HILLIARD LYONS

COMPANY UPDATE / ESTIMATE CHANGES

REITs
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First Potomac Realty Trust

FPO -- NYSE – Neutral -- 3

Key Metrics

FPO - NYSE (as of 2/23/2017)	$10.64
Price Target	NA
52-Week Range	$8.01 - $11.16
Shares & Units Outstanding (mm)	61
Market Cap. ($mm)	$649
3-Mo. Average Daily Volume (000)	127.9
Institutional Ownership	100%
Debt/Total Market Capital (12/16)	52.7%
Dividend	$0.40
Dividend Yield	3.8%
Interest Coverage Ratio	3.29x

Core FFO Per Share FY 12/31

	2015	2016	Prior 2017E	Curr. 2017E
1Q	$0.24	$0.24	$0.20	$0.22
2Q	$0.25	$0.27	$0.21	$0.21
3Q	$0.25	$0.28	$0.20	$0.19
4Q	$0.28	$0.27	$0.20	$0.20
Year	$1.02	$1.06	$0.81	$0.82
P/Core FFO	10.4x	10.0x		13.0x

Core FFO excludes gains from the early retirement of debt and sale of real estate, acquisition costs, and other one-time charges.

Revenue ($mm)

	2015	2016	Prior 2017E	Curr. 2017E
1Q	$44	$43	$35	$37
2Q	$43	$38	$33	$34
3Q	$43	$40	$34	$34
4Q	$43	$39	$34	$33
Year	$173	$160	$136	$138

Quarterly amounts may not add up to full year amounts due to rounding.
Previous numbers have not been restated.

Company Description: *First Potomac, headquartered in Bethesda, Maryland, is a REIT focused on owning, operating, developing and redeveloping office and business park properties in the greater Washington D.C. region.*

Fourth Quarter Results

- **First Potomac Realty Trust reported fourth quarter FFO of $0.27 per share compared to $0.15 in the year ago period.** Excluding non-recurring items, Core FFO were $0.27 per share versus $0.28. Core FFO was equal to our estimate and a penny above the consensus.

- **The company's portfolio was 93.8% leased and 92.6% occupied at the end of the fourth quarter.** Comparable rental rates increased 19.4% on new leases and 7.1% on renewals on a GAAP basis. Net absorption was negative in the quarter at 30,779 square feet.

- **Management initiated 2017 Core FFO per share guidance of $0.78 to $0.84.** We are raising our 2017 Core FFO per share estimate by a penny to $0.82.

- **We maintain our Neutral rating.** We believe the shares are fairly valued at this time.

Note Important Disclosures on Pages 6 and 7.
Note Analyst Certification on Page 6.

Quarterly Results

Total revenues were $39.0 million, consisting of $31.4 million in rental revenue and $7.6 million in tenant reimbursements and other revenue (please see income statement on page 3). This compares to total revenues of $43.1 million in 2015's fourth quarter, a 9.6% decline year over year.

The company completed new and renewal leases on 95,920 square feet of rentable space. The retention rate declined to 36% from 81% on a sequential basis. FPO's definition of retention is a tenant renewing a lease for the same physical location. Net absorption was negative in the quarter at 30,779 square feet. Consolidated occupancy was down 20 basis points sequentially at 92.6%. Leased space was down 30 basis points sequentially at 93.8%.

Net income was a loss of $1.6 million versus a loss of $41.2 million in the year ago period. FFO per share were $0.27 versus $0.15 on a 0.3% increase in shares and units outstanding. Excluding non-recurring items, Core FFO per share were $0.27 compared to $0.28.

Overview

Current Environment - Net absorption was negative in the quarter. The U.S. government is FPO's largest tenant. Leases with the U.S. government account for 15.7% of annualized base rent for the company. Other than the U.S. Government, FPO has only two additional tenants that account for more than 5.0% of annual rent. FPO has two large leases expiring this year that it does not expect the tenants to renew. Management plans to redevelop these properties when the tenants leave. These vacancies will negatively impact 2017 results.

Acquisitions & Dispositions - Subsequent to the end of the quarter, FPO sold Plaza 500, a 502,830 square foot industrial property in Alexandria, Virginia for $75 million and One Fair Oaks, a 214,214 square foot office building in Fairfax, Virginia for $13.7 million. The company has now completed $295 million of non-core assets sales towards its stated goal of $350 million of non-core asset sales. The company has entered into a binding contract to sell a couple of properties that it owns in joint ventures. These properties are expected to be sold in March.

Balance Sheet and Financials - Debt to total market cap was 52.7% at December 31, 2016, compared to 46.3% at 2015 year end. At the end of the fourth quarter, FPO was in compliance with its covenants on the revolving credit facility, unsecured term loan, land loan, and construction loans. We believe the company's near-term debt maturities are manageable.

Company Guidance and Our Estimates - Management initiated 2017 Core FFO per share guidance of $0.78 to $0.84. Guidance includes same portfolio net operating income growth of -1.0% to 1.0%, and year end occupancy of 91.0% to 93.0%. Our 2017 Core FFO estimate is $0.82 per share.

