CORPORATE OFFICE PROPERTIES TRUST
Form 10-Q
August 08, 2008
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, DC 20549**

# FORM 10-Q

**(Mark one)**

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

**For the quarterly period ended June 30, 2008**

**or**

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

**For the transition period from                    to**

**Commission file number 1-14023**

# Corporate Office Properties Trust

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Maryland** | **23-2947217** |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |
| **6711 Columbia Gateway Drive, Suite 300, Columbia, MD** | **21046** |
| (Address of principal executive offices) | (Zip Code) |

Registrant s telephone number, including area code: **(443) 285-5400**

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer x | Accelerated filer o | Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |

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

As of July 29, 2008, 47,705,998 of the Company s Common Shares of Beneficial Interest, $0.01 par value, were issued and outstanding.

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**PART I: FINANCIAL INFORMATION**

**ITEM 1. Financial Statements**

**Corporate Office Properties Trust and Subsidiaries**

**Consolidated Balance Sheets**

**(Dollars in thousands)**

**(unaudited)**

| | June 30, 2008 | December 31, 2007 |
|---|---|---|
| **Assets** | | |
| Investment in real estate: | | |
| Operating properties, net | $ 2,245,003 | $ 2,192,939 |
| Property held for sale, net | | 14,988 |
| Projects under construction or development | 456,164 | 396,012 |
| Total commercial real estate properties, net | 2,701,167 | 2,603,939 |
| Cash and cash equivalents | 12,857 | 24,638 |
| Restricted cash | 23,066 | 15,121 |
| Accounts receivable, net | 23,452 | 24,831 |
| Deferred rent receivable | 59,238 | 53,631 |
| Intangible assets on real estate acquisitions, net | 104,136 | 108,661 |
| Deferred charges, net | 48,620 | 49,051 |
| Prepaid expenses and other assets | 37,934 | 51,981 |
| **Total assets** | $ 3,010,470 | $ 2,931,853 |
| | | |
| **Liabilities and shareholders equity** | | |
| Liabilities: | | |
| Mortgage and other loans payable | $ 1,704,351 | $ 1,625,842 |
| 3.5% Exchangeable Senior Notes | 200,000 | 200,000 |
| Accounts payable and accrued expenses | 82,526 | 75,535 |
| Rents received in advance and security deposits | 32,569 | 31,234 |
| Dividends and distributions payable | 22,548 | 22,441 |
| Deferred revenue associated with acquired operating leases | 12,762 | 11,530 |
| Distributions in excess of investment in unconsolidated real estate joint venture | 4,506 | 4,246 |
| Other liabilities | 8,820 | 8,288 |
| Total liabilities | 2,068,082 | 1,979,116 |
| Minority interests: | | |
| Common units in the Operating Partnership | 111,033 | 114,127 |
| Preferred units in the Operating Partnership | 8,800 | 8,800 |
| Other consolidated real estate joint ventures | 10,259 | 7,168 |
| Total minority interests | 130,092 | 130,095 |
| Commitments and contingencies (Note 20) | | |
| Shareholders equity: | | |
| Preferred Shares of beneficial interest ($0.01 par value; shares authorized of 15,000,000, issued and outstanding of 8,121,667 at June 30, 2008 and December 31, 2007 (Note 13)) | 81 | 81 |
| Common Shares of beneficial interest ($0.01 par value; 75,000,000 shares authorized, shares issued and outstanding of 47,701,812 at June 30, 2008 and 47,366,475 at December 31, | 477 | 474 |

| | | | | |
|---|---|---|---|---|
| 2007) | | | | |
| Additional paid-in capital | | 956,683 | | 950,615 |
| Cumulative distributions in excess of net income | | (142,330) | | (126,156) |
| Accumulated other comprehensive loss | | (2,615) | | (2,372) |
| Total shareholders equity | | 812,296 | | 822,642 |
| **Total liabilities and shareholders equity** | $ | 3,010,470 | $ | 2,931,853 |

See accompanying notes to consolidated financial statements.

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**Corporate Office Properties Trust and Subsidiaries**

