

CORPORATE OFFICE PROPERTIES TRUST
Form 10-Q
May 10, 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 AND EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2007

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND 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)

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

On April 27, 2007, 47,069,523 shares 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)

	March 31, 2007	December 31, 2006
Assets		
Investment in real estate:		
Operating properties, net	\$ 2,080,310	\$ 1,812,883
Property held for sale, net	14,573	
Projects under construction or development	379,294	298,427
Total commercial real estate properties, net	2,474,177	2,111,310
Cash and cash equivalents	22,003	7,923
Restricted cash	19,030	52,856
Accounts receivable, net	24,478	26,367
Deferred rent receivable	44,294	41,643
Intangible assets on real estate acquisitions, net	131,934	87,325
Deferred charges, net	45,496	43,710
Prepaid and other assets	53,311	48,467
Total assets	\$ 2,814,723	\$ 2,419,601
Liabilities and shareholders' equity		
Liabilities:		
Mortgage and other loans payable	\$ 1,515,183	\$ 1,298,537
3.5% Exchangeable Senior Notes	200,000	200,000
Accounts payable and accrued expenses	61,131	68,190
Rents received in advance and security deposits	25,127	20,237
Dividends and distributions payable	20,687	19,164
Deferred revenue associated with acquired operating leases	14,607	11,120
Distributions in excess of investment in unconsolidated real estate joint venture	3,797	3,614
Fair value of derivatives	556	308
Other liabilities	8,395	7,941
Total liabilities	1,849,483	1,629,111
Minority interests:		
Common units in the Operating Partnership	118,614	104,934
Preferred units in the Operating Partnership	8,800	8,800
Other consolidated real estate joint ventures	2,408	2,453
Total minority interests	129,822	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 March 31, 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 46,879,852 at March 31, 2007 and 42,897,639 at December 31, 2006)	469	429
Additional paid-in capital	932,287	758,032
Cumulative distributions in excess of net income	(96,516)	(83,541)
Accumulated other comprehensive loss	(903)	(693)
Total shareholders' equity	835,418	674,303
Total liabilities and shareholders' equity	\$ 2,814,723	\$ 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 March 31,	
	2007	2006
Revenues		
Rental revenue	\$ 75,882	\$ 60,562
Tenant recoveries and other		
real estate operations revenue	13,793	8,660
Construction contract revenues	8,691	14,544
Other service operations revenues	1,386	1,765
Total revenues	99,752	85,531
Expenses		
Property operating expenses	31,748	21,061
Depreciation and other amortization associated with real estate operations	26,569	18,672
Construction contract expenses	8,483	14,026
Other service operations expenses	1,405	1,678
General and administrative expenses	4,614	3,963
Total operating expenses	72,819	59,400
Operating income	26,933	26,131
Interest expense	(19,876)	(17,029)
Amortization of deferred financing costs	(884)	(556)
Income from continuing operations before equity in loss of unconsolidated entities, income taxes and minority interests	6,173	8,546
Equity in loss of unconsolidated entities	(94)	(23)
Income tax expense	(105)	(215)
Income from continuing operations before minority interests	5,974	8,308
Minority interests in income from continuing operations		
Common units in the Operating Partnership	(308)	(826)
Preferred units in the Operating Partnership	(165)	(165)
Other consolidated entities	47	33
Income from continuing operations	5,548	7,350
(Loss) income from discontinued operations, net of minority interests	(1)	2,477
Income before gain on sales of real estate	5,547	9,827
Gain on sales of real estate, net		110
Net income	5,547	9,937
Preferred share dividends	(3,993)	(3,654)
Net income available to common shareholders	\$ 1,554	\$ 6,283
Basic earnings per common share		
Income from continuing operations	\$ 0.03	\$ 0.10
Discontinued operations		0.06
Net income available to common shareholders	\$ 0.03	\$ 0.16
Diluted earnings per common share		
Income from continuing operations	\$ 0.03	\$ 0.09
Discontinued operations		0.06
Net income available to common shareholders	\$ 0.03	\$ 0.15

See accompanying notes to consolidated financial statements.

Corporate Office Properties Trust and Subsidiaries

Consolidated Statements of Cash Flows

(Dollars in thousands)

(unaudited)

