Benefitfocus,Inc.
Form DEF 14A
April 30, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

SCHEDULE 14A

(RULE 14a-101)

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

Filed by the Registrant x Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement.

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2)).**

x Definitive Proxy Statement.

¨ Definitive Additional Materials.

¨ Soliciting Material Pursuant to §240.14a-12.

BENEFITFOCUS, INC.

(Name of Registrant as Specified in its Charter)

N/A

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

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Notice of June 12, 2015

Annual Meeting and

2015 Proxy Statement

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100 Benefitfocus Way

Charleston, South Carolina 29492

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

TO BE HELD JUNE 12, 2015

To the Stockholders of Benefitfocus, Inc.:

Notice is hereby given that the Annual Meeting of Stockholders of Benefitfocus, Inc. will be held on June 12, 2015, at our principal executive offices located at 100 Benefitfocus Way, Charleston, South Carolina 29492 at 9:00AM EDT. The meeting is called for the following purposes:

1. To elect the three Class II directors named in the Proxy Statement for a three-year term expiring in 2018 or until their successors have been elected and qualified; and

2. To consider and take action upon such other matters as may properly come before the meeting or any adjournment or postponement thereof.

These matters are more fully described in the Proxy Statement accompanying this Notice.

If you were a stockholder of record of Benefitfocus common stock as of the close of business on April 17, 2015, you are entitled to receive this Notice and vote at the Annual Meeting of Stockholders and any adjournments or postponements thereof, provided that the board of directors may fix a new record date for an adjourned meeting. Our stock transfer books will not be closed. A list of the stockholders entitled to vote at the meeting may be examined at our principal executive offices in Charleston, South Carolina during ordinary business hours in the 10-day period preceding the meeting for any purposes related to the meeting.

We are pleased to take advantage of the Securities and Exchange Commission rules that allow us to furnish these proxy materials (including an electronic Proxy Card for the meeting) and our 2014 Annual Report (including our 2014 Annual Report on Form 10-K) to stockholders via the Internet. On or about April 30, 2015, we mailed to our stockholders a Notice of Internet Availability of Proxy Materials containing instructions on how to access our Proxy Statement and 2014 Annual Report to Stockholders and how to vote. We believe that posting these materials on the Internet enables us to provide stockholders with the information they need to vote more quickly, while lowering the cost and reducing the environmental impact of printing and delivering annual meeting materials.

You are cordially invited to attend the meeting. Whether or not you expect to attend, the board of directors respectfully requests that you vote your stock in the manner described in the Proxy Statement. You may revoke

your proxy in the manner described in the Proxy Statement at any time before it has been voted at the meeting.

By Order of the Board of Directors of Benefitfocus, Inc.,

/s/ Mason R. Holland, Jr.
Mason R. Holland, Jr.
Executive Chairman of the Board

Charleston, South Carolina
Dated: April 30, 2015

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BENEFITFOCUS, INC.

Proxy Statement

for the

Annual Meeting of Stockholders

To Be Held June 12, 2015

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BENEFITFOCUS, INC.

PROXY STATEMENT

2015 ANNUAL MEETING OF STOCKHOLDERS

TO BE HELD JUNE 12, 2015

Information Concerning Solicitation and Voting

This Proxy Statement is furnished to the holders of our common stock in connection with the solicitation of proxies on behalf of the board of directors for use at the Annual Meeting of Stockholders to be held on June 12, 2015 at 9:00 AM EDT at our principal executive offices located at 100 Benefitfocus Way, Charleston, South Carolina 29492, or for use at any adjournment or postponement thereof, for the purposes set forth herein and in the accompanying Notice of Annual Meeting of Stockholders. Only stockholders of record at the close of business on April 17, 2015 are entitled to notice of and to vote at the meeting.

In accordance with the rules of the Securities and Exchange Commission, instead of mailing a printed copy of our proxy materials to each stockholder of record, we are furnishing proxy materials, including the Notice, this Proxy Statement, our 2014 Annual Report to Stockholders, including financial statements, and a Proxy Card for the meeting, by providing access to them on the Internet to save printing costs and benefit the environment. These materials were first available on the Internet on April 30, 2015. We mailed a Notice of Internet Availability of Proxy Materials on or about April 30, 2015 to our stockholders of record and beneficial owners as of April 17, 2015, the record date for the meeting. This Proxy Statement and the Notice of Internet Availability of Proxy Materials contain instructions for accessing and reviewing our proxy materials on the Internet and for voting by proxy over the Internet. You will need to obtain your own Internet access if you choose to access the proxy materials and/or vote over the Internet. If you prefer to receive printed copies of our proxy materials, the Notice of Internet Availability of Proxy Materials contains instructions on how to request the materials by mail. You will not receive printed copies of the proxy materials unless you request them. If you elect to receive the materials by mail, you may also vote by proxy on the Proxy Card or Voter Instruction Card that you will receive in response to your request.

Each holder of our common stock is entitled to one vote for each share held as of the record date with respect to all matters that may be considered at the meeting. Stockholder votes will be tabulated by persons appointed by the board of directors to act as inspectors of election for the meeting.

We bear the expense of soliciting proxies. Our directors, officers, or employees may also solicit proxies personally or by telephone, telegram, facsimile, or other means of communication. We do not intend to pay additional compensation for doing so. In addition, we might reimburse banks, brokerage firms, and other custodians, nominees, and fiduciaries representing beneficial owners of our common stock, for their expenses in forwarding soliciting materials to those beneficial owners.

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QUESTIONS AND ANSWERS ABOUT THE 2015 ANNUAL MEETING

Q: Who may vote at the meeting?

A: The board of directors set April 17, 2015 as the record date for the meeting. If you owned shares of our common stock at the close of business on April 17, 2015, you may attend and vote at the meeting. Each stockholder is entitled to one vote for each share of common stock held on all matters to be voted on. As of April 17, 2015, there were 28,574,010 shares of our common stock outstanding and entitled to vote at the meeting.

Q: What is the difference between holding shares as a stockholder of record and as a beneficial owner?

A: If your shares are registered directly in your name with our transfer agent, Computershare Trust Company, N.A., you are considered, with respect to those shares, a stockholder of record. As a stockholder of record, you have the right to vote in person at the meeting. You will need to present a form of personal photo identification in order to be admitted to the 2015 Annual Meeting of Stockholders.

If your shares are held in a brokerage account or by another nominee or trustee, you are considered the beneficial owner of shares held in street name. In that case, the Notice of Internet Availability of Proxy Materials or proxy materials have been forwarded to you by your broker, bank or other holder of record who is considered, with respect to those shares, the stockholder of record. As the beneficial owner, you have the right to direct your broker, bank or other holder of record on how to vote your shares by using the voting instructions included in the Notice of Internet Availability or proxy materials.

Q: What is the quorum requirement for the meeting?

A: A majority of our outstanding shares of capital stock entitled to vote as of the record date must be present at the meeting in order for us to hold the meeting and conduct business. This is called a quorum. Your shares will be counted as present at the meeting if you:

- Are present and entitled to vote in person at the meeting; or
- Properly submitted a Proxy Card or Voter Instruction Card.

If you are present in person or by proxy at the meeting, but abstain from voting on any or all proposals, your shares are still counted as present and entitled to vote. The proposal listed in this Proxy Statement identifies the votes needed to approve the proposed action.

Q: What proposals will be voted on at the meeting?

A: The one proposal to be voted on at the meeting is as follows:

1. To elect the three Class II directors named in the Proxy Statement for a three-year term expiring in 2018 or until their successors have been elected and qualified.

We will also consider any other business that properly comes before the meeting. As of the record date, we are not aware of any other matters to be submitted for consideration at the meeting. If any other matters are properly brought before the meeting, the proxy named in the Proxy Card or Voter Instruction Card will vote the shares it represents using its best judgment.

Q: Can I access these proxy materials on the Internet?

A: Yes. The Notice of Annual Meeting, Proxy Statement, and 2014 Annual Report to Stockholders (including the 2014 Annual Report on Form 10-K), are available for viewing, printing, and downloading at *www.proxyvote.com*. Our Annual Report on Form 10-K for the year ended December 31, 2014 is also available under the *About Investor Relations Financial Information Annual Meeting Materials* section of our website at *www.benefitfocus.com* and through the SEC s EDGAR system at *http://www.sec.gov*. All materials will remain posted on *www.proxyvote.com* at least until the conclusion of the meeting.

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Q: How may I vote my shares in person at the meeting?

A: If your shares are registered directly in your name with our transfer agent, Computershare Trust Company, N.A., you are considered, with respect to those shares, the stockholder of record. As the stockholder of record, you have the right to vote in person at the meeting. You will need to present a form of personal photo identification in order to be admitted to the meeting. If your shares are held in a brokerage account or by another nominee or trustee, you are considered the beneficial owner of shares held in street name. As the beneficial owner, you are also invited to attend the meeting. Because a beneficial owner is not the stockholder of record, you may not vote these shares in person at the meeting unless you obtain a legal proxy from the broker, nominee, or trustee that holds your shares, giving you the right to vote the shares at the meeting.

Q: How can I vote my shares without attending the meeting?

A: If your common stock is held by a broker, bank or other nominee, they should send you instructions that you must follow in order to have your shares voted. If you hold shares in your own name, you may vote by proxy in any one of the following ways:

Via the Internet by accessing the proxy materials on the secured website *www.proxyvote.com* and following the voting instructions on that website;

Via telephone by calling toll free 1-800-690-6903 and following the recorded instructions; or

By requesting that printed copies of the proxy materials be mailed to you pursuant to the instructions provided in the Notice of Internet Availability and completing, dating, signing and returning the Proxy Card that you receive in response to your request.

The Internet and telephone voting procedures are designed to authenticate stockholders identities by use of a control number to allow stockholders to vote their shares and to confirm that stockholders instructions have been properly recorded. Voting via the Internet or telephone must be completed by 11:59 PM EDT on June 11, 2015. Of course, you can always come to the meeting and vote your shares in person. If you submit or return a Proxy Card without giving specific voting instructions, your shares will be voted as recommended by the board of directors, as permitted by law.

Q: How can I change my vote after submitting it?

A: If you are a stockholder of record, you can revoke your proxy before your shares are voted at the meeting by:

Filing a written notice of revocation bearing a later date than the proxy with our Corporate Secretary at 100 Benefitfocus Way, Charleston, South Carolina 29492 at or before the taking of the vote at the meeting;

- Duly executing a later-dated proxy relating to the same shares and delivering it to our Corporate Secretary at 100 Benefitfocus Way, Charleston, South Carolina 29492 at or before the taking of the vote at the meeting;

- Attending the meeting and voting in person (although attendance at the meeting will not in and of itself constitute a revocation of a proxy); or

- If you voted by telephone or via the Internet, voting again by the same means prior to 11:59 PM EDT on June 11, 2015 (your latest telephone or Internet vote, as applicable, will be counted and all earlier votes will be disregarded).

If you are a beneficial owner of shares, you may submit new voting instructions by contacting your bank, broker, or other holder of record. You may also vote in person at the meeting if you obtain a legal proxy from them as described in the answer to a previous question.

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Q: Where can I find the voting results of the meeting?

A: We will announce the preliminary voting results at the meeting. We will publish the results in a Form 8-K filed with the SEC within four business days of the meeting.

Q: For how long can I access the proxy materials on the Internet?

A: The Notice of Annual Meeting, Proxy Statement, 2014 Annual Report to Stockholders, and Annual Report on Form 10-K for the fiscal year ended December 31, 2014 are also available, free of charge, in PDF and HTML format under the *About Investor Relations Financial Information Annual Meeting Materials* section of our website at *www.benefitfocus.com* and will remain posted on this website at least until the conclusion of the meeting.

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PROPOSAL ONE

ELECTION OF DIRECTORS

Nominees

Our board of directors currently consists of eight members and is divided into three classes, the members of which each serve for a staggered three-year term or until a successor has been elected and qualified. The term of office of one class of directors expires each year in rotation so that one class is elected at each annual meeting for a full three-year term. Our Class II directors, Mason R. Holland, Jr., Ann H. Lamont and Stephen M. Swad, have been nominated to fill a three-year term expiring in 2018. The two other classes of directors, who were elected or appointed for terms expiring at the annual meetings in 2016 and 2017, respectively, will remain in office.

If you are a stockholder of record, unless you mark your proxy card to withhold authority to vote, the proxy holder will vote the proxies received by it for the three Class II nominees named below, each of whom is currently a director and each of whom has consented to be named in this Proxy Statement and to serve if elected. In the event that any nominee is unable or declines to serve as a director at the time of the meeting, your proxy will be voted for any nominee designated by the board of directors to fill the vacancy. We do not expect that any nominee will be unable or will decline to serve as a director. If you are a beneficial owner of shares held in street name and you do not provide your broker with voting instructions, your broker may not vote your shares on the election of directors. Therefore, it is important that you vote.

The name of and certain information regarding each Class II nominee as of April 17, 2015 is set forth below, together with information regarding our directors remaining in office. This information is based on data furnished to us by the nominees and directors. There is no family relationship between any director, executive officer or person nominated to become a director or executive officer. The business address for each nominee for matters regarding the Company is 100 Benefitfocus Way, Charleston, South Carolina 29492.

Class II Director Nominees for Terms Expiring in 2018

Name	Age	Position(s) with Benefitfocus	Director Since
Mason R. Holland, Jr.	50	Executive Chairman, Director	June 2000
Ann H. Lamont	58	Director	July 2010
Stephen M. Swad	53	Director	December 2013

Class III Directors with Terms Expiring in 2016

Name	Age	Position(s) with Benefitfocus	Director Since
Douglas A. Dennerline	56	Director	August 2014
Francis J. Pelzer V	44	Director	May 2013

Class I Directors with Terms Expiring in 2017

Name	Age	Position(s) with Benefitfocus	Director Since
Shawn A. Jenkins	47	Chief Executive Officer and Director	June 2000
Joseph P. DiSabato	48	Director	February 2007
A. Lanham Napier	45	Director	September 2014

Class II Director Nominees

Mason R. Holland, Jr. Executive Chairman, Director

Mason Holland, one of our founders, has been our Executive Chairman and a member of our board of directors since our founding in June 2000. Mr. Holland is responsible for the coordination of strategic partnerships with industry leaders and client relations, and serves on the nominating and governance committee. Mr. Holland founded American

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Pensions, Inc. in 1988, serving as its Chairman and President from 1988 to 2003. Mr. Holland s other ventures have included establishing Holland Properties LLC, a real estate development firm, in 1989, and acquiring Eclipse Aerospace, Inc., a jet aircraft manufacturer, in May 2009, for which he serves as Chairman and Chief Executive Officer. Mr. Holland attended Old Dominion University in Norfolk, Virginia.

We believe Mr. Holland brings to our board of directors valuable perspective and experience as our Executive Chairman and one of our founders and as a large stockholder, as well as knowledge of the benefits industry and experience managing and directing companies through various stages of development, all of which qualify him to serve as one of our directors.

Ann H. Lamont Director

Ann Lamont has served on our board of directors since July 2010. She serves on the compensation and nominating and governance committees and is the chair of the nominating and governance committee. Ms. Lamont has been with Oak Investment Partners, a multi-stage venture capital firm, since 1982, serving as a General Partner from 1986 to 2006 and as a Managing Partner since 2006. She currently leads the healthcare and financial services technology teams at Oak. Prior to joining Oak, Ms. Lamont served as a research associate with Hambrecht & Quist. Ms. Lamont serves on the boards of Acculynk, Inc., Castlight Health, Inc., FreshBooks, Independent Living Systems, LLC, Precision for Medicine Holdings, Inc., Radisphere National Radiology Group, Inc. and xG Health Solutions, Inc. Ms. Lamont is ranked the number one healthcare investor on the Forbes Midas List. Additionally, in March 2013, Ms. Lamont completed a five-year term on the Stanford University Board of Trustees. Ms. Lamont holds a B.A. in political science from Stanford University.

We believe Ms. Lamont s experience analyzing corporate performance as a venture capitalist and managing her firm s investments in private companies, knowledge of the healthcare and payment services industries, and service on multiple boards of directors bring to our board of directors important skills related to corporate finance, oversight of management and strategic positioning, and qualify her to serve as one of our directors.

Stephen M. Swad Director

Steve Swad has served on our board of directors since December 2013. He serves on the audit and compensation committees and is the chair of the compensation committee. From February 2012 until April 2015, Mr. Swad served as the President, Chief Executive Officer, and a director of Rosetta Stone Inc. (NYSE: RST), a publicly held language-learning software company. He was previously its Chief Financial Officer beginning in November 2010. Prior to joining Rosetta Stone, Mr. Swad served as the Executive Vice President and Chief Financial Officer of Comverse Technology, Inc., beginning in May 2009. Prior to that, he served as Executive Vice President and Chief Financial Officer of Federal National Mortgage Association (Fannie Mae) (NASDAQ: FNMA) from May 2007 until August 2008. He has also held various senior financial management positions with public companies, including AOL LLC (NYSE: AOL) and Time Warner Inc. (NYSE: TWC) and its subsidiaries. Mr. Swad, a former partner of KPMG LLP, has also served as a Deputy Chief Accountant at the SEC. He served on the board of Eloqua, Inc. from August of 2011 until February 2013, including between August 2012 through February 2013 during which it was a publicly held company. Mr. Swad holds a B.A. in business administration from the University of Michigan and is a Certified Public Accountant.

Among other experience, qualifications, attributes and skills, we believe Mr. Swad s financial and accounting experience, ability to lead public companies, and familiarity with technology companies bring to our board important skills related to corporate finance and governance, and qualify him to serve on our board.

Other Directors Not Up for Re-election at this Meeting

Douglas A. Dennerline Director

Doug Dennerline has served as a member of our board of directors since August 2014. He serves on the audit, compensation and nominating and governance committees. He is currently Chief Executive Officer of Alfresco Software, Inc. and was previously President and a director of SuccessFactors, Inc. Prior to joining

SuccessFactors, Mr. Dennerline was Executive Vice President of Sales, Americas and EMEA for salesforce.com, inc. (NYSE: CRM). Mr. Dennerline holds a B.S. in Business Administration from Arizona State University.

We believe Mr. Dennerline s experience as chief executive officer of a software company and familiarity with the software industry brings to our board of directors important skills. His experience as a director of a software and technology company brings to our board critical skills related to financial oversight of complex organizations, strategic planning and corporate governance and qualify him to serve as one of our directors.

Francis J. Pelzer V Director

Frank Pelzer has served as a member of our board of directors since May 2013. He serves on the audit and compensation committees and is the chair of the audit committee. Since January 2015, Mr. Pelzer has served as Chief Financial Officer of the SAP SE Business Network, an application and analytics software company that includes three SaaS companies owned by SAP. From May 2010 to January 2015, Mr. Pelzer served as the Chief Financial Officer of Concur Technologies, Inc., a provider of web-based and mobile, integrated travel and expense management solutions. From 2004 to May 2010, Mr. Pelzer served as a director and Vice President in the Software Investment Banking group at Deutsche Bank. Prior to that, Mr. Pelzer was a Vice President with Credit Suisse First Boston and a management consultant with Kurt Salmon Associates. Mr. Pelzer serves on the board of directors of Limeade, Inc. and is the chairman of their audit committee. Mr. Pelzer graduated with an M.B.A. as an Edward Tuck Scholar with Distinction from the Tuck School of Business at Dartmouth and holds a B.A. from Dartmouth College.

We believe Mr. Pelzer s experience as a chief financial officer of a public company, familiarity with the software industry, accounting standards and public company disclosure requirements, and his ability to serve as our audit committee financial expert, bring to our board of directors important skills and qualify him to serve on our board.

Shawn A. Jenkins Chief Executive Officer, Director

Shawn Jenkins, one of our founders, has been our Chief Executive Officer and a member of our board of directors since our founding in June 2000, and in addition to these roles, served as our President from June 2000 to April 2015. Prior to founding Benefitfocus, from 1995 to 2000, he served as Vice President with American Pensions, Inc., leading sales, operations, and technology. From 1994 to 1995, Mr. Jenkins was a program analyst with Rockwell Automation, Inc. (NYSE: ROC). Mr. Jenkins serves on the Advisory Board for the School of Computing at Clemson University, Medical University of South Carolina Foundation Board of Directors, College of Charleston Board of Governors, and Charleston Southern University Board of Visitors. He previously served as Chairman of the Growing Forward Campaign for the Lowcountry Food Bank. Mr. Jenkins received an M.B.A. from Charleston Southern University and a B.A. from Geneva College in Beaver Falls, Pennsylvania.

Among other experience, qualifications, attributes and skills, we believe Mr. Jenkins perspective as one of our founders and as a large stockholder, his extensive leadership and experience as our Chief Executive Officer since our founding, his knowledge of our operations, and oversight of our sales organization bring to our board of directors critical strategic planning and operational leadership that qualify him to serve as one of our directors.

