CORPORATE OFFICE PROPERTIES TRUST
Form 10-Q
July 31, 2009
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, DC 20549**

# FORM 10-Q

**(Mark one)**

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

**For the quarterly period ended June 30, 2009**

**or**

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

**For the transition period from to**

**Commission file number 1-14023**

# Corporate Office Properties Trust

(Exact name of registrant as specified in its charter)

| **Maryland** | **23-2947217** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |
| **6711 Columbia Gateway Drive, Suite 300, Columbia, MD** | **21046** |
| (Address of principal executive offices) | (Zip Code) |

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

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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. x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). o Yes o No

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

| Large accelerated filer x | Accelerated filer o |
|---|---|
| Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

As of July 22, 2009, 58,016,093 of the Company s Common Shares of Beneficial Interest, $0.01 par value, were issued and outstanding.

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**PART I: FINANCIAL INFORMATION**

**ITEM 1. Financial Statements**

**Corporate Office Properties Trust and Subsidiaries**

**Consolidated Balance Sheets**

**(Dollars in thousands)**

**(unaudited)**

| | June 30, 2009 | December 31, 2008 |
|---|---|---|
| **Assets** | | |
| Properties, net: | | |
| Operating properties, net | $ 2,340,574 | $ 2,283,870 |
| Projects under construction or development | 513,562 | 494,596 |
| Total properties, net | 2,854,136 | 2,778,466 |
| Cash and cash equivalents | 11,931 | 6,775 |
| Restricted cash | 17,879 | 13,745 |
| Accounts receivable, net | 13,776 | 13,684 |
| Deferred rent receivable | 67,137 | 64,131 |
| Intangible assets on real estate acquisitions, net | 81,090 | 91,848 |
| Deferred charges, net | 48,812 | 51,801 |
| Prepaid expenses and other assets | 103,914 | 93,789 |
| **Total assets** | $ 3,198,675 | $ 3,114,239 |
| | | |
| **Liabilities and equity** | | |
| Liabilities: | | |
| Mortgage and other loans payable | $ 1,677,351 | $ 1,704,123 |
| 3.5% Exchangeable Senior Notes, net | 154,362 | 152,628 |
| Accounts payable and accrued expenses | 142,734 | 93,625 |
| Rents received in advance and security deposits | 29,936 | 30,464 |
| Dividends and distributions payable | 27,057 | 25,794 |
| Deferred revenue associated with acquired operating leases | 8,926 | 10,816 |
| Distributions in excess of investment in unconsolidated real estate joint venture | 4,873 | 4,770 |
| Other liabilities | 7,029 | 9,596 |
| Total liabilities | 2,052,268 | 2,031,816 |
| Commitments and contingencies (Note 15) | | |
| Equity: | | |
| Corporate Office Properties Trust s shareholders equity: | | |
| Preferred Shares of beneficial interest with an aggregate liquidation preference of $216,333 ($0.01 par value; 15,000,000 shares authorized and 8,121,667 issued and outstanding at June 30, 2009 and December 31, 2008) | 81 | 81 |
| Common Shares of beneficial interest ($0.01 par value; 75,000,000 shares authorized, shares issued and outstanding of 58,016,683 at June 30, 2009 and 51,790,442 at December 31, 2008) | 580 | 518 |
| Additional paid-in capital | 1,229,931 | 1,112,734 |
| Cumulative distributions in excess of net income | (179,698) | (162,572) |

| | | | | |
|---|---|---|---|---|
| Accumulated other comprehensive loss | | (1,176) | | (4,749) |
| Total Corporate Office Properties Trust s shareholders equity | | 1,049,718 | | 946,012 |
| Noncontrolling interests in subsidiaries: | | | | |
| Common units in the Operating Partnership | | 76,873 | | 117,356 |
| Preferred units in the Operating Partnership | | 8,800 | | 8,800 |
| Other consolidated real estate joint ventures | | 11,016 | | 10,255 |
| Noncontrolling interests in subsidiaries | | 96,689 | | 136,411 |
| Total equity | | 1,146,407 | | 1,082,423 |
| **Total liabilities and equity** | $ | 3,198,675 | $ | 3,114,239 |

See accompanying notes to consolidated financial statements.

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**Corporate Office Properties Trust and Subsidiaries**

**Consolidated Statements of Operations**

**(Dollars in thousands, except per share data)**

**(unaudited)**

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Revenues | | | | |
| Rental revenue | $ 88,326 | $ 83,154 | $ 177,848 | $ 164,864 |
| Tenant recoveries and other real estate operations revenue | 17,392 | 14,792 | 34,714 | 30,084 |
| Construction contract revenues | 102,753 | 21,899 | 177,292 | 32,035 |
| Other service operations revenues | 571 | 525 | 921 | 1,003 |
| Total revenues | 209,042 | 120,370 | 390,775 | 227,986 |
| Expenses | | | | |
| Property operating expenses | 37,162 | 33,957 | 76,195 | 68,499 |
| Depreciation and other amortization associated with real estate operations | 28,708 | 24,955 | 55,199 | 49,847 |
| Construction contract expenses | 100,647 | 21,472 | 173,545 | 31,377 |
| Other service operations expenses | 514 | 454 | 939 | 1,056 |
| General and administrative expenses | 5,834 | 5,934 | 11,377 | 11,704 |
| Business development expenses | 446 | 102 | 1,092 | 265 |
| Total operating expenses | 173,311 | 86,874 | 318,347 | 162,748 |
| Operating income | 35,731 | 33,496 | 72,428 | 65,238 |
| Interest expense | (18,678) | (21,162) | (38,102) | (43,077) |
| Interest and other income | 1,252 | 170 | 2,330 | 365 |
| Income from continuing operations before equity in loss of unconsolidated entities and income taxes | 18,305 | 12,504 | 36,656 | 22,526 |
| Equity in loss of unconsolidated entities | (202) | (56) | (317) | (110) |
| Income tax (expense) benefit | (52) | 107 | (122) | (5) |
| Income from continuing operations | 18,051 | 12,555 | 36,217 | 22,411 |
| Discontinued operations | | 1,314 | | 2,580 |
| Income before gain on sales of real estate | 18,051 | 13,869 | 36,217 | 24,991 |
| Gain on sales of real estate, net of income taxes | | 41 | | 1,100 |
| Net income | 18,051 | 13,910 | 36,217 | 26,091 |
| Less net income attributable to noncontrolling interests: | | | | |
| Common units in the Operating Partnership | (1,272) | (1,461) | (3,076) | (2,663) |
| Preferred units in the Operating Partnership | (165) | (165) | (330) | (330) |
| Other | 25 | (122) | (25) | (222) |
| Net income attributable to Corporate Office Properties Trust | 16,639 | 12,162 | 32,786 | 22,876 |
| Preferred share dividends | (4,026) | (4,026) | (8,051) | (8,051) |
| Net income attributable to Corporate Office Properties Trust common shareholders | $ 12,613 | $ 8,136 | $ 24,735 | $ 14,825 |
| Net income attributable to Corporate Office Properties Trust | | | | |
| Income from continuing operations | $ 16,639 | $ 11,047 | $ 32,786 | $ 20,689 |
| Discontinued operations | | 1,115 | | 2,187 |
| Net income attributable to Corporate Office Properties Trust | $ 16,639 | $ 12,162 | $ 32,786 | $ 22,876 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Basic earnings per common share (1) | | | | | | | | |
| Income from continuing operations | $ | 0.22 | $ | 0.15 | $ | 0.45 | $ | 0.26 |
| Discontinued operations | | | | 0.02 | | | | 0.05 |
| Net income | $ | 0.22 | $ | 0.17 | $ | 0.45 | $ | 0.31 |
| Diluted earnings per common share (1) | | | | | | | | |
| Income from continuing operations | $ | 0.22 | $ | 0.15 | $ | 0.44 | $ | 0.26 |
| Discontinued operations | | | | 0.02 | | | | 0.04 |
| Net income | $ | 0.22 | $ | 0.17 | $ | 0.44 | $ | 0.30 |
| Dividends declared per common share | $ | 0.3725 | $ | 0.3400 | $ | 0.7450 | $ | 0.6800 |

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

See accompanying notes to consolidated financial statements.

