION FILE NO. 1-6622

**WASHINGTON REAL ESTATE INVESTMENT TRUST**

(Exact name of registrant as specified in its charter)

**MARYLAND**  
(State of incorporation)

**53-0261100**  
(IRS Employer Identification Number)

**6110 EXECUTIVE BOULEVARD,**

**SUITE 800, ROCKVILLE,**

**MARYLAND**

**20852**

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(Address of principal executive office)

(Zip code)

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

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

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES  NO

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  NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (see definition of accelerated filer and large accelerated filer in Exchange Act Rule 12b-2).

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

As of February 23, 2007 45,042,185 Shares of Beneficial Interest were outstanding. As of June 30, 2006, the aggregate market value of such shares held by non-affiliates of the registrant was approximately \$1,653,042,190 (based on the closing price of the stock on June 30, 2006).

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Trust's definitive Proxy Statement relating to the 2007 Annual Meeting of Shareholders, to be filed with the Securities and Exchange Commission, are incorporated by reference in Part III, Items 10-14 of this Annual Report on Form 10-K as indicated herein.

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WASHINGTON REAL ESTATE INVESTMENT TRUST

2006 FORM 10-K ANNUAL REPORT

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**PART I**

**ITEM 1. BUSINESS**

**The Trust**

Washington Real Estate Investment Trust ( WRIT, the Trust, or the company ) is a self-administered, self-managed, equity real estate investment trust ( REIT ) successor to a trust organized in 1960. Our business consists of the ownership and development of income-producing real properties in the greater Washington metro region. We own a diversified portfolio of general purpose office buildings, medical office buildings, industrial/flex properties, multifamily buildings and retail centers.

We believe that we qualify as a 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 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. We did not dispose of any of our properties in 2006, and we distributed all of our 2006, 2005, and 2004 ordinary taxable income to our shareholders. In 2005, \$33.5 million of the gains from the property disposal were reinvested in replacement properties and approximately \$3.5 million of the gains were distributed to shareholders. Gains from the property disposed in 2004 were distributed to shareholders. No provision for income taxes was necessary in 2006, 2005, or 2004. Over the last five years, dividends paid per share have been \$1.64 for 2006, \$1.60 for 2005, \$1.55 for 2004, \$1.47 for 2003, and \$1.39 for 2002.

We generally incur short-term floating rate debt in connection with the acquisition and development of real estate. As market conditions permit, we replace the floating rate debt with fixed-rate secured loans or unsecured senior notes, or repay the debt with the proceeds of sales of equity securities. We may acquire one or more properties in exchange for our equity securities or operating partnership units which are convertible into WRIT shares.

Our geographic focus is based on two principles:

1. Real estate is a local business and is more effectively selected and managed by owners located, and with expertise, in the region.
2. Geographic markets deserving of focus must be among the nation's best markets with a strong primary industry foundation and diversified enough to withstand downturns in their primary industry.

We consider markets to be local if they can be reached from the Washington centered market within two hours by car. Our Washington centered market reaches north to Philadelphia, Pennsylvania and south to Richmond, Virginia. While we have historically focused most of our investments in the greater Washington metro region, in order to maximize acquisition opportunities we will and have considered investments within the two-hour radius described above. We will also consider opportunities to duplicate our Washington focused approach in other geographic markets which meet the criteria described above.

All of our Trustees, officers and employees live and work in the greater Washington metro region and our officers average over 20 years of experience in this region.

This section includes or refers to certain forward-looking statements. You should refer to the explanation of the qualifications and limitations on such forward-looking statements beginning on page 47.

### **The Greater Washington Metro Area Economy**

The Washington metro region is currently the 8<sup>th</sup> largest metropolitan statistical area in the United States. 2006 proved to be another year of strong performance for the greater Washington metro region with the professional

and business services sectors fueling job growth. The region's labor market economic indicators verify the strength of the region's economy with the unemployment rate at 3.0% for the 12 months ended November 2006, which is the lowest rate among all of the nation's largest metro areas and well below the national average of 4.5%. The U.S. Department of Labor, Bureau of Labor Statistics, reported the metropolitan Washington region experienced above average job growth by adding 66,200 jobs through the 12 months ended November 2006, 21% above the long-term average of 54,800. According to the Center for Regional Analysis (CRA) at George Mason University, the increase in jobs were concentrated in the professional and business services and high value-added occupations in health, education, and finance which accounted for 63.4% of the gains.

While there have been shifts among its core industries, the Washington metro area has a robust economy that continues to grow. The professional and business services, education and health services, and retail trade are the core industries that experienced the most job growth in the greater Washington metro economy. In 2005, the Federal government, professional and business services, and transportation were the sectors that led job growth. Federal government employees are pursuing higher paid jobs as contractors, fueling growth in professional and business services. While analysts project a shift in Congress' focus, overall Federal procurement spending should remain high in the region, but will taper off from the growth levels experienced in 2004 and 2005. The Washington area's gross regional product (GRP) was \$334.8 billion in 2006, a 4% increase compared to 2005. Over one-third of the area's GRP was generated by the Federal government. We believe regional job growth in 2007 will continue to be driven by professional and business services firms, including government contractors. CRA projects the economy will add 56,600 new jobs in 2007 and forecast GRP growth of 3.5% for the Washington metro area in 2007.

### **Greater Washington Metro Region Real Estate Markets**

The robust economy in the greater Washington metro region has translated into stronger relative real estate market performance in each of our sectors, compared to other national metropolitan regions as reported by Delta Associates / Transwestern Commercial Services (Delta), a national full service real estate firm that provides market research and evaluation services for commercial property types including office, industrial, retail and apartments:

#### **Office and Medical Office Sectors**

Rents rose 2.7% in 2006 in the region, and rents are expected to rise 2.5% in 2007.

Vacancy was 8.5% at year-end 2006, up from 7.9% at year-end 2005 and down from 9.2% at year-end 2004. The region has the fifth lowest vacancy rate of large metro areas in the United States.

The overall vacancy rate is projected to increase to 9.4% in the District over the next two years due to increased supply still below the national average of 10.4%.

Net absorption totaled 6.8 million square feet, down from 7.6 million square feet in 2005.

Of the 16.8 million square feet of office space under construction at year-end 2006, 35% is pre-leased.

#### **Multifamily Sector**

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Overall, apartment rents increased 4.7% in the greater Washington metro region in 2006.

Delta reports that given modest vacancy rates and solid rent growth, prospects for the apartment market in the Washington market are excellent.



**Grocery-Anchored Retail Centers Sector**

Steady vacancy rates at 2.3% at year-end 2006 compared to 2.9% at year-end 2005.

Rental rates at grocery-anchored centers increased 5.7% in 2006.

**Industrial/Flex Sector**

Average industrial rents increased 2.8% in the greater Washington/Baltimore region in 2006.

Rents are projected to increase 1.5-2.5% in 2007, as market conditions remain favorable.

Vacancy was 9.8% at year-end 2006, up from 9.4% at year-end 2005 and down from 10.4% at year-end 2004.

Of the 10.1 million square feet of industrial space under construction at year-end 2006, 21% is pre-leased, compared to 5.1 million and 34%, respectively, at year-end 2005.

**WRIT PORTFOLIO**

As of December 31, 2006, we owned a diversified portfolio of 82 properties consisting of 24 general purpose office properties, 13 medical office properties, 14 retail centers, 9 multifamily properties, 22 industrial/flex properties and land held for development. Our principal objective is to invest in high quality properties in prime locations, then proactively manage, lease, and direct ongoing capital improvement programs to improve their economic performance. The percentage of total real estate rental revenue by property group for 2006, 2005 and 2004 and the percent leased, calculated as the percentage of physical net rentable area leased, as of December 31, 2006 were as follows:

Percent Leased* December 31, 2006		Real Estate Rental Revenue*		
		2006	2005	2004
93%	Office buildings	40%	40%	45%
99%	Medical office buildings	11	10	8
96%	Retail centers	17	17	16
94%	Multifamily	15	16	17
93%	Industrial	17	17	14
		100%	100%	100%

\* Data excludes discontinued operations.

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On a combined basis, our portfolio was 94% leased at December 31, 2006, 94% leased at December 31, 2005 and 92% leased at December 31, 2004.

Total rental revenue from continuing operations was \$219.7 million for 2006, \$190.0 million for 2005 and \$171.6 million for 2004. During the three year period ended December 31, 2006, we acquired four general purpose office buildings, eight medical office buildings, three retail centers and seven industrial properties. During that same time frame, we sold three office buildings and one industrial property. These acquisitions and dispositions were the primary reason for the shifting of each group's percentage of total revenue reflected above.

No single tenant accounted for more than 3.5% of revenue in 2006, 3.3% of revenue in 2005, and 3.3% of revenue in 2004. All Federal government tenants in the aggregate accounted for approximately 2.3% of our 2006 total revenue. Federal government tenants include the Department of Defense, U.S. Patent and Trademark Office, Federal Bureau of Investigation, Office of Personnel Management, Secret Service, Federal Aviation Administration, NASA and the National Institutes of Health. WRIT's larger non-federal government tenants include the World Bank, Sunrise Senior Living, Inc., Sun Microsystems, INOVA Health Systems, URS Corporations, George Washington University, Lockheed Corporations, United Communications Group and Westat.

We expect to continue investing in additional income producing properties. We only invest in properties which we believe will increase in income and value. Our properties compete for tenants with other properties throughout the respective areas in which they are located on the basis of location, quality and rental rates.

We have recently engaged in ground-up development in order to further strengthen our portfolio with long-term growth prospects. We currently have three ground-up development projects underway. The first is a 224-unit apartment property in Arlington, VA, referred to as Bennett Park, formerly Rosslyn Towers, with completion of the mid-rise building expected in the second quarter 2007 and the high-rise building expected in the third quarter 2007. The second is a 75-unit apartment property in Alexandria, VA referred to as The Clayborne Apartments, formerly South Washington Street, with completion expected in the third quarter of 2007. The third is our December 2005 acquisition of Dulles Station in Herndon, VA. The property is entitled for two office buildings totaling 540,000 square feet. The completion of the first 180,000 square foot office building is expected in the third quarter 2007 and construction of the 360,000 square foot second building is expected to commence sometime in 2008 or 2009, depending on market conditions.

We make capital improvements on an ongoing basis to our properties for the purpose of maintaining and increasing their value and income. Major improvements and/or renovations to the properties in 2006, 2005, and 2004 are discussed under the heading Capital Improvements.

Further description of the property groups is contained in Item 2, Properties and in Schedule III. Reference is also made to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

On February 22, 2007, we had 282 employees including 199 persons engaged in property management functions and 83 persons engaged in corporate, financial, leasing, asset management and other functions.

## **AVAILABILITY OF REPORTS**

A copy of this Annual Report on Form 10-K, as well as our Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to such reports are available, free of charge, on the Internet on our website [www.writ.com](http://www.writ.com). All required reports are made available on the website as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission. The reference to our website address does not constitute incorporation by reference of the information contained in the website and such information should not be considered part of this document.

## **ITEM 1A. RISK FACTORS**

*Set forth below are the risks that we believe are material to our shareholders. We refer to the shares of beneficial interest in Washington Real Estate Investment Trust as our "shares," and the investors who own shares as our "shareholders." This section includes or refers to certain forward-looking statements. You should refer to the explanation of the qualifications and limitations on such forward-looking statements beginning on page 47.*

**Our performance and value are subject to risks associated with our real estate assets and with the real estate industry.**

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Our economic performance and the value of our real estate assets are subject to the risk that if our office, medical office, industrial, multifamily and retail properties do not generate revenues sufficient to meet our operating expenses, including debt service and capital expenditures, our cash flow and ability to pay distributions to our shareholders will be adversely affected. The following factors, among others, may adversely affect the revenues generated by our commercial and multifamily properties:

downturns in the national, regional and local economic climate;

competition from similar asset type properties;

local real estate market conditions, such as oversupply or reduction in demand for office, industrial, multi-family or retail properties;

changes in interest rates and availability of financing;

vacancies, changes in market rental rates and the need to periodically repair, renovate and re-let space;

increased operating costs, including insurance premiums, utilities and real estate taxes;

inflation;

weather conditions;

consumer confidence, unemployment rates, and consumer tastes and preferences;

civil disturbances, earthquakes and other natural disasters, terrorist acts or acts of war may result in uninsured or underinsured losses;

significant expenditures associated with each investment, such as debt service payments, real estate taxes, insurance and maintenance costs, are generally not reduced when circumstances cause a reduction in revenues from a property; and

the economic health of our tenants and the ability to collect rents.

**We are dependent upon the economic climate of the Washington metropolitan region.**

All of our properties are located in the Washington metropolitan region which exposes us to a greater amount of risk than if we were geographically diverse. General economic conditions and local real estate conditions in our geographic region may be dependent upon one or more industries, thus, a downturn in one of the industries may have a particularly strong effect. In particular, economic conditions in our market are directly affected by Federal government spending in the region. In the event of reduced Federal spending or negative economic changes in our region, we may experience a negative impact to our profitability and may be limited in our ability to make distributions to our shareholders.

**We face risks associated with property acquisitions.**

We intend to continue to acquire properties which would continue to increase our size and could alter our capital structure. Our acquisition activities and success may be exposed to the following risks:

we may be unable to acquire a desired property because of competition from other real estate investors, including publicly traded real estate investment trusts, institutional investment funds and private investors;

even if we enter into an acquisition agreement for a property, it is subject to customary conditions to closing, including completion of due diligence investigations have findings that are unacceptable;

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competition from other real estate investors may significantly increase the purchase price;

we may be unable to finance acquisitions on favorable terms;

acquired properties may fail to perform as we expected in analyzing our investments; and

our estimates of the costs of repositioning or redeveloping acquired properties may be inaccurate.

We may acquire properties subject to liabilities and without recourse, or with limited recourse, with respect to unknown liabilities. As a result, if liability were asserted against us based upon the acquisition of a property, we may have to pay substantial sums to settle it, which could adversely affect our cash flow. Unknown liabilities with respect to properties acquired might include:

liabilities for clean-up of undisclosed environmental contamination;

claims by tenants, vendors or other persons dealing with the former owners of the properties;

liabilities incurred in the ordinary course of business; and

claims for indemnification by general partners, directors, officers and others indemnified by the former owners of the properties.

**We face new and different risks associated with property development.**

The ground-up development of Bennett Park, formerly Rosslyn Towers, The Clayborne Apartments, formerly South Washington Street, and Dulles Station, as opposed to renovation and redevelopment of an existing property, is a relatively new activity for WRIT. Developing properties, in addition to the risks historically associated with our business, presents a number of new and additional risks for us, including risks that:

the development opportunity may be abandoned after expending significant resources resulting in the loss of deposits or failure to recover expenses already incurred, if we are unable to obtain all necessary zoning and other required governmental permits and authorizations or abandon the project for any other reason;

the development and construction costs of the project may exceed original estimates due to increased interest rates and increased materials, labor, leasing or other costs, which could make the completion of the project less profitable because market rents may not increase sufficiently to compensate for the increase in construction costs;

construction and/or permanent financing may not be available on favorable terms or may not be available at all, which may cause the cost of the project to increase and lower the expected return;

the project may not be completed on schedule as a result of a variety of factors, many of which are beyond our control, such as weather, labor conditions and material shortages, which would result in increases in construction costs and debt service expenses; and

occupancy rates and rents at the newly completed property may not meet the expected levels and could be insufficient to make the property profitable.

Properties developed or acquired for development may generate little or no cash flow from the date of acquisition through the date of completion of development. In addition, new development activities, regardless of whether or not they are ultimately successful, may require a substantial portion of management's time and attention.

These risks could result in substantial unanticipated delays or expenses and, under certain circumstances, could prevent completion of development activities once undertaken, any of which could have an adverse effect on our financial condition, results of operations, cash flow, the trading price of our common shares, and ability to satisfy our debt service obligations and to pay dividends to shareholders.

**We face potential difficulties or delays renewing leases or re-leasing space.**

From 2007 through 2011, leases on our commercial properties will expire on a total of approximately 69% of our leased square footage as of December 31, 2006, with leases on approximately 11% of our leased square footage expiring in 2007, 12% in 2008, 15% in 2009, 18% in 2010 and 13% in 2011. We derive substantially all of our income from rent received from tenants. Also, if our tenants decide not to renew their leases, we may not be able to re-let the space. If tenants decide to renew their leases, the terms of renewals, including the cost of required improvements or concessions, may be less favorable than current lease terms. As a result, our cash flow could decrease and our ability to make distributions to our shareholders could be adversely affected. Residential properties are leased under operating leases with terms of generally one year or less. For the years ended 2006, 2005 and 2004, the residential tenant retention rate was 68%, 57% and 59%, respectively.

**We face potential adverse effects from major tenants' bankruptcies or insolvencies.**

The bankruptcy or insolvency of a major tenant may adversely affect the income produced by a property. Although we have not experienced material losses from tenant bankruptcies or insolvencies in the past, a major tenant could file for bankruptcy protection or become insolvent in the future. We cannot evict a tenant solely because of its bankruptcy. On the other hand, a court might authorize the tenant to reject and terminate its lease. In such case, our claim against the bankrupt tenant for unpaid, future rent would be subject to a statutory cap that might be substantially less than the remaining rent actually owed under the lease, and, our claim for unpaid rent



would likely not be paid in full. This shortfall could adversely affect our cash flow and results from operations. If a tenant experiences a downturn in its business or other types of financial distress, it may be unable to make timely rental payments.

**Our properties face significant competition.**

We face significant competition from developers, owners and operators of office, medical office, industrial, multifamily, retail and other commercial real estate. Substantially all of our properties face competition from similar properties in the same market. Such competition may affect our ability to attract and retain tenants and may reduce the rents we are able to charge. These competing properties may have vacancy rates higher than our properties, which may result in their owners being willing to make space available at lower prices than the space in our properties.

**Compliance or failure to comply with the Americans with Disabilities Act and other laws could result in substantial costs.**

The Americans with Disabilities Act generally requires that public buildings, including commercial and multifamily properties, be made accessible to disabled persons. Noncompliance could result in imposition of fines by the Federal government or the award of damages to private litigants. If, pursuant to the Americans with Disabilities Act, we are required to make substantial alterations and capital expenditures in one or more of our properties, including the removal of access barriers, it could adversely affect our financial condition and results of operations, as well as the amount of cash available for distribution to our shareholders. We may also incur significant costs complying with other regulations. Our properties are subject to various federal, state and local regulatory requirements, such as state and local fire and life safety requirements. If we fail to comply with these requirements, we may incur fines or private damage awards. We believe that our properties are currently in material compliance with all of these regulatory requirements. However, we do not know whether existing requirements will change or whether compliance with future requirements will require significant unanticipated expenditures that will adversely affect our cash flow and results from operations.

**Some potential losses are not covered by insurance.**

We carry insurance coverage on our properties of types and in amounts that we believe are in line with coverage customarily obtained by owners of similar properties. We believe all of our properties are adequately insured. The property insurance that we maintain for our properties has historically been on an "all risk" basis, which is in full force and effect until renewal in September 2007. There are other types of losses, such as from wars or catastrophic acts of nature, for which we cannot obtain insurance at all or at a reasonable cost. In the event of an uninsured loss or a loss in excess of our insurance limits, we could lose both the revenues generated from the affected property and the capital we have invested in the affected property. Depending on the specific circumstances of the affected property it is possible that we could be liable for any mortgage indebtedness or other obligations related to the property. Any such loss could adversely affect our business and financial condition and results of operations.

Also, we have to renew our policies in most cases on an annual basis and negotiate acceptable terms for coverage, exposing us to the volatility of the insurance markets, including the possibility of rate increases. Any material increase in insurance rates or decrease in available coverage in the future could adversely affect our results of operations and financial condition.

**Potential liability for environmental contamination could result in substantial costs.**

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Under Federal, state and local environmental laws, ordinances and regulations, we may be required to investigate and clean up the effects of releases of hazardous or toxic substances or petroleum products at our properties, regardless of our knowledge or responsibility, simply because of our current or past ownership or operation of

the real estate. In addition, the U.S. Environmental Protection Agency and the U.S. Occupational Safety and Health Administration are increasingly involved in indoor air quality standards, especially with respect to asbestos, mold and medical waste. The clean up of any environmental contamination, including asbestos and mold, can be costly. If unidentified environmental problems arise, we may have to make substantial payments which could adversely affect our cash flow, because:

as owner or operator we may have to pay for property damage and for investigation and clean-up costs incurred in connection with the contamination;

the law typically imposes clean-up responsibility and liability regardless of whether the owner or operator knew of or caused the contamination;

even if more than one person may be responsible for the contamination, each person who shares legal liability under the environmental laws may be held responsible for all of the clean-up costs; and

governmental entities and third parties may sue the owner or operator of a contaminated site for damages and costs.

