

CORPORATE OFFICE PROPERTIES TRUST
Form 10-Q
July 31, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q
(Mark one)

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

For the quarterly period ended June 30, 2017

or

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)
Commission file number 333-189188 (Corporate Office Properties, L.P.)
Corporate Office Properties Trust
Corporate Office Properties, L.P.

(Exact name of registrant as specified in its charter)

Corporate Office Properties Trust	Maryland	23-2947217
	(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

Corporate Office Properties, L.P.	Delaware	23-2930022
	(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

6711 Columbia Gateway Drive, 21046
Suite 300, Columbia, MD
(Address of principal executive offices) (Zip Code)

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

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.

Corporate Office Properties Trust Yes No
Corporate Office Properties, L.P. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Corporate Office Properties Trust Yes No

Corporate Office Properties, L.P. Yes No

Edgar Filing: CORPORATE OFFICE PROPERTIES TRUST - Form 10-Q

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Corporate Office Properties Trust

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company
(Do not check if a smaller reporting company)

Corporate Office Properties, L.P.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company
(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Corporate Office Properties Trust
Corporate Office Properties, L.P.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Corporate Office Properties Trust Yes No
Corporate Office Properties, L.P. Yes No

As of July 21, 2017, 99,466,838 of Corporate Office Properties Trust’s Common Shares of Beneficial Interest, \$0.01 par value, were issued and outstanding.

EXPLANATORY NOTE

This report combines the quarterly reports on Form 10-Q for the period ended June 30, 2017 of Corporate Office Properties Trust (“COPT”) and subsidiaries (collectively, the “Company”) and Corporate Office Properties, L.P. (“COPLP”) and subsidiaries (collectively, the “Operating Partnership”). Unless stated otherwise or the context otherwise requires, “we,” “our,” and “us” refer collectively to COPT, COPLP and their subsidiaries.

COPT is a real estate investment trust, or REIT, and the sole general partner of COPLP. As of June 30, 2017, COPT owned approximately 96.7% of the outstanding common units and none of the outstanding preferred units in COPLP; the remaining common and preferred units in COPLP were owned by third parties. As the sole general partner of COPLP, COPT controls COPLP and can cause it to enter into major transactions including acquisitions, dispositions and refinancings and cause changes in its line of business, capital structure and distribution policies.

There are a few differences between the Company and the Operating Partnership which are reflected in this Form 10-Q. We believe it is important to understand the differences between the Company and the Operating Partnership in

the context of how the Company and the Operating Partnership operate as an interrelated, consolidated company. COPT is a real estate investment trust, whose only material asset is its ownership of partnership interests of COPLP. As a result, COPT does not conduct business itself, other than acting as the sole general partner of COPLP, issuing public equity from time to time and guaranteeing certain debt of COPLP. COPT itself is not directly obligated under any indebtedness but guarantees some of the debt of COPLP. COPLP owns substantially all of the assets of COPT either directly or through its subsidiaries, conducts almost all of the operations of the business and is structured as a limited partnership with no publicly traded equity. Except for net proceeds from public equity issuances by COPT, which are contributed to COPLP in exchange for partnership units, COPLP generates the capital required by COPT's business through COPLP's operations, by COPLP's direct or indirect incurrence of indebtedness or through the issuance of partnership units.

Noncontrolling interests and shareholders' equity and partners' capital are the main areas of difference between the consolidated financial statements of COPT and those of COPLP. The common limited partnership interests in COPLP not

owned by COPT are accounted for as partners' capital in COPLP's consolidated financial statements and as noncontrolling interests in COPT's consolidated financial statements. COPLP's consolidated financial statements also reflect COPT's noncontrolling interests in certain real estate partnerships, limited liability companies ("LLCs") and corporations; the differences between shareholders' equity, partners' capital and noncontrolling interests result from the differences in the equity issued at the COPT and COPLP levels and in COPT's noncontrolling interests in these real estate partnerships, LLCs, business trusts and corporations. The only other significant differences between the consolidated financial statements of COPT and those of COPLP are assets held in connection with a non-qualified elective deferred compensation plan (comprised primarily of mutual funds and equity securities) and the corresponding liability to the plan's participants that are held directly by COPT.

We believe combining the quarterly reports on Form 10-Q of the Company and the Operating Partnership into this single report results in the following benefits:

- combined reports better reflect how management and the analyst community view the business as a single operating unit;
- combined reports enhance investors' understanding of the Company and the Operating Partnership by enabling them to view the business as a whole and in the same manner as management;
- combined reports are more efficient for the Company and the Operating Partnership and result in savings in time, effort and expense; and
- combined reports are more efficient for investors by reducing duplicative disclosure and providing a single document for their review.

To help investors understand the significant differences between the Company and the Operating Partnership, this report presents the following separate sections for each of the Company and the Operating Partnership:

- consolidated financial statements;
- the following notes to the consolidated financial statements:
 - Note 3, Fair Value Measurements of COPT and subsidiaries and COPLP and subsidiaries; and
 - Note 14, Earnings per Share of COPT and subsidiaries and Earnings per Unit of COPLP and subsidiaries;
- "Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources of COPT"; and
- "Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources of COPLP."

This report also includes separate sections under Part I, Item 4. Controls and Procedures and separate Exhibit 31 and Exhibit 32 certifications for each of COPT and COPLP to establish that the Chief Executive Officer and the Chief Financial Officer of each entity have made the requisite certifications and that COPT and COPLP are compliant with Rule 13a-15 and Rule 15d-14 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and 18 U.S.C. §1350.

TABLE OF CONTENTS

FORM 10-Q

	PAGE
<u>PART I: FINANCIAL INFORMATION</u>	
<u>Item 1: Financial Statements:</u>	
<u>Consolidated Financial Statements of Corporate Office Properties Trust</u>	
<u>Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016 (unaudited)</u>	<u>3</u>
<u>Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2017 and 2016 (unaudited)</u>	<u>4</u>
<u>Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2017 and 2016 (unaudited)</u>	<u>5</u>
<u>Consolidated Statements of Equity for the Six Months Ended June 30, 2017 and 2016 (unaudited)</u>	<u>6</u>
<u>Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2017 and 2016 (unaudited)</u>	<u>7</u>
<u>Consolidated Financial Statements of Corporate Office Properties, L.P.</u>	
<u>Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016 (unaudited)</u>	<u>9</u>
<u>Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2017 and 2016 (unaudited)</u>	<u>10</u>
<u>Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2017 and 2016 (unaudited)</u>	<u>11</u>
<u>Consolidated Statements of Equity for the Six Months Ended June 30, 2017 and 2016 (unaudited)</u>	<u>12</u>
<u>Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2017 and 2016 (unaudited)</u>	<u>13</u>
<u>Notes to Consolidated Financial Statements (unaudited)</u>	<u>15</u>
<u>Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>35</u>
<u>Item 3: Quantitative and Qualitative Disclosures About Market Risk</u>	<u>49</u>
<u>Item 4: Controls and Procedures</u>	<u>49</u>
<u>PART II: OTHER INFORMATION</u>	
<u>Item 1: Legal Proceedings</u>	<u>50</u>
<u>Item 1A: Risk Factors</u>	<u>50</u>
<u>Item 2: Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>50</u>
<u>Item 3: Defaults Upon Senior Securities</u>	<u>50</u>
<u>Item 4: Mine Safety Disclosures</u>	<u>50</u>
<u>Item 5: Other Information</u>	<u>50</u>
<u>Item 6: Exhibits</u>	<u>51</u>
<u>SIGNATURES</u>	<u>53</u>

PART I: FINANCIAL INFORMATION

ITEM 1. Financial Statements

Corporate Office Properties Trust and Subsidiaries

Consolidated Balance Sheets

(in thousands, except share data)

(unaudited)

	June 30, 2017	December 31, 2016
Assets		
Properties, net:		
Operating properties, net	\$2,688,174	\$2,671,831
Projects in development or held for future development	446,385	401,531
Total properties, net	3,134,559	3,073,362
Assets held for sale, net	51,291	94,654
Cash and cash equivalents	10,606	209,863
Restricted cash and marketable securities	6,866	8,193
Investment in unconsolidated real estate joint venture	25,335	25,548
Accounts receivable (net of allowance for doubtful accounts of \$435 and \$603, respectively)	42,742	34,438
Deferred rent receivable (net of allowance of \$125 and \$373, respectively)	89,832	90,219
Intangible assets on real estate acquisitions, net	69,205	78,351
Deferred leasing costs (net of accumulated amortization of \$29,720 and \$65,988, respectively)	40,506	41,214
Investing receivables	54,598	52,279
Prepaid expenses and other assets, net	49,347	72,764
Total assets	\$3,574,887	\$3,780,885
Liabilities and equity		
Liabilities:		
Debt, net	\$1,897,734	\$1,904,001
Accounts payable and accrued expenses	95,267	108,682
Rents received in advance and security deposits	25,444	29,798
Dividends and distributions payable	28,462	31,335
Deferred revenue associated with operating leases	13,172	12,666
Redeemable preferred shares of beneficial interest (\$0.01 par value; 531,667 shares issued and outstanding at December 31, 2016 and none at June 30, 2017)	—	26,583
Capital lease obligation	16,177	—
Other liabilities	56,076	50,177
Total liabilities	2,132,332	2,163,242
Commitments and contingencies (Note 15)		
Redeemable noncontrolling interests	23,731	22,979
Equity:		
Corporate Office Properties Trust's shareholders' equity:		
Preferred Shares of beneficial interest at liquidation preference (\$0.01 par value; 25,000,000 shares authorized, 6,900,000 shares issued and outstanding at December 31, 2016 and none at June 30, 2017)	—	172,500
Common Shares of beneficial interest (\$0.01 par value; 125,000,000 shares authorized, shares issued and outstanding of 99,471,641 at June 30, 2017 and 98,498,651 at	995	985

Edgar Filing: CORPORATE OFFICE PROPERTIES TRUST - Form 10-Q

December 31, 2016)

Additional paid-in capital	2,146,119	2,116,581
Cumulative distributions in excess of net income	(793,828)	(765,276)
Accumulated other comprehensive loss	(1,163)	(1,731)
Total Corporate Office Properties Trust's shareholders' equity	1,352,123	1,523,059
Noncontrolling interests in subsidiaries:		
Common units in COPLP	46,233	49,228
Preferred units in COPLP	8,800	8,800
Other consolidated entities	11,668	13,577
Noncontrolling interests in subsidiaries	66,701	71,605
Total equity	1,418,824	1,594,664
Total liabilities, redeemable noncontrolling interest and equity	\$3,574,887	\$3,780,885

See accompanying notes to consolidated financial statements.

3

Corporate Office Properties Trust and Subsidiaries
Consolidated Statements of Operations
(in thousands, except per share data)
(unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues				
Rental revenue	\$ 101,347	\$ 107,524	\$ 201,962	\$ 212,906
Tenant recoveries and other real estate operations revenue	26,950	26,400	53,102	54,105
Construction contract and other service revenues	23,138	12,003	36,172	23,223
Total revenues	151,435	145,927	291,236	290,234
Expenses				
Property operating expenses	48,628	48,141	97,147	100,016
Depreciation and amortization associated with real estate operations	32,793	33,248	65,852	67,775
Construction contract and other service expenses	22,315	11,478	34,801	22,172
Impairment losses	1,625	69,692	1,625	72,138
General, administrative and leasing expenses	7,859	8,026	16,470	19,909
Business development expenses and land carry costs	1,597	2,363	3,290	4,781
Total operating expenses	114,817	172,948	219,185	286,791
Operating income (loss)	36,618	(27,021)	72,051	3,443
Interest expense	(19,163)	(22,639)	(38,157)	(46,198)
Interest and other income	1,583	1,330	3,309	2,486
(Loss) gain on early extinguishment of debt	(513)	5	(513)	22
Income (loss) before equity in income of unconsolidated entities and income taxes	18,525	(48,325)	36,690	(40,247)
Equity in income of unconsolidated entities	718	10	1,443	20
Income tax (expense) benefit	(48)	(1)	(88)	7
Income (loss) before gain on sales of real estate	19,195	(48,316)	38,045	(40,220)
Gain on sales of real estate	12	—	4,250	—
Net income (loss)	19,207	(48,316)	42,295	(40,220)
Net (income) loss attributable to noncontrolling interests:				
Common units in COPLP	(273)	1,976	(907)	1,849
Preferred units in COPLP	(165)	(165)	(330)	(330)
Other consolidated entities	(907)	(914)	(1,841)	(1,892)
Net income (loss) attributable to COPT	17,862	(47,419)	39,217	(40,593)
Preferred share dividends	(3,039)	(3,553)	(6,219)	(7,105)
Issuance costs associated with redeemed preferred shares	(6,847)	—	(6,847)	—
Net income (loss) attributable to COPT common shareholders	\$ 7,976	\$ (50,972)	\$ 26,151	\$ (47,698)
Earnings per common share:				
Net income (loss) attributable to COPT common shareholders - basic	\$ 0.08	\$ (0.54)	\$ 0.26	\$ (0.51)
Net income (loss) attributable to COPT common shareholders - diluted	\$ 0.08	\$ (0.54)	\$ 0.26	\$ (0.51)
Dividends declared per common share	\$ 0.275	\$ 0.275	\$ 0.550	\$ 0.550

See accompanying notes to consolidated financial statements.

Corporate Office Properties Trust and Subsidiaries
Consolidated Statements of Comprehensive Income
(in thousands)
(unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Net income (loss)	\$19,207	\$(48,316)	\$42,295	\$(40,220)
Other comprehensive income (loss)				
Unrealized loss on interest rate derivatives	(1,800)	(5,704)	(1,576)	(16,988)
Loss on interest rate derivatives recognized in interest expense (effective portion)	853	850	2,037	1,720
Loss on interest rate derivatives recognized in interest expense (ineffective portion)	88	—	88	—
Equity in other comprehensive income (loss) of equity method investee	39	(184)	39	(184)
Other comprehensive (loss) income	(820)	(5,038)	588	(15,452)
Comprehensive income (loss)	18,387	(53,354)	42,883	(55,672)
Comprehensive (income) loss attributable to noncontrolling interests	(1,318)	1,085	(3,098)	205
Comprehensive income (loss) attributable to COPT	\$17,069	\$(52,269)	\$39,785	\$(55,467)

See accompanying notes to consolidated financial statements.

Corporate Office Properties Trust and Subsidiaries
Consolidated Statements of Equity
(Dollars in thousands)
(unaudited)

	Preferred Shares	Common Shares	Additional Paid-in Capital	Cumulative Distributions in Excess of Net Income	Other Comprehensive Loss	Noncontrolling Interests	Total
Balance at December 31, 2015 (94,531,512 common shares outstanding)	\$ 199,083	\$ 945	\$ 2,004,507	\$ (657,172)	\$ (2,838)	\$ 72,039	\$ 1,616,564
Conversion of common units to common shares (26,758 shares)	—	—	371	—	—	(371)	—
Costs associated with common shares issued to the public	—	—	(5)	—	—	—	(5)
Share-based compensation (141,089 shares issued, net of redemptions)	—	2	4,301	—	—	—	4,303
Redemption of vested equity awards	—	—	(1,492)	—	—	—	(1,492)
Adjustments to noncontrolling interests resulting from changes in ownership of COPLP	—	—	(5)	—	—	5	—
Comprehensive loss	—	—	—	(40,593)	(14,874)	(1,322)	(56,789)
Dividends	—	—	—	(59,175)	—	—	(59,175)
Distributions to owners of common and preferred units in COPLP	—	—	—	—	—	(2,346)	(2,346)
Distributions to noncontrolling interests in other consolidated entities	—	—	—	—	—	(8)	(8)
Adjustment to arrive at fair value of redeemable noncontrolling interests	—	—	(349)	—	—	—	(349)
Balance at June 30, 2016 (94,699,359 common shares outstanding)	\$ 199,083	\$ 947	\$ 2,007,328	\$ (756,940)	\$ (17,712)	\$ 67,997	\$ 1,500,703
Balance at December 31, 2016 (98,498,651 common shares outstanding)	\$ 172,500	\$ 985	\$ 2,116,581	\$ (765,276)	\$ (1,731)	\$ 71,605	\$ 1,594,664
Redemption of preferred shares (6,900,000 shares)	(172,500)	—	6,847	(6,847)	—	—	(172,500)
Conversion of common units to common shares (187,000 shares)	—	2	2,562	—	—	(2,564)	—

Edgar Filing: CORPORATE OFFICE PROPERTIES TRUST - Form 10-Q

Common shares issued under at-the-market program — (591,042 shares)	6	19,662	—	—	—	19,668	
Exercise of share options (5,000 shares)	—	150	—	—	—	150	
Share-based compensation (189,948 shares issued, net of redemptions)	2	3,045	—	—	—	3,047	
Redemption of vested equity awards	—	(1,813)	) —	—	—	(1,813)
Adjustments to noncontrolling interests resulting from changes in ownership of COPLP	—	(514)	) —	—	514	—
Comprehensive income	—	—	39,217	568	1,958	41,743	
Dividends	—	—	(60,922)	) —	—	(60,922)
Distributions to owners of common and preferred units in COPLP	—	—	—	—	(2,202)	) (2,202)
Distributions to noncontrolling interests in other consolidated entities	—	—	—	—	(2,610)	) (2,610)
Adjustment to arrive at fair value of redeemable noncontrolling interests	—	(401)	) —	—	—	(401)
Balance at June 30, 2017 (99,471,641 common shares outstanding)	\$—	\$ 995	\$ 2,146,119	\$ (793,828)) \$ (1,163)) \$ 66,701	\$ 1,418,824

See accompanying notes to consolidated financial statements.