	For the Three Months Ended March 31,	
	2007	2006
Cash flows from operating activities		
Net income	\$ 5,547	\$ 9,937
Adjustments to reconcile net income to net cash provided by operating activities:		
Minority interests	426	1,538
Depreciation and other amortization	26,626	19,337
Amortization of deferred financing costs	884	559
Amortization of deferred market rental revenue	(511)	(556)
Equity in loss of unconsolidated entities	94	23
Gain on sales of real estate		(2,571)
Share-based compensation	1,340	642
Excess income tax benefits from share-based compensation	(865)	(258)
Changes in operating assets and liabilities:		
Increase in deferred rent receivable	(2,651)	(2,198)
Decrease (increase) in accounts receivable	1,889	(1,123)
Decrease in restricted cash and prepaid and other assets	1,349	5,152
Decrease in accounts payable, accrued expenses and other liabilities	(4,005)	(2,637)
Increase in rents received in advance and security deposits	4,890	1,620
Other	(25)	(79)
Net cash provided by operating activities	34,988	29,386
Cash flows from investing activities		
Purchases of and additions to commercial real estate properties	(187,966)	(38,267)
Proceeds from sales of properties		28,217
Investments in and advances to unconsolidated entities		(190)
Acquisition of partner interests in consolidated joint ventures		(3,016)
Distributions from unconsolidated entities	89	113
Leasing costs paid	(4,059)	(1,984)
Decrease in restricted cash associated with investing activities	13,858	218
Other	(5,951)	(175)
Net cash used in investing activities	(184,029)	(15,084)
Cash flows from financing activities		
Proceeds from mortgage and other loans payable	188,090	47,905
Repayments of mortgage and other loans payable	(10,380)	(36,559)
Deferred financing costs paid	(507)	(49)
Distributions paid to partners in consolidated joint ventures		(787)
Net proceeds from issuance of common shares	5,120	1,581
Dividends paid	(16,931)	(14,721)
Distributions paid	(2,787)	(2,553)
Excess income tax benefits from share-based compensation	865	258
Other	(349)	8
Net cash provided by (used in) financing activities	163,121	(4,917)
Net increase in cash and cash equivalents	14,080	9,385
Cash and cash equivalents		
Beginning of period	7,923	10,784
End of period	\$ 22,003	\$ 20,169

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 March 31, 2007, our investments in real estate included the following:

- 226 wholly owned operating properties in our portfolio totaling 17.4 million square feet;
- 17 wholly owned properties under construction or development that we estimate will total approximately 1.9 million square feet upon completion and two wholly owned office properties totaling approximately 129,000 square feet that were under redevelopment;
- wholly owned land parcels totaling 1,254 acres that we believe are potentially developable into approximately 10.3 million square feet; and
- partial ownership interests in a number of other real estate projects in operations 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 March 31, 2007 follows:

Common Units	84%
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.

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

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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 March 31,	
	2007	2006
Numerator:		
Income from continuing operations	\$ 5,548	\$ 7,350
Add: Gain on sales of real estate, net		110
Less: Preferred share dividends	(3,993)	(3,654)
Numerator for basic and diluted EPS from continuing operations	1,555	3,806
(Loss) income from discontinued operations, net	(1)	2,477
Numerator for basic and diluted EPS on net income available to common shareholders	\$ 1,554	\$ 6,283
Denominator (all weighted averages):		
Denominator for basic EPS (common shares)	45,678	39,668
Dilutive effect of share-based compensation awards	1,465	1,842
Denominator for diluted EPS	47,143	41,510
Basic EPS:		
Income from continuing operations	\$ 0.03	\$ 0.10
Income from discontinued operations		0.06
Net income available to common shareholders	\$ 0.03	\$ 0.16
Diluted EPS:		
Income from continuing operations	\$ 0.03	\$ 0.09
Income from discontinued operations		0.06
Net income available to common shareholders	\$ 0.03	\$ 0.15

Our diluted EPS computations do not include the effects of the following securities since the conversions of such securities would increase diluted EPS for the respective periods:

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	Weighted Average Shares in Denominator For the Three Months Ended March 31,	
	2007	2006
Conversion of weighted average common units	8,411	8,520
Conversion of weighted average convertible preferred units	176	176
Conversion of weighted average convertible preferred shares	395	

The 3.5% Exchangeable Senior Notes did not affect our diluted EPS reported above since the weighted average closing price of our common shares during the period over which the notes were outstanding was less than \$54.30.

4. Recent Accounting Pronouncements

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. Our adoption of FIN 48 did not have a material effect on our financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The Statement does not require any new fair value measurements but does apply under other accounting pronouncements that require or permit fair value measurements. The changes to current practice resulting from the Statement relate to the definition of fair value, the methods used to measure fair value and the expanded disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with earlier application encouraged. We do not expect that the adoption of this Statement will have a material effect on our financial position, results of operations or cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently assessing the impact of SFAS 159 on our consolidated financial position and results of operations.

5. Commercial Real Estate Properties

Operating properties consisted of the following:

	March 31, 2007	December 31, 2006
Land	\$ 409,859	\$ 343,098
Buildings and improvements	1,904,154	1,689,359
	2,314,013	2,032,457
Less: accumulated depreciation	(233,703)	(219,574)
	\$ 2,080,310	\$ 1,812,883

At March 31, 2007, 429 Ridge Road, an office property located in Dayton, New Jersey that we were under contract to sell for \$17,000, was classified as held for sale (Dayton, New Jersey is located in the Northern/Central New Jersey Region). We expect to complete the sale of this property by January 2008. The components associated with 429 Ridge Road as of March 31, 2007 included the following:

	March 31, 2007
Land	\$ 2,932
Buildings and improvements	14,588
	17,520
Less: accumulated depreciation	(2,947)
	\$ 14,573

Projects we had under construction or development consisted of the following:

	March 31, 2007	December 31, 2006
Land	\$ 193,715	\$ 153,436
Construction in progress	185,579	144,991
	\$ 379,294	\$ 298,427