**Consolidated Statements of Operations**

**(Dollars in thousands, except per share data)**

**(unaudited)**

| | For the Three Months Ended June 30, 2008 | For the Three Months Ended June 30, 2007 | For the Six Months Ended June 30, 2008 | For the Six Months Ended June 30, 2007 |
|---|---|---|---|---|
| Revenues | | | | |
| Rental revenue | $ 83,154 | $ 78,337 | $ 164,864 | $ 153,612 |
| Tenant recoveries and other real estate operations revenue | 14,957 | 12,037 | 30,398 | 25,630 |
| Construction contract revenues | 14,619 | 10,620 | 23,133 | 19,311 |
| Other service operations revenues | 525 | 1,073 | 1,003 | 2,459 |
| Total revenues | 113,255 | 102,067 | 219,398 | 201,012 |
| Expenses | | | | |
| Property operating expenses | 33,957 | 29,032 | 68,499 | 60,591 |
| Depreciation and other amortization associated with real estate operations | 24,955 | 26,834 | 49,847 | 52,786 |
| Construction contract expenses | 14,192 | 10,136 | 22,475 | 18,619 |
| Other service operations expenses | 454 | 1,126 | 1,056 | 2,531 |
| General and administrative expenses | 6,036 | 5,326 | 11,969 | 10,203 |
| Total operating expenses | 79,594 | 72,454 | 153,846 | 144,730 |
| Operating income | 33,661 | 29,613 | 65,552 | 56,282 |
| Interest expense | (19,437) | (20,437) | (39,746) | (40,213) |
| Amortization of deferred financing costs | (910) | (921) | (1,713) | (1,805) |
| Gain on sale of non-real estate investment | 5 | 1,033 | 51 | 1,033 |
| Income from continuing operations before equity in loss of unconsolidated entities, income taxes and minority interests | 13,319 | 9,288 | 24,144 | 15,297 |
| Equity in loss of unconsolidated entities | (56) | (57) | (110) | (151) |
| Income tax benefit (expense) | 107 | (178) | (5) | (283) |
| Income from continuing operations before minority interests | 13,370 | 9,053 | 24,029 | 14,863 |
| Minority interests in income from continuing operations | | | | |
| Common units in the Operating Partnership | (1,378) | (807) | (2,365) | (1,088) |
| Preferred units in the Operating Partnership | (165) | (165) | (330) | (330) |
| Other consolidated entities | (120) | 31 | (106) | 78 |
| Income from continuing operations | 11,707 | 8,112 | 21,228 | 13,523 |
| Income (loss) from discontinued operations, net of minority interests | 1,115 | (396) | 2,187 | (260) |
| Income before gain on sales of real estate | 12,822 | 7,716 | 23,415 | 13,263 |
| Gain on sales of real estate, net | 31 | 161 | 833 | 161 |
| Net income | 12,853 | 7,877 | 24,248 | 13,424 |
| Preferred share dividends | (4,026) | (4,025) | (8,051) | (8,018) |
| Net income available to common shareholders | $ 8,827 | $ 3,852 | $ 16,197 | $ 5,406 |
| Basic earnings per common share | | | | |
| Income from continuing operations | $ 0.16 | $ 0.09 | $ 0.30 | $ 0.12 |
| Discontinued operations | 0.03 | (0.01) | 0.04 | |
| Net income available to common shareholders | $ 0.19 | $ 0.08 | $ 0.34 | $ 0.12 |
| Diluted earnings per common share | | | | |
| Income from continuing operations | $ 0.16 | $ 0.09 | $ 0.29 | $ 0.12 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Discontinued operations | | 0.02 | | (0.01) | | 0.05 | | (0.01) |
| Net income available to common shareholders | $ | 0.18 | $ | 0.08 | $ | 0.34 | $ | 0.11 |
| Dividends declared per common share | $ | 0.34 | $ | 0.31 | $ | 0.68 | $ | 0.62 |

See accompanying notes to consolidated financial statements.

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**Corporate Office Properties Trust and Subsidiaries**

**Consolidated Statements of Cash Flows**

**(Dollars in thousands)**

**(unaudited)**

| | For the Six Months Ended June 30, 2008 | For the Six Months Ended June 30, 2007 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net income | $ 24,248 | $ 13,424 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Minority interests | 3,461 | 1,325 |
| Depreciation and other amortization | 50,676 | 54,055 |
| Amortization of deferred financing costs | 1,713 | 1,805 |
| Amortization of deferred market rental revenue | (903) | (985) |
| Equity in loss of unconsolidated entities | 110 | 151 |
| Gain on sales of real estate | (4,204) | (183) |
| Gain on sale of non-real estate investment | (51) | (1,033) |
| Share-based compensation | 4,556 | 3,141 |
| Excess income tax benefits from share-based compensation | (1,053) | |
| Changes in operating assets and liabilities: | | |
| Increase in deferred rent receivable | (5,701) | (5,936) |
| Decrease in accounts receivable | 1,379 | 7,541 |
| Decrease (increase) in restricted cash and prepaid and other assets | 3,380 | (10,274) |
| Increase (decrease) in accounts payable, accrued expenses and other liabilities | 4,406 | (4,037) |
| Increase in rents received in advance and security deposits | 1,335 | 6,310 |
| Other | 268 | (370) |
| Net cash provided by operating activities | 83,620 | 64,934 |
| | | |
| **Cash flows from investing activities** | | |
| Purchases of and additions to commercial real estate properties | (149,358) | (243,936) |
| Proceeds from sales of properties | 28,304 | |
| Leasing costs paid | (2,383) | (8,164) |
| (Increase) decrease in restricted cash associated with investing activities | (425) | 14,838 |
| Other | (2,079) | 1,091 |
| Net cash used in investing activities | (125,941) | (236,171) |
| | | |
| **Cash flows from financing activities** | | |
| Proceeds from mortgage and other loans payable | 227,932 | 431,495 |
| Repayments of mortgage and other loans payable | (149,374) | (216,352) |
| Deferred financing costs paid | (2,250) | (1,556) |
| Net proceeds from issuance of common shares | 1,350 | 6,140 |
| Dividends paid | (40,309) | (35,523) |
| Distributions paid | (5,878) | (5,505) |
| Excess income tax benefits from share-based compensation | 1,053 | |
| Restricted share redemptions | (1,304) | |
| Other | (680) | (262) |
| Net cash provided by financing activities | 30,540 | 178,437 |
| | | |
| Net (decrease) increase in cash and cash equivalents | (11,781) | 7,200 |

| | | | | |
|---|---|---|---|---|
| **Cash and cash equivalents** | | | | |
| Beginning of period | | 24,638 | | 7,923 |
| End of period | $ | 12,857 | $ | 15,123 |

See accompanying notes to consolidated financial statements.