Corporate Office Properties Trust and Subsidiaries
Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	For the Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities		
Revenues from real estate operations received	\$255,302	\$261,980
Construction contract and other service revenues received	39,917	34,992
Property operating expenses paid	(80,385)	(87,005)
Construction contract and other service expenses paid	(31,996)	(24,303)
General, administrative, leasing, business development and land carry costs paid	(20,315)	(19,212)
Interest expense paid	(36,351)	(41,179)
Lease incentives	(9,375)	(996)
Other	940	123
Net cash provided by operating activities	117,737	124,400
Cash flows from investing activities		
Construction, development and redevelopment	(85,926)	(75,339)
Tenant improvements on operating properties	(13,711)	(14,862)
Other capital improvements on operating properties	(11,780)	(16,007)
Proceeds from dispositions of properties	54,798	5,448
Leasing costs paid	(3,904)	(3,434)
Other	1,573	(13)
Net cash used in investing activities	(58,950)	(104,207)
Cash flows from financing activities		
Proceeds from debt		
Revolving Credit Facility	213,000	133,500
Other debt proceeds	—	45,000
Repayments of debt		
Revolving Credit Facility	(19,000)	(119,000)
Scheduled principal amortization	(1,913)	(3,532)
Other debt repayments	(200,100)	(40,498)
Net proceeds from issuance of common shares	19,835	(5)
Redemption of preferred shares	(199,083)	—
Common share dividends paid	(54,439)	(52,021)
Preferred share dividends paid	(9,305)	(7,105)
Distributions paid to noncontrolling interests in COPLP	(2,274)	(2,362)
Distributions paid to redeemable noncontrolling interests	(781)	(14,306)
Redemption of vested equity awards	(1,813)	(1,492)
Other	(2,171)	(5,365)
Net cash used in financing activities	(258,044)	(67,186)
Net decrease in cash and cash equivalents	(199,257)	(46,993)
Cash and cash equivalents		
Beginning of period	209,863	60,310
End of period	\$10,606	\$13,317

See accompanying notes to consolidated financial statements.

Corporate Office Properties Trust and Subsidiaries
Consolidated Statements of Cash Flows (continued)
(in thousands)
(unaudited)

	For the Six Months Ended June 30, 2017	2016
Reconciliation of net income (loss) to net cash provided by operating activities:		
Net income (loss)	\$ 42,295	\$ (40,220)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	66,948	68,901
Impairment losses	1,618	72,138
(Gain) loss on interest rate derivatives	(9)	1,870
Amortization of deferred financing costs and net debt discounts	2,613	2,998
Decrease (increase) in deferred rent receivable	669	(1,276)
Gain on sales of real estate	(4,250)	—
Share-based compensation	2,820	3,839
Other	(2,548)	(1,725)
Operating changes in assets and liabilities:		
Increase in accounts receivable	(8,304)	(3,320)
Decrease (increase) in restricted cash and marketable securities	1,826	(389)
Decrease in prepaid expenses and other assets, net	20,800	11,303
(Decrease) increase in accounts payable, accrued expenses and other liabilities	(2,387)	15,394
Decrease in rents received in advance and security deposits	(4,354)	(5,113)
Net cash provided by operating activities	\$ 117,737	\$ 124,400
Supplemental schedule of non-cash investing and financing activities:		
(Decrease) increase in accrued capital improvements, leasing and other investing activity costs	\$ (4,927)	\$ 1,604
	\$ 16,127	\$ —

Increase in property in connection with capital lease obligation				
Increase in property and redeemable noncontrolling interests in connection with property contributed in a joint venture	\$	—	\$	22,600
Decrease in redeemable noncontrolling interests and increase in other liabilities in connection with distribution payable to redeemable noncontrolling interest	\$	—	\$	6,675
Increase (decrease) in fair value of derivatives applied to accumulated other comprehensive loss and noncontrolling interests	\$	513	\$	(15,268)
Equity in other comprehensive income (loss) of an equity method investee	\$	39	\$	(184)
Dividends/distribution payable	\$	28,462	\$	30,219
Decrease in noncontrolling interests and increase in shareholders' equity in connection with the conversion of common units into common shares	\$	2,564	\$	371
Adjustments to noncontrolling interests resulting from changes in COPLP ownership	\$	514	\$	5
Increase in redeemable noncontrolling interest and decrease in equity to carry redeemable noncontrolling interest at fair value	\$	401	\$	349

See accompanying notes to consolidated financial statements.

Corporate Office Properties, L.P. and Subsidiaries
Consolidated Balance Sheets
(in thousands, except unit data)
(unaudited)

	June 30, 2017	December 31, 2016
Assets		
Properties, net:		
Operating properties, net	\$2,688,174	\$ 2,671,831
Projects in development or held for future development	446,385	401,531
Total properties, net	3,134,559	3,073,362
Assets held for sale, net	51,291	94,654
Cash and cash equivalents	10,606	209,863
Restricted cash and marketable securities	2,721	2,756
Investment in unconsolidated real estate joint venture	25,335	25,548
Accounts receivable (net of allowance for doubtful accounts of \$435 and \$603, respectively)	42,742	34,438
Deferred rent receivable (net of allowance of \$125 and \$373, respectively)	89,832	90,219
Intangible assets on real estate acquisitions, net	69,205	78,351
Deferred leasing costs (net of accumulated amortization of \$29,720 and \$65,988, respectively)	40,506	41,214
Investing receivables	54,598	52,279
Prepaid expenses and other assets, net	49,347	72,764
Total assets	\$3,570,742	\$ 3,775,448
Liabilities and equity		
Liabilities:		
Debt, net	\$1,897,734	\$ 1,904,001
Accounts payable and accrued expenses	95,267	108,682
Rents received in advance and security deposits	25,444	29,798
Distributions payable	28,462	31,335
Deferred revenue associated with operating leases	13,172	12,666
Redeemable preferred units of general partner, 531,667 units outstanding at December 31, 2016 and none at June 30, 2017	—	26,583
Capital lease obligation	16,177	—
Other liabilities	51,931	44,740
Total liabilities	2,128,187	2,157,805
Commitments and contingencies (Note 15)		
Redeemable noncontrolling interests	23,731	22,979
Equity:		
Corporate Office Properties, L.P.'s equity:		
Preferred units		
General partner, 6,900,000 preferred units outstanding at December 31, 2016 and none at June 30, 2017	—	172,500
Limited partner, 352,000 preferred units outstanding at June 30, 2017 and December 31, 2016	8,800	8,800
Common units, 99,471,641 and 98,498,651 held by the general partner and 3,403,391 and 3,590,391 held by limited partners at June 30, 2017 and December 31, 2016, respectively	1,399,578	1,401,597

Edgar Filing: CORPORATE OFFICE PROPERTIES TRUST - Form 10-Q

Accumulated other comprehensive loss	(1,266	) (1,854)
Total Corporate Office Properties, L.P.'s equity	1,407,112	1,581,043	
Noncontrolling interests in subsidiaries	11,712	13,621	
Total equity	1,418,824	1,594,664	
Total liabilities, redeemable noncontrolling interest and equity	\$3,570,742	\$3,775,448	

See accompanying notes to consolidated financial statements.

Corporate Office Properties, L.P. and Subsidiaries
Consolidated Statements of Operations
(in thousands, except per unit data)
(unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues				
Rental revenue	\$ 101,347	\$ 107,524	\$ 201,962	\$ 212,906
Tenant recoveries and other real estate operations revenue	26,950	26,400	53,102	54,105
Construction contract and other service revenues	23,138	12,003	36,172	23,223
Total revenues	151,435	145,927	291,236	290,234
Expenses				
Property operating expenses	48,628	48,141	97,147	100,016
Depreciation and amortization associated with real estate operations	32,793	33,248	65,852	67,775
Construction contract and other service expenses	22,315	11,478	34,801	22,172
Impairment losses	1,625	69,692	1,625	72,138
General, administrative and leasing expenses	7,859	8,026	16,470	19,909
Business development expenses and land carry costs	1,597	2,363	3,290	4,781
Total operating expenses	114,817	172,948	219,185	286,791
Operating income (loss)	36,618	(27,021)	72,051	3,443
Interest expense	(19,163)	(22,639)	(38,157)	(46,198)
Interest and other income	1,583	1,330	3,309	2,486
(Loss) gain on early extinguishment of debt	(513)	5	(513)	22
Income (loss) before equity in income of unconsolidated entities and income taxes	18,525	(48,325)	36,690	(40,247)
Equity in income of unconsolidated entities	718	10	1,443	20
Income tax (expense) benefit	(48)	(1)	(88)	7
Income (loss) before gain on sales of real estate	19,195	(48,316)	38,045	(40,220)
Gain on sales of real estate	12	—	4,250	—
Net income (loss)	19,207	(48,316)	42,295	(40,220)
Net income attributable to noncontrolling interests in consolidated entities	(907)	(911)	(1,841)	(1,890)
Net income (loss) attributable to COPLP	18,300	(49,227)	40,454	(42,110)
Preferred unit distributions	(3,204)	(3,718)	(6,549)	(7,435)
Issuance costs associated with redeemed preferred units	(6,847)	—	(6,847)	—
Net income (loss) attributable to COPLP common unitholders	\$ 8,249	\$ (52,945)	\$ 27,058	\$ (49,545)
Earnings per common unit:				
Net income (loss) attributable to COPLP common unitholders - basic	\$ 0.08	\$ (0.54)	\$ 0.26	\$ (0.51)
Net income (loss) attributable to COPLP common unitholders - diluted	\$ 0.08	\$ (0.54)	\$ 0.26	\$ (0.51)
Distributions declared per common unit	\$ 0.275	\$ 0.275	\$ 0.550	\$ 0.550

See accompanying notes to consolidated financial statements.

Corporate Office Properties, L.P. and Subsidiaries
Consolidated Statements of Comprehensive Income
(in thousands)
(unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Net income (loss)	\$19,207	\$(48,316)	\$42,295	\$(40,220)
Other comprehensive income (loss)				
Unrealized loss on interest rate derivatives	(1,800)	(5,704)	(1,576)	(16,988)
Loss on interest rate derivatives recognized in interest expense (effective portion)	853	850	2,037	1,720
Loss on interest rate derivatives recognized in interest expense (ineffective portion)	88	—	88	—
Equity in other comprehensive income (loss) of equity method investee	39	(184)	39	(184)
Other comprehensive (loss) income	(820)	(5,038)	588	(15,452)
Comprehensive income (loss)	18,387	(53,354)	42,883	(55,672)
Comprehensive income attributable to noncontrolling interests	(907)	(911)	(1,841)	(1,890)
Comprehensive income (loss) attributable to COPLP	\$17,480	\$(54,265)	\$41,042	\$(57,562)

See accompanying notes to consolidated financial statements.

Edgar Filing: CORPORATE OFFICE PROPERTIES TRUST - Form 10-Q

Corporate Office Properties, L.P. and Subsidiaries
 Consolidated Statements of Equity
 (Dollars in thousands)
 (unaudited)

	Limited Partner Preferred Units		General Partner Preferred Units		Common Units		Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests in Subsidiaries	Total Equity
	Units	Amount	Units	Amount	Units	Amount			
Balance at December 31, 2015	352,000	\$8,800	7,431,667	\$199,083	98,208,903	\$1,400,745	\$(2,985)	\$10,921	\$1,616,564
Costs associated with common shares issued to the public	—	—	—	—	—	(5)	—	—	(5)
Share-based compensation (units net of redemption)	—	—	—	—	141,089	4,303	—	—	4,303
Redemptions of vested equity awards	—	—	—	—	—	(1,492)	—	—	(1,492)
Comprehensive loss	—	330	—	7,105	—	(49,545)	(15,452)	773	(56,789)
Distributions to owners of common and preferred units	—	(330)	—	(7,105)	—	(54,086)	—	—	(61,521)
Distributions to noncontrolling interests in subsidiaries	—	—	—	—	—	—	—	(8)	(8)
Adjustment to arrive at fair value of redeemable noncontrolling interest	—	—	—	—	—	(349)	—	—	(349)
Balance at June 30, 2016	352,000	\$8,800	7,431,667	\$199,083	98,349,992	\$1,299,571	\$(18,437)	\$11,686	\$1,500,703
Balance at December 31, 2016	352,000	\$8,800	6,900,000	\$172,500	102,089,042	\$1,401,597	\$(1,854)	\$13,621	\$1,594,664
Redemption of preferred units resulting from	—	—	(6,900,000)	(172,500)	—	—	—	—	(172,500)

redemption of preferred shares									
Issuance of common units resulting from common shares issued under COPT at-the-market program	—	—	—	—	591,042	19,668	—	—	19,668
Issuance of common units resulting from exercise of share options	—	—	—	—	5,000	150	—	—	150
Share-based compensation (units net of redemption)	—	—	—	—	189,948	3,047	—	—	3,047
Redemptions of vested equity awards	—	—	—	—	—	(1,813)	) —	—	(1,813)
Comprehensive income	—	330	—	6,219	—	33,905	588	701	41,743
Distributions to owners of common and preferred units	—	(330)	) —	(6,219)	) —	(56,575)	) —	—	(63,124)
Distributions to noncontrolling interests in subsidiaries	—	—	—	—	—	—	—	(2,610)	(2,610)
Adjustment to arrive at fair value of redeemable noncontrolling interest	—	—	—	—	—	(401)	) —	—	(401)
Balance at June 30, 2017	352,000	\$8,800	—	\$—	102,875,032	\$1,399,578	\$(1,266)	) \$11,712	\$1,418,824

See accompanying notes to consolidated financial statements.

Corporate Office Properties, L.P. and Subsidiaries
Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	For the Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities		
Revenues from real estate operations received	\$255,302	\$261,980
Construction contract and other service revenues received	39,917	34,992
Property operating expenses paid	(80,385)	(87,005)
Construction contract and other service expenses paid	(31,996)	(24,303)
General, administrative, leasing, business development and land carry costs paid	(20,315)	(19,212)
Interest expense paid	(36,351)	(41,179)
Lease incentives	(9,375)	(996)
Other	940	123
Net cash provided by operating activities	117,737	124,400
Cash flows from investing activities		
Construction, development and redevelopment	(85,926)	(75,339)
Tenant improvements on operating properties	(13,711)	(14,862)
Other capital improvements on operating properties	(11,780)	(16,007)
Proceeds from dispositions of properties	54,798	5,448
Leasing costs paid	(3,904)	(3,434)
Other	1,573	(13)
Net cash used in investing activities	(58,950)	(104,207)
Cash flows from financing activities		
Proceeds from debt		
Revolving Credit Facility	213,000	133,500
Other debt proceeds	—	45,000
Repayments of debt		
Revolving Credit Facility	(19,000)	(119,000)
Scheduled principal amortization	(1,913)	(3,532)
Other debt repayments	(200,100)	(40,498)
Net proceeds from issuance of common units	19,835	(5)
Redemption of preferred units	(199,083)	—
Common unit distributions paid	(56,383)	(54,053)
Preferred unit distributions paid	(9,635)	(7,435)
Redemption of vested equity awards	(1,813)	(1,492)
Distributions paid to redeemable noncontrolling interests	(781)	(14,306)
Other	(2,171)	(5,365)
Net cash used in financing activities	(258,044)	(67,186)
Net decrease in cash and cash equivalents	(199,257)	(46,993)
Cash and cash equivalents		
Beginning of period	209,863	60,310
End of period	\$10,606	\$13,317

See accompanying notes to consolidated financial statements.

Corporate Office Properties, L.P. and Subsidiaries
Consolidated Statements of Cash Flows (Continued)
(in thousands)
(unaudited)

	For the Six Months Ended June 30,	
	2017	2016
Reconciliation of net income (loss) to net cash provided by operating activities:		
Net income (loss)	\$42,295	\$(40,220)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	66,948	68,901
Impairment losses	1,618	72,138
(Gain) loss on interest rate derivatives	(9	) 1,870
Amortization of deferred financing costs and net debt discounts	2,613	2,998
Decrease (increase) in deferred rent receivable	669	(1,276)
Gain on sales of real estate	(4,250) —
Share-based compensation	2,820	3,839
Other	(2,548	) (1,725)
Operating changes in assets and liabilities:		
Increase in accounts receivable	(8,304	) (3,320)
Decrease (increase) in restricted cash and marketable securities	534	(1,106)
Decrease in prepaid expenses and other assets, net	20,800	11,303
(Decrease) increase in accounts payable, accrued expenses and other liabilities	(1,095	) 16,111
Decrease in rents received in advance and security deposits	(4,354	) (5,113)
Net cash provided by operating activities	\$117,737	\$124,400
Supplemental schedule of non-cash investing and financing activities:		
(Decrease) increase in accrued capital improvements, leasing and other investing activity costs	\$(4,927	) \$1,604
Increase in property in connection with capital lease obligation	\$16,127	\$—
Increase in property and redeemable noncontrolling interests in connection with property contributed in a joint venture	\$—	\$22,600
Decrease in redeemable noncontrolling interests and increase in other liabilities in connection with distribution payable to redeemable noncontrolling interest	\$—	\$6,675
Increase (decrease) in fair value of derivatives applied to accumulated other comprehensive loss and noncontrolling interests	\$513	\$(15,268)
Equity in other comprehensive income (loss) of an equity method investee	\$39	\$(184)
Distributions payable	\$28,462	\$30,219
Increase in redeemable noncontrolling interest and decrease in equity to carry redeemable noncontrolling interest at fair value	\$401	\$349

See accompanying notes to consolidated financial statements.

