

Edgar Filing: Douglas Emmett Inc - Form 10-Q

Douglas Emmett Inc  
Form 10-Q  
November 06, 2018  
United States  
Securities and Exchange Commission  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

Commission file number: 001-33106

Douglas Emmett, Inc.

(Exact name of registrant as specified in its charter)

Maryland 20-3073047  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

1299 Ocean Avenue, Suite 1000, Santa Monica, California 90401  
(Address of principal executive offices) (Zip Code)

(310) 255-7700  
(Registrant's telephone number, including area code)

808 Wilshire Boulevard, Suite 200, Santa Monica, California 90401  
(Former address of principal executive offices) (Zip Code)

N/A  
(Former name and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Emerging growth 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

Edgar Filing: Douglas Emmett Inc - Form 10-Q

Exchange Act. "

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at	October 30, 2018
Common Stock, \$0.01 par value per share	169,939,296	shares

1

---

DOUGLAS EMMETT, INC.  
FORM 10-Q

## Table of Contents

	Page
<u>Glossary</u>	<u>3</u>
<u>Forward Looking Statements</u>	<u>5</u>
 <u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1 Financial Statements (unaudited)</u>	<u>6</u>
<u>Consolidated Balance Sheets</u>	<u>6</u>
<u>Consolidated Statements of Operations</u>	<u>7</u>
<u>Consolidated Statements of Comprehensive Income</u>	<u>8</u>
<u>Consolidated Statements of Cash Flows</u>	<u>9</u>
<u>Notes to Consolidated Financial Statements</u>	<u>11</u>
<u>Overview</u>	<u>11</u>
<u>Summary of Significant Accounting Policies</u>	<u>12</u>
<u>Investment in Real Estate</u>	<u>14</u>
<u>Acquired Lease Intangibles</u>	<u>15</u>
<u>Investments in Unconsolidated Real Estate Funds</u>	<u>16</u>
<u>Other Assets</u>	<u>16</u>
<u>Secured Notes Payable and Revolving Credit Facility, Net</u>	<u>17</u>
<u>Interest Payable, Accounts Payable and Deferred Revenue</u>	<u>19</u>
<u>Derivative Contracts</u>	<u>19</u>
<u>Equity</u>	<u>21</u>
<u>EPS</u>	<u>24</u>
<u>Fair Value of Financial Instruments</u>	<u>25</u>
<u>Segment Reporting</u>	<u>26</u>
<u>Future Minimum Lease Rental Receipts</u>	<u>27</u>
<u>Future Minimum Lease Rental Payments</u>	<u>27</u>
<u>Commitments, Contingencies &amp; Guarantees</u>	<u>28</u>
<u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>30</u>
<u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u>	<u>45</u>
<u>Item 4 Controls and Procedures</u>	<u>46</u>
 <u>PART II. OTHER INFORMATION</u>	
<u>Item 1 Legal Proceedings</u>	<u>47</u>
<u>Item 1A Risk Factors</u>	<u>47</u>
<u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>47</u>
<u>Item 3 Defaults Upon Senior Securities</u>	<u>47</u>
<u>Item 4 Mine Safety Disclosures</u>	<u>47</u>
<u>Item 5 Other Information</u>	<u>47</u>
<u>Item 6 Exhibits</u>	<u>47</u>
 <u>SIGNATURES</u>	 <u>48</u>



Table of Contents

Glossary

Abbreviations used in this Report:

AOCI	Accumulated Other Comprehensive Income (Loss)
ASU	Accounting Standards Update
ATM	At-the-Market
BOMA	Building Owners and Managers Association
CEO	Chief Executive Officer
CFO	Chief Financial Officer
Code	Internal Revenue Code of 1986, as amended
DEI	Douglas Emmett, Inc.
EPS	Earnings Per Share
Exchange Act	Securities Exchange Act of 1934, as amended
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FFO	Funds from Operations
Fund X	Douglas Emmett Fund X, LLC
Funds	Unconsolidated institutional real estate funds (Fund X, Partnership X and Opportunity Fund)
GAAP	Generally Accepted Accounting Principles (United States)
JV	Joint Venture
LIBOR	London Interbank Offered Rate
LTIP Units	Long-Term Incentive Plan Units
NAREIT	National Association of Real Estate Investment Trusts
OCI	Other Comprehensive Income (Loss)
OP Units	Operating Partnership Units
Operating Partnership	Douglas Emmett Properties, LP
Opportunity Fund	Fund X Opportunity Fund, LLC
Partnership X	Douglas Emmett Partnership X, LP
PCAOB	Public Company Accounting Oversight Board (United States)
REIT	Real Estate Investment Trust
Report	Quarterly Report on Form 10-Q
SEC	Securities and Exchange Commission
Securities Act	Securities Act of 1933, as amended
TRS	Taxable REIT subsidiary(ies)
US	United States
VIE	Variable Interest Entity(ies)

Table of Contents

Glossary

Defined terms used in this Report:

Annualized Rent	Annualized cash base rent (excluding tenant reimbursements, parking and other income) before abatements under leases commenced as of the reporting date. Annualized rent for our triple net office leases is calculated by adding expense reimbursements and estimates of normal building expenses paid by tenants to base rent. Annualized rent does not include lost rent recovered from insurance and rent for building management use.
Consolidated Portfolio	Includes the properties in our consolidated results, which includes the properties owned by our consolidated JVs.
Funds From Operations (FFO)	We calculate FFO in accordance with the standards established by NAREIT by excluding gains (or losses) on sales of investments in real estate, real estate depreciation and amortization (other than amortization of deferred loan costs) from our net income (including adjusting for the effect of such items attributable to consolidated joint ventures and unconsolidated real estate funds, but not for noncontrolling interests included in our Operating Partnership). FFO is a non-GAAP supplemental financial measure that we report because it is useful to our investors. See Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 for a discussion of FFO.
Net Operating Income (NOI)	We calculate NOI, a Non-GAAP measure, as revenue less operating expenses attributable to the properties that we own and operate. NOI is calculated by excluding the following from our net income: general and administrative expense, depreciation and amortization expense, other income, other expense, income, including depreciation, from unconsolidated real estate funds, interest expense, gains (or losses) on sales of investments in real estate and net income attributable to noncontrolling interests. NOI is a non-GAAP supplemental financial measure that we report because it is useful to our investors. See Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 for a discussion of our Same Property NOI.
Occupancy Rate	The percentage leased, excluding signed leases not yet commenced, as of the reporting date. Management space is considered leased and occupied, while space taken out of service during a repositioning is excluded from both the numerator and denominator for calculating percentage leased and occupied.
Recurring Capital Expenditures	Building improvements required to maintain revenues once a property has been stabilized, and excludes capital expenditures for (i) acquired buildings being stabilized, (ii) newly developed space, (iii) upgrades to improve revenues or operating expenses, (iv) casualty damage or (v) bringing the property into compliance with governmental requirements.
Rentable Square Feet	Based on the BOMA remeasurement and consists of leased square feet (including square feet with respect to signed leases not commenced as of the reporting date), available square feet, building management use square feet and square feet of the BOMA adjustment on leased space.
Same Properties	Our wholly-owned properties that have been owned and operated by us in a consistent manner, and reported in our consolidated results during the entire span of both periods being compared. We exclude from our same property subset any properties (i) acquired during the comparative periods; (ii) sold, held for sale, contributed or otherwise removed from our consolidated financial statements during the comparative periods; or (iii) that underwent a major repositioning project that we believed significantly affected its results during the comparative periods.
Short-Term Leases	Represents leases that expired on or before the reporting date or had a term of less than one year, including hold over tenancies, month to month leases and other short term occupancies.
Total Portfolio	Includes our Consolidated Portfolio plus the properties owned by our Funds.

Table of Contents

Forward Looking Statements

This Report contains forward-looking statements within the meaning of the Section 27A of the Securities Act and Section 21E of the Exchange Act. You can find many (but not all) of these statements by looking for words such as “believe”, “expect”, “anticipate”, “estimate”, “approximate”, “intend”, “plan”, “would”, “could”, “may”, “future” or other similar words in this Report. We claim the protection of the safe harbor contained in the Private Securities Litigation Reform Act of 1995. We caution investors that any forward-looking statements used in this Report, or those that we make orally or in writing from time to time, are based on our beliefs and assumptions, as well as information currently available to us. Actual outcomes will be affected by known and unknown risks, trends, uncertainties and factors beyond our control or ability to predict. Although we believe that our assumptions are reasonable, they are not guarantees of future performance and some will inevitably prove to be incorrect. As a result, our future results can be expected to differ from our expectations, and those differences may be material. Accordingly, investors should use caution when relying on previously reported forward-looking statements, which were based on results and trends at the time they were made, to anticipate future results or trends. Some of the risks and uncertainties that could cause our actual results, performance or achievements to differ materially from those expressed or implied by forward-looking statements include the following:

- adverse economic or real estate developments affecting Southern California or Honolulu, Hawaii;
- competition from other real estate investors in our markets;
- decreasing rental rates or increasing tenant incentive and vacancy rates;
- defaults on, early terminations of, or non-renewal of leases by tenants;
- increases in interest rates or operating costs;
- insufficient cash flows to service our outstanding debt or pay rent on ground leases;
- difficulties in raising capital;
- inability to liquidate real estate or other investments quickly;
- adverse changes to rent control laws and regulations;
- environmental uncertainties;
- natural disasters;
- insufficient insurance, or increases in insurance costs;
- inability to successfully expand into new markets and submarkets;
- difficulties in identifying properties to acquire and failure to complete acquisitions successfully;
- failure to successfully operate acquired properties;
- risks associated with property development;
  - risks associated with
    - JVs;
- conflicts of interest with our officers and reliance on key personnel;
- changes in zoning and other land use laws;
- adverse results of litigation or governmental proceedings;
- failure to comply with laws, regulations and covenants that are applicable to our properties;
- possible terrorist attacks or wars;
- possible cyber attacks or intrusions;
- adverse changes to accounting rules;
- weaknesses in our internal controls over financial reporting;
- failure to maintain our REIT status under federal tax laws; and
- adverse changes to tax laws, including those related to property taxes.

