

Piedmont Office Realty Trust, Inc.
Form 10-Q
November 01, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2017

OR

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

For the Transition Period From _____ To _____

Commission file number 001-34626

PIEDMONT OFFICE REALTY TRUST, INC.

(Exact name of registrant as specified in its charter)

Maryland 58-2328421
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

11695 Johns Creek Parkway

Ste. 350

Johns Creek, Georgia 30097

(Address of principal executive offices)

(Zip Code)

(770) 418-8800

(Registrant's telephone number, including area code)

N/A

(Former name, former address, 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 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). 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 the 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 (Do not check if a smaller reporting company)

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

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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

Number of shares outstanding of the Registrant's
common stock, as of October 31, 2017:

144,371,942 shares

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in this Form 10-Q may constitute forward-looking statements within the meaning of the federal securities laws. In addition, Piedmont Office Realty Trust, Inc. ("Piedmont," "we," "our," or "us"), or its executive officers on Piedmont's behalf, may from time to time make forward-looking statements in reports and other documents Piedmont files with the Securities and Exchange Commission or in connection with other written or oral statements made to the press, potential investors, or others. Statements regarding future events and developments and Piedmont's future performance, as well as management's expectations, beliefs, plans, estimates, or projections relating to the future, are forward-looking statements. Forward-looking statements include statements preceded by, followed by, or that include the words "may," "will," "expect," "intend," "anticipate," "estimate," "believe," "continue," or other similar words. Examples of such statements in this report include descriptions of our real estate, financing, and operating objectives; discussions regarding future dividends and share repurchases; and discussions regarding the potential impact of economic conditions on our real estate and lease portfolio.

These statements are based on beliefs and assumptions of Piedmont's management, which in turn are based on information available at the time the statements are made. Important assumptions relating to the forward-looking statements include, among others, assumptions regarding the demand for office space in the markets in which Piedmont operates, competitive conditions, and general economic conditions. These assumptions could prove inaccurate. The forward-looking statements also involve risks and uncertainties, which could cause actual results to differ materially from those contained in any forward-looking statement. Many of these factors are beyond Piedmont's ability to control or predict. Such factors include, but are not limited to, the following:

- Economic, regulatory, and/or socio-economic changes (including accounting standards) that impact the real estate market generally, or that could affect patterns of use of commercial office space;
- The impact of competition on our efforts to renew existing leases or re-let space on terms similar to existing leases;
- Changes in the economies and other conditions affecting the office sector in general and the specific markets in which we operate, particularly in Washington, D.C., the New York metropolitan area, and Chicago where we have high concentrations of our Annualized Lease Revenue (see definition below);
- Lease terminations or lease defaults, particularly by one of our large lead tenants;
- The effect on us of adverse market and economic conditions, including any resulting impairment charges on both our long-lived assets or goodwill;
- The success of our real estate strategies and investment objectives, including our ability to identify and consummate suitable acquisitions and divestitures;
- The illiquidity of real estate investments, including the resulting impediment on our ability to quickly respond to adverse changes in the performance of our properties;
- The risks and uncertainties associated with our acquisition of properties, many of which risks and uncertainties may not be known at the time of acquisition;
- Development and construction delays and resultant increased costs and risks;
- Our real estate development strategies may not be successful;
- Future acts of terrorism in any of the major metropolitan areas in which we own properties, or future cybersecurity attacks against us or any of our tenants;
- Costs of complying with governmental laws and regulations;
- Additional risks and costs associated with directly managing properties occupied by government tenants;
- The effect of future offerings of debt or equity securities or changes in market interest rates on the value of our common stock;
- Uncertainties associated with environmental and other regulatory matters;
- Potential changes in political environment and reduction in federal and/or state funding of our governmental tenants;
- Any change in the financial condition of any of our large lead tenants;
- The effect of any litigation to which we are, or may become, subject;
-

Changes in tax laws impacting REITs and real estate in general, as well as our ability to continue to qualify as a REIT under the Internal Revenue Code of 1986 (the “Code”);

• The future effectiveness of our internal controls and procedures; and

• Other factors, including the risk factors discussed under Item 1A. of our Amended Annual Report on Form 10-K/A for the year ended December 31, 2016.

Management believes these forward-looking statements are reasonable; however, undue reliance should not be placed on any forward-looking statements, which are based on current expectations. Further, forward-looking statements speak only as of the date they are made, and management undertakes no obligation to update publicly any of them in light of new information or future events.

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Information Regarding Disclosures Presented

Annualized Lease Revenue ("ALR"), a non-GAAP measure, is calculated by multiplying (i) rental payments (defined as base rent plus operating expense reimbursements, if payable by the tenant on a monthly basis under the terms of a lease that has been executed, but excluding (a) rental abatements and (b) rental payments related to executed but not commenced leases for space that was covered by an existing lease), by (ii) 12. In instances in which contractual rents or operating expense reimbursements are collected on an annual, semi-annual, or quarterly basis, such amounts are multiplied by a factor of 1, 2, or 4, respectively, to calculate the annualized figure. For leases that have been executed but not commenced relating to un-leased space, ALR is calculated by multiplying (i) the monthly base rental payment (excluding abatements) plus any operating expense reimbursements for the initial month of the lease term, by (ii) 12. Unless stated otherwise, this measure excludes revenues associated with our unconsolidated joint venture property (sold on July 27, 2017) and development/re-development properties, if any.

