

CORPORATE OFFICE PROPERTIES TRUST
Form 10-Q
July 31, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q
(Mark one)

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

For the quarterly period ended June 30, 2018
or

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

For the transition period from to

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

(Exact name of registrant as specified in its charter)

Corporate Office Properties Trust	Maryland	23-2947217
	(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

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

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

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

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

Corporate Office Properties Trust ☒ Yes ☐ No
Corporate Office Properties, L.P. ☒ Yes ☐ No

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

Corporate Office Properties Trust ☒ Yes ☐ No

Corporate Office Properties, L.P. ☒ Yes ☐ No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐ Emerging growth company ☐
(Do not check if a smaller reporting company)

Corporate Office Properties, L.P.

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

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

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

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

Corporate Office Properties Trust ☐ Yes ☒ No
Corporate Office Properties, L.P. ☐ Yes ☒ No

As of July 20, 2018, 103,263,449 of Corporate Office Properties Trust’s Common Shares of Beneficial Interest, \$0.01 par value, were issued and outstanding.

EXPLANATORY NOTE

This report combines the quarterly reports on Form 10-Q for the period ended June 30, 2018 of Corporate Office Properties Trust (“COPT”) and subsidiaries (collectively, the “Company”) and Corporate Office Properties, L.P. (“COPLP”) and subsidiaries (collectively, the “Operating Partnership”). Unless stated otherwise or the context otherwise requires, “we,” “our,” and “us” refer collectively to COPT, COPLP and their subsidiaries.

COPT is a real estate investment trust, or REIT, and the sole general partner of COPLP. As of June 30, 2018, COPT owned approximately 97.0% of the outstanding common units in COPLP; the remaining common units and all of the outstanding COPLP preferred units 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 two operate as an interrelated, consolidated company. COPT is a REIT 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 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, 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 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, investors 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 4, Fair Value Measurements of COPT and subsidiaries and COPLP and subsidiaries; and
 - Note 15, Earnings per Share of COPT and subsidiaries and Earnings per Unit of COPLP and subsidiaries;
- "Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources of COPT"; and
- "Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources of COPLP."

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

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PART I: FINANCIAL INFORMATION

ITEM 1. Financial Statements

Corporate Office Properties Trust and Subsidiaries

Consolidated Balance Sheets

(in thousands, except share data)

(unaudited)

	June 30, 2018	December 31, 2017
Assets		
Properties, net:		
Operating properties, net	\$2,760,632	\$2,737,611
Projects in development or held for future development	422,905	403,494
Total properties, net	3,183,537	3,141,105
Assets held for sale, net	42,226	42,226
Cash and cash equivalents	8,472	12,261
Investment in unconsolidated real estate joint venture	40,806	41,787
Accounts receivable (net of allowance for doubtful accounts of \$811 and \$607, respectively)	23,656	31,802
Deferred rent receivable (net of allowance of \$423 and \$364, respectively)	89,606	86,710
Intangible assets on real estate acquisitions, net	50,586	59,092
Deferred leasing costs (net of accumulated amortization of \$29,546 and \$29,560, respectively)	48,183	48,322
Investing receivables	54,427	57,493
Prepaid expenses and other assets, net	70,863	74,407
Total assets	\$3,612,362	\$3,595,205
Liabilities and equity		
Liabilities:		
Debt, net	\$1,871,445	\$1,828,333
Accounts payable and accrued expenses	88,885	108,137
Rents received in advance and security deposits	24,905	25,648
Dividends and distributions payable	29,449	28,921
Deferred revenue associated with operating leases	10,783	11,682
Deferred property sale	43,377	43,377
Capital lease obligation	640	15,853
Other liabilities	9,849	41,822
Total liabilities	2,079,333	2,103,773
Commitments and contingencies (Note 16)		
Redeemable noncontrolling interests	24,544	23,125
Equity:		
Corporate Office Properties Trust's shareholders' equity:		
Common Shares of beneficial interest (\$0.01 par value; 150,000,000 shares authorized; shares issued and outstanding of 103,260,495 at June 30, 2018 and 101,292,299 at December 31, 2017)	1,033	1,013
Additional paid-in capital	2,254,430	2,201,047
Cumulative distributions in excess of net income	(822,270)	(802,085)
Accumulated other comprehensive income	9,012	2,167
Total Corporate Office Properties Trust's shareholders' equity	1,442,205	1,402,142

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Noncontrolling interests in subsidiaries:

Common units in COPLP	44,651	45,097
Preferred units in COPLP	8,800	8,800
Other consolidated entities	12,829	12,268
Noncontrolling interests in subsidiaries	66,280	66,165
Total equity	1,508,485	1,468,307
Total liabilities, redeemable noncontrolling interests and equity	\$3,612,362	\$3,595,205

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 June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues				
Rental revenue	\$ 101,121	\$ 101,347	\$ 201,955	\$ 201,962
Tenant recoveries and other real estate operations revenue	28,041	26,950	55,485	53,102
Construction contract and other service revenues	17,581	23,138	44,779	36,172
Total revenues	146,743	151,435	302,219	291,236
Expenses				
Property operating expenses	49,446	48,628	100,397	97,147
Depreciation and amortization associated with real estate operations	33,190	32,793	66,702	65,852
Construction contract and other service expenses	16,941	22,315	43,157	34,801
Impairment losses	—	1,625	—	1,625
General, administrative and leasing expenses	7,628	7,859	14,920	16,470
Business development expenses and land carry costs	1,234	1,597	2,848	3,290
Total operating expenses	108,439	114,817	228,024	219,185
Operating income	38,304	36,618	74,195	72,051
Interest expense	(18,945)	(19,163)	(37,729)	(38,157)
Interest and other income	1,439	1,583	2,798	3,309
Loss on early extinguishment of debt	—	(513)	—	(513)
Income before equity in income of unconsolidated entities and income taxes	20,798	18,525	39,264	36,690
Equity in income of unconsolidated entities	373	370	746	747
Income tax expense	(63)	(48)	(118)	(88)
Income before gain on sales of real estate	21,108	18,847	39,892	37,349
Gain on sales of real estate	(23)	12	(27)	4,250
Net income	21,085	18,859	39,865	41,599
Net income attributable to noncontrolling interests:				
Common units in COPLP	(608)	(261)	(1,152)	(883)
Preferred units in COPLP	(165)	(165)	(330)	(330)
Other consolidated entities	(878)	(907)	(1,799)	(1,841)
Net income attributable to COPT	19,434	17,526	36,584	38,545
Preferred share dividends	—	(3,039)	—	(6,219)
Issuance costs associated with redeemed preferred shares	—	(6,847)	—	(6,847)
Net income attributable to COPT common shareholders	\$ 19,434	\$ 7,640	\$ 36,584	\$ 25,479
Earnings per common share:				
Net income attributable to COPT common shareholders - basic	\$ 0.19	\$ 0.08	\$ 0.36	\$ 0.26
Net income attributable to COPT common shareholders - diluted	\$ 0.19	\$ 0.08	\$ 0.36	\$ 0.26
Dividends declared per common share	\$ 0.275	\$ 0.275	\$ 0.550	\$ 0.550

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$21,085	\$18,859	\$39,865	\$41,599
Other comprehensive income				
Unrealized gain (loss) on interest rate derivatives	1,912	(1,800)	6,588	(1,576)
(Gain) loss on interest rate derivatives recognized in interest expense	(47)	941	198	2,125
Equity in other comprehensive income of equity method investee	—	39	—	39
Other comprehensive income (loss)	1,865	(820)	6,786	588
Comprehensive income	22,950	18,039	46,651	42,187
Comprehensive income attributable to noncontrolling interests	(1,708)	(1,306)	(3,498)	(3,074)
Comprehensive income attributable to COPT	\$21,242	\$16,733	\$43,153	\$39,113

See accompanying notes to consolidated financial statements.

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

	Preferred Shares	Common Shares	Additional Paid-in Capital	Cumulative Distributions in Excess of Net Income	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total
Balance at December 31, 2016 (98,498,651 common shares outstanding)	\$172,500	\$985	\$2,116,581	\$ (747,825)	\$ (1,731)	\$ 72,267	\$1,612,777
Redemption of preferred shares (6,900,000 shares)	(172,500)	—	6,847	(6,847)	—	—	(172,500)
Conversion of common units to common shares (187,000 shares)	—	2	2,562	—	—	(2,564)	—
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 (189,948 shares issued, net of redemptions)	—	2	3,045	—	—	—	3,047
Redemption of vested equity awards	—	—	(1,813)	—	—	—	(1,813)
Adjustments to noncontrolling interests resulting from changes in ownership of COPLP	—	—	(514)	—	—	514	—
Comprehensive income	—	—	—	38,545	568	1,934	41,047
Dividends	—	—	—	(60,922)	—	—	(60,922)
Distributions to owners of common and preferred units in COPLP	—	—	—	—	—	(2,202)	(2,202)
Distributions to noncontrolling interests in other consolidated entities	—	—	—	—	—	(2,610)	(2,610)
Adjustment to arrive at fair value of redeemable noncontrolling interests	—	—	(401)	—	—	—	(401)
Balance at June 30, 2017 (99,471,641 common shares outstanding)	\$—	\$995	\$2,146,119	\$ (777,049)	\$ (1,163)	\$ 67,339	\$1,436,241
Balance at December 31, 2017 (101,292,299 common shares outstanding)	\$—	\$1,013	\$2,201,047	\$ (802,085)	\$ 2,167	\$ 66,165	\$1,468,307

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Cumulative effect of accounting change for adoption of hedge accounting guidance	—	—	—	(276	) 276	—	—	
Balance at December 31, 2017, as adjusted	—	1,013	2,201,047	(802,361	) 2,443	66,165	1,468,307	
Conversion of common units to common shares (53,817 shares)	—	1	760	—	—	(761	) —	
Common shares issued under forward equity sale agreements (1,777,000 shares)	—	18	52,209	—	—	—	52,227	
Share-based compensation (137,379 shares issued, net of redemptions)	—	1	3,399	—	—	—	3,400	
Redemption of vested equity awards	—	—	(1,525	) —	—	—	(1,525	)
Adjustments to noncontrolling interests resulting from changes in ownership of COPLP	—	—	(702	) —	—	702	—	
Comprehensive income	—	—	—	36,584	6,569	2,269	45,422	
Dividends	—	—	—	(56,493	) —	—	(56,493	)
Distributions to owners of common and preferred units in COPLP	—	—	—	—	—	(2,088	) (2,088	)
Distributions to noncontrolling interests in other consolidated entities	—	—	—	—	—	(7	) (7	)
Adjustment to arrive at fair value of redeemable noncontrolling interests	—	—	(758	) —	—	—	(758	)
Balance at June 30, 2018 (103,260,495 common shares outstanding)	\$—	\$ 1,033	\$ 2,254,430	\$ (822,270	) \$ 9,012	\$ 66,280	\$ 1,508,485	

See accompanying notes to consolidated financial statements.

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

	For the Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities		
Revenues from real estate operations received	\$262,602	\$254,392
Construction contract and other service revenues received	18,411	39,917
Property operating expenses paid	(83,642)	(79,683)
Construction contract and other service expenses paid	(62,624)	(31,996)
General, administrative, leasing, business development and land carry costs paid	(15,148)	(20,315)
Interest expense paid	(36,155)	(36,351)
Lease incentives paid	(4,825)	(9,375)
Other	2,093	940
Net cash provided by operating activities	80,712	117,529
Cash flows from investing activities		
Construction, development and redevelopment	(67,749)	(85,926)
Tenant improvements on operating properties	(18,352)	(13,711)
Other capital improvements on operating properties	(8,584)	(11,780)
Proceeds from dispositions of properties	—	54,798
Leasing costs paid	(3,838)	(3,904)
Other	1,715	1,746
Net cash used in investing activities	(96,808)	(58,777)
Cash flows from financing activities		
Proceeds from debt		
Revolving Credit Facility	153,000	213,000
Repayments of debt		
Revolving Credit Facility	(109,000)	(19,000)
Scheduled principal amortization	(2,101)	(2,013)
Other debt repayments	—	(200,000)
Payments on capital lease obligation	(15,379)	—
Net proceeds from issuance of common shares	52,277	19,835
Redemption of preferred shares	—	(199,083)
Common share dividends paid	(55,950)	(54,439)
Preferred share dividends paid	—	(9,305)
Distributions paid to noncontrolling interests in COPLP	(2,110)	(2,274)
Redemption of vested equity awards	(1,525)	(1,813)
Other	(5,370)	(2,952)
Net cash provided by (used in) financing activities	13,842	(258,044)
Net decrease in cash and cash equivalents and restricted cash	(2,254)	(199,292)
Cash and cash equivalents and restricted cash		
Beginning of period	14,831	212,619
End of period	\$12,577	\$13,327

See accompanying notes to consolidated financial statements.

