

GERMAN AMERICAN BANCORP, INC.
Form 10-Q
August 04, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period
Ended June 30, 2017

Commission File Number 001-15877

German American Bancorp, Inc.
(Exact name of registrant as specified in its charter)
Indiana 35-1547518
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

711 Main Street, Jasper, Indiana 47546
(Address of Principal Executive Offices and Zip Code)

Registrant's telephone number, including area code: (812) 482-1314

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.

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES NO

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:

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting Emerging growth
" " " company " 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.
"

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at August 1, 2017
Common Shares, no par value	22,929,417

CAUTION REGARDING FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

Information included in or incorporated by reference in this Quarterly Report on Form 10-Q, our other filings with the Securities and Exchange Commission (the “SEC”) and our press releases or other public statements, contains or may contain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Please refer to the discussions of our forward-looking statements and associated risks in our Annual Report on Form 10-K for the year ended December 31, 2016, in Item 1, “Business – Forward-Looking Statements and Associated Risks” and our discussion of risk factors in Item 1A, “Risk Factors” of that Annual Report on Form 10-K, as updated from time to time in our subsequent SEC filings, including by Item 2 of Part I of this Report (“Management’s Discussion and Analysis of Financial Condition and Results of Operations”) at the conclusion of that Item 2 under the heading “Forward-Looking Statements and Associated Risks.”

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

GERMAN AMERICAN BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

(unaudited, dollars in thousands except share and per share data)

	June 30, 2017	December 31, 2016
ASSETS		
Cash and Due from Banks	\$36,833	\$48,467
Federal Funds Sold and Other Short-term Investments	7,204	16,349
Cash and Cash Equivalents	44,037	64,816
Securities Available-for-Sale, at Fair Value	740,578	709,786
Loans Held-for-Sale, at Fair Value	9,844	15,273
Loans	2,035,147	1,993,404
Less: Unearned Income	(3,404)	(3,449)
Allowance for Loan Losses	(15,320)	(14,808)
Loans, Net	2,016,423	1,975,147
Stock in FHLB of Indianapolis and Other Restricted Stock, at Cost	13,048	13,048
Premises, Furniture and Equipment, Net	49,249	48,230
Other Real Estate	1,289	242
Goodwill	54,058	54,058
Intangible Assets	2,549	2,835
Company Owned Life Insurance	46,127	46,642
Accrued Interest Receivable and Other Assets	27,601	25,917
TOTAL ASSETS	\$3,004,803	\$2,955,994
LIABILITIES		
Non-interest-bearing Demand Deposits	\$557,535	\$571,989
Interest-bearing Demand, Savings, and Money Market Accounts	1,453,512	1,399,381
Time Deposits	352,274	378,181
Total Deposits	2,363,321	2,349,551
FHLB Advances and Other Borrowings	263,469	258,114
Accrued Interest Payable and Other Liabilities	23,059	18,062
TOTAL LIABILITIES	2,649,849	2,625,727
SHAREHOLDERS' EQUITY		
Preferred Stock, no par value; 500,000 shares authorized, no shares issued	—	—
Common Stock, no par value, \$1 stated value; 45,000,000 shares authorized ⁽¹⁾	22,930	15,261
Additional Paid-in Capital	164,683	171,744
Retained Earnings	163,181	149,666
Accumulated Other Comprehensive (Loss) Income	4,160	(6,404)
TOTAL SHAREHOLDERS' EQUITY	354,954	330,267
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$3,004,803	\$2,955,994
End of period shares issued and outstanding ⁽¹⁾	22,929,627	22,904,157

⁽¹⁾ Share data has been adjusted to reflect a 3-for-2 stock split on April 21, 2017.

See accompanying notes to consolidated financial statements.

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GERMAN AMERICAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME
(unaudited, dollars in thousands except per share data)

	Three Months Ended June 30,	
	2017	2016
INTEREST INCOME		
Interest and Fees on Loans	\$22,602	\$22,670
Interest on Federal Funds Sold and Other Short-term Investments	27	20
Interest and Dividends on Securities:		
Taxable	2,702	2,287
Non-taxable	2,070	1,873
TOTAL INTEREST INCOME	27,401	26,850
INTEREST EXPENSE		
Interest on Deposits	1,626	1,326
Interest on FHLB Advances and Other Borrowings	962	853
TOTAL INTEREST EXPENSE	2,588	2,179
NET INTEREST INCOME	24,813	24,671
Provision for Loan Losses	350	350
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	24,463	24,321
NON-INTEREST INCOME		
Trust and Investment Product Fees	1,350	1,223
Service Charges on Deposit Accounts	1,478	1,534
Insurance Revenues	1,744	1,605
Company Owned Life Insurance	480	247
Interchange Fee Income	1,156	873
Other Operating Income	630	722
Net Gains on Sales of Loans	959	883
Net Gains on Securities	—	968
TOTAL NON-INTEREST INCOME	7,797	8,055
NON-INTEREST EXPENSE		
Salaries and Employee Benefits	11,460	10,184
Occupancy Expense	1,570	1,614
Furniture and Equipment Expense	654	604
FDIC Premiums	232	339
Data Processing Fees	1,044	1,181
Professional Fees	913	780
Advertising and Promotion	630	629
Intangible Amortization	242	312
Other Operating Expenses	2,251	2,696
TOTAL NON-INTEREST EXPENSE	18,996	18,339
Income before Income Taxes	13,264	14,037
Income Tax Expense	3,425	4,249
NET INCOME	\$9,839	\$9,788

Basic Earnings per Share ⁽¹⁾	\$0.43	\$0.43
Diluted Earnings per Share ⁽¹⁾	\$0.43	\$0.43

Dividends per Share ⁽¹⁾ \$0.13 \$0.12

⁽¹⁾ Per share data has been adjusted to reflect a 3-for-2 stock split on April 21, 2017.

See accompanying notes to consolidated financial statements.

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GERMAN AMERICAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME
(unaudited, dollars in thousands except per share data)

	Six Months Ended June 30,	
	2017	2016
INTEREST INCOME		
Interest and Fees on Loans	\$44,864	\$41,334
Interest on Federal Funds Sold and Other Short-term Investments	54	37
Interest and Dividends on Securities:		
Taxable	5,421	4,564
Non-taxable	4,095	3,595
TOTAL INTEREST INCOME	54,434	49,530
INTEREST EXPENSE		
Interest on Deposits	3,069	2,481
Interest on FHLB Advances and Other Borrowings	1,827	1,594
TOTAL INTEREST EXPENSE	4,896	4,075
NET INTEREST INCOME	49,538	45,455
Provision for Loan Losses	850	1,200
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	48,688	44,255
NON-INTEREST INCOME		
Trust and Investment Product Fees	2,593	2,244
Service Charges on Deposit Accounts	2,962	2,767
Insurance Revenues	4,384	4,332
Company Owned Life Insurance	734	462
Interchange Fee Income	2,179	1,661
Other Operating Income	1,487	1,235
Net Gains on Sales of Loans	1,646	1,603
Net Gains on Securities	—	968
TOTAL NON-INTEREST INCOME	15,985	15,272
NON-INTEREST EXPENSE		
Salaries and Employee Benefits	22,904	21,785
Occupancy Expense	3,119	2,993
Furniture and Equipment Expense	1,287	1,112
FDIC Premiums	471	667
Data Processing Fees	2,055	3,346
Professional Fees	1,716	2,098
Advertising and Promotion	1,408	1,173
Intangible Amortization	495	520
Other Operating Expenses	4,577	4,885
TOTAL NON-INTEREST EXPENSE	38,032	38,579
Income before Income Taxes	26,641	20,948
Income Tax Expense	7,246	6,014
NET INCOME	\$19,395	\$14,934

Basic Earnings per Share ⁽¹⁾	\$0.85	\$0.68
Diluted Earnings per Share ⁽¹⁾	\$0.85	\$0.68

Dividends per Share ⁽¹⁾	\$0.26	\$0.24
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⁽¹⁾ Per share data has been adjusted to reflect a 3-for-2 stock split on April 21, 2017.

See accompanying notes to consolidated financial statements.

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GERMAN AMERICAN BANCORP, INC.
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (unaudited, dollars in thousands)

	Three Months Ended June 30, 2017 2016	
NET INCOME	\$9,839	\$9,788
Other Comprehensive Income:		
Unrealized Gains on Securities		
Unrealized Holding Gain Arising During the Period	10,133	6,134
Reclassification Adjustment for Losses (Gains) Included in Net Income	—	(968)
Tax Effect	(3,567)	(1,812)
Net of Tax	6,566	3,354
Total Other Comprehensive Income	6,566	3,354
COMPREHENSIVE INCOME	\$16,405	\$13,142

	Six Months Ended June 30, 2017 2016	
NET INCOME	\$19,395	\$14,934
Other Comprehensive Income:		
Unrealized Gains on Securities		
Unrealized Holding Gain Arising During the Period	16,312	12,343
Reclassification Adjustment for Losses (Gains) Included in Net Income	—	(968)
Tax Effect	(5,748)	(3,992)
Net of Tax	10,564	7,383
Total Other Comprehensive Income	10,564	7,383
COMPREHENSIVE INCOME	\$29,959	\$22,317

See accompanying notes to consolidated financial statements.

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GERMAN AMERICAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, dollars in thousands)

	Six Months Ended June 30,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$19,395	\$14,934
Adjustments to Reconcile Net Income to Net Cash from Operating Activities:		
Net Amortization on Securities	1,669	1,884
Depreciation and Amortization	2,317	2,227
Loans Originated for Sale	(57,304)	(53,059)
Proceeds from Sales of Loans Held-for-Sale	64,286	60,430
Provision for Loan Losses	850	1,200
Gain on Sale of Loans, net	(1,646)	(1,603)
Gain on Securities, net	—	(968)
Loss (Gain) on Sales of Other Real Estate and Repossessed Assets	(7 )	) 1
Loss on Disposition and Donation of Premises and Equipment	2	5
Increase in Cash Surrender Value of Company Owned Life Insurance	(759)	(502)
Equity Based Compensation	637	528
Change in Assets and Liabilities:		
Interest Receivable and Other Assets	(196 )	) 5,736
Interest Payable and Other Liabilities	(751)	(2,307)
Net Cash from Operating Activities	28,493	28,506
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Other Short-term Investments	—	(1,000)
Proceeds from Maturity of Other Short-term Investments	—	248
Proceeds from Maturities, Calls, Redemptions of Securities Available-for-Sale	40,792	46,809
Proceeds from Sales of Securities Available-for-Sale	—	105,339
Purchase of Securities Available-for-Sale	(56,941)	(91,368)
Proceeds from Maturities of Securities Held-to-Maturity	—	95
Purchase of Federal Home Loan Bank Stock	—	(1,350)
Purchase of Loans	(59)	(4,488)
Loans Made to Customers, net of Payments Received	(43,297)	(74,838)
Proceeds from Sales of Other Real Estate	190	869
Property and Equipment Expenditures	(3,302)	(1,504)
Acquisition of River Valley Bancorp	—	(793)
Net Cash from Investing Activities	(62,617)	(21,981)
CASH FLOWS FROM FINANCING ACTIVITIES		
Change in Deposits	13,909	45,673
Change in Short-term Borrowings	(18,851)	(24,888)
Advances in Long-term Debt	50,000	—
Repayments of Long-term Debt	(25,804)	(20,096)
Issuance of Common Stock	(29 )	) 54
Dividends Paid	(5,880)	(5,137)
Net Cash from Financing Activities	13,345	(4,394)
Net Change in Cash and Cash Equivalents	(20,779)	2,131

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Cash and Cash Equivalents at Beginning of Year	64,816	52,009
Cash and Cash Equivalents at End of Period	\$44,037	\$54,140
Cash Paid During the Period for		
Interest	\$4,913	\$3,901
Income Taxes	7,239	5,133
Supplemental Non Cash Disclosures		
Loans Transferred to Other Real Estate	\$1,230	\$10
Reclassification of Land to Other Assets	330	—

See accompanying notes to consolidated financial statements.

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GERMAN AMERICAN BANCORP, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 June 30, 2017
 (unaudited, dollars in thousands except share and per share data)

NOTE 1 – Basis of Presentation

German American Bancorp, Inc. operates primarily in the banking industry. The accounting and reporting policies of German American Bancorp, Inc. and its subsidiaries (hereinafter collectively referred to as the "Company") conform to U.S. generally accepted accounting principles. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. All adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the periods reported have been included in the accompanying unaudited consolidated financial statements, and all such adjustments are of a normal recurring nature. It is suggested that these consolidated financial statements and notes be read in conjunction with the financial statements and notes thereto in the Company's Annual Report on Form 10-K for the year ended December 31, 2016. Certain items included in the prior period financial statements were reclassified to conform to the current presentation. There was no effect on net income or total shareholders' equity based on these reclassifications.

NOTE 2 - Common Stock Split

On March 27, 2017, the Company declared a 3-for-2 stock split on the Company's authorized and outstanding common shares. The stock split was distributed on April 21, 2017, to shareholders of record as of April 6, 2017. All share and per share data in this Quarterly Report on Form 10-Q relating to a date or period that precedes April 21, 2017 have been adjusted to retroactively reflect the stock split.

NOTE 3 – Per Share Data

The computation of Basic Earnings per Share and Diluted Earnings per Share are as follows:

	Three Months Ended June 30, 2017 2016	
Basic Earnings per Share:		
Net Income	\$9,839	\$ 9,788
Weighted Average Shares Outstanding ⁽¹⁾	22,929,422	22,884,028
Basic Earnings per Share	\$0.43	\$ 0.43
Diluted Earnings per Share:		
Net Income	\$9,839	\$ 9,788
Weighted Average Shares Outstanding ⁽¹⁾	22,929,422	22,884,028
Potentially Dilutive Shares, Net	—	1,801
Diluted Weighted Average Shares Outstanding ⁽¹⁾	22,929,422	22,885,829
Diluted Earnings per Share	\$0.43	\$ 0.43

⁽¹⁾ Share and per share data has been adjusted to reflect a 3-for-2 stock split on April 21, 2017.

For the three months ended June 30, 2017 and 2016, there were no anti-dilutive shares.

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(unaudited, dollars in thousands except share and per share data)

NOTE 3 - Per Share Data (continued)

	Six Months Ended June 30,	
	2017	2016
Basic Earnings per Share:		
Net Income	\$ 19,395	\$ 14,934
Weighted Average Shares Outstanding ⁽¹⁾	22,919,092	21,885,655
Basic Earnings per Share	\$0.85	\$ 0.68
Diluted Earnings per Share:		
Net Income	\$ 19,395	\$ 14,934
Weighted Average Shares Outstanding ⁽¹⁾	22,919,092	21,885,655
Potentially Dilutive Shares, Net	—	3,958
Diluted Weighted Average Shares Outstanding ⁽¹⁾	22,919,092	21,889,613
Diluted Earnings per Share	\$0.85	\$ 0.68

⁽¹⁾ Share and per share data has been adjusted to reflect a 3-for-2 stock split on April 21, 2017.

For the six months ended June 30, 2017 and 2016, there were no anti-dilutive shares.

NOTE 4 – Securities

The amortized cost, unrealized gross gains and losses recognized in accumulated other comprehensive income (loss), and fair value of Securities Available-for-Sale at June 30, 2017 and December 31, 2016, were as follows:

Securities Available-for-Sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2017				
Obligations of State and Political Subdivisions	\$ 258,242	\$ 9,337	\$(592)	\$ 266,987
MBS/CMO - Residential	475,440	2,096	(4,298)	473,238
Equity Securities	353	—	—	353
Total	\$ 734,035	\$ 11,433	\$(4,890)	\$ 740,578
December 31, 2016				
Obligations of State and Political Subdivisions	\$ 247,350	\$ 3,847	\$(3,678)	\$ 247,519
MBS/CMO - Residential	471,852	480	(10,418)	461,914
Equity Securities	353	—	—	353
Total	\$ 719,555	\$ 4,327	\$(14,096)	\$ 709,786

Equity securities that do not have readily determinable fair values are included in the above totals, are carried at historical cost and are evaluated for impairment on a periodic basis. All mortgage-backed securities in the above table are residential mortgage-backed securities and guaranteed by government sponsored entities.

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(unaudited, dollars in thousands except share and per share data)

NOTE 4 - Securities (continued)

The amortized cost and fair value of securities at June 30, 2017 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because some issuers have the right to call or prepay certain obligations with or without call or prepayment penalties. Mortgage-backed and Equity Securities are not due at a single maturity date and are shown separately in the table below.

Securities Available-for-Sale:	Amortized Cost	Fair Value
Due in one year or less	\$ 2,282	\$ 2,303
Due after one year through five years	22,311	23,357
Due after five years through ten years	75,810	79,589
Due after ten years	157,839	161,738
MBS/CMO - Residential	475,440	473,238
Equity Securities	353	353
Total	\$ 734,035	\$ 740,578

Proceeds from the Sales of Securities are summarized below:

	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016
Proceeds from Sales	\$ —	—\$ 42,364
Gross Gains on Sales	—	968
Income Taxes on Gross Gains	—	339

	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
Proceeds from Sales	\$ —	—\$ 105,339
Gross Gains on Sales	—	968
Income Taxes on Gross Gains	—	339

The carrying value of securities pledged to secure repurchase agreements, public and trust deposits, and for other purposes as required by law was \$174,047 and \$186,572 as of June 30, 2017 and December 31, 2016, respectively.

Below is a summary of securities with unrealized losses as of June 30, 2017 and December 31, 2016, presented by length of time the securities have been in a continuous unrealized loss position:

	Less than 12 Months Fair Value	Unrealized Loss	12 Months or More Fair Value	Unrealized Loss	Total Fair Value	Unrealized Loss
June 30, 2017						

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Obligations of State and Political Subdivisions	\$ 35,898	\$ (592)	\$—	\$—	\$ 35,898	\$ (592)
MBS/CMO - Residential	241,223	(3,198)	45,397	(1,100)	286,620	(4,298)
Equity Securities	—	—	—	—	—	—
Total	\$ 277,121	\$ (3,790)	\$ 45,397	\$ (1,100)	\$ 322,518	\$ (4,890)
			Less than 12 Months	12 Months or More	Total	
December 31, 2016	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Obligations of State and Political Subdivisions	\$ 108,918	\$ (3,678)	\$—	\$—	\$ 108,918	\$ (3,678)
MBS/CMO - Residential	356,040	(8,782)	47,271	(1,636)	403,311	(10,418)
Equity Securities	—	—	—	—	—	—
Total	\$ 464,958	\$ (12,460)	\$ 47,271	\$ (1,636)	\$ 512,229	\$ (14,096)

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GERMAN AMERICAN BANCORP, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(unaudited, dollars in thousands except share and per share data)

NOTE 4 - Securities (continued)

Securities are written down to fair value when a decline in fair value is not considered temporary. In estimating other-than-temporary losses, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The Company does not intend to sell or expect to be required to sell these securities, and the decline in fair value is largely due to changes in market interest rates. Therefore, the Company does not consider these securities to be other-than-temporarily impaired. All mortgage-backed securities and collateralized mortgage obligations (MBS/CMO - Residential) in the Company's portfolio are guaranteed by government sponsored entities, are investment grade, and are performing as expected.