Joseph P. DiSabato Director

Joe DiSabato has served on our board of directors since February 2007. Mr. DiSabato has been a Managing Director in the Principal Investment Area at The Goldman Sachs Group, Merchant Banking Division, since 2000. Mr. DiSabato joined Goldman Sachs in 1988 and served as a Financial Analyst until 1991, re-joining as an Associate in 1994. He serves as a director of American Traffic Solutions, Inc., NEOS GeoSolutions Inc., The Endurance

International Group, Inc., APT Software Holdings, Inc., and Backoffice Associates, LLC. Mr. DiSabato holds an M.B.A. from the Anderson Graduate School of Management at the University of California at Los Angeles and a B.S. from the Massachusetts Institute of Technology.

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We believe Mr. DiSabato s experience as a director of various software and technology companies, and his experience with expansion-stage growth companies, brings to our board critical skills related to financial oversight of complex organizations, strategic planning and corporate governance and qualify him to serve as one of our directors.

A. Lanham Napier Director

Lanham Napier has served as a member of our board of directors since September 2014. He serves on the Company s compensation and nominating and governance committees. Mr. Napier was formerly the Chief Executive Officer of Rackspace Hosting, Inc. (NYSE: RAX). At various times during his 14 years at Rackspace, he also served in other capacities at the company, including as its President, Chief Financial Officer, and member of its board of directors. Prior to that, Mr. Napier was an analyst of Merrill Lynch & Co., Inc. Mr. Napier holds an M.B.A. from Harvard University and a B.A. in Economics from Rice University.

We believe Mr. Napier s experience as chief executive officer of a public company, familiarity with the software industry and his experience as a director of a software company brings to our board critical skills related to strategic planning and corporate governance and qualifies him to serve on our board.

Second Amended and Restated Voting Agreement

In connection with our IPO in September 2013, we entered into a Second Amended and Restated Voting Agreement (the Voting Agreement), with GS Capital Partners VI Parallel, L.P., GS Capital Partners VI Offshore Fund, L.P., GS Capital Partners VI Fund, L.P., and GS Capital Partners VI GmbH & CO. KG, which we refer to as the Goldman Funds; Oak Investment Partners XII, L.P.; Mason Holland; the Holland Family Trust; and Shawn Jenkins, all of which we refer to collectively as the Key Holders. Under the Voting Agreement, each Key Holder agrees to vote his, her, or its shares in favor of certain director nominees, including, among others, Class II director nominees Mr. Holland and Ms. Lamont. Additionally, each Key Holder agrees not to vote for the removal of the directors elected under the terms of the Voting Agreement, unless such removal is directed or approved by the party that nominated such director. The Voting Agreement will terminate in September 2018, and will terminate as to any party at such time as such party no longer has a right to nominate a director pursuant to the agreement. The Voting Agreement is more fully described under Certain Relationships and Related-Party Transactions Corporate Governance .

Required Vote

The three Class II director nominees receiving the highest number of affirmative votes of our common stock present or represented and entitled to be voted for them shall be elected as Class II directors. In accordance with Delaware law, votes withheld from any nominee are counted for purposes of determining the presence or absence of a quorum for the transaction of business, but they have no legal effect on the election of directors. While broker non-votes will be counted for purposes of determining the presence or absence of a quorum, they will not be counted for purposes of determining the number of shares represented and voted with respect to the particular proposal on which the broker has expressly not voted and, accordingly, will not affect the election of directors.

The board of directors unanimously recommends that stockholders vote FOR the three Class II director nominees listed above.

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CORPORATE GOVERNANCE MATTERS

Information about the Board

The board of directors currently comprises eight members, divided into three classes as follows: Class I, consisting of Messrs. DiSabato, Jenkins and Napier; Class II, consisting of Messrs. Holland and Swad and Ms. Lamont; and Class III, consisting of Messrs. Dennerline and Pelzer. Upon the expiration of the term of office for each class of directors, each director in such class will be elected for a term of three years and will serve until a successor is duly elected and qualified or until his or her earlier death, resignation or removal. Any additional directorships resulting from an increase in the number of directors or a vacancy may be filled by the directors then in office or the stockholders (as provided in our bylaws). Because only one-third of our directors will be elected at each annual meeting, two consecutive annual meetings of stockholders could be required for the stockholders to change a majority of the board.

As Executive Chairman, Mr. Holland has authority to, among other things, call and preside over meetings of the board of directors, set meeting agendas, and determine materials to be distributed to the board. Accordingly, Mr. Holland has substantial ability to shape the work of the board. Mr. Holland, as a co-founder of our Company, possesses detailed and in-depth knowledge of the issues, opportunities, and challenges facing our Company and our business, and is well positioned to develop agendas that ensure the board s time and attention are focused on critical matters.

We have historically separated the position of Executive Chairman and that of Chief Executive Officer, currently Mr. Jenkins, who is also a co-founder of our Company. While our board of directors believes the separation of these positions has served our Company well, and intends to maintain this separation where appropriate and practicable, the board does not believe that it is appropriate to prohibit one person from serving as both Chairman and Chief Executive Officer. We believe our leadership structure is appropriate given the size of our Company in terms of number of employees and the historical experience and understanding of our Company and industry of each of Messrs. Holland and Jenkins.

Director Independence

Our board of directors has established an audit committee, compensation committee, and nominating and governance committee. Our audit committee consists of independent directors Messrs. Pelzer (Chair), Dennerline and Swad. Our compensation committee consists of Messrs. Swad (Chair), Dennerline, Napier and Pelzer, and Ms. Lamont. Our nominating and governance committee consists of Ms. Lamont (Chair), and Messrs. Dennerline, Holland and Napier. The audit committee, compensation committee, and nominating and governance committee were established in May 2013 in anticipation of our IPO.

Our board has undertaken a review of the independence of our directors and has determined that Messrs. Dennerline, Pelzer and Swad are independent within the meaning of the NASDAQ Stock Market listing rules and meet the additional test for independence for audit committee members imposed by SEC regulation and the NASDAQ Stock Market listing rules.

We are a controlled company as set forth in NASDAQ Stock Market Listing Rule 5615 because more than 50% of the voting power of our common stock is held by a group of stockholders consisting of Messrs. Holland and Jenkins, Oak Investment Partners XII, L.P., and the Goldman Funds. Under NASDAQ Stock Market rules, a controlled company is exempt from the NASDAQ Stock Market corporate governance requirements that a majority of the board of directors consist of independent directors and that directors nominations and executive compensation must be approved by a majority of independent directors or a nominating and governance committee or compensation committee comprised solely of independent directors. We will rely on some of these exemptions from the corporate governance requirements until we are no longer a controlled company or our board determines to no longer rely on these exemptions. In particular, our nominating and governance committee (which approves directors nominations) does not consist entirely of independent directors.

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Family Relationships

There is no family relationship between any director, executive officer or person nominated to become a director or executive officer of our Company.

Executive Sessions of Non-Employee Directors

In order to promote open discussion among non-employee directors, our board of directors has a policy of regularly conducting executive sessions of non-employee directors at scheduled meetings and at such other times requested by a non-employee director.

Selection of Nominees for the Board of Directors

The nominating and governance committee of our board of directors has the responsibility for establishing the criteria for recommending which directors should stand for re-election to the board and the selection of new directors to serve on the board. In addition, the committee is responsible for establishing the procedures for our stockholders to nominate candidates to the board. The committee has not formulated any specific minimum qualifications for director candidates, but has determined certain desirable characteristics, including strength of character, mature judgment, career specialization, relevant technical skills and independence. The Nominating and Governance Committee Charter calls for the committee to consider diversity to be an additional desirable characteristic in potential nominees.

Our bylaws permit any stockholder of record to nominate directors. Stockholders wishing to nominate a director must deliver written notice of the nomination either by personal delivery or by U.S. certified mail, postage prepaid, to the Corporate Secretary (i) with respect to an election to be held at an annual meeting of stockholders, not more than 90 and not less than 60 days before the meeting at which directors are to be elected, and (ii) with respect to an election to be held at a special meeting of stockholders called for the purpose of the election of directors, not later than the close of business on the tenth business day following the date on which notice of such meeting is first given to stockholders.

Any such notice must set forth the following: (A) the name and address, as they appear on the Company s books, of (i) the stockholder who intends to make the nomination and the name and residence address of the person or persons to be nominated, and (ii) any Stockholder Associated Person (as defined below); (B) (i) any material interest in the director nomination of such stockholder or any Stockholder Associated Person, individually or in the aggregate, (ii) as to the stockholder or any Stockholder Associated Person, their holdings of our stock and whether the stockholder has entered into transactions to manage risk with respect to such stock, (iii) as to the stockholder and any Stockholder Associated Person, the name and address of such stockholder and Stockholder Associated Person, as they appear on the Company s stock ledger, and current name and address, if different, and (iv) to the extent known by the stockholder, the name and address of any other stockholder supporting the nominee for election as a director; (C) a representation that the stockholder is a holder of record of stock of the Company entitled to vote at such meeting and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice; (D) a description of all arrangements or understandings between the stockholder and any Stockholder Associated Person and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by the stockholder; (E) such other information regarding each nominee proposed by such stockholder as would be required to be disclosed in solicitations of proxies for election of directors, or as would otherwise be required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, or the Exchange Act, including any information that would be required to be included in a proxy statement filed pursuant to Regulation 14A had the nominee been nominated by the board of directors; and (F) the written consent of each nominee to be named in a proxy statement and to serve as director of the Company if so elected. Our bylaws define Stockholder Associated Person as (a) any person controlling, directly or indirectly, or acting in concert with, such stockholder, (b) any beneficial owner of our shares of stock owned of record or beneficially by such stockholder and (c) any person controlling, controlled by or under common control with such Stockholder Associated Person.

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Our nominating and governance committee will evaluate a nominee recommended by a stockholder in the same manner in which the committee evaluates nominees recommended by other persons as well as its own nominee recommendations.

Information Regarding Meetings of the Board and Committees

During 2014, our board of directors held 13 meetings, and its three permanent committees, the audit committee, compensation committee and nominating and governance committee, collectively held 24 meetings. In 2014, our board of directors also formed a pricing committee in connection with our follow-on offering of the Company s common stock. The pricing committee held one meeting in 2014.

All of our directors attended at least 75% of the aggregate of all meetings of the board of directors and the committees on which he or she served during 2014. Although we do not have a formal written policy with respect to directors attendance at our annual meetings of stockholders, we generally encourage all directors to attend. In 2014, directors Mason R. Holland, Jr. and Shawn A. Jenkins attended the annual meeting of stockholders.

Board Committees

Committees of our Board of Directors

In May 2013, our board of directors adopted written charters for each of its permanent committees, all of which are available under *Overview* in the *About Investor Relations Corporate Governance* section of our website at *www.benefitfocus.com.* The following table provides membership information of our directors in each committee of our board as of April 17, 2015, and summarizes changes in membership in such committees during 2014. Our pricing committee, which comprised Messrs. DiSabato and Holland, and Ms. Lamont, was formed on July 16, 2014 for the purpose of setting the terms of our follow-on offering of the Company s common stock.

	Audit Committee	Compensation Committee	Nominating & Governance Committee
Mason R. Holland, Jr. (Executive Chairman)(1)			
Douglas A. Dennerline(2)			
Joseph P. DiSabato(3)			
Ann H. Lamont			
A. Lanham Napier(4)			
Francis J. Pelzer V(5)			
Stephen M. Swad			

= Committee Chair

= Member

(1) Mr. Holland served on our audit committee until August 20, 2014.
(2) Mr. Dennerline joined our board of directors, as well as our audit committee on August 20, 2014, and joined our compensation and nominating and governance committees on September 18, 2014.
(3) Mr. DiSabato served on our compensation and nominating and governance committees until September 18, 2014.
(4) Mr. Napier joined our board of directors, as well as our compensation and nominating and governance committees on September 18, 2014.
(5) Mr. Pelzer served on our nominating and governance committee until September 18, 2014.

Audit Committee

Our audit committee consists of Messrs. Pelzer (Chair), Dennerline, and Swad. Mr. Holland served on our audit committee until August 20, 2014. Each of Messrs. Pelzer, Dennerline and Swad satisfy the independence

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requirements of Rule 5605(a)(2) of the NASDAQ Stock Market listing rules and SEC Rule 10A-3. Our audit committee met 16 times during our 2014 fiscal year. Our audit committee is responsible for, among other things:

- appointing, terminating, compensating, and overseeing the work of any accounting firm engaged to prepare or issue an audit report or other audit, review or attest services;
- reviewing and approving, in advance, all audit and non-audit services to be performed by the independent auditor, taking into consideration whether the independent auditor s provision of non-audit services to us is compatible with maintaining the independent auditor s independence;
- reviewing and discussing the adequacy and effectiveness of our accounting and financial reporting processes and controls and the audits of our financial statements;
- establishing and overseeing procedures for the receipt, retention, and treatment of complaints received by us regarding accounting, internal accounting controls or auditing matters, including procedures for the confidential, anonymous submission by our employees regarding questionable accounting or auditing matters;
- investigating any matter brought to its attention within the scope of its duties and engaging independent counsel and other advisors as the audit committee deems necessary;
- determining compensation of the independent auditors and of advisors hired by the audit committee and ordinary administrative expenses;
- reviewing and discussing with management and the independent auditor the annual and quarterly financial statements prior to their release;
- monitoring and evaluating the independent auditor s qualifications, performance, and independence on an ongoing basis;
- reviewing reports to management prepared by the internal audit function, as well as management s response;
- reviewing and assessing the adequacy of the formal written charter on an annual basis;

- reviewing and approving related-party transactions for potential conflict of interest situations on an ongoing basis; and
- handling such other matters that are specifically delegated to the audit committee by our board from time to time.

Our board of directors has affirmatively determined that Mr. Pelzer is designated as the audit committee financial expert and that he meets the definition of an independent director for purposes of serving on an audit committee under the NASDAQ Stock Market listing rules. The designation does not impose on Mr. Pelzer any duties, obligations or liabilities that are greater than those generally imposed on members of our audit committee and our board of directors.

Compensation Committee

Our compensation committee consists of Messrs. Swad (Chair), Dennerline, Napier and Pelzer, and Ms. Lamont. Mr. DiSabato served on our compensation committee until September 18, 2014. Our compensation committee met five times during our 2014 fiscal year. Our compensation committee is responsible for, among other things:

- reviewing and approving the compensation, employment agreements and severance arrangements, and other benefits of all of our executive officers and key employees;
- reviewing and approving, on an annual basis, the corporate goals and objectives relevant to the compensation of the executive officers, and evaluating their performance in light thereof;
- reviewing and making recommendations, on an annual basis, to the board with respect to director compensation;

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- reviewing any analysis or report on executive compensation required to be included in the annual proxy statement and periodic reports pursuant to applicable federal securities rules and regulations, and recommending the inclusion of such analysis or report in our proxy statement and period reports;

- reviewing and assessing, periodically, the adequacy of the formal written charter; and

- such other matters that are specifically delegated to the compensation committee by our board from time to time.

Pursuant to its written charter, our compensation committee has the authority to engage the services of outside advisors as it deems appropriate to assist it in the evaluation of the compensation of our directors, our principal executive officer or our other executive and non-executive officers, and in the fulfillment of its other duties. Additionally, our compensation committee has the authority to review and approve the compensation of our other officers and employees and may delegate its authority to review and approve the compensation of other non-executive officer employees to specified executive officers. Our compensation committee engaged Mercer Health & Benefits, LLC as its compensation consultant in 2014, as more fully described in Executive Compensation Employment Agreements .

Nominating and Governance Committee

Our nominating and governance committee consists of Ms. Lamont (Chair), and Messrs. Dennerline, Holland and Napier. Messrs. DiSabato and Pelzer served on our nominating and governance committee until September 18, 2014. Our nominating and governance committee met three times during our 2014 fiscal year. It is responsible for, among other things:

- identifying and screening candidates for our board, and recommending nominees for election as directors;

- establishing procedures to exercise oversight of the evaluation of the board and management;

- developing and recommending to the board a set of corporate governance guidelines, as well as reviewing these guidelines and recommending any changes to the board;

- reviewing the structure of the board s committees and recommending to the board for its approval directors to serve as members of each committee, and where appropriate, making recommendations regarding the removal of any member of any committee;

- developing and reviewing our code of conduct, evaluating management s communication of the importance of our code of conduct, and monitoring compliance with our code of conduct;

- reviewing and assessing the adequacy of the formal written charter on an annual basis; and

- generally advising our board on corporate governance and related matters.

Risk Oversight

While our Company s senior management has responsibility for the management of risk, our board of directors plays an important role in overseeing this function. Our board of directors regularly reviews our market and business risks during its meetings and, since its formation, each of its committees began overseeing risks associated with its respective area of responsibility. In particular, our audit committee oversees risk related to our accounting, tax, financial and public disclosure processes. It also assesses risks associated with our financial assets. Our compensation committee oversees risks related to our compensation and benefit plans and policies to ensure sound pay practices that do not cause risks to arise that are reasonably likely to have a material adverse effect on our Company. Our nominating and governance committee seeks to minimize risks related to governance structure by implementing sound corporate governance principles and practices. Each of our committees reports to the full board of directors as appropriate on its efforts at risk oversight and on any matter that rises to the level of a material or enterprise level of risk.

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Code of Conduct

We have adopted a code of ethics relating to the conduct of our business by all of our employees, officers, and directors, as well as a code of conduct specifically for our principal executive officer and senior financial officers. We have also adopted a corporate communications policy for our employees and directors establishing guidelines for the disclosure of information related to our Company to the investing public, market analysts, brokers, dealers, investment advisors, the media, and any persons who are not our employees or directors. Additionally, we have adopted an insider trading policy to establish guidelines for our employees, officers, directors, and consultants regarding transactions in our securities and the disclosure of material nonpublic information related to our Company. Each of these policies is posted under *Overview* in the *About Investor Relations Corporate Governance* section of our website at *www.benefitfocus.com.*

Communications with the Board of Directors

Stockholders who wish to communicate with members of our board of directors, including the independent directors individually or as a group, may send correspondence to them in care of our Corporate Secretary at our principal executive offices at 100 Benefitfocus Way, Charleston, South Carolina 29492. Such communication will be forwarded to the intended recipient(s). We currently do not intend to have our Corporate Secretary screen this correspondence, but we may change this policy if directed by the board due to the nature or volume of the correspondence.

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DIRECTOR COMPENSATION

In June 2014, our board of directors established a compensation program for our Company s independent directors not serving as a designee of an investor under the Voting Agreement. Each such director will receive an annual retainer of $150,000, payable at the director s election either 50% in cash and 50% in restricted stock units, or 100% in restricted stock units. We will also pay such directors the following cash fees for each quarter they chair one of the board committees: audit, $6,250; compensation, $2,500; and any other committee, $1,875.

In June 2014, our board of directors also adopted an Independent Director Agreement which requires our Company s non-employee directors, not serving as a designee of an investor under the Voting Agreement, to own stock in our Company with a cash value of $225,000 or 3,750 shares, whichever is less. Such director need not own the requisite number of shares until he has completed three years of service as a director of our Company. If the ownership required is not met after the director has completed three years of service as a director of our Company, then all payments made to him by our Company will be entirely in the form of restricted stock units until the required ownership level is reached. For purposes of calculating the number of shares held by a director, shares that are owned directly are counted along with (a) shares over which the director has investment or voting power, and (b) shares that may be acquired pursuant to vested, in-the-money options to acquire Company stock. Shares used to achieve the minimum director ownership requirement may not be pledged, used as security, or otherwise encumbered by a director.

The following table sets forth the total compensation paid to each of our non-employee directors in 2014.

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)	Total ($)
Douglas A. Dennerline	-	$419,632(1)	$419,632
Joseph P. DiSabato	-	-	-
Ann H. Lamont	-	-	-
A. Lanham Napier	-	$419,632(2)	$419,632
Francis J. Pelzer V	$25,000	$181,113(3)	$206,113
Stephen M. Swad	$10,000	$543,339(4)	$553,339

(1) On September 18, 2014, our board of directors approved a grant of restricted stock units to Mr. Dennerline for 13,467 shares of our common stock with an aggregate grant date fair value of $419,632, computed in accordance with FASB ASC Topic 718. This initial grant of restricted stock units, made in connection with Mr. Dennerline joining our board of directors, vests in three equal annual installments beginning on the earlier of the anniversary date of the grant or that year s annual meeting of stockholders of our Company, subject to Mr. Dennerline s continued service on our board.

(2) On September 18, 2014, our board of directors approved a grant of restricted stock units to Mr. Napier for 13,467 shares of our common stock with an aggregate grant date fair value of $419,632, computed in accordance with FASB ASC Topic 718. This initial grant of restricted stock units, made in connection with Mr. Napier joining our board of directors, vests in three equal annual installments beginning on the earlier of the anniversary date of the grant or that year s annual meeting of stockholders of our Company, subject to Mr. Napier s continued service on our board.

(3)

On June 17, 2014, our board of directors approved a grant of restricted stock units to Mr. Pelzer for 4,337 shares of our common stock with an aggregate grant date fair value of $181,113, computed in accordance with FASB ASC Topic 718. The restricted stock units vest on the earlier of the anniversary date of the date of grant or the date of our Company s 2015 annual meeting of stockholders, subject to Mr. Pelzer s continued service on our board. Mr. Pelzer also holds an option to purchase 50,000 shares of our common stock, granted to him in 2013 for service on our board. At December 31, 2014, 19,791 shares subject to this option were vested.