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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 Loss | Noncontrolling Interests in Subsidiaries | Total |
|---|---|---|---|---|---|---|---|
| Balance at December 31, 2008 (51,790,442 common shares outstanding) | $ 81 | $ 518 | $ 1,112,734 | $ (162,572) | $ (4,749) | $ 136,411 | $ 1,082,423 |
| Conversion of common units to common shares (2,824,000 shares) | | 28 | 61,368 | | | (61,396) | |
| Common shares issued to the public (2,990,000 shares) | | 30 | 71,795 | | | | 71,825 |
| Exercise of share options (153,177 shares) | | 2 | 1,855 | | | | 1,857 |
| Share-based compensation | | 2 | 5,248 | | | | 5,250 |
| Restricted common share redemptions (71,267 shares) | | | (1,752) | | | | (1,752) |
| Adjustments to noncontrolling interests resulting from changes in ownership of Operating Partnership by COPT | | | (21,165) | | | 21,165 | |
| Increase in fair value of derivatives | | | | | 3,573 | 650 | 4,223 |
| Decrease in tax benefit from share-based compensation | | | (152) | | | | (152) |
| Net income | | | | 32,786 | | 3,431 | 36,217 |
| Dividends | | | | (49,912) | | | (49,912) |
| Distributions to owners of common and preferred units in the Operating Partnership | | | | | | (4,308) | (4,308) |
| Net contributions and distributions to noncontrolling interests in other consolidated real estate joint ventures | | | | | | 736 | 736 |
| Balance at June 30, 2009 (58,016,683 common shares outstanding) | $ 81 | $ 580 | $ 1,229,931 | $ (179,698) | $ (1,176) | $ 96,689 | $ 1,146,407 |
| | | | | | | | |
| Balance at December 31, 2007 (47,366,475 common shares outstanding) | $ 81 | $ 474 | $ 971,459 | $ (129,599) | $ (2,372) | $ 129,437 | $ 969,480 |
| Conversion of common units to common shares (15,242 shares) | | 1 | 419 | | | (420) | |
| Exercise of share options (90,209 shares) | | 1 | 1,346 | | | | 1,347 |
| Share-based compensation | | 1 | 4,555 | | | | 4,556 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Restricted common share redemptions (40,892 shares) | | | (1,304) | | | | (1,304) |
| Decrease in fair value of derivatives | | | | | (243) | (41) | (284) |
| Increase in tax benefit from share-based compensation | | | 1,053 | | | | 1,053 |
| Net income | | | | 22,876 | | 3,215 | 26,091 |
| Dividends | | | | (40,422) | | | (40,422) |
| Distributions to owners of common and preferred units in the Operating Partnership | | | | | | (5,872) | (5,872) |
| Net contributions and distributions to noncontrolling interests in other consolidated real estate joint ventures | | | | | | 2,868 | 2,868 |
| Balance at June 30, 2008 (47,701,812 common shares outstanding) | $ 81 | $ 477 | $ 977,528 | $ (147,145) | $ (2,615) | $ 129,187 | $ 957,513 |

See accompanying notes to consolidated financial statements.

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**Corporate Office Properties Trust and Subsidiaries**

**Consolidated Statements of Cash Flows**

**(Dollars in thousands)**

**(unaudited)**

| | For the Six Months Ended June 30, | |
|---|---|---|
| | **2009** | **2008** |
| **Cash flows from operating activities** | | |
| Net income | $ 36,217 | $ 26,091 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and other amortization | 56,311 | 50,676 |
| Amortization of deferred financing costs | 2,033 | 1,661 |
| Amortization of deferred market rental revenue | (997) | (903) |
| Amortization of net debt discounts | 1,663 | 1,936 |
| Gain on sales of real estate | | (4,204) |
| Share-based compensation | 5,250 | 4,556 |
| Excess income tax shortfall (benefit) from share-based compensation | 152 | (1,053) |
| Other | (1,946) | 402 |
| Changes in operating assets and liabilities: | | |
| Increase in deferred rent receivable | (3,006) | (5,701) |
| (Increase) decrease in accounts receivable | (92) | 1,379 |
| (Increase) decrease in restricted cash and prepaid expenses and other assets | (4,681) | 3,380 |
| Increase in accounts payable, accrued expenses and other liabilities | 38,055 | 4,406 |
| (Decrease) increase in rents received in advance and security deposits | (528) | 1,335 |
| Net cash provided by operating activities | 128,431 | 83,961 |
| | | |
| **Cash flows from investing activities** | | |
| Purchases of and additions to properties | (101,650) | (149,699) |
| Proceeds from sales of properties | 65 | 28,304 |
| Leasing costs paid | (6,282) | (2,383) |
| Other | (4,636) | (2,504) |
| Net cash used in investing activities | (112,503) | (126,282) |
| | | |
| **Cash flows from financing activities** | | |
| Proceeds from mortgage and other loans payable | 314,147 | 227,932 |
| Repayments of mortgage and other loans payable | (340,848) | (149,374) |
| Deferred financing costs paid | (202) | (2,250) |
| Net proceeds from issuance of common shares | 73,682 | 1,350 |
| Dividends paid | (47,596) | (40,309) |
| Distributions paid | (5,361) | (5,878) |
| Excess income tax (shortfall) benefit from share-based compensation | (152) | 1,053 |
| Restricted share redemptions | (1,752) | (1,304) |
| Other | (2,690) | (680) |
| Net cash (used in) provided by financing activities | (10,772) | 30,540 |
| | | |
| Net increase (decrease) in cash and cash equivalents | 5,156 | (11,781) |
| **Cash and cash equivalents** | | |
| Beginning of period | 6,775 | 24,638 |
| End of period | $ 11,931 | $ 12,857 |

See accompanying notes to consolidated financial statements.

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**Corporate Office Properties Trust and Subsidiaries**

**Notes to Consolidated Financial Statements**

**(Dollars in thousands, except per share data)**

**(unaudited)**

## 1. Organization

Corporate Office Properties Trust ( COPT ) and subsidiaries (collectively, the Company , we or us ) is a fully-integrated and self-managed real estate investment trust ( REIT ) that focuses primarily on strategic customer relationships and specialized tenant requirements in the United States Government, defense information technology and data sectors. We acquire, develop, manage and lease properties that are typically concentrated in large office parks primarily located adjacent to government demand drivers and/or in demographically strong markets possessing growth opportunities. As of June 30, 2009, our investments in real estate included the following:

- 243 wholly owned operating properties totaling 18.7 million square feet;
- 16 wholly owned properties under construction or development that we estimate will total approximately 1.8 million square feet upon completion;
- wholly owned land parcels totaling 1,530 acres that we believe are potentially developable into approximately 13.1 million square feet; and
- partial ownership interests in a number of other real estate projects in operation, under development or redevelopment or held for future development.

We conduct almost all of our operations through our operating partnership, Corporate Office Properties, L.P. (the Operating Partnership ), for which we are the managing general partner. The Operating Partnership owns real estate both directly and through subsidiary partnerships and limited liability companies ( LLCs ). A summary of our Operating Partnership s forms of ownership and the percentage of those securities owned by COPT as of June 30, 2009 follows:

| | |
|---|---|
| Common Units | 92% |
| Series G Preferred Units | 100% |
| Series H Preferred Units | 100% |
| Series I Preferred Units | 0% |
| Series J Preferred Units | 100% |
| Series K Preferred Units | 100% |

Three of our trustees also controlled, either directly or through ownership by other entities or family members, 7% of the Operating Partnership s common units at that date.

In addition to owning interests in real estate, the Operating Partnership also owns 100% of a number of entities that provide real estate services such as property management, construction and development and heating and air conditioning services primarily for our properties but also for third parties.