The Company's equity securities consist of one non-controlling investment in a single banking organization at June 30, 2017 and December 31, 2016. The original investment totaled \$1,350 and other-than-temporary impairment was previously recorded totaling \$997. When a decline in fair value below cost is deemed to be other-than-temporary, the unrealized loss must be recognized as a charge to earnings.

NOTE 5 – Derivatives

The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. The notional amounts of these interest rate swaps and the offsetting counterparty derivative instruments were \$84.5 million at June 30, 2017 and \$67.9 million at December 31, 2016. These interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions with approved, reputable, independent counterparties with substantially matching terms. The agreements are considered stand alone derivatives and changes in the fair value of derivatives are reported in earnings as non-interest income.

Credit risk arises from the possible inability of counterparties to meet the terms of their contracts. The Company's exposure is limited to the replacement value of the contracts rather than the notional, principal or contract amounts. There are provisions in the agreements with the counterparties that allow for certain unsecured credit exposure up to an agreed threshold. Exposures in excess of the agreed thresholds are collateralized. In addition, the Company minimizes credit risk through credit approvals, limits, and monitoring procedures.

The following table reflects the fair value hedges included in the Consolidated Balance Sheets as of:

	June 30, 2017		December 31, 2016	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Included in Other Assets:				
Interest Rate Swaps	\$84,546	\$ 1,655	\$67,902	\$ 1,291
Included in Other Liabilities:				
Interest Rate Swaps	\$84,546	\$ 1,736	\$67,902	\$ 1,238

The following table presents the effect of derivative instruments on the Consolidated Statements of Income for the periods presented:

	Three Months Ended June 30, 2016	Six Months Ended June 30, 2017	2016
Interest Rate Swaps:			
Included in Other Operating Income	\$-\$104	\$348	\$158

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited, dollars in thousands except share and per share data)

NOTE 6 – Loans

Loans were comprised of the following classifications at June 30, 2017 and December 31, 2016:

	June 30, 2017	December 31, 2016
Commercial:		
Commercial and Industrial Loans and Leases	\$467,754	\$457,372
Commercial Real Estate Loans	870,100	856,094
Agricultural Loans	313,254	303,128
Retail:		
Home Equity Loans	141,377	133,575
Consumer Loans	61,185	59,945
Residential Mortgage Loans	181,477	183,290
Subtotal	2,035,147	1,993,404
Less: Unearned Income	(3,404)	(3,449)
Allowance for Loan Losses	(15,320)	(14,808)
Loans, Net	\$2,016,423	\$1,975,147

The following tables present the activity in the allowance for loan losses by portfolio class for the three months ended June 30, 2017 and 2016:

June 30, 2017	Commercial							Unallocated	Total
	and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans			
Beginning Balance	\$ 3,612	\$ 5,696	\$ 4,361	\$ 299	\$ 244	\$ 348	\$ 606	\$15,166	
Provision for Loan Losses	62	(259)	468	16	54	19	(10)	350	
Recoveries	7	34	—	2	67	8	—	118	
Loans Charged-off	(9)	(155)	—	(17)	(111)	(22)	—	(314)	
Ending Balance	\$ 3,672	\$ 5,316	\$ 4,829	\$ 300	\$ 254	\$ 353	\$ 596	\$15,320	

June 30, 2016	Commercial							Unallocated	Total
	and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans			
Beginning Balance	\$ 4,346	\$ 6,463	\$ 2,529	\$ 352	\$ 230	\$ 531	\$ 710	\$15,161	
Provision for Loan Losses	(180)	68	175	9	66	196	16	350	
Recoveries	24	2	—	—	43	4	—	73	
Loans Charged-off	—	—	—	(11)	(97)	(172)	—	(280)	
Ending Balance	\$ 4,190	\$ 6,533	\$ 2,704	\$ 350	\$ 242	\$ 559	\$ 726	\$15,304	

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(unaudited, dollars in thousands except share and per share data)

NOTE 6 - Loans (continued)

The following tables present the activity in the allowance for loan losses by portfolio class for the six months ended June 30, 2017 and 2016:

	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
June 30, 2017								
Beginning Balance	\$ 3,725	\$ 5,452	\$ 4,094	\$ 283	\$ 235	\$ 329	\$ 690	\$ 14,808
Provision for Loan Losses	(53)	19	735	33	172	38	(94)	850
Recoveries	9	39	—	2	127	35	—	212
Loans Charged-off	(9)	(194)	—	(18)	(280)	(49)	—	(550)
Ending Balance	\$ 3,672	\$ 5,316	\$ 4,829	\$ 300	\$ 254	\$ 353	\$ 596	\$ 15,320
June 30, 2016								
Beginning Balance	\$ 4,242	\$ 6,342	\$ 2,115	\$ 383	\$ 230	\$ 414	\$ 712	\$ 14,438
Provision for Loan Losses	(75)	188	589	40	93	351	14	1,200
Recoveries	28	3	—	1	88	9	—	129
Loans Charged-off	(5)	—	—	(74)	(169)	(215)	—	(463)
Ending Balance	\$ 4,190	\$ 6,533	\$ 2,704	\$ 350	\$ 242	\$ 559	\$ 726	\$ 15,304

In determining the adequacy of the allowance for loan loss, general allocations are made for pools of loans, including non-classified loans, homogeneous portfolios of consumer and residential real estate loans, and loans within certain industry categories believed to present unique risk of loss. General allocations of the allowance are primarily made based on historical averages for loan losses for these portfolios, judgmentally adjusted for current economic factors and portfolio trends.

Loan impairment is reported when full repayment under the terms of the loan is not expected. This methodology is used for all loans, including loans acquired with deteriorated credit quality if such loans perform worse than what was expected at the time of acquisition. For purchased loans, the assessment is made at the time of acquisition as well as over the life of loan. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate, or at the fair value of collateral if repayment is expected solely from the collateral. Commercial and industrial loans, commercial real estate loans, and agricultural loans are evaluated individually for impairment. Smaller balance homogeneous loans are evaluated for impairment in total. Such loans include real estate loans secured by one-to-four family residences and loans to individuals for household, family and other personal expenditures. Individually evaluated loans on non-accrual are generally considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Specific allocations on impaired loans are determined by comparing the loan balance to the present value of expected cash flows or expected collateral proceeds. Allocations are also applied to categories of loans not considered individually impaired but for which the rate of loss is expected to be greater than historical averages, including non-performing consumer or residential real estate loans. Such allocations are based on past loss experience and information about specific borrower situations and estimated collateral values.

GERMAN AMERICAN BANCORP, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 6 - Loans (continued)

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio class and based on impairment method as of June 30, 2017 and December 31, 2016:

June 30, 2017	Total	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated
Allowance for Loan Losses:								
Ending Allowance Balance Attributable to Loans:								
Individually Evaluated for Impairment	\$260	\$10	\$180	\$70	\$—	\$—	\$—	\$—
Collectively Evaluated for Impairment	15,000	3,659	5,132	4,711	300	249	353	596
Acquired with Deteriorated Credit Quality	60	3	4	48	—	5	—	—
Total Ending Allowance Balance	\$15,320	\$3,672	\$5,316	\$4,829	\$300	\$254	\$353	\$596
Loans:								
Loans Individually Evaluated for Impairment	\$1,413	\$187	\$836	\$390	\$—	\$—	\$—	n/m ⁽²⁾
Loans Collectively Evaluated for Impairment	2,031,844	467,531	864,532	315,691	141,851	61,281	180,958	n/m ⁽²⁾
Loans Acquired with Deteriorated Credit Quality	9,513	1,247	6,602	683	—	53	928	n/m ⁽²⁾
Total Ending Loans Balance ⁽¹⁾	\$2,042,770	\$468,965	\$871,970	\$316,764	\$141,851	\$61,334	\$181,886	n/m ⁽²⁾

⁽¹⁾Total recorded investment in loans includes \$7,623 in accrued interest.

⁽²⁾n/m = not meaningful

December 31, 2016	Total	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated
Allowance for Loan Losses:								

Ending Allowance Balance Attributable to Loans:								
Individually Evaluated for Impairment	\$255	\$24	\$231	\$—	\$—	\$—	\$—	\$—
Collectively Evaluated for Impairment	14,448	3,698	5,172	4,046	283	230	329	690
Acquired with Deteriorated Credit Quality	105	3	49	48	—	5	—	—
Total Ending Allowance Balance	\$14,808	\$3,725	\$5,452	\$4,094	\$283	\$235	\$329	\$690
Loans:								
Loans Individually Evaluated for Impairment	\$1,239	\$113	\$832	\$294	\$—	\$—	\$—	n/m ⁽²⁾
Loans Collectively Evaluated for Impairment	1,989,128	456,769	849,510	305,946	134,032	60,046	182,825	n/m ⁽²⁾
Loans Acquired with Deteriorated Credit Quality	11,048	1,656	7,688	706	—	53	945	n/m ⁽²⁾
Total Ending Loans Balance ⁽¹⁾	\$2,001,415	\$458,538	\$858,030	\$306,946	\$134,032	\$60,099	\$183,770	n/m ⁽²⁾

⁽¹⁾Total recorded investment in loans includes \$8,011 in accrued interest.

⁽²⁾n/m = not meaningful

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NOTE 6 - Loans (continued)

The following tables present loans individually evaluated for impairment by class of loans as of June 30, 2017 and December 31, 2016:

June 30, 2017	Unpaid Principal Balance ⁽¹⁾	Recorded Investment	Allowance for Loan Losses Allocated
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	\$ 196	\$ 139	\$ —
Commercial Real Estate Loans	838	450	—
Agricultural Loans	199	162	—
Subtotal	1,233	751	—
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	105	64	13
Commercial Real Estate Loans	800	791	184
Agricultural Loans	806	715	118
Subtotal	1,711	1,570	315
Total	\$ 2,944	\$ 2,321	\$ 315
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	\$ 581	\$ 203	\$ —
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	\$ 844	\$ 705	\$ 55

⁽¹⁾ Unpaid Principal Balance is the remaining contractual payments gross of partial charge-offs and discounts.

December 31, 2016	Unpaid Principal Balance ⁽¹⁾	Recorded Investment	Allowance for Loan Losses Allocated
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	\$ 85	\$ 29	\$ —
Commercial Real Estate Loans	1,278	784	—
Agricultural Loans	356	294	—
Subtotal	1,719	1,107	—
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	148	107	27
Commercial Real Estate Loans	839	827	280
Agricultural Loans	588	497	48
Subtotal	1,575	1,431	355
Total	\$ 3,294	\$ 2,538	\$ 355
	\$ 1,018	\$ 531	\$ —

Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)			
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	\$ 910	\$ 768	\$ 100

⁽¹⁾ Unpaid Principal Balance is the remaining contractual payments gross of partial charge-offs and discounts.

GERMAN AMERICAN BANCORP, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 June 30, 2017
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NOTE 6 - Loans (continued)

The following tables present loans individually evaluated for impairment by class of loans for the three month period ended June 30, 2017 and 2016:

June 30, 2017	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	\$ 150	\$ 2	\$ 1
Commercial Real Estate Loans	1,124	26	26
Agricultural Loans	496	19	16
Subtotal	1,770	47	43
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	65	1	—
Commercial Real Estate Loans	795	4	—
Agricultural Loans	727	—	—
Subtotal	1,587	5	—
Total	\$ 3,357	\$ 52	\$ 43
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	\$ 245	\$ 25	\$ 25
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	\$ 712	\$ 4	\$ —
June 30, 2016	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	\$ 185	\$ 3	\$ 1
Commercial Real Estate Loans	3,397	6	1
Agricultural Loans	845	—	—
Subtotal	4,427	9	2
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	86	—	—
Commercial Real Estate Loans	2,198	1	—
Agricultural Loans	—	—	—
Subtotal	2,284	1	—
Total	\$ 6,711	\$ 10	\$ 2
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	\$ 2,324	\$ 4	\$ 1
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	\$ —	\$ —	\$ —

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 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 6 - Loans (continued)

The following tables present loans individually evaluated for impairment by class of loans for the six month period ended June 30, 2017 and 2016:

June 30, 2017	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	\$ 83	\$ 2	\$ 2
Commercial Real Estate Loans	823	30	29
Agricultural Loans	607	24	16
Subtotal	1,513	56	47
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	84	2	1
Commercial Real Estate Loans	1,609	10	6
Agricultural Loans	612	—	—
Subtotal	2,305	12	7
Total	\$ 3,818	\$ 68	\$ 54
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	\$ 311	\$ 25	\$ 25
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	\$ 721	\$ 11	\$ 7
June 30, 2016	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	\$ 133	\$ 25	\$ 12
Commercial Real Estate Loans	1,988	24	4
Agricultural Loans	428	2	1
Subtotal	2,549	51	17
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	108	—	—
Commercial Real Estate Loans	2,216	2	—
Agricultural Loans	—	—	—
Subtotal	2,324	2	—
Total	\$ 4,873	\$ 53	\$ 17
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	\$ 1,697	\$ 12	\$ 2
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	\$ —	\$ —	\$ —

All classes of loans, including loans acquired with deteriorated credit quality, are generally placed on non-accrual status when scheduled principal or interest payments are past due for 90 days or more or when the borrower's ability to repay becomes doubtful. For purchased loans, the determination is made at the time of acquisition as well as over the life of the loan. Uncollected accrued interest for each class of loans is reversed against income at the time a loan is placed on non-accrual. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. All classes of loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments

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NOTE 6 - Loans (continued)

are reasonably assured. Loans are typically charged-off at 180 days past due, or earlier if deemed uncollectible. Exceptions to the non-accrual and charge-off policies are made when the loan is well secured and in the process of collection.

The following tables present the recorded investment in non-accrual loans and loans past due 90 days or more still on accrual by class of loans as of June 30, 2017 and December 31, 2016:

	Non-Accrual Loans		Loans Past Due 90 Days or More & Still Accruing	
	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016
Commercial and Industrial Loans and Leases	\$60	\$ 86	\$ —	\$ 2
Commercial Real Estate Loans	982	1,408	32	—
Agricultural Loans	878	792	31	—
Home Equity Loans	72	73	—	—
Consumer Loans	433	85	—	—
Residential Mortgage Loans	672	1,349	—	—
Total	\$3,097	\$ 3,793	\$ 63	\$ 2
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	\$820	\$ 1,264	\$ —	\$ —

The following tables present the aging of the recorded investment in past due loans by class of loans as of June 30, 2017 and December 31, 2016:

June 30, 2017	Total	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Loans Not Past Due
Commercial and Industrial Loans and Leases	\$468,965	\$ 51	\$ 3	\$ 53	\$107	\$468,858
Commercial Real Estate Loans	871,970	1,060	52	393	1,505	870,465
Agricultural Loans	316,764	110	—	746	856	315,908
Home Equity Loans	141,851	234	19	72	325	141,526
Consumer Loans	61,334	164	40	433	637	60,697
Residential Mortgage Loans	181,886	2,791	982	382	4,155	177,731
Total ⁽¹⁾	\$2,042,770	\$ 4,410	\$ 1,096	\$ 2,079	\$7,585	\$2,035,185
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	\$9,513	\$ —	\$ —	\$ 568	\$568	\$8,945

⁽¹⁾Total recorded investment in loans includes \$7,623 in accrued interest.

December 31, 2016	Total	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Loans Not Past Due
Commercial and Industrial Loans and Leases	\$458,538	\$ 20	\$ 4	\$ 77	\$ 101	\$458,437
Commercial Real Estate Loans	858,030	1,509	21	330	1,860	856,170

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Agricultural Loans	306,946	84	50	610	744	306,202
Home Equity Loans	134,032	707	16	73	796	133,236
Consumer Loans	60,099	175	147	85	407	59,692
Residential Mortgage Loans	183,770	3,470	1,251	806	5,527	178,243
Total ⁽¹⁾	\$2,001,415	\$ 5,965	\$ 1,489	\$ 1,981	\$ 9,435	\$1,991,980
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	\$11,048	\$ 130	\$ —	\$ 627	\$ 757	\$10,291
Loans Acquired in Current Year (Included in the Total Above)	\$262,809	\$ 2,752	\$ 862	\$ 1,126	\$ 4,740	\$258,069

⁽¹⁾Total recorded investment in loans includes \$8,011 in accrued interest.

GERMAN AMERICAN BANCORP, INC.
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NOTE 6 - Loans (continued)

Troubled Debt Restructurings:

In certain instances, the Company may choose to restructure the contractual terms of loans. A troubled debt restructuring occurs when the Bank grants a concession to the borrower that it would not otherwise consider due to a borrower's financial difficulty. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without modification. This evaluation is performed under the Company's internal underwriting policy. The Company uses the same methodology for loans acquired with deteriorated credit quality as for all other loans when determining whether the loan is a troubled debt restructuring.

During the three months ended June 30, 2017 there was one loan modified as a troubled debt restructuring. During the six months ended June 30, 2017, there were two loans modified as troubled debt restructurings. During the three and six months ended June 30, 2016, there were no loans modified as troubled debt restructurings.

The following tables present the recorded investment of troubled debt restructurings by class of loans as of June 30, 2017 and December 31, 2016:

June 30, 2017	Total	Performing	Non-Accrual ⁽¹⁾
Commercial and Industrial Loans and Leases	\$ 127	\$ 127	\$ —
Commercial Real Estate Loans	27	27	—
Total	\$ 154	\$ 154	\$ —
December 31, 2016	Total	Performing	Non-Accrual ⁽¹⁾
Commercial and Industrial Loans and Leases	\$ 28	\$ 28	\$ —
Commercial Real Estate Loans	—	—	—
Total	\$ 28	\$ 28	\$ —

⁽¹⁾The non-accrual troubled debt restructurings are included in the Non-Accrual Loan table presented on a previous page.

The Company had not committed to lending any additional amounts as of June 30, 2017 and December 31, 2016 to customers with outstanding loans that are classified as troubled debt restructurings. The total allowance associated with the loans modified as troubled debt restructurings as of June 30, 2017 and December 31, 2016 was \$16 and \$3, respectively.

The following tables present loans by class modified as troubled debt restructurings that occurred during the three months ending June 30, 2017 and 2016:

June 30, 2017	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and Industrial Loans and Leases	1	\$ 127	\$ 127
Commercial Real Estate Loans	—	—	—
Total	1	\$ 127	\$ 127

The troubled debt restructurings described above increased the allowance for loan losses by \$8 and resulted in charge-offs of \$0 during the three months ending June 30, 2017.