2007 Acquisitions

On January 9 and 10, 2007, we completed a series of transactions that resulted in the acquisition of 56 operating properties totaling approximately 2.4 million square feet and land parcels totaling 187 acres. We refer to these transactions collectively as the Nottingham Acquisition. All of the acquired properties are located in Maryland, with 36 of the operating properties, totaling 1.6 million square feet, and land parcels totaling 175 acres, located in White Marsh, Maryland (located in the Suburban Baltimore region) and the remaining properties and land parcels located in other regions in Northern Baltimore County and the Baltimore/Washington Corridor. We believe that the land parcels can support at least 2.0 million developable square feet. We completed the Nottingham Acquisition for an aggregate cost of \$366,830. The table below sets forth the allocation of the acquisition costs of the Nottingham Acquisition:

Land, operating properties	\$ 69,322
Land, construction or development	37,789
Building and improvements	211,194
Intangible assets on real estate acquisitions	53,214
Total assets	371,519
Deferred revenue associated with acquired operating leases	(4,689)
Total acquisition cost	\$ 366,830

Intangible assets recorded in connection with the Nottingham Acquisition include the following:

	Cost	Weighted Average Amortization Period (in Years)
Tenant relationship value	\$ 25,778	8
Lease-up value	19,425	4
Lease cost portion of deemed cost avoidance	4,206	5
Lease to market value	3,805	4
	\$ 53,214	6

2007 Construction and Development Activities

As of March 31, 2007, we had construction underway on four new buildings in the Baltimore/Washington Corridor (including one partially operational property owned through a 50% joint venture), two in Colorado Springs, Colorado and one each in Suburban Baltimore, Southwest Virginia and Chesterfield, Virginia. We also had development activities underway on five new buildings located in the Baltimore/Washington Corridor (including one owned through a joint venture), two in Suburban Baltimore, two in Suburban Maryland and one each

in King George County, Virginia and Colorado Springs, Colorado (we owned a 50% undivided interest in the Colorado Springs property until April 6, 2007, when we purchased the remaining 50%). In addition, we had redevelopment underway on two wholly owned existing buildings (one is located in the Baltimore/Washington Corridor and the other in Colorado Springs, Colorado) and two buildings owned by a joint venture (one is located in Northern Virginia and the other in the Baltimore/Washington Corridor).

6. Real Estate Joint Ventures

During the three months ended March 31, 2007, we had an investment in one unconsolidated real estate joint venture accounted for using the equity method of accounting. Information pertaining to this joint venture investment is set forth below.

	Investment Balance at March 31, 2007	December 31, 2006	Date Acquired	Owner- ship	Nature of Activity	Total Assets at 3/31/2007	Maximum Exposure to Loss (1)
Harrisburg Corporate Gateway Partners, L.P.	\$(3,797)(2)	\$(3,614)(2)	9/29/2005	20%	Operates 16 buildings(3)	\$75,190	

(1) Derived from the sum of our investment balance and maximum additional unilateral capital contributions or loans required from us. Not reported above are additional amounts that we and our partner are required to fund when needed by this joint venture; these funding requirements are proportional to our respective ownership percentages. Also not reported above are additional unilateral contributions or loans from us, the amounts of which are uncertain, which we would be required to make if certain contingent events occur.

(2) The carrying amount of our investment in this joint venture was lower than our share of the equity in the joint venture by \$4,860 at March 31, 2007 and \$5,072 at December 31, 2006 due to our deferral of gain on the contribution by us of real estate into the joint venture upon its formation. A difference will continue to exist to the extent the nature of our continuing involvement in the joint venture remains the same.

(3) This joint venture's properties are located in Greater Harrisburg, Pennsylvania.

The following table sets forth condensed balance sheets for Harrisburg Corporate Gateway Partners, L.P.:

	March 31, 2007	December 31, 2006
Commercial real estate property	\$ 72,199	\$ 72,688
Other assets	2,991	3,207
Total assets	\$ 75,190	\$ 75,895
Liabilities	\$ 68,149	\$ 67,350
Owners' equity	7,041	8,545
Total liabilities and owners' equity	\$ 75,190	\$ 75,895

The following table sets forth a combined condensed statement of operations for Harrisburg Corporate Gateway Partners, L.P. for the three months ended March 31, 2007:

Revenues	\$ 2,444
Property operating expenses	(960)
Interest expense	(1,138)
Depreciation and amortization expense	(867)
Net loss	\$ (521)

Our investments in consolidated real estate joint ventures included the following:

	Date Acquired	Ownership % at 3/31/2007	Nature of Activity	Total Assets at 3/31/2007	Collateralized Assets at 3/31/2007
COPT Opportunity Invest I, LLC	12/20/2005	92.5%	Redeveloping two properties (1)	\$ 44,919	\$
Commons Office 6-B, LLC	2/10/2006	50.0%	Developing land parcel (2)	7,466	7,430
MOR Forbes 2 LLC	12/24/2002	50.0%	Operates one building (3)	4,074	3,697
COPT-FD Indian Head, LLC	10/23/2006	75.0%	Developing land parcel (4)	3,003	
				\$ 59,462	\$ 11,127

- (1) This joint venture owns one property in the Northern Virginia region and one in the Baltimore/Washington Corridor region.
- (2) This joint venture's property is located in Hanover, Maryland (located in the Baltimore/Washington Corridor region).
- (3) This joint venture's property is located in Lanham, Maryland (located in the Suburban Maryland region).
- (4) This joint venture's property is located in Charles County, Maryland (located in our other business segment).