## 2. Summary of Significant Accounting Policies

**Basis of Presentation**

The consolidated financial statements include the accounts of COPT, the Operating Partnership, their subsidiaries and other entities in which we have 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 significant 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 the entity s operations but cannot control the entity s operations. We use the cost method of accounting when we own an interest in an entity and cannot exert significant influence over its operations.

In preparing the consolidated financial statements, we evaluated subsequent events occurring through July 31, 2009, the date the financial statements were issued.

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These interim financial statements should be read together with the financial statements and notes thereto as of and for the year ended December 31, 2008 included in our Current Report on Form 8-K filed on June 2, 2009. The unaudited consolidated financial statements include all adjustments which are necessary, in the opinion of management, to fairly present 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 the financial statements included in our Current Report on Form 8-K filed on June 2, 2009.

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

**Recent Accounting Pronouncements Resulting in Adjustments**

As discussed further in our Current Report on Form 8-K dated June 2, 2009, we retrospectively adopted Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements ( SFAS 160 ), FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) ( FSP APB 14-1 ) and EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities (EITF 03-6-1 ). This resulted in the recording of certain adjustments to amounts previously reported in our 2008 Annual Report on Form 10-K, including changes that affected our previously reported net income attributable to our common shareholders and earnings per common share. Our Current Report on Form 8-K dated June 2, 2009 updated our 2008 Annual Report on Form 10-K for the effect of these adjustments.

**Other Recent Accounting Pronouncements**

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R) ( SFAS 167 ), which amends FASB Interpretation No. 46 (revised December 2003) to address the elimination of the concept of a qualifying special purpose entity. SFAS 167 also replaces the quantitative-based risks and rewards calculation for determining which enterprise has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity and the obligation to absorb losses of the entity or the right to receive benefits from the entity. Additionally, SFAS 167 provides more timely and useful information about an enterprise s involvement with a variable interest entity. SFAS 167 will become effective on January 1, 2010. We are currently evaluating the impact of this standard on our consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards CodificationTM and the Hierarchy of Generally Accepted Accounting Principles (as amended) ( SFAS 168 ), which establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied in the preparation of financial statements in conformity with generally accepted accounting principles for nongovernmental entities. SFAS 168 explicitly recognizes rules and interpretive releases of the Securities and Exchange Commission ( SEC ) under federal securities laws as authoritative GAAP for SEC registrants. SFAS 168 became effective on July 1, 2009 and is not expected to have a material effect on our consolidated financial statements.

**Fair Value of Financial Instruments**

Under Statement of Financial Accounting Standards No. 157, Fair Value Measurements ( SFAS 157 ), fair value is defined as the exit price, or the amount that would be received upon sale of an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. SFAS 157 also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability developed based on market data obtained from sources independent of us. Unobservable inputs are inputs that reflect our assumptions about the factors market participants would use in valuing the asset or liability developed based upon the best information available in the circumstances. The hierarchy of these inputs is broken down into three levels: Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities; Level 2 inputs include (1) quoted prices for similar assets or liabilities in active markets, (2) quoted prices for identical or similar assets or liabilities in markets that are not active and (3) inputs (other than quoted prices) that are observable for the asset or liability, either directly or indirectly; and Level 3 inputs are unobservable inputs for the asset or liability.

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Categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The assets held in connection with our non-qualified elective deferred compensation plan and the corresponding liability to the participants are measured at fair value on a recurring basis on our consolidated balance sheet using quoted market prices. The assets are treated as trading securities for accounting purposes and included in restricted cash on our consolidated balance sheet. The offsetting liability 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 in our consolidated balance sheet. The assets and corresponding liability of our non-qualified elective deferred compensation plan are classified in Level 1 of the fair value hierarchy.

The valuation of our derivatives is determined using widely accepted valuation techniques, including 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 under SFAS 157, the credit valuation adjustments associated with our derivatives also utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default. However, as of June 30, 2009, 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 derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

The table below sets forth our financial assets and liabilities that are accounted for at fair value on a recurring basis as of June 30, 2009:

| Description | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---|---|---|---|---|
| Assets: | | | | |
| Deferred compensation plan assets (1) | $ 5,520 | $ | $ | $ 5,520 |
| Interest rate swap contracts (2) | | 789 | | 789 |
| Assets | $ 5,520 | $ 789 | $ | $ 6,309 |
| | | | | |
| Liabilities: | | | | |
| Deferred compensation plan liability (3) | $ 5,520 | $ | $ | $ 5,520 |
| Interest rate swap contracts (3) | | 1,666 | | 1,666 |
| Liabilities | $ 5,520 | $ 1,666 | $ | $ 7,186 |

(1) Included in the line entitled restricted cash on our Consolidated Balance Sheet.

(2) Included in the line entitled prepaid and other assets on our Consolidated Balance Sheet.

(3) Included in the line entitled other liabilities on our Consolidated Balance Sheet.

The carrying values of cash and cash equivalents, restricted cash, accounts receivables, other assets (excluding mortgage loans receivable) and accounts payable and accrued expenses are reasonable estimates of their fair values because of the short maturities of these instruments. We estimated the fair values of our mortgage loans receivable by using discounted cash flow analyses based on an appropriate market rate for a

similar type of instrument.  We estimated fair values of our debt based on quoted market prices for publicly-traded debt and on the discounted estimated future cash payments to be made for other debt; 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 at a specific point in time, are subjective in nature and involve uncertainties and matters of significant judgment.  Settlement of such fair value amounts may not be possible and may not be a prudent management decision.

Mortgage loans receivable are included in the line entitled prepaid and other assets on our consolidated balance sheets.  The following table sets forth information pertaining to the fair value of our mortgage loans receivable:

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| | June 30, 2009 | December 31, 2008 |
|---|---|---|
| Carrying Amount | $ 31,119 | $ 29,380 |
| Estimated Fair Value | 30,039 | 28,951 |

For additional fair value information, please refer to Note 6 for debt and Note 7 for derivatives.

**3. Earnings Per Share ( 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 of beneficial interest ( common shares ) outstanding during the period. Our computation of diluted EPS is similar except that:

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

- the numerator is adjusted to add back any changes in income or loss that would result from the assumed conversion 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 (dollars and shares in thousands, except per share data):

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Numerator: | | | | |
| Income from continuing operations | $ 18,051 | $ 12,555 | $ 36,217 | $ 22,411 |
| Add: Gain on sales of real estate, net | | 41 | | 1,100 |
| Less: Preferred share dividends | (4,026) | (4,026) | (8,051) | (8,051) |
| Less: Income from continuing operations attributable to noncontrolling interests | (1,412) | (1,549) | (3,431) | (2,822) |
| Less: Income from continuing operations attributable to restricted shares | (242) | (166) | (510) | (336) |
| Numerator for basic and diluted EPS from continuing operations attributable to COPT common shareholders | 12,371 | 6,855 | 24,225 | 12,302 |
| Add: Income from discontinued operations | | 1,314 | | 2,580 |
| Less: Income from discontinued operations attributable to noncontrolling interests | | (199) | | (393) |
| Numerator for basic and diluted EPS on net income attributable to COPT common shareholders | $ 12,371 | $ 7,970 | $ 24,225 | $ 14,489 |
| Denominator (all weighted averages): | | | | |
| Denominator for basic EPS (common shares) | 56,637 | 47,110 | 54,296 | 47,055 |
| Dilutive effect of stock option awards | 546 | 790 | 522 | 746 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Denominator for diluted EPS | | 57,183 | | 47,900 | | 54,818 | | 47,801 |
| | | | | | | | | |
| Basic EPS: | | | | | | | | |
| Income from continuing operations attributable to COPT common shareholders | $ | 0.22 | $ | 0.15 | $ | 0.45 | $ | 0.26 |
| Income from discontinued operations attributable to COPT common shareholders | | | | 0.02 | | | | 0.05 |
| Net income attributable to COPT common shareholders | $ | 0.22 | $ | 0.17 | $ | 0.45 | $ | 0.31 |
| Diluted EPS: | | | | | | | | |
| Income from continuing operations attributable to COPT common shareholders | $ | 0.22 | $ | 0.15 | $ | 0.44 | $ | 0.26 |
| Income from discontinued operations attributable to COPT common shareholders | | | | 0.02 | | | | 0.04 |
| Net income attributable to COPT common shareholders | $ | 0.22 | $ | 0.17 | $ | 0.44 | $ | 0.30 |

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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:

| | Weighted Average Shares | | | |
|---|---|---|---|---|
| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Conversion of common units | 5,483 | 8,151 | 6,363 | 8,153 |
| Conversion of convertible preferred units | 176 | 176 | 176 | 176 |
| Conversion of convertible preferred shares | 434 | 434 | 434 | 434 |
| Anti-dilutive share-based compensation awards | 524 | 348 | 641 | 468 |

The 3.5% Exchangeable Senior Notes did not affect our diluted EPS reported above since the weighted average closing price of our common shares during each of the periods was less than the exchange price per common share applicable for such periods.