June 30, 2016	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	
Commercial and Industrial Loans and Leases	—	\$	—	\$
Commercial Real Estate Loans	—	—	—	—
Total	—	\$	—	\$

The troubled debt restructurings described above increased the allowance for loan losses by \$0 and resulted in charge-offs of \$0 during the three months ending June 30, 2016.

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NOTE 6 - Loans (continued)

The following tables present loans by class modified as troubled debt restructurings that occurred during the six months ending June 30, 2017 and 2016:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
June 30, 2017			
Commercial and Industrial Loans and Leases	1	\$ 127	\$ 127
Commercial Real Estate Loans	1	28	28
Total	2	\$ 155	\$ 155

The troubled debt restructurings described above increased the allowance for loan losses by \$10 and resulted in charge-offs of \$0 during the six months ending June 30, 2017.

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
June 30, 2016			
Commercial and Industrial Loans and Leases	—	\$ —	\$ —
Commercial Real Estate Loans	—	—	—
Total	—	\$ —	\$ —

The troubled debt restructurings described above increased the allowance for loan losses by \$0 and resulted in charge-offs of \$0 during the six months ending June 30, 2016.

Additionally, there were no loans modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the three and six months ending June 30, 2017 and 2016.

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company classifies loans as to credit risk by individually analyzing loans. This analysis includes commercial and industrial loans, commercial real estate loans, and agricultural loans with an outstanding balance greater than \$250. This analysis is typically performed on at least an annual basis. The Company uses the following definitions for risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

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NOTE 6 - Loans (continued)

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

June 30, 2017	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and Industrial Loans and Leases	\$449,772	\$8,792	\$10,401	\$—	—\$468,965
Commercial Real Estate Loans	833,572	23,865	14,533	—	871,970
Agricultural Loans	287,410	26,230	3,124	—	316,764
Total	\$1,570,754	\$58,887	\$28,058	\$—	—\$1,657,699
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	\$1,479	\$3,120	\$3,933	\$—	—\$8,532
December 31, 2016	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and Industrial Loans and Leases	\$437,353	\$10,454	\$10,731	\$—	—\$458,538
Commercial Real Estate Loans	814,033	26,549	17,448	—	858,030
Agricultural Loans	287,975	14,670	4,301	—	306,946
Total	\$1,539,361	\$51,673	\$32,480	\$—	—\$1,623,514
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	\$1,897	\$3,121	\$5,032	\$—	—\$10,050
Loans Acquired in Current Year (Included in the Total Above)	\$175,915	\$11,638	\$8,145	\$—	—\$195,698

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For home equity, consumer and residential mortgage loan classes, the Company also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in home equity, consumer and residential mortgage loans based on payment activity as of June 30, 2017 and December 31, 2016:

June 30, 2017	Home Equity Loans	Consumer Loans	Residential Mortgage Loans
Performing	\$141,779	\$60,901	\$181,214
Nonperforming	72	433	672
Total	\$141,851	\$61,334	\$181,886
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	\$—	\$53	\$928
December 31, 2016	Home Equity Loans	Consumer Loans	Residential Mortgage Loans
Performing	\$133,959	\$60,014	\$182,421
Nonperforming	73	85	1,349
Total	\$134,032	\$60,099	\$183,770
Loans Acquired With Deteriorated Credit Quality	\$—	\$53	\$945

(Included in the Total Above)

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NOTE 6 - Loans (continued)

The Company has purchased loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The recorded investment of those loans is as follows:

	June 30, December	
	2017	31, 2016
Commercial and Industrial Loans	\$ 1,247	\$ 1,656
Commercial Real Estate Loans	6,602	7,688
Agricultural Loans	683	706
Consumer Loans	53	53
Residential Mortgage Loans	928	945
Total	\$ 9,513	\$ 11,048

Carrying Amount, Net of Allowance \$ 9,453 \$ 10,943

Accretable yield, or income expected to be collected, is as follows:

	2017	2016
Balance at April 1	\$2,790	\$2,613
New Loans Purchased	—	—
Accretion of Income	(240)	(415)
Reclassifications from Non-accretable Difference	155	—
Charge-off of Accretable Yield	—	—
Balance at June 30	\$2,705	\$2,198

For those purchased loans disclosed above, the Company did not increase the allowance for loan losses during the three months ended June 30, 2017 and 2016. The Company reversed allowances for loan losses of \$56 during the three months ended June 30, 2017. No allowance for loan losses were reversed during the three months ended June 30, 2016.

	2017	2016
Balance at January 1	\$2,521	\$1,279
New Loans Purchased	—	1,395
Accretion of Income	(282)	(476)
Reclassifications from Non-accretable Difference	466	—
Charge-off of Accretable Yield	—	—
Balance at June 30	\$2,705	\$2,198

For those purchased loans disclosed above, the Company increased the allowance for loan losses by \$11 and \$0 during the six months ended June 30, 2017 and 2016. The Company reversed allowances for loan losses of \$56 during the six months ended June 30, 2017. No allowance for loan losses was reversed during the six months ended June 30, 2016.

The carrying amount of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements of the applicable jurisdiction totaled \$137 as of June 30, 2017 and \$202 as of December 31, 2016.

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NOTE 7 – Repurchase Agreements Accounted for as Secured Borrowings

Repurchase agreements are short-term borrowings included in FHLB Advances and Other Borrowings and mature overnight and continuously. Repurchase agreements, which were secured by mortgage-backed securities, totaled \$43,026 and \$42,412 as of June 30, 2017 and December 31, 2016, respectively. Risk could arise when the collateral pledged to a repurchase agreement declines in fair value. The Company minimizes risk by consistently monitoring the value of the collateral pledged. At the point in time where the collateral has declined in fair value, the Company is required to provide additional collateral based on the value of the underlying securities.

NOTE 8 – Segment Information

The Company's operations include three primary segments: core banking, trust and investment advisory services, and insurance operations. The core banking segment involves attracting deposits from the general public and using such funds to originate consumer, commercial and agricultural, commercial and agricultural real estate, and residential mortgage loans, primarily in the Company's local markets. The core banking segment also involves the sale of residential mortgage loans in the secondary market. The trust and investment advisory services segment involves providing trust, investment advisory, and brokerage services to customers. The insurance segment offers a full range of personal and corporate property and casualty insurance products, primarily in the Company's banking subsidiary's local markets.

The core banking segment is comprised by the Company's banking subsidiary, German American Bancorp, which operated through 52 banking offices at June 30, 2017. Net interest income from loans and investments funded by deposits and borrowings is the primary revenue for the core-banking segment. The trust and investment advisory services segment's revenues are comprised primarily of fees generated by the trust operations of the Company's banking subsidiary and by German American Investment Services, Inc. These fees are derived by providing trust, investment advisory, and brokerage services to its customers. The insurance segment primarily consists of German American Insurance, Inc., which provides a full line of personal and corporate insurance products. Commissions derived from the sale of insurance products are the primary source of revenue for the insurance segment.

The following segment financial information has been derived from the internal financial statements of the Company which are used by management to monitor and manage financial performance. The accounting policies of the three segments are the same as those of the Company. The evaluation process for segments does not include holding company income and expense. Holding company amounts are the primary differences between segment amounts and consolidated totals, and are reflected in the column labeled "Other" below, along with amounts to eliminate transactions between segments.

	Core Banking	Trust and Investment Advisory Services	Insurance	Other	Consolidated Totals
Three Months Ended June 30, 2017					
Net Interest Income	\$ 24,999	\$ 1	\$ 2	\$(189)	\$ 24,813
Net Gains on Sales of Loans	959	—	—	—	959
Net Gains on Securities	—	—	—	—	—
Trust and Investment Product Fees	1	1,350	—	(1)	1,350

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Insurance Revenues	12	8	1,724	—	1,744
Noncash Items:					
Provision for Loan Losses	350	—	—	—	350
Depreciation and Amortization	1,103	4	19	64	1,190
Income Tax Expense (Benefit)	3,615	49	48	(287)	3,425
Segment Profit (Loss)	9,791	66	74	(92)	9,839
Segment Assets at June 30, 2017	3,001,898	1,907	9,774	(8,776)	3,004,803

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NOTE 8 - Segment Information (continued)

	Core Banking	Trust and Investment Advisory Services	Insurance	Other	Consolidated Totals
Three Months Ended					
June 30, 2016					
Net Interest Income	\$ 24,873	\$ 1	\$ 1	\$ (204)	\$ 24,671
Net Gains on Sales of Loans	883	—	—	—	883
Net Gains on Securities	968	—	—	—	968
Trust and Investment Product Fees	2	1,221	—	—	1,223
Insurance Revenues	4	5	1,596	—	1,605
Noncash Items:					
Provision for Loan Losses	350	—	—	—	350
Depreciation and Amortization	1,089	1	25	64	1,179
Income Tax Expense (Benefit)	4,419	50	58	(278)	4,249
Segment Profit (Loss)	9,800	76	87	(175)	9,788
Segment Assets at December 31, 2016	2,958,585	1,851	8,494	(12,936)	2,955,994
	Core Banking	Trust and Investment Advisory Services	Insurance	Other	Consolidated Totals
Six Months Ended					
June 30, 2017					
Net Interest Income	\$ 49,908	\$ 2	\$ 4	\$ (376)	\$ 49,538
Net Gains on Sales of Loans	1,646	—	—	—	1,646
Net Gains on Securities	—	—	—	—	—
Trust and Investment Product Fees	2	2,594	—	(3)	2,593
Insurance Revenues	14	13	4,357	—	4,384
Noncash Items:					
Provision for Loan Losses	850	—	—	—	850
Depreciation and Amortization	2,144	7	38	128	2,317
Income Tax Expense (Benefit)	7,237	83	475	(549)	7,246
Segment Profit (Loss)	18,756	110	747	(218)	19,395
Segment Assets at June 30, 2017	3,001,898	1,907	9,774	(8,776)	3,004,803

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NOTE 8 - Segment Information (continued)

	Core Banking	Trust and Investment Advisory Services	Insurance	Other	Consolidated Totals
Six Months Ended					
June 30, 2016					
Net Interest Income	\$ 45,771	\$ —	—\$ 3	\$(319)	\$ 45,455
Net Gains on Sales of Loans	1,603	—	—	—	1,603
Net Gains on Securities	968	—	—	—	968
Trust and Investment Product Fees	3	2,241	—	—	2,244
Insurance Revenues	8	13	4,311	—	4,332
Noncash Items:					
Provision for Loan Losses	1,200	—	—	—	1,200
Depreciation and Amortization	2,064	2	51	110	2,227
Income Tax Expense (Benefit)	6,100	64	568	(718)	6,014
Segment Profit (Loss)	14,881	83	877	(907)	14,934
Segment Assets at December 31, 2016	2,958,585	1,851	8,494	(12,936)	2,955,994

NOTE 9 – Stock Repurchase Plan

On April 26, 2001, the Company announced that its Board of Directors approved a stock repurchase program for up to 911,631 of the outstanding shares of common stock of the Company. Shares may be purchased from time to time in the open market and in large block privately negotiated transactions. The Company is not obligated to purchase any shares under the program, and the program may be discontinued at any time before the maximum number of shares specified by the program are purchased. The Board of Directors established no expiration date for this program. As of June 30, 2017, the Company had purchased 502,447 shares under the program. No shares were purchased under the program during the three or six months ended June 30, 2017 and 2016.

NOTE 10 – Equity Plans and Equity Based Compensation

The Company maintains three equity incentive plans under which stock options, restricted stock, and other equity incentive awards can be granted. At June 30, 2017, the Company has reserved 412,104 shares of common stock for the purpose of issuance pursuant to outstanding and future grants of options, restricted stock, and other equity awards to officers, directors and other employees of the Company.

For the three and six months ended June 30, 2017 and 2016, the Company granted no options. The Company recorded no stock compensation expense applicable to options during the three and six months ended June 30, 2017 and 2016 because all outstanding options were fully vested prior to 2007. In addition, there was no unrecognized option expense.

During the periods presented, awards of long-term incentives were granted in the form of restricted stock. Awards that were granted to management under a management incentive plan were granted in tandem with cash credit entitlements (typically in the form of 60% restricted stock grants and 40% cash credit entitlements). The management

and employee restricted stock grants and tandem cash credit entitlements awarded will vest in three equal installments of 33.3% with the first annual vesting on December 5th of the year of the grant and on December 5th of the next two succeeding years. Awards that were granted to directors as additional retainer for their services do not include any cash credit entitlement. These director restricted stock grants are subject to forfeiture in the event that the recipient of the grant does not continue in service as a director of the Company through December 5th of the year after grant or does not satisfy certain meeting attendance requirements, at which time they generally vest 100 percent. For measuring compensation costs, restricted stock awards are valued based upon the market value of the common shares on the date of grant. During the three months ended June 30, 2017, the Company granted awards of 210 shares of restricted stock. The Company granted no shares of restricted stock during the three months ended June 30, 2016. During the six months ended June 30, 2017 and 2016, the Company granted awards of 38,100 and 48,375 shares of restricted stock, respectively. Total unvested restricted stock awards at June 30, 2017 and December 31, 2016 were 91,263 and 53,163, respectively.

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NOTE 10 - Equity Plans and Equity Based Compensation (continued)

The following table presents expense recorded for restricted stock and cash entitlements as well as the related tax information for the periods presented:

	Three Months Ended June 30, 2017 2016	
Restricted Stock Expense	\$342	\$267
Cash Entitlement Expense	181	142
Tax Effect	(205)	(165)
Net of Tax	\$318	\$244
	Six Months Ended June 30, 2017 2016	
Restricted Stock Expense	\$649	\$855
Cash Entitlement Expense	340	284
Tax Effect	(388)	(461)
Net of Tax	\$601	\$678

Unrecognized expense associated with the restricted stock grants and cash entitlements totaled \$2,739 and \$2,411 as of June 30, 2017 and 2016, respectively.

The Company maintains an Employee Stock Purchase Plan whereby eligible employees have the option to purchase the Company's common stock at a discount. The purchase price of the shares under this Plan has been set at 95% of the fair market value of the Company's common stock as of the last day of the plan year. The plan provided for the purchase of up to 750,000 shares of common stock, which the Company may obtain by purchases on the open market or from private sources, or by issuing authorized but unissued common shares. At June 30, 2017, there were 577,426 shares available for future issuance under this plan. Funding for the purchase of common stock is from employee and Company contributions.

There was no expense recorded for the employee stock purchase plan during the three or six months ended June 30, 2017. There was no expense recorded for the employee stock purchase plan during the three and six months ended June 30, 2016. There was no unrecognized compensation expense as of June 30, 2017 and 2016 for the Employee Stock Purchase Plan.

NOTE 11 – Fair Value

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Investment Securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted

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NOTE 11 - Fair Value (continued)

cash flows or other market indicators (Level 3). Level 3 pricing is obtained from a third-party based upon similar trades that are not traded frequently without adjustment by the Company. At June 30, 2017, the Company held \$6.8 million in Level 3 securities which consist of \$6.5 million of non-rated Obligations of State and Political Subdivisions and \$353 thousand of equity securities that are not actively traded. Absent the credit rating, significant assumptions must be made such that the credit risk input becomes an unobservable input and thus these securities are reported by the Company in a Level 3 classification.

Derivatives: The fair values of derivatives are based on valuation models using observable market data as of the measurement date (Level 2).

Impaired Loans: Fair values for impaired collateral dependent loans are generally based on appraisals obtained from licensed real estate appraisers and in certain circumstances includes consideration of offers obtained to purchase properties prior to foreclosure. Appraisals for commercial real estate generally use three methods to derive value: cost, sales or market comparison and income approach. The cost method bases value in the cost to replace the current property. Value of market comparison approach evaluates the sales price of similar properties in the same market area. The income approach considers net operating income generated by the property and an investor's required return. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Comparable sales adjustments are based on known sales prices of similar type and similar use properties and duration of time that the property has been on the market to sell. Such adjustments made in the appraisal process are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, a member of the Company's Risk Management Area reviews the assumptions and approaches utilized in the appraisal. In determining the value of impaired collateral dependent loans and other real estate owned, significant unobservable inputs may be used which include: physical condition of comparable properties sold, net operating income generated by the property and investor rates of return.

Other Real Estate: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate (ORE) are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property utilizing similar techniques as discussed above for Impaired Loans, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, impairment loss is recognized.

Loan Servicing Rights: On a quarterly basis, loan servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount resulting in a Level 2 classification. The valuation model utilizes interest rate, prepayment speed, and default rate assumptions that market participants would use in estimating future net servicing income and that can be validated against available market data.

Loans Held-for-Sale: The fair values of loans held for sale are determined by using quoted prices for similar assets, adjusted for specific attributes of that loan resulting in a Level 2 classification.

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NOTE 11 - Fair Value (continued)

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis, including financial assets and liabilities for which the Company has elected the fair value option, are summarized below:

	Fair Value Measurements at June 30, 2017 Using			
	Quoted Prices in			
	Active	Significant Other	Significant	
	Markets	Observable Inputs	Unobservable Inputs	Total
	for	(Level 2)	(Level 3)	
	Identical Assets			
	(Level 1)			
Assets:				
Obligations of State and Political Subdivisions	\$ —	\$ 260,523	\$ 6,464	\$ 266,987
MBS/CMO - Residential	—	473,238	—	473,238
Equity Securities	—	—	353	353
Total Securities	\$ —	\$ 733,761	\$ 6,817	\$ 740,578
Loans Held-for-Sale	\$ —	\$ 9,844	\$ —	\$ 9,844
Derivative Assets	\$ —	\$ 1,655	\$ —	\$ 1,655
Mortgage Servicing Rights	\$ —	\$ 575	\$ —	\$ 575
Derivative Liabilities	\$ —	\$ 1,736	\$ —	\$ 1,736
Fair Value Measurements at December 31, 2016 Using				
Quoted Prices in				
	Active	Significant Other	Significant	
	Markets	Observable Inputs	Unobservable	Total
	for	(Level 2)	Inputs	
	Identical Assets		(Level 3)	
	(Level 1)			
Assets:				
Obligations of State and Political Subdivisions	\$ —	\$ 240,224	\$ 7,295	\$ 247,519
MBS/CMO - Residential	—	461,914	—	461,914
Equity Securities	—	—	353	353
Total Securities	\$ —	\$ 702,138	\$ 7,648	\$ 709,786
Loans Held-for-Sale	\$ —	\$ 15,273	\$ —	\$ 15,273
Derivative Assets	\$ —	\$ 1,291	\$ —	\$ 1,291
Mortgage Servicing Rights	\$ —	\$ 611	\$ —	\$ 611

Derivative Liabilities	\$ —	\$ 1,238	\$ —	\$ 1,238
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There were no transfers between Level 1 and Level 2 for the periods ended June 30, 2017 and December 31, 2016.