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**Corporate Office Properties Trust and Subsidiaries**

**Notes to Consolidated Financial Statements**

**(Dollars in thousands, except per share data)**

**(unaudited)**

**1. Organization**

Corporate Office Properties Trust ( COPT ) and subsidiaries (collectively, the Company , we or us ) is a specialty office real estate investment trus ( REIT ) that focuses on strategic customer relationships and specialized tenant requirements in the United States Government, defense information technology and data sectors. We acquire, develop, manage and lease properties that are typically concentrated in large office parks primarily located adjacent to government demand drivers and/or in demographically strong markets possessing growth opportunities. As of June 30, 2008, our investments in real estate included the following:

- 234 wholly owned operating properties totaling 18.2 million square feet;
- 18 wholly owned properties under construction or development that we estimate will total approximately 1.8 million square feet upon completion;
- wholly owned land parcels totaling 1,457 acres that we believe are potentially developable into approximately 12.1 million square feet; and
- partial ownership interests in a number of other real estate projects in operation or under development or redevelopment.

We conduct almost all of our operations through our operating partnership, Corporate Office Properties, L.P. (the Operating Partnership ), for which we are the managing general partner. The Operating Partnership owns real estate both directly and through subsidiary partnerships and limited liability companies ( LLCs ). A summary of our Operating Partnership s forms of ownership and the percentage of those securities owned by COPT as of June 30, 2008 follows:

| | |
|---|---|
| Common Units | 85% |
| Series G Preferred Units | 100% |
| Series H Preferred Units | 100% |
| Series I Preferred Units | 0% |
| Series J Preferred Units | 100% |
| Series K Preferred Units | 100% |

Three of our trustees also controlled at that date, either directly or through ownership by other entities or family members, 13% of the Operating Partnership s common units.

In addition to owning interests in real estate, the Operating Partnership also owns 100% of Corporate Office Management, Inc. ( COMI ) and owns, either directly or through COMI, 100% of the consolidated subsidiaries that are set forth below (collectively defined as the Service Companies ):

| **Entity Name** | **Type of Service Business** |
|---|---|
| COPT Property Management Services, LLC ( CPM ) | Real Estate Management |
| COPT Development & Construction Services, LLC ( CDC ) | Construction and Development |
| Corporate Development Services, LLC ( CDS ) | Construction and Development |
| COPT Environmental Systems, LLC ( CES ) | Heating and Air Conditioning |

Most of the services that CPM provides are for us. CDC, CDS and CES provide services to us and to third parties.

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**2. Basis of Presentation**

The accompanying unaudited interim Consolidated Financial Statements have been prepared in accordance with the rules and regulations for reporting on Form 10-Q. Accordingly, certain information and disclosures required by accounting principles generally accepted in the United States for complete Consolidated Financial Statements are not included herein. These interim financial statements should be read together with the financial statements and notes thereto included in our 2007 Annual Report on Form 10-K. The interim financial statements reflect all adjustments that we believe are necessary for the fair statement of our financial position and results of operations for the interim periods presented. These adjustments are of a normal recurring nature. The results of operations for such interim periods are not necessarily indicative of the results for a full year.

We reclassified certain amounts from the prior period to conform to the current period presentation of our Consolidated Financial Statements. These reclassifications did not affect previously reported consolidated net income or shareholders equity.

**3. Earnings Per Share ( EPS )**

We present both basic and diluted EPS. We compute basic EPS by dividing net income available to common shareholders by the weighted average number of common shares of beneficial interest ( common shares ) outstanding during the period. Our computation of diluted EPS is similar except that:

- the denominator is increased to include: (1) the weighted average number of potential additional common shares that would have been outstanding if securities that are convertible into our common shares were converted; and (2) the effect of dilutive potential common shares outstanding during the period attributable to share-based compensation using the treasury stock method; and
- the numerator is adjusted to add back any changes in income or loss that would result from the assumed conversion into common shares that we added to the denominator.

Our computation of diluted EPS does not assume conversion of securities into our common shares if conversion of those securities would increase our diluted EPS in a given period. A summary of the numerator and denominator for purposes of basic and diluted EPS calculations is set forth below (dollars and shares in thousands, except per share data):

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| | For the Three Months Ended June 30, 2008 | 2007 | For the Six Months Ended June 30, 2008 | 2007 |
|---|---|---|---|---|
| Numerator: | | | | |
| Income from continuing operations | $ 11,707 | $ 8,112 | $ 21,228 | $ 13,523 |
| Add: Gain on sales of real estate, net | 31 | 161 | 833 | 161 |
| Less: Preferred share dividends | (4,026) | (4,025) | (8,051) | (8,018) |
| Numerator for basic and diluted EPS from continuing operations | 7,712 | 4,248 | 14,010 | 5,666 |
| Income (loss) from discontinued operations, net | 1,115 | (396) | 2,187 | (260) |
| Numerator for basic and diluted EPS on net income available to common shareholders | $ 8,827 | $ 3,852 | $ 16,197 | $ 5,406 |
| Denominator (all weighted averages): | | | | |
| Denominator for basic EPS (common shares) | 47,110 | 46,686 | 47,055 | 46,185 |
| Dilutive effect of share-based compensation awards | 888 | 1,105 | 797 | 1,305 |
| Denominator for diluted EPS | 47,998 | 47,791 | 47,852 | 47,490 |
| | | | | |
| Basic EPS: | | | | |
| Income from continuing operations | $ 0.16 | $ 0.09 | $ 0.30 | $ 0.12 |
| Income (loss) from discontinued operations | 0.03 | (0.01) | 0.04 | |
| Net income available to common shareholders | $ 0.19 | $ 0.08 | $ 0.34 | $ 0.12 |
| Diluted EPS: | | | | |
| Income from continuing operations | $ 0.16 | $ 0.09 | $ 0.29 | $ 0.12 |
| Income (loss) from discontinued operations | 0.02 | (0.01) | 0.05 | (0.01) |
| Net income available to common shareholders | $ 0.18 | $ 0.08 | $ 0.34 | $ 0.11 |

Our diluted EPS computations do not include the effects of the following securities since the conversions of such securities would increase diluted EPS for the respective periods:

| | Weighted Average Shares in Denominator: For the Three Months Ended June 30, 2008 | 2007 | For the Six Months Ended June 30, 2008 | 2007 |
|---|---|---|---|---|
| Conversion of weighted average common units | 8,151 | 8,313 | 8,153 | 8,361 |
| Conversion of weighted average convertible preferred shares | 434 | 434 | 434 | 415 |
| Conversion of weighted average convertible preferred units | 176 | 176 | 176 | 176 |

The 3.5% Exchangeable Senior Notes did not affect our diluted EPS reported above since the weighted average closing price of our common shares during each of the periods was less than the exchange price per common share applicable for such periods.