(4) On June 17, 2014, our board of directors approved a grant of restricted stock units to Mr. Swad for 13,011 shares of our common stock with an aggregate grant date fair value of $543,339, computed in accordance with FASB ASC Topic 718. This initial grant of restricted stock units, made in connection with Mr. Swad

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joining our board of directors, vests in three equal annual installments beginning on the earlier of the anniversary date of the grant or that year s annual meeting of stockholders of our Company, subject to Mr. Swad s continued service on our board.

The compensation earned by Mr. Jenkins as an employee in 2014, 2013 and 2012 is included in Executive Compensation Summary Compensation Table . Mr. Holland is an executive officer (but not a named executive officer) who serves as a director and did not receive additional compensation for service provided as a director in 2014, 2013 and 2012.

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AUDIT COMMITTEE REPORT

Our audit committee has (1) reviewed and discussed with management the audited financial statements for the year ended December 31, 2014, (2) discussed with Ernst & Young LLP, or EY, our independent registered public accounting firm, the matters required to be discussed by the Auditing Standards No.16, as adopted by the Public Company Accounting Oversight Board, and (3) received the written disclosures and the letter from EY concerning applicable requirements of the Public Company Accounting Oversight Board regarding EY s communications with the audit committee concerning independence, and has discussed with EY its independence. Based upon these discussions and reviews, the audit committee recommended to the board of directors that the audited financial statements be included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014, which is filed with the SEC.

Our audit committee is currently composed of the following three directors: Messrs. Pelzer (Chair), Dennerline and Swad. All are independent directors as defined in Rule 5605(a)(2) of the NASDAQ Stock Market listing rules and Section 10A(m)(3) of the Exchange Act. The board of directors has determined that Mr. Pelzer is an audit committee financial expert as such term is defined in Item 407(d) of Regulation S-K promulgated by the SEC. Our audit committee operates under a written charter adopted by the board, a copy of which is available under *Overview* in the *About Investor Relations Corporate Governance* section of our website at *www.benefitfocus.com.*

EY has served as our independent registered public accounting firm since 2007 and audited our consolidated financial statements for the years ended December 31, 2006 through December 31, 2014.

Summary of Fees

The audit committee has adopted a policy for the pre-approval of all audit and permitted non-audit services that may be performed by our independent registered public accounting firm. Under this policy, each year, at the time it engages an independent registered public accounting firm, the audit committee pre-approves the engagement terms and fees and may also pre-approve detailed types of audit-related and permitted tax services, subject to certain dollar limits, to be performed during the year. All other permitted non-audit services are required to be pre-approved by the audit committee on an engagement-by-engagement basis.

The following table summarizes the aggregate fees billed for professional services rendered to us by EY in 2013 and 2014. A description of these various fees and services follows the table.

	2013	2014
Audit Fees	$ 506,464	$ 928,245
Audit-Related Fees	1,370,529	263,346
Tax Fees		
All Other Fees		
Total	$ 1,876,993	$ 1,191,591

Audit Fees

The aggregate fees billed to us by EY in connection with the annual audit of our financial statements, for the review of our financial statements included in our Quarterly Report on Form 10-Q and Annual Report on Form 10-K and for other services normally provided in connection with statutory and regulatory filings, were $506,464 and $928,245 for the years ended December 31, 2013 and 2014, respectively. The increase in audit fees during 2014 relates primarily to additional audit fees incurred for the preparation of our financial statements and the related notes thereto included in our follow-on offering registration statement and in our Annual Report on Form 10-K and quarterly reviews of interim financial statements during our first full year as a public company.

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Audit-Related Fees

The aggregate audit-related fees billed to us by EY were $1,370,529 and $263,346 for the years ended December 31, 2013 and 2014, respectively. The decrease in audit fees during 2014 relates primarily to the additional fees related to our initial public offering, which occurred in 2013.

Tax Fees

No tax fees were billed to us by EY for the years ended December 31, 2013 and 2014.

All Other Fees

No other fees were billed to us by EY for the years ended December 31, 2013 and 2014.

THE AUDIT COMMITTEE OF

THE BOARD OF DIRECTORS

Francis J. Pelzer V (Chair)

Douglas A. Dennerline

Stephen M. Swad

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SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information regarding the beneficial ownership of our common stock as of April 17, 2015 unless otherwise noted below for the following:

- each person or entity known to own beneficially more than 5% of our outstanding common stock as of the date indicated in the corresponding footnote;
- each of the named executive officers named in the Summary Compensation table;
- each director; and
- all current directors and executive officers as a group.

Applicable percentage ownership is based on 28,574,010 shares of our common stock outstanding as of April 17, 2015, unless otherwise noted below, together with applicable options for each stockholder. Beneficial ownership is determined in accordance with the rules of the SEC, based on factors including voting and investment power with respect to shares. Common stock subject to options currently exercisable, or exercisable within 60 days after April 17, 2015, are deemed outstanding for the purpose of computing the percentage ownership of the person holding those options, but are not deemed outstanding for computing the percentage ownership of any other person. Unless otherwise indicated, the address for each listed stockholder is c/o Benefitfocus, Inc., 100 Benefitfocus Way, Charleston, South Carolina 29492.

Name and Address of Beneficial Owner	Shares Beneficially Owned	Percentage Beneficially Owned
Mason R. Holland, Jr.(1)	2,876,619	9.92%
Shawn A. Jenkins(2)	2,946,647	10.02%
Raymond A. August	80	*
Andrew L. Howell(3)	182,984	*
Douglas A. Dennerline(4)	4,489	*
Joseph P. DiSabato(5)	8,526,041	29.84%
Ann H. Lamont(6)	2,441,009	8.54%
A. Lanham Napier(4)	4,489	*
Francis J. Pelzer V(7)	35,378	*
Stephen M. Swad(8)	4,337	*
All directors and executive officers as a group (12 individuals)	17,295,807	57.36%
5% or Greater Stockholders:		
The Goldman Sachs Group, Inc.(5)	8,526,041	29.84%

BAMCO, Inc.(9)	3,435,622	12.02%
Marsh & McLennan Companies, Inc.(10)	3,398,339	11.66%
Oak Investment Partners XII, Limited Partnership(6)	2,441,009	8.54%

* Less than 1%.

(1) Consists of 2,451,921 shares held by the Holland Family Trust, five shares held by Mr. Holland as custodian for his minor son, 423,729 shares issuable upon the exercise of options exercisable on or before 60 days after April 17, 2015 and 964 shares held upon the vesting of restricted stock units on or before 60 days after April 17, 2015. Mr. Holland and his wife share voting and investment control over the shares held by the Holland Family Trust.

(2) Includes 847,458 shares issuable upon the exercise of options exercisable on or before 60 days after April 17, 2015 and 5,785 shares held upon the vesting of restricted stock units on or before 60 days after April 17, 2015.

(3) Includes 43,021 shares issuable upon the exercise of options exercisable on or before 60 days after April 17, 2015 and 2,589 shares held upon the vesting of restricted stock units on or before 60 days after April 17, 2015.

(4) Consists of 4,489 shares held upon the vesting of restricted stock units on or before 60 days after April 17, 2015.

(5) Based solely on a Schedule 13D filed with the SEC on March 6, 2015 by The Goldman Sachs Group, Inc. Consists of (i) 1,094,398 shares of common stock held directly by GS Capital Partners VI Parallel, L.P., (ii) 3,310,322 shares of common stock held directly by GS Capital Partners VI Offshore Fund, L.P., (iii) 3,979,876 shares of common stock held directly by GS Capital Partners VI Fund, L.P., and (iv) 141,445 shares of common stock held directly by GS Capital Partners VI GmbH & CO. KG, collectively the Goldman Funds . Affiliates of Goldman, Sachs & Co. and The Goldman Sachs Group, Inc. are the general partner, managing general partner, managing partner, managing member or member of each of the Goldman Funds. Goldman, Sachs & Co. is a direct and indirect wholly owned subsidiary of The Goldman Sachs Group, Inc. Goldman, Sachs & Co. is the investment manager of the Goldman Funds. Mr. DiSabato is a managing director of Goldman, Sachs & Co. The address of the Goldman Funds and Mr. DiSabato is 200 West Street, New York, New York 10282.

(6) Based solely on a Schedule 13D filed with the SEC on March 6, 2015 by Oak Investment Partners XII, Limited Partnership. Consists of 2,441,009 shares of common stock held directly by Oak Investment Partners XII, Limited Partnership. Ms. Lamont is a Managing Partner of Oak Investment Partners.

(7) Includes 26,041 shares issuable upon the exercise of options exercisable on or before 60 days after April 17, 2015 and 4,337 shares held upon the vesting of restricted stock units on or before 60 days after April 17, 2015.

(8) Consists of 4,337 shares held upon the vesting of restricted stock units on or before 60 days after April 17, 2015.

(9) Based solely on a Schedule 13G/A filed with the SEC on February 17, 2015 by BAMCO, Inc. (BAMCO). Consists of 3,435,622 shares of common stock held by BAMCO. Baron Capital Management, Inc. (BCM) and BAMCO are subsidiaries of Baron Capital Group, Inc. (BCG). Baron Growth Fund (BGF) is an advisory client of BAMCO. Ronald Baron owns a controlling interest in BCG. The address of BAMCO, BCM, BCG, BGF and Mr. Baron is 767 Fifth Avenue, 49^{th} Floor, New York, New York 10153.

(10) Based solely on a Schedule 13G filed with the SEC on March 6, 2015 by Marsh & McLennan Companies, Inc. Consists of 3,398,339 shares of common stock held directly by Marsh & McLennan Companies, Inc. (MMC). MMC directly owns all of the outstanding shares of capital stock of Mercer Consulting Group, Inc. (Mercer Consulting). Mercer Consulting, in turn, directly owns all of the outstanding equity interests of Mercer LLC (Mercer), and Mercer directly owns the shares of the Company. Each of MMC, Mercer Consulting and Mercer may therefore be deemed to have shared voting and dispositive power over such shares. Includes a warrant for the purchase of up to 580,813 shares of common stock of the Company issued to Mercer by the Company. The address of Marsh & McLennan Companies, Inc. is 1166 Avenue of the Americas, New York, New York 10036.

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SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our executive officers, directors, and persons who beneficially own more than 10% of a registered class of our common stock or other equity securities to file with the SEC certain reports of ownership and reports of changes in ownership of our securities. Executive officers, directors and stockholders who hold more than 10% of our outstanding common stock are required by the SEC to furnish us with copies of all required forms filed under Section 16(a). Based solely on a review of this information and written representations from these persons that no other reports were required, we believe that, during the prior fiscal year and through April 17, 2015, all of our executive officers, directors, and to our knowledge, 10% stockholders complied with the filing requirements of Section 16(a) of the Exchange Act.

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EXECUTIVE COMPENSATION

The following discussion and analysis of compensation arrangements of our named executive officers for 2014 should be read together with the compensation tables and related disclosures on our current plans, considerations, expectations and determinations regarding future compensation programs. Actual compensation programs that we may adopt in the future might differ materially from currently planned programs summarized in this discussion.

The discussion below includes a review of our compensation decisions with respect to 2014 for our named executive officers , including our principal executive officer and our two other most highly compensated executive officers. Our named executive officers for 2014 were:

- Shawn A. Jenkins, who serves as our Chief Executive Officer, or CEO, and is our principal executive officer;

- Raymond August, who serves as our President and Chief Operating Officer; and

- Andrew L. Howell, who serves as our Chief Commercial Officer.

Key Elements of Our Compensation Program for 2014

In 2014, we compensated our named executive officers through a combination of base salary, annual cash bonus payments, and long-term equity incentives in the form of restricted stock units. In the past, we have granted our executive officers options. Our executive officers are also eligible for our standard benefits programs, which include:

- health, vision and dental insurance;

- life insurance;

- short- and long-term disability insurance;

- health savings account contributions; and

- a 401(k) plan with a defined matching of contributions.

We do not use specific formulas or weightings in determining the allocation of the various compensation elements. Instead, the compensation for each of our named executive officers has been designed to provide a combination of fixed and at-risk compensation that is tied to the achievement of our short- and long-term objectives. We believe that this approach achieves the primary objectives of our compensation program.

Management Incentive Bonus Programs

In June 2014, our stockholders approved the Benefitfocus, Inc. Management Incentive Bonus Program, which is designed to provide a long-term framework for performance-based bonus plans going forward, continue to reward high level executives of our Company based on their responsibilities and for their contributions to the successful achievement of certain corporate goals and objectives, and to share the success and risks of our Company based upon the achievement of business goals. This program also permits bonus awards for 2015 and onwards to be structured to qualify as performance-based compensation under Section 162(m) of the Internal Revenue Code of 1986, as amended.

Our named executive officers and other members of our management team participate in our management incentive bonus programs. The foundation of grants made under these programs is the achievement by our Company of consolidated revenues. In 2014, the bonus earned pursuant to the bonus program then in place was a function of a percentage of bonus earned, or PBE, based on achieving annual revenue targets, the executive s annual base salary, and a designated bonus target percent, or BTP. The annual bonus is determined by multiplying the annual base compensation by the designated BTP, multiplied by the PBE. In 2014, Messrs. Jenkins, August and Howell earned bonuses under the 2014 bonus program of $531,993, $326,092 and $198,491, respectively, based on achieving our annual revenue target, and BTPs of 100%, 100% and 50%, respectively.

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Summary Compensation Table

The following table sets forth summary compensation information for our named executive officers for the fiscal years ended December 31, 2014, 2013 and 2012.

Name and principal position	Year	Salary ($)(1)	Stock awards ($)(2)	Option awards ($)(3)	Non-equity incentive plan compensation($)	All other compensation ($)	Total ($)
Shawn A. Jenkins	2014	$ 561,723	$ 1,688,379	$	$ 531,993	$ 15,991[4]	$ 2,798,086
CEO	2013	536,038			375,227	13,013[5]	924,278
	2012	510,513			357,359	13,061[6]	880,933
Raymond August(7)	2014	181,345	4,574,500		326,092	2,058[8]	5,083,995
President and Chief Operating	2013						
Officer	2012						
Andrew L. Howell(9)	2014	415,000	1,386,756		198,491	15,354[10]	2,015,601
Chief Commercial Officer	2013	400,000		436,917	140,000	13,556[11]	990,473
	2012	318,253		153,788	112,731	13,129[12]	597,901

(1) Reflects base salary earned during the fiscal year covered.

(2) Represents the aggregate grant date fair value of awards of restricted stock units computed in accordance with FASB ASC Topic 718. These values have been determined based on the assumptions set forth in Note 10 to our consolidated financial statements included in our Annual Report on Form 10-K and exclude the estimated effect of forfeitures.

(3) Represents the aggregate grant date fair value of the option awards computed in accordance with FASB ASC Topic 718. These values have been determined based on the assumptions set forth in Note 10 to our consolidated financial statements included in our Annual Report on Form 10-K and exclude the estimated effect of forfeitures.

(4) Includes $6,411 in medical insurance premiums, $98 in life insurance premiums, $354 in disability insurance premiums, $1,200 in health savings account contributions, $128 in athletic club membership contributions, and $7,800 in 401(k) plan matching contributions.

(5) Includes $4,443 in medical insurance premiums, $102 in life insurance premiums, $338 in disability insurance premiums, $480 in health savings account contributions, and $7,650 in 401(k) plan matching contributions.

(6) Includes $4,737 in medical insurance premiums, $99 in life insurance premiums, $365 in disability insurance premiums, $360 in health savings account contributions, and $7,500 in 401(k) plan matching contributions.

(7) Mr. August assumed the role of Chief Operating Officer on August 11, 2014 and his annual salary in 2014 was prorated from that date. The Company announced on April 8, 2015 that Mr. August was promoted to President and Chief Operating Officer.

(8) Includes $1,880 in medical insurance premiums, $34 in life insurance premiums, and $144 in disability insurance premiums.

(9) Mr. Howell served as our Chief Operating Officer until August 11, 2014 and then assumed the role of Chief Commercial Officer.

(10) Includes $5,912 in medical insurance premiums, $98 in life insurance premiums, $344 in disability insurance premiums, $1,200 in health savings account contributions, and $7,800 in 401(k) plan matching contributions.

(11) Includes $4,986 in medical insurance premiums, $102 in life insurance premiums, $338 in disability insurance premiums, $480 in health savings account contributions, and $7,650 in 401(k) plan matching contributions.

(12) Includes $4,805 in medical insurance premiums, $99 in life insurance premiums, $365 in disability insurance premiums, $360 in health savings account contributions, and $7,500 in 401(k) plan matching contributions.

Employment Agreements

We have entered into employment agreements with Messrs. Jenkins, Holland, Howell, and August. The compensation committee of our board of directors engaged Mercer Health & Benefits, LLC as its compensation consultant in 2014, to, among other things, continue its review and analysis of our compensation program, including our executives employment agreements. We paid Mercer Health & Benefits, LLC $216,155 in fees to conduct its review.

Employment Agreements with Shawn Jenkins and Mason Holland

In January 2007, we entered into employment agreements with Shawn Jenkins, our Chief Executive Officer, and Mason Holland, our Executive Chairman, which set forth the terms and conditions of their employment. Pursuant to the agreements, we granted Mr. Jenkins and Mr. Holland, each of whom we refer to as an Executive, options to acquire 847,458 shares of our common stock and 423,729 shares of our common stock, respectively. Each agreement continues for terms of three years, which will be extended automatically each day, for an additional day, so that the remaining term continues to be three years in length. Either we or the Executive may at any time fix the term to a finite term of three years. Under the terms of each agreement, we must pay Messrs. Jenkins and Holland salaries at rates of not less than $400,000 and $200,000 per year, respectively. The board will review each Executive s salary at least annually and must increase each Executive s salary by at least 5% per year. Any increase in excess of 5% in any given year must be approved by the board members designated by GS Capital Partners VI Parallel, L.P., or the Goldman Board Designee, currently Joe DiSabato. We may not decrease either Executive s base salary under these agreements.

Each Executive is eligible to participate in any management incentive programs we establish, and each Executive may receive incentive compensation based upon achievement of targeted levels of performance and other criteria established by the board or compensation committee (which in each case requires the approval of at least one of the Goldman Board Designees). In the event we achieve the annual financial targets approved by the board (which approval must include at least one Goldman Board Designee), each of Messrs. Jenkins and Holland will be entitled to an annual bonus in an amount at least equal to his then-current base salary. If we exceed our financial targets by 10% for the year, Mr. Jenkins will earn an additional bonus amount equal to 50% of his then-current base salary.

If we terminate an Executive s employment due to his death or disability, we must pay to him, or his estate, his accrued compensation and, in the case of Mr. Jenkins, an amount equal to the average of the annual bonuses paid or payable to him during the three full fiscal years preceding the date of termination, pro-rated for the number of days the Executive was employed in the fiscal year in which his employment was terminated, which amount we refer to as the Prorated Bonus Amount. If we terminate an Executive s employment for cause (as defined below) or an Executive resigns for any reason other than adequate justification, we must pay such Executive all accrued compensation.

If an Executive resigns for adequate justification (as defined below), or if we terminate an Executive s employment for any reason other than (i) due to his death or disability, or (ii) for cause, including in connection with a change in control of our Company, we must pay such Executive his accrued compensation and a pro rata share of his annual bonus, if such bonus is awarded. Additionally, we must pay such Executive each month, for a period of 36 months, one-twelfth (1/12) of the sum of, (i) his then-current base salary, and (ii) a pro rata share of his annual bonus, if such bonus is awarded. Furthermore, we must continue providing life insurance, disability, medical, dental, and hospitalization benefits to the Executive (which amount will be reduced to the extent the Executive receives these benefits from a subsequent employer). Finally, the restrictions on any outstanding incentive awards held by the Executive, including stock options, will lapse and such awards will become fully vested and immediately exercisable.

Under each agreement, adequate justification is defined as: (a) an uncured material failure of the Company to comply with the agreement; (b) any non-voluntary, Company-imposed relocation of the Executive outside Charleston, South Carolina; (c) a change in control of our Company that results in a material diminution in the Executive s responsibilities; or (d) the removal of the Executive, in the case of Mr. Jenkins, from the position of Chief Executive Officer or, in the case of Mr. Holland, from the position of Chairman of our board of directors, in each case except as otherwise provided in the respective agreement. Under each agreement, termination for cause is defined as: (i) a conviction of the Executive of, or entering a plea of no contest by the Executive with respect to, having committed a felony; (ii) abuse of controlled substances or alcohol, or acts of dishonesty or moral turpitude by the Executive that are detrimental to the Company; (iii) acts or omissions by the Executive that he knew, or should reasonably have known, would substantially damage the business of the Company; (iv) negligence by the Executive in the performance of, or disregard by the Executive of, his obligations under the agreement or otherwise relating to his employment, or a breach by the Executive of the agreement, which negligence, disregard or breach continues uncured after receiving notice from the Company; or (v) failure by the Executive to obey the reasonable and lawful orders and policies of the board that are consistent with the provisions of the agreement.

