CORPORATE OFFICE PROPERTIES TRUST
Form 10-Q
October 27, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q
(Mark one)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2017
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 1-14023 (Corporate Office Properties Trust)
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.)
Corporate Office Properties, L.P.	Delaware (State or other jurisdiction of incorporation or organization)	23-2930022 (IRS Employer Identification No.)

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

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

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 ý Yes o No
Corporate Office Properties, L.P. ý Yes o 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 ý Yes o No

Corporate Office Properties, L.P. ý Yes o 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. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Corporate Office Properties Trust

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

Corporate Office Properties, L.P.

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

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

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

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 o Yes ý No
Corporate Office Properties, L.P. o Yes ý No

As of October 20, 2017, 99,609,634 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 September 30, 2017 of Corporate Office Properties Trust ("COPT") and subsidiaries (collectively, the "Company") and Corporate Office Properties, L.P. ("COPLP") and subsidiaries (collectively, the "Operating Partnership"). Unless stated otherwise or the context otherwise requires, "we," "our," and "us" refer collectively to COPT, COPLP and their subsidiaries.

COPT is a real estate investment trust, or REIT, and the sole general partner of COPLP. As of September 30, 2017, COPT owned approximately 96.8% of the outstanding common units and none of the outstanding preferred units in COPLP; the remaining common and preferred units in COPLP were owned by third parties. As the sole general partner of COPLP, COPT controls COPLP and can cause it to enter into major transactions including acquisitions, dispositions and refinancings and cause changes in its line of business, capital structure and distribution policies.

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

Noncontrolling interests and shareholders' equity and partners' capital are the main areas of difference between the consolidated financial statements of COPT and those of COPLP. The common limited partnership interests in COPLP not owned by COPT are accounted for as partners' capital in COPLP's consolidated financial statements and as noncontrolling interests in COPT's consolidated financial statements. COPLP's consolidated financial statements also reflect COPT's noncontrolling interests in certain real estate partnerships and limited liability companies ("LLCs"); 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 and LLCs. The only other significant differences between the consolidated financial statements of COPT and those of COPLP are assets held in connection with a non-qualified elective deferred compensation plan (comprised primarily of mutual funds and equity securities) and the corresponding liability to the plan's participants that are held directly by COPT.

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

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

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

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

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

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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)

	September 30, 2017	December 31, 2016
Assets		
Properties, net:		
Operating properties, net	$ 2,690,712	$ 2,671,831
Projects in development or held for future development	406,319	401,531
Total properties, net	3,097,031	3,073,362
Assets held for sale, net	74,415	94,654
Cash and cash equivalents	10,858	209,863
Restricted cash and marketable securities	6,173	8,193
Investment in unconsolidated real estate joint venture	25,194	25,548
Accounts receivable (net of allowance for doubtful accounts of $639 and $603, respectively)	27,624	34,438
Deferred rent receivable (net of allowance of $255 and $373, respectively)	84,743	90,219
Intangible assets on real estate acquisitions, net	64,055	78,351
Deferred leasing costs (net of accumulated amortization of $28,590 and $65,988, respectively)	47,033	41,214
Investing receivables	56,108	52,279
Prepaid expenses and other assets, net	66,538	72,764
Total assets	$ 3,559,772	$ 3,780,885
Liabilities and equity		
Liabilities:		
Debt, net	$ 1,873,291	$ 1,904,001
Accounts payable and accrued expenses	121,483	108,682
Rents received in advance and security deposits	26,223	29,798
Dividends and distributions payable	28,462	31,335
Deferred revenue associated with operating leases	12,047	12,666
Redeemable preferred shares of beneficial interest ($0.01 par value; 531,667 shares issued and outstanding at December 31, 2016 and none at September 30, 2017)	—	26,583
Capital lease obligation	16,347	—
Other liabilities	43,866	50,177
Total liabilities	2,121,719	2,163,242
Commitments and contingencies (Note 15)		
Redeemable noncontrolling interests	23,269	22,979
Equity:		
Corporate Office Properties Trust's shareholders' equity:		
Preferred Shares of beneficial interest at liquidation preference ($0.01 par value; 25,000,000 shares authorized, 6,900,000 shares issued and outstanding at December 31, 2016 and none at September 30, 2017)	—	172,500
Common Shares of beneficial interest ($0.01 par value; 125,000,000 shares authorized, shares issued and outstanding of 99,608,170 at September 30, 2017 and 98,498,651 at	996	985

December 31, 2016)		
Additional paid-in capital	2,150,067	2,116,581
Cumulative distributions in excess of net income	(800,290)	(765,276)
Accumulated other comprehensive loss	(859)	(1,731)
Total Corporate Office Properties Trust’s shareholders’ equity	1,349,914	1,523,059
Noncontrolling interests in subsidiaries:		
Common units in COPLP	44,089	49,228
Preferred units in COPLP	8,800	8,800
Other consolidated entities	11,981	13,577
Noncontrolling interests in subsidiaries	64,870	71,605
Total equity	1,414,784	1,594,664
Total liabilities, redeemable noncontrolling interest and equity	$ 3,559,772	$ 3,780,885

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues				
Rental revenue	$102,275	$103,956	$304,237	$316,862
Tenant recoveries and other real estate operations revenue	24,956	26,998	78,058	81,103
Construction contract and other service revenues	29,786	11,149	65,958	34,372
Total revenues	157,017	142,103	448,253	432,337
Expenses				
Property operating expenses	46,368	49,952	143,515	149,968
Depreciation and amortization associated with real estate operations	34,438	32,015	100,290	99,790
Construction contract and other service expenses	28,788	10,341	63,589	32,513
Impairment (recoveries) losses	(161)	27,699	1,464	99,837
General, administrative and leasing expenses	7,368	8,855	23,838	28,764
Business development expenses and land carry costs	1,277	1,716	4,567	6,497
Total operating expenses	118,078	130,578	337,263	417,369
Operating income	38,939	11,525	110,990	14,968
Interest expense	(19,615)	(18,301)	(57,772)	(64,499)
Interest and other income	1,508	1,391	4,817	3,877
Loss on early extinguishment of debt	—	(59)	(513)	(37)
Income (loss) before equity in income of unconsolidated entities and income taxes	20,832	(5,444)	57,522	(45,691)
Equity in income of unconsolidated entities	719	594	2,162	614
Income tax (expense) benefit	(57)	21	(145)	28
Income (loss) before gain on sales of real estate	21,494	(4,829)	59,539	(45,049)
Gain on sales of real estate	1,188	34,101	5,438	34,101
Net income (loss)	22,682	29,272	64,977	(10,948)
Net (income) loss attributable to noncontrolling interests:				
Common units in COPLP	(704)	(901)	(1,611)	948
Preferred units in COPLP	(165)	(165)	(495)	(495)
Other consolidated entities	(897)	(907)	(2,738)	(2,799)
Net income (loss) attributable to COPT	20,916	27,299	60,133	(13,294)
Preferred share dividends	—	(3,552)	(6,219)	(10,657)
Issuance costs associated with redeemed preferred shares	—	—	(6,847)	—
Net income (loss) attributable to COPT common shareholders	$20,916	$23,747	$47,067	$(23,951)
Earnings per common share:				
Net income (loss) attributable to COPT common shareholders - basic	$0.21	$0.25	$0.47	$(0.26)
Net income (loss) attributable to COPT common shareholders - diluted	$0.21	$0.25	$0.47	$(0.26)
Dividends declared per common share	$0.275	$0.275	$0.825	$0.825

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 September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income (loss)	$22,682	$29,272	$64,977	$(10,948)
Other comprehensive income (loss)				
Unrealized (loss) gain on interest rate derivatives	(301)	407	(1,877)	(16,581)
Loss on interest rate derivatives recognized in interest expense (effective portion)	615	1,043	2,652	2,763
Loss on interest rate derivatives recognized in interest expense (ineffective portion)	—	—	88	—
Equity in other comprehensive income (loss) of equity method investee	—	—	39	(184)
Other comprehensive income (loss)	314	1,450	902	(14,002)
Comprehensive income (loss)	22,996	30,722	65,879	(24,950)
Comprehensive income attributable to noncontrolling interests	(1,776)	(2,025)	(4,874)	(1,820)
Comprehensive income (loss) attributable to COPT	$21,220	$28,697	$61,005	$(26,770)

See accompanying notes to consolidated financial statements.