Our commitments and contingencies pertaining to our real estate joint ventures are disclosed in Note 20.

7. Intangible Assets on Real Estate Acquisitions

Intangible assets on real estate acquisitions consisted of the following:

	March 31, 2007			December 31, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Lease-up value	\$ 125,144	\$ 43,900	\$ 81,244	\$ 105,719	\$ 38,279	\$ 67,440
Tenant relationship value	35,149	2,691	32,458	9,371	1,178	8,193
Lease cost portion of deemed cost avoidance	17,086	6,591	10,495	12,880	5,819	7,061
Lease to market value	14,428	7,869	6,559	10,623	7,178	3,445
Market concentration premium	1,333	155	1,178	1,333	147	1,186
	\$ 193,140	\$ 61,206	\$ 131,934	\$ 139,926	\$ 52,601	\$ 87,325

Amortization of the intangible asset categories set forth above totaled \$8,628 in the three months ended March 31, 2007 and \$5,017 in the three months ended March 31, 2006. The approximate weighted average amortization periods of the categories set forth below follow: lease-up value: nine years; tenant relationship value: eight years; lease cost portion of deemed cost avoidance: six years; lease to market value: five years; and market concentration premium: 35 years. The approximate weighted average amortization period for all of the categories combined is nine years. Estimated amortization expense associated with the intangible asset categories set forth above for the nine months ended December 31, 2007 is \$20.1 million, for 2008 is \$21.8 million, for 2009 is \$19.1 million, for 2010 is \$14.8 million, for 2011 is \$11.9 million and for 2012 is \$9.6 million.

8. Deferred Charges

Deferred charges consisted of the following:

March 31, 2007	December 31, 2006
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Deferred leasing costs	\$ 55,716	\$ 52,263
Deferred financing costs	28,837	28,275
Goodwill	1,853	1,853
Deferred other	155	155
	86,561	82,546
Accumulated amortization	(41,065)	(38,836)
Deferred charges, net	\$ 45,496	\$ 43,710

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9. Accounts Receivable

Our accounts receivable are reported net of an allowance for bad debts of \$286 at March 31, 2007 and \$252 at December 31, 2006.

10. Prepaid and Other Assets

Prepaid and other assets consisted of the following:

	March 31, 2007	December 31, 2006
Construction contract costs incurred in excess of billings	\$ 19,194	\$ 18,324
Furniture, fixtures and equipment	10,587	10,495
Prepaid expenses	7,714	9,059
Other assets	15,816	10,589
Prepaid and other assets	\$ 53,311	\$ 48,467

11. Debt

Our debt consisted of the following:

	Maximum			Stated Interest Rates at		Scheduled Maturity Dates at	
	Principal Amount Under Debt at March 31, 2007	Carrying Value at March 31, 2007	December 31, 2006	March 31, 2007		March 31, 2007	
Mortgage and other loans payable:							
<u>Revolving Credit Facility</u>							
Wachovia Bank, N.A. Revolving Credit Facility	\$ 500,000	\$ 264,000	\$ 185,000	LIBOR + 1.15% to 1.55%		March 2008 (1)	
<u>Mortgage Loans</u>							
Fixed rate mortgage loans (2)	N/A	1,048,913	1,020,619	5.20% 9.48% (3)		2007	2034 (4)
Variable rate construction loan facilities	122,447	76,324	56,079	LIBOR + 1.40% to 2.20%		2007	2008 (5)
Other variable rate mortgage loans	N/A	123,615	34,500	LIBOR + 1.20% to 1.50%		2007 (6)	
Total mortgage loans		1,248,852	1,111,198				
<u>Note payable</u>							
Unsecured seller notes	N/A	2,331	2,339	0% 5.95%		2007-2008	
Total mortgage and other loans payable		1,515,183	1,298,537				
3.5% Exchangeable Senior Notes	N/A	200,000	200,000	3.50%		September 2026(7)	
Total debt		\$ 1,715,183	\$ 1,498,537				

(1) The Revolving Credit Facility may be extended for a one-year period, subject to certain conditions.

(2) Several of the fixed rate mortgages carry interest rates that were above or below market rates upon assumption and therefore are recorded at their fair value based on applicable effective interest rates. The carrying values of these loans reflect net premiums totaling \$839 at March 31, 2007 and \$210 at December 31, 2006.

(3) The weighted average interest rate on these loans was 6.05% at March 31, 2007.

(4) A loan with a balance of \$4,874 at March 31, 2007 that matures in 2034 may be repaid in March 2014, subject to certain conditions.

(5) At March 31, 2007, \$53,505 in loans scheduled to mature in 2008 may be extended for a one-year period, subject to certain conditions.

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- (6) At March 31, 2007, a \$34,500 loan scheduled to mature in 2007 may be extended for a one-year period, subject to certain conditions.
- (7) Refer to our 2006 Annual Report on Form 10-K for descriptions of provisions for early redemption and repurchase of these notes.

We capitalized interest costs of \$4,132 in the three months ended March 31, 2007 and \$3,130 in three months ended March 31, 2006.