These costs could be substantial and in extreme cases could exceed the value of the contaminated property. The presence of hazardous or toxic substances or petroleum products or the failure to properly remediate contamination may adversely affect our ability to borrow against, sell or rent an affected property. In addition, applicable environmental laws create liens on contaminated sites in favor of the government for damages and costs it incurs in connection with a contamination.

We have a storage tank third party liability, corrective action and cleanup policy in place to cover potential hazardous releases from underground storage tanks on our properties. This insurance is in place to mitigate any potential remediation costs from the effect of releases of hazardous or toxic substances from these storage tanks. Additional coverage is in place under a pollution legal liability real estate policy. This would, dependent on circumstance and type of pollutants discovered, provide further coverage above and beyond the storage tank policy.

Environmental laws also govern the presence, maintenance and removal of asbestos. Such laws require that owners or operators of buildings containing asbestos:

properly manage and maintain the asbestos;

notify and train those who may come into contact with asbestos; and

undertake special precautions, including removal or other abatement, if asbestos would be disturbed during renovation or demolition of a building.

Such laws may impose fines and penalties on building owners or operators who fail to comply with these requirements and may allow third parties to seek recovery from owners or operators for personal injury associated with exposure to asbestos fibers.

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It is our policy to retain independent environmental consultants to conduct Phase I environmental site assessments and asbestos surveys with respect to our acquisition of properties. These assessments generally include a visual inspection of the properties and the surrounding areas, an examination of current and historical uses of the properties and the surrounding areas and a review of relevant state, Federal and historical documents, but do not involve invasive techniques such as soil and ground water sampling. Where appropriate, on a property-by-property basis, our practice is to have these consultants conduct additional testing, including sampling for asbestos, for mold, for lead in drinking water, for soil contamination where underground storage tanks are or were located or where other past site usages create a potential environmental problem, and for contamination in groundwater. Even though these environmental assessments are conducted, there is still the risk that:

the environmental assessments and updates did not identify all potential environmental liabilities;

a prior owner created a material environmental condition that is not known to us or the independent consultants preparing the assessments;

new environmental liabilities have developed since the environmental assessments were conducted; and

future uses or conditions such as changes in applicable environmental laws and regulations could result in environmental liability to us.

**Recently enacted changes in securities laws are likely to increase our costs.**

The Sarbanes-Oxley Act of 2002, as well as rules subsequently implemented by the Securities and Exchange Commission, has required changes in some of our corporate governance and accounting practices. In addition, the New York Stock Exchange has promulgated a number of regulations. We expect these laws, rules and regulations to increase our legal and financial compliance costs and to continue to make some activities more difficult, time consuming and costly. We also expect these rules and regulations to continue to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we incur significantly higher costs to obtain coverage. These laws, rules and regulations could also make it more difficult for us to attract and retain qualified members of our board of trustees, particularly to serve on our audit committee, and qualified executive officers.

**We face risks associated with the use of debt to fund acquisitions and developments, including refinancing risk.**

We rely on borrowings under our credit facilities to finance acquisitions and development activities and for working capital. If we were unable to borrow under our credit facilities, or to refinance existing indebtedness, our financial condition and results of operations would likely be adversely affected.

We are subject to the risks normally associated with debt financing, including the risk that our cash flow may be insufficient to meet required payments of principal and interest. We anticipate that only a small portion of the principal of our debt will be repaid prior to maturity. Therefore, we are likely to need to refinance at least a portion of our outstanding debt as it matures. There is a risk that we may not be able to refinance existing debt or that the terms of any refinancing will not be as favorable as the terms of the existing debt. If principal payments due at maturity cannot be refinanced, extended or repaid with proceeds from other sources, such as new equity capital, our cash flow will not be sufficient to repay all maturing debt in years when significant balloon payments come due.

**Rising interest rates would increase our interest costs.**

We may incur indebtedness that bears interest at variable rates. Accordingly, if interest rates increase, so will our interest costs, which could adversely affect our cash flow and our ability to service debt. As a protection against rising interest rates, we may enter into agreements such as interest rate swaps, caps, floors and other interest rate exchange contracts. These agreements, however, increase our risks including other parties to the agreements not performing or that the agreements may be unenforceable.

**Covenants in our debt agreements could adversely affect our financial condition.**

Our credit facilities contain customary restrictions, requirements and other limitations on our ability to incur indebtedness. We must maintain certain ratios, including total debt to assets, secured debt to total assets, debt service coverage and minimum ratios of unencumbered assets to unsecured debt. Our ability to borrow under our credit facilities is subject to compliance with our financial and other covenants.

Failure to comply with any of the covenants under our unsecured credit facilities or other debt instruments could result in a default under one or more of our debt instruments. This could cause our lenders to accelerate the timing of payments and would therefore have a material adverse effect on our business, operations, financial condition and liquidity.

**Further issuances of equity securities may be dilutive to current shareholders.**

The interests of our existing shareholders could be diluted if additional equity securities are issued to finance future developments and acquisitions instead of incurring additional debt. Our ability to execute our business strategy depends on our access to an appropriate blend of debt financing, including unsecured lines of credit and other forms of secured and unsecured debt, and equity financing.

**Failure to qualify as a REIT would cause us to be taxed as a corporation, which would substantially reduce funds available for payment of dividends.**

If we fail to qualify as a REIT for federal income tax purposes, we would be taxed as a corporation. We believe that we are organized and qualified as a REIT and intend to operate in a manner that will allow us to continue to qualify as a REIT.

If we fail to qualify as a REIT we could face serious tax consequences that could substantially reduce the funds available for payment of dividends for each of the years involved because:

we would not be allowed a deduction for dividends paid to shareholders in computing our taxable income and could be subject to federal income tax at regular corporate rates;

we also could be subject to the Federal alternative minimum tax and possibly increased state and local taxes;

unless we are entitled to relief under statutory provisions, we could not elect to be subject to tax as a REIT for four taxable years following the year during which we are disqualified; and

all dividends would be subject to tax as ordinary income to the extent of our current and accumulated earnings and profits potentially eligible as qualified dividends subject to the 15% income tax rate.

In addition, if we fail to qualify as a REIT, we would no longer be required to pay dividends. As a result of these factors, our failure to qualify as a REIT could impair our ability to expand our business and raise capital, and could adversely affect the value of our shares.

**The market value of our securities can be adversely affected by many factors.**

As with any public company, a number of factors may adversely influence the public market price of our common shares, many of which are beyond our control. These factors include:

level of institutional interest in us;

perceived attractiveness of investment in WRIT, in comparison to other REITs;

attractiveness of securities of REITs in comparison to other asset classes taking into account, among other things, that a substantial portion of REITs' dividends are taxed as ordinary income;

our financial condition and performance;

the market's perception of our growth potential and potential future cash dividends;

government action or regulation, including changes in tax law;

increases in market interest rates, which may lead investors to expect a higher annual yield from our distributions in relation to the price of our shares; and

relatively low trading volume of shares of REITs in general, which tends to exacerbate a market trend with respect to our stock.



**Provisions of the Maryland General Corporation Law, or the MGCL, may limit a change in control of our company.**

There are several provisions of the Maryland General Corporation Law, or the MGCL, that may limit the ability of a third party to acquire a change in control of our company, including:

a provision where a corporation is not required to engage in any business combination with any interested stockholder, defined as any holder or affiliate of any holder of 10% or more of the corporation's stock, for a period of five years pursuant to that holder becoming an interested stockholder;

a provision where the voting rights of control shares acquired in a control share acquisition, as defined in the law, may be restricted, such that the control shares have no voting rights, except to the extent approved by a vote of two-thirds of the votes entitled to be cast on the matter.

These provisions may delay, defer, or prevent a transaction or a change in control of our company that may involve a premium price for holders of our common stock or otherwise be in their best interests.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

The schedule on the following pages lists our real estate investment portfolio as of December 31, 2006, which consisted of 82 properties.

As of December 31, 2006, the percent leased is the percentage of net rentable area for which fully executed leases exist and may include signed leases for space not yet occupied by the tenant.

Cost information is included in Schedule III to our financial statements included in this Annual Report on Form 10-K.

## SCHEDULE OF PROPERTIES

Properties	Location	Year Acquired	Year Constructed	Net Rentable Square Feet	Percent Leased 12/31/06
<b>Office Buildings</b>					
1901 Pennsylvania Avenue	Washington, D.C.	1977	1960	97,000	99%
51 Monroe Street	Rockville, MD	1979	1975	210,000	100%
515 King Street	Alexandria, VA	1992	1966	76,000	84%
The Lexington Building	Rockville, MD	1993	1970	46,000	50%
The Saratoga Building	Rockville, MD	1993	1977	58,000	100%
Brandywine Center	Rockville, MD	1993	1969	35,000	94%
6110 Executive Boulevard	Rockville, MD	1995	1971	198,000	95%
1220 19 <sup>th</sup> Street	Washington, D.C.	1995	1976	102,000	100%
Maryland Trade Center I	Greenbelt, MD	1996	1981	184,000	97%
Maryland Trade Center II	Greenbelt, MD	1996	1984	158,000	90%
1600 Wilson Boulevard	Arlington, VA	1997	1973	166,000	94%
7900 Westpark Drive	McLean, VA	1997	1972/1986/1999 <sup>1</sup>	523,000	88%
600 Jefferson Plaza	Rockville, MD	1999	1985	112,000	91%
1700 Research Boulevard	Rockville, MD	1999	1982	101,000	100%
Parklawn Plaza	Rockville, MD	1999	1986	40,000	97%
Wayne Plaza	Silver Spring, MD	2000	1970	91,000	85%
Courthouse Square	Alexandria, VA	2000	1979	113,000	100%
One Central Plaza	Rockville, MD	2001	1974	267,000	91%
The Atrium Building	Rockville, MD	2002	1980	80,000	94%
1776 G Street	Washington, D.C.	2003	1979	263,000	100%
Albemarle Point	Chantilly, VA	2005	2001	89,000	95%
6565 Arlington Blvd	Falls Church, VA	2006	1967/1998	140,000	82%
West Gude Drive	Rockville, MD	2006	1984/1986/1988	289,000	95%
The Ridges	Gaithersburg, MD	2006	1990	104,000	100%
<b>Subtotal</b>				<b>3,542,000</b>	<b>93%</b>
<b>Medical Office Buildings</b>					
Woodburn Medical Park I	Annandale, VA	1998	1984	71,000	100%
Woodburn Medical Park II	Annandale, VA	1998	1988	96,000	100%
Prosperity Medical Center I	Merrifield, VA	2003	2000	92,000	100%
Prosperity Medical Center II	Merrifield, VA	2003	2001	88,000	100%
Prosperity Medical Center III	Merrifield, VA	2003	2002	75,000	100%
Shady Grove Medical Village II	Rockville, MD	2004	1999	66,000	100%
8301 Arlington Boulevard	Fairfax, VA	2004	1965	49,000	99%
Alexandria Professional Center	Alexandria, VA	2006	1968	113,000	100%
9707 Medical Center Drive	Rockville, MD	2006	1994	38,000	100%
15001 Shady Grove Road	Rockville, MD	2006	1999	51,000	100%
Plumtree Medical Center	Bel Air, MD	2006	1991	33,000	100%
15005 Shady Grove Road	Rockville, MD	2006	2002	52,000	100%
The Crescent	Gaithersburg, MD	2006	1989	49,000	88%
<b>Subtotal</b>				<b>873,000</b>	<b>99%</b>
<b>Retail Centers</b>					
Takoma Park	Takoma Park, MD	1963	1962	51,000	100%
Westminster	Westminster, MD	1972	1969	151,000	90%
Concord Centre	Springfield, VA	1973	1960	76,000	98%

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Wheaton Park	Wheaton, MD	1977	1967	72,000	100%
Bradlee	Alexandria, VA	1984	1955	168,000	100%
Chevy Chase Metro Plaza	Washington, D.C.	1985	1975	49,000	100%
Montgomery Village Center	Gaithersburg, MD	1992	1969	198,000	99%
Shoppes of Foxchase <sup>2</sup>	Alexandria, VA	1994	1960	128,000	99%

## SCHEDULE OF PROPERTIES (continued)

Properties	Location	Year Acquired	Year Constructed	Net Rentable* Square Feet	Percent Leased 12/31/06
<b><u>Retail Centers (continued)</u></b>					
Frederick County Square	Frederick, MD	1995	1973	227,000	99%
800 S. Washington Street <sup>3</sup>	Alexandria, VA	1998/2003	1955/1959	44,000	95%
Centre at Hagerstown	Hagerstown, MD	2002	2000	332,000	100%
Frederick Crossing	Frederick, MD	2005	1999/2003	295,000	100%
Randolph Shopping Center	Rockville, MD	2006	1972	82,000	93%
Montrose Shopping Center	Rockville, MD	2006	1970	143,000	67%
Subtotal				2,016,000	96%
<b><u>Multifamily Buildings / # units</u></b>					
3801 Connecticut Avenue / 306	Washington, D.C.	1963	1951	179,000	94%
Roosevelt Towers / 190	Falls Church, VA	1965	1964	170,000	94%
Country Club Towers / 227	Arlington, VA	1969	1965	163,000	94%
Park Adams / 200	Arlington, VA	1969	1959	173,000	96%
Munson Hill Towers / 279	Falls Church, VA	1970	1963	259,000	94%
The Ashby at McLean / 254	McLean, VA	1996	1982	252,000	93%
Walker House Apartments / 212	Gaithersburg, MD	1996	1971/2003 <sup>4</sup>	159,000	96%
Bethesda Hill Apartments / 194	Bethesda, MD	1997	1986	226,000	86%
Avondale / 237	Laurel, MD	1999	1987	170,000	96%
Subtotal (2,099 units)				1,751,000	94%
<b><u>Industrial/Flex Properties</u></b>					
Fullerton Business Center	Springfield, VA	1985	1980/1982	104,000	91%
Charleston Business Center	Rockville, MD	1993	1973	85,000	93%
Tech 100 Industrial Park	Elkridge, MD	1995	1990	166,000	90%
Crossroads Distribution Center	Elkridge, MD	1995	1987	85,000	100%
The Alban Business Center	Springfield, VA	1996	1981/1982	87,000	100%
The Earhart Building	Chantilly, VA	1996	1987	92,000	100%
Ammendale Technology Park I	Beltsville, MD	1997	1985	167,000	100%
Ammendale Technology Park II	Beltsville, MD	1997	1986	107,000	77%
Pickett Industrial Park	Alexandria, VA	1997	1973	246,000	100%
Northern Virginia Industrial Park	Lorton, VA	1998	1968/1991	787,000	93%
8900 Telegraph Road	Lorton, VA	1998	1985	32,000	96%
Dulles South IV	Chantilly, VA	1999	1988	83,000	100%
Sully Square	Chantilly, VA	1999	1986	95,000	53%
Amvax	Beltsville, MD	1999	1986	31,000	100%
Sullyfield Center	Chantilly, VA	2001	1985	244,000	73%
Fullerton Industrial Center	Springfield, VA	2003	1980	137,000	99%
8880 Gorman Road	Laurel, MD	2004	2000	141,000	100%
Dulles Business Park Portfolio	Chantilly, VA	2004	1999-2004	324,000	100%
Albemarle Point	Chantilly, VA	2005	2001/2003/2005	207,000	100%
Hampton Overlook	Capital Heights, MD	2006	1989	134,000	100%
Hampton South	Capital Heights, MD	2006	1989/2005	168,000	100%
9950 Business Parkway	Lanham, MD	2006	2005	102,000	79%
Subtotal				3,624,000	93%

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TOTAL	11,806,000
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<sup>1</sup> A 49,000 square foot addition to 7900 Westpark Drive was completed in September 1999.

<sup>2</sup> Development on approximately 60,000 square feet of the center was completed in December 2006.

<sup>3</sup> South Washington Street includes 718 E. Jefferson Street, acquired in May 2003 to complete the ownership of the entire block of 800 S. Washington Street.

<sup>4</sup> A 16 unit addition referred to as The Gardens at Walker House was completed in October 2003.

\* Multifamily buildings are presented in gross square feet.

**ITEM 3. *LEGAL PROCEEDINGS***

None.

**ITEM 4. *SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS***

No matters were submitted to a vote of security holders during the fourth quarter of 2006.

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**PART II**
**ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our shares trade on the New York Stock Exchange. Currently, there are approximately 45,800 shareholders.

The high and low sales price for our shares for 2006 and 2005, by quarter, and the amount of dividends we paid per share are as follows:

Quarter	Dividends Per Share	Quarterly Share Price Range	
		High	Low
<b>2006</b>			
Fourth	\$ .4125	\$ 43.40	\$ 38.36
Third	\$ .4125	\$ 41.89	\$ 35.90
Second	\$ .4125	\$ 39.17	\$ 33.70
First	\$ .4025	\$ 36.61	\$ 30.06
<b>2005</b>			
Fourth	\$ .4025	\$ 32.00	\$ 28.36
Third	\$ .4025	\$ 33.69	\$ 29.42
Second	\$ .4025	\$ 32.54	\$ 28.70
First	\$ .3925	\$ 33.95	\$ 27.65

We have historically paid dividends on a quarterly basis. Dividends are normally paid based on our cash flow from operating activities.

During the period covered by this report, we did not sell equity securities without registration under the Securities Act.

Neither we nor any affiliated purchaser (as that term is defined in Securities Exchange Act Rule 10b-18(a) (3)) made any repurchases of our shares during the fourth quarter of the fiscal years covered by this report.

**ITEM 6. SELECTED FINANCIAL DATA**

	2006	2005	2004	2003	2002
	(in thousands, except per share data)				
Real estate rental revenue	\$ 219,662	\$ 190,046	\$ 171,646	\$ 153,576	\$ 141,136
Income from continuing operations	\$ 38,661	\$ 40,443	\$ 40,641	\$ 40,558	\$ 41,725

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Discontinued Operations:

Income from operations of properties sold or held for sale	\$	184	\$	3,894	\$	4,329	\$	6,273
Gain on property disposed	\$	37,011	\$	1,029			\$	3,838
Net income	\$	38,661	\$	77,638	\$	45,564	\$	51,836
Income per share from continuing operations diluted	\$	0.88	\$	0.96	\$	0.97	\$	1.02
Earnings per share diluted	\$	0.88	\$	1.84	\$	1.09	\$	1.13
Total assets	\$	1,531,265	\$	1,139,159	\$	1,012,393	\$	928,089
Lines of credit payable	\$	61,000	\$	24,000	\$	117,000		\$
Mortgage notes payable	\$	237,073	\$	169,617	\$	173,429	\$	142,182
Notes payable	\$	728,255	\$	518,600	\$	319,597	\$	374,493
Shareholders equity	\$	441,931	\$	380,305	\$	366,009	\$	378,748
Cash dividends paid	\$	72,681	\$	67,322	\$	64,836	\$	58,605
Cash dividends declared and paid per share	\$	1.64	\$	1.60	\$	1.55	\$	1.47

\* See footnote 3 which indicates the Company's acquisitions and dispositions as such activity impacts the comparability of the information year to year.



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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, we evaluate these estimates, including those related to estimated useful lives of real estate assets, estimated fair value of acquired leases, cost reimbursement income, bad debts, contingencies and litigation. We base the estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. There can be no assurance that actual results will not differ from those estimates.

**Overview**

Our revenues are derived primarily from the ownership and operation of income-producing properties in the greater Washington metro region. As of December 31, 2006, we owned a diversified portfolio of 82 properties, consisting of 14 retail centers, 24 general purpose office properties, 13 medical office properties, 22 industrial/flex properties, 9 multi-family properties encompassing in the aggregate 11.8 million net rentable square feet, and land for development. We have a fundamental strategy of regional focus, diversification by property type and conservative capital management.

When evaluating our financial condition and operating performance, management focuses on the following financial and non-financial indicators, discussed in further detail herein:

Net Operating Income ( NOI ) by segment. NOI is calculated as real estate rental revenue less real estate operating expenses excluding depreciation. It is a supplemental measure to Net Income.

Economic occupancy (or occupancy defined as actual rental revenues recognized for the period indicated as a percentage of gross potential rental revenues for that period), leased percentage (the percentage of available physical net rentable area leased for our commercial segments and percentage of apartment units leased for our residential segment) and rental rates.

Leasing activity new leases, renewals and expirations.

Funds From Operations ( FFO ), a supplemental measure to Net Income.

During 2006, we continued our long-standing strategy of focusing our investment in the greater Washington metro region, one of the most stable real estate markets in the country. The area's economy continues to expand, but at a decelerating pace as growth rates have normalized from the accelerated growth experienced in 2004 and 2005. The region posted positive job growth of approximately 2.3% in the twelve months ended November 2006 and an unemployment rate of 3.0% compared to the national averages of 1.3% and 4.5%, respectively. The job growth occurred principally in the professional and business services, education and health, and retail trade sectors. Overall conditions in the region were strong in 2006, with Washington, D.C. remaining one of the top office and high-rise apartment investment markets in the country.

