QTS Realty Trust, Inc.
Form 10-Q
August 07, 2015

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

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

For the quarterly period ended June 30, 2015

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 001-36109

QTS Realty Trust, Inc.

QualityTech, LP

(Exact name of registrant as specified in its charter)

Maryland (QTS Realty Trust, Inc.)	**46-2809094**
Delaware (QualityTech, LP)	**27-0707288**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
12851 Foster Street, Overland Park, Kansas	**66213**
(Address of principal executive offices)	**(Zip Code)**

(Registrant's telephone number, including area code) (913) 312-5503

Not Applicable

(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.

QTS Realty Trust, Inc. Yes x No ¨ QualityTech, LP Yes x 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).

QTS Realty Trust, Inc. Yes x No ¨ QualityTech, LP Yes x No ¨

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

QTS Realty Trust, Inc.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

QualityTech, LP

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	x (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

QTS Realty Trust, Inc. Yes ¨ No x QualityTech, LP Yes ¨ No x

There were 40,825,412 shares of Class A common stock, $0.01 par value per share, and 133,000 shares of Class B common stock, $0.01 par value per share, of QTS Realty Trust, Inc. outstanding on August 6, 2015.

EXPLANATORY NOTE

This report combines the quarterly reports on Form 10-Q of QTS Realty Trust, Inc. (“QTS”) and QualityTech, LP, a Delaware limited partnership, which is our operating partnership (the “Operating Partnership”).

Management operates QTS and the Operating Partnership as one business. The management of QTS consists of the same employees as the management of the Operating Partnership. QTS is the sole general partner of the Operating Partnership, and, as of June 30, 2015, its only material asset consisted of its ownership of approximately 85.4% of the Operating Partnership. QTS does not conduct business itself, other than acting as the sole general partner of the Operating Partnership and issuing public equity from time to time. QTS has not issued or guaranteed any indebtedness. Except for net proceeds from public equity issuances by QTS, which are contributed to the Operating Partnership in exchange for units of limited partnership interest of the Operating Partnership, the Operating Partnership generates all remaining capital required by our business through its operations, the direct or indirect incurrence of indebtedness, and the issuance of partnership units. Therefore, as general partner with control of the Operating Partnership, QTS consolidates the Operating Partnership for financial reporting purposes.

We believe, therefore, that a combined presentation with respect to QTS and the Operating Partnership, including providing one set of notes for the financial statements of QTS and the Operating Partnership, provides the following benefits:

- enhances investors’ understanding of QTS and the Operating Partnership by enabling investors to view the business as a whole in the same manner as management views and operates the business;

- eliminates duplicative disclosure and provides a more streamlined and readable presentation since a substantial portion of the disclosure in this report applies to both QTS and the Operating Partnership; and

- creates time and cost efficiencies through the preparation of one presentation instead of two separate presentations.

In addition, in light of these combined disclosures, we believe it is important for investors to understand the few differences between QTS and the Operating Partnership in the context of how QTS and the Operating Partnership operate as a consolidated company. The presentation of stockholders’ equity and partners’ capital are the main areas of difference between the consolidated balance sheets of QTS and those of the Operating Partnership. The Operating Partnership’s capital includes general and limited common units that are owned by QTS and the other partners. QTS' stockholders’ equity includes common stock, additional paid in capital, accumulated other comprehensive income (loss) and accumulated dividends in excess of earnings. The remaining equity is the portion of net assets that are retained by partners other than QTS, referred to as noncontrolling interests. The primary difference in QTS' Statements of Operations and Comprehensive Income (Loss) is that for net income (loss), QTS retains its proportionate share of the net income (loss) based on its ownership of the Operating Partnership, with the remaining balance being retained by the Operating Partnership.

In order to highlight the few differences between QTS and the Operating Partnership, there are sections and disclosure in this report that discuss QTS and the Operating Partnership separately, including separate financial statements, separate controls and procedures sections, separate Exhibit 31 and 32 certifications, and certain accompanying notes to the financial statements, including Note 8 – Partners' Capital, Equity and Incentive Compensation Plans. In the sections that combine disclosure for QTS and the Operating Partnership, this report refers to actions or holdings as being actions or holdings of "we," "our," "us," "our company" and "the Company." Although the Operating Partnership is generally the entity that enters into contracts, holds assets and issues debt, we believe that these general references to "we," "our," "us," "our company" and "the Company" in this context are appropriate because the business is one enterprise operated through the Operating Partnership.