## 4. Properties, net

Operating properties consisted of the following:

| | June 30, 2009 | December 31, 2008 |
|---|---|---|
| Land | $ 429,064 | $ 423,985 |
| Buildings and improvements | 2,293,895 | 2,202,995 |
| | 2,722,959 | 2,626,980 |
| Less: accumulated depreciation | (382,385) | (343,110) |
| | $ 2,340,574 | $ 2,283,870 |

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

| | June 30, 2009 | December 31, 2008 |
|---|---|---|
| Land | $ 219,775 | $ 220,863 |
| Construction in progress | 293,787 | 273,733 |
| | $ 513,562 | $ 494,596 |

**2009 Construction, Development and Redevelopment Activities**

During the six months ended June 30, 2009, we had three properties (one each located in the Baltimore/Washington Corridor, Suburban Maryland and Colorado Springs, Colorado ( Colorado Springs )) totaling 301,000 square feet become fully operational (85,000 of these square feet were placed into service in 2008). We also placed into service 42,000 square feet in two partially operational properties (one each located in Colorado Springs and the Baltimore/Washington Corridor).

**As of June 30, 2009, we had construction activities underway on four properties in the Baltimore/Washington Corridor (including one through a consolidated joint venture), three in Colorado Springs, two in San Antonio, Texas ( San Antonio ) and one each in Suburban Baltimore and Suburban Maryland (including one through a consolidated joint venture). We also had development activities underway on four office properties in the Baltimore/Washington Corridor, two in Suburban Baltimore and one in San Antonio. In addition, we had redevelopment underway on one property located in the Baltimore/Washington Corridor owned through a consolidated joint venture.**

4. Properties, net

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4. Properties, net

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## 5. Real Estate Joint Ventures

During the six months ended June 30, 2009, we had an investment in one unconsolidated real estate joint venture accounted for using the equity method of accounting. Information pertaining to this joint venture investment is set forth below.

| Investment Balance at June 30, 2009 | Investment Balance at December 31, 2008 | Date Acquired | Ownership | Nature of Activity | Maximum Exposure to Loss (1) |
|---|---|---|---|---|---|
| $ (4,873)(2) | $ (4,770)(2) | 9/29/2005 | 20% | Operates 16 buildings | $ |

(1) Derived from the sum of our investment balance and maximum additional unilateral capital contributions or loans required from us. Not reported above are additional amounts that we and our partner are required to fund when needed by this joint venture; these funding requirements are proportional to our respective ownership percentages. Also not reported above are additional unilateral contributions or loans from us, the amounts of which are uncertain, which we would be required to make if certain contingent events occur (see Note 15).

(2) The carrying amount of our investment in this joint venture was lower than our share of the equity in the joint venture by $5,196 at June 30, 2009 and December 31, 2008 due to our deferral of gain on the contribution by us of real estate into the joint venture upon its formation. A difference will continue to exist to the extent the nature of our continuing involvement in the joint venture remains the same.

The following table sets forth condensed balance sheets for this unconsolidated joint venture:

| | June 30, 2009 | December 31, 2008 |
|---|---|---|
| Properties, net | $ 61,742 | $ 62,308 |
| Other assets | 7,331 | 7,530 |
| Total assets | $ 69,073 | $ 69,838 |
| | | |
| Liabilities (primarily debt) | $ 67,473 | $ 67,725 |
| Owners equity | 1,600 | 2,113 |
| Total liabilities and owners equity | $ 69,073 | $ 69,838 |

The following table sets forth condensed statements of operations for this unconsolidated joint venture:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Revenues | $ 2,313 | $ 2,413 | $ 4,733 | $ 4,796 |
| Property operating expenses | (836) | (876) | (1,671) | (1,701) |

| | | | | |
|---|---|---|---|---|
| Interest expense | (980) | (980) | (1,949) | (1,960) |
| Depreciation and amortization expense | (816) | (830) | (1,627) | (1,660) |
| Net loss | $ (319) | $ (273) | $ (514) | $ (525) |

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The table below sets forth information pertaining to our investments in consolidated joint ventures at June 30, 2009:

| | Date Acquired | Ownership % at 6/30/2009 | Nature of Activity | Total Assets at 6/30/2009 | Pledged Assets at 6/30/2009 |
|---|---|---|---|---|---|
| M Square Associates, LLC | 6/26/2007 | 45.0% | Developing land parcels (1) | $ 48,944 | $ |
| Arundel Preserve #5, LLC | 7/2/2007 | 50.0% | Developing land parcel (2) | 29,204 | 28,475 |
| COPT Opportunity Invest I, LLC | 12/20/2005 | 92.5% | Redeveloping one property (3) | 28,600 | |
| COPT-FD Indian Head, LLC | 10/23/2006 | 75.0% | Developing land parcel (4) | 6,919 | |
| MOR Forbes 2 LLC | 12/24/2002 | 50.0% | Operates one building (5) | 4,653 | |
| | | | | $ 118,320 | $ 28,475 |

(1) This joint venture is developing land parcels located in College Park, Maryland. We own a 90% interest in Enterprise Campus Developer, LLC, which in turn owns a 50% interest in M Square.
(2) This joint venture is developing a land parcel located in Hanover, Maryland.
(3) This joint venture owns a property in the Baltimore/Washington Corridor region.
(4) This joint venture s property is located in Charles County, Maryland (located in our Other business segment).
(5) This joint venture s property is located in Lanham, Maryland (located in the Suburban Maryland region).

Our commitments and contingencies pertaining to our real estate joint ventures are disclosed in Note 15.

## 6. Debt

Our debt consisted of the following:

| | Maximum Principal Amount at June 30, 2009 | Carrying Value at June 30, 2009 | Carrying Value at December 31, 2008 | Stated Interest Rates at June 30, 2009 | Scheduled Maturity Dates at June 30, 2009 |
|---|---|---|---|---|---|
| Mortgage and other loans payable: | | | | | |
| Revolving Credit Facility | $ 600,000 | $ 357,000 | $ 392,500 | LIBOR + 0.75% to 1.25% (1) | September 30, 2011 (2) |
| Mortgage and Other Secured Loans | | | | | |
| Fixed rate mortgage loans (3) | N/A | 932,287 | 967,617 | 5.20% - 7.94% (4) | 2009 - 2034 (5) |
| Revolving Construction Facility | 225,000 | 99,161 | 81,267 | LIBOR + 1.60% to 2.00% (6) | May 2, 2011 (2) |
| Other variable rate secured loans | N/A | 271,400 | 221,400 | LIBOR + 2.25% to 3.00% (7) | 2012-2014 (2) |
| Other construction loan facilities | 23,400 | 16,753 | 40,589 | LIBOR + 2.75% (8) | 2011 (2) |
| Total mortgage and other secured loans | | 1,319,601 | 1,310,873 | | |
| Note payable | | | | | |
| Unsecured seller note | N/A | 750 | 750 | 5.95% | 2016 |
| Total mortgage and other loans payable | | 1,677,351 | 1,704,123 | | |

| | | | | | |
|---|---|---|---|---|---|
| 3.5% Exchangeable Senior Notes | N/A | 154,362 | 152,628 | 3.50% | September 2026 (9) |
| Total debt | | $ 1,831,713 | $ 1,856,751 | | |