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

	For the Six Months Ended June 30,	
	2018	2017
Reconciliation of net income to net cash provided by operating activities:		
Net income	\$39,865	\$41,599
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	67,684	66,948
Impairment losses	—	1,618
Amortization of deferred financing costs and net debt discounts	1,648	2,613
(Increase) decrease in deferred rent receivable	(3,470)	669
Gain on sales of real estate	27	(4,250)
Share-based compensation	3,132	2,820
Other	(777)	(1,861)
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	8,050	(8,304)
Decrease in prepaid expenses and other assets, net	14,718	22,418
Decrease in accounts payable, accrued expenses and other liabilities	(49,422)	(2,387)
Decrease in rents received in advance and security deposits	(743)	(4,354)
Net cash provided by operating activities	\$80,712	\$117,529
Reconciliation of cash and cash equivalents and restricted cash:		
Cash and cash equivalents at beginning of period	\$12,261	\$209,863
Restricted cash at beginning of period	2,570	2,756
Cash and cash equivalents and restricted cash at beginning of period	\$14,831	\$212,619
Cash and cash equivalents at end of period	\$8,472	\$10,606
Restricted cash at end of period	4,105	2,721
Cash and cash equivalents and restricted cash at end of period	\$12,577	\$13,327
Supplemental schedule of non-cash investing and financing activities:		
Increase (decrease) in accrued capital improvements, leasing and other investing activity costs	\$2,909	\$(4,927)
Increase in property in connection with capital lease obligation	\$—	\$16,127
Increase in fair value of derivatives applied to accumulated other comprehensive income and noncontrolling interests	\$6,719	\$513
Equity in other comprehensive income of an equity method investee	\$—	\$39
Dividends/distributions payable	\$29,449	\$28,462
Decrease in noncontrolling interests and increase in shareholders' equity in connection with the conversion of common units into common shares	\$761	\$2,564
Adjustments to noncontrolling interests resulting from changes in COPLP ownership	\$702	\$514
Increase in redeemable noncontrolling interests and decrease in equity to carry redeemable noncontrolling interests at fair value	\$758	\$401

See accompanying notes to consolidated financial statements.

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

	June 30, 2018	December 31, 2017
Assets		
Properties, net:		
Operating properties, net	\$2,760,632	\$ 2,737,611
Projects in development or held for future development	422,905	403,494
Total properties, net	3,183,537	3,141,105
Assets held for sale, net	42,226	42,226
Cash and cash equivalents	8,472	12,261
Investment in unconsolidated real estate joint venture	40,806	41,787
Accounts receivable (net of allowance for doubtful accounts of \$811 and \$607, respectively)	23,656	31,802
Deferred rent receivable (net of allowance of \$423 and \$364, respectively)	89,606	86,710
Intangible assets on real estate acquisitions, net	50,586	59,092
Deferred leasing costs (net of accumulated amortization of \$29,546 and \$29,560, respectively)	48,183	48,322
Investing receivables	54,427	57,493
Prepaid expenses and other assets, net	66,669	69,791
Total assets	\$3,608,168	\$ 3,590,589
Liabilities and equity		
Liabilities:		
Debt, net	\$1,871,445	\$ 1,828,333
Accounts payable and accrued expenses	88,885	108,137
Rents received in advance and security deposits	24,905	25,648
Distributions payable	29,449	28,921
Deferred revenue associated with operating leases	10,783	11,682
Deferred property sale	43,377	43,377
Capital lease obligation	640	15,853
Other liabilities	5,655	37,206
Total liabilities	2,075,139	2,099,157
Commitments and contingencies (Note 16)		
Redeemable noncontrolling interests	24,544	23,125
Equity:		
Corporate Office Properties, L.P.'s equity:		
Preferred units held by limited partner, 352,000 preferred units outstanding at June 30, 2018 and December 31, 2017	8,800	8,800
Common units, 103,260,495 and 101,292,299 held by the general partner and 3,197,061 and 3,250,878 held by limited partners at June 30, 2018 and December 31, 2017, respectively	1,477,575	1,445,022
Accumulated other comprehensive income	9,235	2,173
Total Corporate Office Properties, L.P.'s equity	1,495,610	1,455,995
Noncontrolling interests in subsidiaries	12,875	12,312
Total equity	1,508,485	1,468,307

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Total liabilities, redeemable noncontrolling interests and equity	\$3,608,168	\$ 3,590,589
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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 June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues				
Rental revenue	\$ 101,121	\$ 101,347	\$ 201,955	\$ 201,962
Tenant recoveries and other real estate operations revenue	28,041	26,950	55,485	53,102
Construction contract and other service revenues	17,581	23,138	44,779	36,172
Total revenues	146,743	151,435	302,219	291,236
Expenses				
Property operating expenses	49,446	48,628	100,397	97,147
Depreciation and amortization associated with real estate operations	33,190	32,793	66,702	65,852
Construction contract and other service expenses	16,941	22,315	43,157	34,801
Impairment losses	—	1,625	—	1,625
General, administrative and leasing expenses	7,628	7,859	14,920	16,470
Business development expenses and land carry costs	1,234	1,597	2,848	3,290
Total operating expenses	108,439	114,817	228,024	219,185
Operating income	38,304	36,618	74,195	72,051
Interest expense	(18,945)	(19,163)	(37,729)	(38,157)
Interest and other income	1,439	1,583	2,798	3,309
Loss on early extinguishment of debt	—	(513)	—	(513)
Income before equity in income of unconsolidated entities and income taxes	20,798	18,525	39,264	36,690
Equity in income of unconsolidated entities	373	370	746	747
Income tax expense	(63)	(48)	(118)	(88)
Income before gain on sales of real estate	21,108	18,847	39,892	37,349
Gain on sales of real estate	(23)	12	(27)	4,250
Net income	21,085	18,859	39,865	41,599
Net income attributable to noncontrolling interests in consolidated entities	(878)	(907)	(1,799)	(1,841)
Net income attributable to COPLP	20,207	17,952	38,066	39,758
Preferred unit distributions	(165)	(3,204)	(330)	(6,549)
Issuance costs associated with redeemed preferred units	—	(6,847)	—	(6,847)
Net income attributable to COPLP common unitholders	\$ 20,042	\$ 7,901	\$ 37,736	\$ 26,362
Earnings per common unit:				
Net income attributable to COPLP common unitholders - basic	\$ 0.19	\$ 0.08	\$ 0.36	\$ 0.26
Net income attributable to COPLP common unitholders - diluted	\$ 0.19	\$ 0.08	\$ 0.36	\$ 0.26
Distributions declared per common unit	\$ 0.275	\$ 0.275	\$ 0.550	\$ 0.550

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 June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$21,085	\$18,859	\$39,865	\$41,599
Other comprehensive income				
Unrealized gain (loss) on interest rate derivatives	1,912	(1,800)	6,588	(1,576)
(Gain) loss on interest rate derivatives recognized in interest expense	(47)	941	198	2,125
Equity in other comprehensive income of equity method investee	—	39	—	39
Other comprehensive income (loss)	1,865	(820)	6,786	588
Comprehensive income	22,950	18,039	46,651	42,187
Comprehensive income attributable to noncontrolling interests	(878)	(907)	(1,799)	(1,841)
Comprehensive income attributable to COPLP	\$22,072	\$17,132	\$44,852	\$40,346

See accompanying notes to consolidated financial statements.

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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, 2016	352,000	\$8,800	6,900,000	\$172,500	102,089,042	\$1,419,710	\$(1,854)	\$13,621	\$1,612,777
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)	—	—	—	—	189,948	3,047	—	—	3,047
Redemptions of vested equity awards	—	—	—	—	—	(1,813)	—	—	(1,813)
Comprehensive income	—	330	—	6,219	—	33,209	588	701	41,047
Distributions to owners of common and preferred units	—	(330)	—	(6,219)	—	(56,575)	—	—	(63,124)
Distributions to noncontrolling interests in subsidiaries	—	—	—	—	—	—	—	(2,610)	(2,610)
	—	—	—	—	—	(401)	—	—	(401)

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Adjustment to arrive at fair value of redeemable noncontrolling interests										
Balance at June 30, 2017	352,000	\$8,800	—	\$—	102,875,032	\$1,416,995	\$(1,266)	\$11,712	\$1,436,241	
Balance at December 31, 2017	352,000	\$8,800	—	\$—	104,543,177	\$1,445,022	\$2,173	\$12,312	\$1,468,307	
Cumulative effect of accounting change for adoption of hedge accounting guidance	—	—	—	—	—	(276)	) 276	—	—	
Balance at December 31, 2017, as adjusted	352,000	8,800	—	—	104,543,177	1,444,746	2,449	12,312	1,468,307	
Issuance of common units resulting from common shares issued under COPT forward equity sale agreements	—	—	—	—	1,777,000	52,227	—	—	52,227	
Share-based compensation (units net of redemption)	—	—	—	—	137,379	3,400	—	—	3,400	
Redemptions of vested equity awards	—	—	—	—	—	(1,525)	) —	—	(1,525)	)
Comprehensive income	—	330	—	—	—	37,736	6,786	570	45,422	
Distributions to owners of common and preferred units	—	(330)	) —	—	—	(58,251)	) —	—	(58,581)	)
Distributions to noncontrolling interests in subsidiaries	—	—	—	—	—	—	—	(7)	(7)	)
Adjustment to arrive at fair	—	—	—	—	—	(758)	) —	—	(758)	)

value of
redeemable
noncontrolling
interests

Balance at June 30, 2018	352,000	\$8,800	—	\$—	106,457,556	\$1,477,575	\$9,235	\$12,875	\$1,508,485
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See accompanying notes to consolidated financial statements.

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

	For the Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities		
Revenues from real estate operations received	\$262,602	\$254,392
Construction contract and other service revenues received	18,411	39,917
Property operating expenses paid	(83,642)	(79,683)
Construction contract and other service expenses paid	(62,624)	(31,996)
General, administrative, leasing, business development and land carry costs paid	(15,148)	(20,315)
Interest expense paid	(36,155)	(36,351)
Lease incentives paid	(4,825)	(9,375)
Other	2,093	940
Net cash provided by operating activities	80,712	117,529
Cash flows from investing activities		
Construction, development and redevelopment	(67,749)	(85,926)
Tenant improvements on operating properties	(18,352)	(13,711)
Other capital improvements on operating properties	(8,584)	(11,780)
Proceeds from dispositions of properties	—	54,798
Leasing costs paid	(3,838)	(3,904)
Other	1,715	1,746
Net cash used in investing activities	(96,808)	(58,777)
Cash flows from financing activities		
Proceeds from debt		
Revolving Credit Facility	153,000	213,000
Repayments of debt		
Revolving Credit Facility	(109,000)	(19,000)
Scheduled principal amortization	(2,101)	(2,013)
Other debt repayments	—	(200,000)
Payments on capital lease obligation	(15,379)	—
Net proceeds from issuance of common units	52,277	19,835
Redemption of preferred units	—	(199,083)
Common unit distributions paid	(57,730)	(56,383)
Preferred unit distributions paid	(330)	(9,635)
Redemption of vested equity awards	(1,525)	(1,813)
Other	(5,370)	(2,952)
Net cash provided by (used in) financing activities	13,842	(258,044)
Net decrease in cash and cash equivalents and restricted cash	(2,254)	(199,292)
Cash and cash equivalents and restricted cash		
Beginning of period	14,831	212,619
End of period	\$12,577	\$13,327

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 Six Months Ended June 30,	
	2018	2017
Reconciliation of net income to net cash provided by operating activities:		
Net income	\$39,865	\$41,599
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	67,684	66,948
Impairment losses	—	1,618
Amortization of deferred financing costs and net debt discounts	1,648	2,613
(Increase) decrease in deferred rent receivable	(3,470)	669
Gain on sales of real estate	27	(4,250)
Share-based compensation	3,132	2,820
Other	(777)	(1,861)
Operating changes in assets and liabilities:		
Decrease (increase) in accounts receivable	8,050	(8,304)
Decrease in prepaid expenses and other assets, net	14,296	21,126
Decrease in accounts payable, accrued expenses and other liabilities	(49,000)	(1,095)
Decrease in rents received in advance and security deposits	(743)	(4,354)
Net cash provided by operating activities	\$80,712	\$117,529
Reconciliation of cash and cash equivalents and restricted cash:		
Cash and cash equivalents at beginning of period	\$12,261	\$209,863
Restricted cash at beginning of period	2,570	2,756
Cash and cash equivalents and restricted cash at beginning of period	\$14,831	\$212,619
Cash and cash equivalents at end of period	\$8,472	\$10,606
Restricted cash at end of period	4,105	2,721
Cash and cash equivalents and restricted cash at end of period	\$12,577	\$13,327
Supplemental schedule of non-cash investing and financing activities:		
Increase (decrease) in accrued capital improvements, leasing and other investing activity costs	\$2,909	\$(4,927)
Increase in property in connection with capital lease obligation	\$—	\$16,127
Increase in fair value of derivatives applied to accumulated other comprehensive income and noncontrolling interests	\$6,719	\$513
Equity in other comprehensive income of an equity method investee	\$—	\$39
Distributions payable	\$29,449	\$28,462
Increase in redeemable noncontrolling interests and decrease in equity to carry redeemable noncontrolling interests at fair value	\$758	\$401

See accompanying notes to consolidated financial statements.

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 in the Greater Washington, DC/Baltimore region with durable Class-A office fundamentals and characteristics (“Regional Office”). As of June 30, 2018, our properties included the following:

159 properties totaling 17.7 million square feet comprised of 143 office properties and 16 single-tenant data center shell properties (“data center shells”). We owned six of these data center shells through an unconsolidated real estate joint venture;

• a wholesale data center with a critical load of 19.25 megawatts;

• nine properties under construction or redevelopment (five office properties and four data center shells) that we estimate will total approximately 1.0 million square feet upon completion, including one partially-operational property; and

• approximately 1,000 acres of land controlled for future development that we believe could be developed into approximately 12.3 million square feet and 150 acres of other land.

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 June 30, 2018, COPT owned 97.0% of the outstanding COPLP common units (“common units”); the remaining common units and all of the outstanding COPLP preferred units (“preferred units”) were owned by third parties. Common units not owned by COPT carry certain redemption rights. The number of common units owned by COPT is equivalent to the number of outstanding common shares of beneficial interest (“common shares”) of COPT, and the entitlement of all 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 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; similarly, although 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, 2017 included in our 2017 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 2017 Annual Report on Form 10-K as updated for our adoption of recent accounting pronouncements discussed below.

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, including restricted cash and marketable securities that were reclassified to the line entitled "prepaid expenses and other assets, net" on our consolidated balance sheets after having been reported on a separate line in our Quarterly Reports on Form 10-Q filed in prior years and previous Annual Reports on Form 10-K.