For further discussion of these and other risk factors see Item 1A. "Risk Factors" in our 2017 Annual Report on Form 10-K for the fiscal year ended December 31, 2017. This Report and all subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the

cautionary statements contained or referred to in this section. We do not undertake any obligation to release publicly any revisions to our forward-looking statements to reflect events or circumstances after the date of this Report.



Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

Douglas Emmett, Inc.

Consolidated Balance Sheets

(In thousands, except share data)

	September 30, 2018	December 31, 2017
	Unaudited	
Assets		
Investment in real estate:		
Land	\$ 1,065,099	\$ 1,062,345
Buildings and improvements	7,995,377	7,886,201
Tenant improvements and lease intangibles	821,483	756,190
Property under development	105,567	124,472
Investment in real estate, gross	9,987,526	9,829,208
Less: accumulated depreciation and amortization	(2,200,403 )	(2,012,752 )
Investment in real estate, net	7,787,123	7,816,456
Cash and cash equivalents	172,362	176,645
Tenant receivables, net	5,040	2,980
Deferred rent receivables, net	118,736	106,021
Acquired lease intangible assets, net	3,492	4,293
Interest rate contract assets	124,751	60,069
Investment in unconsolidated real estate funds	118,252	107,735
Other assets	18,023	18,442
Total Assets	\$ 8,347,779	\$ 8,292,641
Liabilities		
Secured notes payable and revolving credit facility, net	\$ 4,122,277	\$ 4,117,390
Interest payable, accounts payable and deferred revenue	151,106	103,947
Security deposits	50,773	50,414
Acquired lease intangible liabilities, net	57,591	75,635
Interest rate contract liabilities	—	807
Dividends payable	42,491	42,399
Total liabilities	4,424,238	4,390,592
Equity		
Douglas Emmett, Inc. stockholders' equity:		
Common Stock, \$0.01 par value, 750,000,000 authorized, 169,939,015 and 169,564,927 outstanding at September 30, 2018 and December 31, 2017, respectively	1,699	1,696
Additional paid-in capital	3,277,746	3,272,539
Accumulated other comprehensive income	94,643	43,099
Accumulated deficit	(917,009 )	(879,810 )
Total Douglas Emmett, Inc. stockholders' equity	2,457,079	2,437,524
Noncontrolling interests	1,466,462	1,464,525
Total equity	3,923,541	3,902,049

Total Liabilities and Equity	\$ 8,347,779	\$ 8,292,641
------------------------------	--------------	--------------

See accompanying notes to the consolidated financial statements.

6

---

Edgar Filing: Douglas Emmett Inc - Form 10-Q

Table of Contents

Douglas Emmett, Inc.

Consolidated Statements of Operations

(Unaudited; in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Revenues				
Office rental				
Rental revenues	\$ 150,316	\$ 140,993	\$ 448,248	\$ 409,674
Tenant recoveries	16,364	15,854	42,071	39,705
Parking and other income	30,374	27,771	87,829	81,129
Total office revenues	197,054	184,618	578,148	530,508
Multifamily rental				
Rental revenues	24,241	22,282	70,957	66,760
Parking and other income	2,013	1,849	5,919	5,594
Total multifamily revenues	26,254	24,131	76,876	72,354
Total revenues	223,308	208,749	655,024	602,862
Operating Expenses				
Office expenses	66,288	62,468	188,462	175,240
Multifamily expenses	7,114	6,041	20,720	17,866
General and administrative	9,440	8,441	28,444	27,189
Depreciation and amortization	74,067	69,974	219,944	206,141
Total operating expenses	156,909	146,924	457,570	426,436
Operating income	66,399	61,825	197,454	176,426
Other income	2,951	2,659	8,373	7,152
Other expenses	(1,561 )	(1,659 )	(5,380 )	(5,156 )
Income, including depreciation, from unconsolidated real estate funds	1,348	1,137	4,522	4,427
Interest expense	(33,721 )	(35,454 )	(99,889 )	(110,408 )
Net income	35,416	28,508	105,080	72,441
Less: Net income attributable to noncontrolling interests	(4,855 )	(2,894 )	(14,629 )	(7,534 )
Net income attributable to common stockholders	\$ 30,561	\$ 25,614	\$ 90,451	\$ 64,907
Net income attributable to common stockholders per share – basic	\$ 0.18	\$ 0.15	\$ 0.53	\$ 0.41
Net income attributable to common stockholders per share – diluted	\$ 0.18	\$ 0.15	\$ 0.53	\$ 0.41
Dividends declared per common share	\$ 0.25	\$ 0.23	\$ 0.75	\$ 0.69

See accompanying notes to the consolidated financial statements.

Table of Contents

Douglas Emmett, Inc.

Consolidated Statements of Comprehensive Income

(Unaudited and in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	\$35,416	\$28,508	\$105,080	\$72,441
Other comprehensive income: cash flow hedges	10,042	1,493	73,405	7,129
Comprehensive income	45,458	30,001	178,485	79,570
Less: Comprehensive income attributable to noncontrolling interests	(7,740 )	(2,719 )	(36,490 )	(7,280 )
Comprehensive income attributable to common stockholders	\$37,718	\$27,282	\$141,995	\$72,290

See accompanying notes to the consolidated financial statements.

Table of Contents

Douglas Emmett, Inc.

Consolidated Statements of Cash Flows

(Unaudited and in thousands)

	Nine Months Ended September 30,	
	2018	2017
<b>Operating Activities</b>		
Net income	\$ 105,080	\$ 72,441
Adjustments to reconcile net income to net cash provided by operating activities:		
Income, including depreciation, from unconsolidated real estate funds	(4,522 )	(4,427 )
Depreciation and amortization	219,944	206,141
Net accretion of acquired lease intangibles	(17,243 )	(13,290 )
Straight-line rent	(12,715 )	(9,012 )
Increase in the allowance for doubtful accounts	1,565	139
Deferred loan costs amortized and written off	6,285	6,865
Amortization of loan premium	(153 )	—
Non-cash market value adjustments on interest rate contracts	—	38
Amortization of stock-based compensation	8,879	7,910
Operating distributions from unconsolidated real estate funds	4,522	4,427
Change in working capital components:		
Tenant receivables	(3,625 )	(830 )
Interest payable, accounts payable and deferred revenue	22,349	40,110
Security deposits	359	2,809
Other assets	1,118	(4,639 )
Net cash provided by operating activities	331,843	308,682
<b>Investing Activities</b>		
Capital expenditures for improvements to real estate	(115,963 )	(80,102 )
Capital expenditures for developments	(48,507 )	(42,143 )
Property acquisitions	—	(532,324 )
Acquisition of additional interests in unconsolidated real estate funds	(9,379 )	(2,571 )
Capital distributions from unconsolidated real estate funds	5,866	41,965
Net cash used in investing activities	(167,983 )	(615,175 )
<b>Financing Activities</b>		
Proceeds from borrowings	597,000	1,010,500
Repayment of borrowings	(595,151 )	(1,330,945)
Loan cost payments	(2,964 )	(7,173 )
Contributions from noncontrolling interests in consolidated JVs	—	284,248
Distributions paid to noncontrolling interests	(39,122 )	(28,682 )
Dividends paid to common stockholders	(127,348 )	(107,045 )
Taxes paid on exercise of stock options	(450 )	(52,867 )
Repurchase of OP Units	(108 )	—
Proceeds from issuance of common stock, net	—	593,272
Net cash (used in) provided by financing activities	(168,143 )	361,308
(Decrease) increase in cash and cash equivalents and restricted cash	(4,283 )	54,815

Edgar Filing: Douglas Emmett Inc - Form 10-Q

Cash and cash equivalents and restricted cash - beginning balance	176,766	113,048
Cash and cash equivalents and restricted cash - ending balance	\$172,483	\$167,863

9

---

Table of Contents

Douglas Emmett, Inc.

Consolidated Statements of Cash Flows

(Unaudited and in thousands)

## Supplemental Cash Flows Information

	Nine Months Ended September 30,	
	2018	2017
Operating Activities		
Cash paid for interest, net of capitalized interest	\$93,455	\$103,305
Capitalized interest paid	\$2,408	\$1,906
Non-cash Investing Transactions		
Accrual for additions to real estate and developments	\$24,681	\$3,024
Capitalized stock-based compensation for improvements to real estate and developments	\$1,460	\$732
Removal of fully depreciated and amortized tenant improvements and lease intangibles	\$32,332	\$36,367
Removal of fully amortized acquired lease intangible assets	\$1,180	\$85
Removal of fully accreted acquired lease intangible liabilities	\$10,515	\$4,026
Non-cash Financing Transactions		
Gain recorded in AOCI - Adoption of ASU 2017-12 - consolidated derivatives	\$211	\$—
Gain (loss) recorded in AOCI - consolidated derivatives	\$70,806	\$(4,027 )
Gain recorded in AOCI - unconsolidated Funds' derivatives (our share)	\$8,087	\$610
Dividends declared	\$127,440	\$111,177
Common stock issued in exchange for OP Units	\$5,720	\$13,261

See accompanying notes to the consolidated financial statements.