QTS Realty Trust, Inc.

QualityTech, LP

Form 10-Q

For the Quarterly Period Ended June 30, 2015

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

QTS REALTY TRUST, INC.

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

BALANCE SHEETS

(in thousands except share data)

	June 30, 2015 (unaudited)	December 31, 2014
ASSETS		
Real Estate Assets		
Land	$ 52,430	$ 48,577
Buildings and improvements	1,073,120	914,286
Less: Accumulated depreciation	(205,284)	(180,167)
	920,266	782,696
Construction in progress	320,885	214,719
Real Estate Assets, net	1,241,151	997,415
Cash and cash equivalents	10,744	10,788
Rents and other receivables, net	30,548	15,579
Acquired intangibles, net	122,005	18,000
Deferred costs, net	38,013	37,058
Prepaid expenses	7,132	3,079
Goodwill	173,237	-
Other assets, net	29,198	24,640
TOTAL ASSETS	$ 1,652,028	$ 1,106,559
LIABILITIES		
Mortgage notes payable	$ 70,000	$ 86,600
Unsecured credit facility	330,000	239,838
Senior notes, net of discount	297,852	297,729
Capital lease and lease financing obligations	56,211	13,062
Accounts payable and accrued liabilities	92,708	64,607
Dividends and distributions payable	15,322	10,705
Advance rents, security deposits and other liabilities	19,444	3,302
Deferred income taxes	16,449	-
Deferred income	19,557	10,531

TOTAL LIABILITIES	917,543	726,374
EQUITY		
Common stock, $0.01 par value, 450,133,000 shares authorized, 40,881,002 and 29,408,138 shares issued and outstanding as of June 30, 2015 and December 31, 2014, respectively	409	294
Additional paid-in capital	664,751	324,917
Accumulated dividends in excess of earnings	(38,014)	(22,503)
Total stockholders’ equity	627,146	302,708
Noncontrolling interests	107,339	77,477
TOTAL EQUITY	734,485	380,185
TOTAL LIABILITIES AND EQUITY	$ 1,652,028	$ 1,106,559

See accompanying notes to financial statements.

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QTS REALTY TRUST, INC.

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (UNAUDITED)

(in thousands except share and per share data)

	Three Months Ended June 30,		**Six Months Ended June 30,**	
Revenues:	**2015**	**2014**	**2015**	**2014**
Rental	$52,193	$41,966	$101,526	$82,545
Recoveries from customers	5,582	3,852	11,246	7,543
Cloud and managed services	8,220	4,970	14,015	9,201
Other	2,122	550	2,716	992
Total revenues	68,117	51,338	129,503	100,281
Operating Expenses:				
Property operating costs	22,031	16,529	41,367	32,752
Real estate taxes and insurance	1,474	1,118	2,959	2,336
Depreciation and amortization	18,062	13,817	34,305	27,064
General and administrative	14,615	11,473	28,453	22,251
Restructuring	-	1,046	-	1,046
Transaction and integration costs	4,669	1,089	4,774	1,153
Total operating expenses	60,851	45,072	111,858	86,602
Operating income	7,266	6,266	17,645	13,679
Other income and expenses:				
Interest income	1	-	1	8
Interest expense	(4,799)	(2,208)	(10,141)	(4,273)
Other (expense) income, net	(83)	(110)	(83)	(110)
Income before taxes	2,385	3,948	7,422	9,304
Tax benefit (expense) of taxable REIT subsidiaries	3,135	(27)	3,135	(55)
Net income	5,520	3,921	10,557	9,249
Net income attributable to noncontrolling interests	(888)	(831)	(1,843)	(1,961)
Net income attributable to QTS Realty Trust, Inc.	4,632	3,090	8,714	7,288
Unrealized gain on swap	-	127	-	232
Comprehensive income	$4,632	$3,217	$8,714	$7,520
Net income per share attributable to common shares:				
Basic	$0.13	$0.11	$0.26	$0.25
Diluted	0.12	0.11	0.25	0.25
Weighted average common shares outstanding:				
Basic	36,668,755	29,016,774	33,996,467	29,001,374
Diluted	44,444,104	37,009,746	41,867,944	36,934,210

See accompanying notes to financial statements.

QTS REALTY TRUST, INC.