In the event the Executive, during the 24 months following the termination of his employment, becomes employed by a company that engages, in whole or part, in the same or substantially the same business as ours, the Executive will forfeit any remaining severance payments.

Employment Agreement with Raymond August

In July 2014, we entered into an employment agreement with Raymond August. Under the agreement, we agreed to pay Mr. August a base salary of $460,000 per year for 2014. Annual compensation reviews and adjustments to Mr. August s compensation will occur on or around the time we perform our annual budget process. We also agreed to pay Mr. August a bonus amount of up to 100% of his then-current base pay, subject to adjustment, upon achievement of the Company s annual targets. Pursuant to the agreement, we granted Mr. August 175,000 restricted stock units in 2014 with a five-year vesting period beginning on October 1, 2015, subject to continued employment.

In the event we terminate Mr. August s employment without cause at any time prior to a change in control, we will provide Mr. August: (i) severance payments at a rate equal to his base salary then in effect for a period of 12 months following his termination date, (ii) a portion of his targeted annual bonus, and (iii) an insurance premium in an amount equal to that which was paid on his behalf prior to the termination of his employment.

In the event we or our acquirer terminates Mr. August s employment without cause at the time of, or within 12 months following, a change in control of our Company, we or our acquirer will provide Mr. August: (i) severance payments at a rate equal to his base salary then in effect for a period of 12 months following his termination date, (ii) a portion of his targeted annual bonus, (iii) immediate acceleration of outstanding restricted stock units granted to him in 2014, and (iv) specified insurance premiums during the period he receives severance payments. If he resigns due to a decrease in his base salary or targeted annual bonus, a change in his position with the Company, or a change in his duties and responsibilities to the Company, and provided he resigns within three months of the occurrence of, and without having consented to, such event, Mr. August will be entitled to receive the same severance benefits he would have been eligible to receive were his employment terminated by us without cause.

If we terminate Mr. August s employment with or without cause, after completion of any period during which his eligibility for a bonus is to be determined, or a Bonus Period, but prior to the date when such bonus is

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to be paid, Mr. August will be entitled to receive such bonus at the time it would have been paid but for the termination of his employment. If we terminate Mr. August s employment without cause prior to the completion of a Bonus Period, he will be entitled to receive a portion of the bonus at the time it would have been paid but for the termination of his employment, prorated for the portion of the Bonus Period that he was employed by the Company.

Under the employment agreement, cause is defined as any determination by our board of any of the following: (i) Mr. August s violation of any applicable material law or regulation respecting the business of the Company, (ii) Mr. August s commission of a felony or a crime involving moral turpitude, (iii) any act of dishonesty, fraud or misrepresentation in relation to his duties to the Company, (iv) Mr. August s uncured failure to perform in any material respect his duties under the agreement, (v) Mr. August s failure to attempt in good faith to implement a clear and reasonable directive from our board or to comply with any of our policies and procedures which failure is material and occurs after written notice from our board, (vi) any act of gross misconduct that is materially and demonstrably injurious to the Company, or (vii) Mr. August s breach of his fiduciary responsibility.

Employment Agreement with Andy Howell

In March 2007, we entered into an employment agreement with Andy Howell, our Chief Commercial Officer. Under the agreement, we originally agreed to pay Mr. Howell a base salary of $225,000 for his service as our Senior Vice President and General Counsel. Mr. Howell has served as our Chief Commercial Officer since August 2014, and his base salary for 2014 was $415,000. Annual compensation reviews and adjustments to Mr. Howell s compensation will occur on or around the time we perform our annual budget process. Mr. Howell is eligible to participate in our bonus plans. The amount of his potential bonus, and the formula we use to calculate that amount, are both subject to modification by us to match our future goals and objectives. In connection with his employment agreement, we granted Mr. Howell an option to purchase 78,606 shares of our common stock.

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Outstanding Equity Awards as of December 31, 2014

The following table lists the outstanding equity awards held by our named executive officers as of December 31, 2014:

	Option awards					Stock awards	
Name	**Vesting commencement date**	**Number of securities underlying unexercised options exercisable(#)**	**Number of securities underlying unexercised options unexercisable(#)**	**Option exercise price ($)**	**Option expiration date**	**Number of shares or units of stock that have not vested (#)**	**Market value of shares or units of stock that have not vested ($)**
Shawn A. Jenkins	2/21/2007	847,458[(1)]		$ 7.09	2/20/2017		
CEO						35,248[(2)]	1,157,544
Raymond August *President and Chief Operating Officer*						175,000[(3)]	5,747,000
Andrew L. Howell	7/1/2009	3,098[(1)]		3.80	6/30/2019		
Chief Commercial Officer	7/1/2010	17,871[(1)]		5.38	6/30/2020		
	10/1/2012	8,000[(4)]	14,667	10.30	9/30/2022		
	5/8/2013	12,190[(5)]	39,271	13.53	5/7/2023		
						15,783[(6)]	518,314
						25,000[(7)]	821,000

(1) This option is fully vested.

(2) The shares subject to this grant of restricted stock units vest in four equal annual installments beginning on April 1, 2015, subject to continued employment.

(3) The shares subject to this grant of restricted stock units vest in five equal annual installments beginning on October 1, 2015, subject to continued employment.

(4) This option was granted on October 1, 2012 and vests over a four-year period with one-fourth (1/4) of the option granted vesting on October 1, 2013, the first anniversary of the vesting commencement date, and the balance of the option granted vesting ratably on a monthly basis over the following 36 months.

(5) This option was granted on May 8, 2013 and vests over a four-year period with one-fourth (1/4) of the option granted vesting on May 8, 2014, the first anniversary of the vesting commencement date, and the balance of the option granted vesting ratably on a monthly basis over the following 36 months.

(6) The shares subject to this restricted stock unit vest in four equal annual installments beginning on April 1, 2015, subject to continued employment.

(7) The shares subject to this grant of restricted stock units vest in four equal annual installments beginning on October 1, 2015, subject to continued employment.

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CERTAIN RELATIONSHIPS AND RELATED-PARTY TRANSACTIONS

The following is a summary of each transaction or series of similar transactions since January 1, 2014, to which we were or are a party in which:

- the amount involved exceeded or exceeds $120,000; and
- any of our directors or executive officers, any holder of 5% of our capital stock or any member of their immediate family had or will have a direct or indirect material interest.

Landlord Daniel Island Executive Center, LLC and DIEC II, LLC

We lease real property from Daniel Island Executive Center, LLC for use as our corporate headquarters in Charleston, South Carolina pursuant to two lease agreements. Each lease agreement has a term of 15 years, with an aggregate of $42.0 million of lease payments due over the remainder of the terms as of December 31, 2014. We made payments related to these agreements in the amount of $4.7 million for the year ended December 31, 2014, for leasing property from Daniel Island Executive Center, LLC.

Pursuant to a lease agreement with DIEC II, LLC, we have extended our campus in Charleston, South Carolina with a Customer Success Center and, at our option and under the new leases, can have either a four-story office building and/or a two-story welcome center built. The lease agreement for the Customer Success Center runs for 15 years, with an aggregate $81.5 million of lease payments due over the remainder of the term as of December 31, 2014. We made payments related to this agreement in the amount of $0.9 million for the year ended December 31, 2014, for leasehold improvements related to our lease with DIEC II, LLC.

Daniel Island Executive Center, LLC and DIEC II, LLC are South Carolina limited liability companies. The Holland Family Trust, with which Mason Holland (our Executive Chairman of the board and a significant stockholder) is affiliated, owns a supermajority interest in Daniel Island Executive Center. The Shawn Arthur Jenkins Living Trust, with which Shawn Jenkins (our CEO) is affiliated, owns the remaining minority interest in Daniel Island Executive Center. The Holland Family Trust and Shawn Arthur Jenkins Living Trust own DIEC II equally.

North American Jet Charter Group LLC

Mason Holland, our Executive Chairman of the board of directors and a significant stockholder, is the supermajority owner of North American Jet Charter Group LLC, which periodically provides jet chartering services to us. For the year ended December 31, 2014, we incurred costs of $0.4 million chartering jets from North American Jet Charter Group.

Indemnification Agreements

Our certificate of incorporation and our bylaws provide that we shall indemnify our directors and officers to the fullest extent permitted by law. In addition, as permitted by the laws of the State of Delaware, we have entered into indemnification agreements with each of our directors. Under the terms of our indemnification agreements, we are required to indemnify each of our directors, to the fullest extent permitted by the laws of the State of Delaware, if the indemnitee acted in good faith and in a manner the indemnitee reasonably believed to be in or not opposed to the best interests of our Company, and with respect to any criminal proceeding, had no reasonable cause to believe the indemnitee s conduct was unlawful. We must indemnify our officers and directors against any and all (a) costs and expenses (including attorneys and experts fees, expenses and charges) actually and reasonably paid or incurred in connection with investigating, defending, being a witness in or participating in, or preparing to investigate, defend, be a witness in or participate in, and (b) judgments, fines, penalties and amounts paid in settlement in connection with, in the case of either (a) or (b), any threatened, pending or completed action, suit, arbitration, alternate dispute resolution mechanism, investigation, inquiry, administrative hearing or any other actual, threatened or completed proceeding, by reason of the fact that (x) such

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person is or was a director or officer, employee, agent or fiduciary of our Company or (y) such person is or was serving at our request as a director, officer, employee or agent or fiduciary of another corporation, partnership, joint venture, trust, employee benefits plan or other enterprise. The indemnification agreements will also require us, if so requested, to advance within 30 days of such request any and all costs and expenses that such director or officer incurred, provided that such person will return any such advance if it is ultimately determined that such person is not entitled to be indemnified for such costs and expenses. Our bylaws also require that such person return any such advance if it is ultimately determined that such person is not entitled to indemnification by us as authorized by the laws of the State of Delaware.

We are not required to provide indemnification under our indemnification agreements for certain matters, including: (1) indemnification in connection with certain proceedings or claims initiated or brought voluntarily by the indemnitee; (2) indemnification related to disgorgement of profits made from the purchase or sale of securities of our Company under Section 16(b) of the Exchange Act, or similar provisions of state statutory or common law; (3) indemnification that is finally determined, under the procedures and subject to the presumptions set forth in the indemnification agreements, to be unlawful; or (4) indemnification for liabilities for which the director has received payment under any insurance policy for such person s benefit, our certificate of incorporation or bylaws or any other contract or otherwise, except with respect to any excess amount beyond the amount so received by such director or officer. The indemnification agreements will require us, to the extent that we maintain an insurance policy or policies providing liability insurance for directors, officers, employees, agents or fiduciaries of our Company or of any other corporation, partnership, joint venture, trust, employee benefits plan or other enterprise that such person serves at the request of our Company, to cover such person by such policy or policies to the maximum extent available.

Employment Agreements

We have entered into employment agreements with certain of our executive officers that provide for salary, bonus and severance compensation. For more information regarding these employment agreements, see Executive Compensation Employment Agreements .

Equity Issued to Executive Officers and Directors

We have granted restricted stock units to our executive officers and directors in 2014, as more fully described in Executive Compensation Outstanding Equity Awards as of December 31, 2014 and Management Director Compensation .

Subsidiary of The Goldman Sachs Group

Due to the size of its voting and economic interest in our Company, we are deemed to be controlled by The Goldman Sachs Group and are therefore considered to be a subsidiary of The Goldman Sachs Group under the Bank Holding Company Act (the BHC Act). The BHC Act imposes regulations and requirements on The Goldman Sachs Group and on any company that is deemed to be controlled by The Goldman Sachs Group under the BHC Act and the regulations of the Board of Governors of the Federal Reserve System, or the Federal Reserve. We will remain subject to this regulatory regime until The Goldman Sachs Group is no longer deemed to control us for purposes of the BHC Act.

As a controlled subsidiary of The Goldman Sachs Group, we are restricted from engaging in activities that are not permissible under the BHC Act, or the rules and regulations promulgated thereunder. Additionally, we are subject to examination by the Federal Reserve and required to provide information and reports for use by the Federal Reserve under the BHC Act. We may also be subject to regulatory oversight and examination because we are a technology service provider to regulated financial institutions. We have agreed to certain covenants primarily for the benefit of

The Goldman Sachs Group that are intended to facilitate its compliance with the BHC Act, but that may impose certain obligations on our Company, as further described below.

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Corporate Governance

In connection with our IPO, we entered into the Voting Agreement. Under this agreement, each Key Holder agrees to vote his, her, or its shares in favor of:

two individuals nominated by GS Capital Partners VI Parallel, L.P. (currently Mr. DiSabato only) for as long as The Goldman Sachs Group and its affiliates hold 10% or more of the fully diluted equity interest in our Company;

one individual nominated by Oak Investment Partners (currently Ms. Lamont) for as long as Oak Investment Partners holds 5% or more of the fully diluted equity interest in our Company; and

for each of Messrs. Holland and Jenkins for as long as each holds shares equal to or in excess of 50% of the number of shares each beneficially held upon entering into this agreement.

Additionally, each Key Holder agrees not to vote for the removal of the foregoing directors unless such removal is directed or approved by the party that nominated such director. This agreement also provides that, so long as a nominee of The Goldman Sachs Group or its affiliate serves as one of our directors and to the extent permitted by the NASDAQ Stock Market listing rules, that director has a right to serve on our nominating and corporate governance and compensation committees. This right will terminate when (i) we cease to be a controlled company under the NASDAQ Stock Market listing rules or (ii) an affiliate of The Goldman Sachs Group ceases to be, either alone or as part of a group, a stockholder of ours whose beneficial ownership of our voting stock results in us being a controlled company , whichever event occurs first. The agreement will terminate in September 2018, and will terminate as to any party at such time as such party no longer has a right to nominate a director pursuant to the agreement.

In connection with our IPO, we also entered into a Second Amended and Restated Investors Rights Agreement (the Investor Rights Agreement) with the Key Holders. On February 24, 2015, in connection with an equity investment by Mercer LLC in our Company, as more fully described below, we amended the Investor Rights Agreement to, among other things, add Mercer as a Key Holder under the Investor Rights Agreement only. Pursuant to the Investor Rights Agreement, as amended, the Key Holders have the right, subject to various conditions and limitations, to include their shares in registration statements relating to our securities. The holders of at least 66⅔%, of the then outstanding shares subject to these registration rights have the right to demand that we register such shares under the Securities Act of 1933, as amended, or Securities Act, with respect to shares having an aggregate offering price of at least $5,000,000, and subject to other limitations. In addition, these holders are entitled to piggyback registration rights with respect to the registration under the Securities Act of shares of common stock. In the event that we propose to register any shares of common stock under the Securities Act either for our account or for the account of other security holders, the holders of shares having piggyback registration rights are entitled to receive notice of such registration and to include shares in any such registration, subject to limitations. Further, at any time after we become eligible to file a registration statement on Form S-3, the holders of at least 5% of the shares subject to these registration rights may require us to file registration statements under the Securities Act on Form S-3 with respect to shares of common stock having an aggregate offering price, net of selling expenses, of at least $5,000,000. To the extent that we qualify as a well-known seasoned issuer, or WKSI, at the time a requisite number of holders demand the registration of shares subject to these registration rights, we will file an automatic shelf registration statement covering the shares for which registration is demanded if so requested by the holders of such shares. These registration rights are subject to conditions and limitations, among them the right of the underwriters of an offering to limit the number of shares of common stock held by such security holders to be included in such registration.

Additionally, because of The Goldman Sachs Group s status as a bank holding company under the BHC Act, we are subject to certain covenants in the Investor Rights Agreement, as amended, for the benefit of The Goldman Sachs Group (and in certain instances Mercer) that are intended to facilitate compliance with the BHC Act. These covenants address the right to conduct audits on, and access certain information of, our Company; the right to review the policies and procedures that we implement to comply with the laws and regulations that relate to our activities; notice rights of certain events and business activities and the obligation to cooperate to mitigate potential adverse consequences resulting therefrom. These covenants will remain in effect as long as the Federal Reserve deems us to be a subsidiary of The Goldman Sachs Group under the BHC Act.

Mercer LLC Investment

On February 24, 2015, we entered into a Securities Purchase Agreement with Mercer, a wholly owned subsidiary of Marsh & McLennan Companies, Inc., a Delaware corporation (the Investor). Pursuant to the Securities Purchase Agreement, we sold and issued to the Investor 2,817,526 shares of our common stock for $26.50 per share or an aggregate of $74,664,439. At the same time, we also issued Mercer a warrant (the Warrant) to purchase an additional 580,813 shares of our common stock for $26.50 per share at any time during the 30-month term of the Warrant. The Securities Purchase Agreement provides as follows:

Board Observer Right. Until the earlier of (i) the expiration or termination of the Alliance Agreement (as defined below) and (ii) the first date on which the Investor and its affiliates own less than (A) 75% of the shares of the Company s common stock acquired on February 24, 2015 or (B) 5% of the Company s common stock outstanding, in each case in this clause (ii), for a period of at least 45 consecutive days (the Termination Date), the Investor is entitled to designate an observer as outlined in the Securities Purchase Agreement, to attend all meetings of our board of directors and its committees, subject to certain exceptions.

Standstill. Until the Termination Date and subject to certain exceptions as set forth in the Securities Purchase Agreement, the Investor and its affiliates are restricted from, among other things, acquiring additional shares of our common stock such that they beneficially own more than 17.5% of our common stock outstanding and any shares issuable pursuant to the Warrant without consent of our board of directors, proposing to enter into, directly or indirectly, any merger or business combination involving our company, taking certain actions to seek control of our management, board of directors or policies, soliciting proxies with respect to our common stock, or joining a group for the purpose of acquiring, holding, voting or disposing of our common stock. These standstill restrictions immediately terminate in circumstances including, but not limited to, any public third-party proposal or announcement relating to a merger or business combination with our company or certain third parties acquiring shares representing 15% or more of our common stock outstanding.

Lockup. Until the earlier of the Termination Date or December 31, 2017, the Investor will not sell, transfer or otherwise dispose of, directly or indirectly, any shares of our common stock or enter into any swap or other arrangement that transfers to another person any of the economic consequences of ownership thereof, except: to our Company; in response to a tender or exchange offer for our common stock; as part of a merger or other transaction in which all outstanding shares of our common stock are converted into or exchanged for other consideration and is approved by our stockholders; transfers to affiliates of the Investor in accordance with the Securities Purchase Agreement; or with approval of our board of directors.

Right of Notice. Until the Termination Date, in the event that our board of directors initiates or participates in a process with respect to a transaction that would result in a sale of substantially all the assets of our Company or would result in a change of control of our Company, the Investor is entitled to notice of such process and to participate in such process on terms at least as favorable as the most favorable terms offered to any third party participating therein.

In addition, for the same period, we have agreed not to enter into any agreement providing for a change of control, unless we notify the Investor in writing at least five business days before taking such action, and consider in good faith any offer or proposal made by the Investor within such period.

Right of First Offer. We have granted the Investor a right of first offer with respect to certain new issuances of our equity securities, as have our majority stockholder and other large stockholders with respect to sales of their shares of our common stock pursuant to a Right of First Offer Agreement. In general, we and the applicable stockholders are required to offer the Investor the right to purchase any shares of our common stock or other equity securities of our company that we or such stockholders propose to issue or sell, at a price we or the stockholders, as applicable, specify, and if the Investor declines to purchase such shares or other securities at such price, we or the stockholders may issue or sell such securities to one or more third parties at a price no less than the price offered to the Investor. These rights of first offer are subject to the limitation on acquisitions of additional shares of common stock by the Investor under the standstill restrictions described above, and are also subject to certain other exceptions, including only applying to 50% of shares or other securities proposed to be sold by any stockholder in a registered offering or certain other similar forms of sales. These rights of first offer will remain in effect until the Termination Date, subject to certain exceptions.

In connection with the Securities Purchase Agreement, we entered into an amendment of the Mercer Exchange Software as a Service Agreement (the Alliance Agreement), with Mercer Health & Benefits LLC, an affiliate of the Investor (Mercer Health). The amendment to the Alliance Agreement, among other things, expands certain terms and conditions of the existing relationship between our Company and Mercer Health.

Procedures for Approval of Related-Party Transactions

Our audit committee, pursuant to its written charter, is responsible for reviewing and approving or ratifying any related-party transaction reaching a certain threshold of significance. In the course of its review and approval or ratification of a related-party transaction, the committee, among other things, considers, consistent with Item 404 of Regulation S-K, the following:

- the nature and amount of the related person s interest in the transaction;
- the material terms of the transaction, including, without limitation, the amount and type of transaction; and
- any other matters the audit committee deems appropriate.

Any member of the audit committee who is a related person with respect to a transaction under review will not be permitted to participate in the deliberations or vote respecting approval or ratification of the transaction. However, such director may be counted in determining the presence of a quorum at a meeting of the committee that considers the transaction.

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COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

Our compensation committee consists of Messrs. Swad (Chair), Dennerline, Napier and Pelzer, and Ms. Lamont. None of our executive officers serves as a member of the board of directors or compensation committee (or other committee performing equivalent functions) of another entity that has one or more executive officers serving on our board of directors or compensation committee. No interlocking relationship exists between any member of the board of directors or any member of the compensation committee (or other committee performing equivalent functions) of any other company.