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

	Preferred Shares	Common Shares	Additional Paid-in Capital	Cumulative Distributions in Excess of Net Income	Accumulated Other Comprehensive Loss	Noncontrolling Interests	Total
Balance at December 31, 2015 (94,531,512 common shares outstanding)	$199,083	$ 945	$2,004,507	$ (657,172)	$ (2,838)	$ 72,039	$1,616,564
Conversion of common units to common shares (87,000 shares)	—	1	1,166	—	—	(1,167)	—
Costs associated with common shares issued to the public	—	—	(5)	—	—	—	(5)
Share-based compensation (146,274 shares issued, net of redemptions)	—	2	6,175	—	—	—	6,177
Redemption of vested equity awards	—	—	(2,179)	—	—	—	(2,179)
Adjustments to noncontrolling interests resulting from changes in ownership of COPLP	—	—	(42)	—	—	42	—
Comprehensive loss	—	—	—	(13,294)	(13,476)	141	(26,629)
Dividends	—	—	—	(88,796)	—	—	(88,796)
Distributions to owners of common and preferred units in COPLP	—	—	—	—	—	(3,498)	(3,498)
Distributions to noncontrolling interests in other consolidated entities	—	—	—	—	—	(12)	(12)
Adjustment to arrive at fair value of redeemable noncontrolling interests	—	—	(516)	—	—	—	(516)
Tax loss from share-based compensation	—	—	(319)	—	—	—	(319)
Balance at September 30, 2016 (94,764,786 common shares outstanding)	$199,083	$ 948	$2,008,787	$ (759,262)	$ (16,314)	$ 67,545	$1,500,787
Balance at December 31, 2016 (98,498,651 common shares outstanding)	$172,500	$ 985	$2,116,581	$ (765,276)	$ (1,731)	$ 71,605	$1,594,664
Redemption of preferred shares (6,900,000 shares)	(172,500)	—	6,847	(6,847)	—	—	(172,500)
	—	3	4,599	—	—	(4,602)	—

Conversion of common units to common shares (337,000 shares)							
Common shares issued under at-the-market program (591,042 shares)	—	6	19,662	—	—	—	19,668
Exercise of share options (5,000 shares)	—	—	150	—	—	—	150
Share-based compensation (176,477 shares issued, net of redemptions)	—	2	4,442	—	—	—	4,444
Redemption of vested equity awards	—	—	(1,869)	—	—	—	(1,869)
Adjustments to noncontrolling interests resulting from changes in ownership of COPLP	—	—	(589)	—	—	589	—
Comprehensive income	—	—	—	60,133	872	3,154	64,159
Dividends	—	—	—	(88,300)	—	—	(88,300)
Distributions to owners of common and preferred units in COPLP	—	—	—	—	—	(3,262)	(3,262)
Distributions to noncontrolling interests in other consolidated entities	—	—	—	—	—	(2,614)	(2,614)
Adjustment to arrive at fair value of redeemable noncontrolling interests	—	—	244	—	—	—	244
Balance at September 30, 2017 (99,608,170 common shares outstanding)	$—	$ 996	$2,150,067	$ (800,290)	$ (859)	$ 64,870	$1,414,784

See accompanying notes to consolidated financial statements.

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

	For the Nine Months Ended September 30,	
	2017	2016
Cash flows from operating activities		
Revenues from real estate operations received	$390,116	$393,300
Construction contract and other service revenues received	72,682	54,399
Property operating expenses paid	(144,187)	(154,203)
Construction contract and other service expenses paid	(57,189)	(33,169)
General, administrative, leasing, business development and land carry costs paid	(27,066)	(27,879)
Interest expense paid	(55,637)	(61,662)
Lease incentives	(9,414)	(1,789)
Other	1,373	976
Net cash provided by operating activities	170,678	169,973
Cash flows from investing activities		
Construction, development and redevelopment	(113,678)	(121,297)
Tenant improvements on operating properties	(19,876)	(26,055)
Other capital improvements on operating properties	(15,174)	(22,063)
Proceeds from dispositions of properties	101,107	210,661
Proceeds from partial sale of properties, net of related debt	—	43,686
Leasing costs paid	(6,468)	(6,024)
Other	1,359	(991)
Net cash (used in) provided by investing activities	(52,730)	77,917
Cash flows from financing activities		
Proceeds from debt		
Revolving Credit Facility	268,000	362,500
Other debt proceeds	—	105,000
Repayments of debt		
Revolving Credit Facility	(98,000)	(406,000)
Scheduled principal amortization	(2,878)	(4,454)
Other debt repayments	(200,150)	(203,056)
Deferred financing costs paid	—	(825)
Net proceeds from issuance of common shares	19,834	(46)
Redemption of preferred shares	(199,083)	—
Common share dividends paid	(81,779)	(78,072)
Preferred share dividends paid	(9,305)	(10,657)
Distributions paid to noncontrolling interests in COPLP	(3,371)	(3,476)
Distributions paid to redeemable noncontrolling interests	(7,860)	(14,329)
Redemption of vested equity awards	(1,869)	(2,179)
Other	(492)	(5,032)
Net cash used in financing activities	(316,953)	(260,626)
Net decrease in cash and cash equivalents	(199,005)	(12,736)
Cash and cash equivalents		
Beginning of period	209,863	60,310
End of period	$10,858	$47,574

See accompanying notes to consolidated financial statements.

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

	For the Nine Months Ended September 30,	
	2017	2016
Reconciliation of net income (loss) to net cash provided by operating activities:		
Net income (loss)	$64,977	$(10,948)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	101,963	101,429
Impairment losses	1,457	99,797
(Gain) loss on interest rate derivatives	(43)	347
Amortization of deferred financing costs and net debt discounts	3,514	4,456
Increase in deferred rent receivable	(545)	(930)
Gain on sales of real estate	(5,438)	(34,101)
Share-based compensation	4,092	5,637
Other	(3,970)	(2,727)
Operating changes in assets and liabilities:		
Decrease in accounts receivable	7,498	3,658
Decrease in restricted cash and marketable securities	2,778	18
Decrease (increase) in prepaid expenses and other assets, net	3,190	(19,778)
(Decrease) increase in accounts payable, accrued expenses and other liabilities	(5,220)	31,523
Decrease in rents received in advance and security deposits	(3,575)	(8,408)
Net cash provided by operating activities	$170,678	$169,973
Supplemental schedule of non-cash investing and financing activities:		
Increase in accrued capital improvements, leasing and other investing activity costs	$17,129	$9,963
Increase in property in connection with capital lease obligation	$16,127	$—
Increase in property and redeemable noncontrolling interests in connection with property contributed in a joint venture	$—	$22,600
Decrease in redeemable noncontrolling interests and increase in other liabilities in connection with distribution payable to redeemable noncontrolling interest	$—	$6,683
Non-cash changes from partial sale of properties, net of debt:		
Decrease in properties, net	$—	$(114,597)
Increase in investment in unconsolidated real estate joint venture	$—	$25,680
Decrease in debt	$—	$59,534
Other net decreases in assets and liabilities	$—	$3,619
Increase (decrease) in fair value of derivatives applied to accumulated other comprehensive loss and noncontrolling interests	$774	$(13,817)
Equity in other comprehensive income (loss) of an equity method investee	$39	$(184)
Dividends/distribution payable	$28,462	$30,225
Decrease in noncontrolling interests and increase in shareholders' equity in connection with the conversion of common units into common shares	$4,602	$1,167
Adjustments to noncontrolling interests resulting from changes in COPLP ownership	$589	$42
(Decrease) increase in redeemable noncontrolling interest and (increase) decrease in equity to carry redeemable noncontrolling interest at fair value	$(244)	$516

See accompanying notes to consolidated financial statements.