Recent Accounting Pronouncements

We adopted guidance issued by the Financial Accounting Standards Board ("FASB") effective January 1, 2018 regarding the recognition of revenue from contracts with customers ("Topic 606"). Under this guidance, an entity recognizes 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 determined that Topic 606 is applicable to our construction contract and other service revenues, which includes predominantly construction and design projects performed primarily for tenants of our properties. We used the modified retrospective method for contracts that were not completed as of January 1, 2018. Under this method, the cumulative effect of initially applying the guidance is recognized as an adjustment to the opening balance of retained earnings as of the date of initial application. Our adoption of Topic 606 effective January 1, 2018 did not affect our consolidated financial statements other than additional disclosure provided in accordance with the guidance. We did not elect to use any of the practical expedients provided for under the guidance. 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, Topic 606 may 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).

We adopted guidance issued by the FASB effective January 1, 2018 that requires entities to measure equity investments at fair value through net income, except for those that result in consolidation or are accounted for under the equity method of accounting. For equity investments without readily determinable fair values, the guidance permits the application of a measurement alternative using the cost of the investment, less any impairments, plus or minus changes resulting from observable price changes for an identical or similar investment of the same issuer. Our adoption of this guidance had no effect on our consolidated financial statements.

We adopted guidance issued by the FASB retrospectively effective January 1, 2018 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. Our adoption of this guidance had no effect on our consolidated financial statements.

We adopted guidance issued by the FASB retrospectively effective January 1, 2018 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. As a result of our adoption of this guidance, the change in restricted cash is no longer reported as either operating or investing activities on our statements of cash flows. Our restricted cash primarily consists of cash escrowed under mortgage debt for capital improvements and real estate taxes and certain tenant security deposits. Our adoption of this guidance had the following effects on our consolidated statements of cash flows for the six months ended June 30, 2017 (in thousands):

	As Previously Reported	Impact of Adoption	As Adjusted
Net cash provided by operating activities	\$ 117,737	\$ (208)	\$ 117,529
Net cash used in investing activities	\$(58,950)	\$ 173	\$(58,777)
Net decrease in cash and cash equivalents and restricted cash	\$(199,257)	\$ (35)	\$(199,292)
Beginning of period cash and cash equivalents and restricted cash	\$ 209,863	\$ 2,756	\$ 212,619
End of period cash and cash equivalents and restricted cash	\$ 10,606	\$ 2,721	\$ 13,327

We adopted guidance issued by the FASB that clarifies the scope of provisions and accounting for nonfinancial asset derecognition, including partial sales of real estate assets, effective January 1, 2018 using the full retrospective method. 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 nonfinancial 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 are now subject to the same derecognition model as all other nonfinancial assets. We had a transaction in July 2016 accounted for as a partial sale under the previous guidance that meets the criteria for immediate full gain recognition under the new guidance; as a result, we retrospectively recognized an additional \$18 million in income in 2016 that was being amortized into income in subsequent periods under the previous guidance. The recognition pattern for our other sales of real estate were not changed by this new guidance. The full retrospective method requires adjustment of each reporting period presented at the time of adoption.

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The tables below set forth the impact of the adoption of this guidance for amounts previously reported on the consolidated financial statements of COPT and subsidiaries (in thousands):

Consolidated Balance Sheets	As of December 31, 2017			As of June 30, 2017			As of December 31, 2016		
	As Previously Reported	Impact of Adoption	As Adjusted	As Previously Reported	Impact of Adoption	As Adjusted	As Previously Reported	Impact of Adoption	As Adjusted
Investment in unconsolidated real estate joint venture	\$25,066	\$16,721	\$41,787	\$25,335	\$17,417	\$42,752	\$25,548	\$18,113	\$43,661
Cumulative distributions in excess of net income	\$(818,190)	\$16,105	\$(802,085)	\$(793,828)	\$16,779	\$(777,049)	\$(765,276)	\$17,451	\$(747,825)
Noncontrolling interests in subsidiaries	\$65,549	\$616	\$66,165	\$66,701	\$638	\$67,339	\$71,605	\$662	\$72,267

Consolidated Statements of Operations and Comprehensive Income	For the Three Months Ended June 30, 2017			For the Six Months Ended June 30, 2017		
	As Previously Reported	Impact of Adoption	As Adjusted	As Previously Reported	Impact of Adoption	As Adjusted
Equity in income of unconsolidated entities	\$718	\$ (348)	\$370	\$1,443	\$ (696)	\$747
Income before gain on sales of real estate	\$19,195	\$ (348)	\$18,847	\$38,045	\$ (696)	\$37,349
Net income	\$19,207	\$ (348)	\$18,859	\$42,295	\$ (696)	\$41,599
Net income attributable to noncontrolling interests - Common units in COPLP	\$(273)	\$ 12	\$(261)	\$(907)	\$ 24	\$(883)
Net income attributable to COPT	\$17,862	\$ (336)	\$17,526	\$39,217	\$ (672)	\$38,545
Net income attributable to COPT common shareholders	\$7,976	\$ (336)	\$7,640	\$26,151	\$ (672)	\$25,479
Comprehensive income	\$18,387	\$ (348)	\$18,039	\$42,883	\$ (696)	\$42,187
Comprehensive income attributable to COPT	\$17,069	\$ (336)	\$16,733	\$39,785	\$ (672)	\$39,113

The tables below set forth the impact of the adoption of this guidance for amounts previously reported on the consolidated financial statements of COPLP and subsidiaries (in thousands):

Consolidated Balance Sheets	As of December 31, 2017			As of June 30, 2017			As of December 31, 2016		
	As Previously Reported	Impact of Adoption	As Adjusted	As Previously Reported	Impact of Adoption	As Adjusted	As Previously Reported	Impact of Adoption	As Adjusted
Investment in unconsolid. real estate joint venture	\$25,066	\$16,721	\$41,787	\$25,335	\$17,417	\$42,752	\$25,548	\$18,113	\$43,661
Common units	\$1,428,301	\$16,721	\$1,445,022	\$1,399,578	\$17,417	\$1,416,995	\$1,401,597	\$18,113	\$1,419,710

Consolidated Statements of Operations and Comprehensive Income	For the Three Months Ended June 30, 2017			For the Six Months Ended June 30, 2017		
	As Previously Reported	Impact of Adoption	As Adjusted	As Previously Reported	Impact of Adoption	As Adjusted

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	Reported			Reported		
Equity in income of unconsolidated entities	\$718	\$ (348)	\$ 370	\$1,443	\$ (696)	\$ 747
Income before gain on sales of real estate	\$19,195	\$ (348)	\$ 18,847	\$38,045	\$ (696)	\$ 37,349
Net income	\$19,207	\$ (348)	\$ 18,859	\$42,295	\$ (696)	\$ 41,599
Net income attributable to COPLP	\$18,300	\$ (348)	\$ 17,952	\$40,454	\$ (696)	\$ 39,758
Net income attributable to COPLP common unitholders	\$8,249	\$ (348)	\$ 7,901	\$27,058	\$ (696)	\$ 26,362
Comprehensive income	\$18,387	\$ (348)	\$ 18,039	\$42,883	\$ (696)	\$ 42,187
Comprehensive income attributable to COPLP	\$17,480	\$ (348)	\$ 17,132	\$41,042	\$ (696)	\$ 40,346

Adoption of this guidance had no impact to cash provided by or used in operating, financing or investing activities on our consolidated statements of cash flows for the six months ended June 30, 2017.

We early adopted guidance issued by the FASB effective January 1, 2018 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. We adopted this guidance using the modified retrospective transition method under which we eliminated \$276,000 in previously-recorded cumulative hedge ineffectiveness as of January 1, 2018 by means of a cumulative-effect adjustment to our beginning balance of accumulated other comprehensive income ("AOCI"), with a corresponding adjustment to the beginning balance of: cumulative distributions in excess of net income for COPT and subsidiaries; and common units for COPLP and subsidiaries.

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 2017 Annual Report on Form 10-K for amounts deferred in 2017, 2016 and 2015). 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: Under the issued and approved guidance, we believed that the new revenue standard would apply to executory costs and other components of revenue deemed to be non-lease components (such as common area maintenance and provision of utilities), in which case we would need: to separate the lease components of revenue due under leases from the non-lease components; and recognize revenue on the non-lease components as the related services are delivered, which could result in a change to our revenue recognition pattern. However, in March 2018, the FASB tentatively approved a practical expedient to provide lessors with an option to not separate lease components of revenue from non-lease components if: the timing and pattern of transfer of these components is the same as the related lease; and the lease would continue to be classified as an operating lease.

Leases in which we are the lessee:

Our most significant leases as lessee are ground leases; as of June 30, 2018, our future minimum rental payments under these leases totaled \$89.4 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 right-of-use assets and lease liabilities 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, we expect to elect to apply the package of practical expedients under which we would 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.

3. Revenue Recognition on Construction Contract and Other Service Revenues

We enter into construction contracts to complete various design and construction services primarily for our United States Government tenants. The revenues and expenses from these services consist primarily of subcontracted costs that are reimbursed to us by our customers along with a fee. These services are an ancillary component of our overall operations, with small operating margins relative to the revenue. We review each contract to determine the performance obligations and allocate the transaction price. We recognize revenue under these contracts as services are performed in an amount that reflects the consideration we expect to receive in exchange for those services. Our performance obligations are satisfied over time as work progresses. Revenue recognition is determined using the input method based on costs incurred as of point in time relative to the total estimated costs at completion to measure progress toward satisfying our performance obligations. We believe incurred costs of work performed best depicts the transfer of control of the services being transferred to the customer.

In determining whether the performance obligations of each construction contract should be accounted for separately versus together, we consider numerous factors that may require significant judgment, including: whether the components contracted are substantially the same with the same pattern of transfer; whether the customer could contract with another party to perform construction based on our design project; and whether the customer can elect not to move forward after the design phase of the contract. Most of our contracts have a single performance obligation as the promise to transfer the services is not separately identifiable from other obligations in the contracts and, therefore, are not distinct. Some contracts have multiple performance obligations, most commonly due to having distinct project phases for design and construction for which our customer is making decisions and managing separately. In these cases, we allocate the transaction price between these performance obligations based on the amounts separately set forth in the contracts for such obligations. Contract modifications, such as change orders, are routine for our construction contracts and are generally determined to be additions to the existing performance obligations because they would have been part of the initial performance obligations if they were identified at the initial contract date.

We have three main types of compensation arrangements for our construction contracts: guaranteed maximum price (“GMP”); firm fixed price (“FFP”); and cost-plus fee.

GMP contracts provide for revenue equal to costs incurred plus a fee equal to a percentage of such costs, up to a maximum contract amount. We generally enter into GMP contracts for projects that are significant in nature based on the size of the project and total fees, and for which the full scope of the project has not been determined as of the contract date. GMP contracts are lower risk to us than FFP contracts since the costs and revenue move proportionately to one another;

FFP contracts provide for revenue equal to a fixed fee. These contracts are typically lower in value and scope relative to GMP contracts, and are generally entered into when the scope of the project is well defined. Typically, we assume more risk with FFP contracts than GMP contracts since the revenue is fixed and we could realize losses or less than expected profits if we incur more costs than originally estimated. However, these types of contracts offer the opportunity for additional profits when we complete the work for less than originally estimated. Determining the estimated total costs for contracts under an FFP compensation arrangement may require significant judgment and has a direct effect on our revenue recognition pattern;

- Cost-plus fee contracts provide for revenue equal to costs incurred plus a fee equal to a percentage of such costs but, unlike GMP contracts, do not have a maximum contract amount. We do not frequently enter into cost-plus fee contracts. Similar to GMP contracts, cost-plus fee contracts are low risk to us since the costs and revenue move proportionately to one another.

Construction contract cost estimates are based on various assumptions, such as performance of subcontractors and cost and availability of materials, to project the outcome of future events over the course of the project. We review and update these estimates regularly as a significant change could affect the profitability of our construction contracts. We recognize adjustments in estimated profit on contracts under the cumulative catch-up method as the modification does not create a new performance obligation. Under this method, the impact of the adjustment on profit recorded to date on a contract is recognized in the period the adjustment is identified. Revenue and profit in future periods are recognized using the adjusted estimate. If at any time the estimate of contract profitability indicates an anticipated loss on the contract, we recognize the total loss in the quarter it is identified.

We disaggregate our construction contract and other service revenues by compensation arrangement and by service type as we believe it best depicts the nature, timing and uncertainty of our revenue. The table below reports construction contract and other service revenues by compensation arrangement (in thousands):

	For the Three Months Ended June 30, 2018		For the Six Months Ended June 30, 2017	
Construction contract revenues:				
GMP	\$9,539	\$18,317	\$30,025	\$24,906
FFP	6,288	4,587	12,723	10,785
Cost-plus fee	1,496	—	1,554	17
Other	258	234	477	464
	\$17,581	\$23,138	\$44,779	\$36,172

The table below reports construction contract and other service revenues by service type (in thousands):

	For the Three Months Ended June 30, 2018		For the Six Months Ended June 30, 2017	
Construction contract revenues:				
Construction	\$16,668	\$21,078	\$42,583	\$31,169
Design	655	1,826	1,719	4,539
Other	258	234	477	464
	\$17,581	\$23,138	\$44,779	\$36,172

We recognized revenue from performance obligations satisfied (or partially satisfied) in previous periods of \$10,000 and \$401,000 in the three months ended June 30, 2018 and 2017, respectively; and \$319,000 and \$547,000 in the six months ended June 30, 2018 and 2017, respectively.

Our timing of revenue recognition for construction contracts generally differs from the timing of invoicing to customers. We recognize such revenue as we satisfy our performance obligations. Payment terms and conditions vary by contract type. Under most of our contracts, we bill customers monthly, as work progresses, in accordance with the contract terms, with payment due in 30 days, although customers occasionally pay in advance of services being provided. We have determined that our contracts generally do not include a significant financing component. The primary purpose of the timing of our invoicing is for convenience, not to receive financing from our customers or to provide customers with financing. Additionally, the timing of transfer of the services is often at the discretion of the customer. We recognized no impairment losses on construction contracts receivable or unbilled construction revenue in the periods set forth herein.