Quarterly Income Statement

(in thousands, except per share data)	4Q16	4Q15	% Change
Rental Revenue	$31,411	$34,955	-10.1%
Tenant Reimbursements and Other Revenue	7,561	8,149	-7.2%
Total Revenues	38,972	43,104	-9.6%
Real Estate Operating Expenses	8,974	9,417	-4.7%
Real Estate Taxes and Insurance	4,917	5,077	-3.2%
Real Estate NOI (R/E Rev. minus R/E Expenses)	25,081	28,610	-12.3%
General and Administrative Expenses	3,980	10,340	-61.5%
Other Income (Expenses)			
EBITDA	21,101	18,270	15.5%
Depreciation and Amortization Expense	16,787	16,715	0.4%
Interest Expense	6,571	6,576	-0.1%
Interest and Other Income	129	998	-87.1%
Acquistion Costs			
Loss (Gain) on the Early Retirement of Debt; Other Charges		1,824	
(Provision) Benefit for Income Taxes			
Income (Loss) from Discontinued Operations, incl. R/E Gains			
Gain on Sale of Investment		26,093	
Equity in Earnings of Affiliates	(411)	(590)	
Impairment of Rental Property		60,826	
Contingent Consideration Related to Acquisition of Property			
Net Income Attributable to Noncontrolling Interests	71	1,870	
Issuance Costs of Redeemed Preferred Shares			
Dividends on Preferred Shares		3,100	
Net Income (Loss)	($1,646)	($41,220)	
Net EPS (diluted)	($0.03)	($0.72)	
Avg. Shares Outstanding (diluted)	57,606	57,470	0.2%

Funds From Operations	**4Q16**	**4Q15**	% Change
Net Income Available to Common Shareholders	($1,646)	($41,220)	
Depreciation and Amortization	16,787	16,715	0.4%
Discontinued Operations			
Joint Venture Acquisition Fee			
Unconsolidated Joint Ventures	940	867	8.4%
Consolidated Joint Ventures			
Gain on Sale of Real Estate Properties		(26,093)	
Impairment of Rental Property		60,826	
Net Income Attributable to Noncontrolling Interest	(71)	(1,870)	
Funds From Operations	**$16,010**	**$9,225**	73.6%
FFO Per Share*	**$0.27**	**$0.15**	80.0%
"Core" FFO Per Share **	**$0.27**	**$0.28**	-3.6%
Avg. Shares and Units Outstanding (diluted)	60,383	60,209	0.3%

*FFO per share includes non-recurring charges and gains.

**Core FFO per share excludes non-recurring charges and gains.

Source: Company reports

Condensed Balance Sheet

(in thousands)	31-Dec-14	31-Dec-15	31-Dec-16
Rental Property (Net of Depreciation)	**$1,288,873**	**$1,130,266**	**$1,059,272**
Assets Held for Sale	59,717	90,674	13,176
Cash	13,323	13,527	14,144
Escrow and Reserves	2,986	2,514	1,419
Accounts & Other Receivables	10,587	9,868	6,892
Accrued Straight-Line Rents	34,226	36,888	42,745
Notes Receivable, net	63,679	34,000	
Investment in Affiliate	47,482	48,223	49,392
Deferred Costs (net)	43,991	44,502	42,712
Prepaid Expenses & Other Assets	7,712	6,950	5,389
Intangible Assets (net)	45,884	32,959	25,106
Total Assets	**$1,618,460**	**$1,450,371**	**$1,260,247**
Mortgage Loans	$305,139	$312,003	$296,212
Liabilities Held-for-Sale			
Exchangeable Senior Notes			
Senior Notes			
Secured Term Loan			
Unsecured Term Loan	300,000	300,000	299,404
Credit Facility	205,000	120,000	141,555
Total Debt	**$810,139**	**$732,003**	**$737,171**
Financing Obligation			
Accounts Payable & Accrued Expenses	41,113	47,972	43,904
Accrued Interest	1,720	1,603	1,537
Rents Received in Advance	7,971	6,003	6,234
Tenant Security Deposits	5,891	4,982	4,982
Other Liabilities	7,389	3,667	1,792
Total Liabilities	**$874,223**	**$796,230**	**$795,620**
Noncontrolling Interest in OP	33,332	28,813	28,244
Total Equity	**$710,905**	**$625,328**	**$436,383**
Total Liabilities and Equity	**$1,618,460**	**$1,450,371**	**$1,260,247**

Balance Sheet Ratio Analysis	31-Dec-14	31-Dec-15	31-Dec-16
Net R/E Investments/ Total Debt	159.1%	154.4%	143.7%
Debt to Equity	114.0%	117.1%	168.9%
Variable Rate Debt as % of Total Debt	68.7%	66.0%	68.7%
Debt to Total Market Capitalization	46.8%	46.3%	52.7%
Debt as % of Total Assets	50.1%	50.5%	58.5%
Equity as % of Total Assets	43.9%	43.1%	34.6%

Previous numbers have not been restated. Source: Company reports

Valuation

At current levels FPO's stock is trading at 13.0x our 2017 Core FFO per share estimate. FPO is trading at a discount to the peer group and at a premium to its median 5-year historic forward Price/FFO multiple. At the current level, we believe the shares are fairly valued given FPO's near term challenges offset by the company's progress on its strategic plan. We rate FPO Neutral.