Corporate Office Properties Trust and Subsidiaries and Corporate Office Properties, L.P. and Subsidiaries
Notes to Consolidated Financial Statements
(unaudited)

1. Organization

Corporate Office Properties Trust (“COPT”) and subsidiaries (collectively, the “Company”) is a fully-integrated and self-managed real estate investment trust (“REIT”). Corporate Office Properties, L.P. (“COPLP”) and subsidiaries (collectively, the “Operating Partnership”) is the entity through which COPT, the sole general partner of COPLP, conducts almost all of its operations and owns almost all of its assets. Unless otherwise expressly stated or the context otherwise requires, “we”, “us” and “our” as used herein refer to each of the Company and the Operating Partnership. We own, manage, lease, develop and selectively acquire office and data center properties. The majority of our portfolio is in locations that support the United States Government and its contractors, most of whom are engaged in national security, defense and information technology (“IT”) related activities servicing what we believe are growing, durable priority missions (“Defense/IT Locations”). We also own a portfolio of office properties located in select urban/urban-like submarkets within our regional footprint with durable Class-A office fundamentals and characteristics, as well as other properties supporting general commercial office tenants (“Regional Office”). As of June 30, 2017, our properties included the following:

- 165 operating office properties totaling 17.3 million square feet, including 14 triple-net leased, single-tenant data center properties. We owned six of these properties through an unconsolidated real estate joint venture; ten office properties under construction or redevelopment that we estimate will total approximately 1.4 million square feet upon completion, including three partially operational properties and two properties completed but held for future lease to the United States Government;
- 987 acres of land we controlled for future development that we believe could be developed into approximately 12.5 million square feet and an additional 194 acres of other land; and
- a wholesale data center with a critical load of 19.25 megawatts.

COPLP owns real estate directly and through subsidiary partnerships and limited liability companies (“LLCs”). In addition to owning real estate, COPLP also owns subsidiaries that provide real estate services such as property management and construction and development services primarily for our properties but also for third parties. Some of these services are performed by a taxable REIT subsidiary (“TRS”).

Equity interests in COPLP are in the form of common and preferred units. As of June 30, 2017, COPT owned 96.7% of the outstanding COPLP common units (“common units”) and none of the outstanding COPLP preferred units (“preferred units”); the remaining common and preferred units in COPLP were owned by third parties. Common units in COPLP not owned by COPT carry certain redemption rights. The number of common units in COPLP owned by COPT is equivalent to the number of outstanding common shares of beneficial interest (“common shares”) of COPT, and the entitlement of all COPLP common units to quarterly distributions and payments in liquidation is substantially the same as those of COPT common shareholders. Similarly, in the case of any series of preferred units in COPLP held by COPT, there is a series of preferred shares of beneficial interest (“preferred shares”) in COPT that is equivalent in number and carries substantially the same terms as such series of COPLP preferred units. COPT’s common shares are publicly traded on the New York Stock Exchange (“NYSE”) under the ticker symbol “OFC”.

Because COPLP is managed by COPT, and COPT conducts substantially all of its operations through COPLP, we refer to COPT’s executive officers as COPLP’s executive officers, and although, as a partnership, COPLP does not have a board of trustees, we refer to COPT’s Board of Trustees as COPLP’s Board of Trustees.

2. Summary of Significant Accounting Policies

Basis of Presentation

The COPT consolidated financial statements include the accounts of COPT, the Operating Partnership, their subsidiaries and other entities in which COPT has a majority voting interest and control. The COPLP consolidated financial statements include the accounts of COPLP, its subsidiaries and other entities in which COPLP has a majority voting interest and control. We also consolidate certain entities when control of such entities can be achieved through means other than voting rights (“variable interest entities” or “VIEs”) if we are deemed to be the primary beneficiary of such entities. We eliminate all intercompany balances and transactions in consolidation.

We use the equity method of accounting when we own an interest in an entity and can exert significant influence over but cannot control the entity's operations. We discontinue equity method accounting if our investment in an entity (and net advances) is reduced to zero unless we have guaranteed obligations of the entity or are otherwise committed to provide further financial support for the entity.

We use the cost method of accounting when we own an interest in an entity and cannot exert significant influence over its operations.

These interim financial statements should be read together with the consolidated financial statements and notes thereto as of and for the year ended December 31, 2016 included in our 2016 Annual Report on Form 10-K. The unaudited consolidated financial statements include all adjustments that are necessary, in the opinion of management, to fairly state our financial position and results of operations. All adjustments are of a normal recurring nature. The consolidated financial statements have been prepared using the accounting policies described in our 2016 Annual Report on Form 10-K.

Reclassification

We reclassified certain amounts from prior periods to conform to the current period presentation of our consolidated financial statements with no effect on previously reported net income or equity.

Recent Accounting Pronouncements

We adopted guidance issued by the Financial Accounting Standards Board ("FASB") effective January 1, 2017 intended to simplify various aspects related to the accounting and presentation for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the consolidated statement of cash flows. In connection with our adoption of this policy, we made an entity-wide accounting policy election to continue to account for potential future award forfeitures by estimating the number of awards that are expected to vest. Our adoption of this guidance did not have a material impact on our consolidated financial statements.

We adopted guidance issued by the FASB prospectively effective January 1, 2017 that clarifies the definition of a business used by entities in determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill and consolidation. Under the new guidance it is expected that the majority of our future operating property acquisitions will be accounted for as asset acquisitions, whereas under the previous guidance our recent acquisitions were accounted for as business combinations; we believe that the primary effect of this change will be that transaction costs associated with future acquisitions will be capitalized rather than expensed as incurred. This guidance had no effect on our consolidated financial statements upon adoption.

In May 2014, the FASB issued guidance regarding the recognition of revenue from contracts with customers. Under this guidance, an entity will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance also requires improved disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Also in connection with this guidance, in 2017, the FASB issued additional guidance, including guidance clarifying the scope of asset derecognition provisions and accounting for partial sales of nonfinancial assets. While we are still completing our assessment of the impact of the guidance, below is a summary of the anticipated primary effects on our accounting and reporting.

-

Construction contract revenue: We reviewed our historical construction management arrangements and related contracts. Based on this review, we believe that we will account for these arrangements using the percentage of completion method, which is the method we have used in most cases historically. We do not currently believe that the resulting effect of the change will be material.

Sales of real estate: The new guidance requires recognition of a sale of real estate and resulting gain or loss when control transfers and the buyer has the ability to direct use of, or obtain substantially all of the remaining benefit from, the asset (which generally will occur on the closing date); the factor of continuing involvement is no longer a specific consideration for the timing of recognition. The new guidance eliminates the need to consider adequacy of buyer investment, which was replaced by additional judgments regarding collectability and intent and/or ability to pay. The new guidance also requires an entity to derecognize nonfinancial assets and in substance non financial assets once it transfers control of such assets. When an entity transfers its controlling interest in a nonfinancial asset, but retains a noncontrolling ownership interest, the entity is required to measure any non-controlling interest it receives or retains at fair value and recognize a full gain or loss on the transaction; as a result, sales and partial sales of real estate assets will now be subject to the same derecognition

model as all other nonfinancial assets. Since all but one of our sale transactions previously met the criteria for immediate gain recognition under existing guidance, we do not believe that the recognition pattern for these transactions will be changed by the new guidance. Our one sale transaction that did not meet the criteria for immediate full recognition under the previous standard was our contribution of data center properties into a newly-formed joint venture in July 2016, as discussed further in our 2016 Annual Report on Form 10-K. We believe that this transaction, which was accounted for as a partial sale under existing guidance, would meet the criteria for immediate full gain recognition under the new guidance; this would result in an additional \$18 million in income being recognizable in 2016 under the new guidance that is currently being amortized into income in subsequent periods under existing guidance.

Real estate revenue associated with executory costs and other non-lease components: Once the new guidance setting forth principles for the recognition, measurement, presentation and disclosure of leases (discussed below) goes into effect, we believe that the new revenue standard may apply to executory costs and other components of revenue due under leases that are deemed to be non-lease components (such as common area maintenance and provision of utilities), even when the revenue for such activities is not separately stipulated in the lease. In that case, then revenue from these items previously recognized on a straight-line basis under current lease guidance would be recognized under the new revenue guidance as the related services are delivered. As a result, while the total revenue recognized over time would not differ under the new guidance, the recognition pattern could be different. We are in the process of evaluating the significance of the difference in the recognition pattern that would result from this change.

We are required to adopt this guidance for our annual and interim periods beginning January 1, 2018 using one of two methods: retrospective restatement for each reporting period presented at the time of adoption, or retrospectively with the cumulative effect of initially applying this guidance recognized at the date of initial application. We have not decided which method of adoption we will use.

In February 2016, the FASB issued guidance that sets forth principles for the recognition, measurement, presentation and disclosure of leases. This guidance requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase of the leased asset by the lessee. The resulting classification determines whether the lease expense is recognized based on an effective interest method or straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases. The guidance requires lessors of real estate to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. While we are still completing our assessment of the impact of this guidance, below is a summary of the anticipated primary effects of this guidance on our accounting and reporting.

Real estate leases in which we are the lessor:

Balance sheet reporting: We believe that we will apply an approach under the new guidance that is similar to the current accounting for operating leases, in which we will continue to recognize the underlying leased asset as property on our balance sheet.

Deferral of compensation-related lease costs: Under the new lease guidance, lessors may only capitalize their incremental direct costs of leasing. As a result, we believe that we will no longer be able to defer the recognition of compensation-related costs in connection with new or extended tenant leases (refer to amounts reported in our 2016 Annual Report on Form 10-K for amounts deferred in 2014, 2015 and 2016).

Lease revenue reporting: As discussed in further detail above in connection with the new revenue guidance, we believe that the new revenue standard may apply to executory costs and other components of revenue deemed to be non-lease components (such as common area maintenance and provision of utilities), even when the revenue for such activities is not separately stipulated in the lease. In that case, we would need to separate the lease components of revenue due under leases from the non-lease components. Under the new guidance, we would continue to recognize

the lease components of lease revenue on a straight-line basis over our respective lease terms as we do under prior guidance. However, we would recognize the non-lease components under the new revenue guidance as the related services are delivered. As discussed above, we are in the process of evaluating the significance of the difference in the recognition pattern that would result from this change.

Leases in which we are the lessee:

Our most significant leases as lessee are ground leases we have for certain properties; as of June 30, 2017, our future minimum rental payments under these leases totaled \$90.4 million, with various expiration dates extending to the year 2100. While we are still in the process of evaluating these leases under the new guidance, we believe that we will be required to recognize a right-of-use asset and a lease liability for the present value of these minimum lease payments. We believe that these leases most likely will be classified as finance leases under the new guidance; as a result, the interest component of each lease payment would be recorded as interest expense and the right-of-use asset would be amortized into expense using the straight-line method over the life of the lease.

This guidance is effective for reporting periods beginning January 1, 2019, with modified retrospective restatement for each reporting period presented at the time of adoption. Early adoption is also permitted for this guidance.

In June 2016, the FASB issued guidance that changes how entities measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. The guidance replaces the current incurred loss model with an expected loss approach, resulting in a more timely recognition of such losses. The guidance will apply to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans, held-to-maturity debt securities, net investments in leases, and off-balance-sheet credit exposures (e.g. loan commitments). Under the new guidance, an entity will recognize its estimate of expected credit losses as an allowance, as the guidance requires that financial assets be measured on an amortized cost basis and to be presented at the net amount expected to be collected. The guidance is effective for us beginning January 1, 2020, with early adoption permitted after December 2018. We are currently assessing the financial impact of this guidance on our consolidated financial statements.

In August 2016, the FASB issued guidance that clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flows with the objective of reducing the existing diversity in practice related to eight specific cash flow issues. The areas addressed in the new guidance relate to debt prepayment costs, settlement of zero-coupon debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned and bank-owned life insurance policies, distributions received from equity method investments, beneficial interest in securitization transactions and separately identifiable cash flows and application of the predominance principle. The guidance is effective for us beginning January 1, 2018, with early adoption permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In November 2016, the FASB issued guidance that requires the statement of cash flows to explain the change during the period in the total of cash, cash equivalents and amounts described as restricted cash or restricted cash equivalents. Under the new guidance, amounts described as restricted cash and restricted cash equivalents will be included with cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown on the statement of cash flows. The guidance is effective for us beginning January 1, 2018, with early adoption permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

3. Fair Value Measurements

Recurring Fair Value Measurements

COPT has a non-qualified elective deferred compensation plan for Trustees and certain members of our management team that permits participants to defer up to 100% of their compensation on a pre-tax basis and receive a tax-deferred return on such deferrals. The assets held in the plan (comprised primarily of mutual funds and equity securities) and the corresponding liability to the participants are measured at fair value on a recurring basis on COPT's consolidated balance sheet using quoted market prices, as are other marketable securities that we hold. The balance of the plan, which was fully funded, totaled \$4.1 million as of June 30, 2017, and is included in the accompanying COPT consolidated balance sheets in the line entitled restricted cash and marketable securities. The offsetting liability associated with the plan 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 on COPT's consolidated balance sheets. The assets of the plan and other marketable securities that we hold are classified in Level 1 of the fair value hierarchy. The liability associated with the plan is classified in Level 2 of the fair value hierarchy.

The fair values of our interest rate derivatives are determined using widely accepted valuation techniques, including a 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, the credit valuation adjustments associated with our interest rate derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default. However, as of June 30, 2017, 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. As a result, we determined that our interest rate derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, other assets (excluding investing receivables) and accounts payable and accrued expenses are reasonable estimates of their fair values because of the short maturities of these instruments. As discussed in Note 6, we estimated the fair values of our investing receivables based on the discounted estimated future cash flows of the loans (categorized within Level 3 of the fair value hierarchy); the discount rates

used approximate current market rates for loans with similar maturities and credit quality, and the estimated cash payments include scheduled principal and interest payments. For our disclosure of debt fair values in Note 8, we estimated the fair value of our unsecured senior notes based on quoted market rates for publicly-traded debt (categorized within Level 2 of the fair value hierarchy) and estimated the fair value of our other debt based on the discounted estimated future cash payments to be made on such debt (categorized within Level 3 of the fair value hierarchy); the discount rates used approximate current market rates for loans, or groups of loans, with similar maturities and credit quality, and the estimated future payments include scheduled principal and interest payments. Fair value estimates are made as of a specific point in time, are subjective in nature and involve uncertainties and matters of significant judgment. Settlement at such fair value amounts may not be possible and may not be a prudent management decision.

For additional fair value information, please refer to Note 6 for investing receivables, Note 8 for debt and Note 9 for interest rate derivatives.

COPT and Subsidiaries

The table below sets forth financial assets and liabilities of COPT and its subsidiaries that are accounted for at fair value on a recurring basis as of June 30, 2017 and the hierarchy level of inputs used in measuring their respective fair values under applicable accounting standards (in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Marketable securities in deferred compensation plan (1)				
Mutual funds	\$ 4,074	\$ —	\$ —	\$ 4,074
Other	71	—	—	71
Interest rate derivatives (2)	—	117	—	117
Total assets	\$ 4,145	\$ 117	\$ —	\$ 4,262
Liabilities:				
Deferred compensation plan liability (3)	\$ —	\$ 4,145	\$ —	\$ 4,145
Interest rate derivatives (3)	—	601	—	601
Total liabilities	\$ —	\$ 4,746	\$ —	\$ 4,746

(1) Included in the line entitled “restricted cash and marketable securities” on COPT’s consolidated balance sheet.

(2) Included in the line entitled “prepaid expenses and other assets” on COPT’s consolidated balance sheet.

(3) Included in the line entitled “other liabilities” on COPT’s consolidated balance sheet.

COPLP and Subsidiaries

The table below sets forth financial assets and liabilities of COPLP and its subsidiaries that are accounted for at fair value on a recurring basis as of June 30, 2017 and the hierarchy level of inputs used in measuring their respective fair values under applicable accounting standards (in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Interest rate derivatives (1)	\$ —	\$ 117	\$ —	\$ 117
Liabilities:				

Interest rate derivatives (2) \$ — \$ 601 \$ — \$601

(1) Included in the line entitled “prepaid expenses and other assets” on COPLP’s consolidated balance sheet.