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12. Derivatives

The following table sets forth our derivative contracts at March 31, 2007 and their respective fair values:

Nature of Derivative	Notional Amount	One-Month LIBOR base	Effective Date	Expiration Date	Fair Value at March 31, 2007	December 31, 2006
Interest rate swap	\$ 50,000	5.0360	% 3/28/2006	3/30/2009	\$ (174)	\$ (42)
Interest rate swap	25,000	5.2320	% 5/1/2006	5/1/2009	(191)	(133)
Interest rate swap	25,000	5.2320	% 5/1/2006	5/1/2009	(191)	(133)
					\$ (556)	\$ (308)

We designated these derivatives as cash flow hedges. These contracts hedge the risk of changes in interest rates on certain of our one-month LIBOR-based variable rate borrowings until their respective maturities.

The table below sets forth our accounting application of changes in derivative fair values:

	For the Three Months Ended	
	March 31, 2007	2006
(Decrease) increase in fair value applied to accumulated other comprehensive loss and minority interests	\$ (248)	\$ 110

13. Shareholders Equity**Preferred Shares**

Preferred shares of beneficial interest (preferred shares) consisted of the following:

	March 31, 2007	December 31, 2006
2,200,000 designated as Series G Cumulative Redeemable Preferred Shares of beneficial interest (2,200,000 shares issued with an aggregate liquidation preference of \$55,000)	\$ 22	\$ 22
2,000,000 designated as Series H Cumulative Redeemable Preferred Shares of beneficial interest (2,000,000 shares issued with an aggregate liquidation preference of \$50,000)	20	20
3,390,000 designated as Series J Cumulative Redeemable Preferred Shares of beneficial interest (3,390,000 shares issued with an aggregate liquidation preference of \$84,750)	34	34
531,667 designated as Series K Cumulative Redeemable Convertible Preferred Shares of beneficial interest (531,667 shares issued with an aggregate liquidation preference of \$26,583)	5	
Total preferred shares	\$ 81	\$ 76

We issued the Series K Cumulative Redeemable Convertible Preferred Shares of beneficial interest (the Series K Preferred Shares) in the Nottingham Acquisition at a value of, and liquidation preference equal to, \$50 per share. The Series K Preferred Shares are nonvoting, redeemable for cash at \$50 per share at our option on or after January 9, 2017, and are convertible, subject to certain conditions, into common shares on the basis of 0.8163 common shares for each preferred share, in accordance with the terms of the Articles Supplementary describing the Series K Preferred Shares. Holders of the Series K Preferred Shares are entitled to cumulative dividends, payable quarterly (as and if declared by our Board of Trustees). Dividends accrue from the date of issue at the annual rate of \$2.80 per share, which is equal to 5.6% of the \$50 per share liquidation preference.

Common Shares

In connection with the Nottingham Acquisition in January 2007, we issued 3,161,000 common shares at a value of \$49.57 per share.

During the three months ended March 31, 2007, we converted 221,350 common units in our Operating Partnership into common shares on the basis of one common share for each common unit.

See Note 17 for disclosure of common share activity pertaining to our share-based compensation plans.

Accumulated Other Comprehensive Loss

The table below sets forth activity in the AOCL component of shareholders' equity:

	For the Three Months Ended March 31,	
	2007	2006
Beginning balance	\$ (693)	\$ (482)
Unrealized (loss) gain on derivatives, net of minority interests	(223)	90
Realized loss on derivatives, net of minority interests	13	12
Ending balance	\$ (903)	\$ (380)

The table below sets forth our comprehensive income:

	For the Three Months Ended March 31,	
	2007	2006
Net income	\$ 5,547	\$ 9,937
Unrealized (loss) gain on derivatives, net of minority interests	(223)	90
Realized loss on derivatives, net of minority interests	13	12
Total comprehensive income	\$ 5,337	\$ 10,039

14. Dividends and Distributions

The following table summarizes our dividends and distributions when either the payable dates or record dates occurred during the three months ended March 31, 2007:

	Record Date	Payable Date	Dividend/ Distribution Per Share/Unit	Total Dividend/ Distribution
Series G Preferred Shares:				
Fourth Quarter 2006	December 29, 2006	January 17, 2007	\$ 0.5000	\$ 1,100
First Quarter 2007	March 30, 2007	April 17, 2007	\$ 0.5000	\$ 1,100
Series H Preferred Shares:				
Fourth Quarter 2006	December 29, 2006	January 17, 2007	\$ 0.4688	\$ 938
First Quarter 2007	March 30, 2007	April 17, 2007	\$ 0.4688	\$ 938
Series J Preferred Shares:				
Fourth Quarter 2006	December 29, 2006	January 17, 2007	\$ 0.4766	\$ 1,616
First Quarter 2007	March 30, 2007	April 17, 2007	\$ 0.4766	\$ 1,616
Series K Preferred Shares:				
First Quarter 2007	March 30, 2007	April 17, 2007	\$ 0.7466	\$ 397
Common Shares:				
Fourth Quarter 2006	December 29, 2006	January 17, 2007	\$ 0.3100	\$ 13,292
First Quarter 2007	March 30, 2007	April 17, 2007	\$ 0.3100	\$ 14,529
Series I Preferred Units:				
Fourth Quarter 2006	December 29, 2006	January 17, 2007	\$ 0.4688	\$ 165
First Quarter 2007	March 30, 2007	April 17, 2007	\$ 0.4688	\$ 165
Common Units:				
Fourth Quarter 2006	December 29, 2006	January 17, 2007	\$ 0.3100	\$ 2,622
First Quarter 2007	March 30, 2007	April 17, 2007	\$ 0.3100	\$ 2,554