At June 30, 2017, the aggregate fair value of the Loans Held-for-Sale was \$9,844. Aggregate contractual principal balance was \$9,622 with a difference of \$222. At December 31, 2016, the aggregate fair value of the Loans Held-for-Sale was \$15,273. Aggregate contractual principal balance was \$14,983 with a difference of \$290.

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NOTE 11 - Fair Value (continued)

The tables below present a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2017 and 2016:

	Obligations of State and Political Subdivisions		Equity Securities	
	2017	2016	2017	2016
	Balance of Recurring Level 3 Assets at April 1	\$ 6,447	\$ 8,196	\$ 353	$ 353
Total Gains or Losses Included in Other Comprehensive Income	17	17	—	—
Maturities / Calls	—	—	—	—
Purchases	—	—	—	—
Balance of Recurring Level 3 Assets at June 30	\$ 6,464	\$ 8,213	\$ 353	\$ 353
	Obligations of State and Political Subdivisions		Equity Securities	
	2017	2016	2017	2016
	Balance of Recurring Level 3 Assets at January 1	\$ 7,295	\$ 9,020	\$ 353	$ 353
Total Gains or Losses Included in Other Comprehensive Income	34	38	—	—
Maturities / Calls	(865)	(845)	—	—
Purchases	—	—	—	—
Balance of Recurring Level 3 Assets at June 30	\$ 6,464	\$ 8,213	\$ 353	\$ 353

Of the total gain/loss for the three and six months ended June 30, 2017, \$17 and \$34 was attributable to other changes in fair value. Of the total gain/loss included in other comprehensive income for the three and six months ended June 30, 2016, \$17 and \$38, respectively, was attributable to other changes in fair value.

Assets and Liabilities Measured on a Non-Recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

	Fair Value Measurements at June 30, 2017 Using				
	Quoted Prices in Active Markets for Identical (Level 1)	Significant Observable Inputs (Level 2)	Other Inputs (Level 3)	Significant Unobservable Inputs (Level 3)	Total
Assets:					
Impaired Loans					
Commercial and Industrial Loans	\$ —	\$ —	\$ 37	\$ 37	\$ 37
Commercial Real Estate Loans	—	—	410	410	410
Agricultural Loans	—	—	158	158	158

Fair Value Measurements at December 31, 2016 Using
Quoted Prices in

	Active Markets for Identical (Level 1)	Significant Observable (Level 2) Assets	Other Inputs	Significant Unobservable Inputs (Level 3)	Total
Assets:					
Impaired Loans					
Commercial and Industrial Loans	\$ —	\$ —	—	\$ 60	\$ 60
Commercial Real Estate Loans	—	—	—	348	348
Agricultural Loans	—	—	—	—	—

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NOTE 11 - Fair Value (continued)

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$865 with a valuation allowance of \$260, resulting in a decrease to the provision for loan losses of \$273 for the three months ended June 30, 2017 and an increase to the provision for loan losses of \$5 for the six months ended June 30, 2017. For the three and six months ended June 30, 2016, impaired loans resulted in a reduction to the provision for loan losses of \$5 and \$8, respectively. Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$663 with a valuation allowance of \$255, resulting in an increase to the provision for loan losses of \$115 for the year ended December 31, 2016.

There was no Other Real Estate carried at fair value less costs to sell at June 30, 2017. No charge to earnings was included in the three and six months ended June 30, 2017 and 2016. There was no Other Real Estate carried at fair value less costs to sell at December 31, 2016. A charge to earnings through Other Operating Income of \$75 was included in the year ended December 31, 2016.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at June 30, 2017 and December 31, 2016:

June 30, 2017	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired Loans - Commercial and Industrial Loans	\$ 37	Sales comparison approach	Adjustment for physical condition of comparable properties sold	0%-100% (95%)
Impaired Loans - Commercial Real Estate Loans	\$ 410	Sales comparison approach	Adjustment for physical condition of comparable properties sold	33%-76% (52%)
Impaired Loans - Agricultural Loans	\$ 158	Sales comparison approach	Adjustment for physical condition of comparable properties sold	35% (35%)
December 31, 2016	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired Loans - Commercial and Industrial Loans	\$ 60	Sales comparison approach	Adjustment for physical condition of comparable properties sold	0%-100% (89%)
Impaired Loans - Commercial Real Estate Loans	\$ 348	Sales comparison approach	Adjustment for physical condition of comparable properties sold	33%-77% (56%)

The carrying amounts and estimated fair values of the Company's financial instruments not previously presented are provided in the tables below for the periods ending June 30, 2017 and December 31, 2016. Not all of the Company's assets and liabilities are considered financial instruments, and therefore are not included in the tables. Because no active market exists for a significant portion of the Company's financial instruments, fair value estimates were based on subjective judgments, and therefore cannot be determined with precision.

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NOTE 11 - Fair Value (continued)

	Carrying Value	Fair Value Measurements at June 30, 2017 Using			Total
		Level 1	Level 2	Level 3	
Financial Assets:					
Cash and Short-term Investments	\$ 44,037	\$36,833	\$7,204	\$ —	\$44,037
Loans, Net	2,015,818	—	—	2,011,522	2,011,522
FHLB Stock and Other Restricted Stock	13,048	N/A	N/A	N/A	N/A
Accrued Interest Receivable	11,287	—	3,555	7,732	11,287
Financial Liabilities:					
Demand, Savings, and Money Market Deposits	(2,011,047)	(2,011,047)	—	—	(2,011,047)
Time Deposits	(352,274)	—	(351,112)	—	(351,112)
Short-term Borrowings	(118,703)	—	(118,703)	—	(118,703)
Long-term Debt	(144,766)	—	(133,346)	(11,110)	(144,456)
Accrued Interest Payable	(773)	—	(758)	(15)	(773)

	Carrying Value	Fair Value Measurements at December 31, 2016 Using			Total
		Level 1	Level 2	Level 3	
Financial Assets:					
Cash and Short-term Investments	\$ 64,816	\$48,467	\$16,349	\$ —	\$ 64,816
Loans, Net	1,974,074	—	—	1,980,523	1,980,523
FHLB Stock and Other Restricted Stock	13,048	N/A	N/A	N/A	N/A
Accrued Interest Receivable	11,413	—	3,289	8,124	11,413
Financial Liabilities:					
Demand, Savings, and Money Market Deposits	(1,971,370)	(1,971,370)	—	—	(1,971,370)
Time Deposits	(378,181)	—	(378,000)	—	(378,000)
Short-term Borrowings	(137,554)	—	(137,554)	—	(137,554)
Long-term Debt	(120,560)	—	(109,709)	(10,793)	(120,502)
Accrued Interest Payable	(789)	—	(775)	(14)	(789)

Cash and Short-term Investments:

The carrying amount of cash and short-term investments approximate fair values and are classified as Level 1 or Level 2.

FHLB Stock and Other Restricted Stock:

It is not practical to determine the fair values of FHLB stock and other restricted stock due to restrictions placed on their transferability.

Loans:

Fair values of loans, excluding loans held for sale and collateral dependent impaired loans carried at fair value, are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of

similar credit quality resulting in a Level 3 classification. Impaired loans are valued as described previously. The methods utilized to estimate fair value of loans do not necessarily represent an exit price.

Accrued Interest Receivable:

The carrying amount of accrued interest approximates fair value resulting in a Level 2 or Level 3 classification consistent with the asset they are associated with.

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NOTE 11 - Fair Value (continued)

Deposits:

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 1 classification. Fair values for fixed rate time deposits are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Short-term Borrowings:

The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings, generally maturing within ninety days, approximate their fair values resulting in a Level 2 classification.

Long-term Debt:

The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

The fair values of the Company's subordinated debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

Accrued Interest Payable:

The carrying amount of accrued interest approximates fair value resulting in a Level 2 or Level 3 classification consistent with the liability they are associated with.

NOTE 12 – Other Comprehensive Income (Loss)

The tables below summarize the changes in accumulated other comprehensive income (loss) by component for the three and six months ended June 30, 2017 and 2016, net of tax:

	Unrealized Gains and Losses on Available-for-Sale Securities	Postretirement Benefit Items	Total
June 30, 2017			
Beginning Balance at April 1, 2017	\$ (2,314)	\$ (92)	\$(2,406)
Other Comprehensive Income (Loss) Before Reclassification	6,566	—	6,566
Amounts Reclassified from Accumulated Other Comprehensive Income (Loss)	—	—	—
Net Current Period Other Comprehensive Income (Loss)	6,566	—	6,566
Ending Balance at June 30, 2017	\$ 4,252	\$ (92)	\$4,160
June 30, 2016			
Beginning Balance at January 1, 2017	\$ (6,312)	\$ (92)	\$(6,404)
Other Comprehensive Income (Loss) Before Reclassification	10,564	—	10,564
	—	—	—

Amounts Reclassified from Accumulated Other Comprehensive
Income (Loss)

Net Current Period Other Comprehensive Income (Loss)	10,564	—	10,564
Ending Balance at June 30, 2017	\$ 4,252	\$ (92)	\$4,160

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NOTE 12 - Other Comprehensive Income (Loss) (continued)

June 30, 2016	Unrealized Gains and Losses on Available-for-Sale Securities	Postretirement Benefit Items	Total
Beginning Balance at April 1, 2016	\$ 7,919	\$ (78)	\$7,841
Other Comprehensive Income (Loss) Before Reclassification	3,983	—	3,983
Amounts Reclassified from Accumulated Other Comprehensive Income (Loss)	(629)	—	(629)
Net Current Period Other Comprehensive Income (Loss)	3,354	—	3,354
Ending Balance at June 30, 2016	\$ 11,273	\$ (78)	\$11,195

June 30, 2016	Unrealized Gains and Losses on Available-for-Sale Securities	Postretirement Benefit Items	Total
Beginning Balance at January 1, 2016	\$ 3,890	\$ (78)	\$3,812
Other Comprehensive Income (Loss) Before Reclassification	8,012	—	8,012
Amounts Reclassified from Accumulated Other Comprehensive Income (Loss)	(629)	—	(629)
Net Current Period Other Comprehensive Income (Loss)	7,383	—	7,383
Ending Balance at June 30, 2016	\$ 11,273	\$ (78)	\$11,195

The tables below summarize the classifications out of accumulated other comprehensive income (loss) by component for the three and six months ended June 30, 2017 and 2016:

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified From Accumulated Other Comprehensive Income (Loss)		Affected Line Item in the Statement Where Net Income is Presented
Unrealized Gains and Losses on Available-for-Sale Securities	\$	—	—Net Gains on Securities
	—	—	Income Tax Expense
	—	—	Net of Tax

Total Reclassifications for the Three Months Ended
June 30, 2017

\$ —

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified From Accumulated Other Comprehensive Income (Loss)		Affected Line Item in the Statement Where Net Income is Presented
Unrealized Gains and Losses on Available-for-Sale Securities	\$	—	—Net Gains on Securities

Unrealized Gains and Losses on Available-for-Sale
Securities

\$ —

—	Income Tax Expense
—	Net of Tax

Total Reclassifications for the Six Months Ended June 30, 2017 \$ —

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 June 30, 2017
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NOTE 12 - Other Comprehensive Income (Loss) (continued)

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified From Accumulated Other Comprehensive Income (Loss)	Affected Line Item in the Statement Where Net Income is Presented
Unrealized Gains and Losses on Available-for-Sale Securities	\$ 968	Net Gains on Securities
	(339	) Income Tax Expense
	629	Net of Tax
Total Reclassifications for the Three Months Ended June 30, 2016	\$ 629	

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified From Accumulated Other Comprehensive Income (Loss)	Affected Line Item in the Statement Where Net Income is Presented
Unrealized Gains and Losses on Available-for-Sale Securities	\$ 968	Net Gains on Securities
	(339	) Income Tax Expense
	629	Net of Tax
Total Reclassifications for the Six Months Ended June 30, 2016	\$ 629	

NOTE 13 - Newly Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (the "FASB") amended existing guidance (ASU 2014-09 Revenue From Contracts With Customers) related to revenue from contracts with customers. This amendment supersedes and replaces nearly all existing revenue recognition guidance, including industry-specific guidance, establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, this amendment specifies the accounting for some costs to obtain or fulfill a contract with a customer. These amendments are effective for public business entities for fiscal periods beginning after December 15, 2017, including interim periods within that reporting period. The Company does not expect this pronouncement to have a material impact on the Company's consolidated results of operations and financial condition as the Company's core revenue does not fall under this guidance.

In January 2016, the FASB amended existing guidance (ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities) that requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. Also, it requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. It requires separate presentation of financial assets and financial liabilities by measurement category and

form of financial asset (i.e., securities or loans and receivables). It eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost. These amendments are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. The Company notes that the impact of adoption is to carry the equity security at fair value through the income statement or at cost, less impairment when fair value is not readily determinable, with observable price changes being recognized in earnings. The Company doesn't expect the impact to be material. For additional information on this equity security, see Note 4 - Securities.

In February 2016, the FASB amended existing guidance (ASU No. 2016-02, Leases (Topic 842)) that requires lessees recognize the following for all leases (with the exception of short-term leases) at the commencement date (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(unaudited, dollars in thousands except share and per share data)

NOTE 13 - Newly Issued Accounting Pronouncements (continued)

guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. These amendments are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that reporting period. Based on our leases outstanding as of June 30, 2017, the Company does not expect this new guidance to have a material impact on the consolidated results of operation. However as a result of this new guidance, the Company anticipates an estimated increase in its Consolidated Balance Sheet of approximately \$6,000. This impact will vary based on the Company's future decisions to enter into new lease agreements or exit/renew current lease agreements prior to the date of implementation.

In June 2016, the FASB issued guidance (ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326)) to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held-to-maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor. These amendments are effective for public business entities for fiscal years beginning after December 15, 2019, including interim periods within that reporting period. The Company anticipates there may be an increase in its allowance for loan losses at the time of adoption of this standard, but can not estimate the amount at this time.

In August 2016, the FASB issued this ASU (ASU No. 2016-15, Statement of Cash Flows (Topic 320): Classification of Certain Cash Receipts and Cash Payments) to address the diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows including the following:

- Debt Prepayment or Debt Extinguishment Costs;
- Settlement of Zero-Coupon Bonds or Debt with Coupon Interest Rates That Are Insignificant in Relation to the Effective Interest Rate;
- Contingent Consideration payments Made Soon After a Business Combination;
- Proceeds From the Settlement of Insurance Claims;
- Proceeds From the Settlement of BOLI and COLI Policies;
- Distributions Received From Equity Method Investees;
- Beneficial Interests in Securitization Transactions; and
- Application of the Predominance Principle.

These amendments are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. This guidance currently has no material impact on the Company's Consolidated Statements of Cash Flows; however, the Company will continue to monitor it going forward.

In March 2017, the FASB issued this ASU (ASU No. 2017-08, Premium Amortization on Purchased Callable Debt Securities) to align the accounting with the economics of a callable debt security and to align the amortization period with expectations that already are included in market pricing on the callable debt securities. This ASU will shorten the amortization period for premiums on purchased callable debt securities by requiring that premiums be amortized to the first (or earliest) call date instead of as an adjustment to the yield over the contractual life. This guidance is

effective for for public business entities for fiscal years beginning after December 15, 2018, including interim period within that reporting period. As a result of the Company's analysis, the Company doesn't expect this pronouncement to have a material impact on its consolidated results of operations and financial condition.

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

GERMAN AMERICAN BANCORP, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

German American Bancorp, Inc., is a NASDAQ-traded (symbol: GABC) financial services holding company based in Jasper, Indiana. German American Bancorp, Inc., through its banking subsidiary German American Bancorp, operates 52 banking offices in 19 contiguous southern Indiana counties and one northern Kentucky county. The Company also owns an investment brokerage subsidiary (German American Investment Services, Inc.) and a full line property and casualty insurance agency (German American Insurance, Inc.).

Throughout this Management's Discussion and Analysis, as elsewhere in this Report, when we use the term "Company," we will usually be referring to the business and affairs (financial and otherwise) of German American Bancorp, Inc. and its subsidiaries and affiliates as a whole. Occasionally, we will refer to the term "parent company" or "holding company" when we mean to refer to only German American Bancorp, Inc.

This section presents an analysis of the consolidated financial condition of the Company as of June 30, 2017 and December 31, 2016 and the consolidated results of operations for the three and six months ended June 30, 2017 and 2016. This discussion should be read in conjunction with the consolidated financial statements and other financial data presented elsewhere herein and with the financial statements and other financial data, as well as the Management's Discussion and Analysis of Financial Condition and Results of Operations, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

MANAGEMENT OVERVIEW

This updated discussion should be read in conjunction with the Management Overview that was included in our Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

On March 1, 2016, the Company completed its acquisition of River Valley Bancorp ("River Valley") and its subsidiaries, including River Valley Financial Bank. This acquisition was consistent with the Company's strategy to build a regional presence in Southern Indiana. The acquisition offers the Company the opportunity to increase profitability by introducing existing products and services to the acquired customer base as well as add new customers in the expanded region.

Net income for the quarter ended June 30, 2017 totaled \$9,839,000, or \$0.43 per diluted share, compared to net income of \$9,788,000, or \$0.43 per diluted share for the quarter ended June 30, 2016. For the first half 2017, earnings improved \$4,461,000, or 30%, to \$19,395,000 as compared to \$14,934,000 for the first six months of 2016. On a per share basis, net income totaled \$0.85 per diluted share during the first six months of 2017 representing a 25% increase from the \$0.68 per diluted share for the first half of 2016. The first half of 2016 included four months of operations of River Valley and was impacted by merger related charges associated with the closing of the River Valley transaction effective March 1, 2016. The merger related charges totaled approximately \$4,129,000, or \$2,612,000 on an after-tax basis, which represented approximately \$0.12 per share during the first half of 2016.

On March 27, 2017, the Company declared a 3-for-2 stock split on the Company's authorized and outstanding common shares. The stock split was distributed on April 21, 2017 to shareholders of record as of April 6, 2017. All share and per share data in this Quarterly Report on Form 10-Q relating to a date or period that precedes April 21, 2017 have been adjusted and are reflective of the stock split.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The financial condition and results of operations for the Company presented in the Consolidated Financial Statements, accompanying Notes to the Consolidated Financial Statements, and selected financial data appearing elsewhere within this Report, are, to a large degree, dependent upon the Company's accounting policies. The selection of and application of these policies involve estimates, judgments, and uncertainties that are subject to change. The critical accounting policies and estimates that the Company has determined to be the most susceptible to change in the near term relate to the determination of the allowance for loan losses, the valuation of securities available for sale, income tax expense, and the valuation of goodwill and other intangible assets.