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF EQUITY

(unaudited and in thousands)

	Common stock		**Additional**	**Accumulated dividends in**	**Total stockholders'**	**Noncontrolling**	
	Shares	**Amount**	**paid-in capital**	**excess of earnings**	**equity**	**interest**	**Total**
Balance January 1, 2015	29,408	$ 294	$ 324,917	$ (22,503)	$ 302,708	$ 77,477	$ 380,185
Issuance of shares through equity award plan	193	2	(2)	-	-	-	-
Reclassification of noncontrolling interest upon conversion of partnership units to common stock	530	5	6,196	-	6,201	(6,201)	-
Equity-based compensation expense	-	-	2,590	-	2,590	548	3,138
Net proceeds from equity offering	10,750	108	331,050	-	331,158	38,151	369,309
Dividends to shareholders	-	-	-	(24,225)	(24,225)	-	(24,225)
Distributions to noncontrolling interests	-	-	-	-	-	(4,479)	(4,479)
Net income	-	-	-	8,714	8,714	1,843	10,557
Balance June 30, 2015	40,881	$ 409	$ 664,751	$ (38,014)	$ 627,146	$ 107,339	$ 734,485

See accompanying notes to financial statements.

QTS REALTY TRUST, INC.

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

STATEMENTS OF CASH FLOW

(unaudited and in thousands)

For the six months ended June 30, 2015 and 2014

Cash flow from operating activities:	**2015**	**2014**
Net income	$10,557	$9,249
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	33,475	25,668
Amortization of deferred loan costs	1,585	1,314
Amortization of senior notes discount	123	-
Equity-based compensation expense	3,138	1,976
Bad debt expense	366	269
Write off of deferred loan costs	83	110
Deferred tax benefit	(3,135)	-
Changes in operating assets and liabilities		
Rents and other receivables, net	(1,556)	1,592
Prepaid expenses	(2,760)	(2,501)
Other assets	(326)	(252)
Accounts payable and accrued liabilities	(1,823)	(7,996)
Advance rents, security deposits and other liabilities	(454)	(64)
Deferred income	1,888	285
Net cash provided by operating activities	41,161	29,650
Cash flow from investing activities:		
Acquisitions, net of cash acquired	(288,865)	(73,300)
Additions to property and equipment	(170,150)	(114,157)
Cash used in investing activities	(459,015)	(187,457)
Cash flow from financing activities:		
Credit facility proceeds	350,162	182,500
Debt repayment	(260,000)	-
Payment of deferred financing costs	(512)	(924)
Payment of cash dividends	(19,673)	(15,368)
Distribution to noncontrolling interests	(4,414)	(4,654)
Principal payments on capital lease obligations	(1,227)	(367)
Scheduled mortgage principal debt repayments	(16,600)	(1,100)
Equity proceeds, net of costs	370,074	-
Net cash provided by financing activities	417,810	160,087
Net (decrease) increase in cash and cash equivalents	(44)	2,279
Cash and cash equivalents, beginning of period	10,788	5,210
Cash and cash equivalents, end of period	$10,744	$7,489

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid for interest (excluding deferred financing costs and amounts capitalized)	$8,866	$2,973
Noncash investing and financing activities:		
Accrued capital additions	$56,366	$32,638
Capital lease and lease financing obligations assumed	$43,832	$-

See accompanying notes to financial statements.

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QUALITYTECH, LP

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

BALANCE SHEETS

(in thousands)

	June 30, 2015 (unaudited)	December 31, 2014
ASSETS		
Real Estate Assets		
Land	$ 52,430	$ 48,577
Buildings and improvements	1,073,120	914,286
Less: Accumulated depreciation	(205,284)	(180,167)
	920,266	782,696
Construction in progress	320,885	214,719
Real Estate Assets, net	1,241,151	997,415
Cash and cash equivalents	10,744	10,788
Rents and other receivables, net	30,548	15,579
Acquired intangibles, net	122,005	18,000
Deferred costs, net	38,013	37,058
Prepaid expenses	7,132	3,079
Goodwill	173,237	-
Other assets, net	29,198	24,640
TOTAL ASSETS	$ 1,652,028	$ 1,106,559
LIABILITIES		
Mortgage notes payable	$ 70,000	$ 86,600
Unsecured credit facility	330,000	239,838
Senior notes, net of discount	297,852	297,729
Capital lease and lease financing obligations	56,211	13,062
Accounts payable and accrued liabilities	92,708	64,607
Dividends and distributions payable	15,322	10,705
Advance rents, security deposits and other liabilities	19,444	3,302
Deferred income taxes	16,449	-
Deferred income	19,557	10,531
TOTAL LIABILITIES	917,543	726,374
PARTNERS' CAPITAL		
Partners' capital	734,485	380,185
TOTAL LIABILITIES AND PARTNERS’ CAPITAL	$ 1,652,028	$ 1,106,559

See accompanying notes to financial statements.