15. Supplemental Information to Statements of Cash Flows

	For the Three Months Ended March 31,	
	2007	2006
Supplemental schedule of non-cash investing and financing activities:		
Debt assumed in connection with acquisition of properties	\$ 38,848	\$
(Decrease) increase in accrued capital improvements and leasing costs	\$ (2,600)	\$ 6,307
Amortization of discounts and premiums on mortgage loans to commercial real estate properties	\$ 255	\$ 45
(Decrease) increase in fair value of derivatives applied to AOCL and minority interests	\$ (248)	\$ 110
Issuance of common shares in connection with acquisition of properties	\$ 156,691	\$
Issuance of preferred shares in connection with acquisition of properties	\$ 26,583	\$
Restricted cash used in connection with acquisition of properties	\$ 20,122	\$
Adjustments to minority interests resulting from changes in ownership of Operating Partnership by COPT	\$ 26,511	\$ 778
Dividends/distribution payable	\$ 20,687	\$ 16,878
Decrease in minority interests and increase in shareholders' equity in connection with the conversion of common units into common shares	\$ 10,563	\$ 1,945

16. Information by Business Segment

As of March 31, 2007, we had nine primary office property segments: Baltimore/Washington Corridor; Northern Virginia; Suburban Baltimore; Colorado Springs, Suburban Maryland; Greater Philadelphia; St. Mary's and King George Counties; San Antonio; and Northern/Central New Jersey.

The table below reports segment financial information. Our segment entitled "Other" includes assets and operations not specifically associated with the other defined segments, including corporate assets, investments in unconsolidated entities and elimination entries required in consolidation. We measure the performance of our segments based on total revenues less property operating expenses, a measure we define as net operating income ("NOI"). We believe that NOI is an important supplemental measure of operating performance for a REIT's operating real estate because it provides a measure of the core operations that is unaffected by depreciation, amortization, financing and general and administrative expenses; this measure is particularly useful in our opinion in evaluating the performance of geographic segments, same-office property groupings and individual properties.

	Baltimore/ Washington Corridor	Northern Virginia	Suburban Baltimore	Colorado Springs	Suburban Maryland	Greater Philadelphia	St. Mary's & King George Counties	San Antonio	Northern/ Central New Jersey	Other	Total
Three Months Ended											
March 31, 2007											
Revenues	\$ 43,837	\$ 17,172	\$ 13,081	\$ 3,595	\$ 3,967	\$ 2,506	\$ 3,098	\$ 1,781	\$ 1,786	\$ (428)	\$ 90,395
Property operating expenses	14,526	6,328	5,771	1,280	1,663	33	771	359	697	596	32,024
NOI	\$ 29,311	\$ 10,844	\$ 7,310	\$ 2,315	\$ 2,304	\$ 2,473	\$ 2,327	\$ 1,422	\$ 1,089	\$ (1,024)	\$ 58,371
Additions to commercial real estate properties	\$ 77,115	\$ 10,852	\$ 261,734	\$ 3,803	\$ 496	\$ 232	\$ 69	\$ (34)	\$ 254	\$ 25,421	\$ 379,942
Segment assets at March 31, 2007	\$ 1,153,457	\$ 480,989	\$ 462,330	\$ 137,948	\$ 117,496	\$ 97,306	\$ 96,884	\$ 57,250	\$ 44,486	\$ 166,577	\$ 2,814,723
Three Months Ended											
March 31, 2006											
Revenues	\$ 34,393	\$ 15,573	\$ 7,357	\$ 1,289	\$ 3,553	\$ 2,505	\$ 2,988	\$ 1,810	\$ 2,893	\$ (182)	\$ 72,179
Property operating expenses	10,369	5,490	2,840	491	1,317	40	691	333	985	(489)	22,067
NOI	\$ 24,024	\$ 10,083	\$ 4,517	\$ 798	\$ 2,236	\$ 2,465	\$ 2,297	\$ 1,477	\$ 1,908	\$ 307	\$ 50,112
Additions to commercial real estate properties	\$ 31,563	\$ 3,123	\$ 871	\$ 5,833	\$ 404	\$ 338	\$ 311	\$ 7,702	\$ 587	\$ (268)	\$ 50,464
Segment assets at March 31, 2006	\$ 925,067	\$ 462,441	\$ 187,732	\$ 69,086	\$ 114,873	\$ 99,029	\$ 98,818	\$ 51,570	\$ 58,203	\$ 76,056	\$ 2,142,875

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The following table reconciles our segment revenues to total revenues as reported on our Consolidated Statements of Operations:

	For the Three Months Ended March 31,	
	2007	2006
Segment revenues	\$ 90,395	\$ 72,179
Construction contract revenues	8,691	14,544
Other service operations revenues	1,386	1,765
Less: Revenues from discontinued real estate operations (Note 19)	(720)	(2,957)
Total revenues	\$ 99,752	\$ 85,531