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

	September 30, 2017	December 31, 2016
Assets		
Properties, net:		
Operating properties, net	$ 2,690,712	$ 2,671,831
Projects in development or held for future development	406,319	401,531
Total properties, net	3,097,031	3,073,362
Assets held for sale, net	74,415	94,654
Cash and cash equivalents	10,858	209,863
Restricted cash and marketable securities	1,766	2,756
Investment in unconsolidated real estate joint venture	25,194	25,548
Accounts receivable (net of allowance for doubtful accounts of $639 and $603, respectively)	27,624	34,438
Deferred rent receivable (net of allowance of $255 and $373, respectively)	84,743	90,219
Intangible assets on real estate acquisitions, net	64,055	78,351
Deferred leasing costs (net of accumulated amortization of $28,590 and $65,988, respectively)	47,033	41,214
Investing receivables	56,108	52,279
Prepaid expenses and other assets, net	66,538	72,764
Total assets	$ 3,555,365	$ 3,775,448
Liabilities and equity		
Liabilities:		
Debt, net	$ 1,873,291	$ 1,904,001
Accounts payable and accrued expenses	121,483	108,682
Rents received in advance and security deposits	26,223	29,798
Distributions payable	28,462	31,335
Deferred revenue associated with operating leases	12,047	12,666
Redeemable preferred units of general partner, 531,667 units outstanding at December 31, 2016 and none at September 30, 2017	—	26,583
Capital lease obligation	16,347	—
Other liabilities	39,459	44,740
Total liabilities	2,117,312	2,157,805
Commitments and contingencies (Note 15)		
Redeemable noncontrolling interests	23,269	22,979
Equity:		
Corporate Office Properties, L.P.'s equity:		
Preferred units		
General partner, 6,900,000 preferred units outstanding at December 31, 2016 and none at September 30, 2017	—	172,500
Limited partner, 352,000 preferred units outstanding at September 30, 2017 and December 31, 2016	8,800	8,800
Common units, 99,608,170 and 98,498,651 held by the general partner and 3,253,391 and 3,590,391 held by limited partners at September 30, 2017 and December 31, 2016,	1,394,911	1,401,597

respectively		
Accumulated other comprehensive loss	(952)	(1,854)
Total Corporate Office Properties, L.P.'s equity	1,402,759	1,581,043
Noncontrolling interests in subsidiaries	12,025	13,621
Total equity	1,414,784	1,594,664
Total liabilities, redeemable noncontrolling interest and equity	$ 3,555,365	$ 3,775,448

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues				
Rental revenue	$102,275	$103,956	$304,237	$316,862
Tenant recoveries and other real estate operations revenue	24,956	26,998	78,058	81,103
Construction contract and other service revenues	29,786	11,149	65,958	34,372
Total revenues	157,017	142,103	448,253	432,337
Expenses				
Property operating expenses	46,368	49,952	143,515	149,968
Depreciation and amortization associated with real estate operations	34,438	32,015	100,290	99,790
Construction contract and other service expenses	28,788	10,341	63,589	32,513
Impairment (recoveries) losses	(161)	27,699	1,464	99,837
General, administrative and leasing expenses	7,368	8,855	23,838	28,764
Business development expenses and land carry costs	1,277	1,716	4,567	6,497
Total operating expenses	118,078	130,578	337,263	417,369
Operating income	38,939	11,525	110,990	14,968
Interest expense	(19,615)	(18,301)	(57,772)	(64,499)
Interest and other income	1,508	1,391	4,817	3,877
Loss on early extinguishment of debt	—	(59)	(513)	(37)
Income (loss) before equity in income of unconsolidated entities and income taxes	20,832	(5,444)	57,522	(45,691)
Equity in income of unconsolidated entities	719	594	2,162	614
Income tax (expense) benefit	(57)	21	(145)	28
Income (loss) before gain on sales of real estate	21,494	(4,829)	59,539	(45,049)
Gain on sales of real estate	1,188	34,101	5,438	34,101
Net income (loss)	22,682	29,272	64,977	(10,948)
Net income attributable to noncontrolling interests in consolidated entities	(897)	(913)	(2,738)	(2,803)
Net income (loss) attributable to COPLP	21,785	28,359	62,239	(13,751)
Preferred unit distributions	(165)	(3,717)	(6,714)	(11,152)
Issuance costs associated with redeemed preferred units	—	—	(6,847)	—
Net income (loss) attributable to COPLP common unitholders	$21,620	$24,642	$48,678	$(24,903)
Earnings per common unit:				
Net income (loss) attributable to COPLP common unitholders - basic	$0.21	$0.25	$0.47	$(0.26)
Net income (loss) attributable to COPLP common unitholders - diluted	$0.21	$0.25	$0.47	$(0.26)
Distributions declared per common unit	$0.275	$0.275	$0.825	$0.825

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income (loss)	$22,682	$29,272	$64,977	$(10,948)
Other comprehensive income (loss)				
Unrealized (loss) gain on interest rate derivatives	(301)	407	(1,877)	(16,581)
Loss on interest rate derivatives recognized in interest expense (effective portion)	615	1,043	2,652	2,763
Loss on interest rate derivatives recognized in interest expense (ineffective portion)	—	—	88	—
Equity in other comprehensive income (loss) of equity method investee	—	—	39	(184)
Other comprehensive income (loss)	314	1,450	902	(14,002)
Comprehensive income (loss)	22,996	30,722	65,879	(24,950)
Comprehensive income attributable to noncontrolling interests	(897)	(913)	(2,738)	(2,803)
Comprehensive income (loss) attributable to COPLP	$22,099	$29,809	$63,141	$(27,753)

See accompanying notes to consolidated financial statements.

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

	Limited Partner Preferred Units		General Partner Preferred Units		Common Units		Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests in Subsidiaries	Total Equity
	Units	Amount	Units	Amount	Units	Amount			
Balance at December 31, 2015	352,000	$8,800	7,431,667	$199,083	98,208,903	$1,400,745	$(2,985)	$10,921	$1,616,564
Costs associated with common shares issued to the public	—	—	—	—	—	(5)	—	—	(5)
Share-based compensation (units net of redemption)	—	—	—	—	146,274	6,177	—	—	6,177
Redemptions of vested equity awards	—	—	—	—	—	(2,179)	—	—	(2,179)
Comprehensive loss	—	495	—	10,657	—	(24,903)	(14,002)	1,124	(26,629)
Distributions to owners of common and preferred units	—	(495)	—	(10,657)	—	(81,142)	—	—	(92,294)
Distributions to noncontrolling interests in subsidiaries	—	—	—	—	—	—	—	(12)	(12)
Adjustment to arrive at fair value of redeemable noncontrolling interest	—	—	—	—	—	(516)	—	—	(516)
Tax loss from share-based compensation	—	—	—	—	—	(319)	—	—	(319)
Balance at September 30, 2016	352,000	$8,800	7,431,667	$199,083	98,355,177	$1,297,858	$(16,987)	$12,033	$1,500,787
Balance at December 31,	352,000	$8,800	6,900,000	$172,500	102,089,042	$1,401,597	$(1,854)	$13,621	$1,594,664

2016									
Redemption of preferred units resulting from redemption of preferred shares	—	—	(6,900,000)	(172,500)	—	—	—	—	(172,500)
Issuance of common units resulting from common shares issued under COPT at-the-market program	—	—	—	—	591,042	19,668	—	—	19,668
Issuance of common units resulting from exercise of share options	—	—	—	—	5,000	150	—	—	150
Share-based compensation (units net of redemption)	—	—	—	—	176,477	4,444	—	—	4,444
Redemptions of vested equity awards	—	—	—	—	—	(1,869)	—	—	(1,869)
Comprehensive income	—	495	—	6,219	—	55,525	902	1,018	64,159
Distributions to owners of common and preferred units	—	(495)	—	(6,219)	—	(84,848)	—	—	(91,562)
Distributions to noncontrolling interests in subsidiaries	—	—	—	—	—	—	—	(2,614)	(2,614)
Adjustment to arrive at fair value of redeemable noncontrolling interest	—	—	—	—	—	244	—	—	244
Balance at September 30, 2017	352,000	$8,800	—	$—	102,861,561	$1,394,911	$(952)	$12,025	$1,414,784

See accompanying notes to consolidated financial statements.

