

CORPORATE OFFICE PROPERTIES TRUST
Form 10-Q
November 09, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2007

or

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

For the transition period from to

Commission file number 1-14023

Corporate Office Properties Trust

(Exact name of registrant as specified in its charter)

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Maryland

(State or other jurisdiction of
incorporation or organization)

23-2947217

(IRS Employer
Identification No.)

6711 Columbia Gateway Drive, Suite 300, Columbia MD

(Address of principal executive offices)

21046

(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.

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of October 31, 2007, 47,363,659 of the Company's Common Shares of Beneficial Interest, \$0.01 par value, were issued.

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PART I: FINANCIAL INFORMATION**ITEM 1. Financial Statements****Corporate Office Properties Trust and Subsidiaries****Consolidated Balance Sheets****(Dollars in thousands)****(unaudited)**

	September 30, 2007	December 31, 2006
Assets		
Investment in real estate:		
Operating properties, net	\$ 2,158,396	\$ 1,812,883
Property held for sale, net	14,578	
Projects under construction or development	411,971	298,427
Total commercial real estate properties, net	2,584,945	2,111,310
Cash and cash equivalents	21,895	7,923
Restricted cash	16,874	52,856
Accounts receivable, net	20,680	26,367
Deferred rent receivable	50,891	41,643
Intangible assets on real estate acquisitions, net	116,368	87,325
Deferred charges, net	46,019	43,710
Prepaid and other assets	58,351	48,467
Total assets	\$ 2,916,023	\$ 2,419,601
Liabilities and shareholders equity		
Liabilities:		
Mortgage and other loans payable	\$ 1,599,912	\$ 1,298,537
3.5% Exchangeable Senior Notes	200,000	200,000
Accounts payable and accrued expenses	80,022	68,190
Rents received in advance and security deposits	24,916	20,237
Dividends and distributions payable	22,433	19,164
Deferred revenue associated with acquired operating leases	12,475	11,120
Distributions in excess of investment in unconsolidated real estate joint venture	4,124	3,614
Other liabilities	7,766	8,249
Total liabilities	1,951,648	1,629,111
Minority interests:		
Common units in the Operating Partnership	115,837	104,934
Preferred units in the Operating Partnership	8,800	8,800
Other consolidated real estate joint ventures	6,970	2,453
Total minority interests	131,607	116,187
Commitments and contingencies (Note 20)		
Shareholders equity:		
Preferred Shares of beneficial interest (\$0.01 par value; shares authorized of 15,000,000, issued and outstanding of 8,121,667 at September 30, 2007 and 7,590,000 at December 31, 2006 (Note 13))	81	76
Common Shares of beneficial interest (\$0.01 par value; 75,000,000 shares authorized, shares issued and outstanding of 47,344,984 at September 30, 2007 and 42,897,639 at December 31, 2006)	473	429

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Additional paid-in capital	949,392	758,032
Cumulative distributions in excess of net income	(115,963)	(83,541)
Accumulated other comprehensive loss	(1,215)	(693)
Total shareholders' equity	832,768	674,303
Total liabilities and shareholders' equity	\$ 2,916,023	\$ 2,419,601

See accompanying notes to consolidated financial statements.

Corporate Office Properties Trust and Subsidiaries

Consolidated Statements of Operations

(Dollars in thousands, except per share data)

(unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
Revenues				
Rental revenue	\$ 80,428	\$ 65,614	\$ 234,807	\$ 187,299
Tenant recoveries and other real estate operations revenue	14,136	11,255	39,895	28,788
Construction contract revenues	10,047	13,219	29,358	39,919
Other service operations revenues	910	1,572	3,369	5,321
Total revenues	105,521	91,660	307,429	261,327
Expenses				
Property operating expenses	31,642	24,983	92,222	67,460
Depreciation and other amortization associated with real estate operations	26,587	21,510	80,487	58,138
Construction contract expenses	9,507	12,465	28,126	38,134
Other service operations expenses	806	1,495	3,337	4,991
General and administrative expenses	5,423	4,226	15,122	11,894
Total operating expenses	73,965	64,679	219,294	180,617
Operating income	31,556	26,981	88,135	80,710
Interest expense	(21,000)	(17,678)	(61,261)	(51,635)
Amortization of deferred financing costs	(901)	(736)	(2,706)	(1,898)
Gain on sale of non-real estate investment			1,033	
Income from continuing operations before equity in (loss) income of unconsolidated entities, income taxes and minority interests	9,655	8,567	25,201	27,177
Equity in (loss) income of unconsolidated entities	(46)	15	(197)	(40)
Income tax expense	(197)	(202)	(480)	(623)
Income from continuing operations before minority interests	9,412	8,380	24,524	26,514
Minority interests in income from continuing operations				
Common units in the Operating Partnership	(808)	(746)	(1,936)	(2,630)
Preferred units in the Operating Partnership	(165)	(165)	(495)	(495)
Other consolidated entities	12	38	90	96
Income from continuing operations	8,451	7,507	22,183	23,485
Income from discontinued operations, net of minority interests	1,942	12,483	1,473	15,423
Income before gain on sales of real estate	10,393	19,990	23,656	38,908
Gain on sales of real estate, net	1,038	597	1,199	732
Net income	11,431	20,587	24,855	39,640
Preferred share dividends	(4,025)	(4,307)	(12,043)	(11,614)
Issuance costs associated with redeemed preferred shares		(1,829)		(1,829)
Net income available to common shareholders	\$ 7,406	\$ 14,451	\$ 12,812	\$ 26,197
Basic earnings per common share				
Income from continuing operations	\$ 0.12	\$ 0.05	\$ 0.24	\$ 0.26
Discontinued operations	0.04	0.29	0.04	0.38
Net income available to common shareholders	\$ 0.16	\$ 0.34	\$ 0.28	\$ 0.64
Diluted earnings per common share				
Income from continuing operations	\$ 0.11	\$ 0.04	\$ 0.24	\$ 0.25

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Discontinued operations		0.04		0.29		0.03		0.36
Net income available to common shareholders	\$	0.15	\$	0.33	\$	0.27	\$	0.61

See accompanying notes to consolidated financial statements.

Corporate Office Properties Trust and Subsidiaries

Consolidated Statements of Cash Flows

(Dollars in thousands)

(unaudited)

	For the Nine Months Ended September 30,	
	2007	2006
Cash flows from operating activities		
Net income	\$ 24,855	\$ 39,640
Adjustments to reconcile net income to net cash provided by operating activities:		
Minority interests	2,829	6,471
Depreciation and other amortization	80,660	59,993
Amortization of deferred financing costs	2,706	2,032
Amortization of deferred market rental revenue	(1,569)	(1,326)
Equity in loss of unconsolidated entities	197	40
Gain on sales of real estate	(4,199)	(17,990)
Gain on sale of non-real estate investment	(1,033)	
Share-based compensation	4,969	2,485
Changes in operating assets and liabilities:		
Increase in deferred rent receivable	(9,248)	(7,446)
Decrease (increase) in accounts receivable	5,687	(11,172)
Increase in restricted cash and prepaid and other assets	(10,217)	(136)
(Decrease) increase in accounts payable, accrued expenses and other liabilities	(3,847)	9,390
Increase in rents received in advance and security deposits	4,679	4,786
Other	(887)	(181)
Net cash provided by operating activities	95,582	86,586
Cash flows from investing activities		
Purchases of and additions to commercial real estate properties	(301,065)	(227,592)
Proceeds from sales of properties	8,763	46,708
Proceeds from sale of non-real estate investment	2,526	
Proceeds from sale of unconsolidated real estate joint venture		1,524
Investments in and advances to unconsolidated entities		127
Acquisition of partner interests in consolidated joint ventures	(1,262)	(3,016)
Distributions from unconsolidated entities	319	367
Leasing costs paid	(8,984)	(6,106)
Decrease in restricted cash associated with investing activities	14,631	5,559
Purchases of furniture, fixtures and equipment	(1,318)	(7,549)
Other	(848)	(182)
Net cash used in investing activities	(287,238)	(190,160)
Cash flows from financing activities		
Proceeds from mortgage and other loans payable	506,571	368,259
Proceeds from 3.5% Exchangeable Senior Notes		200,000
Repayments of mortgage and other loans payable	(243,942)	(548,090)
Deferred financing costs paid	(1,847)	(5,402)
Distributions paid to partners in consolidated joint ventures		(787)
Net proceeds from issuance of common shares	7,013	88,622
Net proceeds from issuance of preferred shares		81,863
Redemption of preferred shares		(28,750)
Dividends paid	(54,163)	(45,138)
Distributions paid	(8,245)	(7,614)
Other	241	637
Net cash provided by financing activities	205,628	103,600