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PART I. FINANCIAL STATEMENTS

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

The information presented in the accompanying consolidated balance sheets and related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows reflects all adjustments that are, in management's opinion, necessary for a fair and consistent presentation of financial position, results of operations, and cash flows in accordance with U.S. generally accepted accounting principles ("GAAP").

The accompanying financial statements should be read in conjunction with the notes to Piedmont's financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this report on Form 10-Q and with Piedmont's Amended Annual Report on Form 10-K/A for the year ended December 31, 2016. Piedmont's results of operations for the nine months ended September 30, 2017 are not necessarily indicative of the operating results expected for the full year.

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PIEDMONT OFFICE REALTY TRUST, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except for share and per share amounts)

	(Unaudited)	
	September 30, 2017	December 31, 2016
Assets:		
Real estate assets, at cost:		
Land	\$ 614,934	\$ 617,138
Buildings and improvements, less accumulated depreciation of \$926,105 and \$856,254 as of September 30, 2017 and December 31, 2016, respectively	2,723,163	2,754,106
Intangible lease assets, less accumulated amortization of \$93,265 and \$109,152 as of September 30, 2017 and December 31, 2016, respectively	78,700	99,695
Construction in progress	8,957	34,814
Real estate assets held for sale, net	—	225,939
Total real estate assets	3,425,754	3,731,692
Investments in and amounts due from unconsolidated joint ventures	49	7,360
Cash and cash equivalents	36,108	6,992
Tenant receivables, net of allowance for doubtful accounts of \$535 and \$197 as of September 30, 2017 and December 31, 2016, respectively	12,802	26,494
Straight-line rent receivables	182,609	163,789
Restricted cash and escrows	1,260	1,212
Prepaid expenses and other assets	28,232	23,201
Goodwill	98,918	98,918
Interest rate swaps	34	—
Deferred lease costs, less accumulated amortization of \$189,469 and \$175,643 as of September 30, 2017 and December 31, 2016, respectively	274,884	298,695
Other assets held for sale, net	—	9,815
Total assets	\$ 4,060,650	\$ 4,368,168
Liabilities:		
Unsecured debt, net of discount and unamortized debt issuance costs of \$8,337 and \$10,269 as of September 30, 2017 and December 31, 2016, respectively	\$ 1,511,663	\$ 1,687,731
Secured debt, net of premiums and unamortized debt issuance costs of \$1,020 and \$1,161 as of September 30, 2017 and December 31, 2016, respectively	191,923	332,744
Accounts payable, accrued expenses, and accrued capital expenditures	108,120	165,410
Deferred income	29,970	28,406
Intangible lease liabilities, less accumulated amortization of \$54,637 and \$49,225 as of September 30, 2017 and December 31, 2016, respectively	41,064	48,005
Interest rate swaps	3,915	8,169
Total liabilities	1,886,655	2,270,465
Commitments and Contingencies	—	—
Stockholders' Equity:		
Shares-in-trust, 150,000,000 shares authorized; none outstanding as of September 30, 2017 or December 31, 2016	—	—
Preferred stock, no par value, 100,000,000 shares authorized; none outstanding as of September 30, 2017 or December 31, 2016	—	—
Common stock, \$.01 par value, 750,000,000 shares authorized; 145,294,845 and 145,235,313 shares issued and outstanding as of September 30, 2017 and December 31, 2016, respectively	1,453	1,452

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Additional paid-in capital	3,676,706	3,673,128
Cumulative distributions in excess of earnings	(1,511,428)	(1,580,863)
Other comprehensive income	5,400	2,104
Piedmont stockholders' equity	2,172,131	2,095,821
Noncontrolling interest	1,864	1,882
Total stockholders' equity	2,173,995	2,097,703
Total liabilities and stockholders' equity	\$ 4,060,650	\$ 4,368,168
See accompanying notes		

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PIEDMONT OFFICE REALTY TRUST, INC.
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except for share and per share amounts)