Overall occupancies, as well as our results in 2006, were primarily impacted by the \$423.4 million in acquisitions we completed in 2006 and 2005, dispositions in 2005 of \$37.0 million and the performance of our core portfolio (consisting of properties owned for the entirety of 2006 and the same time period in 2005) which improved compared to 2005.



The performance of our five operating segments generally reflected market conditions in our region:

The regional office market was steady during the year with overall vacancy increasing slightly due to increased supply. Northern Virginia and the District experienced strong absorption, while suburban Maryland's market softened. The Washington metro region has the fifth lowest overall vacancy rate in the United States, among large metro areas; however, the overall vacancy rate for the region increased slightly to 8.6% from 7.9% one year ago. Our general purpose office portfolio was 92.1% occupied, for 2006, a significant improvement from the year 2005 at 87.9%.

The medical office market continues to be excellent with little to no new construction activity and strong demand. This is reflected in our medical office portfolio occupancy of 98.9% for the year 2006.

The neighborhood and community shopping center market remained strong in the region due to continued job growth, leading to high occupancies and strong sales. Our retail portfolio was 96.0% occupied for the year 2006.

The multifamily market is in strong condition due to job market and low unemployment rate combined with high barriers to entry that have kept the pipeline of on-coming apartment supply in check. The multifamily portfolio was 92.4% occupied for the year 2006.

The industrial market is still healthy, but has softened since last year. Rents have increased 2.6% while absorption has declined from 2005 levels. Our industrial portfolio experienced positive rental rate growth and was 93% occupied for the year 2006.

During 2006, we completed the redevelopment of the Shoppes at Foxchase, a retail shopping center anchored by the Harris Teeter grocery store. Development continued at Bennett Park, formerly Rosslyn Towers, which is a Class A high-rise and mid-rise apartment community located in Arlington, Virginia. We progressed on the development of The Clayborne Apartments, formerly South Washington Street, which is a Class A apartment building that includes additional retail space located in Alexandria, Virginia. Development began on the first phase of Dulles Station, which consists of 180,000 square feet of office space located in Herndon, Virginia. The development of Bennett Park, The Clayborne Apartments, and phase one of Dulles Station is anticipated to be complete during 2007.

Significant transactions during the two years ended December 31, 2006 are summarized below:

## 2006

The acquisition of six medical office properties for \$105.9 million, adding approximately 336,000 square feet of rentable space, 98.3% leased at the end of 2006, three general purpose office properties for \$112.0 million adding approximately 533,000 square feet of rentable space, 92.6% leased at the end of 2006, three industrial/flex properties for \$34.8 million, adding approximately 404,000 square feet of rentable space, 82.3% leased at the end of 2006 and two retail centers, for \$50.3 million, adding approximately 225,000 square feet of rentable space, 70.8% leased as of the end of 2006.

The completion of a public offering of 2,745,000 shares of beneficial interest priced at \$34.40 per share raising \$90.9 million, net.

The issuance of \$150.0 million of 5.95% senior unsecured notes due June 15, 2011 at an effective yield of 5.961% raising \$149.6 million, net.

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The issuance of \$100 million in convertible senior notes with a coupon of 3.875%, raising \$97.0 million, net and the issuance of an additional \$10 million of the convertible senior notes upon the exercise of the underwriters over-allotment option, raising an additional \$9.7 million, net.

The opening of a new, unsecured revolving credit facility of \$200.0 million. This facility replaces Credit Facility No. 3. Under the new Credit Facility interest only payments are due on a monthly basis until the maturity of this facility on November 2, 2010.

The investment of \$68.6 million in the major development and redevelopment of several properties.

The execution of new leases for 1,611,000 square feet of commercial space.

## 2005

The acquisition of one retail property, for \$44.8 million, adding approximately 295,000 square feet of rentable retail space, 100% leased as of the end of 2005, one industrial property for \$8.8 million, adding approximately 60,000 square feet of rentable industrial space, 100.0% leased as of the end of 2005 and one office and industrial property for \$66.8 million, adding approximately 90,000 square feet of rentable office space and approximately 206,000 square feet of rentable industrial space, 97% leased as of the end of 2005. The \$24.7 million acquisition of land for the development of a 540,000 square foot office complex.

The disposition of one industrial and three office properties, totaling approximately 480,000 square feet, for a gain of approximately \$35.1 million and the recognition of a previously deferred gain of \$1.9 million from the sale of an office property in November, 2004.

The extension and increase of our line of Credit Facility No. 1 until 2008 for \$70 million.

The issuance of \$50.0 million of 5.05% senior unsecured notes due May 1, 2012 and \$50.0 million of 5.35% senior unsecured notes due May 1, 2015, at effective yields of 5.064% and 5.359%, respectively. On October 3, 2005, we reopened the series of 5.35% senior unsecured notes and issued an additional \$100 million of notes.

The investment of \$17.3 million in the development and redevelopment of several properties.

The execution of new leases for 1,720,000 square feet of commercial space.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We believe the following critical accounting policies reflect the more significant judgments and estimates used in the preparation of our consolidated financial statements. Our significant accounting policies are described in Note 2 in the Notes to the Consolidated Financial Statements in Item 8 of this Form 10-K.

### *New Accounting Pronouncements*

In December, 2004, the FASB issued SFAS No. 123R, *Share-Based Payment*. This statement is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB opinion No. 25 (APB No. 25), *Accounting for Stock Issued to Employees* and amends SFAS No. 95, *Statement of Cash Flows*. Statement No. 123R addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values and eliminates the intrinsic value method of accounting in APB No. 25, which was permitted under SFAS No. 123, as originally issued. The Company has applied the provisions of this statement as of January 1, 2006.

Since we used the fair-value-based method of accounting under the original provisions of SFAS No. 123, in pro forma disclosure, we were required to adopt the provisions of the new standard using either the modified-prospective-transition or the modified-retrospective-transition method. Under both methods, for awards granted, settled or modified subsequent to adopting the standard and for awards granted prior to the date of adoption for which the requisite service has not been completed as of the adoption date, compensation cost must be recognized in the financial statements. Under the modified-retrospective-method, financial statements for prior periods are restated for this change and under the modified prospective method only statements subsequent to adoption will include this compensation cost. The modified-prospective-method also requires a cumulative adjustment in the first period of adoption to conform to the new standard. The Company has adopted

SFAS No. 123R using the modified-prospective-transition method and that adoption did not have a material impact on income from continuing operations, net income, cash flows from operations or financing activities, or basic and diluted EPS.

In July, 2006 the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FAS 109, *Accounting for Income Taxes* (FIN 48), to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. WRIT will adopt FIN 48 as of January 1, 2007, as required. We do not expect that the adoption of FIN 48 will have a significant impact on our financial position and results of operations.

In September 2006, the FASB issued FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of FASB Statements No. 87, 106, and 132(R) (SFAS No. 158). SFAS No. 158 requires plan sponsors of defined benefit pension and other postretirement benefit plans (collectively, *postretirement benefit plans*) to recognize the funded status of their postretirement benefit plans in the statement of financial position, measure the fair value of plan assets and benefit obligation as of the date of the fiscal year-end statement of financial position, and provide additional disclosures. On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS No. 158. SFAS No. 158 did not have an effect on the Company's consolidated financial condition at December 31, 2006. SFAS No. 158's provisions regarding the change in the measurement date of postretirement benefit plans are not applicable as the Company already uses a measurement date of December 31 for its defined benefit plan. See Note 8 to the consolidated financial statements for further discussion of the effect of adopting SFAS No. 158 on the Company's consolidated financial statements.

#### *Revenue Recognition*

Residential properties are leased under operating leases with terms of generally one year or less, and commercial properties 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.

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.

#### *Capital Expenditures*

We capitalize those expenditures related to acquiring new assets, significantly increasing the value of an existing asset, or substantially extending the useful life of an existing asset. We also capitalize costs incurred in connection with our development projects, including

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capitalizing interest during periods in which development projects are in progress. Expenditures necessary to maintain an existing property in ordinary operating condition are expensed as incurred. In addition, we capitalize tenant leasehold improvements when certain conditions are met, including when we supervise construction and will own the improvements.



### *Real Estate Assets*

Real estate assets 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 are depreciated using the straight-line method over their estimated useful lives ranging from 3 to 30 years. All tenant improvements are amortized over the shorter of the useful life or the term of the lease.

We allocate the purchase price of acquired properties to the related physical assets and in-place leases based on their relative 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.

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/at/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.

### *Discontinued Operations*

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 are reinvested into other properties, used to fund development operations or to support other corporate needs, or are distributed to our shareholders.

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*. 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 treated as discontinued operations for all periods presented in the Statements of Income. As of December 31, 2006 there were no properties held for sale or classified as discontinued operations.

#### *Impairment Losses on Long-Lived Assets*

We recognize impairment losses on long-lived assets used in operations, development or land held for future development, when 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 the three-year period ended December 31, 2006.

#### *Federal Income Taxes*

We believe that we qualify as a 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 90% of our ordinary taxable income to our shareholders. 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. We distributed 100% of our 2006 and 2005 ordinary taxable income to shareholders. \$33.5 million of the gain from property disposed in 2005 was reinvested in replacement properties. Approximately \$3.5 million of the gain from disposed property in 2005 was distributed to shareholders. No provision for income taxes was necessary during the three year period ended December 31, 2006.

## **RESULTS OF OPERATIONS**

The discussion that follows is based on our consolidated results of operations for the years ended December 31, 2006, 2005 and 2004. The ability to compare one period to another may be significantly affected by acquisitions completed and dispositions made during those years.

For purposes of evaluating comparative operating performance, we categorize our properties as core, non-core or discontinued operations. A core property is one that was owned for the entirety of the periods being evaluated and is included in continuing operations. A non-core property is one that was acquired during either of the periods being evaluated and is included in continuing operations. Results for properties sold or held for sale during any of the periods evaluated are classified as discontinued operations. Fourteen properties were acquired during 2006, four properties were acquired during 2005 and four properties were acquired in 2004. There were no properties sold or classified as held for sale in 2006. Four properties were sold in 2005 and are classified as discontinued operations for the 2005 and 2004 Periods. One property was sold in 2004 and classified as discontinued operations for that year.

To provide more insight into our operating results, our discussion is divided into two main sections: (1) Consolidated Results of Operations where we provide an overview analysis of results on a consolidated basis and (2) Net Operating Income (NOI) where we provide a detailed analysis of core versus non-core property-level NOI results by segment. NOI is calculated as real estate rental revenue less real estate operating expenses.



## Consolidated Results of Operations

### Real Estate Rental Revenue

Real Estate Rental Revenue is summarized as follows (all data in thousands except percentage amounts):

	2006	2005	2004	2006 vs 2005	% Change	2005 vs 2004	% Change
Minimum base rent	\$ 196,922	\$ 170,038	\$ 154,956	\$ 26,884	15.8%	\$ 15,082	9.7%
Recoveries from tenants	19,029	15,482	11,989	3,547	22.9%	3,493	29.1%
Parking and other tenant charges	3,711	4,526	4,701	(815)	(18.0%)	(175)	(3.7%)
	<u>\$ 219,662</u>	<u>\$ 190,046</u>	<u>\$ 171,646</u>	<u>\$ 29,616</u>	<u>15.6%</u>	<u>\$ 18,400</u>	<u>10.7%</u>

Real estate rental revenue is comprised of (1) minimum base rent, which includes rental revenues recognized on a straight-line basis, (2) revenue from the recovery of operating expenses from our tenants and (3) other revenue such as parking and termination fees and percentage rents.

Minimum base rent increased \$26.9 million (15.8%) in 2006 as compared to 2005 and \$15.1 million (9.7%) in 2005 as compared to 2004. The increase in minimum base rent in 2006 was due primarily to additional rent from properties acquired in 2005 and 2006 (\$17.9 million), combined with a \$9.0 million increase in minimum base rent from core properties due to rental rate increases in the office, multifamily, industrial and retail sectors and lower vacancies in the office sector. The increase in minimum base rent in 2005 was due primarily to the increase in rent from properties acquired in 2004 and 2005 (\$12.5 million), combined with a \$2.6 million increase in minimum base rent from core properties due to lower vacancies and rental rate increases in the retail, industrial and multifamily sectors.

A summary of economic occupancy for properties classified as continuing operations by sector follows:

### Consolidated Economic Occupancy

Sector	2006	2005	2004	2006 vs 2005	2005 vs 2004
Office	92.1%	87.9%	89.2%	4.2%	(1.3%)
Medical Office	98.9%	98.4%	98.2%	0.5%	0.2%
Retail	96.0%	97.6%	94.8%	(1.6%)	2.8%
Multifamily	92.4%	93.2%	90.5%	(0.8%)	2.7%
Industrial	93.3%	94.5%	92.7%	(1.2%)	1.8%
Total	<u>93.7%</u>	<u>92.3%</u>	<u>91.4%</u>	<u>1.4%</u>	<u>0.9%</u>

Our overall economic occupancy increased 140 basis points in 2006 as compared to 2005 and increased 90 basis points in 2005 as compared to 2004. Property acquisitions and decreased vacancy in the office and medical office sectors, partially offset by higher vacancies in the retail, industrial and multifamily sectors, accounted for the increase in overall economic occupancy in 2006. Property acquisitions in the industrial and retail sectors and decreased vacancy in the multifamily sector, partially offset by higher vacancies in the office sector, accounted for the increase in overall economic occupancy in 2005. A detailed discussion of occupancy by sector can be found in the Net Operating Income section.

Recoveries from tenants increased \$3.5 million (22.9%) in 2006 as compared to 2005 and \$3.5 million (29.1%) in 2005 as compared to 2004. The increase in recoveries from tenants in 2006 was due primarily to properties acquired in 2006 and 2005 (\$3.1 million) and increased recovery income from core properties (\$0.4 million) due to higher operating expense, utilities, common area maintenance, real estate taxes. The increase in recoveries from tenants in 2005 was due primarily to increased recovery income from core properties (\$1.7 million) due to higher operating expense, utilities, common area maintenance, real estate taxes and from properties acquired in 2005 and 2004 (\$1.8 million).

Parking and other tenant charges decreased \$0.8 million in 2006 as compared to 2005 and decreased \$0.2 million in 2005 as compared to 2004. The decrease in parking and other charges in 2006 was driven by core properties due primarily to higher bad debt expense and lower percentage rent. The decrease in parking and other tenant charges for 2005 compared to 2004 was due primarily to lower percentage rent.

### Real estate operating expenses

Real estate operating expenses are summarized as follows (all data in thousands except percentage amounts):

	2006	2005	2004	2006 vs 2005	% Change	2005 vs 2004	% Change
Property operating expenses	\$ 48,933	\$ 42,158	\$ 37,266	\$ 6,775	16.1%	\$ 4,892	13.1%
Real estate taxes	18,335	15,958	14,062	2,377	14.9%	1,896	13.5%
	<u>\$ 67,268</u>	<u>\$ 58,116</u>	<u>\$ 51,328</u>	<u>\$ 9,152</u>	<u>15.7%</u>	<u>\$ 6,788</u>	<u>13.2%</u>

Property operating expenses include utilities, repairs and maintenance, property administration and management, operating services, common area maintenance and other operating expenses. Real estate operating expenses as a percentage of revenue were 30.6% for 2006, 30.6% for 2005 and 29.9% for 2004.

Properties acquired in 2005 and 2006 accounted for \$4.8 million (70.8%) of the \$6.8 million increase in 2006 property operating expenses. Core property operating expenses increased \$2.0 million as a result of higher utility costs due largely to rate increases, increased administrative expenditures and higher repairs and maintenance costs. Real estate taxes increased \$2.4 million due primarily to the properties acquired in 2005 and 2006, which accounted for \$1.8 million (77.7%) of the increase. The remainder of the increase in real estate taxes was due primarily to higher value assessments among our core properties.

Property acquisitions in 2004 and 2005 accounted for \$2.1 million (43.5%) of the \$4.9 million increase in property operating expenses in 2005. Core property operating expenses increased \$2.9 million as a result of higher utility costs due largely to rate increases and an increase in the Montgomery County, MD energy tax, increased administrative expenditures and higher repairs and maintenance costs. Real estate taxes increased \$1.9 million due primarily to property acquisitions, which accounted for \$1.1 million (59.1%) of the increase. The remainder of the increase in real estate taxes was due primarily to higher value assessments among our core properties.

### Other Operating Expenses

Other operating expenses are summarized as follows (all data in thousands except percentage amounts):

	2006	2005	2004	2006 vs 2005	% Change	2005 vs 2004	% Change
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Depreciation and amortization	\$ 54,170	\$ 47,161	\$ 39,309	\$ 7,009	14.9%	\$ 7,852	20.0%
Interest expense	47,846	37,743	34,500	10,103	26.8%	3,243	9.4%
General and administrative	12,622	8,005	6,194	4,617	57.7%	1,811	29.2%
	<u>\$ 114,638</u>	<u>\$ 92,909</u>	<u>\$ 80,003</u>	<u>\$ 21,729</u>	<u>23.4%</u>	<u>\$ 12,906</u>	<u>16.1%</u>

*Depreciation and amortization*

The \$7.0 million increase in depreciation and amortization expense in 2006 relative to 2005 was due substantially to acquisitions of \$303.0 million and \$145.1 million in 2006 and 2005, respectively.

The \$7.9 million increase in depreciation and amortization expense in 2005 as compared to 2004 was due primarily to acquisition activity in both years. The increase in depreciation and amortization expense attributable to 2005 and 2004 acquisitions combined was \$5.1 million (64.7%) of the total \$7.9 million increase, due to the \$145.1 million and \$84.0 million acquisitions in 2005 and 2004, respectively.



*Interest expense*

Interest expense increased \$10.1 million in 2006 compared to 2005 due to increased acquisition and development activity and increases in short term interest rates, partially offset by the refinancing of higher interest rate unsecured notes and mortgages. This activity was funded primarily by debt, including: (1) the issuance in June 2006 of \$100.0 million of 5.95% unsecured notes due June 15, 2011 and \$50.0 million of 5.95% unsecured notes due June 15, 2011, in September 2006 the issuance of \$110.0 million of 3.875% senior convertible notes due September 15, 2026 as well as the issuance in April 2005 of \$50.0 million of 5.05% senior unsecured notes due May 1, 2012 and \$50.0 million of 5.35% senior unsecured notes due May 1, 2015 and in October 2005, the issuance of an additional \$100.0 million of notes of the series of 5.35% senior unsecured notes due May 1, 2015, (2) the increase in short-term borrowing on our lines of credit, and (3) the assumption of five mortgages totaling \$76.1 million for the acquisitions of 9707 Medical Center Drive (\$5.7 million), Plumtree Medical Center (\$4.9 million), 15005 Shady Grove Road (\$8.8 million), West Gude Drive (\$33.9 million) and The Ridges and Crescent (\$23.0 million), offset somewhat by an increase in capitalized interest of \$2.7 million.

Interest expense increased \$3.2 million in 2005 as compared to 2004 due to increased acquisition and development activity and increases in short term interest rates, partially offset by the refinancing of higher interest rate unsecured notes in November 2004, and higher rate mortgages repaid in 2005. This activity was funded with debt, including: (1) the issuance in April 2005 of \$50.0 million of 5.05% senior unsecured notes due May 1, 2012 and \$50.0 million of 5.35% senior unsecured notes due May 1, 2015 and in October 2005, the issuance of an additional \$100.0 million of notes of the series of 5.35% senior unsecured notes due May 1, 2015, (2) the increase in short-term borrowing on our lines of credit, and (3) the mortgage assumption of \$24.3 million in March 2005 for the acquisition of Frederick Crossing Shopping Center. Capitalized interest on development projects increased by \$0.4 million.

A summary of interest expense for the years ended December 31, 2006, 2005 and 2004 appears below (in millions):

<b>Debt Type</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2006 vs.</b>	<b>2005 vs.</b>
				<b>2005</b>	<b>2004</b>
Notes payable	\$ 36.2	\$ 25.5	\$ 24.5	\$ 10.7	\$ 1.0
Mortgages	11.8	11.2	9.7	0.6	1.5
Lines of credit/short-term note payable	3.6	2.1	1.0	1.5	1.1
Capitalized interest	(3.8)	(1.1)	(0.7)	(2.7)	(0.4)
<b>Total</b>	<b>\$ 47.8</b>	<b>\$ 37.7</b>	<b>\$ 34.5</b>	<b>\$ 10.1</b>	<b>\$ 3.2</b>

*General and administrative expense*

The \$4.6 million increase in general and administrative expense in 2006 was due to increased salary costs for the addition of the Chief Investment Officer in 2005 and subsequent severance costs associated with his departure in June, 2006 of \$1.6 million, recognition of compensation expense for accelerated vesting of CEO share grants (upon the adoption of SFAS No. 123R) of \$1.2 million, higher incentive compensation and staff salary increases related to the growth of our portfolio. Benefits expense also increased as a result of these staffing and compensation increases.