Accounts receivable related to our construction contract services is included in accounts receivable, net on our consolidated balance sheets. The beginning and ending balances of accounts receivable related to our construction contracts were as follows (in thousands):

	For the Six Months Ended June 30, 2018		2017
Beginning balance	\$4,577	\$4,131	
Ending balance	\$4,805	\$11,946	

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Under most of our contracts, we bill customers one month subsequent to revenue recognition, resulting in contract assets representing unbilled construction revenue. Contract assets, which we refer to herein as construction costs in excess of billings, are included in prepaid expenses and other assets, net reported on our consolidated balance sheets. The beginning and ending balances of our contract assets were as follows (in thousands):

	For the Six Months Ended June 30,	
	2018	2017
Beginning balance	\$4,884	\$10,350
Ending balance	\$4,158	\$3,620

Our contract liabilities consist of advance payments from our customers or billings in excess of construction contract revenue recognized. Contract liabilities are included in other liabilities reported on our consolidated balance sheets. Changes in contract liabilities were as follows (in thousands):

	For the Six Months Ended June 30,	
	2018	2017
Beginning balance	\$27,402	\$32,650
Ending balance	\$515	\$40,209
Portion of beginning balance recognized in revenue during:		
Three months ended June 30	\$7,999	\$16,762
Six months ended June 30	\$27,296	\$20,961

The change in the contract liabilities balance reported above for the six months ended June 30, 2018 was due primarily to our satisfaction of performance obligations during the period on a contract on which we previously received advance payments from a customer.

Revenue allocated to the remaining performance obligations under existing contracts as of June 30, 2018 that will be recognized as revenue in future periods was \$16.1 million, virtually all of which we expect to recognize during the remainder of 2018.

We have no deferred incremental costs incurred to obtain or fulfill our construction contracts or other service revenues.

4. 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 sheets using quoted market prices, as are other marketable securities that we hold. The balance of the plan, which was fully funded, totaled \$4.2 million as of June 30, 2018, and is included in the line entitled "prepaid expenses and other assets, net" on COPT's consolidated balance sheets. 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 are classified in Level 1 of the fair value hierarchy, while the offsetting liability 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 June 30, 2018, 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 7, 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 9, 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 7 for investing receivables, Note 9 for debt and Note 10 for interest rate derivatives.

COPT and Subsidiaries

The table below sets forth financial assets and liabilities of COPT and subsidiaries that are accounted for at fair value on a recurring basis as of June 30, 2018 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	\$ 4,146	\$ —	\$ —	\$4,146
Other	48	—	—	48
Interest rate derivatives (1)	—	9,792	—	9,792
Total assets	\$ 4,194	\$ 9,792	\$ —	\$13,986
Liabilities:				
Deferred compensation plan liability (2)	\$ —	\$ 4,194	\$ —	\$4,194

(1) Included in the line entitled “prepaid expenses and other assets, net” on COPT’s consolidated balance sheet.

(2) 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 subsidiaries that are accounted for at fair value on a recurring basis as of June 30, 2018 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)	\$ —	\$ 9,792	\$ —	\$9,792

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

5. Properties, Net

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

	June 30, 2018	December 31, 2017
Land	\$469,494	\$455,680
Buildings and improvements	3,130,616	3,068,124

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Less: Accumulated depreciation (839,478) (786,193)
 Operating properties, net \$2,760,632 \$2,737,611

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

	June 30, 2018	December 31, 2017
Land	\$232,758	\$ 240,825
Development in progress, excluding land	190,147	162,669
Projects in development or held for future development	\$422,905	\$ 403,494

Our property held for sale is 11751 Meadowville Lane, a property in our Data Center Shells sub-segment, the sale of which was not recognized for accounting purposes. We provided a financial guaranty to the buyer under which we provided an indemnification 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. We account for this transaction as a financing arrangement. Accordingly, we did not recognize the sale of this property for accounting purposes (and will not until the guaranty expires) and we reported the sales proceeds as a liability on the consolidated balance sheets as of June 30, 2018 and December 31, 2017 in the line entitled “deferred property sale.” We do not expect to incur any losses under this financial guaranty. The table below sets forth the components of this property’s assets as of June 30, 2018 and December 31, 2017 (in thousands):

Properties, net	\$38,670
Deferred rent receivable	3,237
Deferred leasing costs, net	319
Assets held for sale, net	\$42,226

2018 Construction Activities

During the six months ended June 30, 2018, we placed into service 223,000 square feet in two newly-constructed properties and 13,000 square feet in one redeveloped property. As of June 30, 2018, we had seven properties under construction, or which we were contractually committed to construct, that we estimate will total 880,000 square feet upon completion and two properties under redevelopment (including one partially-operational property) that we estimate will total 128,000 square feet upon completion.

6. 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 June 30, 2018 (dollars in thousands):

	Date Acquired	Nominal Ownership % as of 6/30/2018	Nature of Activity	June 30, 2018 (1)		
				Total Assets	Encumbered Assets	Total Liabilities
LW Redstone Company, LLC	3/23/2010	85%	Development and operation of real estate (2)	\$159,805	\$74,012	\$51,157
M Square Associates, LLC	6/26/2007	50%	Development and operation of real estate (3)	73,395	44,457	46,323
Stevens Investors, LLC	8/11/2015	95%	Development of real estate (4)	75,813	—	4,887
				\$309,013	\$118,469	\$102,367

(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.

Unconsolidated Joint Venture

As of June 30, 2018, 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 shell properties in Virginia, that we account for using the equity method of accounting. As of June 30, 2018, we had an investment balance in GI-COPT of \$40.8 million.

7. Investing Receivables

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

	June 30, December 31,	
	2018	2017
Notes receivable from the City of Huntsville	\$51,386	\$ 54,472
Other investing loans receivable	3,041	3,021
	\$54,427	\$ 57,493

Our notes receivable from the City of Huntsville funded infrastructure costs in connection with our LW Redstone Company, LLC joint venture (see Note 6) 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 June 30, 2018 or December 31, 2017. The fair value of these receivables approximated their carrying amounts as of June 30, 2018 and December 31, 2017.

8. Prepaid Expenses and Other Assets, Net

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

	June 30, December 31,	
	2018	2017
Lease incentives, net	\$18,376	\$ 19,011
Prepaid expenses	12,173	24,670
Interest rate derivatives	9,792	3,073
Furniture, fixtures and equipment, net	6,407	5,256
Non-real estate equity investments	5,076	5,056
Marketable securities in deferred compensation plan	4,194	4,616
Construction contract costs incurred in excess of billings	4,158	4,884
Restricted cash	4,105	2,570
Deferred tax asset, net (1)	1,774	1,892
Other assets	4,808	3,379
Prepaid expenses and other assets, net	\$70,863	\$ 74,407

(1) Includes a valuation allowance of \$1.4 million.

9. Debt, Net

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

	Carrying Value (1) as of		Stated Interest Rates as of June 30, 2018	Scheduled Maturity as of June 30, 2018
	June 30, 2018	December 31, 2017		
Mortgage and Other Secured Debt:				
Fixed rate mortgage debt (2)	\$ 148,950	\$ 150,723	3.82% - 7.87% (3)	2019-2026
Variable rate secured debt	12,943	13,115	LIBOR + 1.85% (4)	October 2020
Total mortgage and other secured debt	161,893	163,838		
Revolving Credit Facility	170,000	126,000	LIBOR + 0.875% to 1.60% (5)	May 2019 (6)
Term Loan Facilities (7)	348,185	347,959	LIBOR + 0.90% to 1.85% (8)	2020-2022
Unsecured Senior Notes				
3.600%, \$350,000 aggregate principal	347,767	347,551	3.60% (9)	May 2023
5.250%, \$250,000 aggregate principal	246,887	246,645	5.25% (10)	February 2024
3.700%, \$300,000 aggregate principal	298,567	298,322	3.70% (11)	June 2021
5.000%, \$300,000 aggregate principal	296,918	296,731	5.00% (12)	July 2025
Unsecured note payable	1,228	1,287	0% (13)	May 2026
Total debt, net	\$1,871,445	\$ 1,828,333		

(1) The carrying values of our debt other than the Revolving Credit Facility reflect net deferred financing costs of \$4.5 million as of June 30, 2018 and \$5.0 million as of December 31, 2017.

Certain of the fixed rate mortgages carry interest rates that, upon assumption, were above or below market rates 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 \$315,000 as of June 30, 2018 and \$349,000 as of December 31, 2017.

(3) The weighted average interest rate on our fixed rate mortgage debt was 4.18% as of June 30, 2018.

(4) The interest rate on our variable rate secured debt was 3.83% as of June 30, 2018.

(5) The weighted average interest rate on the Revolving Credit Facility was 3.19% as of June 30, 2018.

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 June 30, 2018, 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.

(8) The weighted average interest rate on these loans was 3.35% as of June 30, 2018.

The carrying value of these notes reflects an unamortized discount totaling \$1.5 million as of June 30, 2018 and \$1.7 million as of December 31, 2017. The effective interest rate under the notes, including amortization of the issuance costs, was 3.70%.

The carrying value of these notes reflects an unamortized discount totaling \$2.8 million as of June 30, 2018 and \$3.0 million as of December 31, 2017. The effective interest rate under the notes, including amortization of the issuance costs, was 5.49%.

The carrying value of these notes reflects an unamortized discount totaling \$1.1 million as of June 30, 2018 and (11) \$1.3 million as of December 31, 2017. 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 \$2.6 million as of June 30, 2018 and \$2.7 million as of December 31, 2017. The effective interest rate under the notes, including amortization of the issuance costs, was 5.15%.

This note carries an interest rate that, upon assumption, was below market rates and it therefore was recorded at (13) its fair value based on applicable effective interest rates. The carrying value of this note reflects an unamortized discount totaling \$333,000 as of June 30, 2018 and \$373,000 as of December 31, 2017.

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 June 30, 2018, we were within the compliance requirements of these financial covenants.

We capitalized interest costs of \$1.4 million in the three months ended June 30, 2018, \$1.6 million in the three months ended June 30, 2017, \$2.8 million in the six months ended June 30, 2018 and \$3.1 million in the six months ended June 30, 2017.

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

	June 30, 2018		December 31, 2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Fixed-rate debt				
Unsecured Senior Notes	\$1,190,139	\$1,220,040	\$1,189,249	\$1,229,398
Other fixed-rate debt	150,178	148,257	152,010	152,485
Variable-rate debt	531,128	530,968	487,074	485,694
	\$1,871,445	\$1,899,265	\$1,828,333	\$1,867,577

10. 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	
					June 30, 2018	December 31, 2017
\$100,000	1.7300%	One-Month LIBOR	9/1/2015	8/1/2019	\$745	\$252
13,026 (1)	1.3900%	One-Month LIBOR	10/13/2015	10/1/2020	343	213
100,000	1.9013%	One-Month LIBOR	9/1/2016	12/1/2022	3,481	1,046
100,000	1.9050%	One-Month LIBOR	9/1/2016	12/1/2022	3,494	1,051
50,000	1.9079%	One-Month LIBOR	9/1/2016	12/1/2022	1,729	511
					\$9,792	\$3,073

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

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	
		June 30, 2018	December 31, 2017
Interest rate swaps designated as cash flow hedges	Prepaid expenses and other assets, net	\$9,792	\$3,073

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

	Amount of Gain (Loss) Recognized in AOCI on Derivatives				Amount of Gain (Loss) Reclassified from AOCI into Interest Expense on Statement of Operations			
	For the Three Months Ended June 30,		For the Six Months Ended June 30,		For the Three Months Ended June 30,		For the Six Months Ended June 30,	
Derivatives in Hedging Relationships	2018	2017	2018	2017	2018	2017	2018	2017
Interest rate derivatives	\$1,912	\$(1,800)	\$6,588	\$(1,576)	\$47	\$(941)	\$(198)	\$(2,125)

Over the next 12 months, we estimate that approximately \$1.9 million of gains will be reclassified from AOCI as a decrease 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. We are not in default with any of these provisions. As of June 30, 2018, we did not have any derivatives in liability positions. As of June 30, 2018, we had not posted any collateral related to these agreements.

11. Redeemable Noncontrolling Interests

Our partners in two real estate joint ventures, LW Redstone Company, LLC and Stevens Investors, LLC (discussed further in Note 6), 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 sheets. 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, occupancy projections and estimated operating and development expenditures. The table below sets forth the activity for these redeemable noncontrolling interests (in thousands):

	For the Six Months Ended June 30,	
	2018	2017
Beginning balance	\$23,125	\$22,979
Contributions from noncontrolling interests	143	—
Distributions to noncontrolling interests	(711)	(789)
Net income attributable to noncontrolling interests	1,229	1,140
Adjustment to arrive at fair value of interests	758	401
Ending balance	\$24,544	\$23,731

12. Equity

During the six months ended June 30, 2018, COPT issued 1.8 million common shares under its forward equity sale agreements for net proceeds of \$52.3 million. 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 the forward equity sale agreements was 5.7 million common shares as of June 30, 2018.

During the six months ended June 30, 2018, certain COPLP limited partners converted 53,817 common units in COPLP for an equal number of common shares in COPT.

As of June 30, 2018, COPT had remaining capacity under its at-the-market stock offering program equal to an aggregate gross sales price of \$70.0 million in common share sales.

See Note 14 for disclosure of COPT common share and COPLP common unit activity pertaining to our share-based compensation plans.