(2) Included in the line entitled “other liabilities” on COPLP’s consolidated balance sheet.

Nonrecurring Fair Value Measurements

As part of our closing process for the first quarter of 2017, we conducted our quarterly review of our portfolio for indicators of impairment and found there to be no impairment losses.

As part of our closing process for the second quarter of 2017, we conducted our quarterly review of our portfolio for indicators of impairment. Further, we performed recoverability analyses for our properties classified as held for sale, which resulted in impairment losses of \$1.6 million. These impairment losses were primarily on properties in White Marsh, Maryland (“White Marsh”) (included in our Regional Office and Other segments) that we reclassified to held for sale during the period and adjusted to fair value less costs to sell.

Changes in the expected future cash flows due to changes in our plans for specific properties (especially our expected holding period) could result in the recognition of impairment losses. In addition, because properties held for sale are carried at the lower of carrying value or estimated fair values less costs to sell, declines in their estimated fair values due to market conditions and other factors could result in the recognition of impairment losses.

The table below sets forth the fair value hierarchy of the valuation technique we used to determine nonrecurring fair value measurements of properties held for sale as of June 30, 2017 (dollars in thousands):

Description	Fair Values as of June 30, 2017			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Assets:				
Assets held for sale, net	\$—	—	\$ 50,003	\$50,003

The table below sets forth quantitative information about significant unobservable inputs used for the Level 3 fair value measurements reported above as of June 30, 2017 (dollars in thousands):

Valuation Technique	Fair Values on Measurement Date	Unobservable Input	Range (Weighted Average)
Discounted cash flow	\$ 47,537	Discount rate	9.0% - 10.5% (9.2%)
		Terminal capitalization rate	8.0% - 9.0% (8.1%)
Yield analyses	\$ 2,466	Investor yield requirement	9.0% (1)

(1) Only one fair value applied for this unobservable input.

4. Properties, Net

Operating properties, net consisted of the following (in thousands):

	June 30, 2017	December 31, 2016
Land	\$432,617	\$433,311
Buildings and improvements	3,010,765	2,944,905
Less: Accumulated depreciation	(755,208)	(706,385)
Operating properties, net	\$2,688,174	\$2,671,831

Projects in development or held for future development consisted of the following (in thousands):

	June 30, 2017	December 31, 2016
Land	\$225,965	\$ 195,521
Development in progress, excluding land	220,420	206,010
Projects in development or held for future development	\$446,385	\$ 401,531

Our properties held for sale included:

as of June 30, 2017: eight operating properties in White Marsh (included in our Regional Office and Other segments); one operating property in our Fort Meade/BW Corridor sub-segment; and land in White Marsh; and
as of December 31, 2016: eight operating properties in White Marsh (included primarily in our Regional Office segment); one operating property in our Northern Virginia Defense/IT sub-segment; and land in White Marsh and Northern Virginia.

20

The table below sets forth the components of assets held for sale on our consolidated balance sheet for these properties (in thousands):

	June 30, December 31,	
	2017	2016
Properties, net	\$47,397	\$ 85,402
Deferred rent receivable	1,831	4,241
Intangible assets on real estate acquisitions, net	338	338
Deferred leasing costs, net	1,326	3,636
Lease incentives, net	399	1,037
Assets held for sale, net	\$51,291	\$ 94,654

2017 Dispositions

On February 15, 2017, we completed the disposition of 3120 Fairview Park Drive, an operating property totaling 190,000 square feet in Falls Church, Virginia (in our Northern Virginia Defense/IT sub-segment), for \$39.0 million, with no gain recognized.

On June 9, 2017, we completed the disposition of 1334 Ashton Road, an operating property totaling 37,000 square feet in Hanover, Maryland (in our Fort Meade/BW Corridor sub-segment), for \$2.3 million, with no gain recognized.

We also sold land in the six months ended June 30, 2017 for \$14.3 million and recognized a gain on sale of \$4.2 million.

On July 28, 2017, we completed the disposition of our remaining assets in White Marsh (in our Regional Office and Other segments), including eight operating properties totaling 412,000 square feet, and land, for \$47.5 million.

2017 Construction Activities

During the six months ended June 30, 2017, we placed into service 295,000 square feet in three newly constructed properties (including a partially operational property) and 88,000 square feet in three redeveloped properties (including two partially operational properties). As of June 30, 2017, we had eight office properties under construction, or for which we were contractually committed to construct, that we estimate will total 1.3 million square feet upon completion (including two properties completed but held for future lease to the United States Government) and two office properties under redevelopment that we estimate will total 61,000 square feet upon completion.

5. Real Estate Joint Ventures

Consolidated Joint Ventures

The table below sets forth information pertaining to our investments in consolidated real estate joint ventures as of June 30, 2017 (dollars in thousands):

	Date Acquired	Nominal Ownership % as of 6/30/2017	Nature of Activity	June 30, 2017 (1)		
				Total Assets	Encumbered Assets	Total Liabilities
LW Redstone Company, LLC	3/23/2010	85%	Development and operation of real estate (2)	\$ 157,624	\$ 77,269	\$ 50,225
	6/26/2007	50%		67,789	45,756	46,580

Edgar Filing: CORPORATE OFFICE PROPERTIES TRUST - Form 10-Q

M Square Associates, LLC	Development and operation of real estate (3)			
Stevens Investors, LLC 8/11/2015 95%	Development of real estate (4)	62,382	—	22,953
		\$287,795	\$ 123,025	\$ 119,758

(1) Excludes amounts eliminated in consolidation.

(2) This joint venture's properties are in Huntsville, Alabama.

(3) This joint venture's properties are in College Park, Maryland.

(4) This joint venture's property is in Washington, DC. Our partner in this joint venture is entitled to receive an additional distribution from the joint venture of \$6.7 million that was reported in other liabilities on our consolidated balance sheet as of June 30, 2017 and paid in July 2017.

Unconsolidated Joint Venture

As of June 30, 2017, we owned a 50% interest in GI-COPT DC Partnership LLC (“GI-COPT”), a joint venture owning six triple-net leased, single-tenant data center properties in Virginia, that we account for using the equity method of accounting. As of June 30, 2017, we had an investment balance in GI-COPT of \$25.3 million. Our balance was \$17.4 million lower than our share of the joint venture’s equity due to a difference between our cost basis and our share of the underlying equity in the net assets upon formation of the joint venture; we are amortizing this basis difference into equity in income from unconsolidated entities over the lives of the underlying assets.

6. Investing Receivables

Investing receivables, including accrued interest thereon, consisted of the following (in thousands):

	June 30, December 31,	
	2017	2016
Notes receivable from the City of Huntsville	\$51,578	\$ 49,258
Other investing loans receivable	3,020	3,021
	\$54,598	\$ 52,279

Our notes receivable from the City of Huntsville funded infrastructure costs in connection with our LW Redstone Company, LLC joint venture (see Note 5) and carry an interest rate of 9.95%.

We did not have an allowance for credit losses in connection with our investing receivables as of June 30, 2017 or December 31, 2016. The fair value of these receivables approximated their carrying amounts as of June 30, 2017 and December 31, 2016.

7. Prepaid Expenses and Other Assets, Net

Prepaid expenses and other assets, net consisted of the following (in thousands):

	June 30, December 31,	
	2017	2016
Lease incentives, net	\$16,964	\$ 18,276
Prepaid expenses	11,972	24,432
Furniture, fixtures and equipment, net	5,303	5,204
Construction contract costs incurred in excess of billings	3,620	10,350
Deferred tax asset, net (1)	2,908	3,036
Non-real estate equity method investments	2,415	2,355
Deferred financing costs, net (2)	1,747	3,128
Other assets	4,418	5,983
Prepaid expenses and other assets, net	\$49,347	\$ 72,764

(1) Includes a valuation allowance of \$2.1 million.

(2) Represents deferred costs, net of accumulated amortization, attributable to our Revolving Credit Facility and interest rate derivatives.

8. Debt, Net

Our debt consisted of the following (dollars in thousands):

	Carrying Value (1) as of		Stated Interest Rates as of June 30, 2017	Scheduled Maturity as of June 30, 2017
	June 30, 2017	December 31, 2016		
Mortgage and Other Secured Debt:				
Fixed rate mortgage debt (2)	\$ 152,449	\$ 154,143	3.82% - 7.87% (3)	2019-2026
Variable rate secured debt	13,283	13,448	LIBOR + 1.85% (4)	October 2020
Total mortgage and other secured debt	165,732	167,591		
Revolving Credit Facility	194,000	—	LIBOR + 0.875% to 1.60% (5)	May 2019
Term Loan Facilities (6)	348,283	547,494	LIBOR + 0.90% to 2.40% (7)	2020-2022
Unsecured Senior Notes				
3.600%, \$350,000 aggregate principal	347,338	347,128	3.60% (8)	May 2023
5.250%, \$250,000 aggregate principal	246,408	246,176	5.25% (9)	February 2024
3.700%, \$300,000 aggregate principal	298,080	297,843	3.70% (10)	June 2021
5.000%, \$300,000 aggregate principal	296,547	296,368	5.00% (11)	July 2025
Unsecured notes payable	1,346	1,401	0% (12)	2026
Total debt, net	\$ 1,897,734	\$ 1,904,001		

(1) The carrying values of our debt other than the Revolving Credit Facility reflect net deferred financing costs of \$5.0 million as of June 30, 2017 and \$6.1 million as of December 31, 2016.

(2) Certain fixed rate mortgages carry interest rates that were above or below market rates upon assumption and therefore were recorded at their fair value based on applicable effective interest rates. The carrying values of these loans reflect net unamortized premiums totaling \$385,000 as of June 30, 2017 and \$422,000 as of December 31, 2016.

(3) The weighted average interest rate on our fixed rate mortgage debt was 4.19% as of June 30, 2017.

(4) The interest rate on our variable rate secured debt as of June 30, 2017 was 2.90%.

(5) The weighted average interest rate on the Revolving Credit Facility was 2.39% as of June 30, 2017.

(6) As of June 30, 2017, we have the ability to borrow an additional \$350.0 million in the aggregate under these term loan facilities, provided that there is no default under the facilities and subject to the approval of the lenders. On May 1, 2017, we repaid \$200.0 million of the loan balance on a term loan scheduled to mature in 2020.

(7) The weighted average interest rate on these loans was 2.75% as of June 30, 2017.

(8) The carrying value of these notes reflects an unamortized discount totaling \$1.8 million as of June 30, 2017 and \$2.0 million as of December 31, 2016. The effective interest rate under the notes, including amortization of the issuance costs, was 3.70%.

(9) The carrying value of these notes reflects an unamortized discount totaling \$3.2 million as of June 30, 2017 and \$3.4 million as of December 31, 2016. The effective interest rate under the notes, including amortization of the issuance costs, was 5.49%.

(10) The carrying value of these notes reflects an unamortized discount totaling \$1.5 million as of June 30, 2017 and \$1.7 million as of December 31, 2016. The effective interest rate under the notes, including amortization of the

issuance costs, was 3.85%.

(11) The carrying value of these notes reflects an unamortized discount totaling \$2.9 million as of June 30, 2017 and \$3.0 million as of December 31, 2016. The effective interest rate under the notes, including amortization of the issuance costs, was 5.15%.

(12) These notes carry interest rates that were below market rates upon assumption and therefore were recorded at their fair value based on applicable effective interest rates. The carrying value of these notes reflects an unamortized discount totaling \$416,000 as of June 30, 2017 and \$460,000 as of December 31, 2016.

All debt is owed by the Operating Partnership. While COPT is not directly obligated by any debt, it has guaranteed the Operating Partnership's Revolving Credit Facility, Term Loan Facilities and Unsecured Senior Notes.

Certain of our debt instruments require that we comply with a number of restrictive financial covenants. As of June 30, 2017, we were compliant with these covenants.

We capitalized interest costs of \$1.6 million in the three months ended June 30, 2017, \$1.3 million in the three months ended June 30, 2016, \$3.1 million in the six months ended June 30, 2017 and \$3.1 million in the six months ended June 30, 2016.

The following table sets forth information pertaining to the fair value of our debt (in thousands):

	June 30, 2017		December 31, 2016	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Fixed-rate debt				
Unsecured Senior Notes	\$1,188,373	\$1,229,354	\$1,187,515	\$1,220,282
Other fixed-rate debt	153,795	155,581	155,544	156,887
Variable-rate debt	555,566	552,782	560,942	558,437
	\$1,897,734	\$1,937,717	\$1,904,001	\$1,935,606

9. Interest Rate Derivatives

The following table sets forth the key terms and fair values of our interest rate swap derivatives, each of which was designated as a cash flow hedge of interest rate risk (dollars in thousands):

Notional Amount	Fixed Rate	Floating Rate Index	Effective Date	Expiration Date	Fair Value at	
					June 30, 2017	December 31, 2016
\$100,000	1.7300%	One-Month LIBOR	9/1/2015	8/1/2019	\$(408)	\$(848)
13,402	(1) 1.3900%	One-Month LIBOR	10/13/2015	10/1/2020	117	100
100,000	1.9013%	One-Month LIBOR	9/1/2016	12/1/2022	(79)	(23)
100,000	1.9050%	One-Month LIBOR	9/1/2016	12/1/2022	(68)	48
50,000	1.9079%	One-Month LIBOR	9/1/2016	12/1/2022	(46)	10
100,000	(2) 1.6730%	One-Month LIBOR	9/1/2015	8/1/2019	—	(701)
					\$(484)	\$(1,414)

(1) The notional amount of this instrument is scheduled to amortize to \$12.1 million.

We cash settled this derivative and interest accrued thereon for \$460,000 on May 1, 2017. Since the hedged transactions associated with this derivative were still probable to occur as of the settlement date, amounts in accumulated other comprehensive loss (“AOCL”) associated with this derivative will be reclassified to interest expense through August 2019.

The table below sets forth the fair value of our interest rate derivatives as well as their classification on our consolidated balance sheets (in thousands):

Derivatives	Balance Sheet Location	Fair Value at	
		June 30, 2017	December 31, 2016
Interest rate swaps designated as cash flow hedges	Prepaid expenses and other assets	\$117	\$158
Interest rate swaps designated as cash flow hedges	Other liabilities	(601)	(1,572)

The table below presents the effect of our interest rate derivatives on our consolidated statements of operations and comprehensive income (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Unrealized loss recognized in AOCL (effective portion)	\$(1,800)	\$(5,704)	\$(1,576)	\$(16,988)
Loss reclassified from AOCL into interest expense (effective portion)	(853)	(850)	(2,037)	(1,720)
	(356)	(319)	98	(1,870)

(Loss) gain on derivatives recognized in interest expense (ineffective portion)

Loss reclassified from AOCL into interest expense (ineffective portion) (1) (88) — (88) —

Represents a loss recognized on certain interest rate swaps from the accelerated reclassification of amounts in (1)AOCL in the three and six months ended June 30, 2017, when we concluded that hedged forecasted transactions were probable not to occur.

Over the next 12 months, we estimate that approximately \$1.9 million of losses will be reclassified from AOCL as an increase to interest expense.

We have agreements with each of our interest rate derivative counterparties that contain provisions under which, if we default or are capable of being declared in default on defined levels of our indebtedness, we could also be declared in default on our derivative obligations. Failure to comply with the loan covenant provisions could result in our being declared in default on any derivative instrument obligations covered by the agreements. As of June 30, 2017, the fair value of interest rate derivatives in a liability position related to these agreements was \$591,000, excluding the effects of accrued interest and credit valuation adjustments. As of June 30, 2017, we had not posted any collateral related to these agreements. We are not in default with any of these provisions. If we breached any of these provisions, we could be required to settle our obligations under the agreements at their termination value of \$822,000.

10. Redeemable Noncontrolling Interests

Our partners in two real estate joint ventures, LW Redstone Company, LLC and Stevens Investors, LLC (discussed further in Note 5), have the right to require us to acquire their respective interests at fair value; accordingly, we classify the fair value of our partners' interests as redeemable noncontrolling interests in the mezzanine section of our consolidated balance sheet. We determine the fair value of the interests based on unobservable inputs after considering the assumptions that market participants would make in pricing the interest. We apply a discount rate to the estimated future cash flows allocable to our partners from the properties underlying the respective joint ventures. Estimated cash flows used in such analyses are based on our plans for the properties and our views of market and economic conditions, and consider items such as current and future rental rates, occupancies for the properties and comparable properties and estimated operating and capital expenditures. The table below sets forth the activity for these redeemable noncontrolling interests (in thousands):

	For the Six Months Ended June 30,	
	2017	2016
Beginning balance	\$22,979	\$19,218
Contributions from noncontrolling interests	—	22,778
Distributions to noncontrolling interests	(789)	(20,989)
Net income attributable to noncontrolling interests	1,140	1,117
Adjustment to arrive at fair value of interests	401	349
Ending balance	\$23,731	\$22,473

11. Equity

During the six months ended June 30, 2017, COPT redeemed all of the outstanding shares of its following series of preferred shares:

the 5.600% Series K Cumulative Redeemable Preferred Shares (the "Series K Preferred Shares"), redeemed effective January 21, 2017 at a price of \$50.00 per share, or \$26.6 million in the aggregate, plus accrued and unpaid dividends thereon through the date of redemption. Concurrently with this redemption, COPLP redeemed its Series K Preferred Units on the same terms. Since we made an irrevocable notification to holders of the Series K Preferred Shares in December 2016 of our intention to redeem such shares, we presented the liquidation preference of the shares/units as a liability on the consolidated balance sheets of COPT and COPLP as of December 31, 2016; we also recognized a \$17,000 decrease to net income available to common shareholders/unitholders in the three months ended December 31, 2016 pertaining to the original issuance costs incurred on the shares/units; and

the 7.375% Series L Cumulative Preferred Shares (the "Series L Preferred Shares"), redeemed effective June 27, 2017 at a price of \$25.00 per share, or \$172.5 million in the aggregate, plus accrued and unpaid dividends thereon up to but

not including the date of redemption. Concurrently with this redemption, COPLP redeemed its Series L Preferred Units on the same terms. We also recognized a \$6.8 million decrease to net income available to common shareholders/unitholders in the three months ended June 30, 2017 pertaining to the original issuance costs incurred on the shares/units.