The following table reconciles our segment property operating expenses to property operating expenses as reported on our Consolidated Statements of Operations:

	For the Three Months Ended March 31,	
	2007	2006
Segment property operating expenses	\$ 32,024	\$ 22,067
Less: Property operating expenses from discontinued real estate operations (Note 19)	(276)	(1,006)
Total property operating expenses	\$ 31,748	\$ 21,061

The following table reconciles our NOI for reportable segments to income from continuing operations as reported on our Consolidated Statements of Operations:

	For the Three Months Ended March 31,	
	2007	2006
NOI for reportable segments	\$ 58,371	\$ 50,112
Construction contract revenues	8,691	14,544
Other service operations revenues	1,386	1,765
Equity in loss of unconsolidated entities	(94)	(23)
Income tax expense	(105)	(215)
Less:		
Depreciation and other amortization associated with real estate operations	(26,569)	(18,672)
Construction contract expenses	(8,483)	(14,026)
Other service operations expenses	(1,405)	(1,678)
General and administrative expenses	(4,614)	(3,963)
Interest expense on continuing operations	(19,876)	(17,029)
Amortization of deferred financing costs	(884)	(556)
Minority interests in continuing operations	(426)	(958)
NOI from discontinued operations	(444)	(1,951)
Income from continuing operations	\$ 5,548	\$ 7,350

The accounting policies of the segments are the same as those previously disclosed for Corporate Office Properties Trust and subsidiaries, where applicable. We did not allocate interest expense, amortization of deferred financing costs and depreciation and other amortization to segments since they are not included in the measure of segment profit reviewed by management. We also did not allocate construction contract

revenues, other service operations revenues, construction contract expenses, other service operations expenses, equity in loss of unconsolidated entities, general and administrative expense, income taxes and minority interests because these items represent general corporate items not attributable to segments.

17. Share-Based Compensation

During the three months ended March 31, 2007, we granted to employees 226,660 options to purchase common shares with a weighted average exercise price of \$49.25 per share. All of these options vest in equal increments annually over a three-year period beginning on the first anniversary of the grant date provided that the employees remain employed by us, and they expire ten years after the grant date. We computed share-based compensation expense for these options under the fair value method using the Black-Scholes option-pricing model; the weighted average assumptions we used in that model are set forth below:

Weighted average fair value per share option granted during the period	\$ 9.85	
Risk-free interest rate	4.61	%(1)
Expected life (in years)	6.25	
Expected volatility	21.51	%(2)
Expected annual dividend yield	3.27	%(3)

(1) Ranged from 4.53% to 4.91%.

(2) Ranged from 21.41% to 21.75%.

(3) Ranged from 3.21% to 3.35%.

During the three months ended March 31, 2007, 469,918 options to purchase common shares were exercised. The weighted average exercise price of these options was \$10.92 per share, and the total intrinsic value of options exercised was \$19,642.

During the three months ended March 31, 2007, certain employees were granted 128,776 restricted shares with a weighted average grant date fair value of \$50.57 per share. All of these shares are subject to forfeiture restrictions that lapse in equal increments annually over a three-year period beginning on the first anniversary of the grant date provided that the employees remain employed by us. During the three months ended March 31, 2007, forfeiture restrictions lapsed on 126,619 common shares previously issued to employees. These shares had a weighted average grant date fair value of \$21.97 per share, and the total fair value of the shares on the vesting date was \$6,514.

Expenses from share-based compensation are reflected in our Consolidated Statements of Operations as follows:

	For the Three Months Ended March 31,	
	2007	2006
Increase in general and administrative expenses	\$ 879	\$ 469
Increase in construction contract and other service operations expenses	354	144
Share-based compensation expense	1,233	613
Income taxes	(35)	(17)
Minority interests	(193)	(109)
Net share-based compensation expense	\$ 1,005	\$ 487

18. Income Taxes

COMI's provision for income tax expense consisted of the following:

	For the Three Months Ended March 31,	
	2007	2006
Deferred		
Federal	\$ 86	\$ 176
State	19	39
Total	\$ 105	\$ 215

Items contributing to temporary differences that lead to deferred taxes include net operating losses that are not deductible until future periods, depreciation and amortization, certain accrued compensation and compensation paid in the form of contributions to a deferred nonqualified compensation plan.

COMI's combined Federal and state effective tax rate was 39% for the three months ended March 31, 2007 and 2006.

19. Discontinued Operations

Income from discontinued operations includes revenues and expenses associated with the following:

- the two Lakeview at the Greens properties that were sold on February 6, 2006;
- the 68 Culver Road property that was sold on March 8, 2006;
- the 710 Route 46 property that was sold on July 26, 2006;
- the 230 Schilling Circle property that was sold on August 9, 2006;
- the 7 Centre Drive property that was sold on August 30, 2006;
- the Brown's Wharf property that was sold on September 28, 2006; and
- the 429 Ridge Road property which, as of March 31, 2007, we were under contract to sell, and was classified as held for sale.