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Net increase in cash and cash equivalents	13,972	26
Cash and cash equivalents		
Beginning of period	7,923	10,784
End of period	\$ 21,895	\$ 10,810

See accompanying notes to consolidated financial statements.

Corporate Office Properties Trust and Subsidiaries

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share data)

(unaudited)

1. Organization

Corporate Office Properties Trust (COPT) and subsidiaries (collectively, the Company) is a fully-integrated and self-managed real estate investment trust (REIT) that focuses on the acquisition, development, ownership, management and leasing of primarily Class A suburban office properties in the Greater Washington, D.C. region and other select submarkets. We also have a core customer expansion strategy that is built on meeting, through acquisitions and development, the multi-location requirements of our strategic tenants. As of September 30, 2007, our investments in real estate included the following:

229 wholly owned operating properties totaling 17.7 million square feet;

19 wholly owned properties under construction or development that we estimate will total approximately 2.0 million square feet upon completion and one wholly owned office property totaling approximately 75,000 square feet that was under redevelopment;

wholly owned land parcels totaling 1,496 acres that we believe are potentially developable into approximately 12.3 million square feet; and

partial ownership interests in a number of other real estate projects in operation or under development or redevelopment.

We conduct almost all of our operations through our operating partnership, Corporate Office Properties, L.P. (the Operating Partnership), for which we are the managing general partner. The Operating Partnership owns real estate both directly and through subsidiary partnerships and limited liability companies (LLCs). A summary of our Operating Partnership s forms of ownership and the percentage of those securities owned by COPT as of September 30, 2007 follows:

Common Units	85%
Series G Preferred Units	100%
Series H Preferred Units	100%
Series I Preferred Units	0%
Series J Preferred Units	100%
Series K Preferred Units	100% (issued on January 9, 2007)

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

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

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

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

2. Basis of Presentation

The accompanying unaudited interim Consolidated Financial Statements have been prepared in accordance with the rules and regulations for reporting on Form 10-Q. Accordingly, certain information and disclosures required by accounting principles generally accepted in the United States for complete Consolidated Financial Statements are not included herein. These interim financial statements should be read together with the financial statements and notes thereto included in our 2006 Annual Report on Form 10-K. The interim financial statements on the previous pages reflect all adjustments that we believe are necessary for the fair statement of our financial position and results of operations for the interim periods presented. These adjustments are of a normal recurring nature. The results of operations for such interim periods are not necessarily indicative of the results for a full year.

3. Earnings Per Share (EPS)

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

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

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

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
Numerator:				
Income from continuing operations	\$ 8,451	\$ 7,507	\$ 22,183	\$ 23,485
Add: Gain on sales of real estate, net	1,038	597	1,199	732
Less: Preferred share dividends	(4,025)	(4,307)	(12,043)	(11,614)
Less: Issuance costs associated with redeemed preferred shares		(1,829)		(1,829)
Numerator for basic and diluted EPS from continuing operations	5,464	1,968	11,339	10,774
Income from discontinued operations, net	1,942	12,483	1,473	15,423
Numerator for basic and diluted EPS on net income available to common shareholders	\$ 7,406	\$ 14,451	\$ 12,812	\$ 26,197
Denominator (all weighted averages):				
Denominator for basic EPS (common shares)	46,781	42,197	46,386	41,134
Dilutive effect of share-based compensation awards	1,005	1,649	1,180	1,785
Denominator for diluted EPS	47,786	43,846	47,566	42,919

Basic EPS:

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Income from continuing operations	\$	0.12	\$	0.05	\$	0.24	\$	0.26
Income from discontinued operations		0.04		0.29		0.04		0.38
Net income available to common shareholders	\$	0.16	\$	0.34				