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STOCKHOLDER PROPOSALS

Stockholders may present proposals for action at meetings of stockholders only if they comply with the proxy rules established by the SEC, applicable Delaware law and our bylaws. We have not received any stockholder proposals for consideration at our 2015 Annual Meeting of Stockholders.

Under SEC Rule 14a-8, in order for a stockholder proposal to be included in our proxy solicitation materials for the 2016 Annual Meeting of Stockholders, it must be delivered to our principal executive offices located at 100 Benefitfocus Way, Charleston, South Carolina 29492 by January 1, 2016; provided, however, that if the date of the 2016 annual meeting is more than 30 days before or 60 days after June 12, 2016, notice by the stockholder must be delivered not later than the close of business no earlier than the 120th day prior to the 2016 annual meeting or the later of (1) the 90th day prior to the 2016 annual meeting or (2) the 10th day following the first public announcement of the date of the 2016 annual meeting.

Our bylaws permit any stockholder of record to nominate directors. Stockholders wishing to nominate a director must deliver written notice of the nomination either by personal delivery or by U.S. certified mail, postage prepaid, to the Corporate Secretary (i) with respect to an election to be held at an annual meeting of stockholders, not more than 90 and not less than 60 days before the meeting at which directors are to be elected, and (ii) with respect to an election to be held at a special meeting of stockholders called for the purpose of the election of directors, not later than the close of business on the 10th business day following the date on which notice of such meeting is first given to stockholders. Stockholder notices must set forth the specific information as more fully described in our bylaws and in Corporate Governance Selection of Nominees for the Board of Directors .

Management s proxy holders for the next annual meeting of stockholders will have discretion to vote proxies given to them on any stockholder proposal of which our Company does not have notice prior to March 16, 2016.

HOUSEHOLDING MATTERS

The SEC has adopted rules that permit companies to deliver a single Notice of Internet Availability or a single copy of proxy materials to multiple stockholders sharing an address unless a company has received contrary instructions from one or more of the stockholders at that address. This means that only one copy of the Annual Report, this Proxy Statement and Notice may have been sent to multiple stockholders in your household. If you would prefer to receive separate copies of the Notice of Internet Availability and/or Proxy Statement either now or in the future, please contact our Corporate Secretary either by calling 1-843-849-7476 or by mailing a request to Attn: Corporate Secretary, 100 Benefitfocus Way, Charleston, South Carolina 29492. Upon written or oral request to the Corporate Secretary, the Company will provide a separate copy of the Annual Report and this Proxy Statement and Notice. In addition, stockholders at a shared address who receive multiple Notices of Internet Availability or multiple copies of proxy statements may request to receive a single Notice of Internet Availability or a single copy of proxy statements in the future in the same manner as described above.

ANNUAL REPORT ON FORM 10-K

Our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 as filed with the SEC is accessible free of charge on our website at *www.benefitfocus.com* under *About Investor Relations Financial Information Annual Meeting Materials* . The Annual Report on Form 10-K contains audited consolidated balance sheets of our Company as of December 31, 2014, 2013, and 2012, and the related consolidated statements of operations and comprehensive loss, changes in stockholders equity (deficit) and cash flows for each of the three years in the period ended December 31, 2014. **You can request a copy of our Annual Report on Form 10-K free of charge by calling**

1-843-849-7476 or sending an e-mail to ir@benefitfocus.com. Please include your contact information with the request.

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OTHER MATTERS

The audit committee of our board of directors has selected the independent registered public accounting firm of Ernst & Young LLP, or EY, to audit our consolidated financial statements for the fiscal year ending December 31, 2015. EY has audited our financial statements annually since 2006. A representative of EY is expected to be present at the 2015 Annual Meeting of Stockholders with the opportunity to make a statement if they desire to do so and to respond to appropriate questions. EY has advised us that it does not have, and has not had, any direct or indirect financial interest in our Company or its subsidiaries in any capacity. Notwithstanding the selection of EY, our audit committee, in its discretion, may appoint a different independent registered public accounting firm at any time, if it believes doing so would be in the best interests of our Company and our stockholders.

Other than those matters set forth in this Proxy Statement, we do not know of any additional matters to be submitted at the meeting. If any other matters properly come before the annual meeting, it is the intention of the persons named in the enclosed form of proxy to vote the shares they represent as the board of directors recommends.

THE BOARD OF DIRECTORS

Dated: April 30, 2015

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DIRECTIONS TO THE ANNUAL MEETING

Benefitfocus, Inc.

100 Benefitfocus Way

Charleston, South Carolina 29492

From the Airport

Follow the signs out of the airport to I-526 East. Follow I-526 East to Exit 24 (Daniel Island). Take your first right onto Fairchild Street. Take your first left onto Benefitfocus Way. Once you turn left onto Benefitfocus Way, you will pass the Benefitfocus Design & Engineering Building on your right and continue straight to reach our principal executive offices at 100 Benefitfocus Way.

From Downtown Charleston

Go north on Meeting Street toward I-26. Follow the road under the overpass and bear left onto I-26 West. Take I-26 West to I-526 East. Continue on I-526 East and take Exit 24 (Daniel Island). Take your first right onto Fairchild Street. Take your first left onto Benefitfocus Way. Once you turn left onto Benefitfocus Way, you will pass the Benefitfocus Design & Engineering Building on your right and continue straight to reach our principal executive offices at 100 Benefitfocus Way.

From South of Charleston

Take Highway 17 North to Charleston. When entering Charleston city limits, watch for sign: North Charleston 526E Right Lane. Stay in the right lane and continue on I-526 East. Follow I-526 East and take Exit 24 (Daniel Island). Take your first right onto Fairchild Street. Take your first left onto Benefitfocus Way. Once you turn left onto Benefitfocus Way, you will pass the Benefitfocus Design & Engineering Building on your right and continue straight to reach our principal executive offices at 100 Benefitfocus Way.

From North of Charleston

Take Highway 17 South to Charleston. Turn right onto I-526 West. Take Exit 24 (Daniel Island). Turn right onto Island Park Drive. Turn Right onto River Landing Drive. Take your first left onto Fairchild Street. Take your first left onto Benefitfocus Way. Once you turn left onto Benefitfocus Way, you will pass the Benefitfocus Design & Engineering Building on your right and continue straight to reach our principal executive offices at 100 Benefitfocus Way.

From West of Charleston

Take I-26 East to Charleston. Exit onto I-526 East. Continue on I-526 East to Exit 24 (Daniel Island). Take your first left onto Fairchild Street. Take your first left onto Benefitfocus Way. Once you turn left onto Benefitfocus Way, you will pass the Benefitfocus Design & Engineering Building on your right and continue straight to reach our principal executive offices at 100 Benefitfocus Way.

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BENEFITFOCUS, INC.

ATTN: MILTON A. ALPERN

100 BENEFITFOCUS WAY

CHARLESTON, SOUTH CAROLINA 29492

VOTE BY INTERNET - www.proxyvote.com

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

ELECTRONIC DELIVERY OF FUTURE PROXY MATERIALS

If you would like to reduce the costs incurred by our company in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access proxy materials electronically in future years.

VOTE BY PHONE - 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

M91697-P59069 KEEP THIS PORTION FOR YOUR RECORDS

DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

BENEFITFOCUS, INC. **For Withhold For All**

	All	All	Except	
The Board of Directors recommends you vote FOR the following:	¨	¨	¨	To withhold authority to vote for any individual nominee(s), mark For All Except and write the number(s) of the nominee(s) on the line below.

1. Election of Directors

Nominees:

01) Mason R. Holland, Jr.

02) Ann H. Lamont

03) Stephen M. Swad

NOTE: In its discretion, the proxy is authorized to vote upon such other business as may properly come before the Annual Meeting. This proxy when properly executed, will be voted as directed herein by the undersigned stockholder. If no direction is made, this proxy will be voted FOR proposal 1.

	Yes	No
Please indicate if you plan to attend this meeting.	¨	¨

Please sign exactly as your name(s) appear(s) hereon. When signing as attorney, executor, administrator, or other fiduciary, please give full title as such. Joint owners should each sign personally. All holders must sign. If a corporation or partnership, please sign in full corporate or partnership name by authorized officer.

Signature [PLEASE SIGN WITHIN BOX] Date Signature (Joint Owners) Date

Important Notice Regarding the Availability of Proxy Materials for the 2015 Annual Meeting of Stockholders:

The Notice of Annual Meeting of Stockholders and Proxy Statement, Annual Report and Annual Report on Form 10-K of

Benefitfocus, Inc. are available at www.proxyvote.com.

M91698-P59069

BENEFITFOCUS, INC.

Proxy for Annual Meeting of Stockholders

June 12, 2015 9:00 AM EDT

This proxy is solicited by the Board of Directors

The undersigned stockholder of Benefitfocus, Inc. acknowledges receipt of the Notice of Annual Meeting of Stockholders and Proxy Statement, each dated April 30, 2015. The undersigned stockholder also appoints Mason R. Holland, Jr., with full power of substitution and power to act alone, as proxy to represent and to vote, as designated on the reverse side of this ballot, all of the shares of common stock of Benefitfocus, Inc. that the stockholder is entitled to vote at the Annual Meeting of Stockholders to be held at 9:00 AM EDT on June 12, 2015, at the Benefitfocus, Inc. principal executive offices located at 100 Benefitfocus Way, Charleston, South Carolina 29492, and any adjournment or postponement thereof.

Continued and to be signed on reverse side

-top:2px;padding-bottom:2px;padding-right:2px;">

Washington DC-Capitol Riverfront

2

360,326

89.0
%

$
14,464,433

$45.12

St Mary's & King George Counties:

King George County - Dahlgren, VA

6

206,207

91.6
%

$
3,758,392

$19.89

St. Mary's County - California, MD

7

317,835

75.2
%

4,882,294

20.42

St. Mary's County - Lexington Park, MD

6

379,550

91.6
%

7,298,048

20.99

Subtotal / Average

19

903,592

85.9
%

$
15,938,734

$20.55

Greater Baltimore:

Baltimore City - Baltimore, MD

1

481,016

93.4
%

$
14,932,204

$33.22
Harford County - Aberdeen, MD

3

284,884

37.9
%

3,296,026

30.54
Hunt Valley/RTE 83 Corridor - Timonium, MD

2

239,835

100.0
%

5,570,833

23.23
White Marsh - White Marsh, MD

26

1,047,170

78.0
%

16,612,279

20.34
Subtotal / Average

32

2,052,905

78.6
%

$
40,411,342

$25.04

Suburban Maryland:

College Park - College Park, MD

2

242,070

94.9
%

$
7,267,194

$31.65
Lanham - Lanham, MD (4)

1

55,866

90.9
%

569,503

11.21
Subtotal / Average

3

297,936

94.1
%

$
7,836,697

$27.95

Colorado Springs:

Colorado Springs East - Colorado Springs, CO (5)

11

732,635

80.1
%

$
12,375,054

$21.09
Colorado Springs Northwest - Colorado Springs, CO

3

322,152

83.0
%

5,389,696

20.16
I-25 North Corridor - Colorado Springs, CO (4)

7

522,724

71.4
%

7,219,269

19.33
Subtotal / Average

21

1,577,511

77.8
%

$
24,984,019

$20.35

17

Market/Submarket and Location	Number of Buildings	Rentable Square Feet	Occupancy (1)		Annualized Rental Revenue (2)	Annualized Rental Revenue per Occupied Square Foot (2)(3)
Greater Philadelphia - Blue Bell, PA	3	488,741	100.0	%	$9,369,523	$19.17
Other Region:						
Huntsville - Huntsville, AL	1	138,466	83.2	%	$3,136,582	$27.24
Richmond Southwest - Richmond, VA	1	193,000	100.0	%	5,449,908	28.24
Southwest Virginia - Lebanon, VA	1	102,842	100.0	%	3,705,802	36.03
Subtotal / Average	3	434,308	94.6	%	$12,292,292	$29.91
Total /Average:	208	18,831,434	87.8	%	$461,856,484	$27.92

(1) This percentage is based upon all rentable square feet under lease terms that were in effect as of December 31, 2012.

(2) Annualized rental revenue is the monthly contractual base rent as of December 31, 2012 multiplied by 12, plus the estimated annualized expense reimbursements under existing leases. We consider annualized rental revenue to be a useful measure for analyzing revenue sources because, since it is point-in-time based, it does not contain increases and decreases in revenue associated with periods in which lease terms were not in effect; historical revenue under generally accepted accounting principles does contain such fluctuations. We find the measure particularly useful for leasing, tenant, segment and industry analysis.

(3) Annualized rental revenue per occupied square foot is a property's annualized rental revenue divided by that property's occupied square feet as of December 31, 2012. Our computation of annualized rental revenue excludes the effect of lease incentives. The annualized rent per occupied square foot, including the effect of lease incentives, for our total office portfolio and two largest regions follows: total office portfolio: $27.85; Baltimore/Washington Corridor: $28.52; and Northern Virginia: $30.55.

(4) These properties were included in our Strategic Reallocation Plan and classified as held for sale as of December 31, 2012.

(5) Nine of these properties were included in our Strategic Reallocation Plan and classified as held for sale as of December 31, 2012.

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The following table provides certain information about our office properties that were under construction or redevelopment, or for which we were contractually committed to construct, as of December 31, 2012 (dollars in thousands):

Property and Location	Submarket	Estimated Rentable Square Feet Upon Completion	Percentage Leased		Calendar Quarter of Anticipated Completion	Costs Incurred to Date (1)	Estimated Costs to Complete (1)
Under Construction							
Baltimore/Washington Corridor:							
7205 Riverwood Road Columbia, MD	Howard County Perimeter	89,268	100	%	1Q 2013	$15,673	$7,117
7175 Riverwood Road Columbia, MD	Howard County Perimeter	25,939	100	%	3Q 2013	5,927	3,122
312 Sentinel Way Annapolis Junction, MD	National Business Park	125,160	0	%	3Q 2014	16,366	20,287
420 National Business Parkway Jessup, MD	National Business Park	137,322	0	%	2Q 2014	18,043	17,439
Subtotal/Average		377,689	31	%		$56,009	$47,965
Northern Virginia:							
7770 Backlick Road (Patriot Ridge) Springfield, VA	Springfield	239,272	49	%	3Q 2013	$58,143	$14,574
Ashburn Crossing - DC-8 Ashburn, VA	Ashburn	200,000	100	%	4Q 2013	7,490	15,036
Ashburn Crossing - DC-9 Ashburn, VA	Ashburn	115,000	100	%	2Q 2015	4,309	7,523
Subtotal/Average		554,272	78	%		$69,942	$37,133
Huntsville:							
1000 Redstone Gateway Huntsville, AL	Huntsville	121,105	100	%	1Q 2013	$19,055	$3,890
1100 Redstone Gateway Huntsville, AL	Huntsville	121,347	100	%	1Q 2014	1,396	20,281
1200 Redstone Gateway Huntsville, AL	Huntsville	121,088	100	%	4Q 2013	3,052	21,761
7200 Redstone Gateway Huntsville, AL	Huntsville	61,434	0	%	4Q 2013	4,530	3,701
Subtotal/Average		424,974	86	%		$28,033	$49,633
Total Under Construction		1,356,935	67	%		$153,984	$134,731
Under Redevelopment							
Greater Philadelphia:							
751 Arbor Way (Hillcrest I)	Greater	113,297	51	%	1Q 2013	$19,138	$2,278

Blue Bell, PA	Philadelphia					
721 Arbor Way (Hillcrest II)	Greater	183,466	59 %	2Q 2014	14,076	17,019
Blue Bell, PA	Philadelphia					
Total Under Redevelopment		296,763	56 %		$33,214	$19,297

(1) Includes land, construction, leasing costs and allocated portion of structured parking and other shared infrastructure, if applicable.

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The following table provides certain information about our land held or under pre-construction as of December 31, 2012, including properties under ground lease to us:

Market/Submarket and Location	Acres		Estimated Developable Square Feet
Strategic Land			
Baltimore/Washington Corridor:			
National Business Park	186		1,792,000
Columbia Gateway	22		520,000
Airport Square	5		84,000
Arundel Preserve	84	up to	1,150,000
Subtotal	297		3,546,000
Northern Virginia;			
Westfields Corporate Center	23		400,000
Westfields Park Center	33		400,000
Woodland Park	5		225,000
Patriot Ridge	11		739,000
Ashburn Crossing	10		120,000
Subtotal	82		1,884,000
San Antonio, Texas			
8100 Potranco Road	9		125,000
Northwest Crossroads	31		375,000
Sentry Gateway	38		658,000
Subtotal	78		1,158,000
Huntsville, Alabama	443		4,173,000
St. Mary’s & King George Counties	44		109,000
Greater Baltimore	49		1,340,000
Suburban Maryland	49		510,000
Total strategic land held and pre-construction	1,042		12,720,000
Non-Strategic Land			
Baltimore/Washington Corridor	7		65,000
Greater Baltimore	138		1,352,000
Suburban Maryland	107		1,000,000
Colorado Springs	175		2,570,000
Greater Philadelphia, Pennsylvania	8		604,000
Other (Charles County, MD)	217		967,000
Total non-strategic land held	652		6,558,000
Total land held and pre-construction	1,694		19,278,000

The following table provides certain information about our wholesale data center property as of December 31, 2012 (dollars in thousands):

Property and Location	Year Built	Gross Building Area	Raised Floor Square Footage (1)	Initial Stabilization Critical Load (in MWs) (2)	Initial Stabilization Critical Load Leased	MW Operational	Costs Incurred to Date (3)	Estimated Costs to Completion (3)

9651 Hornbaker Road - Manassas, VA	2010	233,000	100,000	18	22%	6	$207,785	$67,445

(1) Raised floor square footage is that portion of the gross building area in which tenants locate their computer servers. Raised floor area is considered to be the net rentable square footage.
(2) Critical load is the power available for exclusive use of tenants in the property (expressed in terms of megawatts (“MWs”)).
(3) Includes land, construction and leasing costs.

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Lease Expirations

The following table provides a summary schedule of the lease expirations for leases in place at our office properties as of December 31, 2012, assuming that none of the tenants exercise renewal options. This analysis includes the effect of early renewals completed on existing leases but excludes the effect of new tenant leases on 264,380 square feet executed but yet to commence as of December 31, 2012.

Year of Lease Expiration (1)	Number of Leases Expiring	Square Footage of Leases Expiring	Percentage of Total Occupied Square Feet	Annualized Rental Revenue of Expiring Leases (2)	Percentage of Total Annualized Rental Revenue Expiring (2)	Total Annualized Rental Revenue of Expiring Leases Per Occupied Square Foot
				(in thousands)		
2013	146	2,442,746	14.8%	$71,083	15.4%	$29.10
2014	101	2,221,075	13.4%	63,401	13.7%	28.54
2015	112	2,737,514	16.6%	72,790	15.8%	26.59
2016	79	1,637,241	9.9%	43,799	9.5%	26.75
2017	96	1,842,182	11.1%	49,748	10.8%	27.01
2018	45	1,250,397	7.6%	32,563	7.1%	26.04
2019	35	1,024,008	6.2%	29,610	6.4%	28.92
2020	33	1,294,803	7.8%	35,590	7.7%	27.49
2021	20	561,641	3.4%	15,855	3.4%	28.23
2022	12	793,969	4.8%	23,235	5.0%	29.26
2023	6	149,308	0.9%	2,868	0.6%	19.21
2024	2	29,528	0.2%	802	0.2%	27.15
2025	4	556,372	3.4%	20,512	4.4%	36.87
Total/Weighted Average	691	16,540,784	100.0%	$461,856	100.0%	$27.92

With regard to leases expiring in 2013, we believe that the weighted average annualized rental revenue per occupied square foot for such leases at December 31, 2012 was, on average, approximately 5% to 8% higher than estimated current market contractual rents for the related space, with specific results varying by market.

The following table provides a summary schedule of the lease expirations for leases in place at our wholesale data center property as of December 31, 2012:

Year of Lease Expiration	Number of Leases Expiring	Raised Floor Square Footage Expiring	Critical Load Leased (in megawatts)	Critical Load Used (in megawatts)	Annualized Rental Revenue of Expiring Leases (2) (in thousands)
2019	1	7,172	1	1.00	$2,098
2020	1	19,023	2	2.00	4,232
2022	1	5,604	1	0.25	391
Total/Weighted Average	3	31,799	4	3.25	$6,721

(1) Most of our leases with the United States Government provide for consecutive one-year terms or provide for early termination rights. All of the leasing statistics set forth above assumed that the United States Government will remain in the space that it leases through the end of the respective arrangements, without ending consecutive one-year leases prematurely or exercising early termination rights. We reported the statistics in this manner

because we manage our leasing activities using these same assumptions and believe these assumptions to be probable.