Allowance for Loan Losses

The Company maintains an allowance for loan losses to cover probable incurred credit losses at the balance sheet date. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. A provision for loan losses is charged to operations based on management's periodic evaluation of the necessary allowance balance. Evaluations are conducted at least quarterly and more often if deemed necessary. The ultimate recovery of all loans is susceptible to future market factors beyond the Company's control.

The Company has an established process to determine the adequacy of the allowance for loan losses. The determination of the allowance is inherently subjective, as it requires significant estimates, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on other classified loans and pools of homogeneous loans, and consideration of past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors, all of which may be susceptible to significant change. The allowance consists of two components of allocations, specific and general. These two components represent the total allowance for loan losses deemed adequate to cover losses inherent in the loan portfolio.

Commercial and agricultural loans are subject to a standardized grading process administered by an internal loan review function. The need for specific reserves is considered for credits identified as impaired when: (a) the customer's cash flow or net worth appears insufficient to repay the loan; (b) the loan has been criticized in a regulatory examination; (c) the loan is on non-accrual; or (d) other reasons where the ultimate collectability of the loan is in question, or the loan characteristics require special monitoring. Specific allowances are established in cases where management has identified significant conditions or circumstances related to an individual credit that we believe indicates the loan is impaired.

Specific allocations on impaired loans are determined by comparing the loan balance to the present value of expected cash flows or expected collateral proceeds. Allocations are also applied to categories of loans not considered individually impaired but for which the rate of loss is expected to be greater than historical averages, including non-performing consumer or residential real estate loans. Such allocations are based on past loss experience and information about specific borrower situations and estimated collateral values.

General allocations are made for commercial and agricultural loans that are graded as substandard based on migration analysis techniques to determine historical average losses for similar types of loans. General allocations are also made for other pools of loans, including non-classified loans, homogeneous portfolios of consumer and residential real estate loans, and loans within certain industry categories believed to present unique risk of loss. General allocations of the allowance are primarily made based on historical averages for loan losses for these portfolios, judgmentally adjusted for economic, external and internal factors and portfolio trends. Economic factors include evaluating changes in international, national, regional and local economic and business conditions that affect the collectability of the loan portfolio. Internal factors include evaluating changes in lending policies and procedures; changes in the nature and volume of the loan portfolio; and changes in experience, ability and depth of lending management and staff. In setting our external and internal factors we also consider the overall level of the allowance for loan losses to total loans; our allowance coverage as compared to similar size bank holding companies; and regulatory requirements.

Due to the imprecise nature of estimating the allowance for loan losses, the Company's allowance for loan losses includes a minor unallocated component. The unallocated component of the allowance for loan losses incorporates the Company's judgmental determination of inherent losses that may not be fully reflected in other allocations, including factors such as economic uncertainties, lending staff quality, industry trends impacting specific portfolio segments,

and broad portfolio quality trends. Therefore, the ratio of allocated to unallocated components within the total allowance may fluctuate from period to period.

Securities Valuation

Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported separately in accumulated other comprehensive income (loss), net of tax. The Company obtains market values from a third party on a monthly basis in order to adjust the securities to fair value. Equity securities that do not have readily determinable fair values are carried at cost. Additionally, when securities are deemed to be other than temporarily impaired, a charge will be recorded through earnings; therefore, future changes in the fair value of securities could have a significant impact on the Company's operating results. In determining whether a market value decline is other than temporary, management considers the reason for the decline, the extent of the decline, the duration of the decline and whether the Company intends to sell or believes it will be required to sell the securities prior to recovery. As of June 30, 2017, gross unrealized gains on the securities available-for-sale portfolio totaled approximately \$11,433,000 and gross unrealized losses totaled approximately \$4,890,000.

Income Tax Expense

Income tax expense involves estimates related to the valuation allowance on deferred tax assets and loss contingencies related to exposure from tax examinations presumed to occur.

A valuation allowance reduces deferred tax assets to the amount management believes is more likely than not to be realized. In evaluating the realization of deferred tax assets, management considers the likelihood that sufficient taxable income of appropriate character will be generated within carry-back and carry-forward periods, including consideration of available tax planning strategies. Tax-related loss contingencies, including assessments arising from tax examinations and tax strategies, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. In considering the likelihood of loss, management considers the nature of the contingency, the progress of any examination or related protest or appeal, the views of legal counsel and other advisors, experience of the Company or other enterprises in similar matters, if any, and management's intended response to any assessment.

Goodwill and Other Intangible Assets

Goodwill resulting from business combinations represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Company has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on the Company's balance sheet.

Other intangible assets consist of core deposit and acquired customer relationship intangible assets. They are initially measured at fair value and then are amortized over their estimated useful lives, which range from 6 to 10 years.

RESULTS OF OPERATIONS

Net Income:

Net income for the quarter ended June 30, 2017 totaled \$9,839,000, or \$0.43 per diluted share compared to net income of \$9,788,000, or \$0.43 per diluted share for the quarter ended June 30, 2016. For the first half 2017, earnings improved \$4,461,000, or 30%, to \$19,395,000 as compared to \$14,934,000 for the first six months of 2016. On a per share basis, net income totaled \$0.85 per diluted share during the first six months of 2017 representing a 25% increase from the \$0.68 per diluted share for the first half of 2016. The first half of 2016 included four months of operations of River Valley and was impacted by merger related charges associated with the closing of the River Valley transaction effective March 1, 2016. The merger related charges totaled approximately \$4,129,000, or \$2,612,000 on an after-tax basis, which represented approximately \$0.12 per share during the first half of 2016.

On March 27, 2017, the Company declared a 3-for-2 stock split on the Company's authorized and outstanding common shares. The stock split was distributed on April 21, 2017 to shareholders of record as of April 6, 2017. All share and per share data in this Quarterly Report on Form 10-Q relating to a date or period that precedes April 21, 2017 have been adjusted and are reflective of the stock split.

Net Interest Income:

Net interest income is the Company's single largest source of earnings, and represents the difference between interest and fees realized on earning assets, less interest paid on deposits and borrowed funds. Several factors contribute to the determination of net interest income and net interest margin, including the volume and mix of earning assets, interest rates, and income taxes. Many factors affecting net interest income are subject to control by management policies and actions. Factors beyond the control of management include the general level of credit and deposit demand, Federal Reserve Board monetary policy, and changes in tax laws.

The following table summarizes net interest income (on a tax-equivalent basis). For tax-equivalent adjustments, an effective tax rate of 35% was used for all periods presented⁽¹⁾.

	Average Balance Sheet					
	(Tax-equivalent basis / dollars in thousands)					
	Three Months Ended June 30, 2017			Three Months Ended June 30, 2016		
Principal Balance	Income / Yield / Expense Rate	Principal Balance	Income / Yield / Expense Rate	Principal Balance	Income / Yield / Expense Rate	Principal Balance
ASSETS						
Federal Funds Sold and Other						
Short-term Investments	\$13,268	\$27	0.79%	\$25,918	\$20	0.30%
Securities:						
Taxable	481,556	2,702	2.24%	483,465	2,287	1.89%
Non-taxable	261,798	3,185	4.87%	239,757	2,881	4.81%
Total Loans and Leases ⁽²⁾	2,011,518	22,780	4.54%	1,935,246	22,791	4.73%
TOTAL INTEREST EARNING ASSETS	2,768,140	28,694	4.15%	2,684,386	27,979	4.19%
Other Assets	218,038			216,089		
Less: Allowance for Loan Losses	(15,433)			(15,310)		
TOTAL ASSETS	\$2,970,745			\$2,885,165		
LIABILITIES AND SHAREHOLDERS' EQUITY						
Interest-bearing Demand, Savings and Money Market Deposits	\$1,446,994	\$939	0.26%	\$1,369,446	\$672	0.20%
Time Deposits	360,938	687	0.76%	426,917	654	0.62%
FHLB Advances and Other Borrowings	233,197	962	1.65%	235,435	853	1.46%
TOTAL INTEREST-BEARING LIABILITIES	2,041,129	2,588	0.51%	2,031,798	2,179	0.43%
Demand Deposit Accounts	560,763			502,070		
Other Liabilities	21,818			25,543		
TOTAL LIABILITIES	2,623,710			2,559,411		
Shareholders' Equity	347,035			325,754		
TOTAL LIBABILITIES AND SHAREHOLDERS' EQUITY	\$2,970,745			\$2,885,165		
COST OF FUNDS			0.37%			0.33%
NET INTEREST INCOME		\$26,106			\$25,800	
NET INTEREST MARGIN			3.78%			3.86%

(1) Effective tax rates were determined as though interest earned on the Company's investments in municipal bonds and loans was fully taxable.

(2) Loans held-for-sale and non-accruing loans have been included in average loans.

Net interest income increased \$142,000, or 1% (an increase of \$306,000 or 1% on a tax-equivalent basis), for the quarter ended June 30, 2017 compared with the same quarter of 2016. The net interest margin represents tax-equivalent net interest income expressed as a percentage of average earning assets. The tax equivalent net interest margin was 3.78% for the second quarter of 2017 compared to 3.86% during the second quarter of 2016. The tax equivalent yield on earning assets totaled 4.15% during the quarter ended June 30, 2017 compared to 4.19% in the same period of 2016, while the cost of funds (expressed as a percentage of average earning assets) totaled 0.37% during the quarter ended June 30, 2017 compared to 0.33% in the same period of 2016.

The decline in the net interest margin during the second quarter of 2017 was primarily attributable to a decrease in the amount of accretion of loan discounts on acquired loans. Accretion of loan discounts on acquired loans contributed approximately 10 basis points to the net interest margin on an annualized basis in the second quarter of 2017 compared with 23 basis points in the second quarter of 2016. The higher level of accretion in the second quarter of 2016 was largely attributable to the pay-off activity on loans acquired in the River Valley transaction.

The Company's cost of funds increased approximately 4 basis points in the second quarter of 2017 compared with the second quarter of 2016. The higher cost of funds was largely attributable to an increase in short-term market interest rates over the past several quarters.

The following table summarizes net interest income (on a tax-equivalent basis). For tax-equivalent adjustments, an effective tax rate of 35% was used for all periods presented⁽¹⁾.

Average Balance Sheet						
(Tax-equivalent basis / dollars in thousands)						
Six Months Ended			Six Months Ended			
June 30, 2017			June 30, 2016			
Principal	Income	Yield /	Principal	Income	Yield /	
Balance	/	Rate	Balance	/	Rate	
	Expense			Expense		
ASSETS						
Federal Funds Sold and Other	\$ 12,913	\$ 54	0.83 %	\$ 23,148	\$ 37	0.32 %
Short-term Investments						
Securities:						
Taxable	480,720	5,421	2.26 %	481,447	4,564	1.90 %
Non-taxable	256,924	6,300	4.90 %	228,252	5,530	4.85 %
Total Loans and Leases ⁽²⁾	1,993,283	45,220	4.57 %	1,814,944	41,546	4.60 %
TOTAL INTEREST EARNING ASSETS	2,743,840	56,995	4.18 %	2,547,791	51,677	4.07 %
Other Assets	219,923			191,077		
Less: Allowance for Loan Losses	(15,220)			(14,936)		
TOTAL ASSETS	\$ 2,948,543			\$ 2,723,932		
LIABILITIES AND SHAREHOLDERS' EQUITY						
Interest-bearing Demand, Savings and Money Market Deposits	\$ 1,416,341	\$ 1,677	0.24 %	\$ 1,256,441	\$ 1,136	0.18 %
Time Deposits	380,935	1,392	0.74 %		\$ 7,180	\$ 6,802
Income per common share					\$ 0.03	\$ 0.01
					\$ 0.02	\$ 0.02

EXPLANATORY NOTES

(a) Results include: Two acquired properties.

(b) Results include: One development, two redevelopments and one re-entitlement property.

(c) Represents certain revenues and expenses at the corporate level as well as various intercompany costs that are eliminated in consolidation and third-party management fees.

(d) Pertains to properties that are part of our core portfolio (i.e. not under development, redevelopment or re-entitlement).

Total Revenue

Cash rents from the Total Portfolio increased by \$6.1 million from the second quarter of 2012 to the second quarter of 2013, primarily attributable to:

- an increase of \$3.5 million due to a 3.4% increase in cash rental rates for the second quarter of 2013 compared to the second quarter of 2012.

- an increase of \$2.0 million due to our acquisition of 1900 Market Street during the fourth quarter of 2012. This property was 76.6% occupied as of June 30, 2013, with redevelopment expected to commence in the second half 2013 in anticipation of the lead tenant's departure in late 2015;

- an increase of \$0.7 million related to the acquisition of 7000 West at Lantana during the fourth quarter of 2012. Straight-line rents increased by \$0.2 million due to a \$0.7 million increase related to a tenant taking occupancy of a portion of a redevelopment property, 660 Germantown Pike, during the third quarter of 2012, offset by free rent converting to cash rent subsequent to the second quarter of 2012 at our same store properties.

Tenant reimbursements increased by \$1.3 million, consistent with the increase in operating expenses over the same period. Please see the Property Operating Expenses and Real Estate Taxes explanations below and note that certain costs carry a higher tenant reimbursement percentage.

Termination fees at our Total Portfolio increased by \$0.3 million due to timing and volume of tenant move-outs during the second quarter of 2013 when compared to the second quarter of 2012.

Property Operating Expenses

Property operating expenses across our Total Portfolio increased \$3.1 million for the second quarter of 2013 compared to the second quarter of 2012, primarily attributable to: (i) an increase of \$1.2 million in repairs and maintenance expenses, directly attributable to timing and tenant needs, (ii) an increase of \$1.0 million as a result of our acquisitions of 1900 Market Street and 7000 West Lantana during the fourth quarter of 2012, and (iii) an increase of \$0.5 million in salaries and related benefits from 2012 to 2013. The remaining increase is attributable to various expenses none of which was materially significant.

Real Estate Taxes

Real estate taxes increased by \$0.7 million, mainly attributable to our acquisitions of 7000 West Lantana and 1900 Market Street during the fourth quarter of 2012, as well as the placement into service of a portion of 660 West Germantown Pike subsequent to the second quarter of 2012.

General and Administrative Expenses

General and administrative expenses increased \$1.2 million from the second quarter of 2012 to the second quarter of 2013, mainly attributable to the following:

- an increase in the amortization of performance-based compensation of \$0.7 million. This increase is due to the fact that certain of our executive personnel met qualifying retirement conditions during 2013, causing an acceleration of their associated performance based compensation expense for financial reporting purposes;

- an increase of \$0.3 million related to acquisition costs incurred, and;

- an increase of \$0.2 million in salaries and related benefits.

Depreciation and Amortization

Depreciation and amortization expense increased by \$1.8 million, primarily attributable to the acceleration of depreciation expense for Plaza 1000 at Main Street and 6 East Clementon. We are in the process of re-entitling these properties for residential and mixed-use development, and accordingly, we shortened the useful lives for each of these buildings to the expected demolition date. In addition, a portion of 660 West Germantown Pike was placed into service subsequent to the second quarter of 2012 resulting in additional depreciation expense during the second quarter of 2013.

Interest Income

Interest income decreased by \$1.7 million primarily due to the recognition of \$1.0 million of accrued interest income related to the payoff of the Trenton note receivable during the second quarter of 2012. The installment sales method was used to account for the transaction as a result of the associated note receivable, and therefore interest income was recognized on a cash basis. We recognized all of the interest income accrued through the second quarter of 2012 upon receipt of payment from the borrower. The remaining decrease of \$0.7 million is due to a decrease in interest income earned related to investments in available-for-sale securities that were outstanding during the second quarter of 2012. Interest income during the second quarter of 2013 primarily represents interest earned on our available operating cash balances (\$215.9 million as of June 30, 2013).

Interest Expense

The decrease in interest expense of \$2.5 million is primarily due to the following:

- a decrease of \$2.6 million as a result of the repurchases of debt subsequent to the second quarter of 2012, including (i) \$6.2 million of our 5.400% Guaranteed Notes due 2014, (ii) \$55.8 million of our 7.500% Guaranteed Notes due 2015, and (iii) \$100.1 million of our 6.000% Guaranteed Notes due 2016;
- a decrease of \$1.4 million in mortgage interest expense which is directly related to the \$60.0 million decrease resulting from the repayment of two mortgage loans during the fourth quarter of 2012;
- a decrease of \$0.8 million in Term Loan interest expense which is directly related to repayment of our \$150.0 million term loan due 2016 during the fourth quarter of 2012; and,
- a decrease of \$0.3 million in swap interest expense which is directly related to us terminating the interest rate swap contracts upon repayment of our \$150.0 million term loan due 2016 during the fourth quarter of 2012.

The decrease of \$5.1 million in interest expense described above was offset by the following increases in interest expense during the second quarter of 2013 compared to the second quarter of 2012:

- an increase of \$2.5 million related to our \$250.0 million 3.950% Guaranteed Notes due 2023 issued in the fourth quarter of 2012; and,
- an increase of \$0.1 million related to a decrease in capitalized interest.

Equity in Income of Real Estate Ventures

The increase in equity in income of real estate ventures of \$0.7 million is attributable to the following: (i) an increase of \$0.3 million from a cash distribution received from the Two Tower Bridge Venture in excess of our investment basis, (ii) an increase of \$0.4 million as a result of an increase in the preferred return recognized at the One and Two Commerce Square Real Estate Ventures, and (iii) an increase of \$0.5 million is the result of normal operating activities at the partnership level. These increases were offset by a decrease of \$0.5 million as a result of selling our interest in the Beacon Venture during the first quarter of 2013.

Gain on Remeasurement of an Investment in a Real Estate Venture

Gain on remeasurement of an investment in a real estate venture increased \$7.8 million with no comparable gains recognized during the six-month period ended June 30, 2012. This gain resulted from the Company taking control of Six Tower Bridge during the second quarter of 2013 which required the remeasurement at fair value of our existing equity interest in Six Tower Bridge (discussed in Footnote 4 of our consolidated financial statements).

Net Gain on Real Estate Venture Transactions

The \$3.7 million increase in gain on real estate venture transactions is the result of the exchange of our remaining ownership in the Two Tower Bridge Venture for the remaining ownership interest in the Six Tower Bridge Venture that we did not already own, as discussed above in Footnote 4 of our consolidated financial statements.

Discontinued Operations

During the three months ended June 30, 2013, we sold one property located in San Diego, California, one property located in Carlsbad, California, one property located in Malvern, Pennsylvania and one property located in Exton, Pennsylvania. Through the date of sale during the second quarter, the properties had total revenues of \$0.6 million,

property operating expenses of \$0.4 million and \$0.3 million of depreciation and amortization expense. We recognized a net loss on sale related to these transactions of \$2.3 million which includes of \$1.1 million of closing costs to sell the properties discussed above.