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited)

## 1. Overview

## Organization and Business Description

Douglas Emmett, Inc. is a fully integrated, self-administered and self-managed REIT. We are one of the largest owners and operators of high-quality office and multifamily properties in Los Angeles County, California and Honolulu, Hawaii. Through our interest in our Operating Partnership and its subsidiaries, consolidated JVs and unconsolidated Funds, we focus on owning, acquiring, developing and managing a significant market share of top-tier office properties and premier multifamily communities in neighborhoods that possess significant supply constraints, high-end executive housing and key lifestyle amenities. The terms "us," "we" and "our" as used in the financial statements refer to Douglas Emmett, Inc. and its subsidiaries on a consolidated basis. At September 30, 2018, our Consolidated Portfolio consisted of (i) a 16.6 million square foot office portfolio, (ii) 3,563 multifamily apartment units and (iii) fee interests in two parcels of land from which we receive rent under ground leases. We also manage and own equity interests in unconsolidated Funds which, at September 30, 2018, owned an additional 1.8 million square feet of office space. We manage our unconsolidated Funds alongside our Consolidated Portfolio, and we therefore present the statistics for our office portfolio on a Total Portfolio basis. As of September 30, 2018, our portfolio (not including two parcels of land from which we receive rent under ground leases), consisted of the following office and multifamily properties (both of which include ancillary retail space):

	Consolidated Portfolio	Total Portfolio
Office		
Wholly-owned properties	53	53
Consolidated JV properties	10	10
Unconsolidated Fund properties	—	8
	63	71
Multifamily		
Wholly-owned properties	10	10
Total	73	81

## Basis of Presentation

The accompanying financial statements are the consolidated financial statements of Douglas Emmett, Inc. and its subsidiaries, including our Operating Partnership and our consolidated JVs. All significant intercompany balances and transactions have been eliminated in our consolidated financial statements. Our Operating Partnership and consolidated JVs are VIEs of which we are the primary beneficiary. As of September 30, 2018, the total consolidated assets, liabilities and equity of the VIEs was \$8.35 billion (of which \$7.79 billion related to investment in real estate), \$4.42 billion and \$3.92 billion (of which \$1.47 billion related to noncontrolling interests), respectively.

The accompanying unaudited interim financial statements have been prepared pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with GAAP may have been condensed or omitted pursuant to SEC rules and regulations, although we



believe that the disclosures are adequate to make their presentation not misleading. The accompanying unaudited interim financial statements include, in our opinion, all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial information set forth therein. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. The interim financial statements should be read in conjunction with the consolidated financial statements in our 2017 Annual Report on Form 10-K and the notes thereto. References in this Report to the number of properties, square footage, per square footage amounts, apartment units and geography, are outside the scope of our independent registered public accounting firm's review of our financial statements in accordance with the standards of the PCAOB.

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

2. Summary of Significant Accounting Policies

We adopted ASUs during the nine months ended September 30, 2018 that changed our accounting policies for revenue recognition and hedge accounting disclosed in our 2017 Annual Report on Form 10-K - see "New Accounting Pronouncements" below. The adoption of these ASUs did not have a material impact on our financial statements. We have not made any other changes to our significant accounting policies disclosed in our 2017 Annual Report on Form 10-K.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make certain estimates that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates.

Income Taxes

We have elected to be taxed as a REIT under the Code. Provided that we qualify for taxation as a REIT, we are generally not subject to corporate-level income tax on the earnings distributed currently to our stockholders that we derive from our REIT qualifying activities. We are subject to corporate-level tax on the earnings that we derive through our TRS.

New Accounting Pronouncements

Changes to GAAP are implemented by the FASB in the form of ASUs. We consider the applicability and impact of all ASUs. Other than the ASUs discussed below, the FASB has not issued any other ASUs during 2018 that we expect to be applicable and have a material impact on our financial statements.

Adopted ASUs

During the nine months ended September 30, 2018 we adopted the ASUs listed below:

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers" (Topic 606), which provides guidance for the accounting of revenue from contracts with customers, and supersedes Topic 605, "Revenue Recognition", and most industry-specific guidance throughout the industry topics of the Codification. In March 2016, the FASB issued ASU No. 2016-08, "Principal versus Agent Considerations (Reporting Revenue Gross versus Net)", which amends Topic 606 and clarifies the guidance for principal versus agent considerations. In April 2016, the FASB issued ASU No. 2016-10, "Identifying Performance Obligations and Licensing" which amends Topic 606 and provides guidance for identifying performance obligations and licensing. In May 2016, the FASB issued ASU No. 2016-12, "Narrow-Scope Improvements and Practical Expedients" which amends Topic 606 and provides guidance for a variety of revenue recognition related topics. In February 2017, the FASB issued ASU No. 2017-05 "Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets" (Subtopic 610-20), which provides guidance for recognizing gains and losses from the transfer of nonfinancial assets in contracts with non-customers. Sales of real estate are now accounted for under Subtopic 610-20 which focuses on a transfer of control. The amendments in these ASUs were effective in the first quarter of 2018 and were required to be applied on a retrospective basis.

Most of our revenues are derived from lease contracts with tenants and are not within the scope of the respective ASUs. Although our office parking revenues are within the scope of the respective ASUs, the timing and pattern of revenue recognition was not impacted. However, the scoping of our revenues could be impacted by ASU No. 2016-02, "Leases" (Topic 842), which we plan to adopt in the first quarter of 2019 - see "ASUs Not Yet Adopted" further below.

Our office parking revenues are mostly derived from lease contracts with our office tenants. The lease contracts generally make a specified number of parking spaces available to the tenant, and we bill and recognize parking revenues on a monthly basis in accordance with the lease agreements generally using the monthly parking rates in effect at the time of billing. Office parking revenues were \$26.0 million and \$24.6 million for the three months ended September 30, 2018 and 2017, and \$76.8 million and \$71.8 million for the nine months ended September 30, 2018 and 2017, respectively, and are included in Office parking and other income in our consolidated statements of operations. Office parking receivables were \$1.1 million and \$1.0 million as of September 30, 2018 and December 31, 2017, respectively. Office parking receivables are included in Tenant receivables in our consolidated balance sheets.

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

Derivatives and Hedging

In August 2017, the FASB issued ASU No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities". The ASU requires the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness be recorded in other comprehensive income. GAAP historically provided special hedge accounting only for the portion of the hedge deemed to be "highly effective" and requires an entity to separately reflect the amount by which the hedging instrument does not offset the hedged item, which is referred to as the "ineffective" amount. The amendments are effective in the first quarter of 2019 and are required to be applied on a prospective basis. We early adopted the ASU and it did not have a material impact on our financial statements. The ASU requires the cumulative effect of initially applying the ASU as an adjustment to AOCI with a corresponding adjustment to the opening balance of retained earnings as of the beginning of the fiscal year in which the ASU is adopted. On January 1, 2018, we recorded such an adjustment to AOCI and accumulated deficit of \$211 thousand. See Note 10.

ASUs Not Yet Adopted

Leases

In February 2016, the FASB issued ASU No. 2016-02, "Leases" (Topic 842). The primary difference between Topic 842 and current GAAP is the recognition of lease assets and liabilities on the balance sheet by lessees for leases classified as operating leases under current GAAP. The accounting applied by lessors is largely unchanged from current GAAP, for example, the vast majority of operating leases will remain classified as operating leases, and lessors will continue to recognize lease income for those leases on a straight-line basis over the lease term.

Topic 842 requires separation of the lease from the non-lease components (for example, maintenance services or other activities that transfer a good or service to the customer) in a contract. Only the lease components should be accounted for in accordance with Topic 842. The consideration in the contract is allocated to the lease and non-lease components on a relative standalone selling price basis and the non-lease component would be accounted for in accordance with ASC 606 ("Revenue from Contracts with Customers"). In July 2018, the FASB issued ASU No. 2018-11 which includes an optional practical expedient for lessors to elect, by class of underlying asset, to not separate the lease from the non-lease components if certain criteria are met. Based on our preliminary assessment, we expect that operating leases for which we are the lessor will qualify for the single component presentation, and we therefore expect to elect adoption of this practical expedient.

Topic 842 defines initial direct costs of a lease (which we have historically capitalized) as costs that would not have been incurred had the lease not been executed. Costs to negotiate a lease that would have been incurred regardless of whether the lease was executed, such as employee salaries, are not considered to be initial direct costs, and may not be capitalized. We capitalized \$5.8 million of leasing costs during the nine months ended September 30, 2018 that would not qualify as initial direct costs and would be expensed under Topic 842. The expensing of those costs, adjusted for amortization expense, would have reduced net income attributable to common stockholders by \$4.6 million for the nine months ended September 30, 2018.

We pay rent under a ground lease which expires on December 31, 2086. See Note 15 for more information regarding this ground lease. We currently account for the lease as an operating lease. We expect to recognize a right-of-use asset and lease liability for this ground lease in the first quarter of 2019 when we adopt the ASU. We do not expect the change in accounting for the ground lease to have a material impact on our financial position or results of operations.

The ASUs are effective in the first quarter of 2019 and are required to be adopted using either a) a modified retrospective approach which results in a cumulative adjustment to the opening balance of retained earnings (accumulated deficit) on January 1, 2017, and restatement of the amounts presented prior to January 1, 2019 for leases that existed or were entered into after January 1, 2017, the beginning of the earliest comparative period presented in the 2019 consolidated financial statements, or b) a modified retrospective transition method which results in a cumulative adjustment to the opening balance of retained earnings (accumulated deficit) on January 1, 2019 for leases that existed or were entered into prior to January 1, 2019, the effective date of the ASU. All leases entered into on or after January 1, 2019 would be accounted for as prescribed by ASC 842.