13. Information by Business Segment

We have the following reportable segments: Defense/IT Locations; Regional Office; 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). As of June 30, 2018 and December 31, 2017, our Regional Office segment included properties located in select urban/urban-like submarkets in the Greater Washington, DC/Baltimore region with durable Class-A office fundamentals and characteristics; during 2017, this segment also included suburban properties that did not meet these characteristics (that were since disposed).

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 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	Wholesale Data Center	Other
Three Months Ended June 30, 2018										
Revenues from real estate operations	\$61,993	\$13,118	\$12,382	\$8,127	\$3,652	\$5,955	\$105,227	\$15,296	\$8,105	\$5,000
Property operating expenses	(20,099)	(4,909)	(7,494)	(3,431)	(1,509)	(799)	(38,241)	(7,169)	(4,150)	(11,000)
UJV NOI allocable to COPT	—	—	—	—	—	1,202	1,202	—	—	—
NOI from real estate operations	\$41,894	\$8,209	\$4,888	\$4,696	\$2,143	\$6,358	\$68,188	\$8,127	\$3,955	\$6,000
Additions to long-lived assets	\$8,151	\$1,186	\$—	\$1,450	\$351	\$—	\$11,138	\$5,361	\$81	\$1,000
Transfers from non-operating properties	\$3,035	\$352	\$—	\$3	\$26	\$29,675	\$33,091	\$—	\$1,133	\$—
Three Months Ended June 30, 2017										
Revenues from real estate operations	\$61,284	\$11,095	\$13,029	\$7,449	\$3,624	\$5,800	\$102,281	\$17,462	\$7,033	\$1,000
Property operating expenses	(20,129)	(4,219)	(8,130)	(3,025)	(1,491)	(577)	(37,571)	(7,082)	(3,501)	(4,000)
UJV NOI allocable to COPT	—	—	—	—	—	1,198	1,198	—	—	—
NOI from real estate operations	\$41,155	\$6,876	\$4,899	\$4,424	\$2,133	\$6,421	\$65,908	\$10,380	\$3,532	\$1,000
Additions to long-lived assets	\$5,853	\$977	\$16	\$2,231	\$84	\$—	\$9,161	\$4,018	\$2,005	\$(2,000)
	\$18,159	\$218	\$—	\$466	\$1,709	\$26,215	\$46,767	\$(25)	\$—	\$—

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Transfers from non-operating properties										
Six Months Ended June 30, 2018										
Revenues from real estate operations	\$ 124,775	\$ 25,679	\$ 23,825	\$ 15,997	\$ 7,285	\$ 11,786	\$ 209,347	\$ 30,580	\$ 16,182	\$ 1
Property operating expenses	(41,703)	(9,632)	(14,092)	(6,735)	(2,949)	(1,593)	(76,704)	(15,047)	(8,408)	(23
UJV NOI allocable to COPT	—	—	—	—	—	2,401	2,401	—	—	—
NOI from real estate operations	\$ 83,072	\$ 16,047	\$ 9,733	\$ 9,262	\$ 4,336	\$ 12,594	\$ 135,044	\$ 15,533	\$ 7,774	\$ 1
Additions to long-lived assets	\$ 15,272	\$ 3,126	\$ —	\$ 2,558	\$ 430	\$ —	\$ 21,386	\$ 9,245	\$ 117	\$ 3
Transfers from non-operating properties	\$ 20,221	\$ 693	\$ —	\$ —	\$ 470	\$ 30,789	\$ 52,173	\$ —	\$ 2,145	\$ —
Segment assets at June 30, 2018	\$ 1,269,525	\$ 396,139	\$ 126,956	\$ 190,537	\$ 106,374	\$ 330,622	\$ 2,420,153	\$ 396,847	\$ 221,239	\$ 4
Six Months Ended June 30, 2017										
Revenues from real estate operations	\$ 122,139	\$ 22,802	\$ 24,663	\$ 14,459	\$ 7,084	\$ 11,322	\$ 202,469	\$ 35,738	\$ 13,803	\$ 3
Property operating expenses	(40,649)	(8,671)	(14,932)	(6,234)	(2,862)	(1,236)	(74,584)	(14,568)	(6,866)	(1,
UJV NOI allocable to COPT	—	—	—	—	—	2,400	2,400	—	—	—
NOI from real estate operations	\$ 81,490	\$ 14,131	\$ 9,731	\$ 8,225	\$ 4,222	\$ 12,486	\$ 130,285	\$ 21,170	\$ 6,937	\$ 1
Additions to long-lived assets	\$ 9,275	\$ 3,445	\$ 16	\$ 4,399	\$ 216	\$ —	\$ 17,351	\$ 11,138	\$ 3,579	\$ 1
Transfers from	\$ 31,575	\$ 440	\$ —	\$ 466	\$ 1,705	\$ 25,200	\$ 59,386	\$ (25)	\$ 8	\$ 1

non-operating
properties
Segment

assets at June 30, 2017 \$ 1,267,635 \$ 357,747 \$ 130,431 \$ 195,732 \$ 109,586 \$ 247,974 \$ 2,309,105 \$ 435,399 \$ 229,224 \$ 1

30

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 June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Segment revenues from real estate operations	\$129,162	\$128,297	\$257,440	\$255,064
Construction contract and other service revenues	17,581	23,138	44,779	36,172
Total revenues	\$146,743	\$151,435	\$302,219	\$291,236

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 June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
UJV NOI allocable to COPT	\$1,202	\$1,198	\$2,401	\$2,400
Less: Income from UJV allocable to COPT attributable to depreciation and amortization expense and interest expense	(828)	(827)	(1,652)	(1,651)
Add: Equity in loss of unconsolidated non-real estate entities	(1)	(1)	(3)	(2)
Equity in income of unconsolidated entities	\$373	\$370	\$746	\$747

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 June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Construction contract and other service revenues	\$17,581	\$23,138	\$44,779	\$36,172
Construction contract and other service expenses	(16,941)	(22,315)	(43,157)	(34,801)
NOI from service operations	\$640	\$823	\$1,622	\$1,371

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
NOI from real estate operations	\$80,918	\$80,867	\$159,444	\$160,317
NOI from service operations	640	823	1,622	1,371
Interest and other income	1,439	1,583	2,798	3,309
Equity in income of unconsolidated entities	373	370	746	747
Income tax expense	(63)	(48)	(118)	(88)
Depreciation and other amortization associated with real estate operations	(33,190)	(32,793)	(66,702)	(65,852)
Impairment losses	—	(1,625)	—	(1,625)
General, administrative and leasing expenses	(7,628)	(7,859)	(14,920)	(16,470)
Business development expenses and land carry costs	(1,234)	(1,597)	(2,848)	(3,290)
Interest expense	(18,945)	(19,163)	(37,729)	(38,157)
Less: UJV NOI allocable to COPT included in equity in income of unconsolidated entities	(1,202)	(1,198)	(2,401)	(2,400)
Loss on early extinguishment of debt	—	(513)	—	(513)
Income before gain on sales of real estate	\$21,108	\$18,847	\$39,892	\$37,349

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

	June 30, 2018	June 30, 2017
Segment assets	\$3,042,452	\$2,993,078
Non-operating property assets	431,661	452,824
Other assets	138,249	146,402
Total COPT consolidated assets	\$3,612,362	\$3,592,304

The accounting policies of the segments are the same as those used to prepare our consolidated financial statements, except that 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 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.

14. Share-Based Compensation

Performance Share Awards (“PSUs”)

On January 1, 2018, our Board of Trustees granted 59,110 PSUs with an aggregate grant date fair value of \$1.9 million to our three executives. The PSUs have a performance period beginning on January 1, 2018 and concluding on the earlier of December 31, 2020 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	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 number of earned PSUs in settlement of the award plan; and
- pay cash equal to 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.

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.

We computed a grant date fair value of \$31.97 per PSU using a Monte Carlo model. Significant assumptions for that model included the following: baseline common share value of \$29.20; expected volatility for COPT common shares of 17.0%; and a risk-free interest rate of 2.04%.

We issued 13,328 common shares on February 22, 2018 to executives in settlement of PSUs issued in 2015, representing 75% of the target award for those PSUs.

Restricted Shares

During the six months ended June 30, 2018, certain employees and non-employee members of our Board of Trustees were granted a total of 196,366 restricted common shares with an aggregate grant date fair value of \$5.0 million (weighted average of \$25.38 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 employee remains 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 six months ended June 30, 2018, forfeiture restrictions lapsed on 161,322 previously issued common shares; these shares had a weighted average grant date fair value of \$29.72 per share, and the aggregate intrinsic value of the shares on the vesting dates was \$4.1 million.

Deferred Share Awards

During the six months ended June 30, 2018, non-employee members of our Board of Trustees were granted a total of 13,832 deferred share awards with an aggregate grant date fair value of \$388,000 (\$28.08 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 six months ended June 30, 2018, we issued 5,515 common shares in settlement of deferred share awards; these shares had a grant date fair value of \$29.32 per share, and the aggregate intrinsic value of the shares on the settlement date was \$154,000.

15. 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 COPT's forward equity sale agreements and our 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 June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Numerator:				
Net income attributable to COPT	\$19,434	\$17,526	\$36,584	\$38,545
Preferred share dividends	—	(3,039)	—	(6,219)
Issuance costs associated with redeemed preferred shares	—	(6,847)	—	(6,847)
Income attributable to share-based compensation awards	(117)	(117)	(234)	(242)
Numerator for basic and diluted EPS on net income attributable to COPT common shareholders	\$19,317	\$7,523	\$36,350	\$25,237
Denominator (all weighted averages):				
Denominator for basic EPS (common shares)	101,789	99,036	101,397	98,725
Dilutive effect of share-based compensation awards	119	160	131	158
Denominator for diluted EPS (common shares)	101,908	99,196	101,528	98,883
Basic EPS	\$0.19	\$0.08	\$0.36	\$0.26
Diluted EPS	\$0.19	\$0.08	\$0.36	\$0.26

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 (in thousands):

	Weighted Average Shares Excluded from Denominator			
	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Conversion of common units	3,197	3,405	3,208	3,425
Conversion of Series I preferred units	176	176	176	176

The following securities were also excluded from the computation of diluted EPS because their effects were not dilutive:

• weighted average shares related to COPT's forward equity sale agreements for the three and six months ended June 30, 2018 of 6.8 million and 7.1 million, respectively;

• weighted average restricted shares and deferred share awards for the three months ended June 30, 2018 and 2017 of 458,000 and 455,000, respectively, and for the six months ended June 30, 2018 and 2017 of 451,000 and 424,000, respectively; and

• weighted average options for the three months ended June 30, 2018 and 2017 of 47,000 and 61,000, respectively, and for the six months ended June 30, 2018 and 2017 of 53,000 and 100,000, respectively.

COPLP and Subsidiaries EPU

We present both basic and diluted EPU. We compute basic EPU by dividing net income available to common unitholders allocable to unrestricted common units under the two-class method by the weighted average number of

unrestricted common units outstanding during the period. Our computation of diluted EPU is similar except that:

the denominator is increased to include: (1) the weighted average number of potential additional common units that would have been outstanding if securities that are convertible into our common units were converted; and (2) the effect of dilutive potential common units outstanding during the period attributable to COPT's forward equity sale agreements and our 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 units that we added to the denominator.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Numerator:				
Net income attributable to COPLP	\$20,207	\$17,952	\$38,066	\$39,758
Preferred unit distributions	(165)	(3,204)	(330)	(6,549)
Issuance costs associated with redeemed preferred units	—	(6,847)	—	(6,847)
Income attributable to share-based compensation awards	(117)	(117)	(234)	(242)
Numerator for basic and diluted EPU on net income attributable to COPLP common unitholders	\$19,925	\$7,784	\$37,502	\$26,120
Denominator (all weighted averages):				
Denominator for basic EPU (common units)	104,986	102,441	104,605	102,150
Dilutive effect of share-based compensation awards	119	160	131	158
Denominator for diluted EPU (common units)	105,105	102,601	104,736	102,308
Basic EPU	\$0.19	\$0.08	\$0.36	\$0.26
Diluted EPU	\$0.19	\$0.08	\$0.36	\$0.26

Our diluted EPU computations do not include the effect of 176,000 common units resulting from an assumed conversion of the Series I preferred units since such a conversion would increase diluted EPU for the three and six months ended June 30, 2018 and 2017. The following securities were also excluded from the computation of diluted EPU because their effects were not dilutive:

weighted average units related to COPT's forward equity sale agreements for the three and six months ended June 30, 2018 of 6.8 million and 7.1 million, respectively;

weighted average restricted units and deferred share awards for the three months ended June 30, 2018 and 2017 of 458,000 and 455,000, respectively, and for the six months ended June 30, 2018 and 2017 of 451,000 and 424,000, respectively; and

weighted average options for the three months ended June 30, 2018 and 2017 of 47,000 and 61,000, respectively, and for the six months ended June 30, 2018 and 2017 of 53,000 and 100,000, respectively.

16. Commitments and Contingencies

Litigation and Claims

In the normal course of business, we are subject to legal actions and other claims. We record losses for specific legal proceedings and claims when we determine that a loss is probable and the amount of loss can be reasonably estimated. Management believes that it is reasonably possible that we could incur losses pursuant to such claims but do not believe such losses would materially affect our financial position, liquidity or results of operations. Our assessment of the potential outcomes of these matters involves significant judgment and is subject to change based on future developments.

Environmental

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.

In connection with a lease and subsequent sale in 2008 and 2010 of three properties in Dayton, New Jersey, we agreed to provide certain environmental indemnifications limited to \$19 million in the aggregate. We have insurance coverage in place to mitigate much of any potential future losses that may result from these indemnification agreements.

Tax Incremental Financing Obligation

In August 2010, Anne Arundel County, Maryland issued \$30 million in tax incremental financing bonds to third-party investors in order to finance public improvements needed in connection with our project known as National Business Park North. The real estate taxes on increases in assessed value of a development district encompassing National Business Park North are to be transferred to a special fund pledged to the repayment of the bonds. While we are obligated to fund, through a special tax, any future shortfalls between debt service of the bonds and real estate taxes available to repay the bonds, as of June 30, 2018, we do not expect any such future fundings will be required.