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The \$1.8 million increase in general and administrative expense in 2005 from 2004 was due primarily to increased salary costs for the addition of the Chief Investment Officer and other staff related to the growth of our portfolio. Benefits expenses also increased as a result of both this staffing and benefit rate increases. This was somewhat offset by decreases in reduced software maintenance and internal audit costs.

### **Discontinued Operations**

We dispose of assets (sometimes using tax-deferred exchanges) that are inconsistent with our long-term strategic or return objectives and where market conditions for sale are favorable. The proceeds from the sales are reinvested into other properties, used to fund development, or distributed to our shareholders.

There were no discontinued operations for 2006. Discontinued operations for 2005 consist of the properties sold in February and September 2005. For 2004, discontinued operations include those same properties and 8230 Boone Boulevard, which was sold on November 15, 2004. There was a gain of \$1.9 million recognized in 2005 that had been previously deferred from the sale of Boone Boulevard.

On September 8, 2005 the Pepsi Distribution Center, an industrial property, was sold for \$6.0 million resulting in a gain of \$3.0 million. Proceeds of \$5.8 million were escrowed in a tax-free exchange account.

On February 1, 2005 we sold three office buildings, 7700 Leesburg, Tycon Plaza II, Tycon Plaza III and certain development rights and approvals related to Tycon Plaza II for \$67.5 million with a gain on the sale of \$32.1 million. Proceeds of \$31.3 million were escrowed in a tax-free property exchange account and subsequently used to fund a portion of the purchase price of Frederick Crossing Shopping Center on March 23, 2005 and the Coleman Building on April 8, 2005. The remaining \$31.0 million of the proceeds were used to pay down \$31.0 million outstanding under Credit Facility No. 2.

On November 15, 2004, we sold 8230 Boone Boulevard for a sale price of \$10.0 million. A portion of the proceeds was in the form of a subordinated \$1.8 million 10% note receivable from the seller, which matured in November 2005. We recognized a gain on disposal of \$1.0 million gain at the time of sale, and offset the \$1.8 million note from the buyer with a deferred gain liability in the same amount, in accordance with Statement of Financial Accounting Standards (SFAS) No. 66, Accounting for Sales of Real Estate. SFAS 66 limits gain recognition when the seller's note is subject to future subordination to the amount by which the buyer's cash payments at settlement exceed the seller's cost of the property sold. The deferred gain was recognized in April, 2005.

In November 2004 we classified 7700 Leesburg, Tycon Plaza II, Tycon Plaza III and certain development rights and approvals related to Tycon Plaza III as held for sale as specified by SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

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

	<u>2005</u>	<u>2004</u>
Revenues	\$ 656	\$ 8,895
Property expenses	(401)	(3,217)
Depreciation and amortization	(71)	(1,784)
	<u>\$ 184</u>	<u>\$ 3,894</u>

Net operations of properties sold or held for sale decreased \$0.2 million for 2006 compared to 2005 and \$3.7 million for 2005 compared to 2004. The decrease from 2005 to 2006 was because there were no property sales in 2006 and the decrease in 2005 from 2004 was due primarily to the number and timing of the property sales within each year.

#### Net Operating Income

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Real estate Net Operating Income ( NOI ), defined as real estate rental revenue less real estate operating expenses, is the primary performance measure we use to assess the results of our operations at the property level. We provide NOI as a supplement to net income calculated in accordance with accounting principles generally accepted in the United States of America ( GAAP ). NOI does not represent net income calculated in accordance with GAAP. As such, it should not be considered an alternative to net income as an indication of our operating performance. NOI is calculated as net income, less non-real estate ( other ) revenue and the results of discontinued operations (including the gain on sale, if any), plus interest expense, depreciation and amortization and general and administrative expenses. A reconciliation of NOI to net income is provided on the following page.

**2006 Compared to 2005**

The following tables of selected operating data provide the basis for our discussion of NOI in 2006 compared to 2005. All amounts are in thousands except percentage amounts.

	Years Ended December 31,			
	2006	2005	\$ Change	% Change
<b>Real Estate Rental Revenue</b>				
Core	\$ 191,464	\$ 183,069	\$ 8,395	4.6%
Non-core <sup>(1)</sup>	28,198	6,977	21,221	304.2%
<b>Total Real Estate Rental Revenue</b>	<b>\$ 219,662</b>	<b>\$ 190,046</b>	<b>\$ 29,616</b>	<b>15.6%</b>
<b>Real Estate Expenses</b>				
Core	\$ 59,188	\$ 56,682	\$ 2,506	4.4%
Non-core <sup>(1)</sup>	8,081	1,434	6,647	463.5%
<b>Total Real Estate Expenses</b>	<b>\$ 67,269</b>	<b>\$ 58,116</b>	<b>\$ 9,153</b>	<b>15.7%</b>
<b>Net Operating Income</b>				
Core	\$ 132,276	\$ 126,387	\$ 5,889	4.7%
Non-core <sup>(1)</sup>	20,117	5,543	14,574	262.9%
<b>Total Net Operating Income</b>	<b>\$ 152,393</b>	<b>\$ 131,930</b>	<b>\$ 20,463</b>	<b>15.5%</b>
<b>Reconciliation to Net Income</b>				
NOI	\$ 152,393	\$ 131,930		
Other revenue	906	918		
Other income from property settlement		504		
Interest expense	(47,846)	(37,743)		
Depreciation and amortization	(54,170)	(47,161)		
General and administrative expenses	(12,622)	(8,005)		
Discontinued operations <sup>(2)</sup>		184		
Gain on Disposal		37,011		
<b>Net Income</b>	<b>\$ 38,661</b>	<b>\$ 77,638</b>		

<u>Economic Occupancy</u>	<u>2006</u>	<u>2005</u>
Core	93.9%	92.2%
Non-core <sup>(1)</sup>	92.3%	94.9%
<b>Total</b>	<b>93.7%</b>	<b>92.3%</b>

<sup>(1)</sup> Non-core properties include:

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2006 acquisitions Hampton Overlook, Hampton South, Alexandria Medical Center, 9707 Medical Center Drive, 15001 Shady Grove Road, Montrose Shopping Center, Randolph Shopping Center, 9950 Business Parkway, Plumtree Medical Center, 15005 Shady Grove Road, 6565 Arlington Blvd, West Gude Drive, The Ridges, The Crescent

2005 acquisitions Frederick Crossing, Coleman Building and Albemarle Point

<sup>(2)</sup> Discontinued operations include gain on disposals and income from operations for:

2005 disposals Tycon Plaza II, Tycon Plaza III, 7700 Leesburg Pike and the Pepsi Distribution Center

We recognized NOI of \$152.4 million in 2006, which was \$20.5 million (15.5%) greater than in 2005 due largely to our acquisitions of four office properties, six medical office properties, three retail centers and five industrial properties in 2005 and 2006, which added approximately 2,151,000 square feet of net rentable space. Acquired properties contributed \$20.1 million in NOI in 2006 (13.2% of total NOI), a \$14.6 million increase over 2005.

Core properties experienced a \$5.9 million (4.7%) increase in NOI due to an \$8.3 million increase in revenues offset by a \$2.5 million increase in real estate expenses. Revenue was positively impacted by improvements in all lines of business due to rental rate growth across the portfolio (3.4%) and higher core occupancy in the office, retail and medical office sectors. The increase in core expenses was driven by the office, retail and multifamily sectors, which contributed \$1.7, \$0.4 and \$0.4 million, respectively, in additional expense as a result of higher utilities, repairs and maintenance, operating services, and real estate taxes.

Overall economic occupancy increased from 92.3% in 2005 to 93.7% in 2006 due to higher core occupancy in the office and retail sectors and higher occupancy in our acquired office and medical office properties. Core economic occupancy increased 170 basis points due to a 400 basis point increase in the office sector and a 180 basis point increase in the retail sector offset somewhat by a 130 basis point decrease in the industrial sector and an 80 basis point decrease in the multifamily sector. During 2006, 78.0% of the commercial square footage expiring was renewed as compared to 70.2% in 2005 and 1,611,000 commercial square feet were leased at an average rental rate increase of 12.8%

An analysis of NOI by sector follows.

**Office Sector**

	Years Ended December 31,			
	2006	2005	\$ Change	% Change
<b>Real Estate Rental Revenue</b>				
Core	\$ 80,113	\$ 76,055	\$ 4,058	5.3%
Non-core <sup>(1)</sup>	6,700	921	5,779	627.5%
<b>Total Real Estate Rental Revenue</b>	<b>\$ 86,813</b>	<b>\$ 76,976</b>	<b>\$ 9,837</b>	<b>12.8%</b>
<b>Real Estate Expenses</b>				
Core	\$ 27,704	\$ 26,015	\$ 1,689	6.5%
Non-core <sup>(1)</sup>	2,160	262	1,898	724.4%
<b>Total Real Estate Expenses</b>	<b>\$ 29,864</b>	<b>\$ 26,277</b>	<b>\$ 3,587</b>	<b>13.7%</b>
<b>Net Operating Income</b>				
Core	\$ 52,409	\$ 50,040	\$ 2,369	4.7%
Non-core <sup>(1)</sup>	4,540	659	3,881	588.9%
<b>Total Net Operating Income</b>	<b>\$ 56,949</b>	<b>\$ 50,699</b>	<b>\$ 6,250</b>	<b>12.3%</b>

<b>Economic Occupancy</b>	<b>2006</b>	<b>2005</b>
Core	92.1%	88.1%
Non-core <sup>(1)</sup>	91.9%	80.7%
<b>Total</b>	<b>92.1%</b>	<b>87.9%</b>

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(1) Non-core properties include:

2006 acquisitions 6565 Arlington Blvd, West Gude Drive, The Ridges

2005 acquisitions Albemarle Point Office Building

(2) Discontinued operations include gain on disposals and income from operations for:

2005 disposals Tycon Plaza II, Tycon Plaza III, 7700 Leesburg Pike

The office sector recognized NOI of \$56.9 million which was \$6.3 million (12.3%) higher than in 2005 due primarily to the \$2.4 million increase in Core NOI and the NOI from acquired properties in 2006 which contributed \$4.5 million (8.0% of total) to NOI.



Core office properties achieved a \$2.4 million (4.7%) increase in NOI due to a \$4.1 million increase in revenues offset somewhat by a \$1.7 million increase in core real estate expenses. Core revenue was higher due to the 400 basis point increase in occupancy (\$3.1 million) led by occupancy gains at Maryland Trade Center I and II, 1600 Wilson Boulevard, 1700 Research Boulevard, 600 Jefferson Plaza and 7900 Westpark, and rental rate increases (\$1.7 million). This increase was offset somewhat by an increase in bad debt reserves (\$0.3 million) and rent abatements (\$0.3 million). The increase in real estate expenses was due to higher utility costs driven by escalating fuel rates, consumption and energy taxes, real estate tax expense that increased due to higher value assessments for properties across several tax jurisdictions and increased custodial costs associated with the increase in occupancy.

During 2006, 71.4% of the square footage that expired was renewed compared to 65.1% in 2005, excluding properties sold or classified as held for sale. During 2006, we executed new leases for 597,000 square feet of office space at an average rent increase of 9.1%.

### Medical Office Sector

	Years Ended December 31,			
	2006	2005	\$ Change	% Change
<b>Real Estate Rental Revenue</b>				
Core	\$ 18,094	\$ 18,024	\$ 70	0.4%
Non-core <sup>(1)</sup>	6,566		6,566	
<b>Total Real Estate Rental Revenue</b>	<b>\$ 24,660</b>	<b>\$ 18,024</b>	<b>\$ 6,636</b>	<b>36.8%</b>
<b>Real Estate Expenses</b>				
Core	\$ 4,759	\$ 4,649	\$ 110	2.4%
Non-core <sup>(1)</sup>	2,427		2,427	
<b>Total Real Estate Expenses</b>	<b>\$ 7,186</b>	<b>\$ 4,649</b>	<b>\$ 2,537</b>	<b>54.6%</b>
<b>Net Operating Income</b>				
Core	\$ 13,335	\$ 13,375	\$ (40)	(0.3%)
Non-core <sup>(1)</sup>	4,139		4,139	
<b>Total Net Operating Income</b>	<b>\$ 17,474</b>	<b>\$ 13,375</b>	<b>\$ 4,099</b>	<b>30.6%</b>

Economic Occupancy	2006	2005
Core	98.8%	98.4%
Non-core <sup>(1)</sup>	99.2%	
<b>Total</b>	<b>98.9%</b>	<b>98.4%</b>

<sup>(1)</sup> Non-core properties include:

2006 acquisitions Alexandria Professional Center, 9707 Medical Center Drive, 15001 Shady Grove Road, Plumtree Medical Center, 15005 Shady Grove Road and The Crescent

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The medical office sector NOI increased from \$13.4 million in 2005 to \$17.5 million in 2006, an increase of \$4.1 million or 30.6%. This was substantially due to the acquisitions made in 2006 which contributed \$4.1 million to the NOI and added approximately 336,000 net rentable square feet to the portfolio.

Core medical office property NOI was flat. Revenues for core properties were positively impacted by a 40 basis point increase in occupancy and a 0.6% increase in rental rates. Expenses increased due to higher repair and maintenance costs.

During 2006, 87.7% of the square footage that expired was renewed compared to 74.7% in 2005. During 2006, we executed new leases for 119,900 square feet of medical office space at an average rent increase of 19.9%.

**Retail Sector**

	Years Ended December 31,			
	2006	2005	\$ Change	% Change
<b>Real Estate Rental Revenue</b>				
Core	\$ 30,545	\$ 28,425	\$ 2,120	7.5%
Non-core <sup>(1)</sup>	6,718	3,482	3,236	92.9%
<b>Total Real Estate Rental Revenue</b>	<b>\$ 37,263</b>	<b>\$ 31,907</b>	<b>\$ 5,356</b>	<b>16.8%</b>
<b>Real Estate Expenses</b>				
Core	\$ 6,718	\$ 6,296	\$ 422	6.7%
Non-core <sup>(1)</sup>	1,265	583	682	117.0%
<b>Total Real Estate Expenses</b>	<b>\$ 7,983</b>	<b>\$ 6,879</b>	<b>\$ 1,104</b>	<b>16.0%</b>
<b>Net Operating Income</b>				
Core	\$ 23,827	\$ 22,129	\$ 1,698	7.7%
Non-core <sup>(1)</sup>	5,453	2,899	2,554	88.1%
<b>Total Net Operating Income</b>	<b>\$ 29,280</b>	<b>\$ 25,028</b>	<b>\$ 4,252</b>	<b>17.0%</b>

<b>Economic Occupancy</b>	2006	2005
Core	99.1%	97.3%
Non-core <sup>(1)</sup>	84.2%	100.0%
<b>Total</b>	<b>96.0%</b>	<b>97.6%</b>

<sup>(1)</sup> Non-core properties include:

2006 acquisitions Randolph and Montrose Shopping Centers

2005 acquisition Frederick Crossing

Retail sector NOI increased \$4.3 million (17.0%) in 2006 due to the 2006 and 2005 acquisitions which contributed \$5.4 million to NOI (18.6% of the total) and a \$1.7 million increase in NOI from core properties. The core revenue increase was due to rental rate growth of 8.5% driven by the Harris Teeter lease at Shoppes at Foxchase and escalating market rates at other centers and a 180 basis point increase in occupancy across most of the remaining portfolio.

Overall economic occupancy for the retail sector decreased approximately 160 basis points primarily as a result of the acquisitions of the Montrose and Randolph shopping centers which were 58% and 91% leased, respectively, at the time of their acquisition. During 2006, our

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retention rate was 90.8% compared to 95.3% in 2005 and we executed new leases for approximately 123,000 square feet of retail space at an average rent increase of 20.8%.

*Multifamily Sector*

	Years Ended December 31,			
	2006	2005	\$ Change	% Change
<b>Real Estate Rental Revenue</b>				
Core/Total	\$ 32,478	\$ 30,529	\$ 1,949	6.4%
<b>Real Estate Expenses</b>				
Core/Total	13,220	12,816	404	3.2%
<b>Net Operating Income</b>				
Core/Total	\$ 19,258	\$ 17,713	\$ 1,545	8.7%

<b>Economic Occupancy</b>	2006	2005
Core/Total	92.4%	93.2%

Multifamily NOI increased \$1.5 million (8.7%) in 2006 as compared to 2005 as a result of a \$1.9 million increase in revenue offset somewhat by a \$0.4 million increase in expenses. The revenue increase was driven by an increase in minimum base rent throughout the portfolio (\$2.0 million), offset somewhat by the 80 basis point decrease in occupancy (\$0.4 million) compared to 2005 due to units at two properties that were taken off-line for renovation and the move out of a block of 28 units leased by one individual. Real estate expenses increased \$0.4 million due primarily to higher repairs and maintenance costs, higher administrative costs related to property-level leasing and maintenance positions and increased marketing costs, and increased utility expense related to higher fuel costs.

**Industrial Sector**

	Years Ended December 31,			
	2006	2005	\$ Change	% Change
<b>Real Estate Rental Revenue</b>				
Core	\$ 30,234	\$ 30,036	\$ 198	0.7%
Non-core <sup>(1)</sup>	8,214	2,574	5,640	219.1%
<b>Total Real Estate Rental Revenue</b>	<b>\$ 38,448</b>	<b>\$ 32,610</b>	<b>\$ 5,838</b>	<b>17.9%</b>
<b>Real Estate Expenses</b>				
Core	\$ 6,787	\$ 6,906	(\$ 119)	(1.7%)
Non-core <sup>(1)</sup>	2,229	589	1,640	278.4%
<b>Total Real Estate Expenses</b>	<b>\$ 9,016</b>	<b>\$ 7,495</b>	<b>\$ 1,521</b>	<b>20.3%</b>
<b>Net Operating Income</b>				
Core	\$ 23,447	\$ 23,130	\$ 317	1.4%
Non-core <sup>(1)</sup>	5,985	1,985	4,000	201.5%
<b>Total Net Operating Income</b>	<b>\$ 29,432</b>	<b>\$ 25,115</b>	<b>\$ 4,317</b>	<b>17.2%</b>

<b>Economic Occupancy</b>	2006	2005
Core	92.8%	94.1%
Non-core <sup>(1)</sup>	95.1%	98.5%
<b>Total</b>	<b>93.3%</b>	<b>94.2%</b>

<sup>(1)</sup> Non-core properties include:

2006 acquisitions Hampton Overlook, Hampton South and 9950 Business Parkway

2005 acquisitions Coleman Building and Albemarle Point Industrial Buildings

<sup>(2)</sup> Discontinued operations include gain on disposal and income from operations for:

2005 disposal Pepsi Distribution Center

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Industrial sector NOI increased \$4.3 million (17.2%) over 2005 due to acquisitions in 2005 and 2006. These acquisitions contributed \$6.0 million in NOI, 20.3% of the total NOI.

Core properties achieved a \$0.3 million (1.4%) increase in NOI due to a \$0.2 million increase in real estate revenues, while real estate expenses decreased \$0.1 million. The revenue increase was driven by a 2.6% increase in rental rates offset somewhat by a 130 basis point decrease in occupancy primarily due to vacancies at Sully Square.

During 2006 our retention rate was 79.3% compared to 65.0% in 2005 and we executed new leases for approximately 770,000 square feet of industrial space at an average rent increase of 14.3%.

**2005 Compared to 2004**

The following tables of selected operating data provide the basis for our discussion of NOI in 2005 compared to 2004. All amounts are in thousands except percentage amounts.

