

CORPORATE OFFICE PROPERTIES TRUST
Form 10-Q
August 03, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q
(Mark one)

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

For the quarterly period ended June 30, 2015

or

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

For the transition period from to

Commission file number 1-14023 (Corporate Office Properties Trust)
Commission file number 333-189188 (Corporate Office Properties, L.P.)

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

(Exact name of registrant as specified in its charter)

Corporate Office Properties Trust	Maryland (State or other jurisdiction of incorporation or organization)	23-2947217 (IRS Employer Identification No.)
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Corporate Office Properties, L.P.	Delaware (State or other jurisdiction of incorporation or organization)	23-2930022 (IRS Employer Identification No.)
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6711 Columbia Gateway Drive, Suite 300, Columbia, MD	21046
(Address of principal executive offices)	(Zip Code)

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

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

Corporate Office Properties Trust Yes No

Corporate Office Properties, L.P. Yes No

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

Corporate Office Properties Trust Yes No

Corporate Office Properties, L.P. Yes No

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

Corporate Office Properties Trust

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

Corporate Office Properties, L.P.

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

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

Corporate Office Properties Trust Yes No

Corporate Office Properties, L.P. Yes No

As of July 17, 2015, 94,528,982 of Corporate Office Properties Trust’s Common Shares of Beneficial Interest, \$0.01 par value, were issued and outstanding.

EXPLANATORY NOTE

This report combines the quarterly reports on Form 10-Q for the period ended June 30, 2015 of Corporate Office Properties Trust (“COPT”) and subsidiaries (collectively, the “Company”) and Corporate Office Properties, L.P. (“COPLP”) and subsidiaries (collectively, the “Operating Partnership”). Unless stated otherwise or the context otherwise requires, “we,” “our,” and “us” refer collectively to COPT, COPLP and their subsidiaries.

COPT is a real estate investment trust, or REIT, and the sole general partner of COPLP. As of June 30, 2015, COPT owned approximately 96.3% of the outstanding common units and approximately 95.5% of the outstanding preferred units in COPLP; the remaining common and preferred units in COPLP were owned by third parties. As the sole general partner of COPLP, COPT controls COPLP and can cause it to enter into major transactions including acquisitions, dispositions and refinancings and cause changes in its line of business, capital structure and distribution policies.

There are a few differences between the Company and the Operating Partnership which are reflected in this Form 10-Q. We believe it is important to understand the differences between the Company and the Operating Partnership in the context of how the Company and the Operating Partnership operate as an interrelated, consolidated company. COPT is a real estate investment trust, whose only material asset is its ownership of partnership interests of COPLP. As a result, COPT does not conduct business itself, other than acting as the sole general partner of COPLP, issuing public equity from time to time and guaranteeing certain debt of COPLP. COPT itself is not directly obligated under any indebtedness but guarantees some of the debt of COPLP. COPLP owns substantially all of the assets of COPT either directly or through its subsidiaries, conducts almost all of the operations of the business and is structured as a limited partnership with no publicly traded equity. Except for net proceeds from public equity issuances by COPT, which are contributed to COPLP in exchange for partnership units, COPLP generates the capital required by COPT’s business through COPLP’s operations, by COPLP’s direct or indirect incurrence of indebtedness or through the

issuance of partnership units.

Noncontrolling interests and shareholders' equity and partners' capital are the main areas of difference between the consolidated financial statements of COPT and those of COPLP. The common limited partnership interests in COPLP not owned by COPT are accounted for as partners' capital in COPLP's consolidated financial statements and as noncontrolling interests in COPT's consolidated financial statements. COPLP's consolidated financial statements also reflect COPT's noncontrolling interests in certain real estate partnerships, limited liability companies ("LLCs"), business trusts and corporations; the differences between shareholders' equity, partners' capital and noncontrolling interests result from the differences in the equity issued at the COPT and COPLP levels and in COPT's noncontrolling interests in these real estate partnerships, LLCs, business trusts and corporations. The only other significant differences between the consolidated financial statements of COPT and those of COPLP are assets in connection with a non-qualified elective deferred compensation plan

(comprised primarily of mutual funds and equity securities) and the corresponding liability to the plan's participants that are held directly by COPT.