**4. Recent Accounting Pronouncements**

**SFAS 157**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The Statement does not require or permit any new fair value measurements but does apply under other accounting pronouncements that require or permit fair value measurements. The changes to current practice resulting from the Statement relate to the definition of fair value, the methods used to measure fair value and the expanded disclosures about fair value measurements. With respect to SFAS 157, the FASB also issued FASB Staff Position SFAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 ( FSP FAS 157-1 ) and FASB Staff Position SFAS 157-2, Effective Date of FASB Statement No. 157 ( FSP FAS 157-2 ). FSP FAS 157-1 amends SFAS 157 to exclude from the scope of SFAS 157 certain leasing transactions accounted for under Statement of Financial

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Accounting Standards No. 13, Accounting for Leases. FSP FAS 157-2 amends SFAS 157 to defer the effective date of SFAS 157 for all non-financial assets and non-financial liabilities except those that are recognized or disclosed at fair value in the financial statements on a recurring basis to fiscal years beginning after November 15, 2008. Effective January 1, 2008, we adopted, on a prospective basis, the portions of SFAS 157 not deferred by FSP FAS 157-2; this adoption did not have a material effect on our financial position, results of operations or cash flows. We are evaluating the impact that SFAS 157 will have on our non-financial assets and non-financial liabilities since the application of SFAS 157 for such items for us was deferred to January 1, 2009.

Under SFAS 157, fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. SFAS 157 also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability developed based on market data obtained from sources independent of us. Unobservable inputs are inputs that reflect our assumptions about the factors market participants would use in valuing the asset or liability developed based upon the best information available in the circumstances. The hierarchy of these inputs is broken down into three levels: Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities; Level 2 inputs include (1) quoted prices for similar assets or liabilities in active markets, (2) quoted prices for identical or similar assets or liabilities in markets that are not active and (3) inputs (other than quoted prices) that are observable for the asset or liability, either directly or indirectly; and Level 3 inputs are unobservable inputs for the asset or liability. Categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The assets held in connection with our non-qualified elective deferred compensation plan and the corresponding liability to the participants are measured at fair value on a recurring basis on our consolidated balance sheet using quoted market prices. The assets are treated as trading securities for accounting purposes and included in restricted cash on our consolidated balance sheet. The offsetting liability is adjusted to fair value at the end of each accounting period based on the fair value of the plan assets and reported in other liabilities in our consolidated balance sheet. The assets and corresponding liability of our non-qualified elective deferred compensation plan are classified in Level 1 of the fair value hierarchy.

The valuation of our derivatives is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate market data and implied volatilities in such interest rates. While we determined that the majority of the inputs used to value our derivatives fall within Level 2 of the fair value hierarchy under SFAS 157, the credit valuation adjustments associated with our derivatives also utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default. However, as of June 30, 2008, we assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our derivatives and determined that these adjustments are not significant to the overall valuation of our derivatives. As a result, we determined that our derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

The table below sets forth our financial assets and liabilities that are accounted for at fair value on a recurring basis as of June 30, 2008:

| **Description** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** | **Total** |
|---|---|---|---|---|
| Assets: | | | | |
| Deferred compensation plan assets (1) | $ 6,331 | $ | $ | $ 6,331 |
| Liabilities: | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Deferred compensation plan liability (2) | $ | 6,331 | $ | | $ | | $ | 6,331 |
| Interest rate swap contracts (2) | | | | 2,648 | | | | 2,648 |
| Liabilities | $ | 6,331 | $ | 2,648 | $ | | $ | 8,979 |

(1) Included in the line entitled restricted cash on our Consolidated Balance Sheet.

(2) Included in the line entitled other liabilities on our Consolidated Balance Sheet.

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**Other Recent Accounting Pronouncements**

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. We adopted SFAS 159 on a prospective basis effective January 1, 2008. Our adoption of SFAS 159 did not have a material effect on our financial position, results of operations or cash flows since we did not elect to apply the fair value option for any of our eligible financial instruments or other items on the January 1, 2008 effective date.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), Business Combinations ( SFAS 141(R) ). SFAS 141(R) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transactions; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. While we are currently assessing the impact of SFAS 141(R) on our consolidated financial position and results of operations, SFAS 141(R) will require us to expense transaction costs associated with property acquisitions occurring subsequent to the pronouncment s effective date, which is a significant change since our current practice is to capitalize such costs into the cost of the acquisitions.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements ( SFAS 160 ). SFAS 160 requires all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements. SFAS 160 is effective for fiscal years beginning after December 15, 2008. We are currently assessing the impact of SFAS 160 on our consolidated financial position and results of operations.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161 Disclosures about Derivative Instruments and Hedging Activities ( SFAS 161 ). This new standard expands the disclosure requirements for derivative instruments and for hedging activities in order to provide users of financial statements with an enhanced understanding of: (1) how and why an entity uses derivative instruments; (2) how derivative instruments and related hedged items are accounted for under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities and its related interpretations; and (3) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS 161 is to be applied prospectively for the first annual reporting period beginning on or after November 15, 2008. We are evaluating the impact that SFAS 161 will have on our reporting for derivatives.