	Years Ended December 31,			
	2005	2004	\$ Change	% Change
<b>Real Estate Rental Revenue</b>				
Core	\$ 173,963	\$ 169,595	\$ 4,368	2.6%
Non-core <sup>(1)</sup>	16,083	2,051	14,032	684.2%
<b>Total Real Estate Rental Revenue</b>	<b>\$ 190,046</b>	<b>\$ 171,646</b>	<b>\$ 18,400</b>	<b>10.7%</b>
<b>Real Estate Expenses</b>				
Core	\$ 54,429	\$ 50,890	\$ 3,539	7.0%
Non-core <sup>(1)</sup>	3,687	438	3,249	741.8%
<b>Total Real Estate Expenses</b>	<b>\$ 58,116</b>	<b>\$ 51,328</b>	<b>\$ 6,788</b>	<b>13.2%</b>
<b>Net Operating Income</b>				
Core	\$ 119,534	\$ 118,705	\$ 829	0.7%
Non-core <sup>(1)</sup>	12,396	1,613	10,783	668.5%
<b>Total Net Operating Income</b>	<b>\$ 131,930</b>	<b>\$ 120,318</b>	<b>\$ 11,612</b>	<b>9.7%</b>
<b>Reconciliation to Net Income</b>				
NOI	\$ 131,930	\$ 120,318		
Other revenue	918	326		
Other income from property settlement	504			
Interest expense	(37,743)	(34,500)		
Depreciation and amortization	(47,161)	(39,309)		
General and administrative expenses	(8,005)	(6,194)		
Discontinued operations <sup>(2)</sup>	184	3,894		
Gain on Disposal	37,011	1,029		
<b>Net Income</b>	<b>\$ 77,638</b>	<b>\$ 45,564</b>		

<u>Economic Occupancy</u>	<u>2005</u>	<u>2004</u>
Core	91.9%	91.4%
Non-core <sup>(1)</sup>	97.4%	97.8%
<b>Total</b>	<b>92.3%</b>	<b>91.4%</b>

<sup>(1)</sup> Non-core properties include:



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2005 acquisitions Frederick Crossing, Coleman Building and Albemarle Point

2004 acquisitions Shady Grove Medical Village II, 8301 Arlington Boulevard, 8880 Gorman Road and Dulles Business Park

<sup>(2)</sup> Discontinued operations include gain on disposals and income from operations for:

2005 disposals Tycon Plaza II, Tycon Plaza III, 7700 Leesburg Pike and the Pepsi Distribution Center

2004 disposal 8230 Boone Boulevard

We recognized NOI of \$131.9 million in 2005, which was \$11.6 million (9.7%) greater than in 2004 due largely to our acquisitions of one office building, two medical office buildings, one retail property and four industrial properties in 2004 and 2005, which added approximately 1,173,000 square feet of net rentable space. Acquired properties contributed \$12.4 million in NOI in 2005 (9.4% of total NOI), a \$10.8 million increase over 2004.

Rental operations at 718 Jefferson Street ceased in the third quarter of 2004 as the property was incorporated into the Clayborne Apartments development project.

Core properties experienced a \$0.8 million (0.7%) increase in NOI due to a \$4.4 million increase in revenues offset by a \$3.5 million increase in real estate expenses. Revenue was positively impacted by improvements in all lines of business except the office sector due to lower occupancy and reduced rental rates. Higher occupancy and rental rate increases in the industrial, medical office, retail and multifamily sectors and higher expense recoveries in the retail and industrial sectors positively impacted those respective lines of business. The increase in core expenses was driven by the industrial, office and multifamily sectors, which contributed \$0.5, \$1.2 and \$1.2 million, respectively, in additional expense as a result of higher utilities, repairs and maintenance, operating services, and real estate taxes.

Overall economic occupancy increased from 91.4% in 2004 to 92.4% in 2005 due to higher core occupancy, higher occupancy in our acquired office property and 100% occupancy in our acquired retail property. Core economic occupancy increased 50 basis points due to increases in every sector except the office sector. During 2005, 70.2% of the square footage expiring was renewed as compared to 65.9% in 2004 and 1,720,000 square feet were leased at an average rental rate increase of 8.7%.

An analysis of NOI by sector follows.

#### Office Sector

	Years Ended December 31,			
	2005	2004	\$ Change	% Change
<b>Real Estate Rental Revenue</b>				
Core	\$ 76,055	\$ 77,070	\$ (1,015)	(1.3%)
Non-core <sup>(1)</sup>	921		921	100.0%
<b>Total Real Estate Rental Revenue</b>	<b>\$ 76,976</b>	<b>\$ 77,070</b>	<b>\$ (94)</b>	<b>(0.1%)</b>
<b>Real Estate Expenses</b>				
Core	\$ 26,015	\$ 24,835	\$ 1,180	4.8%
Non-core <sup>(1)</sup>	262		262	100.0%
<b>Total Real Estate Expenses</b>	<b>\$ 26,277</b>	<b>\$ 24,835</b>	<b>\$ 1,442</b>	<b>5.8%</b>
<b>Net Operating Income</b>				
Core	\$ 50,040	\$ 52,235	\$ (2,195)	(4.2%)
Non-core <sup>(1)</sup>	659		659	100.0%
<b>Total Net Operating Income</b>	<b>\$ 50,699</b>	<b>\$ 52,235</b>	<b>\$ (1,536)</b>	<b>(2.9%)</b>

<b>Economic Occupancy</b>	<b>2005</b>	<b>2004</b>
Core	88.1%	89.2%

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Non-core <sup>(1)</sup>	90.1%	—
<b>Total</b>	<b>87.9%</b>	<b>89.2%</b>

<sup>(1)</sup> Non-core properties include:

2005 acquisitions Albemarle Point Office Building

<sup>(2)</sup> Discontinued operations include gain on disposals and income from operations for:

2005 disposals Tycon Plaza II, Tycon Plaza III, 7700 Leesburg Pike

2004 disposal 8230 Boone Boulevard

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The office sector recognized NOI of \$50.7 million (2.9%) lower than in 2004 due primarily to the \$2.2 million reduction in Core NOI. The property acquired in 2005 contributed \$0.7 million (1.3% of total) to NOI.

Core office properties experienced a \$2.2 million (4.2%) decrease in NOI due to a \$1.0 million decline in revenues combined with a \$1.2 million increase in core real estate expenses. Revenue was impacted by lower minimum base rent of \$0.6 million due primarily to higher vacancies and a decrease in rental rates, higher bad debt expense of \$0.3 million and lower lease termination fee income of \$0.1 million. The increase in real estate expenses was due to higher utility costs driven by escalating fuel rates and energy taxes, additional real estate tax expense due to higher value assessments for properties across several tax jurisdictions and increased repairs and maintenance costs.

Core economic occupancy declined 110 basis points due to vacancies at Maryland Trade Center I, 6110 Executive Boulevard, Saratoga, Lexington, and 515 King Street. Overall economic occupancy decreased from 89.2% to 88.1%.

During 2005, 65.1% of the square footage that expired was renewed compared to 50.5% in 2004, excluding properties sold or classified as held for sale. During 2005, we executed new leases for 711,700 square feet of office space at an average rent increase of 3.8%.

### *Medical Office Sector*

	Years Ended December 31,			
	2005	2004	\$ Change	% Change
<b>Real Estate Rental Revenue</b>				
Core	\$ 14,787	\$ 14,016	\$ 771	5.5%
Non-core <sup>(1)</sup>	3,237	1,034	2,203	213.1%
<b>Total Real Estate Rental Revenue</b>	<b>\$ 18,024</b>	<b>\$ 15,050</b>	<b>\$ 2,974</b>	<b>19.8%</b>
<b>Real Estate Expenses</b>				
Core	\$ 3,686	\$ 3,400	\$ 286	8.4%
Non-core <sup>(1)</sup>	964	286	678	237.1%
<b>Total Real Estate Expenses</b>	<b>\$ 4,650</b>	<b>\$ 3,686</b>	<b>\$ 964</b>	<b>26.2%</b>
<b>Net Operating Income</b>				
Core	\$ 11,101	\$ 10,616	\$ 485	4.6%
Non-core <sup>(1)</sup>	2,273	748	1,525	203.9%
<b>Total Net Operating Income</b>	<b>\$ 13,374</b>	<b>\$ 11,364</b>	<b>\$ 2,010</b>	<b>17.7%</b>

Economic Occupancy	2005	2004
Core	99.3%	98.4%
Non-core <sup>(1)</sup>	94.5%	96.3%

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Total	98.4%	98.2%
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(1) Non-core properties include:

2004 acquisitions Shady Grove Medical Village II and 8301 Arlington Boulevard

The medical office sector NOI increased from \$11.4 million in 2004 to \$13.4 million in 2005, an increase of \$2.0 million or 17.7%. This was substantially due to the acquisitions made in 2004 which contributed \$2.3 million to the NOI and added approximately 116,000 net rentable square feet to the portfolio.

Core medical office property NOI increased \$0.5 million with a \$0.8 million revenue increase offset somewhat by a \$0.3 million increase in real estate expenses. Revenues for core properties were positively impacted by

increased occupancy and rental rates as well as increased expense reimbursements from tenants. Expenses increased due to higher utility costs and real estate taxes. Core occupancy increased 90 basis points as vacancies decreased at Woodburn II.

During 2005, 74.7% of the square footage that expired was renewed compared to 100% in 2004. During 2005, we executed new leases for 40,000 square feet of medical office space at an average rent increase of 11.2%.

**Retail Sector**

	Years Ended December 31,			
	2005	2004	\$ Change	% Change
<b>Real Estate Rental Revenue</b>				
Core	\$ 28,425	\$ 27,243	\$ 1,182	4.3%
Non-core <sup>(1)</sup>	3,482		3,482	100.0%
<b>Total Real Estate Rental Revenue</b>	<b>\$ 31,907</b>	<b>\$ 27,243</b>	<b>\$ 4,664</b>	<b>17.1%</b>
<b>Real Estate Expenses</b>				
Core	\$ 6,296	\$ 5,899	\$ 397	6.7%
Non-core <sup>(1)</sup>	582		582	100.0%
<b>Total Real Estate Expenses</b>	<b>\$ 6,878</b>	<b>\$ 5,899</b>	<b>\$ 979</b>	<b>16.6%</b>
<b>Net Operating Income</b>				
Core	\$ 22,129	\$ 21,344	\$ 785	3.7%
Non-core <sup>(1)</sup>	2,900		2,900	100.0%
<b>Total Net Operating Income</b>	<b>\$ 25,029</b>	<b>\$ 21,344</b>	<b>\$ 3,685</b>	<b>17.3%</b>

<b>Economic Occupancy</b>	2005	2004
Core	97.3%	94.8%
Non-core <sup>(1)</sup>	100.0%	
<b>Total</b>	<b>97.6%</b>	<b>94.8%</b>

<sup>(1)</sup> Non-core properties include:

2005 acquisition Frederick Crossing

Retail sector NOI increased \$3.7 million (17.3%) in 2005 due to the 2005 acquisition which contributed \$2.9 million to NOI and a \$0.8 million increase in NOI from core properties. The acquisition NOI was \$2.9 million (11.6%) of the total. The core revenue increase was due to rental rate growth of 1.5% driven by escalating market rates, higher common area maintenance and higher occupancy. Rental operations at 718

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Jefferson Street ceased in the third quarter of 2004 as the property was incorporated into the Clayborne Apartments development project.

Overall economic occupancy for the retail sector increased approximately 280 basis points primarily as a result of the completion of the renovation at Westminster where a national grocery store chain took possession in November 2004. During 2005, our retention rate was 95.3% compared to 77.4% in 2004 and we executed new leases for 180,700 square feet of retail space at an average rent increase of 28.6%.

*Multifamily Sector*

	Years Ended December 31,			
	2005	2004	\$ Change	% Change
<b>Real Estate Rental Revenue</b>				
Core/Total	\$ 30,529	\$ 28,858	\$ 1,671	5.8%
<b>Real Estate Expenses</b>				
Core/Total	12,816	11,637	1,179	10.1%
<b>Net Operating Income</b>				
Core/Total	\$ 17,713	\$ 17,221	\$ 492	2.9%

<b>Economic Occupancy</b>	2005	2004
Core/Total	93.2%	90.5%

Multifamily NOI increased \$0.5 million (2.9%) as compared to 2004 as a result of a \$1.7 million increase in revenue offset somewhat by a \$1.2 million increase in expenses. The revenue increase was driven by an increase in minimum base rent and increases in occupancy throughout most of the portfolio. Occupancy for the overall portfolio increased 270 basis points compared to 2004. Revenue was additionally impacted by increased rent abatements, the result of efforts to improve leasing activity across the portfolio. Real estate expenses increased \$1.2 million due primarily to higher administrative costs related to property-level leasing and maintenance positions and increased marketing costs, higher repairs and maintenance expense and increased utility expense related to higher fuel costs.



**Industrial Sector**

	Years Ended December 31,			
	2005	2004	\$ Change	% Change
<b>Real Estate Rental Revenue</b>				
Core	\$ 24,167	\$ 22,408	\$ 1,759	7.8%
Non-core <sup>(1)</sup>	8,443	1,017	7,426	730.2%
<b>Total Real Estate Rental Revenue</b>	<b>\$ 32,610</b>	<b>\$ 23,425</b>	<b>\$ 9,185</b>	<b>39.2%</b>
<b>Real Estate Expenses</b>				
Core	\$ 5,616	\$ 5,119	\$ 497	9.7%
Non-core <sup>(1)</sup>	1,879	152	1,727	1136.2%
<b>Total Real Estate Expenses</b>	<b>\$ 7,495</b>	<b>\$ 5,271</b>	<b>\$ 2,224</b>	<b>42.2%</b>
<b>Net Operating Income</b>				
Core	\$ 18,551	\$ 17,289	\$ 1,262	7.3%
Non-core <sup>(1)</sup>	6,564	865	5,699	658.8%
<b>Total Net Operating Income</b>	<b>\$ 25,115</b>	<b>\$ 18,154</b>	<b>\$ 6,961</b>	<b>38.3%</b>

<b>Economic Occupancy</b>	2005	2004
Core	93.0%	92.4%
Non-core <sup>(1)</sup>	98.6%	99.5%
<b>Total</b>	<b>94.5%</b>	<b>92.7%</b>

<sup>(1)</sup> Non-core properties include:

2005 acquisitions Coleman Building and Albemarle Point Industrial Buildings

2004 acquisitions 8880 Gorman Road and Dulles Business Park

<sup>(2)</sup> Discontinued operations include gain on disposal and income from operations for:

2005 disposal Pepsi Distribution Center

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Industrial sector NOI increased \$7.0 million (38.3%) over 2004 due to the acquisitions of 8880 Gorman Road and Dulles Business Park in 2004 and the acquisition of the Coleman Building and the Albemarle Point Industrial Buildings in 2005. These acquisitions contributed \$6.6 million in NOI, 26.1% of the total NOI.

Core properties experienced a \$1.3 million (7.3%) increase in NOI due to a \$1.8 million increase in real estate revenues, while real estate expenses increased only \$0.5 million. The revenue increase was driven by a 60 basis point growth in occupancy due to increased leasing activity, particularly at Ammendale Technology Park II, Earhart and Northern Virginia Industrial Park. Revenue was also positively impacted by higher lease termination fees and reimbursements for common area maintenance and real estate taxes (\$0.5 million combined) and a 4.4% increase in rental rates.

We executed new leases for 787,500 square feet of industrial space at an average rent increase of 12.2%.

### **LIQUIDITY AND CAPITAL RESOURCES**

#### **Capital Structure**

We manage our capital structure to reflect a long-term investment approach, generally seeking to match the cash flow of our assets with a mix of equity and various debt instruments. We expect that our capital structure will allow us to obtain additional capital from diverse sources that could include additional equity offerings of

common shares, public and private debt financings and possible asset dispositions. Our ability to raise funds through the sale of debt and equity securities is dependent on, among other things, general economic conditions, general market conditions for REITs, our operating performance, our debt rating and the current trading price of our shares. We will always analyze which source of capital is most advantageous to us at any particular point in time; however the capital markets may not consistently be available on terms that we consider attractive.

We currently expect that our principal sources of liquidity for acquisitions, development, expansion and renovation of properties, plus operating and administrative will include:

Cash flow from operations;

Borrowings under our unsecured credit facilities;

Proceeds for unsecured note issuances and equity offerings; and

Net proceeds from the sale of assets.

During 2007, we expect that we will have significant capital requirements, including the following items. There can be no assurance that our capital requirements will not be materially higher or lower than these expectations.

Funding dividends on our common shares and minority interest distributions to third party unit holders;

Approximately \$44.0 million to invest in our existing portfolio of operating assets, including approximately \$16.0 million to fund tenant-related capital requirements and leasing commissions;

Approximately \$64.0 million to invest in our development projects;

Approximately \$150.0 million to fund our expected property acquisitions;

We believe that we will generate sufficient cash flow from operations and have access to the capital resources necessary to fund our requirements. However, as a result of general, greater Washington metro region, or tenant economic downturns, unfavorable fluctuations in interest rates or our share price, unfavorable changes in the supply of competing properties, or our properties not performing as expected, we may not generate sufficient cash flow from operations or otherwise have access to capital on favorable terms, or at all. If we are unable to obtain capital from other sources, we may not be able to pay the dividend required to maintain our status as a REIT, make required principal and interest payments, make strategic acquisitions or make necessary routine capital improvements or undertake re-development opportunities with respect to our existing portfolio of operating assets. In addition, if a property is mortgaged to secure payment of indebtedness and we are unable to meet mortgage payments, the holder of the mortgage could foreclose on the property, resulting in loss of income and asset value.

## **Debt Financing**

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We generally use unsecured, corporate-level debt, including unsecured notes and our unsecured credit facilities, to meet our borrowing needs. Long-term, we generally use fixed rate debt instruments in order to match the returns from our real estate assets. We also utilize variable rate debt for short-term financing purposes. At times, our mix of variable and fixed rate debt may not suit our needs. At those times, we may use derivative financial instruments including interest rate swaps and caps, forward interest rate options or interest rate options in order to assist us in managing our debt mix. We would either hedge our variable rate debt to give it a fixed interest rate or hedge fixed rate debt to give it a variable interest rate. At December 31, 2006, there were no derivative securities outstanding.

Typically we have obtained the ratings of two credit rating agencies in the underwriting of our unsecured debt. As of December 31, 2006, Standard & Poors had assigned its A- rating with a negative outlook, and Moody's Investor Service has assigned its Baa1 rating with a stable outlook, to our unsecured debt offerings. A downgrade in rating by either of these rating agencies could result from, among other things, a change in our financial

position, or a downturn in general economic condition. Any such downgrade could adversely affect our ability to obtain future financing or could increase the interest rates on our existing variable rate debt. However, we have no debt instruments under which the principal maturity would be accelerated upon a downward change in our debt rating. Each rating is subject to revision or withdrawal at any time by the assigning rating organization.

Our total debt at December 31, 2006 is summarized as follows (in thousands):

	<b>Total Debt</b>
Fixed rate mortgages	\$ 237,073
Unsecured credit facilities	61,000
Senior unsecured notes	730,000
	<u>\$ 1,028,073</u>

#### **Mortgage Debt**

At December 31, 2006, our \$237.1 million in fixed rate mortgages, which includes \$3.1 million in unamortized premiums due to fair value adjustments, bore an effective weighted average interest rate of 5.9% and had a weighted average maturity of 5.3 years. We generally do not initiate secured mortgage debt, but will assume mortgage debt from time-to-time in conjunction with property acquisitions.

#### **Unsecured Credit Facilities**

Our primary source of liquidity is our two revolving credit facilities. We can borrow up to \$270.0 million under these lines, which bear interest at an adjustable spread over LIBOR based on our public debt rating. Credit Facility No. 1 is a three-year, \$70.0 million unsecured credit facility expiring in July 2008. We had \$28.0 outstanding as of December 31, 2006 related to Credit Facility No. 1, \$1.9 million in letters of credit issued and \$40.1 million unused and available.

Credit Facility No. 2 is a four-year \$200.0 million unsecured credit facility expiring in November 2010, with a one year extension option. This facility replaces the previous \$85 million credit facility.

We had \$33.0 million outstanding as of December 31, 2006, related to Credit Facility No. 2, as a result of borrowings for development and capital improvements.

Our unsecured credit facilities contain financial and other covenants with which we must comply. Some of these covenants include:

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A minimum ratio of annual EBITDA (earnings before interest, taxes, depreciation and amortization) to interest expense;

A minimum ratio of tangible fair market value of our unencumbered assets to aggregate unsecured debt; and

A maximum ratio of total debt to tangible fair market value of our assets.

Failure to comply with any of the covenants under our unsecured credit facilities or other debt instruments could result in a default under one or more of our debt instruments. This could cause our lenders to accelerate the timing of payments and would therefore have a material adverse effect on our business, operations, financial condition and liquidity.

As of December 31, 2006, we were in compliance with our loan covenants; however, our ability to draw on our unsecured credit facility or incur other unsecured debt in the future could be restricted by the loan covenants.

If principal amounts due at maturity cannot be refinanced, extended or paid with proceeds of other capital transactions, such as new equity capital, our cash flow may be insufficient to repay all maturing debt. Prevailing interest rates or other factors at the time of a refinancing (such as possible reluctance of lenders to make commercial real estate loans) may result in higher interest rates and increased interest expense.

**Senior Unsecured Notes**

We generally issue senior unsecured notes to fund our real estate assets long-term. We intend to ladder the maturities of our debt to mitigate exposure to interest rate risk in future years.