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

	For the Nine Months Ended September 30,	
	2017	2016
Cash flows from operating activities		
Revenues from real estate operations received	$390,116	$393,300
Construction contract and other service revenues received	72,682	54,399
Property operating expenses paid	(144,187)	(154,203)
Construction contract and other service expenses paid	(57,189)	(33,169)
General, administrative, leasing, business development and land carry costs paid	(27,066)	(27,879)
Interest expense paid	(55,637)	(61,662)
Lease incentives	(9,414)	(1,789)
Other	1,373	976
Net cash provided by operating activities	170,678	169,973
Cash flows from investing activities		
Construction, development and redevelopment	(113,678)	(121,297)
Tenant improvements on operating properties	(19,876)	(26,055)
Other capital improvements on operating properties	(15,174)	(22,063)
Proceeds from dispositions of properties	101,107	210,661
Proceeds from partial sale of properties, net of related debt	—	43,686
Leasing costs paid	(6,468)	(6,024)
Other	1,359	(991)
Net cash (used in) provided by investing activities	(52,730)	77,917
Cash flows from financing activities		
Proceeds from debt		
Revolving Credit Facility	268,000	362,500
Other debt proceeds	—	105,000
Repayments of debt		
Revolving Credit Facility	(98,000)	(406,000)
Scheduled principal amortization	(2,878)	(4,454)
Other debt repayments	(200,150)	(203,056)
Deferred financing costs paid	—	(825)
Net proceeds from issuance of common units	19,834	(46)
Redemption of preferred units	(199,083)	—
Common unit distributions paid	(84,655)	(81,053)
Preferred unit distributions paid	(9,800)	(11,152)
Distributions paid to redeemable noncontrolling interests	(7,860)	(14,329)
Redemption of vested equity awards	(1,869)	(2,179)
Other	(492)	(5,032)
Net cash used in financing activities	(316,953)	(260,626)
Net decrease in cash and cash equivalents	(199,005)	(12,736)
Cash and cash equivalents		
Beginning of period	209,863	60,310
End of period	$10,858	$47,574

See accompanying notes to consolidated financial statements.

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

	For the Nine Months Ended September 30,	
	2017	2016
Reconciliation of net income (loss) to net cash provided by operating activities:		
Net income (loss)	$64,977	$(10,948)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	101,963	101,429
Impairment losses	1,457	99,797
(Gain) loss on interest rate derivatives	(43)	347
Amortization of deferred financing costs and net debt discounts	3,514	4,456
Increase in deferred rent receivable	(545)	(930)
Gain on sales of real estate	(5,438)	(34,101)
Share-based compensation	4,092	5,637
Other	(3,970)	(2,727)
Operating changes in assets and liabilities:		
Decrease in accounts receivable	7,498	3,658
Decrease (increase) in restricted cash and marketable securities	1,748	(495)
Decrease (increase) in prepaid expenses and other assets, net	3,190	(19,778)
(Decrease) increase in accounts payable, accrued expenses and other liabilities	(4,190)	32,036
Decrease in rents received in advance and security deposits	(3,575)	(8,408)
Net cash provided by operating activities	$170,678	$169,973
Supplemental schedule of non-cash investing and financing activities:		
Increase in accrued capital improvements, leasing and other investing activity costs	$17,129	$9,963
Increase in property in connection with capital lease obligation	$16,127	$—
Increase in property and redeemable noncontrolling interests in connection with property contributed in a joint venture	$—	$22,600
Decrease in redeemable noncontrolling interests and increase in other liabilities in connection with distribution payable to redeemable noncontrolling interest	$—	$6,683
Non-cash changes from partial sale of properties, net of debt:		
Decrease in properties, net	$—	$(114,597)
Increase in investment in unconsolidated real estate joint venture	$—	$25,680
Decrease in debt	$—	$59,534
Other net decreases in assets and liabilities	$—	$3,619
Increase (decrease) in fair value of derivatives applied to accumulated other comprehensive loss and noncontrolling interests	$774	$(13,817)
Equity in other comprehensive income (loss) of an equity method investee	$39	$(184)
Distributions payable	$28,462	$30,225
(Decrease) increase in redeemable noncontrolling interest and (increase) decrease in equity to carry redeemable noncontrolling interest at fair value	$(244)	$516

See accompanying notes to consolidated financial statements.

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

1. Organization

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

- 159 operating office properties totaling 17.4 million square feet, including 15 triple-net leased, single-tenant data center properties. We owned six of these properties through an unconsolidated real estate joint venture;
- ten office properties under construction or redevelopment that we estimate will total approximately 1.1 million square feet upon completion, including three triple-net leased, single-tenant data center properties, three partially operational properties and two properties completed but held for future lease to the United States Government;
- 984 acres of land we controlled for future development that we believe could be developed into approximately 12.3 million square feet and an additional 152 acres of other land; and
- a wholesale data center with a critical load of 19.25 megawatts.

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

Equity interests in COPLP are in the form of common and preferred units. As of September 30, 2017, COPT owned 96.8% of the outstanding COPLP common units ("common units") and none of the outstanding COPLP preferred units ("preferred units"); the remaining common and preferred units in COPLP were owned by third parties. Common units in COPLP not owned by COPT carry certain redemption rights. The number of common units in COPLP owned by COPT is equivalent to the number of outstanding common shares of beneficial interest ("common shares") of COPT, and the entitlement of all COPLP common units to quarterly distributions and payments in liquidation is substantially the same as those of COPT common shareholders. Similarly, in the case of any series of preferred units in COPLP held by COPT, there is a series of preferred shares of beneficial interest ("preferred shares") in COPT that is equivalent in number and carries substantially the same terms as such series of COPLP preferred units. COPT's common shares are publicly traded on the New York Stock Exchange ("NYSE") under the ticker symbol "OFC".

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

2. Summary of Significant Accounting Policies

Basis of Presentation

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

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

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

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

Reclassification

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

Recent Accounting Pronouncements

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

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

In May 2014, the FASB issued guidance regarding the recognition of revenue from contracts with customers. Under this guidance, an entity will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance also requires improved disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. We will adopt this guidance for our annual and interim periods beginning January 1, 2018 and expect to use the modified retrospective method, under which the cumulative effect of initially applying the guidance is recognized at the date of initial application. We do not believe that our adoption of this guidance beginning on January 1, 2018 will have a material effect on our consolidated financial statements. However, as discussed further below, once the new guidance setting forth principles for the recognition, measurement, presentation and disclosure of leases goes into effect on January 1, 2019, we believe that the new revenue standard will apply to executory costs and other components of revenue due under leases that are deemed to be non-lease components (such as common area maintenance and provision of utilities), which could affect our recognition pattern for such revenue.

In February 2016, the FASB issued guidance that sets forth principles for the recognition, measurement, presentation and disclosure of leases. This guidance requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase of the leased asset by the lessee. The resulting classification determines whether the lease expense is recognized based on an effective interest method or straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases. The guidance requires lessors of real estate to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. This guidance is effective for reporting periods beginning January 1, 2019 using a modified retrospective transition approach at the time of adoption. Early adoption is also permitted for this guidance. In addition, the guidance permits lessees and lessors to elect to apply a package of practical expedients that allow them not to reassess upon adoption: the lease classification for any expired or existing leases; their deferred recognition of incremental direct costs of leasing for any expired or existing leases; and whether any expired or existing contracts are, or contain, leases. While we are still completing our assessment of the impact of this guidance, below is a summary of the anticipated primary effects of this guidance on our accounting and reporting.