ASC 842 provides a practical expedient package that allow entities to not (a) reassess whether any expired or existing contracts are considered or contain leases; (b) reassess the lease classification for any expired or existing leases; and (c) reassess initial direct costs for any existing leases.

The Company plans to elect the modified retrospective transition method for adoption on January 1, 2019 and expects to elect the use of the practical expedient package described above.

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

We continue to evaluate the impact of the ASUs, and the related practical expedients, on our financial statements and we plan to adopt the ASUs in the first quarter of 2019.

## 3. Investment in Real Estate

We account for our property acquisitions as asset acquisitions. The acquired properties results of operations are included in our results of operations from the respective acquisition dates. During the nine months ended September 30, 2018, we did not purchase any properties. During the nine months ended September 30, 2017, a consolidated JV that we manage and in which we own an equity interest acquired three Class A office properties. The table below summarizes the purchase price allocations for the acquisitions. The contract and purchase prices differ due to prorations and similar matters:

(In thousands)	1299 Ocean	429 Santa Monica	9665 Wilshire
Submarket	Santa Monica	Santa Monica	Beverly Hills
Acquisition date	April 25	April 25	July 20
Contract price	\$275,800	\$77,000	\$177,000
Building square footage	206	87	171
Investment in real estate:			
Land	\$22,748	\$4,949	\$5,568
Buildings and improvements	260,188	69,286	175,960
Tenant improvements and lease intangibles	5,010	3,248	1,112
Acquired above- and below-market leases, net	(10,683 )	(722 )	(4,339 )
Net assets and liabilities acquired	\$277,263	\$76,761	\$178,301

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

4. Acquired Lease Intangibles

Summary of our Acquired Lease Intangibles

(In thousands)	September 30, 2018	December 31, 2017
Above-market tenant leases	\$ 5,997	\$ 7,177
Above-market tenant leases - accumulated amortization	(3,454)	(3,846)
Above-market ground lease where we are the lessor	1,152	1,152
Above-market ground lease - accumulated amortization	(203)	(190)
Acquired lease intangible assets, net	\$ 3,492	\$ 4,293
Below-market tenant leases	\$ 117,090	\$ 127,606
Below-market tenant leases - accumulated accretion	(62,919)	(55,428)
Above-market ground lease where we are the tenant	4,017	4,017
Above-market ground lease - accumulated accretion	(597)	(560)
Acquired lease intangible liabilities, net	\$ 57,591	\$ 75,635

Impact on the Consolidated Statements of Operations

The table below summarizes the net amortization/accretion related to our above- and below-market leases:

(In thousands)	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Net accretion of above- and below-market tenant lease assets and liabilities <sup>(1)</sup>	\$4,940	\$4,805	\$17,218	\$13,265
Amortization of an above-market ground lease asset <sup>(2)</sup>	(5)	(4)	(13)	(13)
Accretion of an above-market ground lease liability <sup>(3)</sup>	13	13	38	38
Total	\$4,948	\$4,814	\$17,243	\$13,290

(1) Recorded as a net increase to office and multifamily rental revenues.

(2) Recorded as a decrease to office parking and other income.

(3) Recorded as a decrease to office expense.

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

## 5. Investments in Unconsolidated Real Estate Funds

## Description of our Funds

We manage and own equity interests in three unconsolidated Funds, the Opportunity Fund, Fund X and Partnership X, through which we and investors own eight office properties totaling 1.8 million square feet. During the three months ended September 30, 2018 we purchased an additional 1.9% interest in Fund X. At September 30, 2018, we held direct and indirect equity interests of 6.2% of the Opportunity Fund, 71.3% of Fund X and 24.5% of Partnership X. Our Funds pay us fees and reimburse us for certain expenses related to property management and other services we provide. We also receive distributions based on invested capital and on any profits that exceed certain specified cash returns to the investors. The table below presents cash distributions received from our Funds:

(In thousands)	Nine Months Ended September 30,	
	2018	2017
Operating distributions received	\$4,522	\$4,427
Capital distributions received	5,866	41,965
Total distributions received	\$10,388	\$46,392

## Summarized Financial Information for our Funds

The tables below present selected financial information for the Funds on a combined basis. The amounts presented reflect 100% (not our pro-rata share) of amounts related to the Funds, and are based upon historical acquired book value:

(In thousands)	September 30, 2018	December 31, 2017
Total assets	\$ 706,707	\$ 704,186
Total liabilities	\$ 525,771	\$ 523,767
Total equity	\$ 180,936	\$ 180,419

(In thousands)	Nine Months Ended September 30,	
	2018	2017
Total revenues	\$58,935	\$56,550
Operating income	\$16,870	\$14,918
Net income	\$4,333	\$3,974

## 6. Other Assets

(In thousands)	September 30, 2018	December 31, 2017
----------------	-----------------------	----------------------



Edgar Filing: Douglas Emmett Inc - Form 10-Q

Restricted cash	\$ 121	\$ 121
Prepaid expenses	12,331	9,235
Other indefinite-lived intangibles	1,988	1,988
Furniture, fixtures and equipment, net	777	1,155
Other	2,806	5,943
Total other assets	\$ 18,023	\$ 18,442

16

---

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

## 7. Secured Notes Payable and Revolving Credit Facility, Net

Description	Maturity Date <sup>(1)</sup>	Principal Balance as of September 30, 2018	Principal Balance as of December 31, 2017	Variable Interest Rate	Fixed Interest Rate <sup>(2)</sup>	Swap Maturity Date
(In thousands)						
Wholly Owned Subsidiaries						
Term loan <sup>(3)</sup>	—	\$ —	\$ 146,974	—	—	—
Term loan <sup>(3)</sup>	—	—	280,721	—	—	—
Fannie Mae loan	10/1/2019	145,000	145,000	LIBOR + 1.25%	N/A	N/A
Term loan <sup>(4)</sup>	4/15/2022	340,000	340,000	LIBOR + 1.40%	2.77%	4/1/2020
Term loan <sup>(4)</sup>	7/27/2022	180,000	180,000	LIBOR + 1.45%	3.06%	7/1/2020
Term loan <sup>(4)</sup>	11/1/2022	400,000	400,000	LIBOR + 1.35%	2.64%	11/1/2020
Term loan <sup>(4)</sup>	6/23/2023	360,000	360,000	LIBOR + 1.55%	2.57%	7/1/2021
Term loan <sup>(4)</sup>	12/23/2023	220,000	220,000	LIBOR + 1.70%	3.62%	12/23/2021
Term loan <sup>(4)</sup>	1/1/2024	300,000	300,000	LIBOR + 1.55%	3.46%	1/1/2022
Term loan <sup>(4)</sup>	3/3/2025	335,000	—	LIBOR + 1.30%	3.84%	3/1/2023
Fannie Mae loan <sup>(4)</sup>	4/1/2025	102,400	102,400	LIBOR + 1.25%	2.84%	3/1/2020
Fannie Mae loans <sup>(4)</sup>	12/1/2025	115,000	115,000	LIBOR + 1.25%	2.76%	12/1/2020
Fannie Mae loans <sup>(4)</sup>	6/1/2027	550,000	550,000	LIBOR + 1.37%	3.16%	6/1/2022
Term loan <sup>(5)</sup>	6/1/2038	31,757	32,213	N/A	4.55%	N/A
Revolving credit facility <sup>(6)</sup>	8/21/2020	95,000	—	LIBOR + 1.40%	N/A	N/A
Total Wholly Owned Subsidiary Debt		3,174,157	3,172,308			
Consolidated JVs						
Term loan <sup>(4)</sup>	2/28/2023	580,000	580,000	LIBOR + 1.40%	2.37%	3/1/2021
Term loan <sup>(4)</sup>	12/19/2024	400,000	400,000	LIBOR + 1.30%	3.47%	1/1/2023
Total Consolidated Debt <sup>(7)</sup>		4,154,157	4,152,308			
Unamortized loan premium, net		4,037	4,191			
Deferred loan costs, net		(35,917)	(39,109)			
Total Consolidated Debt, net		\$ 4,122,277	\$ 4,117,390			

Except as noted below, each loan (including our revolving credit facility) is non-recourse and secured by one or more separate collateral pools consisting of one or more properties, and requires monthly payments of interest only with the outstanding principal due upon maturity.

(1) Maturity dates include the effect of extension options.

(2) Includes the effect of interest rate swaps and excludes the effect of prepaid loan fees. See Note 9 for details of our interest rate swaps.

(3) At September 30, 2018, this loan had been paid off.

(4) Loan agreement includes a zero-percent LIBOR floor. The corresponding swaps do not include such a floor.

- (5) Requires monthly payments of principal and interest. Principal amortization is based upon a 30-year amortization schedule.
- (6) \$400.0 million revolving credit facility. Unused commitment fees range from 0.15% to 0.20%.
- (7) See Note 12 for our fair value disclosures.

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

## Debt Statistics

The following table summarizes our fixed and floating rate debt:

(In thousands)	Principal Balance as of September 30, 2018	Principal Balance as of December 31, 2017
Aggregate swapped to fixed rate loans	\$3,882,400	\$3,547,400
Aggregate fixed rate loans	31,757	459,908
Aggregate floating rate loans	240,000	145,000
Total Debt	\$4,154,157	\$4,152,308

The following table summarizes certain debt statistics at September 30, 2018:  
 Statistics for consolidated loans with interest fixed under the terms of the  
 loan or a swap

Principal balance (in billions)	\$3.91
Weighted average remaining life (including extension options)	5.6 years
Weighted average remaining fixed interest period	2.9 years
Weighted average annual interest rate	3.07%

## Future Principal Payments

At September 30, 2018, the minimum future principal payments due on our secured notes payable and revolving credit facility were as follows:

Twelve months ending September 30:	Excluding Maturity Extension Options	Including Maturity Extension Options <sup>(1)</sup>
	(In thousands)	
2019	\$710	\$710
2020	420,743	240,743
2021	115,778	778
2022	640,814	520,814
2023	1,675,852	1,340,852
Thereafter	1,300,260	2,050,260
Total future principal payments	\$4,154,157	\$4,154,157

<sup>(1)</sup> Our loan agreements generally require that we meet certain minimum financial thresholds to be able to extend the loan maturity.