(1) The interest rate on the Revolving Credit Facility was 1.11% at June 30, 2009.
(2) Includes loans that may be extended for a one-year period at our option, subject to certain conditions.
(3) Several of the fixed rate mortgages carry interest rates that were above or below market rates upon assumption and therefore were recorded at their fair value based on applicable effective interest rates. The carrying values of these loans reflect unamortized premiums totaling $430 at June 30, 2009 and $501 at December 31, 2008.
(4) The weighted average interest rate on these loans was 5.68% at June 30, 2009.
(5) A loan with a balance of $4,701 at June 30, 2009 that matures in 2034 may be repaid in March 2014, subject to certain conditions.
(6) The weighted average interest rate on this loan was 2.00% at June 30, 2009.
(7) The loans in this category at June 30, 2009 are subject to floor interest rates ranging from 4.25% to 5.5%.
(8) The interest rate on this loan was 3.07% at June 30, 2009.
(9) As described further in our 2008 Annual Report on Form 10-K, the notes have an exchange settlement feature that provides that they may, under certain circumstances, be exchangeable for cash (up to the principal amount of the notes) and, with respect to any excess exchange value, may be exchangeable into (at our option) cash, our common shares or a combination of cash and our common shares at an exchange rate (subject to adjustment) of 18.8266 shares per one thousand dollar principal amount of the notes (exchange rate is as of June 30, 2009 and is equivalent to an exchange price of $53.12 per common share). The carrying value of these notes included a principal amount of $162,500 and an unamortized discount totaling $8,138 at June 30, 2009 and $9,872 at December 31, 2008. The

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effective interest rate under the notes, including amortization of the discount, was 5.97%. The table below sets forth interest expense recognized on these notes before deductions for amounts capitalized:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Interest expense at stated interest rate | $ 1,422 | $ 1,750 | $ 2,844 | $ 3,500 |
| Interest expense associated with amortization of discount | 874 | 1,013 | 1,734 | 2,011 |
| Total | $ 2,296 | $ 2,763 | $ 4,578 | $ 5,511 |

We capitalized interest costs of $3,985 in the three months ended June 30, 2009, $4,533 in the three months ended June 30, 2008, $8,484 in the six months ended June 30, 2009 and $9,298 in the six months ended June 30, 2008.

The following table sets forth information pertaining to the fair value of our debt:

| | June 30, 2009 | | December 31, 2008 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Fixed-rate debt | $ 1,087,399 | $ 998,101 | $ 1,120,995 | $ 1,010,127 |
| Variable-rate debt | 744,314 | 710,239 | 735,756 | 702,092 |
| | $ 1,831,713 | $ 1,708,340 | $ 1,856,751 | $ 1,712,219 |

**7. Derivatives**

We are exposed to certain risks arising from changes in market conditions. These changes in market conditions may adversely affect our financial performance. We use derivative financial instruments to assist in managing our exposure to these changes in market conditions. Specifically, we enter into derivative financial instruments to manage exposures that arise from business activities that result in the payment of future known and uncertain cash amounts, the value of which are determined by interest rates. Our derivative financial instruments are used to manage differences in the amount, timing, and duration of our known or expected cash payments related to our borrowings.

Our primary objectives in using interest rate derivatives are to add stability to interest expense and to manage exposure to interest rate movements. To accomplish this objective, we primarily use interest rate swaps as part of our interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for our making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. During 2009, these derivatives were used to hedge the variable cash flows associated with both existing and future variable-rate debt. We defer the effective portion of the changes in fair value of the designated cash flow hedges to accumulated other comprehensive loss ( AOCL ) and reclassify such deferrals to interest expense as interest expense is recognized on the hedged forecasted transactions. We recognize directly in interest expense the ineffective portion of the change in fair value of interest rate derivatives. We do not use derivatives for trading or speculative purposes and do not have any derivatives that are not designated as hedges as of June 30, 2009.

As of June 30, 2009, we had four outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk with an aggregate notional value of $370,000.  All four derivative instruments were interest rate swaps.  Under one of these interest rate derivatives, we are hedging our exposure to the variability in future cash flows for forecasted transactions over the period ending January 1, 2010.  The table below sets forth the fair value of our derivative financial instruments as well as their classification on our Consolidated Balance Sheet as of June 30, 2009:

| **Derivatives Designated as Hedging Instruments Under SFAS 133** | **June 30, 2009** | | |
|---|---|---|---|
| | **Balance Sheet Location** | | **Fair Value** |
| Interest Rate Swaps | Prepaid and other assets | $ | 789 |
| Interest Rate Swaps | Other liabilities | | (1,666) |

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The table below presents the effect of our interest rate swaps on our Consolidated Statements of Operations and comprehensive income for the three and six months ended June 30, 2009:

| | For the Three Months Ended June 30, 2009 | For the Six Months Ended June 30, 2009 |
|---|---|---|
| Amount of gain recognized in AOCL (effective portion) | 1,658 | 277 |
| Amount of loss reclassified from AOCL into interest expense (effective portion) | (1,647) | (3,946) |
| Amount of gain (loss) recognized in interest expense (ineffective portion and amount excluded from effectiveness testing) | 51 | (228) |

Over the next 12 months, we estimate that approximately $3,304 will be reclassified from AOCL as an increase to interest expense.

We have agreements with each of our derivative counterparties that contain provisions under which if we default or are capable of being declared in default on any of our indebtedness, we could also be declared in default on our derivative obligations.

We have agreements with our derivative counterparties that incorporate the loan covenant provisions of our indebtedness with a lender affiliate of the derivative counterparties. Failure to comply with the loan covenant provisions would result in our being in default on any derivative instrument obligations covered by the agreements.

As of June 30, 2009, the fair value of derivatives in a liability position related to these agreements was $1,307, excluding the effects of accrued interest. As of June 30, 2009, we had not posted any collateral related to these agreements. We are not in default with any of these provisions. If we breached any of these provisions, we would be required to settle our obligations under the agreements at their termination value of $1,682.

## 8. Shareholders Equity

### Common Shares

In April 2009, we issued 2.99 million common shares in an underwritten public offering made in conjunction with our inclusion in the S&P MidCap 400 Index effective April 1, 2009. The shares were issued at a public offering price of $24.35 per share for net proceeds of $72,078 after underwriting discounts but before offering expenses.

During the six months ended June 30, 2009, we converted 2,824,000 common units in our Operating Partnership into common shares on the basis of one common share for each common unit.

See Note 12 for disclosure of common share activity pertaining to our share-based compensation plans.