(2) Annualized rental revenue is the monthly contractual base rent as of December 31, 2012 multiplied by 12, plus the estimated annualized expense reimbursements under existing office leases. Our computation of annualized rental revenue excludes the effect of lease incentives, although the effect of this exclusion is generally not material.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures
Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities
Market Information
Our common shares trade on the New York Stock Exchange ("NYSE") under the symbol "OFC." The table below shows the range of the high and low sale prices for our common shares as reported on the NYSE, as well as the quarterly common share dividends per share declared:

	Price Range		Dividends
2011	Low	High	Per Share
First Quarter	$33.83	$36.90	$0.4125
Second Quarter	$30.63	$36.79	$0.4125
Third Quarter	$21.75	$32.07	$0.4125
Fourth Quarter	$19.35	$25.96	$0.4125

	Price Range		Dividends
2012	Low	High	Per Share
First Quarter	$20.58	$25.48	$0.2750
Second Quarter	$21.13	$24.05	$0.2750
Third Quarter	$21.36	$25.61	$0.2750
Fourth Quarter	$23.22	$26.12	$0.2750

The number of holders of record of our common shares was 608 as of December 31, 2012. This number does not include shareholders whose shares are held of record by a brokerage house or clearing agency, but does include any such brokerage house or clearing agency as one record holder.
We pay dividends at the discretion of our Board of Trustees. Our ability to pay cash dividends will be dependent upon: (1) the cash flow generated from our operations; (2) cash generated or used by our financing and investing activities; and (3) the annual distribution requirements under the REIT provisions of the Code described above and such other factors as the Board of Trustees deems relevant. Our ability to make cash dividends will also be limited by the terms of our Operating Partnership Agreement, as well as by limitations imposed by state law. In addition, we are prohibited from paying cash dividends in excess of the amount necessary for us to qualify for taxation as a REIT if a default or event of default exists pursuant to the terms of our Revolving Credit Facility; this restriction does not currently limit our ability to pay dividends, and we do not believe that this restriction is reasonably likely to limit our ability to pay future dividends because we expect to comply with the terms of our Revolving Credit Facility.

Unregistered Sales of Equity Securities and Use of Proceeds

During the three months ended December 31, 2012, 139,696 of the Operating Partnership's common units were exchanged for 139,696 common shares in accordance with the Operating Partnership's Second Amended and Restated Limited Partnership Agreement, as amended. The issuance of these common shares was effected in reliance upon the exemption from registration under Section 4(2) of the Securities Act of 1933, as amended.

Common Shares Performance Graph

The graph and the table set forth below assume $100 was invested on December 31, 2007 in the common shares of Corporate Office Properties Trust. The graph and the table compare the cumulative return (assuming reinvestment of dividends) of this investment with a $100 investment at that time in the S&P 500 Index or the All Equity REIT Index of the National Association of Real Estate Investment Trusts (“NAREIT”):

	Period Ended					
Index	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12
Corporate Office Properties Trust	100.00	101.77	127.51	126.90	82.21	101.24
S&P 500	100.00	63.00	79.68	91.68	93.61	108.59
NAREIT All Equity REIT Index	100.00	62.27	79.70	101.98	110.42	132.18

Item 6. Selected Financial Data

The following table sets forth summary financial data as of and for each of the years ended December 31, 2008 through 2012. Since this information is only a summary, you should refer to our consolidated financial statements and notes thereto and the section of this report entitled “Management's Discussion and Analysis of Financial Condition and Results of Operations” for additional information.

Corporate Office Properties Trust and Subsidiaries
(in thousands, except per share data and number of properties)

	2012	2011	2010	2009	2008
Revenues					
Revenues from real estate operations (1)	$454,171	$428,496	$387,559	$349,463	$326,223
Construction contract and other service revenues	73,836	84,345	104,675	343,087	188,385
Total revenues	528,007	512,841	492,234	692,550	514,608
Expenses					
Property operating expenses (1)(2)(3)	167,161	162,397	146,617	123,769	109,967
Depreciation and amortization associated with real estate operations (1)	113,480	113,111	97,897	81,446	75,264
Construction contract and other service expenses	70,576	81,639	102,302	336,519	184,142
Impairment losses	43,214	83,478	—	—	—
General, administrative and leasing expenses (3)(4)	31,900	30,314	28,501	27,877	28,739
Business development expenses and land carry costs (2)	5,711	6,122	6,403	5,259	2,206
Total operating expenses	432,042	477,061	381,720	574,870	400,318
Operating income	95,965	35,780	110,514	117,680	114,290
Interest expense (1)	(94,624)	(98,222)	(95,729)	(76,718)	(79,542)
Interest and other income	7,172	5,603	9,568	5,164	2,070
(Loss) gain on early extinguishment of debt	(943)	(1,639)	—	—	8,101
Loss on interest rate derivatives	—	(29,805)	—	—	—
Income (loss) from continuing operations before equity in (loss) income of unconsolidated entities and income taxes	7,570	(88,283)	24,353	46,126	44,919
Equity in (loss) income of unconsolidated entities	(546)	(331)	1,376	(941)	(147)
Income tax (expense) benefit (4)	(381)	6,710	(108)	(196)	(201)
Income (loss) from continuing operations	6,643	(81,904)	25,621	44,989	44,571
Discontinued operations (1)(2)(3)(5)	13,677	(48,404)	17,054	16,310	15,655
Income (loss) before gain on sales of real estate	20,320	(130,308)	42,675	61,299	60,226
Gain on sales of real estate, net of income taxes (1)(6)	21	2,732	2,829	—	1,090
Net income (loss)	20,341	(127,576)	45,504	61,299	61,316
Net loss (income) attributable to noncontrolling interests (4)	636	8,148	(2,744)	(4,970)	(7,351)
Net income (loss) attributable to Corporate Office Properties Trust	20,977	(119,428)	42,760	56,329	53,965
Preferred share dividends	(20,844)	(16,102)	(16,102)	(16,102)	(16,102)
Issuance costs associated with redeemed preferred shares (7)	(1,827)	—	—	—	—
Net (loss) income attributable to Corporate Office Properties Trust common shareholders	$(1,694)	$(135,530)	$26,658	$40,227	$37,863

Basic earnings per common share (8)					
(Loss) income from continuing operations	$(0.21)	$(1.31)	$0.17	$0.44	$0.50
Net (loss) income	$(0.03)	$(1.97)	$0.43	$0.70	$0.77
Diluted earnings per common share (8)					
(Loss) income from continuing operations	$(0.21)	$(1.31)	$0.17	$0.44	$0.49
Net (loss) income	$(0.03)	$(1.97)	$0.43	$0.70	$0.76
Weighted average common shares outstanding – basic	73,454	69,382	59,611	55,930	48,132
Weighted average common shares outstanding – diluted	73,454	69,382	59,944	56,407	48,820

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	2012	2011	2010	2009	2008
Balance Sheet Data (as of year end):					
Total properties, net	$3,163,044	$3,352,975	$3,445,455	$3,029,900	$2,778,466
Total assets (4)	$3,653,759	$3,863,555	$3,844,517	$3,380,022	$3,114,239
Debt	$2,019,168	$2,426,303	$2,323,681	$2,053,841	$1,856,751
Total liabilities (4)	$2,206,962	$2,648,748	$2,521,379	$2,259,390	$2,031,816
Redeemable noncontrolling interest (4)	$10,298	$8,908	$9,000	$—	$—
Total equity (4)(9)	$1,436,499	$1,205,899	$1,323,138	$1,120,632	$1,082,423
Other Financial Data (for the year ended):					
Cash flows provided by (used in):					
Operating activities	$191,838	$152,143	$156,436	$194,817	$180,892
Investing activities	$13,744	$(260,387)	$(479,167)	$(349,076)	$(290,822)
Financing activities	$(200,547)	$103,701	$324,571	$155,746	$92,067
Numerator for diluted EPS (4)	$(2,163)	$(136,567)	$25,587	$39,217	$37,135
Diluted funds from operations (4)(9)	$165,720	$53,062	$148,645	$152,626	$143,592
Diluted funds from operations per share (4)(9)	$2.13	$0.72	$2.30	$2.46	$2.52
Cash dividends declared per common share	$1.10	$1.65	$1.61	$1.53	$1.425
Property Data (as of year end):					
Number of properties owned (10)	208	238	256	253	240
Total rentable square feet owned (10)	18,831	20,514	20,432	19,543	18,559

(1) Certain prior period amounts pertaining to properties included in discontinued operations have been reclassified to conform with the current presentation. These reclassifications did not affect consolidated net income or shareholders' equity.

(2) Certain prior period amounts pertaining to expenses on properties not in operations have been reclassified to conform with the current presentation, as described in Note 2 to our consolidated financial statements in the section entitled "Reclassifications." These reclassifications did not affect consolidated net income or shareholders' equity.

(3) Certain prior period amounts pertaining to costs expensed in connection with marketing space for lease to prospective tenants have been reclassified to conform with the current presentation, as described in Note 2 to our consolidated financial statements in the section entitled "Reclassifications." These reclassifications did not affect consolidated net income or shareholders' equity.

(4) Certain amounts as of, and for the year ended, December 31, 2011 were revised in connection with errors identified in 2012 described in Note 2 to our Consolidated Financial Statements in the section entitled "Revisions." These revisions affected consolidated net income and shareholders' equity.

(5) Includes income derived from three operating properties disposed in 2008, three operating properties disposed in 2010, 23 operating properties disposed in 2011, 35 operating properties disposed in 2012 and 17 operating properties classified as held for sale at December 31, 2012 (see Note 17 to our consolidated financial statements).

(6) Reflects gain from sales of properties and unconsolidated real estate joint ventures not associated with discontinued operations.

(7) Reflects a decrease to net income available to common shareholders pertaining to the original issuance costs recognized upon the redemption of the Series G preferred shares of beneficial interest in 2012.

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

(9) For definitions of diluted funds from operations per share and diluted funds from operations and reconciliations of these measures to their comparable measures under generally accepted accounting principles, you should refer to the section entitled "Funds from Operations" within the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations."

(10) Amounts reported reflect only operating office properties.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

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

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

- general economic and business conditions, which will, among other things, affect office property and data center demand and rents, tenant creditworthiness, interest rates, financing availability and property values;
- adverse changes in the real estate markets, including, among other things, increased competition with other companies;
- governmental actions and initiatives, including risks associated with the impact of a government shutdown or budgetary reductions or impasses, such as a reduction in rental revenues, non-renewal of leases and/or a curtailment of demand for additional space by our strategic customers;
- our ability to borrow on favorable terms;
- risks of real estate acquisition and development activities, including, among other things, risks that development projects may not be completed on schedule, that tenants may not take occupancy or pay rent or that development or operating costs may be greater than anticipated;
- our ability to sell properties included in our Strategic Reallocation Plan;
- risks of investing through joint venture structures, including risks that our joint venture partners may not fulfill their financial obligations as investors or may take actions that are inconsistent with our objectives;
- changes in our plans for properties or views of market economic conditions or failure to obtain development rights, either of which could result in recognition of significant impairment losses;
- our ability to satisfy and operate effectively under Federal income tax rules relating to real estate investment trusts and partnerships;
- the dilutive effects of issuing additional common shares;
- our ability to achieve projected results; and
- environmental requirements.

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

Overview

We are an office real estate investment trust (“REIT”) that focuses primarily on serving the specialized requirements of United States Government agencies and defense contractors, most of whom are engaged in defense information technology and national security related activities. We generally acquire, develop, manage and lease office and data center properties concentrated in large office parks located near knowledge-based government demand drivers and/or in targeted markets or submarkets in the Greater Washington, DC/Baltimore region.

Our revenues relating to real estate operations are derived from rents and property operating expense reimbursements earned from tenants leasing space in our properties. Most of our expenses relating to our real estate operations take the form of: property operating costs, such as real estate taxes, utilities and repairs and maintenance; and depreciation and amortization associated with our operating properties. Most of our profitability from real estate operations depends on our ability to maintain high levels of occupancy and increase rents, which is affected by a number of factors, including, among other things, our tenants' ability to fulfill their lease obligations and their continuing space needs based on, among other things, employment levels, business confidence, competition and general economic conditions of the markets in which we operate.

Our strategy for operations and growth focuses on serving the specialized requirements of United States Government agencies and defense contractors, most of whom are engaged in defense information technology and national security related activities. These tenants' missions generally pertain more to knowledge-based activities (such as cyber security, research and development and other highly technical defense and security areas) than to force structure (troops) and weapon system production. As a result of this strategy, a large concentration of our revenue is derived from several large tenants. As of December 31, 2012, 64.5% of our annualized rental revenue (as defined below) from office properties was from our 20 largest tenants, 40.9% from our four largest tenants and 24.2% from our largest tenant, the United States Government. In addition, as of December 31, 2012, 70.0% of the total annualized rental revenue of our office properties held for long-term investment was from properties located near defense installations and other knowledge-based government demand drivers (referred to elsewhere as "Strategic Demand Drivers"), or that were otherwise at least 50% leased by United States Government agencies or defense contractors; we refer to these properties herein as "Strategic Tenant Properties."

We made significant progress in 2012 under the Strategic Reallocation Plan that we launched in 2011, which entails the disposition by the end of 2013 of approximately $562.0 million in office properties and land no longer closely aligned with our strategy, and use of the proceeds to invest in Strategic Tenant Properties, to repay borrowings and for general corporate purposes. In 2012, we completed dispositions of 35 operating properties totaling 2.3 million square feet and non-operating properties for aggregate transaction values totaling $313.6 million. Aggregate dispositions since implementation of the Strategic Reallocation Plan total $390.3 million, including 58 operating properties totaling 3.2 million square feet. We used most of the proceeds from these sales to pay down our Revolving Credit Facility. In 2012, we also approved a plan for the future disposition of our office properties and developable land in Greater Philadelphia, Pennsylvania because the properties no longer meet our strategic investment criteria; we expect this disposition to occur in the next four years.

Our operations in recent years have been hindered by continuing delays in Federal budget approvals and mounting uncertainty regarding the potential for future reductions in government spending targeting defense, as well as the otherwise challenging economic conditions in the United States. Furthermore, the Budget Control Act passed in 2011, which imposed caps on the Federal budget in order to achieve targeted spending levels over the 2013-2021 fiscal years, currently requires that $110 billion be sequestered from the United States Government's funding levels for the 2013 fiscal year, approximately 50% of which could come from defense; this action could feasibly begin to occur as early as March 2013, although we believe that such sequestrations could be further deferred, reduced or eliminated if reduction levels are agreed to in the 2013 Federal budget. This defense spending uncertainty has delayed our progress in leasing existing properties and new construction proximate to Strategic Demand Drivers. In addition, the otherwise challenging economic conditions have prompted certain operations to consolidate and businesses to close, downsize their space requirements or cancel or delay expansion plans in our regions, placing downward pressure on occupancy and rental rates.

Despite these challenges, our office property portfolio's occupancy improved to 87.8% as of December 31, 2012, a 1.6% increase over year end 2011. We also successfully completed 3.3 million square feet of leasing, including 1.2 million of construction and redevelopment space. The improvement in our portfolio's occupancy was attributable primarily to an improvement in occupancy of our Same Office Properties (defined below) to 89.1% at December 31, 2012 (up from 88.3% at December 31, 2011) and our dispositions in 2012 of lower occupancy properties under the Strategic Reallocation Plan. Our properties proximate to Strategic Demand Drivers were 92.1% occupied at December 31, 2012, notably stronger than our other properties, which were 84.4% occupied.

We believe that the continuing Federal budget discussions will eventually lead to modest additional reductions in defense spending. However, if such reductions were to occur, we continue to believe that our properties' proximate to Strategic Demand Drivers will not be significantly affected, and could position us for future growth, for reasons that include the following:

- we expect defense spending reductions, should they occur, will be targeted more towards force structure (troops) and weapon system production than towards the knowledge-based activities of most of our tenants, which we believe are considered increasingly critical to our national security;

- in 2011, Federal agencies completed their relocation to the following government installations that serve as demand drivers to our portfolio of Strategic Tenant Properties primarily in connection with mandates by the Base Realignment and Closure Commission of the United States Congress ("BRAC"): Fort George G. Meade (which also houses the recently-formed United States Cyber Command), Redstone Arsenal, Fort Belvoir, San Antonio and Aberdeen Proving Ground; the shifting of jobs by defense contractors supporting these agencies that we believe still needs to occur has been delayed by the defense spending uncertainty;
- if defense construction spending is cut, government demand to lease space in our business parks could possibly increase if the government decides to lease space instead of build it.

We believe that the outlook for our properties proximate to Strategic Demand Drivers would be hindered more by an extended period of uncertainty regarding future defense spending reductions than by the actual spending reductions.

The relative contribution to our operations by properties not proximate to Strategic Demand Drivers has decreased due to our property dispositions in 2011 and 2012, and we expect that trend to continue as we complete the Strategic Reallocation Plan. Nevertheless, our market strategy is to continue to own these types of properties in targeted markets or submarkets in the Greater Washington, DC/Baltimore region with strong growth attributes. These properties tend to be more subject to general market conditions that have been affected by the slow economic recovery. As a result, we expect a longer road to recovery to pre-recession occupancy levels for these properties.

Our capital strategy is aimed at maintaining a flexible capital structure, and we believe that we significantly improved our balance sheet and expanded our access to capital in 2012 not only through our execution of the Strategic Reallocation Plan but also by:

- issuing 6.9 million Series L Cumulative Preferred Shares (the “Series L Preferred Shares”) at a price of $25.00 per share for net proceeds of $165.7 million after underwriting discounts but before offering expenses. These shares are nonvoting, redeemable for cash at $25.00 per share at our option on or after June 27, 2017 and accrue dividends equal to 7.375% of the liquidation preference. The net proceeds were used to pay down our Revolving Credit Facility and for general corporate purposes;
- redeeming all of our Series G Preferred Shares of beneficial interest (the “Series G Preferred Shares”) at a price of $25.00 per share, or $55.0 million in the aggregate, plus accrued and unpaid dividends thereon through the date of redemption. These shares accrued dividends equal to 8.0% of the liquidation preference;
- completing a public offering of 8.6 million common shares at a price of $24.75 per share for net proceeds of $204.9 million after underwriter discounts but before offering expenses, and using the proceeds to pay down our Revolving Credit Facility and for general corporate purposes;
- entering into unsecured term loan agreements, under which we borrowed $370 million in the aggregate. The net proceeds from these borrowings were used to pay down our Revolving Credit Facility; and
- established an at-the-market (“ATM”) stock offering program under which we may, from time to time, offer and sell common shares in “at the market” stock offerings having an aggregate gross sales price of up to $150.0 million.

These activities contributed towards our: improving the relationship of our outstanding debt relative to both assets and adjusted earnings before interest expense, income taxes, depreciation, amortization (“adjusted EBITDA,” which we define below); improving the relationship of our interest expense to adjusted EBITDA; and paying down our Revolving Credit Facility to zero by the end of 2012, providing significant liquidity and flexibility for future investing and financing activities.

Our 2012 investing activities grew our portfolio’s concentration in Strategic Tenant Properties through the dispositions of nonstrategic properties discussed above and by:

- placing into service an aggregate of 371,000 square feet in four newly constructed properties proximate to Strategic Demand Drivers that were 45.8% leased as of December 31, 2012; and
- acquiring for $48.3 million a property in Herndon, Virginia totaling 202,000 square feet that was 100% leased to a defense contractor.

We discuss significant factors contributing to changes in our net income attributable to common shareholders and diluted earnings per share over the last three years in the section below entitled “Results of Operations.” In addition, the section below entitled “Liquidity and Capital Resources” includes discussions of, among other things:

- how we expect to generate cash for short and long-term capital needs;
- our off-balance sheet arrangements in place that are reasonably likely to affect our financial condition; and
- our commitments and contingencies.

We refer to the measure “annualized rental revenue” in various sections of the Management's Discussion and Analysis of Financial Condition and Results of Operations section of this Annual Report on Form 10-K. Annualized rental revenue is a measure that we use to evaluate the source of our rental revenue as of a point in time. It is computed by multiplying by 12 the sum of monthly contractual base rents and estimated monthly expense reimbursements under active leases as of a point in time. Our computation of annualized rental revenue excludes the effect of lease incentives, although the effect of this exclusion is generally not material. We consider annualized rental revenue to be a useful measure for analyzing revenue sources because, since it is point-in-time based, it does not contain increases and decreases in revenue associated with periods in which lease terms were not in effect; historical revenue under generally accepted accounting principles in the United States of America (“GAAP”) does contain such fluctuations. We find the measure particularly useful for leasing, tenant, segment and industry analysis.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with GAAP, which require us to make certain estimates and assumptions. A summary of our significant accounting policies is provided in Note 2 to our consolidated financial statements. The following section is a summary of certain aspects of those accounting policies involving estimates and assumptions that (1) require our most difficult, subjective or complex judgments in accounting for uncertain matters or matters that are susceptible to change and (2) materially affect our reported operating performance or financial condition. It is possible that the use of different reasonable estimates or assumptions in making these judgments could result in materially different amounts being reported in our consolidated financial statements. While reviewing this section, you should refer to Note 2 to our consolidated financial statements, including terms defined therein.