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QUALITYTECH, LP

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (UNAUDITED)

(in thousands)

	Three Months Ended June 30,		**Six Months Ended June 30,**	
Revenues:	**2015**	**2014**	**2015**	**2014**
Rental	$52,193	$41,966	$101,526	$82,545
Recoveries from customers	5,582	3,852	11,246	7,543
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General and administrative	14,615	11,473	28,453	22,251
Restructuring	-	1,046	-	1,046
Transaction and integration costs	4,669	1,089	4,774	1,153
Total operating expenses	60,851	45,072	111,858	86,602
Operating income	7,266	6,266	17,645	13,679
Other income and expenses:				
Interest income	1	-	1	8
Interest expense	(4,799)	(2,208)	(10,141)	(4,273)
Other (expense) income, net	(83)	(110)	(83)	(110)
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Tax benefit (expense) of taxable REIT subsidiaries	3,135	(27)	3,135	(55)
Net income	5,520	3,921	10,557	9,249
Unrealized gain on swap	-	127	-	232
Comprehensive income	$5,520	$4,048	$10,557	$9,481

See accompanying notes to financial statements.

QUALITYTECH, LP

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF PARTNERS' CAPITAL

(unaudited and in thousands)

	Limited Partners' Capital		General Partner's Capital		
	Units	**Amount**	**Units**	**Amount**	**Total**
Balance January 1, 2015	36,935	$380,185	1	$ -	$380,185
Issuance of shares through equity award plan	193	-	-	-	-
Equity-based compensation expense	-	3,138	-	-	3,138
Net proceeds from QTS Realty Trust, Inc. equity offering	10,750	369,309	-	-	369,309
Dividends to QTS Realty Trust, Inc.	-	(24,225)	-	-	(24,225)
Partnership distributions	-	(4,479)	-	-	(4,479)
Net income	-	10,557	-	-	10,557
Balance June 30, 2015	47,878	$734,485	1	$ -	$734,485

See accompanying notes to financial statements.

QUALITYTECH, LP

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

STATEMENTS OF CASH FLOW

(unaudited and in thousands)

For the six months ended June 30, 2015 and 2014

Cash flow from operating activities:	**2015**	**2014**
Net income	$10,557	$9,249
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	33,475	25,668
Amortization of deferred loan costs	1,585	1,314
Amortization of senior notes discount	123	-
Equity-based compensation expense	3,138	1,976
Bad debt expense	366	269
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Rents and other receivables, net	(1,556)	1,592
Prepaid expenses	(2,760)	(2,501)
Other assets	(326)	(252)
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Cash and cash equivalents, beginning of period	10,788	5,210
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SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid for interest (excluding deferred financing costs and amounts capitalized)	$8,866	$2,973
Noncash investing and financing activities:		
Accrued capital additions	$56,366	$32,638
Capital lease and lease financing obligations assumed	$43,832	$-

See accompanying notes to financial statements.

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QTS REALTY TRUST, INC.

QUALITYTECH, LP

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business

QTS Realty Trust, Inc. ("QTS") through its controlling interest in QualityTech, LP (the "Operating Partnership" and collectively with QTS and their subsidiaries, the "Company") and the subsidiaries of the Operating Partnership, is engaged in the business of owning, acquiring, redeveloping and managing multi-tenant data centers. The Company's portfolio consists of 25 wholly-owned and leased properties with data centers located throughout the United States, Canada, Europe and the Asia-Pacific region.

QTS was formed as a Maryland corporation on May 17, 2013. On October 15, 2013, QTS completed its initial public offering of 14,087,500 shares of Class A common stock, $0.01 par value per share (the "IPO"), including shares issued pursuant to the underwriters' option to purchase additional shares, which was exercised in full, and received net proceeds of approximately $279 million. QTS elected to be taxed as a real estate investment trust ("REIT"), for U.S. federal income tax purposes, commencing with its taxable year ended December 31, 2013. As a REIT, QTS generally is not required to pay federal corporate income taxes on its taxable income to the extent it is currently distributed to its stockholders.