**Accumulated Other Comprehensive Loss**

The table below sets forth activity in the accumulated other comprehensive loss component of shareholders equity:

| | For the Six Months Ended June 30, | |
|---|---|---|
| | 2009 | 2008 |
| Beginning balance | $ (4,749) | $ (2,372) |
| Amount of gain (loss) recognized in AOCL (effective portion) | 277 | (1,450) |
| Amount of loss reclassified from AOCL to income | 3,946 | 1,166 |
| Adjustment to AOCL attributable to noncontrolling interests | (650) | 41 |
| Ending balance | $ (1,176) | $ (2,615) |

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The table below sets forth total comprehensive income and total comprehensive income attributable to COPT:

| | For the Three Months Ended June 30, 2009 | For the Three Months Ended June 30, 2008 | For the Six Months Ended June 30, 2009 | For the Six Months Ended June 30, 2008 |
|---|---|---|---|---|
| Net income | $ 18,051 | $ 13,910 | $ 36,217 | $ 26,091 |
| Amount of gain (loss) recognized in AOCL (effective portion) | 1,658 | 1,230 | 277 | (1,450) |
| Amount of loss reclassified from AOCL to income | 1,647 | 838 | 3,946 | 1,166 |
| Total comprehensive income | 21,356 | 15,978 | 40,440 | 25,807 |
| Net income attributable to noncontrolling interests | (1,412) | (1,748) | (3,431) | (3,215) |
| Other comprehensive income attributable to noncontrolling interests | (300) | (315) | (416) | 44 |
| Total comprehensive income attributable to COPT | $ 19,644 | $ 13,915 | $ 36,593 | $ 22,636 |

## 9. Dividends and Distributions

The following table summarizes our dividends and distributions when either the payable dates or record dates occurred during the six months ended June 30, 2009:

| | Record Date | Payable Date | Dividend/ Distribution Per Share/Unit |
|---|---|---|---|
| Series G Preferred Shares: | | | |
| Fourth Quarter 2008 | December 31, 2008 | January 15, 2009 | $ 0.5000 |
| First Quarter 2009 | March 31, 2009 | April 15, 2009 | $ 0.5000 |
| Second Quarter 2009 | June 30, 2009 | July 15, 2009 | $ 0.5000 |
| | | | |
| Series H Preferred Shares: | | | |
| Fourth Quarter 2008 | December 31, 2008 | January 15, 2009 | $ 0.4688 |
| First Quarter 2009 | March 31, 2009 | April 15, 2009 | $ 0.4688 |
| Second Quarter 2009 | June 30, 2009 | July 15, 2009 | $ 0.4688 |
| | | | |
| Series J Preferred Shares: | | | |
| Fourth Quarter 2008 | December 31, 2008 | January 15, 2009 | $ 0.4766 |
| First Quarter 2009 | March 31, 2009 | April 15, 2009 | $ 0.4766 |
| Second Quarter 2009 | June 30, 2009 | July 15, 2009 | $ 0.4766 |
| | | | |
| Series K Preferred Shares: | | | |
| Fourth Quarter 2008 | December 31, 2008 | January 15, 2009 | $ 0.7000 |
| First Quarter 2009 | March 31, 2009 | April 15, 2009 | $ 0.7000 |
| Second Quarter 2009 | June 30, 2009 | July 15, 2009 | $ 0.7000 |
| | | | |
| Common Shares: | | | |
| Fourth Quarter 2008 | December 31, 2008 | January 15, 2009 | $ 0.3725 |
| First Quarter 2009 | March 31, 2009 | April 15, 2009 | $ 0.3725 |
| Second Quarter 2009 | June 30, 2009 | July 15, 2009 | $ 0.3725 |

| | | | | |
|---|---|---|---|---|
| Series I Preferred Units: | | | | |
| Fourth Quarter 2008 | December 31, 2008 | January 15, 2009 | $ | 0.4688 |
| First Quarter 2009 | March 31, 2009 | April 15, 2009 | $ | 0.4688 |
| Second Quarter 2009 | June 30, 2009 | July 15, 2009 | $ | 0.4688 |
| | | | | |
| Common Units: | | | | |
| Fourth Quarter 2008 | December 31, 2008 | January 15, 2009 | $ | 0.3725 |
| First Quarter 2009 | March 31, 2009 | April 15, 2009 | $ | 0.3725 |
| Second Quarter 2009 | June 30, 2009 | July 15, 2009 | $ | 0.3725 |

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**10. Supplemental Information to Statements of Cash Flows**

| | For the Six Months Ended June 30, | |
|---|---|---|
| | **2009** | **2008** |
| Supplemental schedule of non-cash investing and financing activities: | | |
| Increase in accrued capital improvements, leasing, and acquisition costs | $ 11,971 | $ 2,176 |
| Consolidation of real estate joint venture: | | |
| Real estate assets | $ | $ 14,208 |
| Prepaid and other assets | | (10,859) |
| Noncontrolling interests | | (3,349) |
| Net adjustment | $ | $ |
| Proceeds from sale of property invested in restricted cash | $ | $ 5,103 |
| Increase (decrease) in fair value of derivatives applied to AOCL and noncontrolling interests | $ 4,225 | $ (315) |
| Dividends/distribution payable | $ 27,057 | $ 22,548 |

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**11. Information by Business Segment**

As of June 30, 2009, we had nine primary office property segments: Baltimore/Washington Corridor; Northern Virginia; Suburban Baltimore; Colorado Springs; Suburban Maryland; Greater Philadelphia; St. Mary s and King George Counties; San Antonio; and Central New Jersey.

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

| | Baltimore/ Washington Corridor | Northern Virginia | Suburban Baltimore | Colorado Springs | Suburban Maryland | Greater Philadelphia | St. Mary s & King George Counties | San Antonio | Central New Jersey | Other | Intersegment Elimination | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Three Months Ended June 30, 2009 | | | | | | | | | | | | |
| Revenues | $ 49,531 | $ 19,211 | $ 13,793 | $ 5,803 | $ 5,179 | $ 2,507 | $ 3,478 | $ 3,547 | $ 601 | $ 2,998 | $ (930) | $ 105,718 |
| Property operating expenses | 17,494 | 7,510 | 5,818 | 1,718 | 2,030 | 1 | 792 | 963 | 47 | 864 | (75) | 37,162 |
| NOI | $ 32,037 | $ 11,701 | $ 7,975 | $ 4,085 | $ 3,149 | $ 2,506 | $ 2,686 | $ 2,584 | $ 554 | $ 2,134 | $ (855) | $ 68,556 |
| Additions to properties, net | $ 15,642 | $ 2,299 | $ 5,592 | $ 12,870 | $ 13,102 | $ 2,098 | $ 178 | $ 11,998 | $ 9 | $ 1,075 | $ (7) | $ 64,856 |
| Three Months Ended June 30, 2008 | | | | | | | | | | | | |
| Revenues | $ 46,426 | $ 18,927 | $ 13,502 | $ 4,691 | $ 4,907 | $ 2,506 | $ 3,134 | $ 1,999 | $ 586 | $ 2,256 | $ (903) | $ 98,031 |
| Property operating expenses | 15,686 | 7,255 | 5,691 | 1,738 | 1,587 | 40 | 747 | 443 | 38 | 1,062 | (319) | 33,968 |
| NOI | $ 30,740 | $ 11,672 | $ 7,811 | $ 2,953 | $ 3,320 | $ 2,466 | $ 2,387 | $ 1,556 | $ 548 | $ 1,194 | $ (584) | $ 64,063 |
| Additions to properties, net | $ 40,092 | $ 803 | $ 4,309 | $ 41,510 | $ 1,238 | $ 384 | $ 674 | $ 18,738 | $ 22 | $ 968 | $ (29) | $ 108,709 |
| Six Months Ended June 30, | | | | | | | | | | | | |