As described further in Note 2 to our Consolidated Financial Statements in the section entitled “Revisions,” during 2012, we identified errors in the consolidated financial statements pertaining to our:

- recognition of a deferred tax asset resulting from an impairment of assets in the fourth quarter of 2011 that failed to consider a partial reversal of that asset that would result from a cancellation of related inter-company debt in the first quarter of 2012;
- over-accrual of incentive compensation cost for the year ended December 31, 2011;
- misapplication of accounting guidance requiring that we recognize loss allocations to a noncontrolling interest holder in a consolidated real estate joint venture associated with decreases in such holder’s claim on the book value of the joint venture’s assets, despite the fact that the real estate held by the joint venture was under development and the joint venture had no underlying losses under GAAP; and
- reporting for a noncontrolling interest in a consolidated real estate joint venture for which the holder of such interest possesses the right of requiring us to acquire the interest at fair value.

With respect to the errors described in the first two bullets above, we assessed the materiality of these errors on the financial statements in connection with previously filed periodic reports and concluded at such time that the errors were not material to any prior annual or interim periods. In assessing the cumulative effect of all such errors, we have since concluded that a correction of the errors in 2012 could be considered material to our 2012 net income. Accordingly, the consolidated financial statements as of, and for the year ended, December 31, 2011 included in the Annual Report on Form 10-K were revised. For each of the calendar quarters from January 1, 2011 through September 30, 2011, amounts included in Note 20 to the consolidated financial statements pertaining to such periods have been revised, and we will revise the financial statements in future filings including such periods.

Acquisitions of Properties

When we acquire properties, we allocate the purchase price to numerous tangible and intangible components. Most of the terms in this bullet section are discussed in further detail in Note 2 to the consolidated financial statements entitled “Acquisitions of Properties.” Our process for determining the allocation to these components requires many estimates and assumptions, including the following: (1) determination of market rental rates; (2) estimation of leasing and tenant improvement costs associated with the remaining term of acquired leases; (3) assumptions used in determining the in-place lease value, if-vacant value and tenant relationship value, including the rental rates, period of time that it will take to lease vacant space and estimated tenant improvement and leasing costs; and (4) allocation of the if-vacant value between land and building. A change in any of the above key assumptions, which are subjective, can materially change not only the presentation of acquired properties in our consolidated financial statements but also our reported results of operations. The allocation to different components affects the following:

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the amount of the purchase price allocated among different categories of assets and liabilities on our consolidated balance sheets; the amount of costs assigned to individual properties in multiple property acquisitions; and the amount of gain recognized in our consolidated statements of operations should we determine that the fair value of the acquisition exceeds its cost;

- where the amortization of the components appear over time in our consolidated statements of operations. Allocations to above- and below-market leases are amortized into rental revenue, whereas allocations to most of the other tangible and intangible assets are amortized into depreciation and amortization expense. As a REIT, this is important to us since much of the investment community evaluates our operating performance using non-GAAP measures such as funds from operations, the computation of which includes rental revenue but does not include depreciation and amortization expense; and
- the timing over which the items are recognized as revenue or expense in our consolidated statements of operations. For example, for allocations to the as-if vacant value, the land portion is not depreciated and the building portion is depreciated

over a longer period of time than the other components (generally 40 years). Allocations to above- and below-market leases, in-place lease value and tenant relationship value are amortized over significantly shorter timeframes, and if individual tenants' leases are terminated early, any unamortized amounts remaining associated with those tenants are written off upon termination. These differences in timing can materially affect our reported results of operations. In addition, we establish lives for tenant relationship values based on our estimates of how long we expect the respective tenants to remain in the properties.

Impairment of Long-Lived Assets

We assess each of our operating properties for impairment quarterly using cash flow projections and estimated fair values that we derive for each of the properties. We update the leasing and other assumptions used in these projections regularly, paying particular attention to properties that have experienced chronic vacancy or face significant market challenges. We review our plans and intentions for our development projects and land parcels quarterly. Each quarter, we also review the reasonableness of changes in our estimated operating property fair values from amounts estimated in the prior quarter. If events or changes in circumstances indicate that the carrying values of certain operating properties, properties in development or land held for future development may be impaired, we perform a recovery analysis for such properties. For long-lived assets to be held and used, we analyze recoverability based on the estimated undiscounted future cash flows expected to be generated from the operations and eventual disposition of the assets over, in most cases, a ten-year holding period. If we believe there is a significant possibility that we might dispose of the assets earlier, we analyze recoverability using a probability weighted analysis of the estimated undiscounted future cash flows expected to be generated from the operations and eventual disposition of the assets over the various possible holding periods. If the analysis indicates that the carrying value of a tested property is not recoverable from estimated future cash flows, it is written down to its estimated fair value and an impairment loss is recognized. If and when our plans change, we revise our recoverability analyses to use the cash flows expected from the operations and eventual disposition of each asset using holding periods that are consistent with our revised plans.

Property fair values are determined based on contract prices, indicative bids, discounted cash flow analyses or yield analyses. Estimated cash flows used in such analyses are based on our plans for the property and our views of market and economic conditions. The estimates consider items such as current and future rental rates, occupancies for the tested property and comparable properties, estimated operating and capital expenditures and recent sales data for comparable properties; most of these items are influenced by market data obtained from third party sources such as CoStar Group and real estate leasing and brokerage firms and our direct experience with the properties and their markets. Determining the appropriate capitalization or yield rate also requires significant judgment and is typically based on many factors, including the prevailing rate for the market or submarket, as well as the quality and location of the properties. Changes in the estimated future cash flows due to changes in our plans for a property, views of market and economic conditions and/or our ability to obtain development rights could result in recognition of impairment losses which could be substantial.

Properties held for sale are carried at the lower of their carrying values (i.e., cost less accumulated depreciation and any impairment loss recognized, where applicable) or estimated fair values less costs to sell. Accordingly, decisions to sell certain operating properties, properties in development or land held for development will result in impairment losses if carrying values of the specific properties exceed their estimated fair values less costs to sell. The estimates of fair value consider matters such as recent sales data for comparable properties and, where applicable, contracts or the results of negotiations with prospective purchasers. These estimates are subject to revision as market conditions, and our assessment of such conditions, change.

Assessment of Lease Term

As discussed above, a significant portion of our portfolio is leased to the United States Government, and the majority of those leases consist of a series of one-year renewal options. Applicable accounting guidance requires us to recognize minimum rental payments on a straight-line basis over the terms of each lease and to assess the lease terms as including all periods for which failure to renew the lease imposes a penalty on the lessee in such amounts that a renewal appears, at the inception of the lease, to be reasonably assured. Factors to consider when determining whether a penalty is significant include the uniqueness of the purpose or location of the property, the availability of a comparable replacement property, the relative importance or significance of the property to the continuation of the lessee's line of business and the existence of leasehold improvements or other assets whose value would be impaired by the lessee vacating or discontinuing use of the leased property. We have concluded for a number of our leases, based on the factors above, that the United States Government's exercise of all of those renewal options is reasonably assured. Changes in these assessments could result in the write-off of any recorded assets associated with straight-line rental revenue and acceleration of depreciation and amortization expense associated with costs we have incurred related to these leases.

Revenue Recognition on Tenant Improvements

Most of our leases involve some form of improvements to leased space. When we are required to provide improvements under the terms of a lease, we need to determine whether the improvements constitute landlord assets or tenant assets. If the improvements are landlord assets, we capitalize the cost of the improvements and recognize depreciation expense associated with such improvements over the shorter of the useful life of the assets or the term of the lease and recognize any payments from the tenant as rental revenue over the term of the lease. If the improvements are tenant assets, we defer the cost of improvements funded by us as a lease incentive asset and amortize it as a reduction of rental revenue over the term of the lease. Our determination of whether improvements are landlord assets or tenant assets also may affect when we commence revenue recognition in connection with a lease.

In determining whether improvements constitute landlord or tenant assets, we consider numerous factors that may require subjective or complex judgments, including: whether the improvements are unique to the tenant or reusable by other tenants; whether the tenant is permitted to alter or remove the improvements without our consent or without compensating us for any lost fair value; whether the ownership of the improvements remains with us or remains with the tenant at the end of the lease term; and whether the economic substance of the lease terms is properly reflected.

Collectability of Accounts and Deferred Rent Receivable

Allowances for doubtful accounts and deferred rent receivable are established based on quarterly analyses of the risk of loss on specific accounts. The analyses place particular emphasis on past-due accounts and consider information such as the nature and age of the receivables, the payment history of the tenants, the financial condition of the tenants and our assessment of their ability to meet their lease obligations, the basis for any disputes and the status of related negotiations. Our estimate of the required allowance is subject to revision as these factors change and is sensitive to the effects of economic and market conditions on tenants.

Accounting Method for Investments

We use three different accounting methods to report our investments in entities: the consolidation method; the equity method; and the cost method (see Note 2 to our consolidated financial statements). We use the consolidation method when we own most of the outstanding voting interests in an entity and can control its operations. We also consolidate certain entities when control of such entities can be achieved through means other than voting rights (“variable interest entities” or “VIEs”) if we are deemed to be the primary beneficiary. Generally, this applies to entities for which either: (1) the equity investors (if any) lack one or more of the essential characteristics of a controlling financial interest; (2) the equity investment at risk is insufficient to finance that entity's activities without additional subordinated financial support; or (3) the equity investors have voting rights that are not proportionate to their economic interests and the activities of the entity involve, or are conducted on behalf of, an investor with a disproportionately small voting interest. We use the equity method of accounting when we own an interest in an entity and can exert significant influence over, but cannot control, the entity's operations.

In making these determinations, we need to make subjective estimates and judgments regarding the entity's future operating performance, financial condition, future valuation and other variables that may affect the cash flows of the entity. We must consider both our and our partner's ability to participate in the management of the entity’s operations and make decisions that allow the parties to manage their economic risks. We may also need to estimate the probability of different scenarios taking place over time and their effect on the partners’ cash flows. The conclusion reached as a result of this process affects whether or not we use the consolidation method in accounting for our investment or the equity method. Whether or not we consolidate an investment can materially affect our consolidated financial statements.

Accounting for Interest Rate Derivatives

We use interest rate derivatives to hedge the cash flows associated with interest rates on debt, including forecasted borrowings. When we designate a derivative as a cash flow hedge, we defer the effective portion of changes in its fair value to the accumulated other comprehensive income (loss) section of shareholders' equity and recognize the ineffective portion of changes in fair value of derivatives in earnings. If and when a derivative ceases to qualify as a cash flow hedge, we reclassify the associated accumulated other comprehensive income (loss) to net earnings (loss). Our accounting for derivatives requires that we make judgments in determining the nature of the derivatives and their effectiveness as hedges, including ones regarding the likelihood that a forecasted transaction will take place. Therefore, these judgments could materially affect our consolidated financial statements.

Concentration of Operations

Customer Concentration of Property Operations

The table below sets forth the 20 largest tenants in our portfolio of office properties based on percentage of annualized rental revenue:

	Percentage of Annualized Rental Revenue of Office Properties for 20 Largest Tenants as of December 31,					
Tenant	2012		2011		2010	
United States of America	24.2	%	22.2	%	21.6	%
Northrop Grumman Corporation (1)	6.3	%	6.9	%	7.2	%
Booz Allen Hamilton, Inc.	5.5	%	5.1	%	4.7	%
Computer Sciences Corporation (1)	4.8	%	4.8	%	4.1	%
General Dynamics Corporation (1)	3.6	%	1.5	%	1.0	%
CareFirst, Inc.	1.9	%	1.6	%	1.7	%
The MITRE Corporation	1.9	%	1.8	%	1.8	%
ITT Exelis (1)	1.7	%	1.7	%	1.8	%
The Aerospace Corporation (1)	1.7	%	1.7	%	1.7	%
Wells Fargo & Company (1)	1.7	%	1.7	%	1.6	%
Kratos Defense & Security Solution, Inc. (1)	1.5	%	1.4	%	1.4	%
L-3 Communications Holdings, Inc. (1)	1.4	%	1.6	%	1.6	%
The Boeing Company (1)	1.4	%	1.3	%	1.3	%
AT&T Corporation (1)	1.2	%	1.2	%	1.2	%
Raytheon Company (1)	1.1	%	1.0	%	N/A	
Ciena Corporation	1.0	%	1.1	%	1.0	%
Science Applications International Corporation (1)	1.0	%	0.9	%	N/A	
Lockheed Martin Corporation	0.8	%	N/A		N/A	
The Johns Hopkins Institutions (1)	0.8	%	0.8	%	0.8	%
Unisys Corporation	0.8	%	0.8	%	0.9	%
Comcast Corporation (1)	N/A		1.2	%	1.3	%
Merck & Co., Inc. (1)	N/A		N/A		0.6	%
First Mariner Bank (1)	N/A		N/A		0.6	%
Subtotal of 20 largest tenants	64.5	%	60.3	%	57.9	%
All remaining tenants	35.5	%	39.7	%	42.1	%
Total	100.0	%	100.0	%	100.0	%

(1) Includes affiliated organizations and agencies and predecessor companies.

The United States Government's concentration increased each of the last two years in large part due to it taking occupancy of a significant portion of our newly-constructed square feet placed into service and our significant dispositions of properties in which it was not a tenant.

Our Strategic Tenant Properties accounted for 70.0% of our annualized rental revenue from office properties held for long-term investment at December 31, 2012. We believe that we are well positioned for future growth in the concentration of our revenue derived from customers in these sectors, as discussed further in the section in Item 1 to this Annual Report on Form 10-K entitled "Business and Growth Strategies."

Geographic Concentration of Property Operations

The table below sets forth the regional allocation of our annualized rental revenue of office properties as of the end of the last three calendar years:

Region	Percentage of Annualized Rental Revenue of Office Properties as of December 31, 2012		2011		2010		Number of Office Properties as of December 31, 2012	2011	2010
Baltimore/Washington Corridor	47.5	%	45.6	%	44.1	%	98	111	112
Northern Virginia	19.1	%	16.0	%	16.4	%	19	17	17
San Antonio	6.3	%	5.8	%	5.7	%	8	9	8
Washington, DC - Capitol Riverfront	3.1	%	3.0	%	3.4	%	2	2	2
St. Mary's and King George Counties	3.4	%	3.4	%	2.9	%	19	19	18
Greater Baltimore	8.8	%	12.6	%	14.9	%	32	46	66
Suburban Maryland	1.7	%	4.1	%	3.9	%	3	8	8
Colorado Springs	5.4	%	5.1	%	5.2	%	21	21	21
Greater Philadelphia	2.0	%	1.7	%	1.5	%	3	2	2
Other	2.7	%	2.7	%	2.0	%	3	3	2
	100.0	%	100.0	%	100.0	%	208	238	256

The most significant changes in our regional allocations set forth above were due to newly-constructed properties placed into service and our significant dispositions of properties in the Greater Baltimore and Suburban Maryland regions.

Occupancy and Leasing

Office Properties

The tables below set forth occupancy information pertaining to our portfolio of operating office properties:

	December 31, 2012		2011		2010	
Occupancy rates at period end						
Total	87.8	%	86.2	%	87.6	%
Baltimore/Washington Corridor	89.4	%	87.9	%	88.1	%
Northern Virginia	89.2	%	84.8	%	91.9	%
San Antonio	96.4	%	90.7	%	100.0	%
Washington, DC - Capitol Riverfront	89.0	%	91.6	%	98.5	%
St. Mary's and King George Counties	85.9	%	87.3	%	86.8	%
Greater Baltimore	78.6	%	84.5	%	85.0	%
Suburban Maryland	94.1	%	79.6	%	76.5	%
Colorado Springs	77.8	%	74.9	%	76.2	%
Greater Philadelphia	100.0	%	99.7	%	100.0	%
Other	94.6	%	100.0	%	100.0	%
Average contractual annual rental rate per square foot at year end (1)	$27.92		$26.59		$25.58	

(1) Includes estimated expense reimbursements.

	Rentable Square Feet (in thousands)	Occupied Square Feet
December 31, 2011	20,514	17,685
Square feet vacated upon lease expiration (1)	—	(782)
Occupancy of previously vacated space in connection with new lease (2)	—	717
Square feet constructed or redeveloped	425	548
Acquisition	202	202
Dispositions	(2,302)	(1,833)
Other changes	(8)	4
December 31, 2012	18,831	16,541

(1) Includes lease terminations and space reductions occurring in connection with lease renewals.
(2) Excludes occupancy of vacant square feet acquired or developed.

Please refer to the section above entitled "Overview" for discussion regarding our leasing activity in 2012 and our expectations regarding the future outlook. As the table above reflects, much of the increase in our total occupancy from 2011 to 2012 was attributable to our disposition of properties with lower occupancy rates. Occupancy of our Same Office Properties was 89.1% at December 31, 2012, up slightly from 88.3% at December 31, 2011.

In 2012, we completed 3.3 million square feet of leasing, including 1.2 million of construction and redevelopment space. Our construction leasing was highlighted by: Strategic Demand Driver leasing of 363,000 square feet in three properties proximate to Redstone Arsenal in Huntsville (our first construction leasing in that region) and 115,000 square feet in Riverwood Corporate Park in the Baltimore/Washington Corridor; and 315,000 square feet in two properties on land we acquired in Ashburn, Virginia, a market we were targeting to add to our Northern Virginia holdings. At December 31, 2012, we had 1.4 million square feet under construction that was 67% leased.

In 2012, we renewed 64.3% of the square footage of our lease expirations (including the effect of early renewals). The annualized rents of these renewals decreased on average by approximately 4.2% and revenue under GAAP increased on average by approximately 2.2% relative to the leases previously in place for the space; these leases had a weighted average lease term of approximately 3.3 years and the average estimated tenant improvements and lease costs associated with completing this leasing was approximately $6.35 per square foot.

We believe that our continuing exposure to the challenging leasing environment described above in the section entitled "Overview" is mitigated to a certain extent by the generally long-term nature of our leases and the staggered timing of our future lease expirations. Our weighted average lease term for office properties at December 31, 2012 was approximately four years. The table below sets forth as of December 31, 2012 our scheduled lease expirations of office properties by region in terms of percentage of annualized rental revenue:

	Expiration of Annualized Rental Revenue of Office Properties						
	2013	2014	2015	2016	2017	Thereafter	Total
Baltimore/Washington Corridor	11.2%	4.7%	7.8%	5.6%	6.5%	11.7%	47.5%
Northern Virginia	0.9%	5.6%	4.5%	1.1%	2.3%	4.7%	19.1%
San Antonio	0.0%	0.0%	0.0%	0.0%	0.0%	6.3%	6.3%
Washington, DC - Capitol Riverfront	1.1%	0.7%	0.3%	0.4%	0.0%	0.6%	3.1%
St. Mary's and King George Counties	0.8%	0.7%	1.1%	0.3%	0.0%	0.5%	3.4%
Greater Baltimore	0.4%	0.5%	1.0%	1.4%	1.2%	4.3%	8.8%

Suburban Maryland	0.3	%	0.1	%	0.0	%	0.0	%	0.1	%	1.2	%	1.7	%
Colorado Springs	0.7	%	0.7	%	0.5	%	0.6	%	0.6	%	2.3	%	5.4	%
Greater Philadelphia	0.0	%	0.0	%	0.6	%	0.0	%	0.0	%	1.4	%	2.0	%
Other	0.0	%	0.7	%	0.0	%	0.0	%	0.0	%	2.0	%	2.7	%
Total	15.4	%	13.7	%	15.8	%	9.5	%	10.8	%	34.9	%	100.0	%

With regard to leases expiring in 2013, we believe that the weighted average annualized rental revenue per occupied square foot for such leases at December 31, 2012 was, on average, approximately 5% to 8% higher than estimated current market contractual rents for the related space, with specific results varying by market.

As noted above, most of the leases with our largest tenant, the United States Government, provide for consecutive one-year terms or provide for early termination rights; all of the leasing statistics set forth above assume that the United States Government will remain in the space that they lease through the end of the respective arrangements, without ending consecutive one-year leases prematurely or exercising early termination rights.

Wholesale Data Center Property

Our wholesale data center property, which upon completion is expected to have a critical load of 18 megawatts, had six megawatts in operation at December 31, 2012, of which four were leased to tenants with further expansion rights of up to a combined five megawatts. This leasing includes our completion in 2012 of a new lease that provides for an initial commitment of one megawatt with further expansion rights for one additional megawatt, which was our first lease for the property since its acquisition in 2010. We expect that leasing of this property could continue to be slow, and expect, due to the long lease commencement lead time required for this type of property, that any new leasing completed in 2013 will contribute minimally to our income for that year. We plan to hold this property long-term. However, if our strategic plan for this property changes, we could recognize a significant impairment charge.

Results of Operations

We evaluate the operating performance of our properties using NOI from real estate operations, our segment performance measure derived by subtracting property operating expenses from revenues from real estate operations. We view our NOI from real estate operations as comprising the following primary categories of operating properties:

- office properties owned and 100% operational throughout the two years being compared, excluding operating properties disposed or held for future disposition. We define these as changes from "Same Office Properties." For further discussion of the concept of "operational," you should refer to the section of Note 2 of the consolidated financial statements entitled "Properties";
- office properties acquired during the two years being compared;
- constructed office properties placed into service that were not 100% operational throughout the two years being compared;
- office properties held for sale as of December 31, 2012;
- office properties in the Greater Philadelphia region. In September 2012, we shortened the holding period for these properties because they no longer meet our strategic investment criteria; and
- property dispositions.