- Real estate leases in which we are the lessor:

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

Deferral of non-incremental lease costs: Under the new lease guidance, we will no longer be able to defer the recognition of non-incremental costs in connection with new or extended tenant leases (refer to amounts reported in our 2016 Annual Report on Form 10-K for amounts deferred in 2014, 2015 and 2016). Upon adoption of the new guidance, we would expense previously deferred non-incremental lease costs for existing leases unless we elect the package of practical expedients, in which case such costs would remain deferred and amortized over the remaining lease terms.

Lease revenue reporting: We believe that the new revenue standard will apply to executory costs and other components of revenue deemed to be non-lease components (such as common area maintenance and provision of utilities), even when the revenue for such activities is not separately stipulated in the lease. In that case, we would need to separate the lease components of revenue due under leases from the non-lease components and the revenue from these items previously recognized on a straight-line basis under current lease guidance would be recognized under the new revenue guidance as the related services are delivered. As a result, while the total revenue recognized over time would not differ under the new guidance, the recognition pattern could be different. We are in the process of evaluating the significance of the difference in the recognition pattern that would result from this change.

- Leases in which we are the lessee:

Our most significant leases as lessee are ground leases we have for certain properties; as of September 30, 2017, our future minimum rental payments under these leases totaled $90.2 million, with various expiration dates extending to the year 2100. While we are still in the process of evaluating these leases under the new guidance, we believe that we will be required to recognize a right-of-use asset and a lease liability for the present value of these minimum lease payments. We also believe that these types of leases most likely would be classified as finance leases under the new guidance, which would result in the interest component of each lease payment being recorded as interest expense and the right-of-use asset being amortized into expense using the straight-line method over the life of the lease; however, if we elect to apply the package of practical expedients, we will continue to account for our existing ground leases as operating leases upon adoption of the guidance.

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

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

In November 2016, the FASB issued guidance that requires the statement of cash flows to explain the change during the period in the total of cash, cash equivalents and amounts described as restricted cash or restricted cash equivalents. Under the new guidance, amounts described as restricted cash and restricted cash equivalents will be included with cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown on the statement of cash flows.

The guidance is effective for us beginning January 1, 2018, with early adoption permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In February 2017, the FASB issued guidance clarifying the scope of asset derecognition provisions and accounting for partial sales of nonfinancial assets. The new guidance requires recognition of a sale of real estate and resulting gain or loss when control transfers and the buyer has the ability to direct use of, or obtain substantially all of the remaining benefit from, the asset (which generally will occur on the closing date); the factor of continuing involvement is no longer a specific consideration for the timing of recognition. The new guidance eliminates the need to consider adequacy of buyer investment, which was replaced by additional judgments regarding collectability and intent and/or ability to pay. The new guidance also requires an entity to derecognize nonfinancial assets and in substance non financial assets once it transfers control of such assets. When an entity transfers its controlling interest in a nonfinancial asset, but retains a noncontrolling ownership interest, the entity is required to measure any non-controlling interest it receives or retains at fair value and recognize a full gain or loss on the transaction; as a result, sales and partial sales of real estate assets will now be subject to the same derecognition model as all other nonfinancial assets. As discussed further in our 2016 Annual Report on Form 10-K, we had a transaction in July 2016 accounted for as a partial sale under existing guidance that would meet the criteria for immediate full gain recognition under the new guidance; this would result in an additional $18 million in income being recognized in 2016 that is currently being amortized into income in subsequent periods under existing guidance. We do not believe that the recognition pattern for our other sales of real estate will be changed by the new guidance. We will adopt this guidance for our annual and interim periods beginning January 1, 2018 and expect to use the the full retrospective method, under which we would retrospectively restate each reporting period presented at the time of adoption.

In August 2017, the FASB issued guidance that makes targeted improvements to hedge accounting. This new guidance simplifies the application of hedge accounting and better aligns financial reporting for hedging activities with companies' economic objectives in undertaking those activities. Under the new guidance, all changes in the fair value of highly effective cash flow hedges will be recorded in other comprehensive income instead of income. The new guidance also eases the administrative burden of hedge documentation requirements and assessing hedge effectiveness. The guidance is effective for us beginning January 1, 2019, with early adoption permitted. We are currently evaluating the impact of this guidance, including transition elections and required disclosures, on our financial statements and the timing of adoption.

3. Fair Value Measurements

Recurring Fair Value Measurements

COPT has a non-qualified elective deferred compensation plan for Trustees and certain members of our management team that permits participants to defer up to 100% of their compensation on a pre-tax basis and receive a tax-deferred return on such deferrals. The assets held in the plan (comprised primarily of mutual funds and equity securities) and the corresponding liability to the participants are measured at fair value on a recurring basis on COPT's consolidated balance sheet using quoted market prices, as are other marketable securities that we hold. The balance of the plan, which was fully funded, totaled $4.4 million as of September 30, 2017, and is included in the accompanying COPT consolidated balance sheets in the line entitled restricted cash and marketable securities. The offsetting liability associated with the plan is adjusted to fair value at the end of each accounting period based on the fair value of the plan assets and reported in other liabilities on COPT's consolidated balance sheets. The assets of the plan and other marketable securities that we hold are classified in Level 1 of the fair value hierarchy. The liability associated with the plan is classified in Level 2 of the fair value hierarchy.

The fair values of our interest rate derivatives are determined using widely accepted valuation techniques, including a discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate market data and implied volatilities in such interest rates. While we determined that the majority of the inputs used to value our derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with our interest rate derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default. However, as of September 30, 2017, we assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our derivatives and determined that these adjustments are not significant. As a result, we determined that our interest rate derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, other assets (excluding investing receivables) and accounts payable and accrued expenses are reasonable estimates of their fair values because of the short maturities of these instruments. As discussed in Note 6, we estimated the fair values of our investing receivables based on the discounted estimated future cash flows of the loans (categorized within Level 3 of the fair value hierarchy); the discount rates used approximate current market rates for loans with similar maturities and credit quality, and the estimated cash payments include scheduled principal and interest payments. For our disclosure of debt fair values in Note 8, we estimated the fair value of our unsecured senior notes based on quoted market rates for publicly-traded debt (categorized within Level 2 of the fair value hierarchy) and estimated the fair value of our other debt based on the discounted estimated future cash payments to be made on such debt (categorized within Level 3 of the fair value hierarchy); the discount rates used approximate current market rates for loans, or groups of loans, with similar maturities and credit quality, and the estimated future payments include scheduled principal and interest payments. Fair value estimates are made as of a specific point in time, are subjective in nature and involve uncertainties and matters of significant judgment. Settlement at such fair value amounts may not be possible and may not be a prudent management decision.

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

COPT and Subsidiaries

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

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs(Level 2)	Significant Unobservable Inputs(Level 3)	Total
Assets:				
Marketable securities in deferred compensation plan (1)				
Mutual funds	$ 4,336	$ —	$ —	$4,336
Other	71	—	—	71
Interest rate derivatives (2)	—	126	—	126
Total assets	$ 4,407	$ 126	$ —	$4,533
Liabilities:				
Deferred compensation plan liability (3)	$ —	$ 4,407	$ —	$4,407
Interest rate derivatives (3)	—	316	—	316
Total liabilities	$ —	$ 4,723	$ —	$4,723

(1) Included in the line entitled “restricted cash and marketable securities” on COPT’s consolidated balance sheet.
(2) Included in the line entitled “prepaid expenses and other assets” on COPT’s consolidated balance sheet.
(3) Included in the line entitled “other liabilities” on COPT’s consolidated balance sheet.