The June 30, 2012 amounts are reclassified to include the operations of the properties sold through the second quarter of 2013, as well as all properties that were sold through the year ended December 31, 2012. Therefore, the discontinued operations amount for the second quarter of 2012 includes total revenue of \$8.2 million, operating expense of \$2.9 million, and depreciation and amortization of \$2.7 million.

Net income

Net income increased by \$0.4 million during the three months ended June 30, 2013 compared to the three months ended June 30, 2012 as a result of the factors described above. Net income is significantly impacted by depreciation of operating properties and amortization of acquired intangibles. These non-cash charges do not directly affect our ability to pay dividends. Amortization of acquired intangibles will continue over the related lease terms or estimated duration of the tenant relationships.

Income per Common Share

Income per share was \$0.03 during the three months ended June 30, 2013 as compared to income per share of \$0.01 during the three months ended June 30, 2012 as a result of the factors described above.

Comparison of the Six-Month Periods Ended June 30, 2013 and June 30, 2012

The table below shows selected operating information for the “Same Store Property Portfolio” and the “Total Portfolio.” The Same Store Property Portfolio consists of 204 properties containing an aggregate of approximately 23.1 million net rentable square feet, and represents properties that we owned for the entire six-month periods ended June 30, 2013 and 2012. The Same Store Property Portfolio includes properties acquired or placed in service on or prior to January 1, 2012 and owned through June 30, 2013. The Total Portfolio includes the effects of other properties that were either placed into service, acquired or redeveloped after January 1, 2012 or disposed prior to June 30, 2013. A property is excluded from our Same Store Property Portfolio and moved into the redevelopment column in the period that we determine that a redevelopment would be the best use of the asset, and when said asset is taken out of service or is undergoing re-entitlement for a future development strategy. This table also includes a reconciliation from the Same Store Property Portfolio to the Total Portfolio net income (i.e., all properties owned by us during the six-month periods ended June 30, 2013 and 2012) by providing information for the properties which were acquired, placed into service, under development or redevelopment and administrative/elimination information for the six-month periods ended June 30, 2013 and 2012 (in thousands).

The Total Portfolio net income presented in the table is equal to the net income of the Parent Company and the Operating Partnership.

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Comparison of six-months ended June 30, 2013 to the six-months ended June 30, 2012

	Same Store Property Portfolio			Recently Completed/Developed/Other Properties				Total Portfolio			
	2013	2012	Increase/ (Decrease)	2013	2012	2013	2012	2013	2012		
(dollars in thousands)											
Revenue:											
Cash rents	\$212,464	\$204,812	\$7,652	\$1,215	\$(4,214)	330	\$(1,370)	\$(1,368)	\$216,523	\$203,774	
Straight-line rents	9,529	11,958	(2,429)	162	—	1,412	14	1	5	11,104	11,977
Above/below market rent amortization	2,984	2,953	31	100	—	490	—	—	—	3,574	2,953
Total rents	224,977	219,723	5,254	1,477	—	6,116	344	(1,369)	(1,363)	231,201	218,704
Tenant reimbursements	38,309	36,460	1,849	719	—	895	423	(7)	2	39,916	36,885
Termination fees	906	1,591	(685)	—	—	—	—	—	—	906	1,591
Third party management fees, labor reimbursement and leasing	—	—	—	—	—	—	6,389	6,014	6,389	6,014	
Other	1,578	2,233	(655)	—	—	135	10	617	156	2,330	2,399
Total revenue	265,770	260,007	5,763	2,196	—	7,146	777	5,630	4,809	280,742	265,593
Property operating expenses	79,745	78,409	1,336	386	—	2,554	641	(3,777)	(4,827)	78,908	74,223
Real estate taxes	26,842	26,328	514	352	—	1,016	222	342	427	28,552	26,977
Third party management expenses	—	—	—	—	—	—	2,788	2,514	2,788	2,514	
Net Operating Income	159,183	155,270	3,913	1,458	—	3,576	(86)	6,277	6,695	170,494	161,879
General & administrative expenses	—	(6)	6	181	—	3	—	13,702	12,135	13,886	12,129
Depreciation and amortization	91,023	94,702	(3,679)	703	—	3,411	350	3,709	298	98,846	95,350
Operating Income (loss)	\$68,160	\$60,574	\$7,586	\$574	—	\$162	(436)	\$(11,134)	\$(5,738)	\$57,762	\$54,400
Number of properties	204	204		2		4				210	
Square feet	23,121	23,121		—		792				24,165	
	87.9	% 87.5	%	87.7	%	N/A				87.9	%

Occupancy % (d)			
Other Income (Expense):			
Interest income	180	2,320	(
Interest expense	(61,351)	(67,125 )	) 5
Interest expense — deferred	(2,344)	(2,572 )	) 2
financing costs			
Interest expense — financing	(429)	(378)) (
obligation			
Equity in income of real estate ventures	3,043	882	2
Gain from remeasurement of investment in a real estate venture	7,847	—	7
Net gain (loss) on real estate venture transactions	3,683	(11 )	) 3
Loss on early extinguishment of debt	(1,116)	(1,498 )	) 3
Income (loss) from continuing operations	7,275	(13,982)) \$
Income from discontinued operations	3,824	30,120	(
Net income	\$11,099	\$16,138	\$
Income per common share	\$0.05	\$0.06	\$

EXPLANATORY NOTES

(a) Results include: Two acquired properties.

(b) Results include: One development, two redevelopments and one re-entitlement property.

(c) Represents certain revenues and expenses at the corporate level as well as various intercompany costs that are eliminated in consolidation and third-party management fees.

(d) Pertains to properties that are part of our core portfolio (i.e. not under development, redevelopment or re-entitlement).

Total Revenue

Cash rents from the Total Portfolio increased by \$12.7 million from the six months ended June 30, 2012 to the six months ended June 30, 2013, primarily reflecting:

an increase of \$7.6 million due to a 3.7% increase in renewal cash rental rates from the six-month period ended June 30, 2012 to the six-month period ended June 30, 2013;

an increase of \$3.9 million due to our acquisition of 1900 Market Street during the fourth quarter of 2012. This property was 76.6% occupied as of June 30, 2013, with redevelopment expected to commence in the second half of 2013 in anticipation of the lead tenant's departure in late 2015, and;

an increase of \$1.2 million related to the acquisition of 7000 West at Lantana during the fourth quarter of 2012. Straight-line rents decreased by \$0.9 million during the six-month period ended June 30, 2013 compared to the six-month period ended June 30, 2012 due to a \$1.4 million increase related to a tenant taking occupancy of a portion of a redevelopment property, 660 Germantown Pike, during the third quarter of 2012 offset by free rent converting to cash rent subsequent to the second quarter of 2012 at our same store properties.

Tenant reimbursements increased by \$3.0 million consistent with the increase in operating expenses over the same period. Please see the Property Operating Expenses and Real Estate Taxes explanations below and note that certain costs, such as snow removal costs, carry a higher tenant reimbursement percentage.

Property Operating Expenses

Property operating expenses at the Total Portfolio increased by \$4.7 million mainly due to \$2.3 million of additional expenses from the aforementioned properties that we acquired and placed in service during 2012. The remaining increase is attributable to the following, (i) a \$0.7 million increase in repairs and maintenance expenses, directly attributable to timing and tenant needs, (ii) an increase of \$0.5 million in contract janitorial and landscaping expenses, (iii) an increase of \$0.4 million in snow removal costs as a result of a more severe winter during 2013 compared to 2012, (iv) an increase of \$0.5 million in salaries and related benefits from 2012 to 2013, and (v) an increase of \$0.2 million in bad debt expense, directly related to the increase in straight-line revenue. The remaining increase is attributable to increases in various expenses from the six-month period ended June 30, 2012 to the six-month period ended June 30, 2013, none of which were materially significant.

Real Estate Taxes

Real estate taxes increased by \$1.6 million mainly due to additional real estate taxes from the aforementioned properties that we acquired and placed into service during 2012.

General and Administrative Expenses

General and administrative expenses increased \$1.8 million from the six-month period ended June 30, 2012 to the six-month period ended June 30, 2013, mainly attributable to the following:

an increase in the amortization of performance-based compensation of \$1.2 million. This increase is due to the fact that certain of our executive personnel meet qualifying retirement conditions during 2013, causing an acceleration of their associated performance based compensation to fully vest;

- an increase of \$0.3 million related to acquisition costs incurred;
- an increase of \$0.2 million in professional fees, and;
- an increase \$0.1 million in payroll expenditures.

Depreciation and Amortization

Depreciation and amortization increased by \$3.5 million from the six-month period ended June 30, 2012 to the six-month period ended June 30, 2013 was attributable to a \$4.5 million increase in depreciation expense for Plaza 1000 at Main Street and 6 East Clementon. We are in the process of re-entitling these properties for residential and mixed-use development, and accordingly, we shortened the useful lives for each of these buildings to the expected demolition date. An additional increase of \$2.7 million is related to the aforementioned properties that we acquired and placed in service during 2012. These increases were offset by a decrease of \$3.7 million as a result of retiring assets at our same store portfolio.

Interest Income

Interest income decreased by \$2.1 million primarily due to the recognition of \$1.0 million of accrued interest income related to the payoff of the Trenton note receivable during second quarter of 2012. The installment sales method was used to account for the transaction as a result of the associated note receivable, and therefore interest income was recognized on a cash basis. We recognized all of the interest income accrued through the second quarter of 2012 upon receipt of payment from the borrower. The remaining decrease of \$1.1 million is due a decrease in interest income earned on investments in available-for-sale securities that were outstanding during the six-month period ended June 30, 2012. Interest income earned during the six-month period ended June 30, 2013 primarily represents interest earned on our available operating cash balances (\$215.9 million as of June 30, 2013).

Interest Expense

The decrease in interest expense of \$5.8 million is primarily due to the following:

- a decrease of \$5.4 million as a result of the repurchases of debt subsequent to the second quarter of 2012, including (i) \$6.2 million of our 5.400% Guaranteed Notes due 2014, (ii) \$55.8 million of our 7.500% Guaranteed Notes due 2015, and (iii) \$100.1 million of our 6.000% Guaranteed Notes due 2016;
- a decrease of \$2.7 million in mortgage interest expense which is directly related to the \$60.0 million decrease resulting from the repayment of two mortgage loans during the fourth quarter of 2012;
- a decrease of \$2.2 million related to our \$151.5 million 5.400% Guaranteed Notes that matured and were repaid in full during April 2012; and,
- a decrease of \$0.5 million in Term Loan interest expense which is directly related to repayment of our \$150.0 million term loan due 2016 during the fourth quarter of 2012.

The decrease of \$10.8 million in interest expense described above was offset by the following increases in interest expense during six-month period ending June 30, 2013 compared to the six-month period ending June 30, 2012:

- an increase of \$5.0 million related to our \$250.0 million 3.950% Guaranteed Notes due 2023 issued in the fourth quarter of 2012.

Equity in Income of Real Estate Ventures

The increase in equity in income of real estate ventures of \$2.2 million is attributable to the following, (i) an increase of \$1.0 million as a result of an increase in the preferred return recognized at the One and Two Commerce Square Real Estate Ventures, (ii) an increase of \$0.3 million related the Six Tower Bridge Venture as a result of repaying its mortgage indebtedness in full during the fourth quarter of 2012, (iii) an increase of \$0.2 million from a cash distribution received from the Two Tower Bridge Venture in excess of our investment basis, (iv) an increase of \$0.3 from selling our interest in the Beacon Venture during the first quarter of 2013, and (v) an increase of \$0.4 million as a result of normal operating activities at the partnership level.

Gain on Remeasurement of an Investment in a Real Estate Venture

Gain on remeasurement of an investment in a real estate venture increased \$7.8 million with no comparable gains recognized during the six-month period ended June 30, 2012. This gain resulted from the Company taking control of Six Tower Bridge during the six months ended June 30, 2013 which required the remeasurement at fair value of our existing equity interest in Six Tower Bridge that we did not already own(discussed in Footnote 4 of our consolidated financial statements).

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Net Gain on Real Estate Venture Transactions

The \$3.7 million increase in gain on real estate venture transactions is the result of the exchange of our remaining ownership in the Two Tower Bridge Venture for the remaining ownership interest in the Six Tower Bridge Venture, as discussed above in Footnote 4 of our consolidated financial statements.

Loss on Early Extinguishment of Debt

During the six-month period ended June 30, 2013, we repurchased (i) \$6.2 million of our 5.400% Guaranteed Notes due 2014, (ii) \$5.1 million of our 7.500% Guaranteed Notes due 2015, and (iii) \$0.5 million of our 6.000% Guaranteed Notes due 2016, which resulted in a net loss on early extinguishment of debt of \$1.1 million.

During the six-month period ended June 30, 2012, we repurchased (i) \$4.3 million of our 5.400% Guaranteed Notes due 2014, (ii) \$10.1 million of our 7.500% Guaranteed Notes due 2015, and (iii) \$0.3 million of our 5.750% Guaranteed Notes due 2012, which resulted in a net loss on early extinguishment of debt of \$1.5 million.

Discontinued Operations

During the six-month period ended June 30, 2013, we sold a portfolio of eight office properties located in Lawrenceville, New Jersey, one property located in San Diego, California, one property located in Carlsbad, California, one property located in Malvern, Pennsylvania and one property located in Exton, Pennsylvania. Through the date of sale during the six-month period ending June 30, 2013, the properties had total revenues of \$4.6 million, property operating expenses of \$2.1 million and \$1.7 million of depreciation and amortization expense. We recognized a net gain on sale related to these transactions of \$3.0 million.

The amounts for the six months ended June 30, 2012 are reclassified to include the operations of the properties sold during the six months ended June 30, 2013, as well as all properties that were sold through the year ended December 31, 2012. Therefore, the discontinued operations amount for the six-month period ended June 30, 2012 includes total revenue of \$18.4 million, operating expense of \$6.8 million, and depreciation and amortization of \$6.3 million.

Net income

Net income decreased by \$5.0 million during the six months ended June 30, 2013 compared to the six months ended June 30, 2012 as a result of the factors described above. Net income is significantly impacted by depreciation of operating properties and amortization of acquired intangibles. These non-cash charges do not directly affect our ability to pay dividends. Amortization of acquired intangibles will continue over the related lease terms or estimated duration of the tenant relationships.

Income per Common Share

Income per share was \$0.05 during the six months ended June 30, 2013 as compared to income per share of \$0.06 during the six months ended June 30, 2012 as a result of the factors described above.

LIQUIDITY AND CAPITAL RESOURCES OF THE PARENT COMPANY

The Parent Company conducts its business through the Operating Partnership and the Parent Company's only material asset is its ownership of partnership interests in the Operating Partnership. The Parent Company, other than acting as the sole general partner of the Operating Partnership, issues equity from time to time (and contributes the net proceeds of such issuances to the Operating Partnership in exchange for additional equity interests in the Operating Partnership) and guarantees the debt obligations of the Operating Partnership. The Parent Company's principal funding requirement is the payment of dividends on its common shares and preferred shares. The Parent Company's source of funding for its dividend payments and other obligations is the distributions it receives from the Operating Partnership.

As of June 30, 2013, the Parent Company owned a 98.8% interest in the Operating Partnership. The remaining interest of approximately 1.2% pertains to common limited partnership interests owned by non-affiliated investors who contributed property to the Operating Partnership in exchange for their interests. As the sole general partner of the Operating Partnership, the Parent Company has full and complete responsibility for the Operating Partnership's day-to-day operations and management.

As noted above, the Parent Company's only source of capital (other than proceeds of equity issuances which the Parent Company contributes to the Operating Partnership) is distributions it receives from the Operating Partnership. The Parent Company believes that the Operating Partnership's sources of working capital, particularly its cash flows from operations and borrowings available under its credit facilities, are adequate for it to make its distribution payments to

the Parent Company, which in turn enables the Parent Company to make dividend payments to its shareholders.

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The Parent Company receives proceeds from equity issuances from time to time and contributes such proceeds from its equity issuances to the Operating Partnership in exchange for partnership units of the Operating Partnership. The Parent Company's ability to sell common shares and preferred shares is dependent on, among other things, general market conditions for REITs, market perceptions about the Company as a whole and the current trading price of its shares. The Parent Company regularly analyzes which source of capital is most advantageous to it at any particular point in time.

On April 10, 2013, the Parent Company completed a public offering of 12,650,000 common shares, inclusive of 1,650,000 common shares issued upon exercise by the underwriters of the option granted to them to purchase additional shares. The Parent Company contributed the net proceeds from the sale of shares, amounting to \$181.7 million after deducting underwriting discounts and commissions and other offering expenses, to the Operating Partnership in exchange for partnership units of the Operating Partnership. The Operating Partnership intends to continue to use the net proceeds for working capital, capital expenditures and other general corporate purposes, which may include acquisitions, developments and the repayment, repurchase and refinancing of debt.

On May 30, 2013, the Parent Company declared a distribution of \$0.15 per common share, totaling \$23.8 million, which it paid on July 19, 2013 to its shareholders of record as of July 5, 2013. In addition, the Parent Company declared distributions on its Series E Preferred Shares to holders of record as of June 30, 2013. These shares are entitled to a preferential return of 6.90% per annum on the \$25.00 per share liquidation preference. Distributions paid on July 15, 2013 to holders of Series E Preferred Shares totaled \$1.7 million.

The Parent Company maintains a share repurchase program under which its Board of Trustees has authorized the Parent Company to repurchase common shares from time to time. As of June 30, 2013, there were approximately 0.5 million shares available for repurchase under this program. The Parent Company did not repurchase any shares during the three-month period ended June 30, 2013. The Parent Company's Board of Trustees has not limited the duration of the program and the program may be terminated at any time.

Together with the Operating Partnership, the Parent Company maintains a shelf registration statement that covers common shares, preferred shares, depositary shares, warrants and unsecured debt securities. Subject to the Company's ongoing compliance with securities laws, and if warranted by market conditions, the Parent Company and the Operating Partnership may offer and sell equity and debt securities from time to time under the shelf registration statement.

The Parent Company unconditionally guarantees the Operating Partnership's secured and unsecured obligations, which, as of June 30, 2013, amounted to \$438.4 million and \$1,947.2 million, respectively. If the Operating Partnership were to fail to comply with the covenants and restrictions in its loan agreements and indenture, then the Parent Company would be required to fulfill the Operating Partnership's commitments under such guarantees. The Parent Company's only material asset, however, is its ownership interest in the Operating Partnership. As of June 30, 2013, the Operating Partnership was in compliance with all of its debt covenant and requirement obligations. In order to maintain its qualification as a REIT, the Parent Company is required to, among other things, pay dividends to its shareholders amounting to at least 90% of its REIT taxable income. The Parent Company has satisfied and expects to continue to satisfy this requirement.