| 2009 | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenues | $ 99,123 | $ 41,570 | $ 27,621 | $ 10,681 | $ 10,216 | $ 5,013 | $ 6,888 | $ 6,492 | $ 1,222 | $ 5,597 | $ (1,861) | $ 212,562 |
| Property operating expenses | 36,136 | 15,372 | 12,520 | 3,031 | 4,089 | 99 | 1,664 | 1,800 | 83 | 1,666 | (265) | 76,195 |
| NOI | $ 62,987 | $ 26,198 | $ 15,101 | $ 7,650 | $ 6,127 | $ 4,914 | $ 5,224 | $ 4,692 | $ 1,139 | $ 3,931 | $ (1,596) | $ 136,367 |
| Additions to properties, net | $ 34,987 | $ 2,368 | $ 8,903 | $ 18,067 | $ 17,759 | $ 4,411 | $ 525 | $ 19,377 | $ 11 | $ 8,616 | $ (14) | $ 115,010 |
| Segment assets at June 30, 2009 | $ 1,277,271 | $ 455,539 | $ 436,220 | $ 268,667 | $ 167,227 | $ 97,618 | $ 94,398 | $ 116,590 | $ 20,768 | $ 265,372 | $ (995) | $ 3,198,675 |
| | | | | | | | | | | | | |
| Six Months Ended June 30, 2008 | | | | | | | | | | | | |
| | | | | | | | | | | | | |
| Revenues | $ 92,003 | $ 37,931 | $ 27,412 | $ 8,863 | $ 9,491 | $ 5,012 | $ 6,294 | $ 3,907 | $ 1,338 | $ 4,833 | $ (1,781) | $ 195,303 |
| Property operating expenses | 31,901 | 14,239 | 12,014 | 3,320 | 3,251 | 104 | 1,489 | 876 | 247 | 1,813 | (557) | 68,697 |
| NOI | $ 60,102 | $ 23,692 | $ 15,398 | $ 5,543 | $ 6,240 | $ 4,908 | $ 4,805 | $ 3,031 | $ 1,091 | $ 3,020 | $ (1,224) | $ 126,606 |
| Additions to properties, net | $ 54,281 | $ 1,729 | $ 7,737 | $ 53,531 | $ 22,096 | $ 612 | $ 1,236 | $ 18,248 | $ 43 | $ 2,275 | $ (29) | $ 161,759 |
| Segment assets at June 30, 2008 | $ 1,248,815 | $ 469,146 | $ 438,548 | $ 235,765 | $ 139,787 | $ 95,123 | $ 94,798 | $ 84,359 | $ 22,155 | $ 183,862 | $ (984) | $ 3,011,374 |

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Segment revenues | $ 105,718 | $ 98,031 | $ 212,562 | $ 195,303 |
| Construction contract revenues | 102,753 | 21,899 | 177,292 | 32,035 |
| Other service operations revenues | 571 | 525 | 921 | 1,003 |
| Less: Revenues from discontinued real estate operations (Note 14) | | (85) | | (355) |
| Total revenues | $ 209,042 | $ 120,370 | $ 390,775 | $ 227,986 |

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Segment property operating expenses | $ 37,162 | $ 33,968 | $ 76,195 | $ 68,697 |
| Less: Property operating expenses from discontinued real estate operations (Note 14) | | (11) | | (198) |
| Total property operating expenses | $ 37,162 | $ 33,957 | $ 76,195 | $ 68,499 |

As previously discussed, we own 100% of a number of entities that provide real estate services such as property management, construction and development and heating and air conditioning services primarily for our properties but also for third parties. The revenues and costs associated with these services include subcontracted costs that are reimbursed to us by the customer at no mark up. As a result, the operating margins from these operations are small relative to the revenue. We use the net of such revenues and expenses to evaluate the performance of our service operations since we view such service operations to be an ancillary component of our overall operations that we expect to continue to be a small contributor to our operating income relative to our real estate operations. The table below sets forth the computation of our income from service operations:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Construction contract revenues | $ 102,753 | $ 21,899 | $ 177,292 | $ 32,035 |
| Other service operations revenues | 571 | 525 | 921 | 1,003 |
| Construction contract expenses | (100,647) | (21,472) | (173,545) | (31,377) |
| Other service operations expenses | (514) | (454) | (939) | (1,056) |
| Income from service operations | $ 2,163 | $ 498 | $ 3,729 | $ 605 |

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| NOI for reportable segments | $ 68,556 | $ 64,063 | $ 136,367 | $ 126,606 |
| Income from service operations | 2,163 | 498 | 3,729 | 605 |
| Interest and other income | 1,252 | 170 | 2,330 | 365 |
| Equity in loss of unconsolidated entities | (202) | (56) | (317) | (110) |
| Income tax expense | (52) | 107 | (122) | (5) |
| Other adjustments: | | | | |
| Depreciation and other amortization associated with real estate operations | (28,708) | (24,955) | (55,199) | (49,847) |
| General and administrative expenses | (5,834) | (5,934) | (11,377) | (11,704) |
| Business development expenses | (446) | (102) | (1,092) | (265) |
| Interest expense on continuing operations | (18,678) | (21,162) | (38,102) | (43,077) |
| Net operating income from discontinued operations | | (74) | | (157) |
| Income from continuing operations | $ 18,051 | $ 12,555 | $ 36,217 | $ 22,411 |

The accounting policies of the segments are the same as those previously disclosed for Corporate Office Properties Trust and subsidiaries, where applicable. We did not allocate interest expense and depreciation and other amortization to segments since they are not included in the measure of segment profit reviewed by management. We also did not allocate construction contract revenues, other service operations revenues, construction contract expenses, other service operations expenses, equity in loss of unconsolidated entities, general and administrative expenses, business development expenses, interest and other income and income taxes because these items represent general corporate items not attributable to segments.

**12. Share-Based Compensation**

During the six months ended June 30, 2009, we granted 40,000 options to purchase common shares ( options ) to members of our Board of Trustees with an exercise price of $29.98 per share. These options vest on the first anniversary of the grant date provided that the Trustees remain in their positions. These option grants expire ten years after the grant date. We computed share-based compensation expense for these options under the fair value method using the Black-Scholes option-pricing model; the assumptions we used in that model are set forth below:

| | |
|---|---|
| Fair value of grants on grant date | $ 9.62 |
| Risk-free interest rate | 2.08% |
| Expected life (in years) | 5.31 |
| Expected volatility | 47.60% |
| Expected annual dividend yield | 3.73% |

During the six months ended June 30, 2009, 153,177 options to purchase common shares were exercised. The weighted average exercise price of these options was $12.12 per share, and the total intrinsic value of the options exercised was $2,785.

During the six months ended June 30, 2009, certain employees were granted a total of 332,060 restricted shares with a weighted average grant date fair value of $25.05 per share; these shares are subject to forfeiture restrictions that lapse in equal increments annually over periods of three to five years, beginning on or about the first anniversary of the grant date, provided that the employees remain employed

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by us. During the six months ended June 30, 2009, forfeiture restrictions lapsed on 207,855 common shares previously issued to employees; these shares had a weighted average grant date fair value of $35.85 per share, and the total fair value of the shares on the vesting dates was $5,146.

We realized a windfall tax shortfall of $152 in the six months ended June 30, 2009 and windfall tax benefit of $1,053 in the six months ended June 30, 2008 on options exercised and vesting restricted shares in connection with employees of our subsidiaries that are subject to income tax.

## 13. Income Taxes

We own a taxable REIT subsidiary ( TRS ) that is subject to Federal and state income taxes. Our TRS provision for income tax consisted of the following:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Deferred | | | | |
| Federal | $ (46) | $ 53 | $ (100) | $ (303) |
| State | (10) | 8 | (22) | (71) |
| | (56) | 61 | (122) | (374) |
| Current | | | | |
| Federal | 3 | 34 | | (171) |
| State | 1 | 7 | | (38) |
| | 4 | 41 | | (209) |
| Total income tax (expense) benefit | $ (52) | $ 102 | $ (122) | $ (583) |
| | | | | |
| Reported on line entitled income tax (expense) benefit | $ (52) | $ 107 | $ (122) | $ (5) |
| Reported on line entitled gain on sale of real estate, net | | (5) | | (578) |
| Total income tax (expense) benefit | $ (52) | $ 102 | $ (122) | $ (583) |

Items in our TRS contributing to temporary differences that lead to deferred taxes include depreciation and amortization, share-based compensation, certain accrued compensation and compensation paid in the form of contributions to a deferred nonqualified compensation plan.

Our TRS combined Federal and state effective tax rate was 39% for the three and six months ended June 30, 2009 and 2008.

## 14. Discontinued Operations

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

- 429 Ridge Road property located in the Central New Jersey region that was sold on January 31, 2008;
- 47 Commerce Drive property located in the Central New Jersey region that was sold on April 1, 2008; and
- 7253 Ambassador Road property located in the Suburban Baltimore region that was sold on June 2, 2008.