In May 2008, the FASB issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) ( FSP APB-14-1 ). FSP APB-14-1 requires that the initial proceeds from convertible debt instruments that may be settled in cash, including partial cash settlements, be allocated between a liability component and an equity component associated with the embedded conversion option. This pronouncement s objective is to require the liability and equity components of convertible debt to be separately accounted for in order to enable interest expense to be recorded at a rate that would reflect the issuer s conventional debt borrowing rate (previously, interest expense on such debt was recorded based on the contractual rate of interest under the debt). Under this pronouncement, the liability component is recorded at its fair value, as calculated based on the present value of its cash flows discounted using the issuer s conventional debt borrowing rate. The equity component is recorded based on the difference between the debt proceeds and the fair value of the liability. The difference between the liability s principal amount and fair value is reported as a debt discount and amortized as interest expense over the debt s expected life using the effective interest method. The provisions of FSP APB 14-1 will be effective beginning January 1, 2009 and are to be applied retrospectively to all periods presented. While we are in the process of evaluating FSP APB 14-1, we currently believe that this pronouncement will affect the accounting for our 3.5% Exchangeable Senior Notes by resulting in our recognition of additional annual interest expense of approximately $3,000 to $4,000 over the five-year expected life of the debt, beginning on the debt s

September 18, 2006 origination date.

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## 5. Commercial Real Estate Properties

Operating properties consisted of the following:

| | June 30, 2008 | December 31, 2007 |
|---|---|---|
| Land | $ 420,182 | $ 413,779 |
| Buildings and improvements | 2,145,700 | 2,064,960 |
| | 2,565,882 | 2,478,739 |
| Less: accumulated depreciation | (320,879) | (285,800) |
| | $ 2,245,003 | $ 2,192,939 |

As of December 31, 2007, 429 Ridge Road, an office property located in Dayton, New Jersey that we were under contract to sell for $17,000, was classified as held for sale (Dayton, New Jersey is located in the Northern/Central New Jersey Region). We completed the sale of this property on January 31, 2008. The components associated with 429 Ridge Road as of December 31, 2007 included the following:

| | December 31, 2007 |
|---|---|
| Land | $ 2,932 |
| Buildings and improvements | 15,003 |
| | 17,935 |
| Less: accumulated depreciation | (2,947) |
| | $ 14,988 |

Projects we had under construction or development consisted of the following:

| | June 30, 2008 | December 31, 2007 |
|---|---|---|
| Land | $ 208,742 | $ 214,696 |
| Construction in progress | 247,422 | 181,316 |
| | $ 456,164 | $ 396,012 |

**2008 Acquisitions**

We acquired the following office properties during the six months ended June 30, 2008:

| Project Name | Location | Date of Acquisition | Number of Buildings | Total Rentable Square Feet | Acquisition Cost |
|---|---|---|---|---|---|
| 3535 Northrop Grumman Point | Colorado Springs, CO | 6/10/2008 | 1 | 124,305 | $ 23,240 |
| 1560 Cable Ranch Road (Buildings A and B) | San Antonio, TX | 6/19/2008 | 2 | 122,975 | 17,317 |
| | | | 3 | 247,280 | $ 40,557 |

**The table below sets forth the allocation of the acquisition costs of the three properties:**

| | 3535 Northrop Grumman Point | 1560 Cable Ranch Road | Total |
|---|---|---|---|
| Land, operating properties | $ | $ 3,396 | $ 3,396 |
| Building and improvements | 22,163 | 10,315 | 32,478 |
| Intangible assets on real estate acquisitions | 3,423 | 4,208 | 7,631 |
| Total assets | 25,586 | 17,919 | 43,505 |
| Deferred revenue associated with acquired operating leases | (2,346) | (602) | (2,948) |
| Total acquisition cost | $ 23,240 | $ 17,317 | $ 40,557 |

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**Intangible assets recorded in connection with the above acquisitions included the following:**

| | | | Weighted Average Amortization Period (in Years) |
|---|---|---|---|
| Lease-up value | $ | 4,558 | 10 |
| Tenant relationship value | | 1,537 | 12 |
| Lease cost portion of deemed cost avoidance | | 1,536 | 11 |
| | $ | 7,631 | 11 |

**2008 Construction, Development and Redevelopment Activities**

During the six months ended June 30, 2008, we had five properties totaling 437,064 square feet become fully operational (89,497 of these square feet were placed into service in 2007).  Three of these properties are located in Colorado Springs, Colorado (   Colorado Springs   ) and two in the Baltimore/Washington Corridor.

**As of June 30, 2008, we had construction underway on four new properties in the Baltimore/Washington Corridor (including one through a joint venture), four in Colorado Springs, two in San Antonio, Texas (   San Antonio   ) and one in the Suburban Maryland region through a joint venture.  We also had development activities underway on three new properties in Suburban Baltimore, two each in the Baltimore/Washington Corridor, San Antonio and Suburban Maryland (including one through a joint venture) and one in King George County, Virginia.  In addition, we had redevelopment underway on two properties owned by a joint venture (one located in the Baltimore/Washington Corridor and the other in Northern Virginia).**

**2008 Dispositions**

We sold the following operating properties during the six months ended June 30, 2008:

| Project Name | Location | Date of Sale | Number of Buildings | Total Rentable Square Feet | Sale Price | Gain on Sale |
|---|---|---|---|---|---|---|
| 429 Ridge Road | Dayton, New Jersey | 1/31/2008 | 1 | 142,385 | $ 17,000 | $ 1,365 |
| 7253 Ambassador Road | Woodlawn, Maryland | 6/2/2008 | 1 | 38,930 | 5,100 | 1,278 |
| 47 Commerce Road | Cranbury, New Jersey | 4/1/2008 | 1 | 41,398 | 3,150 | |
| | | | 3 | 222,713 | $ 25,250 | $ 2,643 |

During the six months ended June 30, 2008, we also completed the sale of six recently constructed office condominiums located in Herndon Virginia (located in the Northern Virginia region) for sale prices totaling $8,388 in the aggregate. We recognized an aggregate gain before minority interests and taxes of $1,368 on these sales.