COPLP and Subsidiaries

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

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs(Level 2)	Significant Unobservable Inputs(Level 3)	Total
Assets:				
Interest rate derivatives (1)	$ —	$ 126	$ —	$126
Liabilities:				

Interest rate derivatives (2)	$ —	$ 316	$ —	$316

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

Nonrecurring Fair Value Measurements

As part of our closing process for the first, second and third quarters of 2017, we conducted our quarterly review of our portfolio of long-lived assets to be held and used for indicators of impairment and found there to be no impairment losses. Further, for the respective quarters in 2017, we performed recoverability analyses for our properties classified as held for sale, which resulted in impairment losses of $1.6 million in the second quarter of 2017. These impairment losses were primarily on properties in White Marsh, Maryland ("White Marsh") (included in our Regional Office and Other segments) that we reclassified to held for sale during the period and adjusted to fair value less costs to sell. These properties were sold in the third quarter.

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

4. Properties, Net

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

	September 30, 2017	December 31, 2016
Land	$ 440,771	$ 433,311
Buildings and improvements	3,009,203	2,944,905
Less: Accumulated depreciation	(759,262)	(706,385)
Operating properties, net	$ 2,690,712	$ 2,671,831

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

	September 30, 2017	December 31, 2016
Land	$ 216,108	$ 195,521
Development in progress, excluding land	190,211	206,010
Projects in development or held for future development	$ 406,319	$ 401,531

Our properties held for sale included:

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

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

	September 30, 2017	December 31, 2016
Properties, net	$ 68,081	$ 85,402
Deferred rent receivable	5,582	4,241
Intangible assets on real estate acquisitions, net	—	338
Deferred leasing costs, net	742	3,636
Lease incentives, net	10	1,037
Assets held for sale, net	$ 74,415	$ 94,654

2017 Dispositions

During the nine months ended September 30, 2017, we sold the following operating properties (dollars in thousands):

Project Name	City, State	Segment	Date of Sale	Number of Buildings	Total Rentable Square Feet	Transaction Value	Gain on Sale
3120 Fairview Park Drive	Falls Church, VA	Northern Virginia Defense/IT	2/15/2017	1	190,000	$ 39,000	$—
1334 Ashton Road	Hanover, MD	Fort Meade/BW Corridor	6/9/2017	1	37,000	2,300	—
Remaining White Marsh Properties (1)	White Marsh, MD	Regional Office and Other	7/28/2017	8	412,000	47,500	1,180
Dispositions through 9/30/2017				10	639,000	$ 88,800	$1,180

(1) This sale also included land.

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

On October 27, 2017, we sold:

- 201 Technology Drive, an operating property totaling 103,000 square feet in Lebanon, Virginia (in our Data Center Shells sub-segment), for $29.2 million; and
- 11751 Meadowville Lane, an operating property totaling 193,000 square feet in Chester, Virginia (in our Data Center Shells sub-segment), for $44.3 million. We provided a financial guaranty to the buyer under which we would indemnify it for up to $20 million in losses it could incur related to a potential defined capital event occurring on the property by June 30, 2019. Accordingly, we will not recognize the sale of this property for accounting purposes, and will reflect the sale price of the property as a liability, until the guaranty expires. We do not expect to incur any losses under this financial guaranty.

2017 Construction Activities

During the nine months ended September 30, 2017, we placed into service 751,000 square feet in five newly constructed properties (including a partially operational property) and 88,000 square feet in three redeveloped properties (including a partially operational property). As of September 30, 2017, we had eight office properties under construction, or for which we were contractually committed to construct, that we estimate will total 1.1 million square feet upon completion (including two properties completed but held for future lease to the United States Government) and two office properties under redevelopment that we estimate will total 36,000 square feet upon completion.

5. Real Estate Joint Ventures

Consolidated Joint Ventures

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

	Date	Nominal Ownership % as of	September 30, 2017 (1) Total	Encumbered Total

	Acquired	9/30/2017	Nature of Activity	Assets	Assets	Liabilities
LW Redstone Company, LLC	3/23/2010	85%	Development and operation of real estate (2)	$158,937	$ 76,374	$50,344
M Square Associates, LLC	6/26/2007	50%	Development and operation of real estate (3)	70,767	45,813	46,895
Stevens Investors, LLC	8/11/2015	95%	Development of real estate (4)	70,383	—	23,566
				$300,087	$ 122,187	$120,805

(1) Excludes amounts eliminated in consolidation.

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

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

(4) This joint venture's property is in Washington, DC. Our partner in this joint venture received an additional distribution from the joint venture of $6.7 million in July 2017 that was reported in other liabilities on our consolidated balance sheet as of December 31, 2016.

Unconsolidated Joint Venture

As of September 30, 2017, we owned a 50% interest in GI-COPT DC Partnership LLC (“GI-COPT”), a joint venture owning six triple-net leased, single-tenant data center properties in Virginia, that we account for using the equity method of accounting. As of September 30, 2017, we had an investment balance in GI-COPT of $25.2 million. Our balance was $17.1 million lower than our share of the joint venture’s equity due to a difference between our cost basis and our share of the underlying equity in the net assets upon formation of the joint venture; we are amortizing this basis difference into equity in income from unconsolidated entities over the lives of the underlying assets.

6. Investing Receivables

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

	September 30, 2017	December 31, 2016
Notes receivable from the City of Huntsville	$ 53,088	$ 49,258
Other investing loans receivable	3,020	3,021
	$ 56,108	$ 52,279

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

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

7. Prepaid Expenses and Other Assets, Net

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

	September 30, 2017	December 31, 2016
Prepaid expenses	$ 30,932	$ 24,432
Lease incentives, net	17,202	18,276
Furniture, fixtures and equipment, net	5,422	5,204
Deferred tax asset, net (1)	2,851	3,036
Non-real estate equity method investments	2,413	2,355
Construction contract costs incurred in excess of billings	2,005	10,350
Deferred financing costs, net (2)	1,419	3,128
Other assets	4,294	5,983
Prepaid expenses and other assets, net	$ 66,538	$ 72,764

(1) Includes a valuation allowance of $2.1 million.
(2) Represents deferred costs, net of accumulated amortization, attributable to our Revolving Credit Facility and interest rate derivatives.

8. Debt, Net

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

	Carrying Value (1) as of			
	September 30, 2017	December 31, 2016	Stated Interest Rates as of September 30, 2017	Scheduled Maturity as of September 30, 2017
Mortgage and Other Secured Debt:				
Fixed rate mortgage debt (2)	$151,594	$ 154,143	3.82% - 7.87% (3)	2019-2026
Variable rate secured debt	13,200	13,448	LIBOR + 1.85% (4)	October 2020
Total mortgage and other secured debt	164,794	167,591		
Revolving Credit Facility	170,000	—	LIBOR + 0.875% to 1.60% (5)	May 2019 (6)
Term Loan Facilities (7)	348,371	547,494	LIBOR + 0.90% to 2.40% (8)	2020-2022
Unsecured Senior Notes				
3.600%, $350,000 aggregate principal	347,445	347,128	3.60% (9)	May 2023
5.250%, $250,000 aggregate principal	246,525	246,176	5.25% (10)	February 2024
3.700%, $300,000 aggregate principal	298,200	297,843	3.70% (11)	June 2021
5.000%, $300,000 aggregate principal	296,639	296,368	5.00% (12)	July 2025
Unsecured notes payable	1,317	1,401	0% (13)	2026
Total debt, net	$1,873,291	$ 1,904,001		

(1) The carrying values of our debt other than the Revolving Credit Facility reflect net deferred financing costs of $4.8 million as of September 30, 2017 and $6.1 million as of December 31, 2016.

(2) Certain fixed rate mortgages carry interest rates that were above or below market rates upon assumption and therefore were recorded at their fair value based on applicable effective interest rates. The carrying values of these loans reflect net unamortized premiums totaling $367,000 as of September 30, 2017 and $422,000 as of December 31, 2016.