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

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

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

- consolidated financial statements;
- the following notes to the consolidated financial statements:
 - Note 3, Fair Value Measurements of COPT and subsidiaries and COPLP and subsidiaries; and
 - Note 16, Earnings per Share of COPT and subsidiaries and Earnings per Unit of COPLP and subsidiaries;
- "Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources of COPT"; and
- "Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources of COPLP."

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

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PART I: FINANCIAL INFORMATION

ITEM 1. Financial Statements

Corporate Office Properties Trust and Subsidiaries

Consolidated Balance Sheets

(in thousands, except share data)

(unaudited)

	June 30, 2015	December 31, 2014
Assets		
Properties, net:		
Operating properties, net	\$2,896,809	\$ 2,751,488
Projects in development or held for future development	521,991	545,426
Total properties, net	3,418,800	3,296,914
Assets held for sale, net	77,013	14,339
Cash and cash equivalents	37,074	6,077
Restricted cash and marketable securities	10,121	9,069
Accounts receivable (net of allowance for doubtful accounts of \$1,135 and \$717, respectively)	16,181	26,901
Deferred rent receivable (net of allowance of \$2,203 and \$1,418, respectively)	101,488	95,910
Intangible assets on real estate acquisitions, net	81,728	43,854
Deferred leasing and financing costs, net	67,613	64,797
Investing receivables	45,766	52,147
Prepaid expenses and other assets, net	55,137	60,249
Total assets	\$3,910,921	\$ 3,670,257
Liabilities and equity		
Liabilities:		
Debt, net	\$2,130,170	\$ 1,920,057
Accounts payable and accrued expenses	155,989	123,035
Rents received in advance and security deposits	27,371	31,011
Dividends and distributions payable	30,178	29,862
Deferred revenue associated with operating leases	15,179	13,031
Interest rate derivatives	3,121	1,855
Other liabilities	11,866	12,105
Total liabilities	2,373,874	2,130,956
Commitments and contingencies (Note 17)		
Redeemable noncontrolling interest	19,414	18,417
Equity:		
Corporate Office Properties Trust's shareholders' equity:		
Preferred Shares of beneficial interest at liquidation preference (\$0.01 par value; 25,000,000 shares authorized; issued and outstanding of 7,431,667 at June 30, 2015 and December 31, 2014)	199,083	199,083
Common Shares of beneficial interest (\$0.01 par value; 125,000,000 shares authorized, shares issued and outstanding of 94,529,618 at June 30, 2015 and 93,255,284 at December 31, 2014)	946	933
Additional paid-in capital	2,000,775	1,969,968
Cumulative distributions in excess of net income	(747,234)	(717,264)
Accumulated other comprehensive loss	(3,141)	(1,297)

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Total Corporate Office Properties Trust's shareholders' equity	1,450,429	1,451,423
Noncontrolling interests in subsidiaries:		
Common units in COPLP	48,707	51,534
Preferred units in COPLP	8,800	8,800
Other consolidated entities	9,697	9,127
Noncontrolling interests in subsidiaries	67,204	69,461
Total equity	1,517,633	1,520,884
Total liabilities, redeemable noncontrolling interest and equity	\$3,910,921	\$ 3,670,257