## Loan Costs

## Edgar Filing: Douglas Emmett Inc - Form 10-Q

Deferred loan costs are net of accumulated amortization of \$22.2 million and \$18.0 million at September 30, 2018 and December 31, 2017, respectively. The table below presents loan costs which are included in Interest expense in our consolidated statements of operations:

(In thousands)	Three Months		Nine Months	
	Ended	Ended	Ended	Ended
	September 30,	September 30,	September 30,	September 30,
	2018	2017	2018	2017
Loan costs expensed	\$7	\$163	\$411	\$539
Deferred loan cost amortization	1,999	2,343	5,874	6,865
Total	\$2,006	\$2,506	\$6,285	\$7,404

18

---

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

## 8. Interest Payable, Accounts Payable and Deferred Revenue

(In thousands)	September 30, 2018	December 31, 2017
Interest payable	\$ 10,132	\$ 9,829
Accounts payable and accrued liabilities	102,413	62,741
Deferred revenue	38,561	31,377
Total interest payable, accounts payable and deferred revenue	\$ 151,106	\$ 103,947

## 9. Derivative Contracts

We make use of interest rate swap and cap contracts to manage the risk associated with changes in interest rates on our floating-rate debt. When we enter into a floating-rate term loan, we generally enter into an interest rate swap agreement for the equivalent principal amount, for a period covering the majority of the loan term, which effectively converts our floating-rate debt to a fixed-rate basis during that time. In limited instances, we also make use of interest rate caps to limit our exposure to interest rate increases on our floating-rate debt. We do not speculate in derivatives and we do not make use of any other derivative instruments. See Note 7 regarding our debt, and our consolidated JVs debt, that is hedged. See Note 16 regarding our unconsolidated Funds debt that is hedged.

## Derivative Summary

As of September 30, 2018, all of our interest rate swaps, which include the interest rate swaps of our consolidated JVs and our unconsolidated Funds, were designated as cash flow hedges:

	Number of Interest Rate Swaps	Notional (In thousands)
Consolidated derivatives <sup>(1)(3)</sup>	27	\$3,882,400
Unconsolidated Funds' derivatives <sup>(2)(3)</sup>	4	\$510,000

(1) The notional amount reflects 100%, not our pro-rata share, of our consolidated JVs' derivatives.

(2) The notional amount reflects 100%, not our pro-rata share, of our unconsolidated Funds' derivatives.

(3) See Note 12 for our derivative fair value disclosures.

## Credit-risk-related Contingent Features

We have agreements with each of our interest rate swap counterparties that contain a provision under which we could also be declared in default on our derivative obligations if we default on the underlying indebtedness that we are hedging. As of September 30, 2018, there have been no events of default with respect to our interest rate swaps or our consolidated JVs' or unconsolidated Funds' interest rate swaps. We do not post collateral for our interest rate swap contract liabilities. As of September 30, 2018, we, including our consolidated JVs and our unconsolidated Funds, did not have any interest rate swaps with fair values that were in a liability position.



Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

## Counterparty Credit Risk

We are subject to credit risk from the counterparties on our interest rate swap contract assets because we do not receive collateral. We seek to minimize that risk by entering into agreements with a variety of high quality counterparties with investment grade ratings. The fair value of our interest rate swap contract assets, including accrued interest and excluding credit risk adjustments, were as follows:

(In thousands)	September 30, 2018	December 31, 2017
Consolidated derivatives <sup>(1)</sup>	\$ 126,832	\$ 60,093
Unconsolidated Funds' derivatives <sup>(2)</sup>	\$ 21,110	\$ 9,350

(1) The amounts reflect 100%, not our pro-rata share, of our consolidated JVs' derivatives.

(2) The amounts reflect 100%, not our pro-rata share, of our unconsolidated Funds' derivatives.

## Impact of Hedges on AOCI and the Consolidated Statements of Operations

The table below presents the effect of our derivatives on our AOCI and the consolidated statements of operations:

(In thousands)	Nine Months Ended September 30, 2018      2017	
Derivatives Designated as Cash Flow Hedges:		
Consolidated derivatives:		
Gain recorded in AOCI - adoption of ASU 2017-12 <sup>(1)(2)</sup>	\$ 211	\$—
Gain (loss) recorded in AOCI <sup>(1)(2)</sup>	\$ 70,806	\$ (4,027 )
(Gain) loss reclassified from AOCI to Interest Expense <sup>(1)</sup>	\$ (5,316 )	\$ 10,353
Total Interest Expense presented in the consolidated statements of operations	\$ (99,889)	\$ (110,408)
Gain related to ineffectiveness recorded in Interest Expense	\$—	\$ 38
Unconsolidated Funds' derivatives (our share) <sup>(3)</sup> :		
Gain recorded in AOCI <sup>(1)</sup>	\$ 8,087	\$ 610
(Gain) loss reclassified from AOCI to Income, including depreciation, from unconsolidated real estate funds <sup>(1)</sup>	\$ (383 )	\$ 193
Total Income, including depreciation, from unconsolidated real estate funds presented in the consolidated statements of operations	\$ 4,522	\$ 4,427

(1) See Note 10 for our AOCI reconciliation.

(2) See Note 2 regarding the ASU adoption.

(3) We calculate our share by multiplying the total amount for each Fund by our equity interest in the respective Fund.

## Future Reclassifications from AOCI

At September 30, 2018, our estimate of the AOCI related to derivatives designated as cash flow hedges, that will be reclassified to earnings during the next twelve months as interest rate swap payments are made is as follows:

(In  
thousands)



Consolidated derivatives:	
Gains to be reclassified from AOCI to Interest Expense	\$ 39,104
Unconsolidated Funds' derivatives (our share):	
Gains to be reclassified from AOCI to Income, including depreciation, from unconsolidated real estate funds	\$ 2,799

20

---

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

## 10. Equity

## Transactions

During the nine months ended September 30, 2018, we (i) acquired 352 thousand OP Units in exchange for issuing an equal number of shares of our common stock to the holders of the OP Units, (ii) acquired 3 thousand OP Units for \$108 thousand in cash and (iii) issued 21 thousand shares of our common stock for the exercise of 48 thousand stock options on a net settlement basis (net of the exercise price and related taxes).

During the nine months ended September 30, 2017, we (i) acquired 986 thousand OP Units in exchange for issuing an equal number of shares of our common stock to the holders of the OP Units, (ii) issued 1.3 million shares of our common stock for the exercise of 3.9 million stock options on a net settlement basis (net of the exercise price and related taxes) and (iii) issued 15.7 million shares of our common stock under our ATM program for net proceeds of \$593.3 million.

## Condensed Consolidated Statements of Equity

(In thousands)	DEI Stockholders' Equity	Noncontrolling Interests	Total Equity
Balance as of January 1, 2018	\$ 2,437,524	\$ 1,464,525	\$ 3,902,049
Adjustment to opening balance of accumulated deficit <sup>(1)</sup>	(211	) —	(211 )
Net income	90,451	14,629	105,080
Cash flow hedge fair value adjustments	51,544	21,861	73,405
Dividends and distributions	(127,440	) (39,122	) (166,562 )
Exchange of OP Units for common stock	5,720	(5,720	) —
OP Units redeemed with cash	(59	) (49	) (108 )
Exercise of stock options <sup>(2)</sup>	(450	) —	(450 )
Stock-based compensation	—	10,338	10,338
Balance as of September 30, 2018	\$ 2,457,079	\$ 1,466,462	\$ 3,923,541

(1) Reflects the adoption of ASU No. 2017-12. See Note 2 for details.

(2) Reflects withholding taxes. We issued shares of our common stock for the exercise of stock options on a net settlement basis (net of the exercise price and related taxes).

(In thousands)	DEI Stockholders' Equity	Noncontrolling Interests	Total Equity
Balance as of January 1, 2017	\$ 1,921,143	\$ 1,092,928	\$ 3,014,071
Net income	64,907	7,534	72,441
Cash flow hedge fair value adjustments	7,383	(254	) 7,129
Contributions to consolidated JV	—	284,248	284,248
Dividends and distributions	(111,177	) (28,682	) (139,859 )
Exchange of OP Units for common stock	13,261	(13,261	) —
Exercise of stock options <sup>(1)</sup>	(52,867	) —	(52,867 )

Edgar Filing: Douglas Emmett Inc - Form 10-Q

Stock-based compensation	—	8,642	8,642
Sale of common stock, net of offering costs	593,272	—	593,272
Balance as of September 30, 2017	\$ 2,435,922	\$ 1,351,155	\$ 3,787,077

---

(1) Reflects withholding taxes. We issued shares of our common stock for the exercise of stock options on a net settlement basis (net of the exercise price and related taxes).