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

(4) The interest rate on our variable rate secured debt as of September 30, 2017 was 3.09%.

(5) The weighted average interest rate on the Revolving Credit Facility was 2.40% as of September 30, 2017.

(6) The facility matures in May 2019, with the ability for us to further extend such maturity by two six-month periods at our option, provided that there is no default under the facility and we pay an extension fee of 0.075% of the total availability under the facility for each extension period.

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

(8) The weighted average interest rate on these loans was 2.93% as of September 30, 2017.

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

(10) The carrying value of these notes reflects an unamortized discount totaling $3.1 million as of September 30, 2017 and $3.4 million as of December 31, 2016. The effective interest rate under the notes, including amortization of

the issuance costs, was 5.49%.

(11) The carrying value of these notes reflects an unamortized discount totaling $1.4 million as of September 30, 2017 and $1.7 million as of December 31, 2016. The effective interest rate under the notes, including amortization of the issuance costs, was 3.85%.

(12) The carrying value of these notes reflects an unamortized discount totaling $2.8 million as of September 30, 2017 and $3.0 million as of December 31, 2016. The effective interest rate under the notes, including amortization of the issuance costs, was 5.15%.

(13) These notes carry interest rates that were below market rates upon assumption and therefore were recorded at their fair value based on applicable effective interest rates. The carrying value of these notes reflects an unamortized discount totaling $394,000 as of September 30, 2017 and $460,000 as of December 31, 2016.

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

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

We capitalized interest costs of $1.1 million in the three months ended September 30, 2017, $1.2 million in the three months ended September 30, 2016, $4.2 million in the nine months ended September 30, 2017 and $4.3 million in the nine months ended September 30, 2016.

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

	September 30, 2017		December 31, 2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Fixed-rate debt				
Unsecured Senior Notes	$1,188,809	$1,231,222	$1,187,515	$1,220,282
Other fixed-rate debt	152,911	154,781	155,544	156,887
Variable-rate debt	531,571	531,520	560,942	558,437
	$1,873,291	$1,917,523	$1,904,001	$1,935,606

9. Interest Rate Derivatives

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

Notional Amount		Fixed Rate	Floating Rate Index	Effective Date	Expiration Date	Fair Value at September 30, 2017	Fair Value at December 31, 2016
$100,000		1.7300%	One-Month LIBOR	9/1/2015	8/1/2019	$(237)	$ (848)
13,311	(1)	1.3900%	One-Month LIBOR	10/13/2015	10/1/2020	126	100
100,000		1.9013%	One-Month LIBOR	9/1/2016	12/1/2022	(27)	(23)
100,000		1.9050%	One-Month LIBOR	9/1/2016	12/1/2022	(22)	48
50,000		1.9079%	One-Month LIBOR	9/1/2016	12/1/2022	(30)	10
100,000	(2)	1.6730%	One-Month LIBOR	9/1/2015	8/1/2019	—	(701)
						$(190)	$ (1,414)

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

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

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

Derivatives	Balance Sheet Location	Fair Value at September 30, 2017	Fair Value at December 31, 2016
Interest rate swaps designated as cash flow hedges	Prepaid expenses and other assets	$126	$ 158
Interest rate swaps designated as cash flow hedges	Other liabilities	(316)	(1,572)

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
Unrealized (loss) gain recognized in AOCL (effective portion)	$(301)	$407	$(1,877)	$(16,581)
Loss reclassified from AOCL into interest expense (effective portion)	(615)	(1,043)	(2,652)	(2,763)
Gain (loss) on derivatives recognized in interest expense (ineffective portion)	34	1,523	132	(347)

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

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

Over the next 12 months, we estimate that approximately $1.6 million of losses will be reclassified from AOCL as an increase to interest expense.

We have agreements with each of our interest rate derivative counterparties that contain provisions under which, if we default or are capable of being declared in default on defined levels of our indebtedness, we could also be declared in default on our derivative obligations. Failure to comply with the loan covenant provisions could result in our being declared in default on any derivative instrument obligations covered by the agreements. As of September 30, 2017, the fair value of interest rate derivatives in a liability position related to these agreements was $305,000, excluding the effects of accrued interest and credit valuation adjustments. As of September 30, 2017, we had not posted any collateral related to these agreements. We are not in default with any of these provisions. If we breached any of these provisions, we could be required to settle our obligations under the agreements at their termination value of $484,000.

10. Redeemable Noncontrolling Interests

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

	For the Nine Months Ended September 30,	
	2017	2016
Beginning balance	$22,979	$19,218
Contributions from noncontrolling interests	—	22,779
Distributions to noncontrolling interests	(1,186)	(21,344)
Net income attributable to noncontrolling interests	1,720	1,679
Adjustment to arrive at fair value of interests	(244)	516
Ending balance	$23,269	$22,848

11. Equity

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

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

the 7.375% Series L Cumulative Preferred Shares (the “Series L Preferred Shares”), redeemed effective June 27, 2017 at a price of $25.00 per share, or $172.5 million in the aggregate, plus accrued and unpaid dividends thereon up to but not including the date of redemption. Concurrently with this redemption, COPLP redeemed its Series L Preferred Units on the same terms. We also recognized a $6.8 million decrease to net income available to common shareholders/unitholders in the nine months ended September 30, 2017 pertaining to the original issuance costs incurred on the shares/units.

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

During the nine months ended September 30, 2017, certain COPLP limited partners converted 337,000 common units in COPLP for an equal number of common shares in COPT.

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

12. Information by Business Segment

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

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

	Operating Office Property Segments									
	Defense/Information Technology Locations									
	Fort Meade/BW Corridor	Northern Virginia Defense/IT	Lackland Air Force Base	Navy Support Locations	Redstone Arsenal	Data Center Shells	Total Defense/IT Locations	Regional Office	Operating Wholesale Data Center	Ot
Three Months Ended September 30, 2017										
Revenues from real estate operations	$61,254	$12,190	$11,024	$7,494	$3,532	$6,676	$102,170	$16,656	$7,398	$1
Property operating expenses	(19,708)	(4,343)	(6,193)	(3,157)	(1,432)	(637)	(35,470)	(7,406)	(3,175)	(31
UJV NOI allocable to COPT	—	—	—	—	—	1,297	1,297	—	—	—
NOI from real estate operations	$41,546	$7,847	$4,831	$4,337	$2,100	$7,336	$67,997	$9,250	$4,223	$6
Additions to long-lived assets	$5,810	$2,587	$55	$1,910	$843	$—	$11,205	$5,338	$9	$7
Transfers from non-operating	$5,519	$45,554	$—	$8	$(62)	$29,803	$80,822	$25	$—	$–

properties										
Three Months Ended September 30 2016										
Revenues from real estate operations	$61,460	$12,231	$12,532	$7,232	$3,189	$5,175	$101,819	$20,499	$6,809	$1
Property operating expenses	(20,598)	(4,462)	(7,599)	(3,374)	(1,112)	(528)	(37,673)	(8,155)	(3,317)	(8
UJV NOI allocable to COPT	—	—	—	—	—	1,008	1,008	—	—	—
NOI from real estate operations	$40,862	$7,769	$4,933	$3,858	$2,077	$5,655	$65,154	$12,344	$3,492	$1
Additions to long-lived assets	$5,901	$7,153	$—	$2,207	$2,642	$—	$17,903	$4,168	$108	$5
Transfers from non-operating properties	$5,331	$308	$3	$—	$3,100	$25,513	$34,255	$(4)	$40	$–
Nine Months Ended September 30, 2017										
Revenues from real estate operations	$183,393	$34,992	$35,687	$21,953	$10,616	$17,998	$304,639	$52,394	$21,201	$4
Property operating expenses	(60,357)	(13,014)	(21,125)	(9,391)	(4,294)	(1,873)	(110,054)	(21,974)	(10,041)	(1,
UJV NOI allocable to COPT	—	—	—	—	—	3,889	3,889	—	—	—
NOI from real estate operations	$123,036	$21,978	$14,562	$12,562	$6,322	$20,014	$198,474	$30,420	$11,160	$2
Additions to long-lived assets	$15,085	$6,032	$71	$6,309	$1,059	$—	$28,556	$16,476	$3,588	$2
Transfers from non-operating properties	$37,094	$45,994	$—	$474	$1,643	$55,003	$140,208	$—	$8	$1
Segment assets at	$1,265,569	$400,855	$129,657	$194,801	$108,884	$258,611	$2,358,377	$398,579	$226,909	$1