Operating Leases

We are obligated as lessee under operating leases (mostly ground leases) with various expiration dates extending to the year 2100. Future minimum rental payments due under the terms of these operating leases as of June 30, 2018 follow (in thousands):

Year Ending December 31,

2018 (1)	\$644
2019	1,277
2020	1,270
2021	1,274
2022	1,158
Thereafter	84,611
	\$90,234

(1) Represents the six months ending December 31, 2018.

Capital Lease

On May 25, 2017, we entered into a ground lease on land under development in Washington, DC through our Stevens Investors, LLC joint venture. The lease has a 99-year term, and we possess an option to purchase the property for one dollar (estimated to occur in 2020). Upon inception of the lease, we recorded a \$16.1 million capital lease liability on our consolidated balance sheets based on the present value of the future minimum rental payments and have since paid down most of this liability. The remaining capital lease obligation as of June 30, 2018 was comprised of the following (in thousands):

Minimum rental payments due in 2020	\$660
Less: Amount representing interest	(20)
Capital lease obligation	\$640

Contractual Obligations

We had amounts remaining to be incurred under various contractual obligations as of June 30, 2018 that included the following (excluding amounts incurred and therefore reflected as liabilities reported on our consolidated balance sheets):

- new development and redevelopment obligations of \$89.4 million;
- capital expenditures for operating properties of \$41.5 million;
- third party construction of \$4.5 million; and
- other obligations of \$2.4 million.

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

Overview

During the six months ended June 30, 2018:

• we finished the period with our office and data center shell portfolio 91.4% occupied;
• we placed into service an aggregate of 236,000 square feet in three newly-constructed or redeveloped properties that were 75.9% leased as of June 30, 2018; and
• COPT issued 1.8 million common shares under its forward equity sale agreements for net proceeds of \$52.3 million, which it contributed to COPLP in exchange for an equal number of units in COPLP. COPLP used the proceeds primarily to repay borrowings under our Revolving Credit Facility that funded development costs.

With regard to our operating portfolio square footage, occupancy and leasing statistics included below and elsewhere in this Quarterly Report on Form 10-Q, amounts disclosed:

include information pertaining to six properties owned through an unconsolidated real estate joint venture except for amounts reported for Annualized Rental Revenue, which represent the portion attributable to our ownership interest; and
exclude, for purposes of amounts reported as of June 30, 2018 and December 31, 2017, a property reported as held for sale that we sold in 2017 subject to our providing a financial guaranty to the buyer under which we 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 did not recognize the sale of this property for accounting purposes, and we reported the sales proceeds as a liability on our consolidated balance sheets.

We discuss significant factors contributing to changes in our net income in the section below entitled "Results of Operations." The results of operations discussion is combined for COPT and COPLP because there are no material differences in the results of operations between the two reporting entities.

In addition, the section below entitled "Liquidity and Capital Resources" includes discussions of, among other things:

• how we expect to generate cash for short and long-term capital needs; and
• our commitments and contingencies.

You should refer to our consolidated financial statements and the notes thereto as you read this section.

This section contains "forward-looking" statements, as defined in the Private Securities Litigation Reform Act of 1995, that are based on our current expectations, estimates and projections about future events and financial trends affecting the financial condition and operations of our business. Forward-looking statements can be identified by the use of words such as "may," "will," "should," "could," "believe," "anticipate," "expect," "estimate," "plan" or other comparable terms. Forward-looking statements are inherently subject to risks and uncertainties, many of which we cannot predict with accuracy and some of which we might not even anticipate. Although we believe that the expectations, estimates and projections reflected in such forward-looking statements are based on reasonable assumptions at the time made, we can give no assurance that these expectations, estimates and projections will be achieved. Future events and actual results may differ materially from those discussed in the forward-looking statements. Important factors that may affect these expectations, estimates and projections include, but are not limited to:

• general economic and business conditions, which will, among other things, affect office property and data center demand and rents, tenant creditworthiness, interest rates, financing availability and property values;

• adverse changes in the real estate markets, including, among other things, increased competition with other companies;
• governmental actions and initiatives, including risks associated with the impact of a prolonged government shutdown or budgetary reductions or impasses, such as a reduction in rental revenues, non-renewal of leases and/or a curtailment of demand for additional space by our strategic customers;
• our ability to borrow on favorable terms;
• risks of real estate acquisition and development activities, including, among other things, risks that development projects may not be completed on schedule, that tenants may not take occupancy or pay rent or that development or operating costs may be greater than anticipated;
• risks of investing through joint venture structures, including risks that our joint venture partners may not fulfill their financial obligations as investors or may take actions that are inconsistent with our objectives;

- changes in our plans for properties or views of market economic conditions or failure to obtain development rights, either of which could result in recognition of significant impairment losses;
- our ability to satisfy and operate effectively under Federal income tax rules relating to real estate investment trusts and partnerships;
- possible adverse changes in tax laws;
- the dilutive effects of issuing additional common shares;
- our ability to achieve projected results; and
- environmental requirements.

We undertake no obligation to update or supplement forward-looking statements.

Occupancy and Leasing

Office and Data Center Shell Portfolio

The tables below set forth occupancy information pertaining to our portfolio of office and data center shell properties:

	June 30, 2018	December 31, 2017
Occupancy rates at period end		
Total	91.4 %	93.6 %
Defense/IT Locations:		
Fort Meade/BW Corridor	90.9 %	95.6 %
Northern Virginia Defense/IT	82.9 %	89.1 %
Lackland Air Force Base	100.0 %	100.0 %
Navy Support Locations	88.2 %	87.7 %
Redstone Arsenal	98.2 %	98.2 %
Data Center Shells	100.0 %	100.0 %
Total Defense/IT Locations	92.0 %	95.2 %
Regional Office	87.2 %	89.5 %
Other	82.2 %	34.4 %
Average contractual annual rental rate per square foot at period end (1)	\$30.09	\$29.84

- (1) Includes estimated expense reimbursements. Amounts reported include the portion of six properties owned through an unconsolidated real estate joint venture that was allocable to our ownership interest.

	Rentable Square Feet (in thousands)	Occupied Square Feet
December 31, 2017	17,345	16,227
Vacated upon lease expiration (1)	—	(497)
Occupancy for new leases (2)	—	205
Constructed or redeveloped (3)	566	200
Removed from operations (4)	(241)	—
Other changes	(15)	—
June 30, 2018	17,655	16,135

- (1) Includes lease terminations and space reductions occurring in connection with lease renewals.

- (2) Excludes occupancy of vacant square feet acquired or developed.

- (3) Includes 330,000 unoccupied square feet that were completed in 2016 but reported as construction projects through December 31, 2017 since they were held for future lease to the United States Government.

- (4) Includes the removal of one property for which we have no leasing plan or intention to allocate future capital and one property reclassified as redevelopment.

Total occupancy decreased from December 31, 2017 to June 30, 2018 due primarily to the addition of 404,000 unoccupied, newly-constructed square feet during the period, including: 243,000 in the Fort Meade/BW Corridor sub-segment; and 161,000 in the Northern Virginia Defense/IT sub-segment leased in June 2018 that we expect to be occupied by the end of the year.

During the six months ended June 30, 2018, we completed 2.1 million square feet of leasing, including: renewed leases on 1.2 million square feet, representing 77.0% of the square footage of our lease expirations (including the effect of early renewals and excluding the effect of 108,000 square feet vacated in a property in the Fort Meade/BW Corridor sub-segment that was removed from service for redevelopment); 675,000 of construction and redevelopment space; and 187,000 in other leasing.

Wholesale Data Center

Our 19.25 megawatt wholesale data center had 16.86 megawatts leased as of June 30, 2018 and December 31, 2017.

Results of Operations

We evaluate the operating performance of our properties using NOI from real estate operations, our segment performance measure, 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”). We view our NOI from real estate operations as comprising the following primary categories:

- office and data center shell properties:
 - continually owned and 100% operational throughout the current and prior year reporting periods, excluding properties held for sale. We define these as changes from “Same Properties”;
 - constructed or redeveloped and placed into service that were not 100% operational throughout the current and prior year reporting periods; and
 - disposed (including a property reported as held for sale as of December 31, 2017, the sale of which in 2017 was not recognized for accounting purposes); and
- our wholesale data center.

In addition to owning properties, we provide construction management and other services. The primary manner in which we evaluate the operating performance of our construction management and other service activities is through a measure we define as NOI from service operations, which is based on the net of the revenues and expenses from these activities. The revenues and expenses from these activities consist primarily of subcontracted costs that are reimbursed to us by customers 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.

Since both of the measures discussed above exclude certain items includable in operating income, reliance on these measures has limitations; management compensates for these limitations by using the measures simply as supplemental measures that are considered alongside other GAAP and non-GAAP measures. A reconciliation of NOI from real estate operations and NOI from service operations to income before gain on sales of real estate reported on the consolidated statements of operations of COPT and subsidiaries is provided in Note 13 to our consolidated financial statements.

Comparison of Statements of Operations for the Three Months Ended June 30, 2018 and 2017

	For the Three Months Ended June 30,		
	2018	2017	Variance
	(in thousands)		
Revenues			
Revenues from real estate operations	\$129,162	\$128,297	\$ 865
Construction contract and other service revenues	17,581	23,138	(5,557)
Total revenues	146,743	151,435	(4,692)
Expenses			
Property operating expenses	49,446	48,628	818
Depreciation and amortization associated with real estate operations	33,190	32,793	397
Construction contract and other service expenses	16,941	22,315	(5,374)
Impairment losses	—	1,625	(1,625)
General, administrative and leasing expenses	7,628	7,859	(231)
Business development expenses and land carry costs	1,234	1,597	(363)
Total operating expenses	108,439	114,817	(6,378)
Operating income	38,304	36,618	1,686
Interest expense	(18,945)	(19,163)	218
Interest and other income	1,439	1,583	(144)
Loss on early extinguishment of debt	—	(513)	513
Equity in income of unconsolidated entities	373	370	3
Income tax expense	(63)	(48)	(15)
Income before gain on sales of real estate	21,108	18,847	2,261
Gain on sales of real estate	(23)	12	(35)
Net income	\$21,085	\$18,859	\$ 2,226

NOI from Real Estate Operations

	For the Three Months Ended June 30,		
	2018	2017	Variance
	(Dollars in thousands, except per square foot data)		
Revenues			
Same Properties revenues			
Rental revenue, excluding lease termination revenue	\$ 89,071	\$ 88,860	\$ 211
Lease termination revenue	558	517	41
Tenant recoveries and other real estate operations revenue	24,567	24,468	99
Same Properties total revenues	114,196	113,845	351
Constructed and redeveloped properties placed in service	6,476	1,879	4,597
Wholesale data center	8,105	7,033	1,072
Dispositions	5	4,899	(4,894)
Other	380	641	(261)
	129,162	128,297	865
Property operating expenses			
Same Properties	(43,461)	(42,944)	(517)
Constructed and redeveloped properties placed in service	(1,666)	(867)	(799)
Wholesale data center	(4,150)	(3,501)	(649)
Dispositions	(8)	(941)	933
Other	(161)	(375)	214
	(49,446)	(48,628)	(818)
Same Properties UJV NOI allocable to COPT	1,202	1,198	4
NOI from real estate operations			
Same Properties	71,937	72,099	(162)
Constructed and redeveloped properties placed in service	4,810	1,012	3,798
Wholesale data center	3,955	3,532	423
Dispositions	(3)	3,958	(3,961)
Other	219	266	(47)
	\$ 80,918	\$ 80,867	\$ 51
Same Properties rent statistics			
Average occupancy rate	91.0	% 91.5	% (0.5)%
Average straight-line rent per occupied square foot (1)	\$ 6.45	\$ 6.39	\$ 0.06

(1) Includes minimum base rents, net of abatements, and lease incentives on a straight-line basis for the periods set forth above.

Our Same Properties pool consisted of 147 properties, comprising 91.9% of our office and data center shell portfolio's square footage as of June 30, 2018. This pool of properties included the following changes from the pool used for purposes of comparing 2017 and 2016 in our 2017 Annual Report on Form 10-K: the addition of 14 properties placed in service and 100% operational on or before January 1, 2017 (including six unconsolidated real estate joint venture properties and two properties added to our rentable square feet in 2018 that were previously reported as construction projects since they were held for future lease to the United States Government); and the removal of one property in 2018 for which we have no leasing plan or intention to allocate future capital and one property reclassified as redevelopment.

Our NOI from constructed and redeveloped properties placed in service included 12 properties placed in service in 2017 and 2018.

NOI from Service Operations

	For the Three Months Ended June 30,		
	2018	2017	Variance
	(in thousands)		
Construction contract and other service revenues	\$17,581	\$23,138	\$(5,557)
Construction contract and other service expenses	16,941	22,315	(5,374)
NOI from service operations	\$640	\$823	\$(183)

Construction contract and other service revenue and expenses decreased due primarily to a lower volume of construction activity in connection with several of our tenants. Construction contract activity is inherently subject to significant variability depending on the volume and nature of projects undertaken by us (primarily on behalf of tenants). Service operations are an ancillary component of our overall operations that typically contribute an insignificant amount of operating income relative to our real estate operations.