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
Revenues				
Rental revenue	\$ 105,508	\$ 94,332	\$ 203,746	\$ 192,367
Tenant recoveries and other real estate operations revenue	22,683	21,627	47,155	48,469
Construction contract and other service revenues	42,172	23,861	80,496	45,651
Total revenues	170,363	139,820	331,397	286,487
Expenses				
Property operating expenses	46,418	43,772	97,099	93,544
Depreciation and amortization associated with real estate operations	33,786	30,895	65,385	74,491
Construction contract and other service expenses	41,293	23,136	78,791	41,760
Impairment losses	1,238	1,302	1,238	1,302
General, administrative and leasing expenses	7,534	7,528	15,425	15,671
Business development expenses and land carry costs	2,623	1,351	5,413	2,677
Total operating expenses	132,892	107,984	263,351	229,445
Operating income	37,471	31,836	68,046	57,042
Interest expense	(21,768)	(23,478)	(42,606)	(44,305)
Interest and other income	1,242	1,299	2,525	2,584
Loss on early extinguishment of debt	(65)	(270)	(68)	(270)
Income from continuing operations before equity in income (loss) of unconsolidated entities and income taxes	16,880	9,387	27,897	15,051
Equity in income (loss) of unconsolidated entities	9	(47)	34	13
Income tax expense	(50)	(92)	(105)	(156)
Income from continuing operations	16,839	9,248	27,826	14,908
Discontinued operations	394	(198)	156	(187)
Income before gain on sales of real estate	17,233	9,050	27,982	14,721
Gain on sales of real estate	(1)	—	3,985	—
Net income	17,232	9,050	31,967	14,721
Net income attributable to noncontrolling interests:				
Common units in COPLP	(476)	(158)	(874)	(174)
Preferred units in COPLP	(165)	(165)	(330)	(330)
Other consolidated entities	(810)	(837)	(1,627)	(1,586)
Net income attributable to COPT	15,781	7,890	29,136	12,631
Preferred share dividends	(3,553)	(4,344)	(7,105)	(8,834)
Issuance costs associated with redeemed preferred shares	—	(1,769)	—	(1,769)
Net income attributable to COPT common shareholders	\$ 12,228	\$ 1,777	\$ 22,031	\$ 2,028
Net income attributable to COPT:				
Income from continuing operations	\$ 15,402	\$ 8,077	\$ 28,983	\$ 12,805
Discontinued operations, net	379	(187)	153	(174)
Net income attributable to COPT	\$ 15,781	\$ 7,890	\$ 29,136	\$ 12,631
Basic earnings per common share (1)				
Income from continuing operations	\$ 0.13	\$ 0.02	\$ 0.23	\$ 0.02

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Discontinued operations	0.00	0.00	0.00	0.00
Net income attributable to COPT common shareholders	\$0.13	\$0.02	\$0.23	\$0.02
Diluted earnings per common share (1)				
Income from continuing operations	\$0.13	\$0.02	\$0.23	\$0.02
Discontinued operations	0.00	0.00	0.00	0.00
Net income attributable to COPT common shareholders	\$0.13	\$0.02	\$0.23	\$0.02
Dividends declared per common share	\$0.275	\$0.275	\$0.550	\$0.550

(1) Basic and diluted earnings per common share are calculated based on amounts attributable to common shareholders of Corporate Office Properties Trust.

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	\$17,232	\$9,050	\$31,967	\$14,721
Other comprehensive income (loss)				
Unrealized gain (loss) on interest rate derivatives	392	(3,630)	(3,082)	(5,753)
Losses on interest rate derivatives included in interest expense	769	719	1,542	1,414
Equity in other comprehensive loss of equity method investee	(264)	—	(264)	—
Other comprehensive income (loss)	897	(2,911)	(1,804)	(4,339)
Comprehensive income	18,129	6,139	30,163	10,382
Comprehensive income attributable to noncontrolling interests	(1,542)	(1,081)	(2,871)	(1,992)
Comprehensive income attributable to COPT	\$16,587	\$5,058	\$27,292	\$8,390

See accompanying notes to consolidated financial statements.

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

	Preferred Shares	Common Shares	Additional Paid-in Capital	Cumulative Distributions in Excess of Net Income	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total
Balance at December 31, 2013 (87,394,512 common shares outstanding)	\$ 249,083	\$ 874	\$ 1,814,015	\$ (641,868)	\$ 3,480	\$ 71,665	\$ 1,497,249
Redemption of preferred shares (2,000,000 shares)	(50,000)	—	1,769	(1,769)	—	—	(50,000)
Conversion of common units to common shares (78,498 shares)	—	—	1,047	—	—	(1,047)	—
Costs associated with common shares issued to the public	—	—	(7)	—	—	—	(7)
Exercise of share options (51,289 shares)	—	—	1,185	—	—	—	1,185
Share-based compensation (144,009 shares issued, net of redemptions)	—	3	3,542	—	—	—	3,545
Redemption of vested equity awards	—	—	(1,326)	—	—	—	(1,326)
Adjustments to noncontrolling interests resulting from changes in ownership of COPLP	—	—	(72)	—	—	72	—
Comprehensive income	—	—	—	12,631	(4,241)	976	9,366
Dividends	—	—	—	(57,027)	—	—	(57,027)
Distributions to owners of common and preferred units in COPLP	—	—	—	—	—	(2,483)	(2,483)
Contributions from noncontrolling interests in other consolidated entities	—	—	—	—	—	3	3
Distributions to noncontrolling interests in other consolidated entities	—	—	—	—	—	(8)	(8)
Adjustment to arrive at fair value of redeemable noncontrolling interest	—	—	(717)	—	—	—	(717)
Balance at June 30, 2014 (87,668,308 common shares outstanding)	\$ 199,083	\$ 877	\$ 1,819,436	\$ (688,033)	\$ (761)	\$ 69,178	\$ 1,399,780