September 30, 2017

Nine Months Ended September 30, 2016										
Revenues from real estate operations	$184,881	$36,404	$34,408	$21,164	$9,496	$18,793	$305,146	$67,284	$20,106	$5
Property operating expenses	(64,222)	(13,310)	(19,863)	(9,573)	(3,050)	(2,164)	(112,182)	(26,707)	(8,629)	(2,
UJV NOI allocable to COPT	—	—	—	—	—	1,008	1,008	—	—	—
NOI from real estate operations	$120,659	$23,094	$14,545	$11,591	$6,446	$17,637	$193,972	$40,577	$11,477	$2
Additions to long-lived assets	$19,516	$13,290	$—	$5,710	$3,561	$—	$42,077	$9,107	$108	$3
Transfers from non-operating properties	$41,850	$28,158	$240	$—	$3,315	$81,467	$155,030	$104	$(391)	$(
Segment assets at September 30, 2016	$1,261,337	$416,886	$132,722	$195,244	$111,310	$189,746	$2,307,245	$453,766	$234,551	$3

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
Segment revenues from real estate operations	$127,231	$130,954	$382,295	$397,965
Construction contract and other service revenues	29,786	11,149	65,958	34,372
Total revenues	$157,017	$142,103	$448,253	$432,337

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
UJV NOI allocable to COPT	$1,297	$1,008	$3,889	$1,008
Less: Income from UJV allocable to COPT attributable to depreciation and amortization expense and interest expense	(577)	(415)	(1,724)	(415)
Add: Equity in (loss) income of unconsolidated non-real estate entities	(1)	1	(3)	21
Equity in income of unconsolidated entities	$719	$594	$2,162	$614

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
Construction contract and other service revenues	$29,786	$11,149	$65,958	$34,372
Construction contract and other service expenses	(28,788)	(10,341)	(63,589)	(32,513)
NOI from service operations	$998	$808	$2,369	$1,859

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
NOI from real estate operations	$82,160	$82,010	$242,669	$249,005
NOI from service operations	998	808	2,369	1,859
Interest and other income	1,508	1,391	4,817	3,877
Equity in income of unconsolidated entities	719	594	2,162	614
Income tax (expense) benefit	(57)	21	(145)	28
Depreciation and other amortization associated with real estate operations	(34,438)	(32,015)	(100,290)	(99,790)
Impairment recoveries (losses)	161	(27,699)	(1,464)	(99,837)
General, administrative and leasing expenses	(7,368)	(8,855)	(23,838)	(28,764)
Business development expenses and land carry costs	(1,277)	(1,716)	(4,567)	(6,497)
Interest expense	(19,615)	(18,301)	(57,772)	(64,499)
Less: UJV NOI allocable to COPT included in equity in income of unconsolidated entities	(1,297)	(1,008)	(3,889)	(1,008)
Loss on early extinguishment of debt	—	(59)	(513)	(37)
Income (loss) before gain on sales of real estate	$21,494	$(4,829)	$59,539	$(45,049)

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

	September 30, 2017	September 30, 2016
Segment assets	$ 2,997,212	$ 3,027,125
Non-operating property assets	413,255	421,364
Other assets	149,305	185,705
Total COPT consolidated assets	$ 3,559,772	$ 3,634,194

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

13. Share-Based Compensation and Other Compensation Matters

Performance-Based Share Units (“PSUs”)

On January 1, 2017, our Board of Trustees granted 36,525 PSUs with an aggregate grant date fair value of $1.4 million to our three executives (the “January Grants”). The PSUs have a performance period beginning on January 1, 2017 and concluding on the earlier of December 31, 2019 or the date of: (1) termination by us without cause, death or disability of the executive or constructive discharge of the executive (collectively, “qualified termination”); or (2) a sale event. The number of PSUs earned (“earned PSUs”) at the end of the performance period will be determined based on the percentile rank of COPT’s total shareholder return relative to a peer group of companies, as set forth in the following schedule:

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

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

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

If a performance period ends due to a sale event or qualified termination, the number of earned PSUs is prorated based on the portion of the three-year performance period that has elapsed. If employment is terminated by the employee or by us for cause, all PSUs are forfeited. PSUs do not carry voting rights.

On August 23, 2017, the January Grants were modified to include a provision that limits the earned PSUs payout percentage to 100% of the PSUs granted if COPT's total shareholder return is negative during the performance period irrespective of its percentile rank in the peer group (the "Negative TSR Modifier"). In addition, as a result of the modification to the January Grants, on August 23, 2017, we augmented the January Grants by issuing an aggregate of 2,826 additional PSUs to the executives. Each of the PSU Certificates also includes the Negative TSR Modifier. The incremental award to the executives on August 23, 2017 resulting from these modifications totaled $12,000.

For the January Grants, we computed a grant date fair value of $38.43 per PSU using a Monte Carlo model, which included assumptions of, among other things, the following: baseline common share value of $31.22; expected volatility for COPT common shares of 19.0%; and a risk-free interest rate of 1.47%. For the award modification on August 23, 2017, we computed a pre-modification fair value of $49.66 per PSU and a post-modification fair value of $46.39 per PSU using a Monte Carlo model, which included assumptions of, among other things, the following: baseline common share value of $33.40; expected volatility for COPT common shares of 18.7%; and a risk-free interest rate of 1.36%.

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

Restricted Shares

During the nine months ended September 30, 2017, certain employees and non-employee members of our Board of Trustees were granted a total of 230,635 restricted common shares with an aggregate grant date fair value of $7.8 million (weighted average of $33.96 per share). Restricted shares granted to employees vest based on increments and over periods of time set forth under the terms of the respective awards provided that the employees remain employed by us. Restricted shares granted to non-employee Trustees vest on the first anniversary of the grant date, provided that the Trustee remains in his or her position. During the nine months ended September 30, 2017, forfeiture restrictions lapsed on 148,401 previously issued common shares; these shares had a weighted average grant date fair value of $26.18 per share, and the aggregate intrinsic value of the shares on the vesting dates was $5.0 million.

Deferred Share Awards

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

Options

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

14. Earnings Per Share ("EPS") and Earnings Per Unit ("EPU")

COPT and Subsidiaries EPS

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

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

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
Numerator:				
Net income (loss) attributable to COPT	$20,916	$27,299	$60,133	$(13,294)
Preferred share dividends	—	(3,552)	(6,219)	(10,657)
Issuance costs associated with redeemed preferred shares	—	—	(6,847)	—
Income attributable to share-based compensation awards	(95)	(105)	(337)	(319)
Numerator for basic and diluted EPS on net income (loss) attributable to COPT common shareholders	$20,821	$23,642	$46,730	$(24,270)
Denominator (all weighted averages):				
Denominator for basic EPS (common shares)	99,112	94,433	98,855	94,312
Dilutive effect of share-based compensation awards	146	81	154	—
Denominator for diluted EPS (common shares)	99,258	94,514	99,009	94,312
Basic EPS:				
Net income (loss) attributable to COPT common shareholders	$0.21	$0.25	$0.47	$(0.26)
Diluted EPS:				
Net income (loss) attributable to COPT common shareholders	$0.21	$0.25	$0.47	$(0.26)