Concurrently with the completion of the IPO, the Company consummated a series of transactions, including the merger of General Atlantic REIT, Inc. with the Company, pursuant to which the Company became the sole general partner and majority owner of QualityTech, LP, the Operating Partnership. QTS contributed the net proceeds received from the IPO to the Operating Partnership in exchange for partnership units therein. As of June 30, 2015, QTS owned approximately 85.4% of the interests in the Operating Partnership. Substantially all of QTS' assets are held by, and QTS' operations are conducted through, the Operating Partnership. QTS' interest in the Operating Partnership entitles QTS to share in cash distributions from, and in the profits and losses of, the Operating Partnership in proportion to QTS' percentage ownership. As the sole general partner of the Operating Partnership, QTS generally has the exclusive power under the partnership agreement to manage and conduct the Operating Partnership's business and affairs, subject to certain limited approval and voting rights of the limited partners. QTS' board of directors manages the Company's business and affairs.

2. Summary of Significant Accounting Policies

Basis of Presentation – The accompanying financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"). In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

The accompanying financial statements are presented for both QTS Realty Trust, Inc. and QualityTech, LP. References to "QTS" mean QTS Realty Trust, Inc. and its controlled subsidiaries; and references to the "Operating Partnership" mean QualityTech, LP and its controlled subsidiaries.

Management operates QTS and the Operating Partnership as one business. The management of QTS consists of the same employees as the management of the Operating Partnership. QTS is the sole general partner of the Operating Partnership, and its only material asset consists of its ownership interest in the Operating Partnership. QTS does not conduct business itself, other than acting as the sole general partner of the Operating Partnership and issuing public equity from time to time. QTS has not issued or guaranteed any indebtedness. Except for net proceeds from public equity issuances by QTS, which are contributed to the Operating Partnership in exchange for units of limited partnership interest of the Operating Partnership, the Operating Partnership generates all remaining capital required by the business through its operations, the direct or indirect incurrence of indebtedness, and the issuance of partnership units. As general partner with control of the Operating Partnership, QTS consolidates the Operating Partnership for financial reporting purposes.

The Company believes, therefore, that providing one set of notes for the financial statements of QTS and the Operating Partnership provides the following benefits:

- enhances investors' understanding of QTS and the Operating Partnership by enabling investors to view the business as a whole in the same manner as management views and operates the business;
- eliminates duplicative disclosure and provides a more streamlined and readable presentation since a substantial portion of the disclosure applies to both QTS and the Operating Partnership; and
- creates time and cost efficiencies through the preparation of one set of notes instead of two separate sets of notes.

In addition, in light of these combined notes, the Company believes it is important for investors to understand the few differences between QTS and the Operating Partnership in the context of how QTS and the Operating Partnership operate as a consolidated company. The presentation of stockholders' equity and partners' capital are the main areas of difference between the consolidated balance sheets of QTS and those of the Operating Partnership. The Operating Partnership's capital includes general and limited common units that are owned by QTS and the other partners. QTS' stockholders' equity includes common stock, additional paid in capital, accumulated other comprehensive income (loss) and accumulated dividends in excess of earnings. The remaining equity is the portion of net assets that are retained by partners other than QTS, referred to as noncontrolling interests. The primary difference in QTS' Statements of Operations and Comprehensive Income (Loss) is that for net income (loss), QTS retains its proportionate share of the net income (loss) based on its ownership of the Operating Partnership, with the remaining balance being retained by the Operating Partnership. These combined notes refer to actions or holdings as being actions or holdings of "the Company." Although the Operating Partnership is generally the entity that enters into contracts, holds assets and issues debt, management believes that these general references to "the Company" in this context is appropriate because the business is one enterprise operated through the Operating Partnership.

As discussed above, QTS owns no operating assets and has no operations independent of the Operating Partnership and its subsidiaries. Also, the Operating Partnership owns no operating assets and has no operations independent of its subsidiaries. Obligations under the 5.875% Senior Notes due 2022 and the unsecured credit facility, both discussed in Note 5, are fully, unconditionally, and jointly and severally guaranteed by the Operating Partnership's existing subsidiaries, other than QTS Finance Corporation, the co-issuer of the 5.875% Senior Notes due 2022, and entities related to Carpathia Hosting, Inc. The indenture governing the 5.875% Senior Notes due 2022 restricts the ability of the Operating Partnership to make distributions to QTS, subject to certain exceptions, including distributions required in order for QTS to maintain its status as a real estate investment trust under the Internal Revenue Code of 1986, as amended.