During the six months ended June 30, 2017, COPT issued 591,042 common shares at a weighted average price of \$33.84 per share under its existing at-the-market (“ATM”) stock offering program. Net proceeds from the shares issued totaled \$19.7 million, after payment of \$300,000 in commissions to sales agents. COPT contributed the net proceeds from these issuances to COPLP in exchange for an equal number of units in COPLP. COPT’s remaining capacity under this ATM program is an aggregate gross sales price of \$70.0 million in common share sales.

During the six months ended June 30, 2017, certain COPLP limited partners converted 187,000 common units in COPLP for an equal number of common shares in COPT.

See Note 13 for disclosure of COPT common share and COPLP common unit activity pertaining to our share-based compensation plans.

12. Information by Business Segment

We have the following reportable segments: Defense/IT Locations; Regional Office; our operating wholesale data center; and other. We also report on Defense/IT Locations sub-segments, which include the following: Fort George G. Meade and the Baltimore/Washington Corridor (referred to herein as “Fort Meade/BW Corridor”); Northern Virginia Defense/IT Locations; Lackland Air Force Base (in San Antonio); locations serving the U.S. Navy (“Navy Support Locations”), which included properties proximate to the Washington Navy Yard, the Naval Air Station Patuxent River in Maryland and the Naval Surface Warfare Center Dahlgren Division in Virginia; Redstone Arsenal (in Huntsville); and data center shells (properties leased to tenants to be operated as data centers in which the tenants generally fund the costs for the power, fiber connectivity and data center infrastructure). We measure the performance of our segments through the measure we define as net operating income from real estate operations (“NOI from real estate operations”), which includes: real estate revenues and property operating expenses; and the net of revenues and property operating expenses of real estate operations owned through unconsolidated real estate joint ventures (“UJVs”) that is allocable to COPT’s ownership interest (“UJV NOI allocable to COPT”). Amounts reported for segment assets represent long-lived assets associated with consolidated operating properties (including the carrying value of properties, intangible assets, deferred leasing costs, deferred rents receivable and lease incentives) and the carrying value of investments in UJVs owning operating properties. Amounts reported as additions to long-lived assets represent additions to existing consolidated operating properties, excluding transfers from non-operating properties, which we report separately.

The table below reports segment financial information for our reportable segments (in thousands):

	Operating Office Property Segments									
	Defense/Information Technology Locations									
	Fort Meade/BW Corridor	Northern Virginia Defense/IT	Lackland Air Force Base	Navy Support Locations	Redstone Arsenal	Data Center Shells	Total Defense/IT Locations	Regional Office	Operating Wholesale Data Center	Other
Three Months Ended June 30, 2017										
Revenues from real estate operations	\$61,284	\$11,095	\$13,029	\$7,449	\$3,624	\$5,800	\$102,281	\$17,462	\$7,033	\$1,000
Property operating expenses	(20,129)	(4,219)	(8,130)	(3,025)	(1,491)	(577)	(37,571)	(7,082)	(3,501)	(4,000)
UJV NOI allocable to COPT	—	—	—	—	—	1,294	1,294	—	—	—
NOI from real estate operations	\$41,155	\$6,876	\$4,899	\$4,424	\$2,133	\$6,517	\$66,004	\$10,380	\$3,532	\$1,000
Additions to long-lived assets	\$5,853	\$977	\$16	\$2,231	\$84	\$—	\$9,161	\$4,018	\$2,005	\$(1,000)
Transfers from non-operating properties	\$18,159	\$218	\$—	\$466	\$1,709	\$26,215	\$46,767	\$(25)	\$—	\$—

Edgar Filing: CORPORATE OFFICE PROPERTIES TRUST - Form 10-Q

Three Months Ended June 30, 2016											
Revenues from real estate operations	\$60,912	\$12,057	\$11,651	\$6,998	\$3,191	\$7,288	\$102,097	\$23,283	\$6,804	\$1	
Property operating expenses	(20,378)	(4,307)	(6,844)	(2,675)	(960)	(826)	(35,990)	(8,721)	(2,651)	(77)	
NOI from real estate operations	\$40,534	\$7,750	\$4,807	\$4,323	\$2,231	\$6,462	\$66,107	\$14,562	\$4,153	\$9	
Additions to long-lived assets	\$7,096	\$3,059	\$—	\$2,233	\$301	\$—	\$12,689	\$2,180	\$—	\$1	
Transfers from non-operating properties	\$768	\$27,944	\$231	\$—	\$4	\$29,857	\$58,804	\$26	\$(482)	\$—	
Six Months Ended June 30, 2017											
Revenues from real estate operations	\$122,139	\$22,802	\$24,663	\$14,459	\$7,084	\$11,322	\$202,469	\$35,738	\$13,803	\$3	
Property operating expenses	(40,649)	(8,671)	(14,932)	(6,234)	(2,862)	(1,236)	(74,584)	(14,568)	(6,866)	(1)	
UJV NOI allocable to COPT	—	—	—	—	—	2,592	2,592	—	—	—	
NOI from real estate operations	\$81,490	\$14,131	\$9,731	\$8,225	\$4,222	\$12,678	\$130,477	\$21,170	\$6,937	\$1	
Additions to long-lived assets	\$9,275	\$3,445	\$16	\$4,399	\$216	\$—	\$17,351	\$11,138	\$3,579	\$1	
Transfers from non-operating properties	\$31,575	\$440	\$—	\$466	\$1,705	\$25,200	\$59,386	\$(25)	\$8	\$1	
Segment assets at June 30, 2017	\$1,267,635	\$357,747	\$130,431	\$195,732	\$109,586	\$230,557	\$2,291,688	\$435,399	\$229,224	\$1	
Six Months Ended June 30, 2016											
Revenues from real	\$123,421	\$24,173	\$21,876	\$13,932	\$6,307	\$13,618	\$203,327	\$46,785	\$13,297	\$3	

Edgar Filing: CORPORATE OFFICE PROPERTIES TRUST - Form 10-Q

estate operations										
Property operating expenses	(43,624	) (8,848	) (12,264	) (6,199	) (1,938	) (1,636	) (74,509	) (18,552	) (5,312	) (1,
NOI from real estate operations	\$79,797	\$15,325	\$9,612	\$7,733	\$4,369	\$11,982	\$128,818	\$28,233	\$7,985	\$1,
Additions to long-lived assets	\$13,615	\$6,137	\$—	\$3,503	\$919	\$—	\$24,174	\$4,939	\$—	\$3
Transfers from non-operating properties	\$36,519	\$27,850	\$237	\$—	\$215	\$55,954	\$120,775	\$108	\$(431) \$(
Segment assets at June 30, 2016	\$1,305,769	\$424,441	\$133,359	\$195,195	\$106,810	\$256,276	\$2,421,850	\$594,750	\$237,226	\$3

27

The following table reconciles our segment revenues to total revenues as reported on our consolidated statements of operations (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Segment revenues from real estate operations	\$128,297	\$133,924	\$255,064	\$267,011
Construction contract and other service revenues	23,138	12,003	36,172	23,223
Total revenues	\$151,435	\$145,927	\$291,236	\$290,234

The following table reconciles UJV NOI allocable to COPT to equity in income of unconsolidated entities as reported on our consolidated statements of operations (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
UJV NOI allocable to COPT	\$1,294	\$—	\$2,592	\$—
Less: Income from UJV allocable to COPT attributable to depreciation and amortization expense and interest expense	(575)	—	(1,147)	—
Add: Equity in (loss) income of unconsolidated non-real estate entities	(1)	10	(2)	20
Equity in income of unconsolidated entities	\$718	\$10	\$1,443	\$20

As previously discussed, we provide real estate services such as property management and construction and development services primarily for our properties but also for third parties. The primary manner in which we evaluate the operating performance of our service activities is through a measure we define as net operating income from service operations (“NOI from service operations”), which is based on the net of revenues and expenses from these activities. Construction contract and other service revenues and expenses consist primarily of subcontracted costs that are reimbursed to us by the customer along with a management fee. The operating margins from these activities are small relative to the revenue. We believe NOI from service operations is a useful measure in assessing both our level of activity and our profitability in conducting such operations. The table below sets forth the computation of our NOI from service operations (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Construction contract and other service revenues	\$23,138	\$12,003	\$36,172	\$23,223
Construction contract and other service expenses	(22,315)	(11,478)	(34,801)	(22,172)
NOI from service operations	\$823	\$525	\$1,371	\$1,051

The following table reconciles our NOI from real estate operations for reportable segments and NOI from service operations to income from before gain on sales of real estate as reported on our consolidated statements of operations (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
NOI from real estate operations	\$80,963	\$85,783	\$160,509	\$166,995
NOI from service operations	823	525	1,371	1,051
Interest and other income	1,583	1,330	3,309	2,486
Equity in income of unconsolidated entities	718	10	1,443	20
Income tax (expense) benefit	(48)	(1)	(88)	7
Depreciation and other amortization associated with real estate operations	(32,793)	(33,248)	(65,852)	(67,775)
Impairment losses	(1,625)	(69,692)	(1,625)	(72,138)
General, administrative and leasing expenses	(7,859)	(8,026)	(16,470)	(19,909)
Business development expenses and land carry costs	(1,597)	(2,363)	(3,290)	(4,781)
Interest expense	(19,163)	(22,639)	(38,157)	(46,198)
Less: UJV NOI allocable to COPT included in equity in income of unconsolidated entities	(1,294)	—	(2,592)	—
(Loss) gain on early extinguishment of debt	(513)	5	(513)	22
Income (loss) before gain on sales of real estate	\$19,195	\$(48,316)	\$38,045	\$(40,220)

The following table reconciles our segment assets to the consolidated total assets of COPT and subsidiaries (in thousands):

	June 30, 2017	June 30, 2016
Segment assets	\$2,975,661	\$3,289,117
Non-operating property assets	452,824	413,597
Other assets	146,402	138,978
Total COPT consolidated assets	\$3,574,887	\$3,841,692

The accounting policies of the segments are the same as those used to prepare our consolidated financial statements, except that discontinued operations and UJV NOI allocable to COPT are not presented separately for segment purposes. In the segment reporting presented above, we did not allocate interest expense, depreciation and amortization, impairment losses, (loss) gain on early extinguishment of debt, gain on sales of real estate and equity in income of unconsolidated entities not included in NOI to our real estate segments since they are not included in the measure of segment profit reviewed by management. We also did not allocate general, administrative and leasing expenses, business development expenses and land carry costs, interest and other income, income taxes and noncontrolling interests because these items represent general corporate or non-operating property items not attributable to segments.

13. Share-Based Compensation and Other Compensation Matters

Performance Share Units (“PSUs”)

On January 1, 2017, our Board of Trustees granted 36,525 PSUs with an aggregate grant date fair value of \$1.4 million to executives. The PSUs have a performance period beginning on January 1, 2017 and concluding on the earlier of December 31, 2019 or the date of: (1) termination by us without cause, death or disability of the executive or

Edgar Filing: CORPORATE OFFICE PROPERTIES TRUST - Form 10-Q

constructive discharge of the executive (collectively, “qualified termination”); or (2) a sale event. The number of PSUs earned (“earned PSUs”) at the end of the performance period will be determined based on the percentile rank of COPT’s total shareholder return relative to a peer group of companies, as set forth in the following schedule:

Percentile Rank	Earned PSUs Payout %
75th or greater	200% of PSUs granted
50th or greater	100% of PSUs granted
25th	50% of PSUs granted
Below 25th	0% of PSUs granted

If the percentile rank exceeds the 25th percentile and is between two of the percentile ranks set forth in the table above, then the percentage of the earned PSUs will be interpolated between the ranges set forth in the table above to reflect any performance between the listed percentiles. At the end of the performance period, we, in settlement of the award, will issue a number of fully-vested COPT common shares equal to the sum of:

the number of earned PSUs in settlement of the award plan; plus
the aggregate dividends that would have been paid with respect to the common shares issued in settlement of the earned PSUs through the date of settlement had such shares been issued on the grant date, divided by the share price on such settlement date, as defined under the terms of the agreement.

If a performance period ends due to a sale event or qualified termination, the number of earned PSUs is prorated based on the portion of the three-year performance period that has elapsed. If employment is terminated by the employee or by us for cause, all PSUs are forfeited. PSUs do not carry voting rights. We computed a grant date fair value of \$38.43 per PSU using a Monte Carlo model, which included assumptions of, among other things, the following: baseline common share value of \$31.22; expected volatility for COPT common shares of 19.0%; and a risk-free interest rate of 1.47%. We are recognizing the grant date fair value in connection with these PSU awards over the period commencing on January 1, 2017 and ending on December 31, 2019.

We issued 9,763 common shares on February 7, 2017 to Mr. Stephen E. Budorick, our Chief Executive Officer, in settlement of PSUs issued in 2014, representing 100% of the target award for those PSUs.

Restricted Shares

During the six months ended June 30, 2017, certain employees and non-employee members of our Board of Trustees were granted a total of 227,235 restricted common shares with an aggregate grant date fair value of \$7.7 million (weighted average of \$33.97 per share). Restricted shares granted to employees vest based on increments and over periods of time set forth under the terms of the respective awards provided that the employees remain employed by us. Restricted shares granted to non-employee Trustees vest on the first anniversary of the grant date, provided that the Trustee remains in his or her position. During the six months ended June 30, 2017, forfeiture restrictions lapsed on 144,006 previously issued common shares; these shares had a weighted average grant date fair value of \$26.22 per share, and the aggregate intrinsic value of the shares on the vesting dates was \$4.9 million.

Deferred Share Awards

During the six months ended June 30, 2017, nonemployee members of our Board of Trustees were granted a total of 10,032 deferred share awards with an aggregate grant date fair value of \$326,000 (\$32.47 per share). Deferred share awards vest on the first anniversary of the grant date, provided that the Trustee remains in his or her position. We settle deferred share awards by issuing an equivalent number of common shares upon vesting of the awards or a later date elected by the Trustee (generally upon cessation of being a Trustee). During the six months ended June 30, 2017, we issued 15,590 common shares in settlement of deferred share awards granted in 2016; these shares had a grant date fair value of \$26.89 per share, and the aggregate intrinsic value of the shares on the settlement date was \$508,000.

Options

During the six months ended June 30, 2017, 5,000 options to purchase common shares (“options”) were exercised. The weighted average exercise price of these options was \$29.98 per share, and the aggregate intrinsic value of the options exercised was \$18,000.

14. Earnings Per Share (“EPS”) and Earnings Per Unit (“EPU”)

COPT and Subsidiaries EPS

We present both basic and diluted EPS. We compute basic EPS by dividing net income available to common shareholders allocable to unrestricted common shares under the two-class method by the weighted average number of unrestricted 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 COPT common shares were converted; and (2) the effect

30

of dilutive potential common shares outstanding during the period attributable to share-based compensation using the treasury stock or if-converted methods; 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.

Summaries of the numerator and denominator for purposes of basic and diluted EPS calculations are set forth below (in thousands, except per share data):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Numerator:				
Net income (loss) attributable to COPT	\$17,862	\$(47,419)	\$39,217	\$(40,593)
Preferred share dividends	(3,039)	(3,553)	(6,219)	(7,105)
Issuance costs associated with redeemed preferred shares	(6,847)	—	(6,847)	—
Income attributable to share-based compensation awards	(117)	(96)	(242)	(214)
Numerator for basic and diluted EPS on net income (loss) attributable to COPT common shareholders	\$7,859	\$(51,068)	\$25,909	\$(47,912)
Denominator (all weighted averages):				
Denominator for basic EPS (common shares)	99,036	94,300	98,725	94,251
Dilutive effect of share-based compensation awards	160	—	158	—
Denominator for diluted EPS (common shares)	99,196	94,300	98,883	94,251
Basic EPS:				
Net income (loss) attributable to COPT common shareholders	\$0.08	\$(0.54)	\$0.26	\$(0.51)
Diluted EPS:				
Net income (loss) attributable to COPT common shareholders	\$0.08	\$(0.54)	\$0.26	\$(0.51)

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 (in thousands):

	Weighted Average Shares Excluded from Denominator			
	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Conversion of common units	3,405	3,676	3,425	3,676
Conversion of Series I Preferred Units	176	176	176	176
Conversion of Series K Preferred Shares	—	434	—	434

The following share-based compensation securities were excluded from the computation of diluted EPS because their effects were antidilutive:

weighted average restricted shares and deferred share awards for the three months ended June 30, 2017 and 2016 of 455,000 and 403,000, respectively, and for the six months ended June 30, 2017 and 2016 of 424,000 and 404,000, respectively; and

weighted average options for the three months ended June 30, 2017 and 2016 of 61,000 and 309,000, respectively, and for the six months ended June 30, 2017 and 2016 of 100,000 and 344,000, respectively.