21

---

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

## Noncontrolling Interests

Our noncontrolling interests consist of interests in our Operating Partnership and consolidated JVs which are not owned by us. Noncontrolling interests in our Operating Partnership consist of OP Units and fully-vested LTIP Units, and represented approximately 14% of our Operating Partnership's total interests as of September 30, 2018 when we and our Operating Partnership had 169.9 million shares of common stock and 27.4 million OP Units and fully-vested LTIP Units outstanding. A share of our common stock, an OP Unit and an LTIP Unit (once vested and booked up) have essentially the same economic characteristics, sharing equally in the distributions from our Operating Partnership. Investors who own OP Units have the right to cause our Operating Partnership to acquire their OP Units for an amount of cash per unit equal to the market value of one share of our common stock at the date of acquisition, or, at our election, exchange their OP Units for shares of our common stock on a one-for-one basis. LTIP Units have been granted to our key employees and non-employee directors as part of their compensation. These awards generally vest over a service period and once vested can generally be converted to OP Units provided our stock price increases by more than a specified hurdle.

## Changes in our Ownership Interest in our Operating Partnership

The table below presents the effect on our equity from net income attributable to common stockholders and changes in our ownership interest in our Operating Partnership:

(In thousands)	Nine Months Ended September 30,	
	2018	2017
Net income attributable to common stockholders	\$90,451	\$64,907
Transfers from noncontrolling interests:		
Exchange of OP Units with noncontrolling interests	5,720	13,261
Repurchase of OP Units from noncontrolling interests	(59)	—
Net transfers from noncontrolling interests	5,661	13,261
Change from net income attributable to common stockholders and transfers from noncontrolling interests	\$96,112	\$78,168

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

AOCI Reconciliation<sup>(1)</sup>

The table below presents a reconciliation of our AOCI, which consists solely of adjustments related to derivatives designated as cash flow hedges:

(In thousands)	Nine Months Ended September 30,	
	2018	2017
Beginning balance	\$43,099	\$15,156
Adoption of ASU 2017-12 - cumulative opening balance adjustment <sup>(2)</sup>	211	—
Consolidated derivatives:		
Other comprehensive income (loss) before reclassifications	70,806	(4,027 )
Reclassification of (gains) losses from AOCI to Interest Expense	(5,316 )	10,353
Unconsolidated Funds' derivatives (our share):		
Other comprehensive income before reclassifications	8,087	610
Reclassification of gains from AOCI to Income, including depreciation, from unconsolidated real estate funds	(383 )	193
Net current period OCI	73,405	7,129
OCI attributable to noncontrolling interests	(21,861 )	254
OCI attributable to common stockholders	51,544	7,383
Ending balance	\$94,643	\$22,539

(1) See Note 9 for the details of our derivatives and Note 12 for our derivative fair value disclosures.

(2) See Note 2 regarding our adoption of the ASU on January 1, 2018.

## Equity Compensation

On June 2, 2016, the Douglas Emmett 2016 Omnibus Stock Incentive Plan ("2016 Plan") became effective after receiving stockholder approval, superseding our prior plan, the Douglas Emmett 2006 Omnibus Stock Incentive Plan ("2006 Plan"), both of which allow for awards to our directors, officers, employees and consultants. The key terms of the two plans are substantially identical, except for the date of expiration, the number of shares authorized for grants and various technical provisions. Grants after June 2, 2016 were awarded under the 2016 Plan, while grants prior to that date were awarded under the 2006 Plan (grants under the 2006 Plan remain outstanding according to their terms). Both plans are administered by the compensation committee of our board of directors.

Total net stock-based compensation expense was \$2.9 million and \$2.6 million for the three months ended September 30, 2018 and 2017, and \$8.9 million and \$7.9 million for the nine months ended September 30, 2018 and 2017 respectively. These amounts are net of capitalized stock-based compensation of \$512 thousand and \$257 thousand for the three months ended September 30, 2018 and 2017, and \$1.5 million and \$0.7 million for the nine months ended September 30, 2018 and 2017 respectively. The intrinsic value of options exercised was \$0.4 million for the three months ended September 30, 2018 and September 30, 2017, and \$1.2 million and \$102.5 million for the nine months ended September 30, 2018 and 2017 respectively.



Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

## 11. EPS

We calculate basic EPS by dividing the net income attributable to common stockholders for the period by the weighted average number of common shares outstanding during the period. We calculate diluted EPS by dividing the net income attributable to common stockholders for the period by the weighted average number of common shares and dilutive instruments outstanding during the period using the treasury stock method. We account for unvested LTIP awards that contain nonforfeitable rights to dividends as participating securities and include these securities in the computation of basic and diluted EPS using the two-class method. The table below presents the calculation of basic and diluted EPS:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
Numerator (In thousands):				
Net income attributable to common stockholders	\$30,561	\$25,614	\$90,451	\$64,907
Allocation to participating securities: Unvested LTIP Units	(149 )	(158 )	(442 )	(345 )
Numerator for basic and diluted net income attributable to common stock holders	\$30,412	\$25,456	\$90,009	\$64,562
Denominator (In thousands):				
Weighted average shares of common stock outstanding - basic	169,926	165,471	169,815	158,000
Effect of dilutive securities: Stock options <sup>(1)</sup>	5	49	13	419
Weighted average shares of common stock and common stock equivalents outstanding - diluted	169,931	165,520	169,828	158,419
Basic EPS:				
Net income attributable to common stockholders per share	\$0.18	\$0.15	\$0.53	\$0.41
Diluted EPS:				
Net income attributable to common stockholders per share	\$0.18	\$0.15	\$0.53	\$0.41

(1) The following securities were excluded from the calculation of diluted EPS because including them would be anti-dilutive to the calculation:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
(In thousands)	2018	2017	2018	2017
OP Units	26,630	24,790	26,736	24,750
Vested LTIP Units	812	8	807	358

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

## 12. Fair Value of Financial Instruments

Our estimates of the fair value of financial instruments were determined using available market information and widely used valuation methods. Considerable judgment is necessary to interpret market data and determine an estimated fair value. The use of different market assumptions or valuation methods may have a material effect on the estimated fair values. The FASB fair value framework hierarchy distinguishes between assumptions based on market data obtained from sources independent of the reporting entity, and the reporting entity's own assumptions about market-based inputs. The hierarchy is as follows:

Level 1 - inputs utilize unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 - inputs are observable either directly or indirectly for similar assets and liabilities in active markets.

Level 3 - inputs are unobservable assumptions generated by the reporting entity

As of September 30, 2018, we did not have any fair value estimates of financial instruments using Level 3 inputs.

## Financial instruments disclosed at fair value

Short term financial instruments: The carrying amounts for cash and cash equivalents, tenant receivables, revolving credit line, interest payable, accounts payable, security deposits and dividends payable approximate fair value because of the short-term nature of these instruments.

Secured notes payable: See Note 7 for the details of our secured notes payable. We estimate the fair value of our consolidated secured notes payable (excluding our revolving credit facility) by calculating the credit-adjusted present value of the principal and interest payments for each secured note payable. The calculation incorporates observable market interest rates which we consider to be Level 2 inputs, assumes that the loans will be outstanding through maturity, and excludes any maturity extension options. The table below presents the estimated fair value of our secured notes payable:

(In thousands)	September 30, 2018	December 31, 2017
----------------	-----------------------	----------------------

Fair value	\$ 4,088,904	\$ 4,195,489
------------	--------------	--------------

Carrying value	\$ 4,063,194	\$ 4,156,499
----------------	--------------	--------------

## Financial instruments measured at fair value

Derivative instruments: See Note 9 for the details of our derivatives. We present our derivatives on the balance sheet at fair value, on a gross basis, excluding accrued interest. We estimate the fair value of our derivative instruments by calculating the credit-adjusted present value of the expected future cash flows of each derivative. The calculation incorporates the contractual terms of the derivatives, observable market interest rates which we consider to be Level 2 inputs, and credit risk adjustments to reflect the counterparty's as well as our own nonperformance risk. Our derivatives are not subject to master netting arrangements. The table below presents the estimated fair value of our derivatives:

(In thousands)	September 30, 2018	December 31, 2017
----------------	-----------------------	----------------------

Derivative Assets:		
--------------------	--	--



Edgar Filing: Douglas Emmett Inc - Form 10-Q

Fair value - consolidated derivatives <sup>(1)</sup>	\$ 124,751	\$ 60,069
Fair value - unconsolidated Funds' derivatives <sup>(2)</sup>	\$ 20,818	\$ 9,437

Derivative Liabilities:

Fair value - consolidated derivatives <sup>(1)</sup>	\$ —	\$ 807
Fair value - unconsolidated Funds' derivatives <sup>(2)</sup>	\$ —	\$ —

---

Consolidated derivatives, which include 100%, not our pro-rata share, of our consolidated JVs' derivatives, are (1) included in interest rate contracts in our consolidated balance sheets. The fair values exclude accrued interest which is included in interest payable in the consolidated balance sheets.

Reflects 100%, not our pro-rata share, of our unconsolidated Funds' derivatives. Our pro-rata share of the amounts (2) related to the unconsolidated Funds' derivatives is included in our Investment in unconsolidated real estate funds in our consolidated balance sheets. See Note 16 regarding our unconsolidated Funds debt and derivatives.