	(Unaudited) Three Months Ended September 30,		(Unaudited) Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues:				
Rental income	\$ 113,350	\$ 113,821	\$ 361,048	\$ 340,326
Tenant reimbursements	23,796	24,163	72,340	70,000
Property management fee revenue	441	501	1,341	1,478
	137,587	138,485	434,729	411,804
Expenses:				
Property operating costs	54,090	54,867	165,253	161,438
Depreciation	30,000	31,610	90,827	94,948
Amortization	18,123	18,640	57,852	53,848
Impairment loss on real estate assets	—	22,951	—	33,901
General and administrative	6,618	7,429	23,250	23,518
	108,831	135,497	337,182	367,653
Real estate operating income	28,756	2,988	97,547	44,151
Other income (expense):				
Interest expense	(16,183)	(15,496)	(52,661)	(48,294)
Other income/(expense)	290	(720)	228	(467)
Net recoveries from casualty events	—	34	—	34
Equity in income of unconsolidated joint ventures	3,754	129	3,872	354
	(12,139)	(16,053)	(48,561)	(48,373)
Income/(loss) from continuing operations	16,617	(13,065)	48,986	(4,222)
Discontinued operations:				
Operating income	—	1	—	—
Income from discontinued operations	—	1	—	—
Gain/(loss) on sale of real estate assets, net	109,512	(57)	115,951	73,758
Net income/(loss)	126,129	(13,121)	164,937	69,536
Plus: Net income applicable to noncontrolling interest	4	14	10	7
Net income/(loss) applicable to Piedmont	\$ 126,133	\$ (13,107)	\$ 164,947	\$ 69,543
Per share information – basic and diluted:				
Income/(loss) from continuing operations and gain/(loss) on sale of real estate assets	\$ 0.87	\$ (0.09)	\$ 1.13	\$ 0.48
Income from discontinued operations	—	—	—	—
Net income applicable to common stockholders	\$ 0.87	\$ (0.09)	\$ 1.13	\$ 0.48
Weighted-average common shares outstanding – basic	145,415,678	145,231,160	145,372,182	145,228,755
Weighted-average common shares outstanding – diluted	145,719,431	145,669,237	145,679,582	145,601,026
See accompanying notes				

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PIEDMONT OFFICE REALTY TRUST, INC.
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (in thousands)

	(Unaudited) Three Months Ended September 30,		(Unaudited) Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income/(loss) applicable to Piedmont	\$ 126,133	\$(13,107)	\$ 164,947	\$ 69,543
Other comprehensive income/(loss):				
Effective portion of gain/(loss) on derivative instruments that are designated and qualify as cash flow hedges (See <u>Note 5</u>)	175	2,847	307	(12,182)
Plus: Reclassification of previously recorded loss included in net income (See <u>Note 5</u>)	653	1,045	2,936	3,291
Gain on investment in available for sale securities	25	7	53	19
Other comprehensive income/(loss)	853	3,899	3,296	(8,872)
Comprehensive income/(loss) applicable to Piedmont	\$ 126,986	\$(9,208)	\$ 168,243	\$ 60,671

See accompanying notes

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PIEDMONT OFFICE REALTY TRUST, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2016
AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017 (UNAUDITED)
(in thousands, except per share amounts)

	Common Shares	Stock Amount	Additional Paid-In Capital	Cumulative Distributions in Excess of Earnings	Other Comprehensive Income/(Loss)	Non- controlling Interest	Total Stockholders' Equity
Balance, December 31, 2015	145,512	\$1,455	\$3,669,977	\$(1,550,698)	\$ 1,661	\$ 1,025	\$2,123,420
Share repurchases as part of an announced plan	(462)	(5)	—	(7,938)	—	—	(7,943)
Offering costs	—	—	(342)	—	—	—	(342)
Noncontrolling interest in consolidated joint venture	—	—	—	—	—	888	888
Dividends to common stockholders (\$0.84 per share), dividends to preferred stockholders of subsidiary, and dividends reinvested	—	—	(173)	(121,959)	—	(16)	(122,148)
Shares issued and amortized under the 2007 Omnibus Incentive Plan, net of tax	185	2	3,666	—	—	—	3,668
Net income applicable to noncontrolling interest	—	—	—	—	—	(15)	(15)
Net income applicable to Piedmont	—	—	—	99,732	—	—	99,732
Other comprehensive income	—	—	—	—	443	—	443
Balance, December 31, 2016	145,235	1,452	3,673,128	(1,580,863)	2,104	1,882	2,097,703
Share repurchases as part of an announced plan	(195)	(2)	—	(3,893)	—	—	(3,895)
Offering costs	—	—	(97)	—	—	—	(97)
Dividends to common stockholders (\$0.63 per share), dividends to preferred stockholders of subsidiary, and dividends reinvested	—	—	(79)	(91,619)	—	(8)	(91,706)
Shares issued and amortized under the 2007 Omnibus Incentive Plan, net of tax	255	3	3,754	—	—	—	3,757
Net income applicable to noncontrolling interest	—	—	—	—	—	(10)	(10)
Net income applicable to Piedmont	—	—	—	164,947	—	—	164,947
Other comprehensive income	—	—	—	—	3,296	—	3,296
Balance, September 30, 2017	145,295	\$1,453	\$3,676,706	\$(1,511,428)	\$ 5,400	\$ 1,864	\$2,173,995

See accompanying notes

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PIEDMONT OFFICE REALTY TRUST, INC.
 CONSOLIDATED STATEMENTS OF CASH FLOWS
 (in thousands)

	(Unaudited)	
	Nine Months	
	Ended	
	September 30,	
	2017	2016
Cash Flows from Operating Activities:		
Net income	\$ 164,937	\$ 69,536
Operating distributions received from unconsolidated joint ventures	—	579
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	90,827	94,948
Amortization of debt issuance costs	1,214	1,264
Other amortization	57,146	