The table below sets forth the components of the line on our Consolidated Statements of Operations entitled gain on sales of real estate for the three and six months ended June 30, 2008:

| | For the Three Months Ended June 30, 2008 | For the Three Months Ended June 30, 2007 | For the Six Months Ended June 30, 2008 | For the Six Months Ended June 30, 2007 |
|---|---|---|---|---|
| Gain on sales of real estate | $ 46 | $ 194 | $ 1,678 | $ 194 |
| Income taxes | (5) | (3) | (578) | (3) |
| Minority interests | | | | |
| Common units in the Operating Partnership | (8) | (30) | (151) | (30) |
| Other consolidated entities | (2) | | (116) | |
| Gain on sale of real estate, net | $ 31 | $ 161 | $ 833 | $ 161 |

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## 6. Real Estate Joint Ventures

During the six months ended June 30, 2008, we had an investment in one unconsolidated real estate joint venture accounted for using the equity method of accounting. Information pertaining to this joint venture investment is set forth below.

| | Investment Balance at June 30, 2008 | Investment Balance at December 31, 2007 | Date Acquired | Ownership | Nature of Activity | Total Assets at 6/30/2008 | Maximum Exposure to Loss (1) |
|---|---|---|---|---|---|---|---|
| Harrisburg Corporate Gateway Partners, L.P. | $ (4,506)(2) | $ (4,246)(2) | 9/29/2005 | 20% | Operates 16 buildings (3) | $ 71,261 | $ |

(1) Derived from the sum of our investment balance and maximum additional unilateral capital contributions or loans required from us. Not reported above are additional amounts that we and our partner are required to fund when needed by this joint venture; these funding requirements are proportional to our respective ownership percentages. Also not reported above are additional unilateral contributions or loans from us, the amounts of which are uncertain, which we would be required to make if certain contingent events occur.

(2) The carrying amount of our investment in this joint venture was lower than our share of the equity in the joint venture by $5,196 at June 30, 2008 and December 31, 2007 due to our deferral of gain on the contribution by us of real estate into the joint venture upon its formation. A difference will continue to exist to the extent the nature of our continuing involvement in the joint venture remains the same.

(3) This joint venture s properties are located in Greater Harrisburg, Pennsylvania.

The following table sets forth condensed balance sheets for Harrisburg Corporate Gateway Partners, L.P.:

| | June 30, 2008 | December 31, 2007 |
|---|---|---|
| Commercial real estate property | $ 62,961 | $ 63,773 |
| Other assets | 8,300 | 9,051 |
| Total assets | $ 71,261 | $ 72,824 |
| | | |
| Liabilities | $ 67,799 | $ 67,991 |
| Owners equity | 3,462 | 4,833 |
| Total liabilities and owners equity | $ 71,261 | $ 72,824 |

The following table sets forth condensed statements of operations for Harrisburg Corporate Gateway Partners, L.P.:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Revenues | $ 2,413 | $ 2,426 | $ 4,796 | $ 4,870 |
| Property operating expenses | (876) | (876) | (1,701) | (1,836) |
| Interest expense | (980) | (980) | (1,960) | (2,118) |
| Depreciation and amortization expense | (830) | (855) | (1,660) | (1,722) |
| Net loss | $ (273) | $ (285) | $ (525) | $ (806) |

On January 29, 2008, we completed the formation of M Square Associates, LLC ( M Square ), a consolidated joint venture in which we hold a 50% equity interest through Enterprise Campus Developer, LLC, another consolidated joint venture in which we own a 90% interest. M Square was formed to develop and own office properties, approved for up to approximately 750,000 square feet, located in M Square Research Park in College Park, Maryland (located in the Suburban Maryland region).

The table below sets forth information pertaining to our investments in consolidated joint ventures at June 30, 2008:

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| | Date Acquired | Ownership % at 6/30/2008 | Nature of Activity | Total Assets at 6/30/2008 | Collateralized Assets at 6/30/2008 |
|---|---|---|---|---|---|
| COPT Opportunity Invest I, LLC | 12/20/2005 | 92.5% | Redeveloping two properties(1) | $ 43,252 | $ |
| Arundel Preserve #5, LLC | 7/2/2007 | 50.0% | Developing land parcel(2) | 26,113 | |
| Enterprise Campus Developer, LLC | 6/26/2007 | 90.0% | Developing land parcels(3) | 24,317 | |
| COPT-FD Indian Head, LLC | 10/23/2006 | 75.0% | Developing land parcel(4) | 4,772 | |
| MOR Forbes 2 LLC | 12/24/2002 | 50.0% | Operates one building(5) | 4,409 | |
| 13849 Park Center Road, LLC | 10/2/2007 | 92.5% | Redeveloping one property(6) | 542 | |
| | | | | $ 103,405 | $ |

(1) This joint venture owns one property in the Northern Virginia region and one in the Baltimore/Washington Corridor region.

(2) This joint venture is developing a land parcel located in Hanover, Maryland (located in the Baltimore/Washington Corridor).