We anticipate that over the near term, interest rate fluctuations will not have a material adverse effect on earnings. Our unsecured fixed-rate notes payable have maturities ranging from February 2008 through February 2028 (see Note 6), as follows (in thousands):

	<b>December 31, 2006</b>
	<b>Note Principal</b>
2007	\$
2008	60,000
2009	
2010	
2011	150,000
Thereafter	520,000
	<b>\$ 730,000</b>

Our unsecured notes contain covenants with which we must comply. These include:

Limits on our total indebtedness;

Limits on our secured indebtedness;

Limits on our required debt service payments; and

Maintenance of a minimum level of unencumbered assets.

We are in compliance with our unsecured notes covenants as of December 31, 2006.

**Common Equity**

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We have authorized for issuance 45 million common shares, of which 42.1 million shares were outstanding at December 31, 2006.

In June 2006, we completed a public offering of 2.745 million common shares of beneficial interest which provided net cash of \$90.9 million. We used the proceeds to repay borrowings on our lines of credit.

### Dividends

We pay dividends quarterly. The maintenance of these dividends is subject to various factors, including the discretion of the Board of Trustees, the ability to pay dividends under Maryland law, the availability of cash to make the necessary dividend payments and the effect of REIT distribution requirements, which require at least 90% of our taxable income to be distributed to shareholders. The table below details our dividend and distribution payments for 2006, 2005 and 2004 (in thousands).

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Common dividends	\$ 72,681	\$ 67,322	\$ 64,836
Minority interest distributions	134	131	127
	<u>\$ 72,815</u>	<u>\$ 67,453</u>	<u>\$ 64,963</u>



Dividends paid for 2006 as compared to 2005 increased as a direct result of a dividend rate increase from \$1.60 per share in 2005 to \$1.64 per share in 2006 as well as the issuance of 2,745,000 shares in an equity offering in June 2006. Dividends paid in 2005 increased as compared to 2004 due to the dividend rate increase to \$1.60 per share from \$1.55 per share.

Cash flows from operations are an important factor in our ability to sustain our dividend at its current rate. Cash flows from operations decreased from \$87.5 million in 2005 to \$85.2 million in 2006 due in part to an increase in other assets for the acquisitions completed in 2006. If our cash flows from operations were to decline significantly, we may have to borrow on our lines of credit to sustain the dividend rate or reduce the dividend payout rate.

### Capital Commitments

We will require capital for development and redevelopment projects currently underway and in the future. As of December 31, 2006, we had under development Bennett Park, Clayborne Apartments and Dulles Station. Our total investment in Bennett Park is expected to be \$76.6 million and we expect to fund \$32.0 million during 2007; a construction contract worth approximately \$55.7 million has been executed for this project. As of December 31, 2006, we had invested \$44.7 million in Bennett Park including land costs. Our total investment in Clayborne Apartments is expected to be \$32.7 million. As of December 31, 2006, we had invested \$18.0 million in this project, and we expect to fund approximately \$14.7 million of the total project costs during 2007. There is a \$14.7 million construction contract in place for the project's completion. Our investment in phase one of Dulles Station is expected to be \$59.2 million. As of December 31, 2006, we had invested \$51.5 million in this project, including \$26.2 million to acquire the land for both phases, and we expect to fund approximately \$33.9 million of the total project costs during 2007.

As of December 31, 2006, the redevelopment of the Shoppes at Foxchase was substantially complete after an investment of \$11.2 million. We expect to fund the remaining project cost of approximately \$0.6 million in 2007. In addition, we anticipate funding several major renovation projects in our portfolios during 2007, as follows (in thousands):

<u>Sector</u>	<u>Project Spending</u>
Office buildings	\$ 5,179
Medical office buildings	390
Retail centers	1,117
Multifamily	9,462
Industrial	1,493
	<hr/>
Total	\$ 17,641
	<hr/>

These projects include common area and unit renovations at several of our multifamily properties, roof replacement projects at some of our industrial and retail properties, and restroom, façade and common area renovations at some of our office properties. Not all of the anticipated spending had been committed via executed construction contracts at December 31, 2006. We expect to meet our requirements using cash generated by our real estate operations, through borrowings on our unsecured credit facilities, or raising additional debt or equity capital in the public market.

**Contractual Obligations**

Below is a summary of certain contractual obligations that will require significant capital (in thousands):

	Payments due by Period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Long-term debt <sup>(1)</sup>	\$ 1,712,551	\$ 70,735	\$ 365,395	\$ 316,279	\$ 960,142
Purchase obligations <sup>(2)</sup>	9,142	3,339	3,635	728	1,440
Estimated development commitments <sup>(3)</sup>	52,161	52,161			
Tenant-related capital <sup>(4)</sup>	3,111	2,890	32	110	79
Building capital <sup>(5)</sup>	11,729	8,738	2,991		
Operating leases	71	34	37		

<sup>(1)</sup> See Notes 4, 5 and 6 of Notes to Consolidated Financial Statements. Amounts include principal, interest, unused commitment fees and facility fees.

<sup>(2)</sup> Represents elevator maintenance contracts with terms through 2016, electricity sales agreements with terms through 2008, and natural gas purchase agreements with terms through 2007.

<sup>(3)</sup> Committed development obligations based on contracts in place as of December 31, 2006.

<sup>(4)</sup> Committed tenant-related capital based on executed leases as of December 31, 2006.

<sup>(5)</sup> Committed building capital additions based on contracts in place as of December 31, 2006.

We have various standing or renewable contracts with vendors. The majority of these contracts are cancelable with immaterial or no cancellation penalties, with the exception of our elevator maintenance and natural gas purchase agreements, which are included above on the purchase obligations line. Contract terms on cancelable leases are generally one year or less. Development commitments include executed construction and professional services contracts associated with our Bennett Park, Clayborne Apartments, Dulles Station and Shoppes at Foxchase projects. We are currently committed to fund tenant-related capital improvements as described in the table above for executed leases. However, expected leasing levels could require additional tenant-related capital improvements which are not currently committed. We expect that total tenant-related capital improvements, including those already committed, will be approximately \$18.9 million in 2007. Due to the competitive office leasing market we expect that tenant-related capital costs will continue at this level into 2008.

**Historical Cash Flows**

Consolidated cash flow information is summarized as follows (in millions):

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	For the year ended			Variance	
	December 31,			2006 vs. 2005	2005 vs. 2004
	2006	2005	2004		
Cash provided by operating activities	\$ 86.3	\$ 87.5	\$ 79.8	\$ (1.2)	\$ 7.7
Cash used in investing activities	\$ (334.7)	\$ (98.5)	\$ (80.4)	\$ (236.2)	\$ (18.1)
Cash provided by financing activities	\$ 252.1	\$ 10.9	\$ 0.9	\$ 241.2	\$ 10.0

Operations generated \$86.3 million of net cash in 2006 compared to \$87.5 million in 2005. The decrease in cash flow in 2006 compared to 2005 was due primarily changes in rents and other assets from properties acquired in 2005 and 2006. The level of net cash provided by operating activities is also affected by the timing of receipt of revenues and payment of expenses.

Our investing activities used net cash of \$334.7 million in 2006 and \$98.5 million in 2005. The change in cash flows from investing activities in 2006 was primarily due to the \$226.5 million of cash invested in acquisitions,

net of assumed debt, throughout the year, which was \$103.2 million higher than the prior year and development spending of \$68.6 million which was \$50.8 million higher than the prior year, property disposals in 2005 that provided \$73.9 million of net cash proceeds in the prior year and increased spending on capital improvements of \$7.1 million.

Our financing activities provided net cash of \$252.1 million in 2006 and \$10.9 million in 2005. The increase in net cash provided by financing activities in 2006 is the result of the debt offerings in June, July and September which provided \$255.1 million and the equity offering in June which provided \$90.9 million. Borrowings on the lines of credit provided \$37.0 million, offset somewhat by the note repayments of \$50.0 million, payment of dividends of \$72.7 million and mortgage principal payments of \$9.1 million. Dividends increased in 2006 due to the issuance of 2,745,000 shares in June and an increase in the dividend rate.

#### CAPITAL IMPROVEMENTS AND DEVELOPMENT COSTS

Capital improvements and development costs of \$106.4 million were completed in 2006, including tenant improvements. These improvements to our properties in 2005 and 2004 were \$48.6 million and \$33.2 million, respectively. We consider capital improvements to be accretive to revenue and not necessarily to net income.

Our capital improvement and development costs for the three years ending December 31, 2006 were as follows (in thousands):

	Year Ended December 31,		
	2006	2005	2004
Accretive capital improvements:			
Acquisition related	\$ 1,430	\$ 918	\$ 212
Expansions and major renovations	18,195	11,762	6,446
Development/redevelopment	68,621	17,866	8,079
Tenant improvements	9,473	8,932	9,432
<b>Total accretive capital improvements</b>	<b>97,719</b>	<b>39,478</b>	<b>24,169</b>
Other:	8,685	9,125	9,068
<b>Total</b>	<b>\$ 106,404</b>	<b>\$ 48,603</b>	<b>\$ 33,237</b>

#### *Accretive Capital Improvements*

**Acquisition Related** These are capital improvements to properties acquired during the current and preceding two years which were anticipated at the time we acquired the properties. These types of improvements were made in 2006 to Albemarle Point, Montrose, Randolph, Dulles Business Park, Alexandria Professional, Hampton Overlook and Hampton South.

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**Expansions and Major Renovations** Expansion projects increase the rentable area of a property, while major renovation projects are improvements sufficient to increase the income otherwise achievable at a property. 2006 expansions and major renovations included common area and unit renovations for Bethesda Hill, Munson Hill, Park Adams and Country Club Towers; façade renovation at Wayne Plaza; lobby renovations at Maryland Trade Centers I and II; and roof replacements at Ammendale Park, Tech 100 and Northern Virginia Industrial Park.

**Development/Re-development** Development costs represent expenditures for ground up development of new operating properties. Re-development costs represent expenditures for improvements intended to re-position properties in their markets and increase income that would be otherwise achievable. Development costs in each of the years presented include costs associated with the ground up development of Bennett Park and Clayborne. In 2006 these costs also include expenditures associated with Dulles Station. Completion of Bennett Park, our residential project under development in Arlington, VA, is expected in the second quarter 2007 for the mid-rise

building and third quarter 2007 for the high-rise building. Completion of Clayborne Apartments, our residential project under construction in Alexandria, VA, is also expected in the third quarter 2007. Completion of Phase I of Dulles Station, our 540,000 square foot office project in Herndon, VA, of which Phase I represents 180,000 square feet, is expected in the third quarter of 2007. Re-development costs in each of the years presented were incurred for the Shoppes at Foxchase, which was substantially completed in 2006. In 2004 and 2005, re-development costs included expenditures for the completion of the Food Lion grocery store at Westminster.

**Tenant Improvements** Tenant Improvements are costs, such as space build-out, associated with commercial lease transactions. Our average Tenant Improvement Costs per square foot of space leased were as follows during the three years ended December 31, 2006:

	Year Ended December 31,		
	2006	2005	2004
Office Buildings*	\$ 11.52	\$ 10.42	\$ 7.13
Medical Office Buildings	\$ 17.78	\$ 7.65	\$ 9.35
Retail Centers	\$ 0.05	\$ 0.85	\$ 0.90
Industrial/Flex Properties*	\$ 1.84	\$ 1.44	\$ 1.01

\* Excludes properties sold or classified as held for sale.

The \$1.10 increase in tenant improvement costs per square foot of space leased for office buildings in 2006 was primarily due to leases executed at 7900 Westpark requiring \$2.7 million in tenant improvements, including \$1.5 million for a single tenant. The \$10.13 increase in tenant improvement costs per square foot of space leased for medical office buildings in 2006 was primarily due to leases executed at 15001 Shady Grove and Woodburn I requiring \$1.8 million in tenant improvements, primarily to a single tenant. The retail and industrial tenant improvement costs are substantially lower than office and medical office improvement costs due to the tenant improvements required in these property types being substantially less extensive than in office and medical. Excluding properties sold or classified as held for sale, approximately 71% of our office tenants renewed their leases with us in 2006, compared to 65% in 2005 and 50% in 2004. Renewing tenants generally require minimal tenant improvements. In addition, lower tenant improvement costs are one of the many benefits of our focus on leasing to smaller office tenants. Smaller office suites have limited configuration alternatives. Therefore, we are often able to lease an existing suite with limited tenant improvements.

#### *Other Capital Improvements*

Other Capital Improvements are those not included in the above categories. These are also referred to as recurring capital improvements. Over time these costs will be recurring in nature to maintain a property's income and value. In our residential properties, these include new appliances, flooring, cabinets and bathroom fixtures. These improvements, which are made as needed upon vacancy of an apartment, totaled \$0.6 million in 2006, and averaged \$925 per apartment for the 32% of apartments turned over relative to our total portfolio of apartment units. In our commercial properties and residential properties aside from apartment turnover discussed above, these include installation of new heating and air conditioning equipment, asphalt replacement, new signage, permanent landscaping, window replacements, new lighting and new finishes. In addition, during 2006, we incurred repair and maintenance expenses of \$8.2 million that were not capitalized, to maintain the quality of our buildings.

**FORWARD-LOOKING STATEMENTS**

This Annual Report contains forward-looking statements which involve risks and uncertainties. Such forward looking statements include the following statements with respect to the metropolitan Washington real estate markets: (a) continued spending by the Federal Government, government contracting firms and professional services firms is expected to continue to drive regional economic growth; (b) industrial rental rates are projected to increase; (c) the Washington metro area is expected to be a strong multifamily market; and (d) office vacancy is expected to increase due to increased supply in the market. Such forward looking statements also include the following statements with respect to WRIT: (a) our intention to invest in properties that we believe will increase in income and value; (b) our belief that external sources of capital will continue to be available and that additional sources of capital will be available from the sale of shares or notes; and (c) our belief that we have the liquidity and capital resources necessary to meet our known obligations and to make additional property acquisitions and capital improvements when appropriate to enhance long-term growth. Forward looking statements also include other statements in this report preceded by, followed by or that include the words believe, expect, intend, anticipate, potential, project, will and other similar expressions.

We claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 for the foregoing statements. The following important factors, in addition to those discussed elsewhere in this Annual Report, could affect our future results and could cause those results to differ materially from those expressed in the forward-looking statements: (a) the economic health of our tenants; (b) the economic health of the greater Washington Metro region, or other markets we may enter, including the effects of changes in Federal government spending; (c) the supply of competing properties; (d) inflation; (e) consumer confidence; (f) unemployment rates; (g) consumer tastes and preferences; (h) stock price and interest rate fluctuations; (i) our future capital requirements; (j) compliance with applicable laws, including those concerning the environment and access by persons with disabilities; (k) governmental or regulatory actions and initiatives; (l) changes in general economic and business conditions; (m) terrorist attacks or actions; (n) acts of war; (o) weather conditions; (p) the effects of changes in capital available to the technology and biotechnology sectors of the economy, and (q) other factors discussed under the caption Risk Factors. We undertake no obligation to update our forward-looking statements or risk factors to reflect new information, future events, or otherwise.

**RATIOS OF EARNINGS TO FIXED CHARGES AND DEBT SERVICE COVERAGE**

The following table sets forth our ratios of earnings to fixed charges and debt service coverage for the periods shown:

	<b>Year Ended December 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
Earnings to fixed charges	1.68x	2.01x	2.13x
Debt service coverage	2.76x	3.05x	3.29x

We computed the ratio of earnings to fixed charges by dividing earnings by fixed charges. For this purpose, earnings consist of income from continuing operations plus fixed charges, less capitalized interest. Fixed charges consist of interest expense, including amortized costs of debt issuance, plus interest costs capitalized.

We computed the debt service coverage ratio by dividing EBITDA (which is earnings before interest income and expense, taxes, depreciation, amortization and gain on sale of real estate) by interest expense and principal amortization.

**Funds From Operations**

Funds from Operations ( FFO ) is a widely used measure of operating performance for real estate companies. We provide FFO as a supplemental measure to net income calculated in accordance with accounting principles



generally accepted in the United States of America ( GAAP ). Although FFO is a widely used measure of operating performance for REITs, FFO does not represent net income calculated in accordance with GAAP. As such, it should not be considered an alternative to net income as an indication of our operating performance. In addition, FFO does not represent cash generated from operating activities in accordance with GAAP, nor does it represent cash available to pay distributions and should not be considered as an alternative to cash flow from operating activities, determined in accordance with GAAP as a measure of our liquidity. The National Association of Real Estate Investment Trusts, Inc. ( NAREIT ) defines FFO (April, 2002 White Paper) as net income (computed in accordance with GAAP) excluding gains (or losses) from sales of property plus real estate depreciation and amortization. We consider FFO to be a standard supplemental measure for REITs because it facilitates an understanding of the operating performance of our properties without giving effect to real estate depreciation and amortization, which historically assumes that the value of real estate assets diminishes predictably over time. Since real estate values have instead historically risen or fallen with market conditions, we believe that FFO more accurately provides investors an indication of our ability to incur and service debt, make capital expenditures and fund other needs. Our FFO may not be comparable to FFO reported by other REITs. These other REITs may not define the term in accordance with the current NAREIT definition or may interpret the current NAREIT definition differently.

The following table provides the calculation of our FFO and a reconciliation of FFO to net income for the years presented (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Net income	\$ 38,661	\$ 77,638	\$ 45,564
Adjustments			
Depreciation and amortization	54,170	47,161	39,309
Gain on property disposed		(37,515)	(1,029)
Discontinued operations depreciation and amortization		71	1,784
FFO as defined by NAREIT	<u>\$ 92,831</u>	<u>\$ 87,355</u>	<u>\$ 85,628</u>

**ITEM 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK**

The principal material financial market risk to which we are exposed is interest rate risk. Our exposure to interest rate risk relates primarily to refinancing long-term fixed rate obligations, the opportunity cost of fixed rate obligations in a falling interest rate environment and our variable rate lines of credit. We primarily enter into debt obligations to support general corporate purposes including acquisition of real estate properties, capital improvements and working capital needs. In the past we have used interest rate hedge agreements to hedge against rising interest rates in anticipation of imminent refinancing or new debt issuance.

The table below presents principal, interest and related weighted average fair value interest rates by year of maturity, with respect to debt outstanding on December 31, 2006.

(In thousands)	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Thereafter</u>	<u>Total</u>	<u>Fair Value</u>
<b>Unsecured fixed rate debt</b>								
Principal		\$ 60,000			\$ 150,000	\$ 520,000	\$ 730,000	\$ 736,081
Interest payments	\$ 39,826	\$ 37,757	\$ 35,688	\$ 35,688	\$ 31,225	\$ 170,837	\$ 351,021	
Interest rate on debt maturities		6.74%			6.00%	5.23%	5.51%	
<b>Unsecured variable rate debt</b>								
Principal		\$ 28,000		\$ 33,000			\$ 61,000	\$ 61,000
Variable interest rate on debt maturities <sup>(a)</sup>		5.90%		5.78%			5.83%	
<b>Mortgages</b>								
Principal amortization (30 year schedule)	\$ 11,264	\$ 3,571	\$ 53,768	\$ 25,428	\$ 12,763	\$ 130,279	\$ 237,073	\$ 239,781
Interest payments	\$ 13,427	\$ 13,241	\$ 12,151	\$ 8,863	\$ 7,796	\$ 10,521	\$ 65,999	
Weighted average interest rate on principal amortization	6.38%	5.43%	7.02%	5.76%	5.30%	5.46%	5.88%	

(a) Variable interest rates based on LIBOR in effect on our borrowings outstanding at December 31, 2006.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The financial statements and supplementary data appearing on pages 60 to 92 are incorporated herein by reference.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer, Chief Financial Officer and Senior Vice President of Accounting, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer, Chief Financial Officer and Senior Vice President of Accounting, of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2006. Based on the foregoing, our Chief Executive Officer, Chief Financial Officer and Senior Vice President of Accounting concluded that the Trust's disclosure controls and procedures were effective.

***Internal Control over Financial Reporting***

See the Report of Management in Item 8 of this Form 10-K.

See the Reports of Independent Registered Public Accounting Firm in Item 8 of this Form 10-K. During the three months ended December 31, 2006, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control for financial reporting.

**ITEM 9B. OTHER INFORMATION**

None.

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**PART III**

Certain information required by Part III is omitted from this report in that we will file a definitive proxy statement pursuant to Regulation 14A with respect to our 2007 Annual Meeting (the Proxy Statement) no later than 120 days after the end of the fiscal year covered by this report, and certain information included therein is incorporated herein by reference. Only those sections of the Proxy Statement which specifically address the items set forth herein are incorporated by reference. In addition, we have adopted a Code of Ethics which can be reviewed and printed from our website [www.writ.com](http://www.writ.com).