The table below sets forth the components of income from discontinued operations:

	For the Three Months Ended March 31,	
	2007	2006
Revenue from real estate operations	\$ 720	\$ 2,957
Expenses from real estate operations:		
Property operating expenses	276	1,006
Depreciation and amortization	57	665
Interest expense	388	686
Other		3
Expenses from real estate operations	721	2,360
Income from discontinued operations before gain on sales of real estate and minority interests	(1)	597
Gain on sales of real estate		2,435
Minority interests in discontinued operations		(555)
Income from discontinued operations, net of minority interests	\$ (1)	\$ 2,477

20. Commitments and Contingencies

In the normal course of business, we are involved in legal actions arising from our ownership and administration of properties. Management does not anticipate that any liabilities that may result will have a materially adverse effect on our financial position, operations or liquidity. We are subject to various Federal, state and local environmental regulations related to our property ownership and operation. We have performed environmental assessments of our properties, the results of which have not revealed any environmental liability that we believe would have a materially adverse effect on our financial position, operations or liquidity.

Acquisitions

As of March 31, 2007, we were under contract to acquire the following properties:

- a parcel of land in Aberdeen, Maryland for \$10,000, of which we paid a deposit of \$100 in 2006; and
- the remaining 91 acres of land not yet acquired as part of the acquisition of the former Fort Ritchie United States Army base located in Cascade, Washington County, Maryland; we expect to make the following additional future cash payments to the seller for (1) the acquisition of the remaining 91 acres and (2) portions of the contract price on which payment was deferred by the contract: \$1,310 in 2007, \$1,000 in 2008 and \$155 in 2009. We could incur an additional cash obligation to the seller after that of up to \$4,000; this \$4,000 cash obligation is subject to reduction by an amount ranging between \$750 and \$4,000, with the amount of such reduction to be determined based on defined levels of (1) job creation resulting from the future development of the property and (2) future real estate taxes generated by the property. Following completion of this acquisition, we will be obligated to incur \$7,500 in development and construction costs for the property.

Joint Ventures

As part of our obligations under the partnership agreement of Harrisburg Corporate Gateway Partners, LP, we may be required to make unilateral payments to fund rent shortfalls on behalf of a tenant that was in bankruptcy at the time the partnership was formed. Our total unilateral commitment under this guaranty is approximately \$153; the tenant's account was current as of March 31, 2007. We also agreed to indemnify the partnership's lender for 80% of any losses under standard nonrecourse loan guarantees (environmental indemnifications and guarantees against fraud and misrepresentation) during the period of time in which we manage the partnership's properties; we do not expect to incur any losses under these loan guarantees.

We are party to a contribution agreement that formed a joint venture relationship with a limited partnership to develop up to 1.8 million square feet of office space on 63 acres of land located in Hanover, Maryland. Under the contribution agreement, we agreed to fund up to \$2,200 in pre-construction costs associated with the property. As we and the joint venture partner agree to proceed with the construction of buildings in the future, we would make additional cash capital contributions into newly-formed entities and our joint venture partner would contribute land into such entities. We will have a 50% interest in this joint venture relationship.

We may need to make our pro rata share of additional investments in our real estate joint ventures (generally based on our percentage ownership) in the event that additional funds are needed. In the event that the other members of these joint ventures do not pay their share of investments when additional funds are needed, we may then need to make even larger investments in these joint ventures.

In two of the consolidated joint ventures that we owned as of March 31, 2007, we would be obligated to acquire the other members' 50% interests in the joint ventures if defined events were to occur. The amounts we would need to pay for those membership interests are computed based on the amounts that the owners of the interests would receive under the joint venture agreements in the event that office properties owned by the joint ventures were sold for a capitalized fair value (as defined in the agreements) on a defined date. We estimate the aggregate amount we would need to pay for the other members' membership

interests in these joint ventures to be \$2,383; however, since the determination of this amount is dependent on the operations of the office properties, which are not both completed and sufficiently occupied, this estimate is preliminary and could be materially different from the actual obligation.

Ground Lease

On April 4, 2006, we entered into a 62-year ground lease agreement on a six-acre land parcel on which we expect to construct a 110,000 square foot property. We paid \$550 to the lessor upon lease execution and expect to pay an additional amount of approximately \$1,898 in rent under the lease in 2007. No other rental payments are required over the life of the lease, although we are responsible for expenses associated with the property. We will recognize the total lease payments incurred under the lease evenly over the term of the lease

Office Space Operating Leases

We are obligated as lessee under five operating leases for office space. Future minimum rental payments due under the terms of these leases as of March 31, 2007 follow:

Nine months ended December 31, 2007	\$ 212
2008	261
2009	176
2010	135
2011	57
	\$ 841

Other Operating Leases

We are obligated under various leases for vehicles and office equipment. Future minimum rental payments due under the terms of these leases as of March 31, 2007 follow:

Nine months ended December 31, 2007	\$ 426
2008	493
2009	317
2010	142
2011	21
	\$ 1,399

Environmental Indemnity Agreement

We agreed to provide certain environmental indemnifications in connection with a lease of three properties in our New Jersey region. The prior owner of the properties, a Fortune 100 company that is responsible for groundwater contamination at such properties, previously agreed to indemnify us for (1) direct losses incurred in connection with the contamination and (2) its failure to perform remediation activities required by the State of New Jersey, up to the point that the state declares the remediation to be complete. Under the lease agreement, we agreed to the following:

- to indemnify the tenant against losses covered under the pri