(3) This joint venture is developing land parcels located in College Park, Maryland through the M Square joint venture.

(4) This joint venture s property is located in Charles County, Maryland (located in our other business segment).

(5) This joint venture s property is located in Lanham, Maryland (located in the Suburban Maryland region).

(6) This joint venture is redeveloping a property in the Northern Virginia region.

Our commitments and contingencies pertaining to our real estate joint ventures are disclosed in Note 20.

## 7. Intangible Assets on Real Estate Acquisitions

Intangible assets on real estate acquisitions consisted of the following:

| | June 30, 2008 | | | December 31, 2007 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Lease-up value | $ 129,613 | $ 65,322 | $ 64,291 | $ 125,338 | $ 58,435 | $ 66,903 |
| Tenant relationship value | 36,514 | 10,623 | 25,891 | 35,189 | 7,892 | 27,297 |
| Lease cost portion of deemed cost avoidance | 18,587 | 9,828 | 8,759 | 17,133 | 8,697 | 8,436 |
| Lease to market value | 14,428 | 10,369 | 4,059 | 14,428 | 9,555 | 4,873 |
| Market concentration premium | 1,333 | 197 | 1,136 | 1,333 | 181 | 1,152 |
| | $ 200,475 | $ 96,339 | $ 104,136 | $ 193,421 | $ 84,760 | $ 108,661 |

Amortization of the intangible asset categories set forth above totaled $11,724 in the six months ended June 30, 2008 and $16,678 in the six months ended June 30, 2007. The approximate weighted average amortization periods of the categories set forth above follow: lease-up value: nine years; tenant relationship value: seven years; lease cost portion of deemed cost avoidance: six years; lease to market value: four years; and market concentration premium: 34 years. The approximate weighted average amortization period for all of the categories combined is nine years. Estimated amortization expense associated with the intangible asset categories set forth above is $10,500 for the six months ending December 31, 2008, $19,100 for 2009, $14,900 for 2010, $12,100 for 2011, $9,800 for 2012 and $7,300 for 2013.

## 8. Deferred Charges

Deferred charges consisted of the following:

| | June 30, 2008 | December 31, 2007 |
|---|---|---|
| Deferred leasing costs | $ 64,946 | $ 63,052 |
| Deferred financing costs | 34,874 | 32,617 |
| Goodwill | 1,853 | 1,853 |
| Deferred other | 155 | 155 |
| | 101,828 | 97,677 |
| Accumulated amortization | (53,208) | (48,626) |
| Deferred charges, net | $ 48,620 | $ 49,051 |

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## 9. Accounts Receivable

Our accounts receivable are reported net of an allowance for bad debts of $1,249 at June 30, 2008 and $798 at December 31, 2007.

## 10. Prepaid Expenses and Other Assets

Prepaid and other assets consisted of the following:

| | June 30, 2008 | December 31, 2007 |
|---|---|---|
| Furniture, fixtures and equipment | $ 11,807 | $ 11,410 |
| Prepaid expenses | 8,834 | 13,907 |
| Construction contract costs incurred in excess of billings | 8,031 | 19,425 |
| Other assets | 9,262 | 7,239 |
| Prepaid expenses and other assets | $ 37,934 | $ 51,981 |

## 11. Debt

Our debt consisted of the following:

| | Maximum Principal Amount Under Debt at June 30, 2008 | Carrying Value at June 30, 2008 | Carrying Value at December 31, 2007 | Stated Interest Rates at June 30, 2008 | Scheduled Maturity Dates at June 30, 2008 |
|---|---|---|---|---|---|
| Mortgage and other loans payable: | | | | | |
| Revolving Credit Facility | $ 600,000 | $ 465,000 | $ 361,000 | LIBOR + 0.75% to 1.25% | September 30, 2011 (1) |
| | | | | | |
| Mortgage and Other Secured Loans | | | | | |
| Fixed rate mortgage loans (2) | N/A | 1,063,596 | 1,124,551 | 5.20% - 8.63 (3)% | 2008 - 2034 (4) |
| Revolving Construction Facility (5) | 225,000 | 35,432 | | LIBOR + 1.60% to 2.00% | May 2, 2011 (1) |
| Other construction loan facilities | 111,500 | 104,089 | 104,089 | LIBOR + 1.40% to 1.50% | 2008-2009 |
| Other variable-rate secured loans | N/A | 34,500 | 34,500 | LIBOR + 1.20% to 1.50% | 2008 |
| Total mortgage and other secured loans | | 1,237,617 | 1,263,140 | | |
| | | | | | |
| Note payable | | | | | |
| Unsecured seller notes | N/A | 1,734 | 1,702 | 0% - 5.95% | 2008-2016 |
| Total mortgage and other loans payable | | 1,704,351 | 1,625,842 | | |
| | | | | | |
| 3.5% Exchangeable Senior Notes | N/A | 200,000 | 200,000 | 3.50% | September 2026 (6) |

| | | | | |
|---|---|---|---|---|
| Total debt | $ | 1,904,351 | $ | 1,825,842 |

(1) These facilities may be extended for a one-year period at our option, subject to certain conditions.

(2) Several of the fixed rate mortgages carry interest rates that were above or below market rates upon assumption and therefore are recorded at their fair value based on applicable effective interest rates. The carrying values of these loans reflect net premiums totaling $556 at June 30, 2008 and $605 at December 31, 2007.

(3) The weighted average interest rate on these loans was 5.82% at June 30, 2008.

(4) A loan with a balance of $4,781 at June 30, 2008 that matures in 2034 may be repaid in March 2014, subject to certain conditions.

(5) This loan is described in further detail below.