COPLP and Subsidiaries EPU

We present both basic and diluted EPU. We compute basic EPU by dividing net income available to common unitholders allocable to unrestricted common units under the two-class method by the weighted average number of unrestricted common units outstanding during the period. Our computation of diluted EPU is similar except that:

the denominator is increased to include: (1) the weighted average number of potential additional common units that would have been outstanding if securities that are convertible into our common units were converted; and (2) the effect of dilutive potential common units outstanding during the period attributable to share-based compensation using the treasury stock or if-converted methods; and

the numerator is adjusted to add back any changes in income or loss that would result from the assumed conversion into common units that we added to the denominator.

Summaries of the numerator and denominator for purposes of basic and diluted EPU calculations are set forth below (in thousands, except per unit data):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Numerator:				
Net income (loss) attributable to COPLP common unitholders	\$18,300	\$(49,227)	\$40,454	\$(42,110)
Preferred unit distributions	(3,204)	(3,718)	(6,549)	(7,435)
Issuance costs associated with redeemed preferred units	(6,847)	—	(6,847)	—
Income attributable to share-based compensation awards	(117)	(96)	(242)	(214)
Numerator for basic and diluted EPU on net income (loss) attributable to COPLP common unitholders	\$8,132	\$(53,041)	\$26,816	\$(49,759)
Denominator (all weighted averages):				
Denominator for basic EPU (common units)	102,441	97,976	102,150	97,927
Dilutive effect of share-based compensation awards	160	—	158	—
Denominator for diluted EPU (common units)	102,601	97,976	102,308	97,927
Basic EPU:				
Net income (loss) attributable to COPLP common unitholders	\$0.08	\$(0.54)	\$0.26	\$(0.51)
Diluted EPU:				
Net income (loss) attributable to COPLP common unitholders	\$0.08	\$(0.54)	\$0.26	\$(0.51)

Our diluted EPU computations do not include the effects of the following securities since the conversions of such securities would increase diluted EPU for the respective periods (in thousands):

	Weighted Average Units Excluded from Denominator			
	For the Three Months Ended June 30, 2017	For the Six Months Ended June 30, 2016	For the Three Months Ended June 30, 2017	For the Six Months Ended June 30, 2016
Conversion of Series I preferred units	176	176	176	176
Conversion of Series K preferred units	—	434	—	434

The following share-based compensation securities were excluded from the computation of diluted EPU because their effects were antidilutive:

weighted average restricted units and deferred share awards for the three months ended June 30, 2017 and 2016 of 455,000 and 403,000, respectively, and for the six months ended June 30, 2017 and 2016 of 424,000 and 404,000, respectively; and

weighted average options for the three months ended June 30, 2017 and 2016 of 61,000 and 309,000, respectively, and for the six months ended June 30, 2017 and 2016 of 100,000 and 344,000, respectively.

15. Commitments and Contingencies

Litigation

In the normal course of business, we are involved in legal actions arising from our ownership and administration of properties. We establish reserves for specific legal proceedings when we determine that the likelihood of an unfavorable outcome is probable and the amount of loss can be reasonably estimated. Management does not anticipate that any liabilities that may result from such proceedings will have a materially adverse effect on our financial position, operations or liquidity. Our assessment of the potential outcomes of these matters involves significant judgment and is subject to change based on future developments.

Environmental

We are subject to various Federal, state and local environmental regulations related to our property ownership and operation. We have performed environmental assessments of our properties, the results of which have not revealed any environmental liability that we believe would have a materially adverse effect on our financial position, operations or liquidity.

Tax Incremental Financing Obligation

In August 2010, Anne Arundel County, Maryland issued \$30 million in tax incremental financing bonds to third-party investors in order to finance public improvements needed in connection with our project known as National Business Park North. The real estate taxes on increases in assessed value of a development district encompassing National Business Park North are to be transferred to a special fund pledged to the repayment of the bonds. We recognized a \$1.4 million liability through June 30, 2017 representing our estimated obligation to fund through a special tax any future shortfalls between debt service on the bonds and real estate taxes available to repay the bonds.

Operating Leases

We are obligated as lessee under operating leases (mostly ground leases) with various expiration dates extending to the year 2100. Future minimum rental payments due under the terms of these operating leases as of June 30, 2017 follow (in thousands):

Year Ending December 31,	
2017 (1)	\$634
2018	1,257
2019	1,240
2020	1,232
2021	1,231
Thereafter	85,744
	\$91,338

(1) Represents the six months ending December 31, 2017.

Capital Lease

On May 25, 2017, we entered into a ground lease on land under development in Washington, D.C. for our Stevens Investors, LLC joint venture. The lease has a 99-year term, and we possess an option to purchase the property for one dollar (estimated to occur between 2019 and 2020). Upon inception of the lease, we recorded a \$16.1 million capital lease liability on our consolidated balance sheets based on the present value of the future minimum rental payments. Future minimum rental payments due under the term of this lease as of June 30, 2017 follow (in thousands):

Year Ending December 31,	
2017 (1)	\$700
2018	15,775
2020	135
Thereafter	75
Total minimum rental payments	\$16,685
Less: Amount representing interest	(508)
Capital lease obligation	\$16,177

(1) Represents the six months ending December 31, 2017.

Contractual Obligations

We had amounts remaining to be incurred under various contractual obligations as of June 30, 2017 that included the following:

• new development and redevelopment obligations of \$53.3 million;

33

• capital expenditures for operating properties of \$50.7 million;
• third party construction and development of \$65.1 million; and
• other obligations of \$1.2 million.

Environmental Indemnity Agreement

In connection with a lease and subsequent sale in 2008 and 2010 of three properties in Dayton, New Jersey, we agreed to provide certain environmental indemnifications limited to \$19 million in the aggregate. We have insurance coverage in place to mitigate much of any potential future losses that may result from these indemnification agreements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

During the six months ended June 30, 2017:

we finished the period with occupancy of our portfolio of operating office properties at 93.0%, including six properties owned through an unconsolidated real estate joint venture;

we placed into service an aggregate of 383,000 square feet in six newly constructed or redeveloped properties that were 79% leased as of June 30, 2017;

we sold two operating properties totaling 227,000 square feet that were 79.6% occupied for \$41.3 million and other land for \$14.3 million. The net proceeds from these sales were used primarily to fund cash reserves;

we repaid \$200.0 million of the loan balance on a term loan scheduled to mature in 2020 using available cash;

COPT redeemed all of the outstanding shares of its:

Series K Preferred Shares effective January 21, 2017 at a price of \$50.00 per share, or \$26.6 million in the aggregate, plus accrued and unpaid dividends thereon through the date of redemption using available cash. Concurrently with this redemption, COPLP redeemed its Series K Preferred Units on the same terms; and

Series L Preferred Shares effective June 27, 2017 at a price of \$25.00 per share, or \$172.5 million in the aggregate, plus accrued and unpaid dividends thereon through the date of redemption using borrowings from our Revolving Credit Facility. Concurrently with this redemption, COPLP redeemed its Series L Preferred Units on the same terms; and

COPT issued 591,042 common shares at a weighted average price of \$33.84 per share under its ATM stock offering program. Net proceeds from the shares issued totaled \$19.7 million, which were used primarily to fund cash reserves.

On July 28, 2017, we completed the sale of our remaining assets in White Marsh, including eight operating properties totaling 412,000 square feet, and land, for \$47.5 million. The net proceeds from this sale were used primarily to repay borrowings under our Revolving Credit Facility.

We discuss significant factors contributing to changes in our net income in the section below entitled "Results of Operations." The results of operations discussion is combined for COPT and COPLP because there are no material differences in the results of operations between the two reporting entities.

In addition, the section below entitled "Liquidity and Capital Resources" includes discussions of, among other things:

how we expect to generate cash for short and long-term capital needs; and

our commitments and contingencies.

You should refer to our consolidated financial statements and the notes thereto as you read this section.

This section contains "forward-looking" statements, as defined in the Private Securities Litigation Act of 1995, that are based on our current expectations, estimates and projections about future events and financial trends affecting the financial condition and operations of our business. Forward-looking statements can be identified by the use of words such as "may," "will," "should," "could," "believe," "anticipate," "expect," "estimate," "plan" or other comparable terminology. Forward-looking statements are inherently subject to risks and uncertainties, many of which we cannot predict with accuracy and some of which we might not even anticipate. Although we believe that the expectations, estimates and projections reflected in such forward-looking statements are based on reasonable assumptions at the time made, we can give no assurance that these expectations, estimates and projections will be achieved. Future events and actual results may differ materially from those discussed in the forward-looking statements. Important factors that may affect these expectations, estimates and projections include, but are not limited to:

general economic and business conditions, which will, among other things, affect office property and data center demand and rents, tenant creditworthiness, interest rates, financing availability and property values;

adverse changes in the real estate markets, including, among other things, increased competition with other companies;

governmental actions and initiatives, including risks associated with the impact of a prolonged government shutdown or budgetary reductions or impasses, such as a reduction in rental revenues, non-renewal of leases and/or a curtailment of demand for additional space by our strategic customers;

our ability to borrow on favorable terms;

risks of real estate acquisition and development activities, including, among other things, risks that development projects may not be completed on schedule, that tenants may not take occupancy or pay rent or that development or operating costs may be greater than anticipated;

risks of investing through joint venture structures, including risks that our joint venture partners may not fulfill their financial obligations as investors or may take actions that are inconsistent with our objectives;

- changes in our plans for properties or views of market economic conditions or failure to obtain development rights, either of which could result in recognition of significant impairment losses;

our ability to satisfy and operate effectively under Federal income tax rules relating to real estate investment trusts and partnerships;

the dilutive effects of issuing additional common shares;

our ability to achieve projected results; and

environmental requirements.

We undertake no obligation to update or supplement forward-looking statements.

Occupancy and Leasing

Office Properties

The tables below set forth occupancy information pertaining to our portfolio of operating office properties, which included six properties owned through an unconsolidated real estate joint venture:

	June 30, 2017		December 31, 2016	
Occupancy rates at period end				
Total	93.0	%	92.1	%
Defense/IT Locations:				
Fort Meade/BW Corridor	94.6	%	94.3	%
Northern Virginia Defense/IT	86.5	%	85.0	%
Lackland Air Force Base	100.0	%	100.0	%
Navy Support Locations	81.9	%	72.7	%
Redstone Arsenal	98.7	%	96.4	%
Data Center Shells	100.0	%	100.0	%
Total Defense/IT Locations	94.0	%	92.6	%
Regional Office	93.0	%	95.2	%
Other	52.9	%	52.9	%
Average contractual annual rental rate per square foot at period end (1)	\$30.06		\$30.16	

(1) Includes estimated expense reimbursements. Amounts reported include the portion of properties owned through an unconsolidated real estate joint venture that was allocable to our ownership interest.

	Rentable Square Feet (in thousands)	Occupied Square Feet (in thousands)
December 31, 2016	17,190	15,831
Square feet vacated	—	(213)
Occupancy of previously vacated space in connection with new leases (1)	—	298
Square feet constructed or redeveloped	383	371
Dispositions	(227)	(181)
Square feet removed from operations for redevelopment	(22)	—

Other changes	(1) 5
June 30, 2017	17,323 16,111

(1)Excludes occupancy of vacant square feet acquired or developed.

During the six months ended June 30, 2017, we completed 1.1 million square feet of leasing, including 383,000 of construction and redevelopment space, and renewed 72.7% of the square footage of our lease expirations (including the effect of early renewals).

36

Occupancy of our Same Office Properties increased from 91.9% as of December 31, 2016 to 92.7% as of June 30, 2017.

Wholesale Data Center Property

Our 19.25 megawatt wholesale data center property had 16.9 megawatts leased as of June 30, 2017, a 2.0 megawatt increase relative to December 31, 2016.

Results of Operations

We evaluate the operating performance of our properties using NOI from real estate operations, our segment performance measure, which includes: real estate revenues and property operating expenses; and the net of revenues and property operating expenses of real estate operations owned through unconsolidated real estate joint ventures (“UJVs”) that is allocable to COPT’s ownership interest (“UJV NOI allocable to COPT”). We view our NOI from real estate operations as comprising the following primary categories of operating properties:

- office properties continually owned and 100% operational throughout the current and prior year reporting periods, excluding properties held for sale. We define these as changes from “Same Office Properties”;
- constructed or redeveloped office properties placed into service that were not 100% operational throughout the current and prior year reporting periods;
- our wholesale data center;
- properties held for sale as of June 30, 2017; and
- property dispositions.

In addition to owning properties, we provide construction management and other services. The primary manner in which we evaluate the operating performance of our construction management and other service activities is through a measure we define as NOI from service operations, which is based on the net of the revenues and expenses from these activities. The revenues and expenses from these activities consist primarily of subcontracted costs that are reimbursed to us by customers along with a management fee. The operating margins from these activities are small relative to the revenue. We believe NOI from service operations is a useful measure in assessing both our level of activity and our profitability in conducting such operations.

Since both of the measures discussed above exclude certain items includable in income before gain on sales of real estate, reliance on these measures has limitations; management compensates for these limitations by using the measures simply as supplemental measures that are considered alongside other GAAP and non-GAAP measures. A reconciliation of NOI from real estate operations and NOI from service operations to income before gain on sales of real estate reported on the consolidated statements of operations of COPT and subsidiaries is provided in Note 12 to our consolidated financial statements.

Comparison of Statements of Operations for the Three Months Ended June 30, 2017 and 2016

	For the Three Months Ended		
	June 30,		
	2017	2016	Variance
	(in thousands)		
Revenues			
Revenues from real estate operations	\$128,297	\$133,924	\$(5,627)
Construction contract and other service revenues	23,138	12,003	11,135
Total revenues	151,435	145,927	5,508
Expenses			
Property operating expenses	48,628	48,141	487
Depreciation and amortization associated with real estate operations	32,793	33,248	(455)
Construction contract and other service expenses	22,315	11,478	10,837
Impairment losses	1,625	69,692	(68,067)
General, administrative and leasing expenses	7,859	8,026	(167)
Business development expenses and land carry costs	1,597	2,363	(766)
Total operating expenses	114,817	172,948	(58,131)
Operating income (loss)	36,618	(27,021)	63,639
Interest expense	(19,163)	(22,639)	3,476
Interest and other income	1,583	1,330	253
(Loss) gain on early extinguishment of debt	(513)	5	(518)
Equity in income of unconsolidated entities	718	10	708
Income tax expense	(48)	(1)	(47)
Income (loss) before gain on sales of real estate	19,195	(48,316)	67,511
Gain on sales of real estate	12	—	12
Net income (loss)	\$19,207	\$(48,316)	\$67,523

NOI from Real Estate Operations

	For the Three Months Ended June 30,		
	2017	2016	Variance
	(Dollars		
	in thousands, except per square foot data)		
Revenues			
Same Office Properties revenues			
Rental revenue, excluding lease termination revenue	\$ 88,734	\$ 86,787	\$ 1,947
Lease termination revenue	517	336	181
Tenant recoveries and other real estate operations revenue	24,432	22,956	1,476
Same Office Properties total revenues	113,683	110,079	3,604
Constructed and redeveloped properties placed in service			
Wholesale data center	7,033	6,804	229
Properties held for sale	2,404	2,333	71
Dispositions	61	12,569	(12,508)
Other	259	256	3
	128,297	133,924	(5,627)
Property operating expenses			
Same Office Properties			
Constructed and redeveloped properties placed in service	(1,378)	(304)	(1,074)
Wholesale data center	(3,501)	(2,651)	(850)
Properties held for sale	(677)	(654)	(23)
Dispositions	(43)	(3,750)	3,707
Other	(282)	(219)	(63)
	(48,628)	(48,141)	(487)
UJV NOI allocable to COPT	1,294	—	1,294
NOI from real estate operations			
Same Office Properties			
Constructed and redeveloped properties placed in service	3,479	1,579	1,900
Wholesale data center	3,532	4,153	(621)
Properties held for sale	1,727	1,679	48
Dispositions	18	8,819	(8,801)
Other	1,271	37	1,234
	\$ 80,963	\$ 85,783	\$ (4,820)
Same Office Properties rent statistics			
Average occupancy rate	92.7	% 91.6	% 1.1 %
Average straight-line rent per occupied square foot (1)	\$ 6.51	\$ 6.45	\$ 0.06

(1) Includes minimum base rents, net of abatements, and lease incentives on a straight-line basis for the three-month periods set forth above.