Comparison of Statements of Operations for the Six Months Ended June 30, 2018 and 2017

	For the Six Months Ended June 30,		
	2018	2017	Variance
	(in thousands)		
Revenues			
Revenues from real estate operations	\$257,440	\$255,064	\$2,376
Construction contract and other service revenues	44,779	36,172	8,607
Total revenues	302,219	291,236	10,983
Expenses			
Property operating expenses	100,397	97,147	3,250
Depreciation and amortization associated with real estate operations	66,702	65,852	850
Construction contract and other service expenses	43,157	34,801	8,356
Impairment losses	—	1,625	(1,625)
General, administrative and leasing expenses	14,920	16,470	(1,550)
Business development expenses and land carry costs	2,848	3,290	(442)
Total operating expenses	228,024	219,185	8,839
Operating income	74,195	72,051	2,144
Interest expense	(37,729)	(38,157)	428
Interest and other income	2,798	3,309	(511)
Loss on early extinguishment of debt	—	(513)	513
Equity in income of unconsolidated entities	746	747	(1)
Income tax expense	(118)	(88)	(30)
Income before gain on sales of real estate	39,892	37,349	2,543
Gain on sales of real estate	(27)	4,250	(4,277)
Net income	\$39,865	\$41,599	\$(1,734)

NOI from Real Estate Operations

For the Six Months Ended June 30,
 2018 2017 Variance
 (Dollars
 in thousands, except per square foot data)

Revenues

Same Properties revenues

Rental revenue, excluding lease termination revenue	\$ 177,410	\$ 177,472	\$ (62)
Lease termination revenue	1,566	1,223	343
Tenant recoveries and other real estate operations revenue	48,678	48,389	289
Same Properties total revenues	227,654	227,084	570
Constructed and redeveloped properties placed in service	12,370	2,373	9,997
Wholesale data center	16,182	13,803	2,379
Dispositions	140	10,443	(10,303)
Other	1,094	1,361	(267)
	257,440	255,064	2,376

Property operating expenses

Same Properties	(88,278)	(85,686)	(2,592)
Constructed and redeveloped properties placed in service	(3,277)	(1,520)	(1,757)
Wholesale data center	(8,408)	(6,866)	(1,542)
Dispositions	(30)	(2,191)	2,161
Other	(404)	(884)	480
	(100,397)	(97,147)	(3,250)

Same Properties UJV NOI allocable to COPT	2,401	2,400	1
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NOI from real estate operations

Same Properties	141,777	143,798	(2,021)
Constructed and redeveloped properties placed in service	9,093	853	8,240
Wholesale data center	7,774	6,937	837
Dispositions	110	8,252	(8,142)
Other	690	477	213
	\$ 159,444	\$ 160,317	\$ (873)

Same Properties rent statistics

Average occupancy rate	91.0	%	91.4	%	(0.4)%
Average straight-line rent per occupied square foot (1)	\$ 12.85		\$ 12.79		\$ 0.06

(1) Includes minimum base rents, net of abatements, and lease incentives on a straight-line basis for the periods set forth above.

The decrease in our Same Properties NOI from real estate operations reflected above was due primarily to higher snow and utilities expenses in the current period, as well as higher real estate taxes at certain properties resulting from increased property assessments.

Our NOI from constructed and redeveloped properties placed in service included 12 properties placed in service in 2017 and 2018.

NOI from Service Operations

	For the Six Months Ended		
	June 30,		
	2018	2017	Variance
	(in thousands)		
Construction contract and other service revenues	\$44,779	\$36,172	\$ 8,607
Construction contract and other service expenses	43,157	34,801	8,356
NOI from service operations	\$1,622	\$1,371	\$ 251

Construction contract and other service revenue and expenses increased due primarily to a greater volume of construction activity in connection with several of our tenants.

Gain on Sales of Real Estate

We recognized a gain on sales of real estate of \$4.3 million in the prior period in connection with a land sale.

Funds from Operations

Funds from operations (“FFO”) is defined as net income computed using GAAP, excluding gains on sales of, and impairment losses on, previously depreciated operating properties, plus real estate-related depreciation and amortization. When multiple properties consisting of both operating and non-operating properties exist on a single tax parcel, we classify all of the gains on sales of, and impairment losses on, the tax parcel as all being for previously depreciated operating properties when most of the value of the parcel is associated with operating properties on the parcel. FFO also includes adjustments to net income for the effects of the items noted above pertaining to UJVs that were allocable to our ownership interest in the UJVs. We believe that we use the National Association of Real Estate Investment Trusts (“NAREIT”) definition of FFO, although others may interpret the definition differently and, accordingly, our presentation of FFO may differ from those of other REITs. We believe that FFO is useful to management and investors as a supplemental measure of operating performance because, by excluding gains related to sales of, and impairment losses on, previously depreciated operating properties, net of related tax benefit, and excluding real estate-related depreciation and amortization, FFO can help one compare our operating performance between periods. In addition, since most equity REITs provide FFO information to the investment community, we believe that FFO is useful to investors as a supplemental measure for comparing our results to those of other equity REITs. We believe that net income is the most directly comparable GAAP measure to FFO.

Since FFO excludes certain items includable in net income, reliance on the measure has limitations; management compensates for these limitations by using the measure simply as a supplemental measure that is weighed in balance with other GAAP and non-GAAP measures. FFO is not necessarily an indication of our cash flow available to fund cash needs. Additionally, it should not be used as an alternative to net income when evaluating our financial performance or to cash flow from operating, investing and financing activities when evaluating our liquidity or ability to make cash distributions or pay debt service.

Basic FFO available to common share and common unit holders (“Basic FFO”) is FFO adjusted to subtract (1) preferred share dividends, (2) issuance costs associated with redeemed preferred shares, (3) income attributable to noncontrolling interests through ownership of preferred units in the Operating Partnership or interests in other consolidated entities not owned by us, (4) depreciation and amortization allocable to noncontrolling interests in other consolidated entities and (5) Basic FFO allocable to restricted shares. With these adjustments, Basic FFO represents FFO available to common shareholders and common unitholders. Common units in the Operating Partnership are substantially similar to our common shares and are exchangeable into common shares, subject to certain conditions. We believe that Basic FFO is useful to investors due to the close correlation of common units to common shares. We believe that net income is the most directly comparable GAAP measure to Basic FFO. Basic FFO has essentially the same limitations as FFO; management compensates for these limitations in essentially the same manner as described above for FFO.

Diluted FFO available to common share and common unit holders (“Diluted FFO”) is Basic FFO adjusted to add back any changes in Basic FFO that would result from the assumed conversion of securities that are convertible or exchangeable into common shares. We believe that Diluted FFO is useful to investors because it is the numerator used to compute Diluted FFO per share, discussed below. We believe that net income is the most directly comparable GAAP measure to Diluted FFO. Since Diluted FFO excludes certain items includable in the numerator to diluted

EPS, reliance on the measure has limitations; management compensates for these limitations by using the measure simply as a supplemental measure that is weighed in the balance with other GAAP and non-GAAP measures. Diluted FFO is not necessarily an indication of our cash flow available to fund cash needs. Additionally, it should not be used as an alternative to net income when evaluating our financial performance or to cash flow from operating, investing and financing activities when evaluating our liquidity or ability to make cash distributions or pay debt service.

Diluted FFO available to common share and common unit holders, as adjusted for comparability is defined as Diluted FFO adjusted to exclude operating property acquisition costs; gains on sales of, and impairment losses on, properties other than previously depreciated operating properties, net of associated income tax; gain or loss on early extinguishment of debt; FFO associated with properties securing non-recourse debt on which we have defaulted and which we have extinguished, or expect to extinguish, via conveyance of such properties, including property NOI, interest expense and gains on debt extinguishment; loss on interest rate derivatives; demolition costs on redevelopment and nonrecurring improvements; executive transition costs;

and issuance costs associated with redeemed preferred shares. This measure also includes adjustments for the effects of the items noted above pertaining to UJVs that were allocable to our ownership interest in the UJVs. We believe this to be a useful supplemental measure alongside Diluted FFO as it excludes gains and losses from certain investing and financing activities and certain other items that we believe are not closely correlated to (or associated with) our operating performance. We believe that net income is the most directly comparable GAAP measure to this non-GAAP measure. This measure has essentially the same limitations as Diluted FFO, as well as the further limitation of not reflecting the effects of the excluded items; we compensate for these limitations in essentially the same manner as described above for Diluted FFO.

Diluted FFO per share is (1) Diluted FFO divided by (2) the sum of the (a) weighted average common shares outstanding during a period, (b) weighted average common units outstanding during a period and (c) weighted average number of potential additional common shares that would have been outstanding during a period if other securities that are convertible or exchangeable into common shares were converted or exchanged. We believe that Diluted FFO per share is useful to investors because it provides investors with a further context for evaluating our FFO results in the same manner that investors use earnings per share ("EPS") in evaluating net income available to common shareholders. In addition, since most equity REITs provide Diluted FFO per share information to the investment community, we believe that Diluted FFO per share is a useful supplemental measure for comparing us to other equity REITs. We believe that diluted EPS is the most directly comparable GAAP measure to Diluted FFO per share. Diluted FFO per share has most of the same limitations as Diluted FFO (described above); management compensates for these limitations in essentially the same manner as described above for Diluted FFO.

Diluted FFO per share, as adjusted for comparability is (1) Diluted FFO, as adjusted for comparability divided by (2) the sum of the (a) weighted average common shares outstanding during a period, (b) weighted average common units outstanding during a period and (c) weighted average number of potential additional common shares that would have been outstanding during a period if other securities that are convertible or exchangeable into common shares were converted or exchanged. We believe that this measure is useful to investors because it provides investors with a further context for evaluating our FFO results. We believe this to be a useful supplemental measure alongside Diluted FFO per share as it excludes gains and losses from certain investing and financing activities and certain other items that we believe are not closely correlated to (or associated with) our operating performance. We believe that diluted EPS is the most directly comparable GAAP measure to this per share measure. This measure has most of the same limitations as Diluted FFO (described above) as well as the further limitation of not reflecting the effects of the excluded items; we compensate for these limitations in essentially the same manner as described above for Diluted FFO.

The computations for all of the above measures on a diluted basis assume the conversion of common units in COPLP but do not assume the conversion of other securities that are convertible into common shares if the conversion of those securities would increase per share measures in a given period.

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The table below sets forth the computation of the above stated measures for the three and six months ended June 30, 2018 and 2017, and provides reconciliations to the GAAP measures of COPT and subsidiaries associated with such measures:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
	(Dollars and shares in thousands, except per share data)			
Net income	\$21,085	\$18,859	\$39,865	\$41,599
Add: Real estate-related depreciation and amortization	33,190	32,793	66,702	65,852
Add: Depreciation and amortization on UJV allocable to COPT	564	563	1,127	1,126
Add: Impairment losses on previously depreciated operating properties	—	1,610	—	1,610
Less: Gain on sales of previously depreciated operating properties	23	(12)	27	(31)
FFO	54,862	53,813	107,721	110,156
Less: Noncontrolling interests-preferred units in the Operating Partnership	(165)	(165)	(330)	(330)
Less: FFO allocable to other noncontrolling interests	(753)	(906)	(1,697)	(1,884)
Less: Preferred share dividends	—	(3,039)	—	(6,219)
Less: Issuance costs associated with redeemed preferred shares	—	(6,847)	—	(6,847)
Basic and diluted FFO allocable to share-based compensation awards	(224)	(185)	(437)	(401)
Basic and diluted FFO available to common share and common unit holders	53,720	42,671	105,257	94,475
Gain on sales of non-operating properties	—	—	—	(4,219)
Impairment losses on non-operating properties	—	15	—	15
Loss (gain) on interest rate derivatives	—	444	—	(9)
Loss on early extinguishment of debt	—	513	—	513
Issuance costs associated with redeemed preferred shares	—	6,847	—	6,847
Executive transition costs	213	31	376	730
Demolition costs on redevelopment and nonrecurring improvements	9	72	48	294
Diluted FFO comparability adjustments allocable to share-based compensation awards	(1)	(31)	(2)	(17)
Diluted FFO available to common share and common unit holders, as adjusted for comparability	\$53,941	\$50,562	\$105,679	\$98,629
Weighted average common shares	101,789	99,036	101,397	98,725
Conversion of weighted average common units	3,197	3,405	3,208	3,425
Weighted average common shares/units - Basic FFO	104,986	102,441	104,605	102,150
Dilutive effect of share-based compensation awards	119	160	131	158
Weighted average common shares/units - Diluted FFO	105,105	102,601	104,736	102,308
Diluted FFO per share	\$0.51	\$0.42	\$1.00	\$0.92
Diluted FFO per share, as adjusted for comparability	\$0.51	\$0.49	\$1.01	\$0.96
Denominator for diluted EPS	101,908	99,196	101,528	98,883
Weighted average common units	3,197	3,405	3,208	3,425
Denominator for diluted FFO per share measures	105,105	102,601	104,736	102,308

Property Additions

The table below sets forth the major components of our additions to properties for the six months ended June 30, 2018 (in thousands):

Construction, development and redevelopment	\$73,323
Tenant improvements on operating properties (1)	15,624
Capital improvements on operating properties	7,697
	\$96,644

(1) Tenant improvement costs incurred on newly-constructed properties are classified in this table as construction, development and redevelopment.

Cash Flows

Net cash flow from operating activities decreased \$36.8 million when comparing the six months ended June 30, 2018 and 2017 due primarily to our payment in 2018 of construction costs on a contract that the customer pre-funded to us in prior years.

Net cash flow from investing activities decreased \$38.0 million when comparing the six months ended June 30, 2018 and 2017 due primarily to a decrease in property sales in 2018 relative to 2017, which was offset in part by lower expenditures for development in 2018 relative to 2017.

Net cash flow provided by financing activities in the six months ended June 30, 2018 was \$13.8 million, and included the following:

- net debt borrowings of \$41.9 million; and
- net proceeds from the issuance of common shares (or units) of \$52.3 million; offset in part by dividends and/or distributions to equity holders of \$58.1 million; and
- payments on a capital lease obligation of \$15.4 million.

Net cash flow used in financing activities in the six months ended June 30, 2017 was \$258.0 million, and included the following:

- redemption of preferred shares (or units) of \$199.1 million; and
- dividends and/or distributions to equity holders of \$66.0 million; offset in part by
- net proceeds from the issuance of common shares (or units) of \$19.8 million.