The interim condensed consolidated financial statements of QTS Realty Trust, Inc. for the three and six months ended June 30, 2015 and 2014, and as of June 30, 2015 and December 31, 2014 present the accounts of QTS Realty Trust, Inc. and its majority owned subsidiaries. This includes the operating results of the Operating Partnership for all periods presented.

Use of Estimates – The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of fixed assets, allowances for doubtful accounts and deferred tax assets and the valuation of derivatives, real estate assets, acquired intangible assets and certain accruals.

Principles of Consolidation – The consolidated financial statements of QTS Realty Trust, Inc. include the accounts of QTS Realty Trust, Inc. and its majority-owned subsidiaries. The consolidated financial statements of QualityTech, LP include the accounts of QualityTech, LP and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in the financial statements.

Real Estate Assets – Real estate assets are reported at cost. All capital improvements for the income-producing properties that extend their useful lives are capitalized to individual property improvements and depreciated over their estimated useful lives. Depreciation is generally provided on a straight-line basis over 40 years from the date the property was placed in service. Property improvements are depreciated on a straight-line basis over the life of the respective improvement ranging from 20 to 40 years from the date the components were placed in service. Leasehold improvements are depreciated over the lesser of 20 years or through the end of the respective life of the lease. Repairs and maintenance costs are expensed as incurred. For the three months ended June 30, 2015, depreciation expense related to real estate assets and non-real estate assets was $12.4 million and $1.7 million, respectively, for a total of $14.1 million. For the three months ended June 30, 2014, depreciation expense related to real estate assets and non-real estate assets was $9.1 million and $1.6 million, respectively, for a total of $10.7 million. For the six months ended June 30, 2015, depreciation expense related to real estate assets and non-real estate assets was $23.3 million and $3.6 million, respectively, for a total of $26.9 million. For the six months ended June 30, 2014, depreciation expense related to real estate assets and non-real estate assets was $17.9 million and $3.0 million, respectively, for a total of $20.9 million. The Company capitalizes certain development costs, including internal costs incurred in connection with development. The capitalization of costs during the construction period (including interest and related loan fees, property taxes and other direct and indirect costs) begins when development efforts commence and ends when the asset is ready for its intended use. Capitalization of such costs, excluding interest, aggregated to $2.6 million and $2.5 million for the three months ended June 30, 2015 and 2014, respectively, and $5.9 million and $4.7 million for the six months ended June 30, 2015 and 2014, respectively. Interest is capitalized during the period of development by first applying the Company's actual borrowing rate on the related asset and second, to the extent necessary, by applying the Company's weighted average effective borrowing rate to the actual development and other costs expended during the construction period. Interest is capitalized until the property is ready for its intended use. Interest costs capitalized totaled $2.4 million and $1.8 million for the three months ended June 30, 2015 and 2014, respectively, and $4.4 million and $3.4 million for the six months ended June 30, 2015 and 2014, respectively.

Acquisitions – Acquisitions of real estate and other entities are either accounted for as asset acquisitions or business combinations depending on facts and circumstances. Purchase accounting is applied to the assets and liabilities related to all real estate investments acquired in accordance with the accounting requirements of ASC 805, *Business Combinations*, which requires the recording of net assets of acquired businesses at fair value. The fair value of the consideration transferred is allocated to the acquired tangible assets, consisting primarily of land, building and improvements, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, value of in-place leases, value of customer relationships, trade names, software intangibles and capital leases. The excess of the fair value of liabilities assumed, common stock issued and cash paid over the fair value of identifiable assets acquired is allocated to goodwill, which is not amortized by the Company.

In developing estimates of fair value of acquired assets and assumed liabilities, management analyzed a variety of factors including market data, estimated future cash flows of the acquired operations, industry growth rates, current replacement cost for fixed assets and market rate assumptions for contractual obligations. Such a valuation requires management to make significant estimates and assumptions, particularly with respect to the intangible assets.