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

| | For the Three Months Ended June 30, 2008 | For the Six Months Ended June 30, 2008 |
|---|---|---|
| Revenue from real estate operations | $ 85 | $ 355 |
| Expenses from real estate operations: | | |
| Property operating expenses | 11 | 198 |
| Depreciation and amortization | | 52 |
| Interest expense | 10 | 51 |
| Expenses from real estate operations | 21 | 301 |
| Income from discontinued operations before gain on sales of real estate | 64 | 54 |
| Gain on sales of real estate | 1,250 | 2,526 |
| Income from discontinued operations | $ 1,314 | $ 2,580 |

**15. Commitments and Contingencies**

In the normal course of business, we are involved in legal actions arising from our ownership and administration of properties. We establish reserves for specific legal proceedings when we determine that the likelihood of an unfavorable outcome is probable and the amount of loss can be reasonably estimated. Management does not anticipate that any liabilities that may result from such proceedings will have a materially adverse effect on our financial position, operations or liquidity. Our assessment of the potential outcomes of these matters involves significant judgment and is subject to change based on future developments.

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.

**Joint Ventures**

In connection with our 2005 contribution of properties to an unconsolidated partnership in which we hold a limited partnership interest, we entered into standard nonrecourse loan guarantees (environmental indemnifications and guarantees against fraud and misrepresentation, including springing guarantees of partnership debt in the event of a voluntary bankruptcy of the partnership). The maximum amount we could be required to pay under the guarantees is approximately $67 million. So long as we continue to be the property manager for the properties, 20% of any amounts paid under the guarantees are recoverable from an affiliate of the general partner pursuant to an indemnity agreement. In the event that we no longer manage the properties, the percentage recoverable under the indemnity agreement is increased to 80%. Management estimates that the aggregate fair value of the guarantees is not material and would not exceed the amounts included in distributions in excess of investment in unconsolidated real estate joint venture reported on the consolidated balance sheets.

We are party to a contribution agreement that formed a joint venture relationship with a limited partnership to develop up to 1.8 million square feet of office space on 63 acres of land located in Hanover, Maryland. Under the contribution agreement, we agreed to fund up to $2,200 in pre-construction costs associated with the property. As we and the joint venture partner agree to proceed with the construction of buildings in the future, our joint venture partner would contribute land into newly-formed entities and we would make additional cash capital contributions into such entities to fund development and construction activities for which financing is not obtained. We owned a 50% interest in one such joint venture as of June 30, 2009.

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

**Environmental Indemnity Agreement**

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

- to indemnify the tenant against losses covered under the prior owner s indemnity agreement if the prior owner fails to indemnify the tenant for such losses. This indemnification is capped at $5,000 in perpetuity after the State of New Jersey declares the remediation to be complete;
- to indemnify the tenant for consequential damages (e.g., business interruption) at one of the buildings in perpetuity and another of the buildings for 15 years after the tenant s acquisition of the property from us. This indemnification is capped at $12,500; and
- to pay 50% of additional costs related to construction and environmental regulatory activities incurred by the tenant as a result of the indemnified environmental condition of the properties. This indemnification is capped at $300 annually and $1,500 in the aggregate.

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

**Overview**

We are a specialty office real estate investment trust ( REIT ) that focuses primarily on strategic customer relationships and specialized tenant requirements in the United States Government, defense information technology and data sectors. We acquire, develop, manage and lease properties that are typically concentrated in large office parks primarily located adjacent to government demand drivers and/or in demographically strong markets possessing growth opportunities. As of June 30, 2009, our investments in real estate included the following:

- 243 wholly owned operating properties totaling 18.7 million square feet;
- 16 wholly owned properties under construction or development that we estimate will total approximately 1.8 million square feet upon completion;
- wholly owned land parcels totaling 1,530 acres that we believe are potentially developable into approximately 13.1 million square feet; and
- partial ownership interests in a number of other real estate projects in operation, under development or redevelopment or held for future development.

During the six months ended June 30, 2009, we:

- experienced significant growth in our revenues from real estate operations in total by amounts that exceeded the growth in our property operating expenses compared to the six months ended June 30, 2008. This increase is attributable to both the growth of our portfolio from property additions and the performance of properties that were owned and 100% operational since January 1, 2008;
- finished the period with occupancy of our wholly owned portfolio of properties at 92.3%;
- placed into service an aggregate of 258,000 square feet in newly constructed space located in five properties; and
- issued 2.99 million common shares in an underwritten public offering made in conjunction with our inclusion in the S&P MidCap 400 Index effective April 1, 2009. The shares were issued at a public offering price of $24.35 per share for net proceeds of $72.1 million after underwriting discounts but before offering expenses.

As discussed in greater detail in our 2008 Annual Report Form 10-K, the United States and world economies are in the midst of a significant recession that has had devastating effects on the capital markets, reducing stock prices and limiting credit availability.  We believe that for much of the office real estate sector, since the core operations tend to be structured as long-term leases and since revenue streams generally remain in place until leases expire or tenants fail to satisfy lease terms, the effect of the changes in the overall economy on our operations has not been fully felt to date.  As a result, we do not believe that the economic downturn has significantly affected the operations of our real estate properties yet but do expect the effects to become increasingly evident over the remainder of 2009 and 2010, and perhaps beyond.  We continue to see signs of increased competition for tenants and downward pressure on rental rates in most of our regions, which we expect, along with an anticipated increased tendency by certain tenants to reduce costs through job cuts and associated space reductions, could adversely affect our occupancy and renewal rates.  In addition, we may also experience higher bad debt expense should tenants be unable to pay their rents.  However, we believe that our future real estate operations may be affected to a lesser degree than many of our peers for the following reasons:

- our expectation of continued strength in demand from our customers in the United States Government, defense information technology and data sectors; and

- our high concentration of large, high-quality tenants with a relatively small concentration of revenue from the financial services sector.

In this section, we discuss our financial condition and results of operations as of and for the three and six months ended June 30, 2009.  This section includes discussions on, among other things:

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- our results of operations and why various components of our Consolidated Statements of Operations changed for the three and six months ended June 30, 2009 compared to the same periods in 2008;
- our cash flows;
- how we expect to generate cash for short and long-term capital needs;
- our commitments and contingencies at June 30, 2009; and
- the computation of our Funds from Operations.

You should refer to our Consolidated Financial Statements 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, expect, estimate or other comparable terminology. 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:

- our ability to borrow on favorable terms;
- general economic and business conditions, which will, among other things, affect office property demand and rents, tenant creditworthiness, interest rates and financing availability;
- adverse changes in the real estate markets, including, among other things, increased competition with other companies;
- 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 and 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;
- our ability to satisfy and operate effectively under Federal income tax rules relating to real estate investment trusts and partnerships;
- governmental actions and initiatives; and

- environmental requirements.

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

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**Results of Operations**

Occupancy and Leasing

The table below sets forth leasing information pertaining to our portfolio of wholly owned operating properties:

| | June 30, 2009 | December 31, 2008 |
|---|---|---|
| Occupancy rates | | |
| Total | 92.3% | 93.2% |
| Baltimore/Washington Corridor | 93.0% | 93.4% |
| Northern Virginia | 94.7% | 97.4% |
| Suburban Baltimore | 82.1% | 83.1% |
| Colorado Springs | 93.0% | 94.3% |
| Suburban Maryland | 92.8% | 97.7% |
| St. Mary s and King George Counties | 97.5% | 95.2% |
| Greater Philadelphia | 100.0% | 100.0% |
| San Antonio | 100.0% | 100.0% |
| Central New Jersey | 100.0% | 100.0% |
| Other | 99.3% | 100.0% |
| Average contractual annual rental rate per square foot at period end (1) | $ 23.12 | $ 22.40 |

(1) Includes estimated expense reimbursements.

We renewed 74.3% of the square footage scheduled to expire in the six months ended June 30, 2009 (including the effects of early renewals and leases terminated less than one year prior to the scheduled lease expiration date).