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

## 13. Segment Reporting

Segment information is prepared on the same basis that our management reviews information for operational decision-making purposes. We operate in two business segments: (i) the acquisition, development, ownership and management of office real estate and (ii) the acquisition, development, ownership and management of multifamily real estate. The services for our office segment primarily include rental of office space and other tenant services, including parking and storage space rental. The services for our multifamily segment include rental of apartments and other tenant services, including parking and storage space rental. Asset information by segment is not reported because we do not use this measure to assess performance or make decisions to allocate resources. Therefore, depreciation and amortization expense is not allocated among segments. General and administrative expenses and interest expense are not included in segment profit as our internal reporting addresses these items on a corporate level. The table below presents the operating activity of our reportable segments:

(In thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
<b>Office Segment</b>				
Total office revenues	\$197,054	\$184,618	\$578,148	\$530,508
Office expenses	(66,288 )	(62,468 )	(188,462 )	(175,240 )
Office segment profit	130,766	122,150	389,686	355,268
<b>Multifamily Segment</b>				
Total multifamily revenues	26,254	24,131	76,876	72,354
Multifamily expenses	(7,114 )	(6,041 )	(20,720 )	(17,866 )
Multifamily segment profit	19,140	18,090	56,156	54,488
Total profit from all segments	\$149,906	\$140,240	\$445,842	\$409,756

The table below presents a reconciliation of the total profit from all segments to net income attributable to common stockholders:

(In thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Total profit from all segments	\$149,906	\$140,240	\$445,842	\$409,756
General and administrative	(9,440 )	(8,441 )	(28,444 )	(27,189 )
Depreciation and amortization	(74,067 )	(69,974 )	(219,944 )	(206,141 )
Other income	2,951	2,659	8,373	7,152
Other expenses	(1,561 )	(1,659 )	(5,380 )	(5,156 )
Income, including depreciation, from unconsolidated real estate funds	1,348	1,137	4,522	4,427
Interest expense	(33,721 )	(35,454 )	(99,889 )	(110,408 )
Net income	35,416	28,508	105,080	72,441
Less: Net income attributable to noncontrolling interests	(4,855 )	(2,894 )	(14,629 )	(7,534 )
Net income attributable to common stockholders	\$30,561	\$25,614	\$90,451	\$64,907



Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

## 14. Future Minimum Lease Rental Receipts

We lease space to tenants primarily under non-cancelable operating leases that generally contain provisions for a base rent plus reimbursement of certain operating expenses, and we own fee interests in two parcels of land from which we receive rent under ground leases. The table below presents the future minimum base rentals on our non-cancelable office tenant and ground leases at September 30, 2018:

Twelve months ending September 30:	(In thousands)
2019	\$ 571,867
2020	532,197
2021	447,337
2022	357,971
2023	282,924
Thereafter	723,762
Total future minimum base rentals <sup>(1)</sup>	\$ 2,916,058

Does not include (i) residential leases, which typically have a term of one year or less, (ii) holdover rent, (iii) other types of rent such as storage and antenna rent, (iv) tenant reimbursements, (v) straight- line rent, (vi) amortization/accretion of acquired above/below-market lease intangibles and (vii) percentage rents. The amounts assume that early termination options held by tenants are not exercised.

## 15. Future Minimum Lease Rental Payments

We pay rent under a ground lease which expires on December 31, 2086. The rent is fixed at \$733 thousand per year until February 28, 2019, and will then reset to the greater of the existing ground rent or market. We incurred ground rent expense of \$183 thousand for the three months ended September 30, 2018 and 2017 and \$550 thousand for the nine months ended September 30, 2018 and 2017 respectively. The table below, which assumes that the ground rent payments will continue to be \$733 thousand per year after February 28, 2019, presents the future minimum ground lease payments as of September 30, 2018:

Twelve months ending September 30:	(In thousands)
2019	\$ 733
2020	733
2021	733
2022	733
2023	733
Thereafter	46,361
Total future minimum lease payments	\$ 50,026

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

16. Commitments, Contingencies and Guarantees

Legal Proceedings

From time to time, we are party to various lawsuits, claims and other legal proceedings that arise in the ordinary course of our business. Excluding ordinary, routine litigation incidental to our business, we are not currently a party to any legal proceedings that we believe would reasonably be expected to have a materially adverse effect on our business, financial condition or results of operations.

Concentration of Risk

We are subject to credit risk with respect to our tenant receivables and deferred rent receivables related to our tenant leases. Our tenants' ability to honor the terms of their respective leases remains dependent upon economic, regulatory and social factors. We seek to minimize our credit risk from our tenant leases by (i) targeting smaller, more affluent tenants, from a diverse mix of industries, (ii) performing credit evaluations of prospective tenants and (iii) obtaining security deposits or letters of credit from our tenants. For the nine months ended September 30, 2018 and 2017, no tenant accounted for more than 10% of our total revenues.

All of our properties, including the properties of our consolidated JVs and unconsolidated Funds, are located in Los Angeles County, California and Honolulu, Hawaii, and we are therefore susceptible to adverse economic and regulatory developments, as well as natural disasters, in those markets.

We are subject to credit risk with respect to our interest rate swap counterparties that we use to manage the risk associated with our floating rate debt. We do not post or receive collateral with respect to our swap transactions. See Note 9 for the details of our interest rate contracts. We seek to minimize our credit risk by entering into agreements with a variety of high quality counterparties with investment grade ratings.

We have significant cash balances invested in a variety of short-term money market funds that are intended to preserve principal value and maintain a high degree of liquidity while providing current income. These investments are not insured against loss of principal and there is no guarantee that our investments in these funds will be redeemable at par value. We also have significant cash balances in bank accounts with high quality financial institutions with investment grade ratings. Interest bearing bank accounts at each U.S. banking institution are insured by the FDIC up to \$250 thousand.

Asset Retirement Obligations

Conditional asset retirement obligations represent a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement is conditional on a future event that may or may not be within our control. A liability for a conditional asset retirement obligation must be recorded if the fair value of the obligation can be reasonably estimated. Environmental site assessments have identified twenty-eight buildings in our Consolidated Portfolio and four buildings owned by our unconsolidated Funds which contain asbestos, and would have to be removed in compliance with applicable environmental regulations if these properties are demolished or undergo major renovations. As of September 30, 2018, the obligations to remove the asbestos from these properties if they were demolished have indeterminable settlement dates, and we are unable to reasonably estimate the associated conditional asset retirement obligation. As of September 30, 2018, the obligations to remove the asbestos from properties that are currently undergoing major renovations, or that we plan to renovate in the future, are not material to our financial statements.

## Development and Other Contracts

During 2016, we commenced building an additional 475 apartments (net of existing apartments removed) at our Moanalua Hillside Apartments in Honolulu, Hawaii. We are also investing additional capital to upgrade the existing apartments, improve the parking and landscaping, building a new leasing and management office, and construct a new recreation and fitness facility with a new pool. As of September 30, 2018, we had leased 221 of the new apartments. In West Los Angeles, we are building a high-rise apartment building with 376 apartments. As of September 30, 2018, we had an aggregate remaining contractual commitment for these development projects of approximately \$213.6 million. As of September 30, 2018, we had an aggregate remaining contractual commitment for repositionings, capital expenditure projects and tenant improvements of approximately \$63.3 million.

Table of Contents

Douglas Emmett, Inc.

Notes to Consolidated Financial Statements (unaudited) (continued)

## Guarantees

We have made certain environmental and other limited indemnities and guarantees covering customary non-recourse carve-outs for our unconsolidated Funds' debt. We have also guaranteed the related swaps. Our Funds have agreed to indemnify us for any amounts that we would be required to pay under these agreements. As of September 30, 2018, all of the obligations under the related debt and swap agreements have been performed in accordance with the terms of those agreements. The table below summarizes our Funds' debt as of September 30, 2018. The amounts represent 100% (not our pro-rata share) of the amounts related to our Funds:

Fund <sup>(1)</sup>	Loan Maturity Date	Principal Balance (In Millions)	Variable Interest Rate	Swap Fixed Interest Rate	Swap Maturity Date
Partnership X <sup>(2)(4)</sup>	3/1/2023	\$ 110.0	LIBOR + 1.40%	2.30%	3/1/2021
Fund X <sup>(3)(4)</sup>	7/1/2024	400.0	LIBOR + 1.65%	3.44%	7/1/2022
		\$ 510.0			

(1) See Note 5 for more information regarding our unconsolidated Funds.

(2) Floating rate term loan, swapped to fixed, which is secured by two properties and requires monthly payments of interest only, with the outstanding principal due upon maturity. As of September 30, 2018, assuming a zero-percent LIBOR interest rate during the remaining life of the swap, the maximum future payments under the swap agreement were \$2.4 million.

(3) Floating rate term loan, swapped to fixed, which is secured by six properties and requires monthly payments of interest only, with the outstanding principal due upon maturity. As of September 30, 2018, assuming a zero-percent LIBOR interest rate during the remaining life of the swap, the maximum future payments under the swap agreement were \$27.3 million. Loan agreement includes the requirement to purchase an interest rate cap if one-month LIBOR equals or exceeds 3.56% for fourteen consecutive days after the related swap matures.

(4) Loan agreement includes a zero-percent LIBOR floor. The corresponding swaps do not include such a floor.

Table of Contents

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

The following discussion should be read in conjunction with our consolidated financial statements and related notes in Part I, Item 1 of this Report, and our Forward Looking Statements disclaimer.

## Business Description

Douglas Emmett, Inc. is a fully integrated, self-administered and self-managed REIT. Through our interest in our Operating Partnership and its subsidiaries, our consolidated JVs and our unconsolidated Funds, we are one of the largest owners and operators of high-quality office and multifamily properties in Los Angeles County, California and in Honolulu, Hawaii. We focus on owning, acquiring, developing and managing a substantial share of top-tier office properties and premier multifamily communities in neighborhoods that possess significant supply constraints, high-end executive housing and key lifestyle amenities. As of September 30, 2018, our portfolio consisted of the following:

	Consolidated Portfolio <sup>(1)</sup>	Total Portfolio <sup>(2)</sup>
Office		
Class A Properties <sup>(3)</sup>	63	71
Rentable Square Feet (in thousands)	16,599	18,434
Leased rate	91.5%	91.4%
Occupied rate	89.6%	89.5%
Multifamily		
Properties <sup>(3)</sup>	10	10
Units	3,563	3,563
Leased rate	98.8%	98.8%
Occupied rate	96.9%	96.9%

---

Our Consolidated Portfolio includes the properties in our consolidated results. Through our subsidiaries, we own (1) 100% of these properties except for ten office properties totaling 2.8 million square feet, which we own through three consolidated JVs. Our Consolidated Portfolio also includes two parcels of land from which we receive ground rent from ground leases to the owners of a Class A office building and a hotel.