Overall, the liquidity of the Parent Company is dependent on the Operating Partnership's ability to make distributions to the Parent Company. However, there can be no assurance that the Operating Partnership's sources of capital will continue to be available to meet its working capital needs including its ability to make distribution payments to the Parent Company. In cases where the Operating Partnership is faced with working capital problems or would need to raise capital to fund acquisitions and developments, the Parent Company will have to consider alternative sources to increase liquidity, including, among other things, equity or debt, use of its available line of credit and potential sale of properties.

LIQUIDITY AND CAPITAL RESOURCES OF THE OPERATING PARTNERSHIP

General

The Operating Partnership's principal liquidity needs for the next twelve months are as follows:

- fund normal recurring expenses,
- fund capital expenditures, including capital and tenant improvements and leasing costs,
- fund repayment of certain debt instruments when they mature,
- fund current development and redevelopment costs, and
- fund distributions to the Parent Company.

The Operating Partnership believes that with continued uncertain economic conditions, vacancy rates may increase, effective rental rates on new and renewed leases may decrease and tenant installation costs, including concessions, may increase in most or all of its markets throughout 2013 and possibly beyond. As a result, the Operating Partnership's revenue from the overall reduced demand for office space, and its cash flow could be insufficient to cover increased tenant installation costs over the short-term. If this situation were to occur, the Operating Partnership expects that it would finance cash deficits through borrowings under its unsecured credit facility and other sources of debt and equity financings.

The Operating Partnership believes that its liquidity needs will be satisfied through available cash balances and cash flows generated by operations, financing activities and selective property sales. Rental revenue, expense recoveries from tenants, and other income from operations are its principal sources of cash that it uses to pay operating expenses, debt service, recurring capital expenditures and the minimum distributions required to maintain its REIT qualification. The Operating Partnership seeks to increase cash flows from its properties by maintaining quality standards for its properties that promote high occupancy rates and permit increases in rental rates while reducing tenant turnover and controlling operating expenses. The Operating Partnership's revenue also includes third-party fees generated by its property management, leasing, development and construction businesses. The Operating Partnership believes that its revenue, together with proceeds from property sales and debt financings, will continue to provide funds for its short-term liquidity needs. However, material changes in its operating or financing activities may adversely affect net cash flows of the Operating Partnership. Reduction in net cash flows would, in turn, adversely affect the Operating Partnership's ability to fund distributions to the Parent Company, pay debt service, and fund tenant improvements and other expenses. In addition, a material adverse change in cash provided by operations could adversely affect the Operating Partnership's compliance with financial performance covenants under its unsecured credit facility, including unsecured term loans and unsecured notes.

In light of the continuing volatility in financial markets and economic uncertainties, it is possible, that one or more lenders under the Operating Partnership's unsecured revolving credit facility could fail to fund a borrowing request of the Operating Partnership. Such an event could adversely affect the Operating Partnership's ability to access funds from its Credit Facility when needed to fund distributions or pay expenses.

The Operating Partnership uses multiple financing sources to fund its long-term capital needs. When needed, the Operating Partnership uses borrowings under its unsecured credit facility for general business purposes, including to meet debt maturities and to fund distributions to the Parent company as well as acquisition, development and acquisition costs and other expenses from time to time as necessary.

The Operating Partnership's ability to incur additional debt is dependent upon a number of factors, including its credit ratings, the value of its unencumbered assets, its degree of leverage and borrowing restrictions imposed by its lenders. If one or more rating agencies were to downgrade the Operating Partnership's unsecured credit rating, the Operating Partnership's access to the unsecured debt market would be more limited and the interest rate under its unsecured credit facility and unsecured term loans would increase.

As noted above, the ability of the Parent Company to sell equity securities (and contribute the net proceeds to the Operating Partnership) is dependent on, among other things, general market conditions for REITs, market perceptions about the Company and the current trading price of the Parent Company's shares. The Operating Partnership may also issue its own partnership units as consideration for property acquisitions or as part of financing.

The Operating Partnership also considers sales of selected assets as part of its liquidity and balance sheet management. The Operating Partnership has from time to time used proceeds from asset sales to repay existing

indebtedness, provide capital for its development activities and to strengthen its financial condition. There can be no assurance that the Operating Partnership will be able to sell assets at an attractive price to generate additional capital.

Liquidity management is a key priority of management, and the Operating Partnership regularly evaluates financing opportunities to maintain an appropriate balance sheet position. As a result of these dedicated efforts, the Operating Partnership believes that its current balance sheet is in an adequate position at the date of this filing, despite the volatility in the credit and financial market. The Operating Partnership believes it is able and will continue to be able to meet debt maturities and to fund distributions to the Parent Company as well as development and acquisition costs and other expenses from time to time as necessary.

Cash Flows

The following discussion of the Operating Partnership's cash flows is based on the consolidated statement of cash flows and is not meant to be a comprehensive discussion of the changes in our cash flows for the periods presented. As of June 30, 2013 and December 31, 2012, the Operating Partnership maintained cash and cash equivalents of \$215.9 million and \$1.5 million, respectively. The following are the changes in cash flow from its activities for the six-month periods ended June 30, 2013 and June 30, 2012 (in thousands):

Activity	2013	2012
Operating	\$96,791	\$75,621
Investing	68,607	9,988
Financing	49,001	104,036
Net cash flows	\$214,399	\$189,645

The Operating Partnership's principal source of cash flows is from the operation of its properties. The Operating Partnership does not restate its cash flow for discontinued operations.

Cash provided from operating activities of the Operating Partnership for the six-month periods ended June 30, 2013 and 2012 were \$96.8 million and \$75.6 million, respectively. This increase of \$21.2 million is primarily attributable to 2012 acquisitions and increased net operating income on the same store property portfolio in the 2013 period as compared to the 2012 period.

The net increase of \$58.6 million in cash from investing activities of the Operating Partnership during the six months ended June 30, 2013 compared to the six months ended June 30, 2012 is primarily attributable to the following:

- the purchase of \$98.7 million in held-to-maturity securities during the six months ended June 30, 2012, with no comparable purchases for the six-month period ended June 30, 2013;

- an increase of \$25.0 million of net proceeds from the sale of 12 properties during the six months ended June 30, 2013.

- There were three property sales during the six months ended June 30, 2012 (see Note 3 to the consolidated financial statements for details);

- an increase of \$17.0 million in proceeds from the sale of the Operating Partnership's entire 20% ownership interest in the Real Estate Venture known as "BDN Beacon, LLC Venture" during the six months ended June 2013, with no comparable activity for the six months ended June 2012 (see Note 4 to the consolidated financial statements for details);

- a \$0.7 million decrease in capital expenditures related to developments, redevelopments, tenant and building improvements and leasing commissions during the six months ended June 30, 2013 compared to the six months ended June 30, 2012. During the six months ended June 30, 2013, we incurred lower expenditures related to new leasing efforts compared to the six months ended June 30, 2012.

- a decrease of \$6.0 million of investments in unconsolidated Real Estate Ventures during the six months ended June 30, 2013, primarily reflecting \$12.0 million that we contributed to a Real Estate Venture to fund our pro rata share of the repayment of mortgage indebtedness during the six months ended June 30, 2012, offset by our contribution our pro rata share of capital to fund the Grove Venture and our contribution to the Real Estate Venture that owns One and Two Commerce Square to fund operations during the six months ended June 30, 2013;

- our receipt of \$2.0 million in reimbursement of pre-formation development expenses from a Real Estate Venture during the six months ended June 30, 2013 with no comparable reimbursements during the six months ended June 30, 2012; and

- an increase of \$1.7 million in cash distributions from a Real Estate Venture during the six-months ended June 30, 2013 compared to the six-months ended June 30, 2012, primarily reflecting increased distributions of operating cash flow by the Real Estate Venture known as "BDN AI Venture" during the six-month period ended June 30, 2013.

The increase in cash from investing activities was partially offset by the following transactions:

- proceeds of \$56.3 million received related to the maturity of available for sale securities during the six months ended June 30, 2012 with no comparable receipt of proceeds during the six months ended June 30, 2013;
- receipt of \$23.9 million on a mortgage note receivable during the six months ended June 30, 2012 compared to receipt of \$0.2 million during the six months ended June 30, 2013;
- an increase of \$11.5 million in funds used to acquire operating properties, mainly attributable to the Operating Partnership's acquisition of the 1.8 acre land parcel underlying Three Logan Square during the six months ended June 30, 2013 compared to our acquisition of a development property, 660 West Germantown Pike, during the six months ended June 30, 2012, and;
- a decrease in advances made for purchase of tenant assets, net of repayments of \$1.0 million during the six months ended June 30, 2013, when compared to the six months ended June 30, 2012.

The net decrease of \$55.0 million in cash from financing activities during the six months ended June 30, 2013 compared to the six months ended June 30, 2012 is mainly due to the following:

- receipt of new unsecured term loan funding of \$600.0 million during the six months ended June 30, 2012, with no comparable funding for the six months ended June 30, 2013; and,
- receipt of \$96.2 million proceeds from the issuance of the Parent Company's 6.90% Series E Preferred Shares during the six month period ended June 30, 2012, with no comparable preferred share issuance in the six months ended June 30, 2013.

The net decrease in cash from financing activities described above was offset by the following:

- receipt of \$181.5 million in proceeds from the 12,650,000 common share issuance by the Parent Company during the six months ended June 30, 2013 with no comparable share issuance during the the six months ended June 30, 2012;
- an increase of \$164.5 million in borrowings under the unsecured credit facility during the six months ended June 30, 2013 compared to the six months ended June 30, 2012;
- redemption of the Parent Company's 7.50% Series C Preferred Shares of \$50.2 million during the six months ended June 30, 2012, with no comparable charges during the six months ended June 30, 2013;
- a \$42.5 million decrease in repayments under the unsecured credit facility and mortgage notes payable during the six months ended June 30, 2013 compared to the six months ended June 30, 2012;
- repayment of an unsecured term loan of \$37.5 million during the six months ended June 30, 2012, with no comparable repayment during the six months ended June 30, 2013;
- debt financing cost payments of \$8.4 million during the six months ended June 30, 2012, with nominal costs paid during the six months ended June 30, 2013;
- repayment of unsecured notes of \$167.4 million during the six months ended June 30, 2012, with \$13.0 million repayments during the six months ended June 30, 2013;
- a \$1.5 million increase in proceeds from the exercise of stock options during the six month period ended June 30, 2013 compared to the six month period ended June 30, 2012;
- net settlement of hedge transactions of \$0.1 million during the six months ended June 30, 2012, with no comparable settlements during the six months ended June 30, 2013, and;
- a decrease in distributions paid to the Parent Company's shareholders and on non-controlling interests in the Operating Partnership from \$47.9 million during the six months ended June 30, 2012 to \$47.3 million during the six months ended June 30, 2013.

Capitalization

Indebtedness

During the six months ended June 30, 2013, we repurchased \$11.8 million of our outstanding unsecured notes in a series of transactions which are summarized in the table below (in thousands):

Notes	Repurchase Amount	Principal	Loss	Deferred Financing Amortization
2014 5.400% Notes	\$6,570	\$6,180	\$(401)	) \$7
2015 7.500% Notes	5,728	5,105	(652)	) 15
2016 6.000% Notes	573	510	(63)	) 1
	\$12,871	\$11,795	\$(1,116)	) \$23

The table below summarizes the Operating Partnership's indebtedness under its mortgage notes payable, its unsecured notes and its Credit Facility at June 30, 2013 and December 31, 2012:

	June 30, 2013 (dollars in thousands)	December 31, 2012		
Balance:				
Fixed rate	\$2,285,562	\$2,302,895		
Variable rate — unhedged	100,000	169,000		
Total	\$2,385,562	\$2,471,895		
Percent of Total Debt:				
Fixed rate	95.8	% 93.2		%
Variable rate — unhedged	4.2	% 6.8		%
Total	100	% 100		%
Weighted-average interest rate at period end:				
Fixed rate	5.3	% 5.3		%
Variable rate — unhedged	1.9	% 1.9		%
Total	5.1	% 5.1		%

The variable rate debt shown above generally bear interest based on various spreads over a LIBOR term selected by the Operating Partnership.

The Operating Partnership will use Credit Facility borrowings for general business purposes, including the acquisition, development and redevelopment of properties and the repayment of other debt. It has the option to increase the maximum borrowings under the Credit Facility to \$800.0 million subject to the absence of any defaults and its ability to obtain additional commitments from its existing or new lenders. The Credit Facility requires the maintenance of financial covenants, including ratios related to minimum net worth, debt to total capitalization and fixed charge coverage and customary non-financial covenants. The Operating Partnership is in compliance with all covenants as of June 30, 2013.

The indenture under which the Operating Partnership issued its unsecured notes contains financial covenants, including (i) a leverage ratio not to exceed 60%, (ii) a secured debt leverage ratio not to exceed 40%, (iii) a debt service coverage ratio of greater than 1.5 to 1.0 and (iv) an unencumbered asset value of not less than 150% of unsecured debt. The Operating Partnership is in compliance with all covenants as of June 30, 2013.

The Operating Partnership has mortgage loans that are collateralized by certain of its Properties. Payments on mortgage loans are generally due in monthly installments of principal and interest, or interest only. The Operating Partnership intends to refinance or repay its mortgage loans as they mature through the use of proceeds from selective Property sales and secured or unsecured borrowings. However, in the current and expected future economic environment one or more of these sources may not be available on attractive terms or at all.

The charter documents of the Parent Company and Operating Partnership do not limit the amount or form of indebtedness that the Operating Partnership may incur, and its policies on debt incurrence are solely within the discretion of the Parent Company's Board of Trustees, subject to the financial covenants in the Credit Facility, indenture and other credit agreements.

As of June 30, 2013, the Operating Partnership had guaranteed repayment of approximately \$0.6 million of loans on behalf of one Real Estate Venture. In addition, in connection with our development of the Grove project through the

Grove Venture, the Operating Partnership and Campus Crest have each provided, in addition to customary non-recourse carve-out guarantees, a completion and cost overrun guaranty, as well as a payment guaranty, on the construction financing (with the Company's share of

the payment guaranty being approximately \$23.0 million). The Operating Partnership also provides customary environmental indemnities and completion guarantees in connection with construction and permanent financing both for its own account and on behalf of certain of the Real Estate Ventures.

Equity

On April 10, 2013, the Parent Company completed a public offering of 12,650,000 common shares, inclusive of 1,650,000 common shares issued upon exercise by the underwriters of the option granted to them to purchase additional shares. The Parent Company contributed the net proceeds from the sale of shares, amounting to \$181.7 million after deducting underwriting discounts and commissions and other offering expenses, to the Operating Partnership in exchange for partnership units of the Operating Partnership. The Operating Partnership is using the net proceeds for working capital, capital expenditures and other general corporate purposes, which may include acquisitions, developments and the repayment, repurchase and refinancing of debt.

On May 30, 2013, the Operating Partnership declared a distribution of \$0.15 per common partnership unit, totaling \$23.8 million, which was paid on July 19, 2013 to unitholders of record as of July 5, 2013.

On May 30, 2013, the Operating Partnership declared distributions on its Series E-Linked Preferred Mirror Units to holders of record as of June 30, 2013. These units are entitled to a preferential return of 6.90% per annum on the \$25.00 per share liquidation preference. Distributions paid on July 15, 2013 to holders of Series E-Linked Preferred Mirror Units totaled \$1.7 million.

Together with the Operating Partnership, the Parent Company maintains a shelf registration statement that covers common shares, preferred shares, depositary shares, warrants and unsecured debt securities. Subject to the Company's ongoing compliance with securities laws, if warranted by market conditions, the Parent Company and the Operating Partnership may offer and sell equity and debt securities from time to time under the shelf registration statement.

The Parent Company did not purchase any shares under its share repurchase program during the six-month period ended June 30, 2013 and accordingly, during the six-month period ended June 30, 2012, the Operating Partnership did not repurchase any units in connection with the Parent Company's share repurchase program.

Short- and Long-Term Liquidity

The Operating Partnership believes that its available cash balances and cash flow from operations are adequate to fund its short-term liquidity requirements, excluding principal payments under its debt obligations. Cash flow from operations is generated primarily from rental revenues and operating expense reimbursements from tenants and management services income from providing services to third parties. The Operating Partnership intends to use these funds to meet short-term liquidity needs, which are to fund operating expenses, recurring capital expenditures, tenant allowances, leasing commissions, interest expense and the minimum distributions required to maintain the Parent Company's REIT qualification under the Internal Revenue Code. The Operating Partnership expects to meet short-term scheduled debt maturities through borrowings under the Credit Facility and proceeds from potential asset dispositions. As of June 30, 2013, the Operating Partnership had \$1,947.2 million of total unsecured debt and \$438.4 million of mortgage debt with \$5.7 million of mortgage principal payments scheduled to be repaid through December 31, 2013. The Operating Partnership expects to meet its long-term liquidity requirements, such as for property acquisitions, development, investments in real estate ventures, scheduled debt maturities, major renovations, expansions and other significant capital improvements, through cash from operations, borrowings under the Credit Facility, additional secured and unsecured indebtedness, the issuance of equity securities, contributions from Real Estate Venture investors and proceeds from asset dispositions.

Inflation

A majority of the Operating Partnership's leases provide for tenant reimbursement of real estate taxes and operating expenses either on a triple net basis or over a base amount. In addition, many of its office leases provide for fixed base rent increases. The Operating Partnership believes that inflationary increases in expenses will be partially offset by expense reimbursement and contractual rent increases.

Commitments and Contingencies

The following table outlines the timing of payment requirements related to the Operating Partnership's contractual commitments as of June 30, 2013:

	Payments by Period (in thousands)				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Mortgage notes payable (a)	\$438,404	\$11,599	\$197,753	\$40,414	\$188,638
Unsecured term loans	450,000	—	250,000	—	200,000
Unsecured debt (a)	1,497,158	—	543,548	625,000	328,610
Ground leases (b)	290,770	2,243	4,576	4,576	279,375
Development contracts (c)	428	428	—	—	—
Interest expense (d)	502,017	103,905	163,755	89,450	144,907
Other liabilities (e)	14,507	—	—	—	14,507
	\$3,193,284	\$118,175	\$1,159,632	\$759,440	\$1,156,037

(a) Amounts do not include unamortized discounts and/or premiums.

(b) Future minimum rental payments under the terms of all non-cancelable ground leases under which we are the lessee are expensed on a straight-line basis regardless of when payments are due. The table also does not include the future minimum rental payments related to the ground lease in connection with our acquisition of 3020 Market Street in Philadelphia, Pennsylvania. This ground lease is discussed below.

(c) Represents contractual obligations for development projects and does not contemplate all costs expected to be incurred for such developments.