Our Same Office Properties pool consisted of 137 office properties, comprising 84.9% of our total operating office square footage as of June 30, 2017 (87.2% excluding the effect of properties held for sale). This pool of properties included the following changes from the pool used for purposes of comparing 2016 and 2015 in our 2016 Annual Report on Form 10-K: the addition of four properties placed in service that were 100% operational on or before January 1, 2016 and three properties acquired in 2015; and the removal of two properties reclassified to held for sale and one property reclassified as redevelopment in 2017. The increase in tenant recoveries and other real estate

operations revenue and property operating expenses from our Same Office Properties was due primarily to an increase in operating expenses directly reimbursable from tenants.

Our NOI from constructed and redeveloped properties placed in service included 12 properties placed in service in 2016 and 2017.

NOI from Service Operations

	For the Three Months		
	Ended June 30,		
	2017	2016	Variance
	(in thousands)		
Construction contract and other service revenues	\$23,138	\$12,003	\$11,135
Construction contract and other service expenses	22,315	11,478	10,837
NOI from service operations	\$823	\$525	\$298

Construction contract and other service revenue and expenses increased due primarily to a greater volume of construction activity in connection with several of our tenants. Construction contract activity is inherently subject to significant variability depending on the volume and nature of projects undertaken by us (primarily on behalf of tenants). Service operations are an ancillary component of our overall operations that typically contribute an insignificant amount of operating income relative to our real estate operations.

Impairment Losses

As part of our closing process for the second quarter of 2017, we conducted our quarterly review of our portfolio for indicators of impairment. Further, we performed recoverability analyses for our properties classified as held for sale, which resulted in impairment losses of \$1.6 million. These impairment losses were primarily on properties in White Marsh (included in our Regional Office and Other segments) that we reclassified to held for sale during the period and adjusted to fair value less costs to sell.

During the second quarter of 2016, as part of our closing process, we conducted our quarterly review of our portfolio for indicators of impairment considering the refined investment strategy of our then newly-appointed Chief Executive Officer and the goals of an asset sales program and concluded that we would: (1) not hold our operating properties in Aberdeen, Maryland (“Aberdeen”) for the long-term; (2) sell specific properties in our Northern Virginia Defense/IT and Fort Meade/BW Corridor sub-segments; (3) not develop commercial properties on land in Frederick, Maryland; and (4) sell an operating property in Greater Philadelphia that had not previously been classified as held for sale. Accordingly, we performed recoverability analyses for each of these properties and recorded the following impairment losses:

- \$34.4 million on operating properties in Aberdeen (included in our Other segment). After shortening our estimated holding period for these properties, we determined that the carrying amount of the properties would not likely be recovered from the operation and eventual dispositions of the properties during the shortened holding period.

Accordingly, we adjusted the properties to their estimated fair value;

- \$14.1 million on operating properties in our Northern Virginia Defense/IT and Fort Meade/BW Corridor sub-segments that we reclassified to held for sale during the period whose carrying amounts exceeded their estimated fair values less costs to sell;

- \$8.2 million on land in Frederick, Maryland. We determined that the carrying amount of the land would not likely be recovered from its sale and adjusted the land to its estimated fair value;

- \$6.2 million on a property in Greater Philadelphia (included in our Regional Office segment) that we reclassified to held for sale during the period and adjusted to fair value less costs to sell;

- \$4.4 million on land in Aberdeen. In performing our analysis related to the operating properties in Aberdeen, we determined that the weakening leasing and overall commercial real estate conditions in that market indicated that our land holdings in the market may be impaired. As a result, we determined that the carrying amount of the land was not

recoverable and adjusted the land to its estimated fair value; and \$2.4 million primarily on land in Colorado Springs, Colorado and operating properties in White Marsh classified as held for sale whose carrying amounts exceeded their estimated fair values less costs to sell based on updated negotiations with prospective buyers.

Interest Expense

The decrease in interest expense included the effect of a 15% decrease in our average outstanding debt in the current period relative to the prior period.

Comparison of Statements of Operations for the Six Months Ended June 30, 2017 and 2016

	For the Six Months Ended June 30,		
	2017	2016	Variance
	(in thousands)		
Revenues			
Revenues from real estate operations	\$255,064	\$267,011	\$(11,947)
Construction contract and other service revenues	36,172	23,223	12,949
Total revenues	291,236	290,234	1,002
Expenses			
Property operating expenses	97,147	100,016	(2,869)
Depreciation and amortization associated with real estate operations	65,852	67,775	(1,923)
Construction contract and other service expenses	34,801	22,172	12,629
Impairment losses	1,625	72,138	(70,513)
General, administrative and leasing expenses	16,470	19,909	(3,439)
Business development expenses and land carry costs	3,290	4,781	(1,491)
Total operating expenses	219,185	286,791	(67,606)
Operating income	72,051	3,443	68,608
Interest expense	(38,157)	(46,198)	8,041
Interest and other income	3,309	2,486	823
(Loss) gain on early extinguishment of debt	(513)	22	(535)
Equity in income of unconsolidated entities	1,443	20	1,423
Income tax (expense) benefit	(88)	7	(95)
Income (loss) before gain on sales of real estate	38,045	(40,220)	78,265
Gain on sales of real estate	4,250	—	4,250
Net income (loss)	\$42,295	\$(40,220)	\$82,515

Edgar Filing: CORPORATE OFFICE PROPERTIES TRUST - Form 10-Q

NOI from Real Estate Operations

For the Six Months Ended June 30,
2017 2016 Variance
(Dollars
in thousands, except per square foot data)

Revenues			
Same Office Properties revenues			
Rental revenue, excluding lease termination revenue	\$ 177,222	\$ 172,331	\$ 4,891
Lease termination revenue	1,223	1,289	(66)
Tenant recoveries and other real estate operations revenue	48,294	46,808	1,486
Same Office Properties total revenues	226,739	220,428	6,311
Constructed and redeveloped properties placed in service	8,388	2,686	5,702
Wholesale data center	13,803	13,297	506
Properties held for sale	4,716	4,933	(217)
Dispositions	863	25,153	(24,290)
Other	555	514	41
	255,064	267,011	(11,947)
Property operating expenses			
Same Office Properties	(85,108)	(83,603)	(1,505)
Constructed and redeveloped properties placed in service	(2,651)	(503)	(2,148)
Wholesale data center	(6,866)	(5,312)	(1,554)
Properties held for sale	(1,418)	(1,745)	327
Dispositions	(334)	(8,426)	8,092
Other	(770)	(427)	(343)
	(97,147)	(100,016)	2,869
UJV NOI allocable to COPT	2,592	—	2,592
NOI from real estate operations			
Same Office Properties	141,631	136,825	4,806
Constructed and redeveloped properties placed in service	5,737	2,183	3,554
Wholesale data center	6,937	7,985	(1,048)
Properties held for sale	3,298	3,188	110
Dispositions	529	16,727	(16,198)
Other	2,377	87	2,290
	\$ 160,509	\$ 166,995	\$ (6,486)
Same Office Properties rent statistics			
Average occupancy rate	92.5	% 91.5	% 1.0 %
Average straight-line rent per occupied square foot (1)	\$ 13.03	\$ 12.83	\$ 0.20

(1) Includes minimum base rents, net of abatements, and lease incentives on a straight-line basis for the six-month periods set forth above.

Our NOI from constructed and redeveloped properties placed in service included 12 properties placed in service in 2016 and 2017.

NOI from Service Operations

For the Six Months Ended
June 30,

	2017	2016	Variance
	(in thousands)		
Construction contract and other service revenues	\$36,172	\$23,223	\$12,949
Construction contract and other service expenses	34,801	22,172	12,629
NOI from service operations	\$1,371	\$1,051	\$320

Construction contract and other service revenue and expenses increased due primarily to a greater volume of construction activity in connection with several of our tenants.

Impairment Losses

The decrease in impairment losses was attributable primarily to the losses described above for the three-month period ended June 30, 2016.

General, Administrative and Leasing Expenses

General, administrative and leasing expenses decreased due primarily to our recognition in the prior period of \$4.4 million in executive transition costs, representing mostly severance and termination benefits primarily in connection with executive departures, compared to \$730,000 in such costs recognized in the current period.

Interest Expense

The decrease in interest expense included \$1.9 million in hedge ineffectiveness on our interest rate swaps recognized in the prior period and the effect of a 13% decrease in our average outstanding debt in the current period relative to the prior period.

Gain on Sales of Real Estate

We recognized gain on sales of real estate of \$4.2 million in the current period in connection with a land sale (discussed further in Note 4 to our consolidated financial statements).

Funds from Operations

Funds from operations (“FFO”) is defined as net income computed using GAAP, excluding gains on sales of, and impairment losses on, previously depreciated operating properties, plus real estate-related depreciation and amortization. When multiple properties consisting of both operating and non-operating properties exist on a single tax parcel, we classify all of the gains on sales of, and impairment losses on, the tax parcel as all being for previously depreciated operating properties when most of the value of the parcel is associated with operating properties on the parcel. FFO also includes adjustments to net income for the effects of the items noted above pertaining to UJVs that were allocable to our ownership interest in the UJVs. We believe that we use the National Association of Real Estate Investment Trusts (“NAREIT”) definition of FFO, although others may interpret the definition differently and, accordingly, our presentation of FFO may differ from those of other REITs. We believe that FFO is useful to management and investors as a supplemental measure of operating performance because, by excluding gains related to sales of, and impairment losses on, previously depreciated operating properties, net of related tax benefit, and excluding real estate-related depreciation and amortization, FFO can help one compare our operating performance between periods. In addition, since most equity REITs provide FFO information to the investment community, we believe that FFO is useful to investors as a supplemental measure for comparing our results to those of other equity REITs. We believe that net income is the most directly comparable GAAP measure to FFO.

Since FFO excludes certain items includable in net income, reliance on the measure has limitations; management compensates for these limitations by using the measure simply as a supplemental measure that is weighed in the balance with other GAAP and non-GAAP measures. FFO is not necessarily an indication of our cash flow available to fund cash needs. Additionally, it should not be used as an alternative to net income when evaluating our financial performance or to cash flow from operating, investing and financing activities when evaluating our liquidity or ability to make cash distributions or pay debt service.

Basic FFO available to common share and common unit holders (“Basic FFO”) is FFO adjusted to subtract (1) preferred share dividends, (2) issuance costs associated with redeemed preferred shares, (3) income attributable to noncontrolling interests through ownership of preferred units in the Operating Partnership or interests in other

consolidated entities not owned by us, (4) depreciation and amortization allocable to noncontrolling interests in other consolidated entities and (5) Basic FFO allocable to restricted shares. With these adjustments, Basic FFO represents FFO available to common shareholders and common unitholders. Common units in the Operating Partnership are substantially similar to our common shares and are exchangeable into common shares, subject to certain conditions. We believe that Basic FFO is useful to investors due to the close correlation of common units to common shares. We believe that net income is the most directly comparable GAAP measure to Basic FFO. Basic FFO has essentially the same limitations as FFO; management compensates for these limitations in essentially the same manner as described above for FFO.

Diluted FFO available to common share and common unit holders (“Diluted FFO”) is Basic FFO adjusted to add back any changes in Basic FFO that would result from the assumed conversion of securities that are convertible or exchangeable into

common shares. We believe that Diluted FFO is useful to investors because it is the numerator used to compute Diluted FFO per share, discussed below. We believe that net income is the most directly comparable GAAP measure to Diluted FFO. Since Diluted FFO excludes certain items includable in the numerator to diluted EPS, reliance on the measure has limitations; management compensates for these limitations by using the measure simply as a supplemental measure that is weighed in the balance with other GAAP and non-GAAP measures. Diluted FFO is not necessarily an indication of our cash flow available to fund cash needs. Additionally, it should not be used as an alternative to net income when evaluating our financial performance or to cash flow from operating, investing and financing activities when evaluating our liquidity or ability to make cash distributions or pay debt service.

Diluted FFO available to common share and common unit holders, as adjusted for comparability is defined as Diluted FFO adjusted to exclude operating property acquisition costs; gains on sales of, and impairment losses on, properties other than previously depreciated operating properties, net of associated income tax; gain or loss on early extinguishment of debt; FFO associated with properties securing non-recourse debt on which we have defaulted and which we have extinguished, or expect to extinguish, via conveyance of such properties, including property NOI and interest expense; loss on interest rate derivatives; demolition costs on redevelopment properties; executive transition costs (including separation related compensation and replacement recruitment for Vice President level positions and above); and issuance costs associated with redeemed preferred shares. This measure also includes adjustments for the effects of the items noted above pertaining to UJVs that were allocable to our ownership interest in the UJVs. We believe this to be a useful supplemental measure alongside Diluted FFO as it excludes gains and losses from certain investing and financing activities and certain other items that we believe are not closely correlated to (or associated with) our operating performance. We believe that net income is the most directly comparable GAAP measure to this non-GAAP measure. This measure has essentially the same limitations as Diluted FFO, as well as the further limitation of not reflecting the effects of the excluded items; we compensate for these limitations in essentially the same manner as described above for Diluted FFO.

Diluted FFO per share is (1) Diluted FFO divided by (2) the sum of the (a) weighted average common shares outstanding during a period, (b) weighted average common units outstanding during a period and (c) weighted average number of potential additional common shares that would have been outstanding during a period if other securities that are convertible or exchangeable into common shares were converted or exchanged. We believe that Diluted FFO per share is useful to investors because it provides investors with a further context for evaluating our FFO results in the same manner that investors use earnings per share (“EPS”) in evaluating net income available to common shareholders. In addition, since most equity REITs provide Diluted FFO per share information to the investment community, we believe that Diluted FFO per share is a useful supplemental measure for comparing us to other equity REITs. We believe that diluted EPS is the most directly comparable GAAP measure to Diluted FFO per share. Diluted FFO per share has most of the same limitations as Diluted FFO (described above); management compensates for these limitations in essentially the same manner as described above for Diluted FFO.

Diluted FFO per share, as adjusted for comparability is (1) Diluted FFO, as adjusted for comparability divided by (2) the sum of the (a) weighted average common shares outstanding during a period, (b) weighted average common units outstanding during a period and (c) weighted average number of potential additional common shares that would have been outstanding during a period if other securities that are convertible or exchangeable into common shares were converted or exchanged. We believe that this measure is useful to investors because it provides investors with a further context for evaluating our FFO results. We believe this to be a useful supplemental measure alongside Diluted FFO per share as it excludes gains and losses from certain investing and financing activities and certain other items that we believe are not closely correlated to (or associated with) our operating performance. We believe that diluted EPS is the most directly comparable GAAP measure to this per share measure. This measure has most of the same limitations as Diluted FFO (described above) as well as the further limitation of not reflecting the effects of the excluded items; we compensate for these limitations in essentially the same manner as described above for Diluted FFO.

The computations for all of the above measures on a diluted basis assume the conversion of common units in COPLP but do not assume the conversion of other securities that are convertible into common shares if the conversion of those securities would increase per share measures in a given period.

We use measures called payout ratios as supplemental measures of our ability to make distributions to investors based on each of the following: FFO; Diluted FFO; and Diluted FFO, adjusted for comparability. These measures are defined as (1) the sum of (a) dividends on common shares and (b) distributions to holders of interests in COPLP and dividends on convertible preferred shares when such distributions and dividends are included in Diluted FFO divided by either (2) FFO, Diluted FFO or Diluted FFO, adjusted for comparability.