Acquired in-place leases are amortized as amortization expense on a straight-line basis over the remaining life of the underlying leases. Amortization of acquired in place lease costs totaled $0.5 million and $0.6 million for the three months ended June 30, 2015 and 2014, respectively, and $0.9 million and $1.3 million for the six months ended June 30, 2015 and 2014, respectively. This amortization expense is accounted for as real estate amortization expense.

Acquired customer relationships are amortized as amortization expense on a straight-line basis over the expected life of the customer relationship. Amortization of acquired customer relationships totaled $0.6 million and $0.3 million for the three months ended June 30, 2015 and 2014, respectively, and $0.9 million and $0.7 million for the six months ended June 30, 2015 and 2014, respectively. This amortization expense is accounted for as real estate amortization expense.

Other acquired intangible assets, which includes platform, above or below market leases, and trade name intangibles, are amortized on a straight-line basis over their respective expected lives. Platform and trade name intangibles are amortized as amortization expense, which totaled $0.2 million for the three and six months ended June 30, 2015. Above or below market leases are amortized as rent expense, which was immaterial for the three and six months ended June 30, 2015. There was no amortization expense related to platform and trade name intangibles for the three and six months ended June 30, 2014. The expense associated with above and below market leases is accounted for as real estate expense, whereas the expense associated with the amortization of platform and trade name intangibles is accounted for as non-real estate expense.

See Note 3 for discussion of the preliminary purchase price allocation for the acquisition of Carpathia Hosting, Inc. on June 16, 2015, as well as the final purchase price allocation for the Princeton facility that the Company acquired on June 30, 2014.

Impairment of Long-Lived and Intangible Assets – The Company reviews its long-lived assets for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Recoverability of assets to be held and used is generally measured by comparison of the carrying amount to the future net cash flows, undiscounted and without interest, expected to be generated by the asset group. If the net carrying value of the asset exceeds the value of the undiscounted cash flows, the fair value of the asset is assessed and may be considered impaired. An impairment loss is recognized based on the excess of the carrying amount of the impaired asset over its fair value. No impairment losses were recorded for the three and six months ended June 30, 2015 and 2014, respectively.

As a result of the Carpathia acquisition in June 2015, the Company recognized approximately $173 million in goodwill. The fair value of goodwill is the consideration transferred which is not allocable to identifiable intangible and tangible assets. The Company believes that it has one reporting unit for goodwill purposes, thus will assess goodwill for impairment at least annually on that basis. Based on the initial purchase price allocation, the Company does not believe there is any immediate impairment that would need to be recognized in relation to goodwill.

Cash and Cash Equivalents – The Company considers all demand deposits and money market accounts purchased with a maturity date of three months or less at the date of purchase to be cash equivalents. The Company's account balances at one or more institutions periodically exceed the Federal Deposit Insurance Corporation ("FDIC") insurance coverage and, as a result, there is concentration of credit risk related to amounts on deposit in excess of FDIC coverage. The Company mitigates this risk by depositing a majority of its funds with several major financial institutions. The Company also has not experienced any losses and, therefore, does not believe that the risk is significant.

Deferred Costs – Deferred costs, net, on the Company's balance sheets include both financing costs and leasing costs.

Deferred financing costs represent fees and other costs incurred in connection with obtaining debt and are amortized over the term of the loan and are included in interest expense. Amortization of the deferred financing costs was $0.8 million and $0.6 million for the three months ended June 30, 2015 and 2014, respectively, and $1.6 million and $1.2 million for the six months ended June 30, 2015 and 2014, respectively. During the three months ended June 30, 2015, the Company wrote off unamortized financing costs of $0.1 million in connection with the repayment of the Atlanta Metro equipment loan, as discussed in Note 5. During the three months ended June 30, 2014, the Company wrote off unamortized financing costs of $0.1 million in connection with the modification of its credit facility that is secured by the Richmond data center. Deferred financing costs, net of accumulated amortization are as follows:

(dollars in thousands)	**June 30, 2015 (unaudited)**	**December 31, 2014**
Deferred financing costs	$ 18,581	$ 18,152
Accumulated amortization	(3,303)	(1,683)
Deferred financing costs, net	$ 15,278	$ 16,469

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Deferred leasing costs consist of external fees and internal costs incurred in the successful negotiations of leases and are deferred and amortized over the terms of the related leases on a straight-line basis. If an applicable lease terminates prior to the expiration of its initial term, the carrying amount of the costs are written off to amorti