(d) Variable rate debt future interest expense commitments are calculated using June 30, 2013 interest rates.

(e) Other liabilities consists of deferred compensation liability and the interest accretion on the existing transfer tax liability on Two Logan Square in Philadelphia, Pennsylvania (see related discussion below), as of June 30, 2013.

The Operating Partnership acquired ground tenancy rights under a long term ground lease agreement related to its acquisition of 3020 Market Street in Philadelphia, Pennsylvania on August 12, 2011. The annual rental payments under this ground lease are equal to a percentage of the NOI generated by the property. The Company has not included the amounts in the table above since such amounts are not fixed or determinable.

As part of the Operating Partnership's September 2004 acquisition of a portfolio of properties from the Rubenstein Company (which the Operating Partnership refers to as the "TRC acquisition"), the Operating Partnership acquired its interest in Two Logan Square, a 708,844 square foot office building in Philadelphia, primarily through its ownership of a second and third mortgage secured by this property. This property is consolidated as the borrower is a variable interest entity and the Operating Partnership, through its ownership of the second and third mortgages, is the primary beneficiary. The Operating Partnership currently does not expect to take title to Two Logan Square until, at the earliest, September 2019. If the Operating Partnership takes fee title to Two Logan Square upon a foreclosure of its mortgage, the Operating Partnership has agreed to pay an unaffiliated third party that holds a residual interest in the fee owner of this property an amount equal to \$2.9 million. On the TRC acquisition date, the Operating Partnership recorded a liability of \$0.7 million and this amount will accrete up to \$2.9 million through September 2019. As of June 30, 2013, the Operating Partnership has a balance of \$1.6 million for this liability on its consolidated balance sheet.

The Operating Partnership was audited by the IRS for its 2004 tax year. The audit concerned the tax treatment of the TRC acquisition in September 2004 in which the Operating Partnership acquired a portfolio of properties through the acquisition of a limited partnership. On December 17, 2010, the Operating Partnership received notice that the IRS

proposed an adjustment to the allocation of recourse liabilities allocated to the contributor of the properties. The Operating Partnership appealed the proposed adjustment

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and during the second quarter of 2013 entered into a settlement agreement with the IRS which will not result in a material liability for the Operating Partnership for federal income taxes. The contributor of partnership interests in the 2004 transaction has agreed not to assert a claim against the Operating Partnership under the tax protection agreement entered into as part of the transaction.

As part of the Operating Partnership's 2006 Prentiss merger, the 2004 TRC acquisition and several of its other transactions, it agreed not to sell certain of the properties it acquired in transactions that would trigger taxable income to the former owners. In the case of the TRC acquisition, the Operating Partnership agreed not to sell acquired properties in non-exempt transactions for periods up to 15 years from the date of the TRC acquisition as follows at June 30, 2013: One Rodney Square and 130/150/170 Radnor Financial Center (January, 2015); and One Logan Square, Two Logan Square and Radnor Corporate Center (January, 2020). In the Prentiss acquisition, the Operating Partnership assumed the obligation of Prentiss not to sell Concord Airport Plaza before March, 2018. The Operating Partnership's agreements generally provide that we may dispose of the subject properties only in transactions that qualify as tax-free exchanges under Section 1031 of the Internal Revenue Code or in other tax deferred transactions. If the Operating Partnership was to sell a restricted property before expiration of the restricted period in a non-exempt transaction, it would be required to make significant payments to the parties who sold the applicable property to the Operating Partnership for tax liabilities attributed to them.

As part of the Operating Partnership's acquisition of properties from time to time in tax-deferred transactions, it has agreed to provide certain of the prior owners of the acquired properties with the right to guarantee its indebtedness. If the Operating Partnership were to seek to repay the indebtedness guaranteed by the prior owner before the expiration of the applicable agreement, it will be required to provide the prior owner an opportunity to guarantee a qualifying replacement debt. These debt maintenance agreements may limit its ability to refinance indebtedness on terms that will be favorable to the Operating Partnership.

In connection with the development of the IRS Philadelphia Campus and the Cira South Garage, during 2008, the Operating Partnership entered into a historic tax credit and new markets tax credit arrangement, respectively. The Operating Partnership is required to be in compliance with various laws, regulations and contractual provisions that apply to its historic and new market tax credit arrangements. Non-compliance with applicable requirements could result in projected tax benefits not being realized and therefore, require a refund to USB or a reduction of investor capital contributions, which are reported as deferred income in the Operating Partnership's consolidated balance sheet, until such time as its obligation to deliver tax benefits is relieved. The remaining compliance periods for its tax credit arrangements runs through 2015. The Operating Partnership does not anticipate that any material refunds or reductions of investor capital contributions will be required in connection with these arrangements.

The Operating Partnership invests in properties and regularly incurs capital expenditures in the ordinary course of its business to maintain the properties. The Operating Partnership believes that such expenditures enhance its competitiveness. The Operating Partnership also enters into construction, utility and service contracts in the ordinary course of its business which may extend beyond one year. These contracts typically provide for cancellation with insignificant or no cancellation penalties.

Interest Rate Risk and Sensitivity Analysis

The analysis below presents the sensitivity of the market value of the Operating Partnership's financial instruments to selected changes in market rates. The range of changes chosen reflects its view of changes which are reasonably possible over a one-year period. Market values are the present value of projected future cash flows based on the market rates chosen.

The Operating Partnership's financial instruments consist of both fixed and variable rate debt. As of June 30, 2013, its consolidated debt consisted of \$438.4 million of mortgage loans and \$1,418.5 million of unsecured notes, all of which are fixed rate borrowings. We also have variable rate debt consisting of \$78.6 million in trust preferred securities and \$450.0 million of unsecured term loans all of which are swapped to fixed, except for \$100.0 million of unsecured term loans which bear interest at a variable rate. All financial instruments were entered into for other than trading purposes and the net market value of these financial instruments is referred to as the net financial position. Changes in interest rates have different impacts on the fixed and variable rate portions of our debt portfolio. A change in interest rates on the fixed portion of the debt portfolio impacts the net financial instrument position, but has no

impact on interest incurred or cash flows. A change in interest rates on the variable portion of the debt portfolio impacts the interest incurred and cash flows, but does not impact the net financial instrument position.

If market rates of interest increase by 100 basis points, the fair value of the Operating Partnership's outstanding fixed-rate mortgage debt would decrease by approximately \$23.7 million. If market rates of interest decrease by 100 basis points, the fair value of its outstanding fixed-rate mortgage debt would increase by approximately \$26.0 million. As of June 30, 2013, based on prevailing interest rates and credit spreads, the fair value of the Operating Partnership's \$1,418.5 million of unsecured notes was \$1,496.0 million. For sensitivity purposes, a 100 basis point change in the discount rate equates to a change in the total fair value of the Operating Partnership's debt of approximately \$14.1 million at June 30, 2013.

From time to time or as the need arises, the Operating Partnership uses derivative instruments to manage interest rate risk exposures and not for speculative purposes. The total carrying value of the Operating Partnership's variable rate debt (including variable swapped to fixed) was approximately \$528.6 million and \$597.6 million at June 30, 2013 and December 31, 2012, respectively. The total fair value of the Operating Partnership's debt was approximately \$526.7 million and \$595.7 million at June 30, 2013 and December 31, 2012, respectively. For sensitivity purposes, if market rates of interest increase by 100 basis points the fair value of its variable rate debt would decrease by approximately \$7.1 million at June 30, 2013. If market rates of interest decrease by 100 basis points the fair value of its outstanding variable rate debt would increase by approximately \$3.4 million. A 100 basis point change in the market rate of interest equates to a change in the total fair value of its debt of approximately \$1.7 million at December 31, 2012. At June 30, 2013, the Operating Partnership's outstanding variable rate debt based on LIBOR totaled approximately \$528.6 million, of which \$100.0 million remained variable, with the remaining \$428.6 million being swapped to fixed. At June 30, 2013, the interest rate on the Operating Partnership's variable rate debt was approximately 1.9%. If market interest rates on its variable rate debt were to change by 100 basis points, total interest expense would have changed by approximately \$0.3 million for the quarter ended June 30, 2013.

These amounts were determined solely by considering the impact of hypothetical interest rates on the Operating Partnership's financial instruments. Due to the uncertainty of specific actions it may undertake to minimize possible effects of market interest rate increases, this analysis assumes no changes in its financial structure.

Funds from Operations (FFO)

Pursuant to the revised definition of FFO adopted by the Board of Governors of the National Association of Real Estate Investment Trusts ("NAREIT"), we calculate FFO by adjusting net income/(loss) attributable to common unit holders (computed in accordance with GAAP) for gains (or losses) from sales of properties, impairment losses on depreciable consolidated real estate, impairment losses on investments in unconsolidated Real Estate Ventures driven by a measurable decrease in the fair value of depreciable real estate held by the unconsolidated Real Estate Ventures, real estate related depreciation and amortization, and after similar adjustments for unconsolidated real estate ventures. FFO is a non-GAAP financial measure. The Operating Partnership believes that the use of FFO combined with the required U.S. GAAP presentations, has been beneficial in improving the understanding of operating results of REITs among the investing public and making comparisons of REITs' operating results more meaningful. The Operating Partnership considers FFO to be a useful measure for reviewing comparative operating and financial performance because, by excluding gains or losses related to sales of previously depreciated operating real estate assets and real estate depreciation and amortization, FFO can help the investing public compare the operating performance of a company's real estate between periods or as compared to other companies. The Operating Partnership's computation of FFO may not be comparable to FFO reported by other REITs or real estate companies that do not define the term in accordance with the current NAREIT definition or that interpret the current NAREIT definition differently.

The Operating Partnership considers net income, as defined by U.S. GAAP, to be the most comparable earnings measure to FFO. While FFO and FFO per unit are relevant and widely used measures of operating performance of REITs, FFO does not represent cash flow from operations or net income as defined by U.S. GAAP and should not be considered as alternatives to those measures in evaluating the company's liquidity or operating performance. The Operating Partnership believes that to further understand our performance, FFO should be compared with its reported net income/(loss) attributable to common unit holders and considered in addition to cash flows in accordance with GAAP, as presented in our consolidated financial statements.

The following table presents a reconciliation of net income (loss) attributable to common unit holders to FFO for the three-month and six-month periods ended June 30, 2013 and 2012:

	Three-month periods ended		Six-month periods ended	
	June 30, 2013	2012	June 30, 2013	2012
	(amounts in thousands, except share information)			
Net income attributable to common unitholders	\$5,370	\$1,568	\$7,456	\$8,810
Add (deduct):				
Amount allocated to unvested restricted unitholders	85	95	193	191
Net loss (gain) on disposition of discontinued operations	2,260	(10,177)	(3,044)	(24,845)
Net gain (loss) on real estate venture transactions	(3,683)	11	(3,683)	11
Gain from remeasurement of investment in a real estate venture	(7,847)	—	(7,847)	—
Depreciation and amortization:				
Real property — continuing operations	40,326	37,183	80,430	74,095
Leasing costs including acquired intangibles — continuing operations	8,942	10,241	18,349	21,097
Real property — discontinued operations	277	2,559	1,713	5,989
Leasing costs including acquired intangibles — discontinued operations	1	136	2	285
Company's share of unconsolidated real estate ventures	3,234	3,167	7,383	6,557
Funds from operations	\$48,965	\$44,783	\$100,952	\$92,190
Funds from operations allocable to unvested restricted shareholders	(176)	(197)	(435)	(515)
Funds from operations available to common share and unit holders (FFO)	\$48,789	\$44,586	\$100,517	\$91,675
Weighted-average shares/units outstanding — fully diluted	158,475,513	146,545,858	152,481,101	146,184,051

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the exposure to loss resulting from changes in interest rates, commodity prices and equity prices. In pursuing the Company's business plan, the primary market risk to which it is exposed is interest rate risk. Changes in the general level of interest rates prevailing in the financial markets may affect the spread between the Company's yield on invested assets and cost of funds and, in turn, the Company's ability to make distributions or payments to its shareholders. While the Company has not experienced any significant credit losses, in the event of a significant rising interest rate environment and/or continued economic slowdown, defaults could increase and result in losses to the Company which would adversely affect its operating results and liquidity.

See "Interest Rate Risk and Sensitivity Analysis" in Item 2 above.

Item 4. Controls and Procedures

Controls and Procedures (Parent Company)

Evaluation of disclosure controls and procedures. Under the supervision and with the participation of its management, including its principal executive officer and principal financial officer, the Parent Company conducted an evaluation of its disclosure controls and procedures, as such term is defined under Rule 13a-15(e) (a) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this quarterly report. Based on this evaluation, the Parent Company's principal executive officer and principal financial officer have concluded that the Parent Company's disclosure controls and procedures are effective as of the end of the period covered by this quarterly report.

(b)

Changes in internal control over financial reporting. There was no change in the Parent Company's internal control over financial reporting that occurred during the period covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, the Parent Company's internal control over financial reporting.

Controls and Procedures (Operating Partnership)

(a) Evaluation of disclosure controls and procedures. Under the supervision and with the participation of its management, including its principal executive officer and principal financial officer, the Operating Partnership

conducted an evaluation of its disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Exchange Act as of the end of the period covered by this quarterly report. Based on this evaluation, the Operating Partnership's principal executive officer and principal financial officer have concluded that the Operating Partnership's disclosure controls and procedures are effective as of the end of the period covered by this quarterly report.

(b) Changes in internal control over financial reporting. There was no change in the Operating Partnership's internal control over financial reporting that occurred during the period covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, the Operating Partnership's internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

There has been no material change to the risk factors previously disclosed by us in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

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

The following table summarizes the share repurchases during the six-month period ended June 30, 2013:

	Total Number of Shares Purchased (a)	Average Price Paid Per Share	Purchased as Part of Publicly Announced Plans or Programs	Shares that May Yet Be Purchased Under the Plans or Programs (b)
2013:				
January	1,374	\$12.76	—	539,200
February	16,728	\$12.96	—	539,200
March	16,028	\$14.01	—	539,200
April	54,953	\$14.90	—	539,200
May	—	—	—	539,200
June	—	—	—	539,200
Total	89,083		—	

(a) Represents common shares surrendered by employees to the Company to satisfy such employees' tax withholding obligations in connection with the vesting of restricted common shares.

(b) Relates to the remaining share repurchase availability under the Parent Company's share repurchase program. There is no expiration date on the share repurchase program. The Parent Company's Board of Trustees initially authorized this program in 1998 and has periodically replenished capacity under the program.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

(a) Exhibits

10.1 Form of Restricted Share Award Agreement for Non-employee Trustees *

31.1 Certification of the Chief Executive Officer of Brandywine Realty Trust pursuant to 13a-14 under the Securities Exchange Act of 1934

31.2 Certification of the Chief Financial Officer of Brandywine Realty Trust pursuant to 13a-14 under the Securities Exchange Act of 1934

31.3 Certification of the Chief Executive Officer of Brandywine Realty Trust, in its capacity as the general partner of Brandywine Operating Partnership, L.P., pursuant to 13a-14 under the Securities Exchange Act of 1934

31.4 Certification of the Chief Financial Officer of Brandywine Realty Trust, in its capacity as the general partner of Brandywine Operating Partnership, L.P., pursuant to 13a-14 under the Securities Exchange Act of 1934

32.1 Certification of the Chief Executive Officer of Brandywine Realty Trust pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of the Chief Financial Officer of Brandywine Realty Trust pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.3 Certification of the Chief Executive Officer of Brandywine Realty Trust, in its capacity as the general partner of Brandywine Operating Partnership, L.P., pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.4 Certification of the Chief Financial Officer of Brandywine Realty Trust, in its capacity as the general partner of Brandywine Operating Partnership, L.P., pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101.1 The following materials from the Quarterly Reports on Form 10-Q of Brandywine Realty Trust and Brandywine Operating Partnership, L.P. for the quarter ended June 30, 2013 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statement of Equity, (iv) the Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial Statements, detailed tagged and filed herewith.

* Management contract or compensatory plan or arrangement.

SIGNATURES OF REGISTRANT

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

BRANDYWINE REALTY TRUST
(Registrant)

Date: August 5, 2013

By: /s/ Gerard H. Sweeney
Gerard H. Sweeney, President and
Chief Executive Officer
(Principal Executive Officer)

Date: August 5, 2013

By: /s/ Howard M. Sipzner
Howard M. Sipzner, Executive Vice President
and Chief Financial Officer
(Principal Financial Officer)

Date: August 5, 2013

By: /s/ Gabriel J. Mainardi
Gabriel J. Mainardi, Vice President and
Chief Accounting Officer
(Principal Accounting Officer)

SIGNATURES OF REGISTRANT

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

BRANDYWINE OPERATING PARTNERSHIP, L.P.
(Registrant)
BRANDYWINE REALTY TRUST,
as general partner

Date: August 5, 2013

By: /s/ Gerard H. Sweeney
Gerard H. Sweeney, President and
Chief Executive Officer
(Principal Executive Officer)

Date: August 5, 2013

By: /s/ Howard M. Sipzner
Howard M. Sipzner, Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: August 5, 2013

By: /s/ Gabriel J. Mainardi
Gabriel J. Mainardi, Vice President and
Chief Accounting Officer
(Principal Accounting Officer)

Index to Exhibits

- 10.1 Form of Restricted Share Award Agreement for Non-employee Trustees *
- 31.1 Certification of the Chief Executive Officer of Brandywine Realty Trust pursuant to 13a-14 under the Securities Exchange Act of 1934
- 31.2 Certification of the Chief Financial Officer of Brandywine Realty Trust pursuant to 13a-14 under the Securities Exchange Act of 1934
- 31.3 Certification of the Chief Executive Officer of Brandywine Realty Trust, in its capacity as the general partner of Brandywine Operating Partnership, L.P., pursuant to 13a-14 under the Securities Exchange Act of 1934
- 31.4 Certification of the Chief Financial Officer of Brandywine Realty Trust, in its capacity as the general partner of Brandywine Operating Partnership, L.P., pursuant to 13a-14 under the Securities Exchange Act of 1934
- 32.1 Certification of the Chief Executive Officer of Brandywine Realty Trust pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of the Chief Financial Officer of Brandywine Realty Trust pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.3 Certification of the Chief Executive Officer of Brandywine Realty Trust, in its capacity as the general partner of Brandywine Operating Partnership, L.P., pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.4 Certification of the Chief Financial Officer of Brandywine Realty Trust, in its capacity as the general partner of Brandywine Operating Partnership, L.P., pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101.1 The following materials from the Quarterly Reports on Form 10-Q of Brandywine Realty Trust and Brandywine Operating Partnership, L.P. for the quarter ended June 30, 2013 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statement of Equity, (iv) the Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial Statements, detailed tagged and filed herewith.

* Management contract or compensatory plan or arrangement.