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this Item is hereby incorporated herein by reference to the Proxy Statement.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item is hereby incorporated herein by reference to the Proxy Statement.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required under this Item by Item 403 of Regulation S-K is hereby incorporated herein by reference to the Proxy Statement.

## Equity Compensation Plan Information\*

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	407,006	\$ 24.18	1,313,000
Equity compensation plans not approved by security holders	44,000	26.67	66,000
<b>Total</b>	<b>451,006</b>	<b>\$ 24.42</b>	<b>1,379,000</b>

\* We maintain a Share Grant Plan for officers, trustees and non-officer employees. As of December 31, 2006, 306,710 shares and 21,880 restricted share units have been granted under this plan. We maintained a stock option plan for trustees which provided for the annual granting of 2,000 non-qualified stock options to trustees the last of which were granted in 2004. 84,000 options had been granted as of December 31, 2006.

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The aggregate number of shares which can be made the subject of awards under this Share Grant Plan, together with the aggregate number of shares issued either directly or in connection with the exercise of a stock option under any other plan maintained by the Trust, may not exceed three percent (3%) of the number of then-outstanding shares in any one calendar year and may not exceed, in the aggregate, during any five (5) year period, ten percent (10%) of the number of then-outstanding shares. See Note 7 to the consolidated financial statements for a description of the Share Grant Plan.

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this Item is hereby incorporated herein by reference to the Proxy Statement.

### **ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this Item is hereby incorporated by reference to the material in the Proxy Statement under the caption Independent Registered Public Accounting Firm.

## PART IV

## ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(A). The following documents are filed as part of this Report:

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1. Financial Statements	
Management's Report on Internal Control Over Financial Reporting	57
Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting	58
Report of Independent Registered Public Accounting Firm	59
Consolidated Balance Sheets as of December 31, 2006 and 2005	60
Consolidated Statements of Income for the Years Ended December 31, 2006, 2005 and 2004	61
Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2006, 2005 and 2004	62
Consolidated Statements of Cash Flows for the Years Ended December 31, 2006, 2005 and 2004	63
Notes to Consolidated Financial Statements	64
2. Financial Statement Schedules	
Schedule III Consolidated Real Estate and Accumulated Depreciation	89
3. Exhibits:	
3. Declaration of Trust and Bylaws	
(a) Declaration of Trust. Incorporated herein by reference to Exhibit 3 to the Trust's registration statement on Form 8-B dated July 10, 1996.	
(b) Bylaws. Incorporated herein by reference to Exhibit 4 to the Trust's registration statement on Form 8-B dated July 10, 1996.	
(c) Amendment to Declaration of Trust dated September 21, 1998. Incorporated herein by reference to Exhibit 3 to the Trust's Form 10-Q dated November 13, 1998.	
(d) Articles of Amendment to Declaration of Trust dated June 24, 1999. Incorporated herein by reference to Exhibit 4c to Amendment No. 1 to the Trust's Form S-3 registration statement filed with the Securities and Exchange Commission as of July 14, 1999.	
(e) Amendment to Bylaws dated February 21, 2002. Incorporated herein by reference to Exhibit 3(e) to the Trust's Form 10-K dated April 1, 2002.	
(f) Articles of Amendment to Declaration of Trust dated June 1, 2006. Incorporated herein by reference to Exhibit 4d to the Trust's Form S-3 registration statement filed with the Securities and Exchange Commission as of August 28, 2006.	
4. Instruments Defining Rights of Security Holders	
(a) [Intentionally omitted]	
(b) Amended and restated credit agreement dated July 25, 1999, among Washington Real Estate Investment Trust, as borrower, SunTrust Bank (successor by merger to Crestar Bank), as lender, First Union National Bank (successor by merger to Signet Bank), as lender, and SunTrust Bank, as agent. <sup>(1)</sup>	
(c) Indenture dated as of August 1, 1996 between Washington Real Estate Investment Trust and The First National Bank of Chicago. <sup>(2)</sup>	
(d) Officers' Certificate Establishing Terms of the Notes, dated August 8, 1996 <sup>(3)</sup>	
(e) [Intentionally omitted]	
(f) Form of 2006 Notes <sup>(2)</sup>	
(g) Form of MOPPRS Notes <sup>(3)</sup>	
(h) Form of 30 year Notes <sup>(3)</sup>	
(i) Remarketing Agreement <sup>(3)</sup>	

- (j) Form of 2004 fixed-rate notes<sup>(4)</sup>
- (k) [Intentionally omitted]
- (l) Credit agreement dated July 23, 2002 between Washington Real Estate Investment Trust, as borrower, Bank One, as lender, and Bank One, as agent<sup>(7)</sup>
- (m) Amendment to amended and restated credit agreement dated July 25, 2002, among Washington Real Estate Investment Trust, as borrower, SunTrust Bank, successor to Crestar Bank, as Agent, and SunTrust Bank (SunTrust), successor to Crestar Bank, and Wachovia Bank, National Association (Wachovia), successor to First Union National Bank (the Credit Agreement).<sup>(7)</sup>
- (n) Officers Certificate Establishing Terms of the Notes, dated March 12, 2003<sup>(8)</sup>
- (o) Form of 2013 Notes.<sup>(8)</sup>
- (p) Officers Certificate Establishing Terms of the Notes, dated December 8, 2003<sup>(9)</sup>
- (q) Form of 2014 Notes.<sup>(9)</sup>
- (r) [Intentionally omitted]
- (s) Amended and Restated Credit Agreement, Dated as of July 21, 2004, among Washington Real Estate Investment Trust, as borrower and Bank One, NA, and Wells Fargo Bank, National Association, as lenders and Bank One, NA, as agent and Banc One Capital Markets, Inc., as lead arranger and sole book runner.<sup>(10)</sup>
- (t) Form of 5.05% Senior Notes due May 1, 2012<sup>(11)</sup>
- (u) Form of 5.35% Senior Notes due May 1, 2015 dated April 26, 2005<sup>(11)</sup>
- (v) Officers Certificate establishing the terms of the Notes, dated April 20, 2005<sup>(11)</sup>
- (w) Amendment to credit agreement dated July 25, 2005 between Washington Real Estate Investment Trust as borrower and SunTrust Bank as lender<sup>(12)</sup>
- (x) Form of 5.35% Senior Notes due May 1, 2015 dated October 6, 2005<sup>(13)</sup>
- (y) Officers Certificate establishing the terms of the Notes, dated October 3, 2005<sup>(13)</sup>
- (z) Form of 5.95% Senior Notes due June 15, 2011<sup>(16)</sup>
- (aa) Officers Certificate establishing the terms of the Notes, dated June 6, 2006<sup>(6)</sup>
- (bb) Amendments to Credit Facility No. 1 dated as of June 30, 2006<sup>(23)</sup>
- (cc) Form of 3.875% Senior Convertible Notes due September 15, 2026<sup>(17)</sup>
- (dd) Officers Certification establishing the terms of the Notes, dated September 11, 2006<sup>(7)</sup>
- (ee) Form of additional 3.875% Senior convertible Notes due September 15, 2026<sup>(18)</sup>
- (ff) Form of 5.95% senior notes due June 15, 2011, dated July 21, 2006<sup>(19)</sup>
- (gg) Officers Certification establishing the terms of the Notes, dated July 21, 2006<sup>(9)</sup>
- (hh) Credit agreement dated November 2, 2006 between Washington Real Estate Investment Trust as borrower and a syndicate of banks as lender with The Bank of New York as documentation agent, The Royal Bank of Scotland, plc as syndication agent and Wells Fargo Bank, NA, as agent<sup>(20)</sup>

We are a party to a number of other instruments defining the rights of holders of long-term debt. No such instrument authorizes an amount of securities in excess of 10 percent of the total assets of the Trust and its Subsidiaries on a consolidated basis. On request, we agree to furnish a copy of each such instrument to the Commission.

10. Management Contracts, Plans and Arrangements

- (a) Employment Agreement dated May 11, 1994 with Edmund B. Cronin, Jr.<sup>(5)</sup>
- (b) 1991 Incentive Stock Option Plan, as amended.<sup>(5)</sup>
- (c) Nonqualified Stock Option Agreement dated December 14, 1994 with Edmund B. Cronin, Jr.<sup>(5)</sup>
- (d) Nonqualified Stock Option Agreement dated December 19, 1995 with Edmund B. Cronin, Jr. Incorporated herein by reference to Exhibit 10(e) to the 1995 Form 10-K filed March 29, 1996.
- (e) Share Grant Plan<sup>(6)</sup>
- (f) Share Option Plan for Trustees<sup>(6)</sup>
- (g) Deferred Compensation Plan for Executives dated January 1, 2000, incorporated herein by reference to Exhibit 10(g) to the 2000 Form 10-K filed March 19, 2001.

- (h) Split-Dollar Agreement dated April 1, 2000, incorporated herein by reference to Exhibit 10(h) to the 2000 Form 10-K filed March 19, 2001.
  - (i) 2001 Stock Option Plan incorporated herein by reference to Exhibit A to 2001 Proxy Statement dated March 29, 2001.
  - (j) Share Purchase Plan.<sup>(7)</sup>
  - (k) Supplemental Executive Retirement Plan.<sup>(7)</sup>
  - (l) Description of Washington Real Estate Investment Trust Short-term and Long-term Incentive Plan incorporated herein by reference to Exhibit 10(l) to the 2005 Form 10-K filed March 16, 2005.
  - (m) Description of Washington Real Estate Investment Trust Revised Trustee Compensation Plan incorporated herein by reference to Exhibit 10(m) to the 2005 Form 10-K filed March 16, 2005.
  - (n) Employment Agreement dated October 3, 2005 with Christopher P. Mundy.<sup>(14)</sup>
  - (o) Change in control Agreement dated October 3, 2005 with Christopher P. Mundy.<sup>(15)</sup>
  - (p) Supplemental Executive Retirement Plan<sup>(21)</sup>
  - (q) Change in control Agreement dated May 22, 2003 with Thomas L. Regnell<sup>(21)</sup>
  - (r) Change in control Agreement dated June 13, 2005 with David A. DiNardo<sup>(21)</sup>
  - (s) Change in control Agreement dated May 22, 2003 with George F. McKenzie<sup>(21)</sup>
  - (t) Change in control Agreement dated May 22, 2003 with Laura M. Franklin<sup>(21)</sup>
  - (u) Change in control Agreement dated May 22, 2003 with Kenneth C. Reed<sup>(21)</sup>
  - (v) Change in control Agreement dated May 22, 2003 with Sara L. Grootwassin<sup>(21)</sup>
  - (w) Change in control Agreement dated January 1, 2006 with James B. Cederdahl<sup>(21)</sup>
  - (x) Change in Control Agreement dated December 17, 1999 with Edmund B. Cronin, Jr.<sup>(22)</sup>
  - (y) Separation Agreement dated July 10, 2006 with Christopher P. Mundy<sup>(23)</sup>
  - (z) Amendment No. 2 to the Share Grant Plan
  - (aa) Long Term Incentive Plan, effective January 1, 2006
  - (bb) Short Term Incentive Plan, effective January 1, 2006
- 12. Computation of Ratio of Earnings to Fixed Charges
  - 21. Subsidiaries of Registrant
  - 23. Consents
    - (a) Consent of Independent Registered Public Accounting Firm
  - 31. Rule 13a-14(a)/15(d)-14(a) Certifications
    - (a) Certification Chief Executive Officer
    - (b) Certification Senior Vice President Accounting and Administration
    - (c) Certification Chief Financial Officer
  - 32. Section 1350 Certifications
    - (a) Written Statement of Chief Executive Officer and Financial Officers

<sup>(1)</sup> Incorporated herein by reference to the Exhibits of the same designation to the Trust's Form 10-K filed March 24, 2000.



- (2) Incorporated herein by reference to the Exhibit of the same designation to the Trust's Form 8-K filed August 13, 1996.
- (3) Incorporated herein by reference to the Exhibit of the same designation to the Trust's Form 8-K filed February 25, 1998.
- (4) Incorporated herein by reference to Exhibit 4 to the Trust's Form 10-Q filed November 14, 2000.
- (5) Incorporated herein by reference to the Exhibit of the same designation to Amendment No. 2 to the Trust's Registration Statement on Form S-3 filed July 17, 1995.
- (6) Incorporated herein by reference to Exhibits 4(a) and 4(b), respectively, to the Trust's Registration Statement on Form S-8 filed on March 17, 1998.
- (7) Incorporated herein by reference to the Exhibits of the same designation to the Trust's Form 10-Q filed November 14, 2002.
- (8) Incorporated herein by reference to Exhibits 4(a) and 4(b), respectively, to the Trust's Form 8-K filed March 17, 2003.
- (9) Incorporated herein by reference to Exhibits 4(a) and 4(b), respectively, to the Trust's Form 8-K filed December 11, 2003.
- (10) Incorporated herein by reference to Exhibit 4 to the Trust's Form 10-Q filed August 6, 2004.
- (11) Incorporated herein by reference to Exhibits 4.1, 4.2 and 4.3 to the Trust's Form 8-K filed April 26, 2005
- (12) Incorporated herein by reference to Exhibit 4 to the Trust's Form 10-Q filed August 5, 2005
- (13) Incorporated herein by reference to Exhibit 4.1 and 4.2 to the Trust's Form 8-K filed October 6, 2005
- (14) Incorporated herein by reference to Exhibit 10 to the Trust's Form 10-Q filed November 9, 2005
- (15) Incorporated herein by reference to Exhibit 10 to the Trust's Form 8-K filed October 7, 2005
- (16) Incorporated herein by reference to Exhibits 4.1 and 4.2, respectively to the Trust's Form 8-K filed June 6, 2006
- (17) Incorporated herein by reference to the Trust's Form 424B5 filed September 11, 2006
- (18) Incorporated herein by reference to Exhibit 4.1 to the Trust's Form 8-K filed September 26, 2006
- (19) Incorporated herein by reference to the Trust's Form 424B5 filed July 21, 2006
- (20) Incorporated herein by reference to Exhibit 4.1 to the Trust's Form 8-K filed November 8, 2006

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- (21) Incorporated herein by reference to Exhibit 10 to the Trust's Form 10-K filed March 16, 2006
- (22) Incorporated herein by reference to Exhibit 10 to the Trust's Form 10-Q filed May 5, 2006
- (23) Incorporated herein by reference to Exhibit 10 to the Trust's Form 10-Q filed August 8, 2006

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WASHINGTON REAL ESTATE INVESTMENT TRUST

Date: March 1, 2007

By: /s/ EDMUND B. CRONIN, JR.  
**Edmund B. Cronin, Jr.**  
 President, Chief Executive Officer and  
 Chairman

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
/s/ EDMUND B. CRONIN, JR. <hr/> <b>Edmund B. Cronin, Jr.</b>	Trustee	March 1, 2007
/s/ JOHN M. DERRICK, JR. <hr/> <b>John M. Derrick, Jr.</b>	Trustee	March 1, 2007
/s/ JOHN P. MCDANIEL <hr/> <b>John P. McDaniel</b>	Trustee	March 1, 2007
/s/ CHARLES T. NASON <hr/> <b>Charles T. Nason</b>	Trustee	March 1, 2007
/s/ DAVID M. OSNOS <hr/> <b>David M. Osnos</b>	Trustee	March 1, 2007
/s/ SUSAN J. WILLIAMS <hr/> <b>Susan J. Williams</b>	Trustee	March 1, 2007
/s/ Edward S. Civera <hr/> <b>Edward S. Civera</b>	Trustee	March 1, 2007

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/s/ Thomas Edgie Russell, III

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Trustee

March 1, 2007

**Thomas Edgie Russell, III**

/s/ LAURA M. FRANKLIN

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Senior Vice President Accounting and  
Administration and Corporate Secretary

March 1, 2007

**Laura M. Franklin**

/s/ SARA L. GROOTWASSINK

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Chief Financial Officer

March 1, 2007

**Sara L. Grootwassink**

**MANAGEMENT'S REPORT ON**

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management of Washington Real Estate Investment Trust (the Trust) is responsible for establishing and maintaining adequate internal control over financial reporting and for the assessment of the effectiveness of internal controls over financial reporting. The Trust's internal control system over financial reporting is a process designed under the supervision of the Trust's principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the consolidated financial statements in accordance with U.S. generally accepted accounting principles.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions.

In connection with the preparation of the Trust's annual consolidated financial statements, management has undertaken an assessment of the effectiveness of the Trust's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Framework). Management's assessment included an evaluation of the design of the Trust's internal control over financial reporting and testing of the operational effectiveness of those controls.

Based on this assessment, management has concluded that as of December 31, 2006, the Trust's internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Ernst & Young LLP, the independent registered public accounting firm that audited the Trust's consolidated financial statements included in this report, have issued an attestation report on management's assessment of internal control over financial reporting, a copy of which appears on the next page of this annual report.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Trustees and Shareholders of

Washington Real Estate Investment Trust

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Washington Real Estate Investment Trust and Subsidiaries (the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Washington Real Estate Investment Trust and Subsidiaries' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Washington Real Estate Investment Trust and Subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Washington Real Estate Investment Trust and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Washington Real Estate Investment Trust and Subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006 of Washington Real Estate Investment Trust and Subsidiaries and our report dated February 26, 2007 expressed an unqualified opinion thereon.

McLean, Virginia

February 26, 2007

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Trustees and Shareholders of

Washington Real Estate Investment Trust

We have audited the accompanying consolidated balance sheets of Washington Real Estate Investment Trust and Subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Washington Real Estate Investment Trust and Subsidiaries at December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the financial statements, in 2006 the Company changed its accounting for stock-based compensation in connection with the adoption of FASB Statement No. 123(R), Share-Based Payment.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Washington Real Estate Investment Trust and Subsidiaries' internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2007 expressed an unqualified opinion thereon.

McLean, Virginia

February 26, 2007



## WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2006 AND 2005

(IN THOUSANDS)

	2006	2005
<b>Assets</b>		
Land	\$ 294,977	\$ 226,217
Income producing property	1,300,824	1,024,702
	<u>1,595,801</u>	<u>1,250,919</u>
Accumulated depreciation and amortization	(290,003)	(240,153)
Net income producing property	1,305,798	1,010,766
Development in progress	120,656	58,241
	<u>1,426,454</u>	<u>1,069,007</u>
Total investments in real estate, net	1,426,454	1,069,007
Cash and cash equivalents	8,721	4,938
Restricted cash	4,151	1,764
Rents and other receivables, net of allowance for doubtful accounts of \$3,635 and \$2,916, respectively	32,632	25,258
Prepaid expenses and other assets	59,307	38,192
	<u>1,531,265</u>	<u>1,139,159</u>
<b>Total assets</b>	<b>\$ 1,531,265</b>	<b>\$ 1,139,159</b>
<b>Liabilities</b>		
Notes payable	\$ 728,255	\$ 518,600
Mortgage notes payable	237,073	169,617
Lines of credit	61,000	24,000
Accounts payable and other liabilities	45,291	32,002
Advance rents	6,325	5,572
Tenant security deposits	9,651	7,393
	<u>1,087,595</u>	<u>757,184</u>
<b>Total liabilities</b>	<b>1,087,595</b>	<b>757,184</b>
Minority interest	1,739	1,670
	<u>1,739</u>	<u>1,670</u>
<b>Shareholders' equity</b>		
Shares of beneficial interest; \$.01 par value; 100,000 shares authorized: 45,042 and 42,139 shares issued and outstanding, respectively	451	421
Additional paid in capital	500,727	405,112
Distributions in excess of net income	(59,247)	(25,228)
	<u>441,931</u>	<u>380,305</u>
<b>Total shareholders' equity</b>	<b>441,931</b>	<b>380,305</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,531,265</b>	<b>\$ 1,139,159</b>

See accompanying notes to the financial statements.

## WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

YEARS ENDED DECEMBER 31, 2006, 2005, AND 2004

(IN THOUSANDS, EXCEPT PER SHARE DATA)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Revenue			
Real estate rental revenue	\$ 219,662	\$ 190,046	\$ 171,646
Expenses			
Utilities	13,858	11,153	9,375
Real estate taxes	18,335	15,958	14,062
Repairs and maintenance	8,182	7,255	6,668
Property administration	6,195	5,472	4,965
Property management	6,592	5,678	5,153
Operating services and common area maintenance	11,342	9,967	8,834
Other real estate expenses	2,765	2,633	2,271
Depreciation and amortization	54,170	47,161	39,309
General and administrative	12,622	8,005	6,194
	<u>134,061</u>	<u>113,282</u>	<u>96,831</u>
Real estate operating income	<u>85,601</u>	<u>76,764</u>	<u>74,815</u>
Other income (expense)			
Interest expense	(47,846)	(37,743)	(34,500)
Other income	906	918	326
Other income from property settlement		504	
	<u>(46,940)</u>	<u>(36,321)</u>	<u>(34,174)</u>
Income from continuing operations	38,661	40,443	40,641
Discontinued operations:			
Income from operations of properties sold or held for sale		184	3,894
Gain on disposal		37,011	1,029
Net income	<u>\$ 38,661</u>	<u>\$ 77,638</u>	<u>\$ 45,564</u>
Basic net income per share			
Continuing operations	\$ 0.89	\$ 0.96	\$ 0.98
Discontinued operations including gain on disposal		0.89	0.11
Net income per share	<u>\$ 0.89</u>	<u>\$ 1.85</u>	<u>\$ 1.09</u>
Diluted net income per share			
Continuing operations	\$ 0.88	\$ 0.96	\$ 0.97
Discontinued operations including gain on disposal		0.88	0.12
Net income per share	<u>\$ 0.88</u>	<u>\$ 1.84</u>	<u>\$ 1.09</u>

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Weighted average shares outstanding	basic	43,679	42,069	41,642
Weighted average shares outstanding	diluted	43,874	42,203	41,863
Dividends paid per share		\$ 1.64	\$ 1.60	\$ 1.55

See accompanying notes to the financial statements.

## WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(IN THOUSANDS)

	Shares	Shares of Beneficial Interest at Par Value	Additional Paid in Capital	Distributions in excess of Net Income	Shareholders Equity
Balance, December 31, 2003	41,607	\$ 416	\$ 394,604	\$ (16,272)	\$ 378,748
Net income				45,564	45,564
Dividends				(64,836)	(64,836)
Share options exercised	302	3	5,662		5,665
Share grants, net of share grant amortization	91	1	867		868
Balance, December 31, 2004	42,000	420	401,133	(35,544)	366,009
Net income				77,638	77,638
Dividends				(67,322)	(67,322)
Share options exercised	136	1	2,845		2,846
Share grants, net of share grant amortization	3		1,134		1,134
Balance, December 31, 2005	42,139	421	405,112	(25,228)	380,305
Net income				38,661	38,661
Dividends				(72,703)	(72,703)
Equity offering, net	2,745	28	90,904		90,932
Share options exercised	80	1	1,802		1,803
Share grants, net of share grant amortization, net of forfeitures	78	1	2,909	23	2,933
Balance, December 31, 2006	45,042	\$ 451	\$ 500,727	\$ (59,247)	\$ 441,931

See accompanying notes to the financial statements.

## WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(IN THOUSANDS)

	2006	2005	2004
<b>Cash flows from operating activities</b>			
Net income	\$ 38,661	\$ 77,638	\$ 45,564
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Gain on sale of real estate		(37,011)	(1,029)
Depreciation and amortization	54,170	47,233	41,093
Provision for losses on accounts receivable	1,500	872	964
Amortization of share grants, net	2,933	1,134	868
Changes in other assets	(17,927)	(6,735)	(9,507)
Changes in other liabilities	7,005	4,391	1,867
<b>Net cash provided by operating activities</b>	<b>86,342</b>	<b>87,522</b>	<b>79,820</b>
<b>Cash flows from investing activities</b>			
Real estate acquisitions, net*	(226,538)	(123,358)	(55,135)
Capital improvements to real estate	(37,846)	(30,737)	(25,158)
Development costs	(68,621)	(17,866)	(8,079)
Net cash received for sale of real estate		73,879	8,071
Non-real estate capital improvements	(1,666)	(437)	(101)
<b>Net cash used in investing activities</b>	<b>(334,671)</b>	<b>(98,519)</b>	<b>(80,402)</b>
<b>Cash flows from financing activities</b>			
Net proceeds from equity offering	90,932		
Line of credit (repayments)/borrowings, net	37,000	(93,000)	117,000
Notes payable repayments	(50,000)		(55,000)
Dividends paid	(72,681)	(67,322)	(64,836)
Principal payments mortgage notes payable	(9,149)	(28,820)	(2,041)
Proceeds from debt offering	259,465	198,810	
Deferred financing costs	(5,449)	(1,782)	
Note discount amortization	191	138	103
Proceeds from exercise of share options	1,803	2,846	5,665
<b>Net cash provided by financing activities</b>	<b>252,112</b>	<b>10,870</b>	<b>891</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>3,783</b>	<b>(127)</b>	<b>309</b>
Cash and cash equivalents at beginning of year	4,938	5,065	4,756
<b>Cash and cash equivalents at end of year</b>	<b>\$ 8,721</b>	<b>\$ 4,938</b>	<b>\$ 5,065</b>
<b>Supplemental disclosure of cash flow information:</b>			
Cash paid for interest	\$ 49,660	\$ 36,662	\$ 32,157

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\* *See Note 3 for the supplemental discussion of non-cash investing and financing activities.*

See accompanying notes to the financial statements.

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**WASHINGTON REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004****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 of income-producing real estate properties in the greater Washington metropolitan region. We own a diversified portfolio of office buildings, medical office buildings, industrial/flex properties, multifamily buildings and retail centers.

*Federal Income Taxes*

We believe that we qualify as a Real Estate Investment Trust (REIT) under Sections 856-860 of the Internal Revenue Code and intend to continue to qualify as such. To maintain our status as a REIT, we are required to distribute 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. We distributed 100% of our 2006, 2005 and 2004 ordinary taxable income to our shareholders. \$33.5 million of the gains from property disposed in 2005 was reinvested in replacement properties. Approximately \$3.5 million of gains from disposed property in 2005 was distributed to shareholders. The gain on the property sold during 2004 was paid out to the shareholders. No provision for income taxes was necessary in 2006, 2005 or 2004.

The following is a breakdown of the taxable percentage of our dividends for 2006, 2005 and 2004, respectively:

	<b>Ordinary Income</b>	<b>Return of Capital</b>	<b>Unrecaptured Section 1250 Gain</b>	<b>Capital Gain</b>
2006	84%	16%	0%	0%
2005	81%	14%	5%	0%
2004	86%	10%	2%	2%

**2. Accounting Policies:***Basis of Presentation*



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The accompanying consolidated financial statements include the accounts of the Trust and its majority owned subsidiaries, after eliminating all intercompany transactions.

### *New Accounting Pronouncements*

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment* (SFAS No. 123R). This statement is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB opinion No. 25 (APB No. 25), *Accounting for Stock Issued to Employees* and amends SFAS No. 95, *Statement of Cash Flows*. SFAS No. 123R addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values and eliminates the intrinsic value method of accounting in APB No. 25, which was permitted under SFAS No. 123, as originally issued. The Company was required to apply the provisions of this statement as of January 1, 2006.

Since we used the fair-value-based method of accounting under the original provisions of SFAS No. 123, in pro forma disclosure, we were required to adopt the provisions of the new standard using either the modified-prospective-transition or the modified-retrospective-transition method. Under both methods, for awards granted, settled or modified subsequent to adopting the standard and for awards granted prior to the date of adoption for which the requisite service has not been completed as of the adoption date, compensation cost must be recognized in the financial statements. Under the modified retrospective method, financial statements for prior periods are restated for this change and under the modified prospective method only statements subsequent to adoption will include this compensation cost. The modified prospective method also requires a cumulative adjustment in the first period of adoption to conform to the new standard. The Company has adopted SFAS No. 123R using the modified prospective transition method and that adoption did not have a material impact on income from continuing operations, net income, cash flows from operations or financing activities, or basic and diluted EPS.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FAS 109, *Accounting for Income Taxes* (FIN 48), to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. WRIT will adopt FIN 48 as of January 1, 2007, as required. We do not expect that the adoption of FIN 48 will have a material impact on our financial position and results of operations.

In September 2006, the FASB also issued FASB Statement No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. The effective date of this statement is for fiscal years beginning after November 15, 2007 and according all the provisions of SFAS No. 157 will be considered when we adopt it in January 2008.

In September 2006, the FASB issued FASB Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of FASB Statements No. 87, 106, and 132(R) (SFAS No. 158). SFAS No. 158 requires plan sponsors of defined benefit pension and other postretirement benefit plans (collectively, *postretirement benefit plans*) to recognize the funded status of their postretirement benefit plans in the statement of financial position, measure the fair value of plan assets and benefit obligation as of the date of the fiscal year-end statement of financial position, and provide additional disclosures. On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS No. 158. SFAS No. 158 did not have an effect on the Company's consolidated financial condition as of December 31, 2006. SFAS No. 158's provisions regarding the change in the measurement date of postretirement benefit plans are not applicable as the Company already uses a measurement date of December 31 for its pension plans. At December 31, 2006 the projected accrued pension obligation and accrued benefit obligation are each \$1.7 million. See Note 8 for further discussion of the effect of adopting SFAS No. 158 on the Company's consolidated financial statements.

#### *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.

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.

#### *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 amounts in our general and administrative expenses, thereby reducing net income. Minority interest expense was \$204,100, \$172,000 and \$154,800 for the years ended December 31, 2006, 2005 and 2004 respectively. Quarterly distributions are made to the minority owner 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 December 31, 2006 and 2005 deferred financing costs of \$16.6 million and \$11.1 million, respectively, net of accumulated amortization of \$5.5 million and \$4.6 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 \$1.6 million, \$1.3 million and \$1.2 million for the years ended December 31, 2006, 2005 and 2004, 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 December 31, 2006 and 2005 deferred leasing costs of \$20.0 million and \$15.1 million, respectively, net of accumulated amortization of \$6.8 million and \$4.9 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 \$2.6 million, \$2.0 million and \$1.5 million for the years ended December 31, 2006, 2005 and 2004, respectively.

#### *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

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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 for the years ended December 31, 2006, 2005 and 2004 was \$47.6 million, \$41.8 million and \$34.4 million, respectively. Maintenance and repair costs 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 \$3,781,600, \$1,127,300 and \$703,400, for the years ended December 31, 2006, 2005 and 2004, 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, 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 the three-year period ended December 31, 2006.

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.

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/at/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.

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Balances, net of accumulated depreciation or amortization, as appropriate, of the components of the fair value of in-place leases at December 31, 2006 and 2005 are as follows (in millions):

	December 31,					
	2006			2005		
	Gross Carrying	Accumulated	Net	Gross Carrying	Accumulated	Net
	Value	Amortization		Value	Amortization	
Tenant Origination Costs	\$ 19.8	\$ 6.4	\$ 13.4	\$ 12.3	\$ 3.8	\$ 8.5
Leasing Commissions/Absorption Costs	\$ 16.3	\$ 3.3	\$ 13.0	\$ 7.4	\$ 2.2	\$ 5.2
Net Lease Intangible Assets	\$ 9.2	\$ 3.5	\$ 5.7	\$ 6.8	\$ 1.7	\$ 5.1
Net Lease Intangible Liabilities	\$ 13.0	\$ 3.3	\$ 9.7	\$ 8.9	\$ 1.8	\$ 7.1

Amortization of these components combined was \$4.0 million, \$3.0 million and \$2.1 million for the years ended December 31, 2006, 2005 and 2004, respectively. No value had been assigned to Customer Relationship Value at December 31, 2006 or December 31, 2005.

### *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*. 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.

### *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 December 31, 2006 and December 31, 2005 consisted of \$4.2 million and \$1.8 million, respectively, in funds escrowed for tenant security deposits, 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.

*Stock Based Compensation*

We maintain a Share Grant Plan and Incentive Stock Option Plans as described in Note 7, and pursuant to these plans we have made restricted share grants and granted share options to officers, eligible employees and trustees. Shares are granted to officers, non-officer employees and trustees under the Share Grant Plan. Officer share grants vesting over five years vest in annual installments commencing one year after the date of grant and share grants that vest 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 5 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.

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 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 while unvested shares for employees eligible for retirement 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.

Had we determined compensation cost prior to January 1, 2006 for the Plans consistent with SFAS No. 123, Accounting for Stock-Based Compensation, our net income and earnings per share would have been reduced to the following pro-forma amounts (in thousands, except per share data):

	<b>For the Years Ended</b>	
	<b>December 31,</b>	
	<b>2005</b>	<b>2004</b>
<b>Pro-forma Information</b>		
Net income, as reported	\$ 77,638	\$ 45,564
Add: Stock-based employee compensation expense included in reported net income	1,134	868
Deduct: Total stock-based employee compensation expense determined under fair value method	(1,210)	(1,218)
<b>Pro-forma net income</b>	<b>\$ 77,562</b>	<b>\$ 45,214</b>
<b>Earnings per share:</b>		
Basic as reported	\$ 1.85	\$ 1.09
Basic pro-forma	\$ 1.84	\$ 1.09
Diluted as reported	\$ 1.84	\$ 1.09
Diluted pro-forma	\$ 1.84	\$ 1.08

*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 is computed as net income divided by the weighted-average common shares outstanding. Diluted earnings per share is computed as net income divided by the total weighted-average common shares outstanding plus the effect of dilutive common equivalent shares outstanding for the period. Dilutive common equivalent shares reflect the assumed issuance of additional common shares pursuant to certain of our share based compensation plans that could potentially reduce or dilute earnings per share, based on the treasury stock method. Other potentially dilutive common shares,



including shares potentially resulting from the senior convertible notes, are considered when calculating diluted earnings per share.

*Use of Estimates in the Financial Statements*

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

*Comprehensive Income*

We recorded no comprehensive income for the twelve months ending December 31, 2006, 2005 and 2004.

**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):

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Office buildings	\$ 645,414	\$ 520,966
Medical office buildings	246,143	142,067
Retail centers	254,472	190,383
Multifamily	145,007	132,464
Industrial/Flex properties	304,765	265,039
	<b>\$ 1,595,801</b>	<b>\$ 1,250,919</b>

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 and one property in our retail sector that was in redevelopment for 2005 and most of 2006, but placed in service in 2006. The cost of our real estate portfolio in development is illustrated below (in thousands):

	December 31,	
	2006	2005
Office buildings	\$ 54,168	\$ 27,144
Medical office buildings		
Retail centers	745	3,054
Multifamily	65,743	28,043
Industrial/Flex properties		
	<u>\$ 120,656</u>	<u>\$ 58,241</u>

We dispose of assets (sometimes using tax-deferred exchanges) that are inconsistent with our long-term strategic or return objectives and where 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. Properties are considered held for sale when they meet the criteria specified by SFAS No. 144 (see Note 2 Discontinued Operations). Depreciation on these properties is discontinued at that time, but operating revenues, other operating expenses and interest continue to be recognized until the date of sale. We had no properties held for sale at December 31, 2006 and December 31, 2005.

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Our results of operations are dependent on the overall economic health of our markets, tenants and the specific segments in which we own properties. These segments include general purpose office, medical office, retail, multifamily and industrial. All sectors are affected by external economic factors, such as inflation, consumer confidence, unemployment rates, etc. as well as changing tenant and consumer requirements. Because the properties are located primarily in the Washington metro region, the Company is subject to a concentration of credit risk related to these properties.

As of December 31, 2006 no single property or tenant accounted for more than 10% of total real estate assets or total revenues.

Properties we acquired during the years ending December 31, 2006, 2005 and 2004 are as follows:

Acquisition Date	Property	Type	Contract	
			Rentable Square Feet	Purchase Price (In thousands)
February 15, 2006	Hampton Overlook	Industrial	134,000	\$ 10,040
February 15, 2006	Hampton South	Industrial	168,000	13,060
April 11, 2006	Alexandria Professional Center	Medical Office	113,000	26,900
April 13, 2006	9707 Medical Center Drive	Medical Office	38,000	15,800
April 29, 2006	15001 Shady Grove Rd	Medical Office	51,000	21,000
May 16, 2006	Montrose Shopping Center	Retail	143,000	33,200
May 16, 2006	Randolph Shopping Center	Retail	82,000	17,100
May 26, 2006	9950 Business Parkway	Industrial	102,000	11,700
June 22, 2006	Plumtree Medical Center	Medical Office	33,000	7,700
July 12, 2006	15005 Shady Grove Road	Medical Office	52,000	22,500
August 11, 2006	6565 Arlington Blvd	Office	140,000	30,000
August 25, 2006	West Gude Drive	Office	289,000	57,000
August 25, 2006	The Ridges	Office	104,000	25,000
August 25, 2006	The Crescent	Medical Office	49,000	12,000
<b>Total 2006</b>			<b>1,498,000</b>	<b>\$ 303,000</b>
March 23, 2005	Frederick Crossing	Retail	295,000	\$ 44,800
April 8, 2005	Coleman Building	Industrial	60,000	8,800
July 29, 2005	Albemarle Point	Office/Industrial	296,000	66,800
December 2, 2005	Dulles Station	Development	n/a	24,700
<b>Total 2005</b>			<b>651,000</b>	<b>\$ 145,100</b>
March 10, 2004	8880 Gorman Road	Industrial	141,000	\$ 11,500
August 12, 2004	Shady Grove Medical Village II	Medical Office	66,000	18,500
October 12, 2004	8301 Arlington Boulevard	Medical Office	50,000	8,000
December 22, 2004	Dulles Business Park	Industrial	265,000	46,000
<b>Total 2004</b>			<b>522,000</b>	<b>\$ 84,000</b>

We accounted for these acquisitions using the purchase method of accounting. As discussed in Note 2, we allocate the purchase price to the related physical assets (land, building and tenant improvements) and in-place leases (absorption, tenant origination costs, leasing commissions,

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and net lease intangible assets/liabilities) based on their fair values in accordance with SFAS No. 141, Business Combinations. The results of operations of the acquired properties are included in the income statement as of their respective acquisition date.

We have allocated the total purchase price of the above acquisitions as follows (in millions):

	Allocation of Purchase Price		
	2006	2005	2004
Land	\$ 68.8	\$ 21.4	\$ 10.0
Buildings	219.6	124.1	72.3
Tenant origination costs	7.5	4.2	2.8
Leasing commissions/Absorption costs	8.9	2.2	1.3
Net lease intangible assets	2.3	1.3	2.9
Net least intangible liabilities	(4.1)	(4.8)	(0.8)
<b>Total*</b>	<b>\$ 303.0</b>	<b>\$ 148.4</b>	<b>\$ 88.5</b>

\* Additional settlement costs, closing costs and adjustments are included in the basis for 2006, 2005 and 2004

The weighted average life in months for the components above, other than land and building, ranged from 4 months to 118 months for 2006 acquisitions and from 58 months to 120 months for 2005 acquisitions.

The difference in total 2006 contract purchase price of properties acquired per the above chart of \$303.0 million and the acquisition cost per the Statement of Cash Flows of \$226.5 million is the \$76.5 million in mortgages assumed on the acquisitions of 9707 Medical Center Drive, Plumtree Medical Center, 15005 Shady Grove Road, West Gude Drive, The Ridges and Crescent. The difference in total 2005 contract purchase price of properties acquired per the above chart of \$145.1 million and the acquisition cost per the Statement of Cash Flows of \$123.4 million is the \$25.0 million mortgage assumed on the acquisition of Frederick Crossing, offset by \$3.3 million in predevelopment costs (not included in the contract price) paid at closing for Dulles Station and closing costs on all acquisitions.

The difference in total 2004 contract purchase price of properties acquired per the above chart of \$84.0 million and the acquisition cost per the Statement of Cash Flows of \$55.1 million is the \$28.9 million in mortgages assumed on the acquisitions of Shady Grove Medical Village II and Dulles Business Park, net of closing costs.

The following unaudited pro-forma combined condensed statements of operations set forth the consolidated results of operations for the years ended December 31, 2006 and 2005 as if the above described acquisitions had occurred at the beginning of the period of acquisition and the same period in the year prior to the acquisition. The unaudited pro-forma information does not purport to be indicative of the results that actually would have occurred if the acquisitions had been in effect for the years ended December 31, 2006 and December 31, 2005. The unaudited data presented is in thousands, except per share data.

	Year Ended December 31,	
	2006	2005
Real estate revenues	\$ 233,214	\$ 219,014
Income from continuing operations	\$ 40,301	\$ 45,307

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Net income	\$ 40,301	\$ 82,502
Diluted earnings per share	\$ 0.92	\$ 1.95

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Properties that were sold or classified as held for sale during the three years ending December 31, 2006 are as follows:

<u>Disposition Date</u>	<u>Property</u>	<u>Type</u>	<u>Rentable Square Feet</u>	<u>Contract Sale Price (in thousands)</u>
February 1, 2005	7700 Leesburg Pike	Office	147,000	\$ 20,150
February 1, 2005	Tycon Plaza II	Office	127,000	19,400
February 1, 2005	Tycon Plaza III	Office	137,000	27,950
September 8, 2005	Pepsi Distribution Center	Industrial	69,000	6,000
		<b>Total</b>	<b>480,000</b>	<b>\$ 73,500</b>