(6) Refer to our 2007 Annual Report on Form 10-K for descriptions of provisions for early redemption and repurchase of these notes.

On May 2, 2008, we entered into a construction loan agreement with a group of lenders for which KeyBanc Capital Markets, Inc. acted as arranger, KeyBank National Association acted as administrative agent, Bank of America, N.A. acted as syndication agent and Manufacturers and Traders Trust Company acted as documentation agent; this loan is referred to in the table above as the Revolving Construction Facility. The construction loan agreement provides for an aggregate commitment by the lenders of $225,000, with a right for us to further increase the lenders aggregate commitment during the term to a maximum of $325,000, subject to certain conditions. Ownership interests in the properties for which construction costs are being financed through loans under the

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agreement are pledged as collateral. Borrowings are generally available for properties included in this construction loan agreement based on 85% of the total budgeted costs of construction of the applicable improvements for such properties as set forth in the properties construction budgets, subject to certain other loan-to-value and debt coverage requirements. As loans for properties under the construction loan agreement are repaid in full and the ownership interests in such properties are no longer pledged as collateral, capacity under the construction loan agreement s aggregate commitment will be restored, giving us the ability to obtain new loans for other construction properties in which we pledge the ownership interests as collateral. The construction loan agreement matures on May 2, 2011, and may be extended by one year at our option, subject to certain conditions. The variable interest rate on each loan is based on one of the following, to be selected by us: (1) subject to certain conditions, the LIBOR rate for the interest period designated by us (customarily the 30-day rate) plus 1.6% to 2.0%, as determined by our leverage levels at different points in time; or (2) the greater of (a) the prime rate of the lender then acting as agent or (b) the Federal Funds Rate, as defined in the construction loan agreement, plus 0.50%. Interest is payable at the end of each interest period (as defined in the agreement), and principal outstanding under each loan under the agreement is payable on the maturity date. The construction loan agreement also carries a quarterly fee that is based on the unused amount of the commitment multiplied by a per annum rate of 0.125% to 0.20%.

We capitalized interest costs of $8,957 in the six months ended June 30, 2008 and $8,906 in the six months ended June 30, 2007.

## 12. Derivatives

The following table sets forth our interest rate swap contracts in place during the six months ended June 30, 2008 and their respective fair values:

| Notional Amount | One-Month LIBOR Base | Effective Date | Expiration Date | Fair Value at June 30, 2008 | Fair Value at December 31, 2007 |
|---|---|---|---|---|---|
| $ 50,000 | 4.3300% | 10/23/2007 | 10/23/2009 | $ (836) | $ (596) |
| 50,000 | 5.0360% | 3/28/2006 | 3/30/2009 | (826) | (765) |
| 25,000 | 5.2320% | 5/1/2006 | 5/1/2009 | (493) | (486) |
| 25,000 | 5.2320% | 5/1/2006 | 5/1/2009 | (493) | (486) |
| | | | | $ (2,648) | $ (2,333) |

These amounts are included on our Consolidated Balance Sheets as other liabilities.

We designated these derivatives as cash flow hedges. These contracts hedge the risk of changes in interest rates on certain of our one-month LIBOR-based variable rate borrowings until their respective maturities.

The table below sets forth our accounting application of changes in derivative fair values:

| | For the Three Months Ended June 30, | For the Six Months Ended June 30, |
|---|---|---|

| | 2008 | 2007 | 2008 | 2007 |
|---|---|---|---|---|
| Beginning balance | $ (4,701) | $ (556) | $ (2,333) | $ (308) |
| Increase (decrease) in fair value applied to accumulated other comprehensive loss and minority interests | 2,053 | 669 | (315) | 421 |
| Ending balance | $ (2,648) | $ 113 | $ (2,648) | $ 113 |

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**13. Shareholders Equity**

**Preferred Shares**

Preferred shares of beneficial interest ( preferred shares ) consisted of the following:

| | June 30, 2008 | December 31, 2007 |
|---|---|---|
| 2,200,000 designated as Series G Cumulative Redeemable Preferred Shares of beneficial interest (2,200,000 shares issued with an aggregate liquidation preference of $55,000) | $ 22 | $ 22 |
| 2,000,000 designated as Series H Cumulative Redeemable Preferred Shares of beneficial interest (2,000,000 shares issued with an aggregate liquidation preference of $50,000) | 20 | 20 |
| 3,390,000 designated as Series J Cumulative Redeemable Preferred Shares of beneficial interest (3,390,000 shares issued with an aggregate liquidation preference of $84,750) | 34 | 34 |
| 531,667 designated as Series K Cumulative Redeemable Convertible Preferred Shares of beneficial interest (531,667 shares issued with an aggregate liquidation preference of $26,583) | 5 | 5 |
| Total preferred shares | $ 81 | $ 81 |

**Common Shares**

During the six months ended June 30, 2008, we converted 15,242 common units in our Operating Partnership into common shares on the basis of one common share for each common unit.

See Note 17 for disclosure of common share activity pertaining to our share-based compensation plans.

**Accumulated Other Comprehensive Loss**

The table below sets forth activity in the accumulated other comprehensive loss component of shareholders equity:

| | For the Six Months Ended June 30, 2008 | 2007 |
|---|---|---|
| Beginning balance | $ (2,372) | $ (693) |
| Unrealized (loss) gain on derivatives, net of minority interests | (269) | 342 |
| Realized loss on derivatives, net of minority interests | 26 | 26 |

| | | |
|---|---|---|
| Ending balance | $ (2,615) | $ (325) |

The table below sets forth our comprehensive income:

| | **For the Three Months Ended June 30,** | **For the Six Months Ended June 30,** |
|---|---|---|