Our Total Portfolio includes our Consolidated Portfolio as well as eight properties totaling 1.8 million square feet (2) owned by our unconsolidated Funds. See Note 5 to our consolidated financial statements in Item 1 of this Report for more information about our unconsolidated Funds.

(3) Our office and multifamily portfolios include ancillary retail space.

## Annualized rent

As of September 30, 2018, annualized rent from our Consolidated Portfolio was derived as follows:



## Table of Contents

### Financings, Developments and Repositionings

#### Financings

In February 2018, we borrowed \$335 million under a secured, non-recourse interest-only loan maturing in March 2025. The loan bears interest at LIBOR + 1.30%, which was effectively fixed at 3.84% for five years through interest rate swaps. The loan is secured by a wholly-owned office property. We used the proceeds from the loan and our credit line to pay off two loans totaling \$426 million which were scheduled to mature in 2019. See Note 7 to our consolidated financial statements in Item 1 of this Report for more information regarding our debt.

#### Developments

We are developing two multifamily projects, one in our Brentwood submarket in Los Angeles, California, and one in Honolulu, Hawaii. Each development is on land which we already own:

In West Los Angeles, we are building a high-rise apartment building with 376 apartments. We expect the cost of the development to be approximately \$180.0 million to \$200.0 million, which does not include the cost of the land which we have owned since 1997, or the existing underground parking garage which we also owned before beginning the project. We expect construction to take about 3 years.

At our Moanalua Hillside Apartments in Honolulu, we are building an additional 475 apartments (net of existing apartments removed), which we expect will cost approximately \$120.0 million, excluding the cost of the land which we have owned since 2005. We are also investing additional capital to upgrade the existing apartments, improve the parking and landscaping, build a new leasing and management office, and construct a new recreation and fitness facility with a new pool. We expect to complete the project around year end and as of September 30, 2018, we had leased 221 of the new units.

#### Repositionings

We often strategically purchase properties with large vacancies or expected near-term lease roll-over and use our knowledge of the property and submarket to reposition the property for the optimal use and tenant mix. The work we undertake to reposition a building typically takes months or even years, and could involve a range of improvements from a complete structural renovation to a targeted remodeling of selected spaces. We generally select a property for repositioning at the time we purchase it, although repositioning efforts can also occur at properties that we already own. During the repositioning, the affected property may display depressed rental revenue and occupancy levels which impacts our results and, therefore, comparisons of our performance from period to period.

Table of Contents

## Rental Rate Trends - Total Portfolio

## Office Rental Rates

The table below presents the average annual rental rate per leased square foot and the annualized lease transaction costs per leased square foot for leases executed in our total office portfolio:

	Nine Months Ended September 30, 2018	Year Ended December 31, 2017	2016	2015	2014
Average straight-line rental rate <sup>(1)(2)</sup>	\$49.21	\$44.48	\$43.21	\$42.65	\$35.93
Annualized lease transaction costs <sup>(3)</sup>	\$5.76	\$5.68	\$5.74	\$4.77	\$4.66

Because straight-line rent takes into account the full economic value of each lease, including rent concessions and escalations, we believe that it may provide a better comparison than ending cash rents, which include the impact of (1) the annual escalations over the entire term of the lease. However, care should be taken in any comparison, as the averages are often significantly affected from period to period by factors such as the buildings, submarkets, and types of space and terms involved in the leases executed during the respective reporting period.

(2) Reflects the weighted average straight-line Annualized Rent.

Reflects the weighted average leasing commissions and tenant improvement allowances divided by the weighted

(3) average number of years for the leases. Excludes leases substantially negotiated by the seller in the case of acquired properties and leases for tenants relocated due to repositioning projects.

## Office Rent Roll

The table below presents the rent roll for new and renewed leases per leased square foot executed in our total office portfolio during the nine months ended September 30, 2018:

Rent Roll <sup>(1)(2)</sup>	Starting Cash Rent	Straight-line Rent	Expiring Cash Rent
Leases signed during the period	\$46.67	\$49.21	N/A
Prior leases for the same space	\$35.03	\$37.11	\$40.99
Percentage change	33.2%	32.6%	13.9% <sup>(3)</sup>

Represents the average initial stabilized cash and straight-line rents on new and renewal leases signed during the quarter compared to the prior lease on the same space, excluding Short-Term Leases, leases where the prior lease (1) was terminated more than a year before signing of the new lease, and leases in acquired buildings where we believe the information about the prior agreement is incomplete or where we believe base rent reflects other off-market inducements to the tenant that are not reflected in the prior lease document.

(2) Our office rent roll can fluctuate from period to period as a result of changes in our submarkets, buildings and term of the expiring leases, making these metrics difficult to predict.

(3) The percentage change for expiring cash rent represents the comparison between the starting cash rent on leases executed during the respective period and the expiring cash rent on the prior leases for the same space.



Table of Contents

Multifamily Rental Rates

The table below presents the average annual rental rate per leased unit for new tenants.

	Nine Months Ended		Year Ended December 31,		
	September 30, 2018	2017	2016	2015	2014
Average annual rental rate - new tenants <sup>(1)</sup>	\$27,612	\$28,613	\$28,435	\$27,936	\$28,870

(1) 2016 and 2015 include the impact of a property acquisition in Honolulu at the end of 2014.

Multifamily Rent Roll

During the nine months ended September 30, 2018, average rent on leases to new tenants was 0.7% lower for the same unit at the time it became vacant.

Occupancy Rates - Total Portfolio

The tables below present the occupancy rates for our total office portfolio and multifamily portfolio:

		December 31,				
Occupancy Rates <sup>(1)</sup> as of:		September 30, 2018	2017	2016	2015	2014
Office portfolio	89.5%	89.8%	90.4%	91.2%	90.5%	
Multifamily portfolio	96.9%	96.4%	97.9%	98.0%	98.2%	

		Nine Months Ended		Year Ended December 31,		
Average Occupancy Rates <sup>(1)(2)</sup> :		September 30, 2018	2017	2016	2015	2014
Office portfolio	89.2%	89.5%	90.6%	90.9%	90.0%	
Multifamily portfolio	96.4%	97.2%	97.6%	98.2%	98.5%	

(1) Occupancy rates include the impact of property acquisitions, most of whose occupancy rates at the time of acquisition were below that of our existing portfolio.

(2) Average occupancy rates are calculated by averaging the occupancy rates at the end of each of the quarters in the period and at the end of the quarter immediately prior to the start of the period.

Table of Contents

Office Lease Expirations

As of September 30, 2018, assuming non-exercise of renewal options and early termination rights, we expect to see expiring square footage in our total office portfolio as follows:

---

(1) Average of the percentage of leases at September 30, 2015, 2016, 2017 with the same remaining duration as the leases for the labeled year had at September 30, 2018. Acquisitions are included in the prior year average commencing in the quarter after the acquisition.

Table of Contents

## Results of Operations

Comparison of three months ended September 30, 2018 to three months ended September 30, 2017

	2018	2017	Favorable (Unfavorable)	Percentage	Commentary
(In thousands)					
Revenues					
Office rental revenue	\$ 150,316	\$ 140,993	\$ 9,323	6.6 %	The increase was due to rental revenues of \$3.6 million from properties that we acquired in 2017 and an increase in rental revenues of \$5.8 million from properties that we owned throughout both periods. The increase from properties that we owned throughout both periods was primarily due to an increase in rental rates, partially offset by a decrease in occupancy.
Office tenant recoveries	\$ 16,364	\$ 15,854	\$ 510	3.2 %	The increase was due to tenant recoveries of \$0.7 million from properties that we acquired in 2017 offset by a decrease in tenant recoveries of \$0.2 million from properties that we owned throughout both periods. The decrease from properties that we owned throughout both periods was due to the timing of prior period reconciliations.
Office parking and other income	\$ 30,374	\$ 27,771	\$ 2,603	9.4 %	The increase was due to parking and other income of \$0.3 million from properties that we acquired in 2017 and an increase of \$2.3 million in parking and other income from properties that we owned throughout both periods. The increase in parking and other income from properties that we owned throughout both periods primarily reflects an increase in ground rent income and parking rates, partially offset by a decrease in occupancy.
Multifamily revenue	\$ 26,254	\$ 24,131	\$ 2,123	8.8 %	The increase was primarily due to an increase in rental revenues of \$2.0 million, which was primarily due to revenues from new apartments at our Moanalua development and an increase in rental rates.
Operating expenses					
Office rental expenses	\$ 66,288	\$ 62,468	\$ (3,820)	(6.1)%	The increase was due to rental expenses of \$1.3 million from properties that we acquired during 2017 and an increase of \$2.5 million in rental expenses from properties that we owned throughout both periods. The increase from

Edgar Filing: Douglas Emmett Inc - Form 10-Q

properties that we owned throughout both periods was primarily due to an increase in utility expenses, scheduled services expenses, personnel expenses and real estate taxes.

The increase was primarily due to an increase in personnel expenses, utility expenses and real estate taxes and to expenses from new apartments at our Moanalua development.

The increase was primarily due to an increase in personnel expenses.

Multifamily rental expenses	\$7,114	\$6,041	\$ (1,073 )	(17.8 )%
General and administrative	\$9,440	\$8,441	\$ (999 )	(11.8 )%