Edgar Filing: CORPORATE OFFICE PROPERTIES TRUST - Form 10-Q

The table appearing below sets forth the computation of the above stated measures for the three and six months ended June 30, 2017 and 2016, and provides reconciliations to the GAAP measures of COPT and subsidiaries associated with such measures:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars and shares in thousands, except per share data)			
Net income (loss)	\$19,207	\$(48,316)	\$42,295	\$(40,220)
Add Real estate-related depreciation and amortization	32,793	33,248	65,852	67,775
Add: Depreciation and amortization on UJV allocable to COPT	311	—	622	—
Add: Impairment losses on previously depreciated operating properties	1,610	55,124	1,610	55,971
Add: Gain on sales of previously depreciated operating properties	(12)	—	(31)	—
FFO	53,909	40,056	110,348	83,526
Less: Preferred share dividends	(3,039)	(3,553)	(6,219)	(7,105)
Less: Noncontrolling interests-preferred units in the Operating Partnership	(165)	(165)	(330)	(330)
Less: FFO allocable to other noncontrolling interests	(906)	(1,014)	(1,884)	(2,041)
Less: Issuance costs associated with redeemed preferred shares	(6,847)	—	(6,847)	—
Basic and diluted FFO allocable to share-based compensation awards	(185)	(130)	(401)	(296)
Basic and diluted FFO available to common share and common unit holders	\$42,767	\$35,194	\$94,667	\$73,754
Gain on sales of non-operating properties	—	—	(4,219)	—
Impairment losses on non-operating properties	15	14,568	15	16,167
Loss (gain) on interest rate derivatives	444	319	(9)	1,870
Loss (gain) on early extinguishment of debt	513	(5)	513	(22)
Issuance costs associated with redeemed preferred shares	6,847	—	6,847	—
Executive transition costs	31	247	730	4,384
Demolition costs on redevelopment properties	72	370	294	578
Diluted FFO comparability adjustments allocable to share-based compensation awards	(31)	(63)	(17)	(94)
Diluted FFO available to common share and common unit holders, as adjusted for comparability	\$50,658	\$50,630	\$98,821	\$96,637
Weighted average common shares	99,036	94,300	98,725	94,251
Conversion of weighted average common units	3,405	3,676	3,425	3,676
Weighted average common shares/units - Basic FFO	102,441	97,976	102,150	97,927
Dilutive effect of share-based compensation awards	160	117	158	107
Weighted average common shares/units - Diluted FFO	102,601	98,093	102,308	98,034
Diluted FFO per share	\$0.42	\$0.36	\$0.93	\$0.75
Diluted FFO per share, as adjusted for comparability	\$0.49	\$0.52	\$0.97	\$0.99
Denominator for diluted EPS	99,196	94,300	98,883	94,251
Weighted average common units	3,405	3,676	3,425	3,676
Anti-dilutive EPS effect of share-based compensation awards	—	117	—	107
Denominator for diluted FFO per share measures	102,601	98,093	102,308	98,034

Property Additions

The table below sets forth the major components of our additions to properties for the six months ended June 30, 2017 (in thousands):

Construction, development and redevelopment	\$ 102,688	
Tenant improvements on operating properties	10,803	(1)
Capital improvements on operating properties	9,186	
	\$ 122,677	

(1) Tenant improvement costs incurred on newly-constructed properties are classified in this table as construction, development and redevelopment.

Cash Flows

Net cash flow provided by operating activities decreased \$6.7 million when comparing the six months ended June 30, 2017 and 2016 due primarily to higher lease incentive payments in the current period, partially offset by lower interest expense payments due to lower outstanding debt balances.

Net cash flow used in investing activities decreased \$45.3 million when comparing the six months ended June 30, 2017 and 2016 due primarily to an increase in property sales in 2017 relative to 2016.

Net cash flow used in financing activities in the six months ended June 30, 2017 was \$258.0 million, and included the following:

- redemption of preferred shares (or units) of \$199.1 million; and
- dividends and/or distributions to equity holders of \$66.0 million; offset in part by
- net proceeds from the issuance of common shares (or units) of \$19.8 million.

Net cash flow used in financing activities in the six months ended June 30, 2016 was \$67.2 million, and included the following:

- dividends and/or distributions to equity holders of \$61.5 million; and
- distributions to redeemable noncontrolling interests of \$14.3 million related primarily to distributions to our partner in Stevens Investors, LLC, as discussed in our 2016 Annual Report on Form 10-K; offset in part by
- net proceeds from debt borrowings of \$15.5 million.

Liquidity and Capital Resources of COPT

COPLP is the entity through which COPT, the sole general partner of COPLP, conducts almost all of its operations and owns almost all of its assets. COPT issues public equity from time to time, but does not otherwise generate any capital itself or conduct any business itself, other than incurring certain expenses in operating as a public company which are fully reimbursed by COPLP. COPT itself does not hold any indebtedness, and its only material asset is its ownership of partnership interests of COPLP. COPT's principal funding requirement is the payment of dividends on its common and preferred shares. COPT's principal source of funding for its dividend payments is distributions it receives from COPLP.

As of June 30, 2017, COPT owned 96.7% of the outstanding common units and none of the outstanding preferred units in COPLP; the remaining common and preferred units in COPLP were owned by third parties. As the sole general partner of COPLP, COPT has the full, exclusive and complete responsibility for COPLP's day-to-day management and control.

The liquidity of COPT is dependent on COPLP's ability to make sufficient distributions to COPT. The primary cash requirement of COPT is its payment of dividends to its shareholders. COPT also guarantees some of the Operating Partnership's debt, as discussed further in Note 8 of the notes to consolidated financial statements included elsewhere herein. If the Operating Partnership fails to fulfill certain of its debt requirements, which trigger COPT's guarantee obligations, then COPT will be required to fulfill its cash payment commitments under such guarantees. However, COPT's only significant asset is its investment in COPLP.

As discussed further below, we believe the Operating Partnership's sources of working capital, specifically its cash flow from operations, and borrowings available under its unsecured line of credit, are adequate for it to make its distribution payments to COPT and, in turn, for COPT to make its dividend payments to its shareholders.

COPT's short-term liquidity requirements consist primarily of funds to pay for future dividends expected to be paid to its shareholders. COPT periodically accesses the public equity markets to raise capital by issuing common and/or preferred shares.

For COPT to maintain its qualification as a REIT, it must pay dividends to its shareholders aggregating annually at least 90% of its ordinary taxable income. As a result of this distribution requirement, it cannot rely on retained earnings to fund its ongoing operations to the same extent that some other companies can. COPT may need to continue to raise capital in the equity markets to fund COPLP's working capital needs, acquisitions and developments.

Liquidity and Capital Resources of COPLP

Our primary cash requirements are for operating expenses, debt service, development of new properties, improvements to existing properties and acquisitions, to the extent they are pursued in the future. We expect to continue to use cash flow provided by operations as the primary source to meet our short-term capital needs, including property operating expenses, general and administrative expenses, interest expense, scheduled principal amortization of debt, distributions to our security holders and improvements to existing properties. As of June 30, 2017, we had \$10.6 million in cash and cash equivalents.

Our senior unsecured debt is currently rated investment grade by the three major rating agencies. We aim to maintain an investment grade rating to enable us to use debt comprised of unsecured, primarily fixed-rate debt (including the effect of interest rate swaps) from public markets and banks. We also use secured nonrecourse debt from institutional lenders and banks, when appropriate. In addition, we periodically access the public equity markets to raise capital by issuing common and/or preferred shares.

We use our Revolving Credit Facility to initially finance much of our investing activities. We subsequently pay down the facility using proceeds from long-term borrowings, equity issuances and property sales. The lenders' aggregate commitment under the facility is \$800.0 million, with the ability for us to increase the lenders' aggregate commitment to \$1.3 billion, provided that there is no default under the facility and subject to the approval of the lenders. Amounts available under the facility are computed based on 60% of our unencumbered asset value, as defined in the loan agreement. The Revolving Credit Facility matures in May 2019, and may be extended by two six-month periods at our option, provided that there is no default under the facility and we pay an extension fee of 0.075% of the total availability of the facility. As of June 30, 2017, the maximum borrowing capacity under this facility totaled \$800.0 million, of which \$606.0 million was available.

We believe that our liquidity and capital resources are adequate for our near-term and longer-term requirements without necessitating property sales.

The following table summarizes our contractual obligations as of June 30, 2017 (in thousands):

	For the Periods Ending December 31,						Total
	2017	2018	2019	2020	2021	Thereafter	
Contractual obligations (1)							
Debt (2)							
Balloon payments due upon maturity	\$—	\$—	\$194,000	\$112,132	\$300,000	\$1,276,829	\$1,882,961
Scheduled principal payments	2,048	4,241	4,387	4,024	3,875	10,680	29,255
Interest on debt (3)	36,596	72,921	69,645	66,170	58,389	116,900	420,621
New development and redevelopment obligations (4)(5)	39,690	12,777	856	—	—	—	53,323
Third-party construction and development obligations (5)(6)	27,232	37,848	—	—	—	—	65,080
Capital expenditures for operating properties (5)(7)	18,162	23,367	9,207	—	—	—	50,736
Capital lease obligation (principal and interest)	700	15,775	—	135	—	75	16,685
Operating leases (8)	634	1,257	1,240	1,232	1,231	85,744	91,338
Other obligations (8)	285	380	342	153	39	9	1,208
Total contractual cash obligations	\$125,347	\$168,566	\$279,677	\$183,846	\$363,534	\$1,490,237	\$2,611,207

The contractual obligations set forth in this table exclude property operations contracts that may be terminated with (1) notice of one month or less and also exclude accruals and payables incurred (with the exclusion of debt) and therefore reflected in our reported liabilities.

Represents scheduled principal amortization payments and maturities only and therefore excludes net debt (2) discounts and deferred financing costs of \$14.5 million. As of June 30, 2017, maturities included \$194.0 million in 2019 that may be extended to 2020, subject to certain conditions.

Represents interest costs for our outstanding debt as of June 30, 2017 for the terms of such debt. For variable rate (3) debt, the amounts reflected above used June 30, 2017 interest rates on variable rate debt in computing interest costs for the terms of such debt.

(4) Represents contractual obligations pertaining to new development and redevelopment activities.

(5) Due to the long-term nature of certain construction and development contracts and leases included in these lines, the amounts reported in the table represent our estimate of the timing for the related obligations being payable.

(6) Represents contractual obligations pertaining to projects for which we are acting as construction manager on behalf of unrelated parties who are our clients. We expect to be reimbursed in full for these costs by our clients.

(7) Represents contractual obligations pertaining to capital expenditures for our operating properties. We expect to finance these costs primarily using cash flow from operations.

(8) We expect to pay these items using cash flow from operations.

We expect to spend approximately \$110 million on construction and development costs and approximately \$30 million on improvements to operating properties (including the commitments set forth in the table above) during the remainder of 2017. We expect to fund the construction and development costs using primarily borrowings under our Revolving Credit Facility. We expect to fund improvements to existing operating properties using cash flow from operations.

Certain of our debt instruments require that we comply with a number of restrictive financial covenants, including maximum leverage ratio, unencumbered leverage ratio, minimum net worth, minimum fixed charge coverage, minimum unencumbered interest coverage ratio, minimum debt service and maximum secured indebtedness ratio. As of June 30, 2017, we were compliant with these covenants.

Off-Balance Sheet Arrangements

We had no material off-balance sheet arrangements during the six months ended June 30, 2017.

Inflation

Most of our tenants are obligated to pay their share of a property's operating expenses to the extent such expenses exceed amounts established in their leases, which are based on historical expense levels. Some of our tenants are obligated to pay their full share of a building's operating expenses. These arrangements somewhat reduce our exposure to increases in such costs resulting from inflation.

Recent Accounting Pronouncements

See Note 2 to our consolidated financial statements for information regarding recent accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to certain market risks, one of the most predominant of which is a change in interest rates. Increases in interest rates can result in increased interest expense under our Revolving Credit Facility and other variable rate debt. Increases in interest rates can also result in increased interest expense when our fixed rate debt matures and needs to be refinanced.

The following table sets forth as of June 30, 2017 our debt obligations and weighted average interest rates on debt maturing each year (dollars in thousands):

	For the Periods Ending December 31,							
	2017	2018	2019	2020	2021	Thereafter	Total	
Debt:								
Fixed rate debt (1)	\$1,862	\$3,858	\$3,991	\$3,718	\$303,875	\$1,037,509	\$1,354,813	
Weighted average interest rate	4.35	% 4.37	% 4.36	% 3.96	% 3.70	% 4.47	% 4.30	%
Variable rate debt (2)	\$186	\$383	\$194,396	\$112,438	\$—	\$250,000	\$557,403	
Weighted average interest rate (3)	2.90	% 2.90	% 2.39	% 2.51	% —	% 2.86	% 2.63	%

(1) Represents principal maturities only and therefore excludes net discounts and deferred financing costs of \$14.5 million.

(2) As of June 30, 2017, maturities included \$194.0 million in 2019 that may be extended to 2020, subject to certain conditions.

(3) The amounts reflected above used interest rates as of June 30, 2017 for variable rate debt.

The fair value of our debt was \$1.9 billion as of June 30, 2017. If interest rates had been 1% lower, the fair value of our fixed-rate debt would have increased by approximately \$73 million as of June 30, 2017.

See Note 9 to our consolidated financial statements for information pertaining to interest rate swap contracts in place as of June 30, 2017 and their respective fair values.

Based on our variable-rate debt balances, including the effect of interest rate swap contracts, our interest expense would have increased by \$401,000 in the six months ended June 30, 2017 if the applicable LIBOR rate was 1% higher.

Item 4. Controls and Procedures

COPT

(a) Evaluation of Disclosure Controls and Procedures

The Company's management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of June 30, 2017. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures as of June 30, 2017 were functioning effectively to provide reasonable assurance that the information required to be disclosed by the Company in reports filed or submitted under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to the Company's management, including its principal executive and principal financial officers, or persons performing similar

functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Change in Internal Control over Financial Reporting

No change in the Company's internal control over financial reporting occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

COPLP

(a) Evaluation of Disclosure Controls and Procedures

The Operating Partnership's management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of its disclosure controls and procedures (as defined in Rule 15d-15(e) under the Exchange Act) as of June 30, 2017. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Operating Partnership's disclosure controls and procedures as of June 30, 2017 were functioning effectively to provide reasonable assurance that the information required to be disclosed by the Operating Partnership in reports filed or submitted under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods

specified in the SEC's rules and forms, and (ii) accumulated and communicated to the Operating Partnership's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Change in Internal Control over Financial Reporting

No change in the Operating Partnership's internal control over financial reporting occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

We are not currently involved in any material litigation nor, to our knowledge, is any material litigation currently threatened against the Company or the Operating Partnership (other than routine litigation arising in the ordinary course of business, substantially all of which is expected to be covered by liability insurance).

Item 1A. Risk Factors

There have been no material changes to the risk factors included in our 2016 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) During the three months ended June 30, 2017, 2,000 of COPLP's common units were exchanged for 2,000 COPT common shares in accordance with COPLP's Second Amended and Restated Limited Partnership Agreement, as amended. The issuance of these common shares was effected in reliance upon the exemption from registration under Section 4(a)(2) of the Securities Act of 1933, as amended.

(b) Not applicable

(c) Not applicable

Item 3. Defaults Upon Senior Securities

(a) Not applicable

(b) Not applicable

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

(a) Exhibits:

51

EXHIBIT NO.	DESCRIPTION
3.1	<u>Amended and Restated Declaration of Trust of Corporate Office Properties Trust, as amended through May 2017 (filed herewith).</u>
3.2	<u>Amended and Restated Bylaws of Corporate Office Properties Trust, as amended through May 2017 (filed herewith).</u>
10.1	<u>Corporate Office Properties Trust 2017 Omnibus Equity and Incentive Plan (included in Annex B to the Company's Definitive Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission on March 27, 2017 and incorporated herein by reference).</u>
12.1	<u>COPT's Statement regarding Computation of Earnings to Combined Fixed Charges and Preferred Share Dividends (filed herewith).</u>
12.2	<u>COPLP's Statement regarding Computation of Consolidated Ratio of Earnings to Fixed Charges (filed herewith).</u>
31.1	<u>Certification of the Chief Executive Officer of Corporate Office Properties Trust required by Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith).</u>
31.2	<u>Certification of the Chief Financial Officer of Corporate Office Properties Trust required by Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith).</u>
31.3	<u>Certification of the Chief Executive Officer of Corporate Office Properties, L.P. required by Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith).</u>
31.4	<u>Certification of the Chief Financial Officer of Corporate Office Properties, L.P. required by Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith).</u>
32.1	<u>Certification of the Chief Executive Officer of Corporate Office Properties Trust required by Rule 13a-14(b) under the Securities Exchange Act of 1934, as amended. (This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Exchange Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.) (Furnished herewith).</u>
32.2	<u>Certification of the Chief Financial Officer of Corporate Office Properties Trust required by Rule 13a-14(b) under the Securities Exchange Act of 1934, as amended. (This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Exchange Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.) (Furnished herewith).</u>
32.3	<u>Certification of the Chief Executive Officer of Corporate Office Properties, L.P. required by Rule 15d-14(b) under the Securities Exchange Act of 1934, as amended. (This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject</u>

to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Exchange Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.) (Furnished herewith).

32.4 Certification of the Chief Financial Officer of Corporate Office Properties, L.P. required by Rule 15d-14(b) under the Securities Exchange Act of 1934, as amended. (This exhibit shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Exchange Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended). (Furnished herewith).

101.INS XBRL Instance Document (filed herewith).

101.SCH XBRL Taxonomy Extension Schema Document (filed herewith).

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document (filed herewith).

101.LAB XBRL Extension Labels Linkbase (filed herewith).

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document (filed herewith).

101.DEF XBRL Taxonomy Extension Definition Linkbase Document (filed herewith).

52

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the undersigned Registrants have duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CORPORATE OFFICE PROPERTIES TRUST

CORPORATE OFFICE PROPERTIES, L.P.

By: Corporate Office Properties Trust,
its General Partner

/s/ Stephen E. Budorick
Stephen E. Budorick
President and Chief Executive Officer

/s/ Stephen E. Budorick
Stephen E. Budorick
President and Chief Executive Officer

/s/ Anthony Mifsud
Anthony Mifsud
Executive Vice President and Chief Financial
Officer

/s/ Anthony Mifsud
Anthony Mifsud
Executive Vice President and Chief Financial
Officer

Dated: July 31, 2017

Dated: July 31, 2017