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Balance at December 31, 2014 (93,255,284 common shares outstanding)	\$ 199,083	\$ 933	\$ 1,969,968	\$ (717,264)	\$ (1,297)	\$ 69,461	\$ 1,520,884
Conversion of common units to common shares (158,000 shares)	—	2	2,120	—	—	(2,122)	—
Common shares issued under at-the-market program (890,241 shares)	—	9	26,526	—	—	—	26,535
Exercise of share options (76,474 shares)	—	—	2,008	—	—	—	2,008
Share-based compensation (149,619 shares issued, net of redemptions)	—	2	3,656	—	—	—	3,658
Redemption of vested equity awards	—	—	(2,245)	—	—	—	(2,245)
Adjustments to noncontrolling interests resulting from changes in ownership of COPLP	—	—	(519)	—	—	519	—
Comprehensive income	—	—	—	29,136	(1,844)	1,728	29,020
Dividends	—	—	—	(59,106)	—	—	(59,106)
Distributions to owners of common and preferred units in COPLP	—	—	—	—	—	(2,354)	(2,354)
Distributions to noncontrolling interests in other consolidated entities	—	—	—	—	—	(28)	(28)
Adjustment to arrive at fair value of redeemable noncontrolling interest	—	—	(739)	—	—	—	(739)
Balance at June 30, 2015 (94,529,618 common shares outstanding)	\$ 199,083	\$ 946	\$ 2,000,775	\$ (747,234)	\$ (3,141)	\$ 67,204	\$ 1,517,633

See accompanying notes to consolidated financial statements.

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

	For the Six Months Ended	
	June 30,	
	2015	2014
Cash flows from operating activities		
Revenues from real estate operations received	\$240,538	\$232,877
Construction contract and other service revenues received	86,790	35,105
Property operating expenses paid	(79,667)	(78,621)
Construction contract and other service expenses paid	(76,355)	(34,588)
General, administrative, leasing, business development and land carry costs paid	(20,121)	(16,904)
Interest expense paid	(32,375)	(35,365)
Payments in connection with early extinguishment of debt	(18)	(104)
Interest and other income received	4,055	346
Income taxes (paid) refunded	(8)	204
Net cash provided by operating activities	122,839	102,950
Cash flows from investing activities		
Acquisitions of operating properties and related intangible assets	(137,125)	—
Construction, development and redevelopment	(117,498)	(105,459)
Tenant improvements on operating properties	(10,314)	(10,842)
Other capital improvements on operating properties	(8,372)	(16,482)
Proceeds from dispositions of properties	17,424	1,971
Investing receivables payments received	5,114	151
Leasing costs paid	(6,732)	(7,772)
Increase in prepaid expenses and other assets associated with investing activities	(3,249)	(1,158)
Other	(289)	(450)
Net cash used in investing activities	(261,041)	(140,041)
Cash flows from financing activities		
Proceeds from debt		
Revolving Credit Facility	294,000	115,000
Unsecured senior notes	296,580	297,342
Other debt proceeds	50,000	9,931
Repayments of debt		
Revolving Credit Facility	(377,000)	(115,000)
Scheduled principal amortization	(3,319)	(3,437)
Other debt repayments	(50,630)	(133,010)
Deferred financing costs paid	(4,693)	(653)
Net proceeds from issuance of common shares	28,567	1,178
Redemption of preferred shares	—	(50,000)
Common share dividends paid	(51,642)	(48,118)
Preferred share dividends paid	(7,105)	(9,626)
Distributions paid to noncontrolling interests in COPLP	(2,461)	(2,641)
Redemption of vested equity awards	(2,245)	(1,326)
Other	(853)	(706)
Net cash provided by financing activities	169,199	58,934
Net increase in cash and cash equivalents	30,997	21,843