Liquidity and Capital Resources of COPT

COPLP 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. COPT occasionally issues public equity but does not otherwise generate any capital itself or conduct any business itself, other than incurring certain expenses in operating as a public company which are fully reimbursed by COPLP. COPT itself does not hold any indebtedness, and its only material asset is its ownership of partnership interests of COPLP. COPT's principal funding requirement is the payment of dividends on its common and preferred shares. COPT's principal source of funding for its dividend payments is distributions it receives from COPLP.

As of June 30, 2018, COPT owned 97.0% of the outstanding common units in COPLP; the remaining common units and all of the outstanding preferred units were owned by third parties. As the sole general partner of COPLP, COPT

has the full, exclusive and complete responsibility for COPLP's day-to-day management and control.

The liquidity of COPT is dependent on COPLP's ability to make sufficient distributions to COPT. The primary cash requirement of COPT is its payment of dividends to its shareholders. COPT also guarantees some of the Operating Partnership's debt, as discussed further in Note 9 of the notes to consolidated financial statements included elsewhere herein. If the Operating Partnership fails to fulfill certain of its debt requirements, which trigger COPT's guarantee obligations, then COPT will be required to fulfill its cash payment commitments under such guarantees. However, COPT's only significant asset is its investment in COPLP.

As discussed further below, we believe the Operating Partnership's sources of working capital, specifically its cash flow from operations, and borrowings available under its Revolving Credit Facility, are adequate for it to make its distribution payments to COPT and, in turn, for COPT to make its dividend payments to its shareholders.

COPT's short-term liquidity requirements consist primarily of funds to pay for future dividends expected to be paid to its shareholders. COPT periodically accesses the public equity markets to raise capital by issuing common and/or preferred shares.

For COPT to maintain its qualification as a REIT, it must pay dividends to its shareholders aggregating annually at least 90% of its ordinary taxable income. As a result of this distribution requirement, it cannot rely on retained earnings to fund its ongoing operations to the same extent that some other companies can. COPT may need to continue to raise capital in the equity markets to fund COPLP's working capital needs, acquisitions and developments.

Liquidity and Capital Resources of COPLP

COPLP's primary cash requirements are for operating expenses, debt service, development of new properties, improvements to existing properties and acquisitions, to the extent they are pursued in the future. We expect COPLP to continue to use cash flow provided by operations as the primary source to meet its short-term capital needs, including property operating expenses, general and administrative expenses, interest expense, scheduled principal amortization of debt, distributions to its security holders and improvements to existing properties. As of June 30, 2018, COPLP had \$8.5 million in cash and cash equivalents.

COPLP's senior unsecured debt is currently rated investment grade by the three major rating agencies. We aim to maintain an investment grade rating to enable COPLP to use debt comprised of unsecured, primarily fixed-rate debt (including the effect of interest rate swaps) from public markets and banks. COPLP also uses secured nonrecourse debt from institutional lenders and banks for joint venture financing. In addition, COPLP periodically raises equity from COPT when COPT accesses the public equity markets by issuing common and/or preferred shares.

COPLP uses its Revolving Credit Facility to initially finance much of its investing activities. COPLP subsequently pays down the facility using cash available from operations and proceeds from long-term borrowings, equity issuances and property sales. The lenders' aggregate commitment under the facility is \$800.0 million, with the ability for COPLP to increase the lenders' aggregate commitment to \$1.3 billion, provided that there is no default under the facility and subject to the approval of the lenders. The Revolving Credit Facility matures in May 2019, and may be extended by two six-month periods at COPLP's option, provided that there is no default under the facility and it pays an extension fee of 0.075% of the total availability of the facility. As of June 30, 2018, the maximum borrowing capacity under this facility totaled \$800.0 million, of which \$630.0 million was available.

As of June 30, 2018, COPT had forward equity sale agreements in place with 5.7 million shares available for future issuance with a settlement value of \$167.0 million that we expect to use to fund development costs.

We believe that COPLP's liquidity and capital resources are adequate for its near-term and longer-term requirements without necessitating property sales. However, we may dispose of interests in properties opportunistically or when capital markets otherwise warrant.

The following table summarizes our contractual obligations as of June 30, 2018 (in thousands):

	For the Periods Ending December 31,						
	2018	2019	2020	2021	2022	Thereafter	Total
Contractual obligations (1)							
Debt (2)							
Balloon payments due upon maturity	\$—	\$170,000	\$112,132	\$300,000	\$250,000	\$1,026,830	\$1,858,962
Scheduled principal payments (3)	2,138	4,387	4,024	3,875	4,033	6,647	25,104
Interest on debt (3)(4)	38,058	72,195	67,801	59,606	54,475	63,592	355,727
New construction and redevelopment obligations (5)(6)	88,630	797	—	—	—	—	89,427
Third-party construction obligations (6)(7)	3,076	1,378	—	—	—	—	4,454
Capital expenditures for operating properties (3)(6)(8)	13,360	18,990	9,158	—	—	—	41,508
Capital lease obligation (principal and interest)	—	—	660	—	—	—	660
Operating leases (3)	644	1,277	1,270	1,274	1,158	84,611	90,234
Other obligations (3)	379	434	254	182	178	977	2,404
Total contractual cash obligations	\$146,285	\$269,458	\$195,299	\$364,937	\$309,844	\$1,182,657	\$2,468,480

The contractual obligations set forth in this table exclude property operations contracts that may be terminated with (1) notice of one month or less and also exclude accruals and payables incurred (with the exclusion of debt) and therefore reflected in our reported liabilities.

Represents scheduled principal amortization payments and maturities only and therefore excludes net debt (2) discounts and deferred financing costs of \$12.6 million. As of June 30, 2018, maturities included \$170.0 million in 2019 that may be extended to 2020, subject to certain conditions.

(3) We expect to pay these items using cash flow from operations.

Represents interest costs for our outstanding debt as of June 30, 2018 for the terms of such debt. For variable rate (4) debt, the amounts reflected above used June 30, 2018 interest rates on variable rate debt in computing interest costs for the terms of such debt. We expect to pay these items using cash flow from operations.

(5) Represents contractual obligations pertaining to new development and redevelopment activities.

(6) Due to the long-term nature of certain construction and development contracts and leases included in these lines, the amounts reported in the table represent our estimate of the timing for the related obligations being payable.

(7) Represents contractual obligations pertaining to projects for which we are acting as construction manager on behalf of unrelated parties who are our clients. We expect to be reimbursed in full for these costs by our clients.

(8) Represents contractual obligations pertaining to capital expenditures for our operating properties. We expect to pay these costs primarily using cash flow from operating activities.

We expect to spend approximately \$200 million on construction and development costs and approximately \$35 million on improvements to operating properties (including the commitments set forth in the table above) during the remainder of 2018. We expect to fund the construction and development costs initially using primarily borrowings under our Revolving Credit Facility and proceeds from common shares issued under COPT's forward equity sale agreements. We expect to fund improvements to existing operating properties using cash flow from operating activities.

Certain of our debt instruments require that we comply with a number of restrictive financial covenants, including maximum leverage ratio, unencumbered leverage ratio, minimum net worth, minimum fixed charge coverage, minimum unencumbered interest coverage ratio, minimum debt service and maximum secured indebtedness ratio. As of June 30, 2018, we were compliant with these covenants.

Off-Balance Sheet Arrangements

We had no material off-balance sheet arrangements during the six months ended June 30, 2018.

Inflation

Most of our tenants are obligated to pay their share of a property's operating expenses to the extent such expenses exceed amounts established in their leases, which are based on historical expense levels. Some of our tenants are obligated to pay their full share of a building's operating expenses. These arrangements somewhat reduce our exposure to increases in such costs resulting from inflation.

Recent Accounting Pronouncements

See Note 2 to our consolidated financial statements for information regarding recent accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to certain market risks, one of the most predominant of which is a change in interest rates. Increases in interest rates can result in increased interest expense under our Revolving Credit Facility and other variable rate debt. Increases in interest rates can also result in increased interest expense when our fixed rate debt matures and needs to be refinanced.

The following table sets forth as of June 30, 2018 our debt obligations and weighted average interest rates on debt maturing each year (dollars in thousands):

	For the Periods Ending December 31,						Total
	2018	2019	2020	2021	2022	Thereafter	
Debt:							
Fixed rate debt (1)	\$1,946	\$3,991	\$3,718	\$303,875	\$4,033	\$1,033,477	\$1,351,040
Weighted average interest rate	4.37	% 4.36	% 3.96	% 3.70	% 3.98	% 4.48	% 4.30
Variable rate debt (2)	\$192	\$170,396	\$112,438	\$—	\$250,000	\$—	\$533,026
Weighted average interest rate (3)	3.83	% 3.19	% 3.44	% —	% 3.34	% —	% 3.31

(1) Represents principal maturities only and therefore excludes net discounts and deferred financing costs of \$12.6 million.

(2) As of June 30, 2018, maturities included \$170.0 million in 2019 that may be extended to 2020, subject to certain conditions.

(3) The amounts reflected above used interest rates as of June 30, 2018 for variable rate debt.

The fair value of our debt was \$1.9 billion as of June 30, 2018. If interest rates had been 1% lower, the fair value of our fixed-rate debt would have increased by approximately \$61 million as of June 30, 2018.

See Note 10 to our consolidated financial statements for information pertaining to interest rate swap contracts in place as of June 30, 2018 and their respective fair values.

Based on our variable-rate debt balances, including the effect of interest rate swap contracts, our interest expense would have increased by \$902,000 in the six months ended June 30, 2018 if the applicable LIBOR rate was 1% higher.

Item 4. Controls and Procedures

COPT

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of COPT's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of June 30, 2018. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that COPT's disclosure controls and procedures as of June 30, 2018 were functioning effectively to provide reasonable

assurance that the information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to its management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Change in Internal Control over Financial Reporting

No change in the COPT's internal control over financial reporting occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

COPLP

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of COPLP's disclosure controls and procedures (as defined in Rule 15d-15(e) under the Exchange Act) as of June 30, 2018. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that COPLP's disclosure controls and procedures as of June 30, 2018 were functioning effectively to provide reasonable assurance that the information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to its management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Change in Internal Control over Financial Reporting

No change in the COPLP's internal control over financial reporting occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

We are not currently involved in any material litigation nor, to our knowledge, is any material litigation currently threatened against the Company or the Operating Partnership (other than routine litigation arising in the ordinary course of business, substantially all of which is expected to be covered by liability insurance).

Item 1A. Risk Factors

There have been no material changes to the risk factors included in our 2017 Annual Report on Form 10-K.

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

None.

Item 3. Defaults Upon Senior Securities

(a) Not applicable

(b) Not applicable

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

(a) Exhibits:

EXHIBIT NO.	DESCRIPTION
<u>3.1</u>	<u>Amended and Restated Declaration of Trust of Corporate Office Properties Trust, as amended through May 15, 2018 (filed herewith).</u>
<u>12.1</u>	<u>COPT's Statement regarding Computation of Consolidated Ratio of Earnings to Combined Fixed Charges and Preferred Share Dividends (filed herewith).</u>
<u>12.2</u>	<u>COPLP's Statement regarding Computation of Consolidated Ratio of Earnings to Fixed Charges (filed herewith).</u>
<u>31.1</u>	<u>Certification of the Chief Executive Officer of Corporate Office Properties Trust required by Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith).</u>
<u>31.2</u>	<u>Certification of the Chief Financial Officer of Corporate Office Properties Trust required by Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith).</u>
<u>31.3</u>	<u>Certification of the Chief Executive Officer of Corporate Office Properties, L.P. required by Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith).</u>
<u>31.4</u>	<u>Certification of the Chief Financial Officer of Corporate Office Properties, L.P. required by Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith).</u>
<u>32.1</u>	<u>Certification of the Chief Executive Officer of Corporate Office Properties Trust required by Rule 13a-14(b) under the Securities Exchange Act of 1934, as amended. (This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Exchange Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.) (Furnished herewith).</u>
<u>32.2</u>	<u>Certification of the Chief Financial Officer of Corporate Office Properties Trust required by Rule 13a-14(b) under the Securities Exchange Act of 1934, as amended. (This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Exchange Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.) (Furnished herewith).</u>
<u>32.3</u>	<u>Certification of the Chief Executive Officer of Corporate Office Properties, L.P. required by Rule 15d-14(b) under the Securities Exchange Act of 1934, as amended. (This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Exchange Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.) (Furnished herewith).</u>

32.4 Certification of the Chief Financial Officer of Corporate Office Properties, L.P. required by Rule 15d-14(b) under the Securities Exchange Act of 1934, as amended. (This exhibit shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Exchange Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended). (Furnished herewith).

101.INS XBRL Instance Document (filed herewith).

101.SCH XBRL Taxonomy Extension Schema Document (filed herewith).

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document (filed herewith).

101.LAB XBRL Extension Labels Linkbase (filed herewith).

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document (filed herewith).

101.DEF XBRL Taxonomy Extension Definition Linkbase Document (filed herewith).

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the undersigned Registrants have duly caused this report to be signed on their behalf by the undersigned thereunto duly authorized.

CORPORATE OFFICE PROPERTIES TRUST

CORPORATE OFFICE PROPERTIES, L.P.

By: Corporate Office Properties Trust,
its General Partner

/s/ Stephen E. Budorick
Stephen E. Budorick
President and Chief Executive Officer

/s/ Stephen E. Budorick
Stephen E. Budorick
President and Chief Executive Officer

/s/ Anthony Mifsud
Anthony Mifsud
Executive Vice President and Chief Financial
Officer

/s/ Anthony Mifsud
Anthony Mifsud
Executive Vice President and Chief Financial
Officer

Dated: July 31, 2018

Dated: July 31, 2018