Peer REITS	Symbol	Price 2/23/2017	Current Dividend	Yield	Payout Ratio	FFO Per Share 2015	2016E/A	2017E	2-Year Exp. Avg. Growth	17/16 Exp. Growth Rate	Price/FFO 2016E/A	2017E
Boston Properties Inc.	BXP	$139.17	$3.00	2.2%	49.8%	$5.34	$6.02	$6.20	8.1%	3.0%	23.1x	22.4x
Mack-Cali Realty Corp.	CLI	$29.18	$0.60	2.1%	27.9%	$1.58	$2.15	$2.33	23.7%	8.4%	13.6x	12.5x
Corporate Office Properties Trust	OFC	$33.78	$1.10	3.3%	64.0%	$2.01	$1.72	$2.06	1.2%	19.8%	19.6x	16.4x
Brandywine Realty Trust	BDN	$16.58	$0.64	3.9%	48.9%	$1.42	$1.31	$1.39	-1.1%	6.1%	12.7x	11.9x
Parkway Properties Inc.	PKY	$21.57	$0.75	3.5%	54.7%	$1.35	$1.37	$1.98	23.3%	44.5%	15.7x	10.9x
Peer Average		**$48.06**	**$1.22**	**3.0%**	**49.1%**	**$2.34**	**$2.51**	**$2.79**	**11.1%**	**16.4%**	**16.9x**	**14.8x**
S&P 500	**SPX**	**2363.81**	**$48.08**	**2.0%**	**41.2%**	**$118.23**	**$116.83**	**$129.74**	**4.9%**	**11.1%**	**20.2x**	**18.2x**
First Potomac Realty Trust	**FPO**	**$10.64**	**$0.40**	**3.8%**	**37.7%**	**$1.02**	**$1.06**	**$0.82**	**-9.8%**	**-22.6%**	**10.0x**	**13.0x**

FPO's FFO numbers are Core FFO.
SPX figures are EPS not FFO per share.

Source: NAREIT, Baseline, and Hilliard Lyons' estimates

Suitability

We assign shares of First Potomac Realty Investors a suitability rating of 3 on our scale of 1 - 4 (1=most conservative, 4=most aggressive). Our rating is based on the company's lack of property type diversification and large exposure to government related tenants.

Risks & Considerations

Interest Rate Risk - Like all REITs, FPO is interest rate sensitive. FPO has 68.7% of its debt at variable rates. However, we note that 47.0% of the company's floating rate debt is hedged. In addition, the company's interest coverage ratio of 3.29x appears adequate. We believe FPO should be able to weather an increase in interest expense in a rising rate environment.

Regional Market Risk - FPO's real estate portfolio is predominately in the Maryland, Washington, D.C., Northern Virginia, and Southern Virginia markets. These markets are dependent on U.S. government spending programs, primarily defense spending. The U.S. government is FPO's largest tenant at 15.7% of total annualized rental revenue.

Strategic Plan Risk - We believe the completion of the company's strategic plan should help shareholder value. However, if the plan takes longer than investors expect or if there is a hiccup, the stock price could negatively react.

Acquisitions Versus Dispositions - We believe one internal risk for First Potomac is growing too rapidly through potentially dilutive acquisitions. We also believe dispositions can be dilutive to FFO.

SEC Inquiry Risk - FPO has fully remediated its material weakness discussed in its 2011 10-K. However, the SEC has made an informal inquiry related to this. There were legal costs in 1Q13 associated with this inquiry. At this point, we do not know if any additional costs or actions could be taken as a result of this inquiry. Any additional cost or negative actions could impact earnings.

Annual yield is calculated by dividing the distribution amount by the current market price of the security. For US income tax purposes, the Company may classify all or a portion of its distributions as dividends or other non-dividend distributions. Note that for some investors, for US income tax purposes

all or a portion of the Company's 2016 dividend or distribution was treated as return of capital and not as "dividend income" as reflected on the IRS Form 1099-Div for the 2016 tax year. The Company generally makes a final determination regarding the proper tax treatment of distributions after calendar year end. We urge each shareholder to consult with his or her own tax advisor to determine the tax consequences of the distributions received, including any state, local or foreign tax considerations.

Additional information is available upon request.

Analyst Certification

I, Carol L. Kemple, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid total returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base.

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	**# of Stocks Covered**	**% of Stocks Covered**	**Banking**	**No Banking**
Buy	36	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 2017

Other Disclosures

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