You may refer to Note 17 of the consolidated financial statements for a summary of operating properties that were either disposed or classified as held for sale and therefore are included in discontinued operations.

In addition to owning properties, we provide construction management and other services. The primary manner in which we evaluate the operating performance of our construction management and other service activities is through a measure we define as NOI from service operations, which is based on the net of the revenues and expenses from these activities. The revenues and expenses from these activities consist primarily of subcontracted costs that are reimbursed to us by customers along with a management fee. The operating margins from these activities are small relative to the revenue. We believe NOI from service operations is a useful measure in assessing both our level of activity and our profitability in conducting such operations.

We believe that operating income, as reported on our consolidated statements of operations, is the most directly comparable generally accepted accounting principles ("GAAP") measure for both NOI from real estate operations and NOI from service operations. Since both of these measures exclude certain items includable in operating income, reliance on these measures has limitations; management compensates for these limitations by using the measures simply as supplemental measures that are considered alongside other GAAP and non-GAAP measures.

The table below reconciles NOI from real estate operations and NOI from service operations to operating income reported on our consolidated statement of operations:

	For the Years Ended December 31,		
	2012	2011	2010
	(in thousands)		
NOI from real estate operations	$312,365	$308,012	$288,959
NOI from service operations	3,260	2,706	2,373
NOI from discontinued operations	(25,355)	(41,913)	(48,017)
Depreciation and amortization associated with real estate operations	(113,480)	(113,111)	(97,897)
Impairment losses	(43,214)	(83,478)	—
General, administrative and leasing expenses	(31,900)	(30,314)	(28,501)
Business development expenses and land carry costs	(5,711)	(6,122)	(6,403)
Operating income	$95,965	$35,780	$110,514

Comparison of the Year Ended December 31, 2012 to the Year Ended December 31, 2011

	For the Years Ended December 31,		
	2012	2011	Variance
	(in thousands)		
Revenues			
Revenues from real estate operations	$454,171	$428,496	$25,675
Construction contract and other service revenues	73,836	84,345	(10,509)
Total revenues	528,007	512,841	15,166
Expenses			
Property operating expenses	167,161	162,397	4,764
Depreciation and amortization associated with real estate operations	113,480	113,111	369
Construction contract and other service expenses	70,576	81,639	(11,063)
Impairment losses	43,214	83,478	(40,264)
General, administrative and leasing expenses	31,900	30,314	1,586
Business development expenses and land carry costs	5,711	6,122	(411)
Total operating expenses	432,042	477,061	(45,019)
Operating income	95,965	35,780	60,185
Interest expense	(94,624)	(98,222)	3,598
Interest and other income	7,172	5,603	1,569
Loss on early extinguishment of debt	(943)	(1,639)	696
Equity in loss of unconsolidated entities	(546)	(331)	(215)
Income tax (expense) benefit	(381)	6,710	(7,091)
Loss on interest rate derivatives	—	(29,805)	29,805
Income (loss) from continuing operations	6,643	(81,904)	88,547
Discontinued operations	13,677	(48,404)	62,081
Gain on sales of real estate, net of income taxes	21	2,732	(2,711)
Net income (loss)	20,341	(127,576)	147,917
Net loss attributable to noncontrolling interests	636	8,148	(7,512)
Preferred share dividends	(20,844)	(16,102)	(4,742)
Issuance costs associated with redeemed preferred shares	(1,827)	—	(1,827)
Net loss attributable to COPT common shareholders	$(1,694)	$(135,530)	$133,836

NOI from Real Estate Operations

	For the Years Ended December 31,		
	2012	2011	Variance
	(Dollars in thousands, except per square foot data)		
Revenues			
Same Office Properties	$414,275	$404,617	$9,658
Constructed office properties placed in service	16,237	8,593	7,644
Acquired office properties	6,574	1,368	5,206
Properties held for sale	19,529	18,584	945
Greater Philadelphia properties	9,698	7,458	2,240
Dispositions	19,957	50,149	(30,192)
Other	6,830	5,063	1,767
	493,100	495,832	(2,732)
Property operating expenses			
Same Office Properties	151,932	150,198	1,734
Constructed office properties placed in service	4,040	1,791	2,249
Acquired office properties	1,450	227	1,223
Properties held for sale	6,671	6,292	379
Greater Philadelphia properties	2,562	1,402	1,160
Dispositions	9,057	24,448	(15,391)
Other	5,023	3,462	1,561
	180,735	187,820	(7,085)
NOI from real estate operations			
Same Office Properties	262,343	254,419	7,924
Constructed office properties placed in service	12,197	6,802	5,395
Acquired office properties	5,124	1,141	3,983
Properties held for sale	12,858	12,292	566
Greater Philadelphia properties	7,136	6,056	1,080
Dispositions	10,900	25,701	(14,801)
Other	1,807	1,601	206
	$312,365	$308,012	$4,353
Same Office Properties rent statistics			
Average occupancy rate	88.6%	89.1%	-0.5%
Average straight-line rent per occupied square foot (1)	$23.57	$23.35	$0.22

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

The increase in revenues from our Same Office Properties was attributable to a $4.5 million increase in rental revenue (including $967,000 in connection with lease terminations) and a $5.2 million increase in tenant recoveries and other real estate operations revenue (most of which pertained to an increase in directly reimbursable expenses). The increase in property operating expenses from our Same Office Properties was primarily due to increases in expenses directly reimbursable from tenants, offset in part by decreases in snow removal and utility expenses resulting from a milder winter and spring in the Mid-Atlantic region.

Our Same Office Properties pool for purposes of comparing 2012 and 2011 consisted of 177 office properties, comprising 84.0% of our operating office square footage as of December 31, 2012. This pool of properties included the following changes from the pool used for purposes of comparing 2011 and 2010: the addition of four properties acquired and fully operational by January 1, 2011; and five properties placed in service and 100% operational by January 1, 2011. Operating office properties disposed, held for sale or otherwise no longer held for long-term investment (currently our Greater Philadelphia properties) by December 31, 2012 were also excluded from all presented Same Office Property pools.

NOI from Service Operations

	For the Years Ended December 31,		
	2012	2011	Variance
	(in thousands)		
Construction contract and other service revenues	$73,836	$84,345	$(10,509)
Construction contract and other service expenses	70,576	81,639	(11,063)
NOI from service operations	$3,260	$2,706	$554

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

Impairment Losses

We recognized the impairment losses described below in the current and prior years:

- in September 2012, our Board of Trustees approved a plan by Management to shorten the holding period for all of our office properties and developable land in Greater Philadelphia, Pennsylvania because the properties no longer meet our strategic investment criteria. We determined that the carrying amounts of these properties will not likely be recovered from the cash flows from the operations and sales of such properties over the likely remaining holding period. Accordingly, in 2012, we recognized aggregate non-cash impairment losses of $46.1 million for the amounts by which the carrying values of the properties exceeded their respective estimated fair values;
- in connection primarily with the Strategic Reallocation Plan, we determined that the carrying amounts of certain properties identified for disposition (the "Impaired Properties") will not likely be recovered from the cash flows from the operations and sales of such properties over the shorter holding periods. Accordingly, we recognized aggregate impairment losses for the amounts by which the carrying values of the Impaired Properties exceeded their respective estimated fair values, plus any exit costs incurred, of: $19.0 million in 2012 ($23.7 million classified as discontinued operations and including $4.2 million in exit costs); and $122.5 million in 2011 ($67.5 million classified as discontinued operations and excluding $4.8 million in related income tax benefit);
- in connection with construction costs incurred on a property held for future development, we recognized an impairment loss of $1.9 million in 2012;
- on February 15 and 17, 2011, the United States Army (the "Army") provided us disclosures regarding the past testing and use of tactical defoliants/herbicides at a property we owned, and subsequently disposed of, in Cascade, Maryland that was formerly an Army base known as Fort Ritchie ("Fort Ritchie"). Upon receipt of these disclosures, we commenced a review of our development plans and prospects for the property. We believed that these disclosures by the Army were likely to cause further delays in the resolution of certain litigation related to the property, and that they also increased the level of uncertainty as to our ultimate development rights at the property and future residential and commercial demand for the property. We analyzed various possible outcomes and resulting cash flows expected from the operations and ultimate disposition of the property. After determining that the carrying amount of the property was not likely to be recovered from those cash flows, we recognized a non-cash impairment loss of $27.7 million in March 2011 for the amount by which the carrying value of the property exceeded its estimated fair value; and
- $803,000 on goodwill associated with operating properties in 2011.

The table below sets forth impairment losses (recoveries) recognized by property classification:

For the Years Ended December 31,	
2012	2011

	(in thousands)	
Operating properties	$70,263	$70,512
Non-operating properties	(3,353)	80,509
Total	$66,910	$151,021

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The timely disposition of assets that no longer meet our strategic objectives is a key component of our strategy. Our identification of additional properties for disposition in future periods could result in our recognition of additional impairment losses in such periods.

General, Administrative and Leasing Expenses

In 2012, we incurred additional expenses in connection with certain staffing reductions made to adjust the size of the organization due in large part to our property dispositions. In 2011, certain of our executives voluntarily cancelled performance share units (“PSUs”) that were originally granted to them in 2010; we recognized a non-cash compensation charge of $1.2 million in 2011 in connection with these PSU cancellations, most of which was included in general, administrative and leasing expenses, and we will have no further compensation charges in the future in connection with the cancelled PSUs.

We capitalize compensation and indirect costs associated with properties, or portions thereof, undergoing construction, development and redevelopment activities, and also capitalize such costs associated with internal-use software development. We also capitalize compensation costs associated with obtaining new tenant leases or extending existing tenants. Capitalized compensation and indirect costs were as follows:

	For the Years Ended December 31,	
	2012	2011
	(in thousands)	
Construction, development, redevelopment, capital and tenant improvements	$7,976	$10,394
Leasing	1,151	1,259
Total	$9,127	$11,653

The decrease in capitalized compensation and indirect costs from 2011 to 2012 was attributable in large part to a lower level of construction and development activity.

Interest Expense

The table below sets forth the components of our interest expense included in continuing operations:

	For the Years Ended December 31,		
	2012	2011	Variance
	(in thousands)		
Interest on mortgage and other secured loans	$63,124	$75,760	$(12,636)
Interest on unsecured term loans	14,728	2,914	11,814
Interest on Exchangeable Senior Notes	13,851	20,267	(6,416)
Interest on Revolving Credit Facility	6,274	10,158	(3,884)
Interest expense recognized on interest rate swaps	3,697	4,600	(903)
Amortization of deferred financing costs	6,243	6,596	(353)
Other interest	2,784	1,406	1,378
Interest expense reclassified to discontinued operations	(2,174)	(6,079)	3,905
Capitalized interest	(13,903)	(17,400)	3,497
Total	$94,624	$98,222	$(3,598)

The decrease in interest expense included the effect of a $132.8 million decrease in our average outstanding debt resulting primarily from our repayments of debt using proceeds from property dispositions and equity issuances. Capitalized interest decreased from 2011 to 2012 due primarily to a decrease in the average costs associated with active construction projects resulting from projects being completed and our being slower to start new projects prior to definitive leasing being in place.

Loss on Interest Rate Swaps

On April 5, 2011, we entered into two forward starting LIBOR swaps for an aggregate notional amount of $175 million designated as cash flow hedges of interest payments on ten-year, fixed-rate borrowings forecasted to occur between August 2011 and April 2012. After meeting with our Board of Trustees on December 21, 2011, we determined that we would pursue other financing options and concluded that the originally forecasted borrowings were expected not to occur. Accordingly, the swaps no longer qualified for hedge accounting and we recognized an aggregate loss of $29.8 million on these interest rate swaps in December 2011, most of which was reclassified from accumulated other comprehensive losses at the time the swaps entered into on April 5, 2011 no longer qualified for hedge accounting. On January 5, 2012, we cash settled all of the forward starting swaps entered into on April 5, 2011 and December 22, 2011 for an aggregate of $29.7 million using borrowings from our Revolving Credit Facility.

Discontinued Operations

The increase in discontinued operations from 2011 to 2012 was due primarily to a $43.8 million decrease in impairment losses and a $16.1 million increase in gain on sales in the current period primarily in connection with the Strategic Reallocation Plan.

Income Tax (Expense) Benefit

The income tax benefit in 2011 was due primarily to a $4.8 million benefit on impairment losses recognized by our taxable REIT subsidiary in connection with the Strategic Reallocation Plan, most of which was recognized in the three months ended June 30, 2011.

Preferred Share Dividends

The increase in preferred share dividends was due to dividends on the newly issued Series L Preferred Shares, partially offset by the decrease in dividends attributable to the Series G Preferred Shares redeemed on August 2012.

Issuance Costs Associated With Redeemed Preferred Shares

In 2012, we recognized a $1.8 million decrease to net income available to common shareholders pertaining to the original issuance costs incurred on the Series G Preferred Shares that were redeemed.

Net Loss Attributable to Noncontrolling Interests

Interests in our Operating Partnership are in the form of preferred and common units. The line entitled net loss attributable to noncontrolling interests includes primarily loss or income allocated to preferred and common units not owned by us. Income is allocated to noncontrolling preferred unitholders in an amount equal to the priority return from the Operating Partnership to which they are entitled. Income and losses are allocated to noncontrolling common unitholders based on income earned by the Operating Partnership, after allocation to preferred unitholders, multiplied by the percentage of the common units in the Operating Partnership owned by those common unitholders.

The net loss attributable to noncontrolling interests changed due primarily to the increase in net income available to allocate to noncontrolling holders of common units in the Operating Partnership primarily resulting from the reasons set forth above.

Comparison of the Year Ended December 31, 2011 to the Year Ended December 31, 2010

	For the Years Ended December 31,		
	2011	2010	Variance
	(in thousands)		
Revenues			
Revenues from real estate operations	$428,496	$387,559	$40,937
Construction contract and other service revenues	84,345	104,675	(20,330)
Total revenues	512,841	492,234	20,607
Expenses			
Property operating expenses	162,397	146,617	15,780
Depreciation and amortization associated with real estate operations	113,111	97,897	15,214
Construction contract and other service expenses	81,639	102,302	(20,663)
Impairment losses	83,478	—	83,478
General, administrative and leasing expense	30,314	28,501	1,813
Business development expenses and land carry costs	6,122	6,403	(281)
Total operating expenses	477,061	381,720	95,341
Operating income	35,780	110,514	(74,734)
Interest expense	(98,222)	(95,729)	(2,493)
Interest and other income	5,603	9,568	(3,965)
Loss on interest rate derivatives	(29,805)	—	(29,805)
Loss on early extinguishment of debt	(1,639)	—	(1,639)
Equity in (loss) income of unconsolidated entities	(331)	1,376	(1,707)
Income tax benefit (expense)	6,710	(108)	6,818
(Loss) income from continuing operations	(81,904)	25,621	(107,525)
Discontinued operations	(48,404)	17,054	(65,458)
Gain on sales of real estate, net of income taxes	2,732	2,829	(97)
Net (loss) income	(127,576)	45,504	(173,080)
Net loss (income) attributable to noncontrolling interests	8,148	(2,744)	10,892
Preferred share dividends	(16,102)	(16,102)	—
Net (loss) income attributable to COPT common shareholders	$(135,530)	$26,658	$(162,188)

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NOI from Real Estate Operations

	For the Years Ended December 31,		
	2011	2010	Variance
	(Dollars in thousands, except per square foot data)		
Revenues			
Same Office Properties	$362,237	$362,853	$(616)
Constructed office properties placed in service	27,048	8,789	18,259
Acquired office properties	25,293	7,315	17,978
Properties held for sale	18,584	18,704	(120)
Greater Philadelphia properties	7,458	6,299	1,159
Dispositions	50,149	56,706	(6,557)
Other	5,063	1,062	4,001
	495,832	461,728	34,104
Property operating expenses			
Same Office Properties	137,286	132,768	4,518
Constructed office properties placed in service	5,705	1,993	3,712
Acquired office properties	9,225	2,317	6,908
Properties held for sale	6,292	5,831	461
Greater Philadelphia properties	1,402	2,131	(729)
Dispositions	24,448	25,974	(1,526)
Other	3,462	1,755	1,707
	187,820	172,769	15,051
NOI from real estate operations			
Same Office Properties	224,951	230,085	(5,134)
Constructed office properties placed in service	21,343	6,796	14,547
Acquired office properties	16,068	4,998	11,070
Properties held for sale	12,292	12,873	(581)
Greater Philadelphia properties	6,056	4,168	1,888
Dispositions	25,701	30,732	(5,031)
Other	1,601	(693)	2,294
	$308,012	$288,959	$19,053
Same Office Properties rent statistics			
Average occupancy rate	88.6%	90.2%	(1.6)%
Average straight-line rent per occupied square foot (1)	$22.50	$22.26	$0.24

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

As the table above indicates, our increase in NOI from real estate operations was attributable to the additions of properties through construction and acquisition activities.

Our Same Office Properties for purposes of comparing 2011 and 2010 consisted of 168 office properties, comprising 70.8% of our operating office square footage as of December 31, 2011. With regard to changes in NOI from real estate operations attributable to Same Office Properties:

- the decrease in revenues included the following:
  - a $2.3 million decrease in rental revenue attributable primarily to changes in occupancy and rental rates between the two years; and

- a $1.5 million decrease in net revenue from the early termination of leases; offset in part by
- a $3.2 million increase in tenant recoveries and other revenue due primarily to the increase in property operating expenses described below.

- the increase in property operating expenses included the following:
- a $1.9 million increase in costs for asset and property management labor, much of which was due to an increase in the size of our employee base supporting certain properties;
- a $1.7 million increase in interior and other repairs and maintenance;

- a $1.5 million increase in heating and air conditioning repairs and maintenance that was predominantly attributable to an increase in heating and air conditioning systems utilization at a property in San Antonio; and
- a $1.0 million increase in cleaning services and related supplies due in large part to increased contract rates and increased space usage of leased space at certain properties; offset in part by
- a $3.5 million decrease in snow removal expenses due primarily to record snowfall in Maryland and Northern Virginia in 2010.

NOI from Service Operations

	For the Years Ended December 31,		
	2011	2010	Variance
	(in thousands)		
Construction contract and other service revenues	$84,345	$104,675	$(20,330)
Construction contract and other service expenses	81,639	102,302	(20,663)
NOI from service operations	$2,706	$2,373	$333

As evidenced in the changes set forth above, construction contract and other service revenue and expenses decreased due primarily to a lower volume of construction activity in connection with one large construction contract that was nearing completion, although the change in NOI from service operations was not significant.

Depreciation and Amortization Associated with Real Estate Operations

Depreciation and amortization expense associated with real estate included in continuing operations increased due primarily to expense attributable to properties added into operations through construction and acquisition activities.
General, Administrative and Leasing Expenses

As described above, we recognized a non-cash compensation charge of $1.2 million in 2011 in connection with voluntary executive PSU cancellations, most of which was included in general, administrative and leasing expenses.

Capitalized compensation and indirect costs were as follows:

	For the Years Ended December 31,	
	2011	2010
	(in thousands)	
Construction, development, redevelopment, capital and tenant improvements	$10,394	$9,684
Leasing	1,259	1,222
Internal-use software development	—	126
Total	$11,653	$11,032

Impairment Losses

We recognized impairment losses in 2011, as described above.

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Interest Expense

The table below sets forth the components of our interest expense included in continuing operations:

	For the Years Ended December 31,		
	2011	2010	Variance
	(in thousands)		
Interest on mortgage and other secured loans	$75,760	$82,635	$(6,875)
Interest on Exchangeable Senior Notes	20,267	19,348	919
Interest on Revolving Credit Facility	10,158	5,923	4,235
Interest expense recognized on interest rate swaps	4,600	3,689	911
Interest on unsecured term loans	2,914	—	2,914
Amortization of deferred financing costs	6,596	5,871	725
Other interest	1,406	1,186	220
Interest expense reclassified to discontinued operations	(6,079)	(6,399)	320
Capitalized interest	(17,400)	(16,524)	(876)
Total	$98,222	$95,729	$2,493

The increase in interest expense included the effect of a $181.4 million increase in our average outstanding debt resulting primarily from our financing of acquisition and construction activities. The table above reflects the effects of our repayments of secured debt and our maintaining a higher weighted average borrowing level on the Revolving Credit Facility in 2011.

Loss on Interest Rate Swaps

As described above, we recognized an aggregate loss of $29.8 million on certain forward starting interest rate swaps in December 2011, most of which was reclassified from accumulated other comprehensive losses.

Interest and Other Income

The decrease in interest and other income was due primarily to a decrease in gain recognized on our investment in common stock of The KEYW Holding Corporation (“KEYW”), an entity supporting the intelligence community's operations and transformation to Cyber Age mission by providing engineering services and integrated platforms that support the intelligence process. We used the equity method of accounting for our investment in KEYW common stock until the resignation of our Chief Executive Officer from the Board of Directors of KEYW effective July 1, 2011, at which time we began accounting for our investment in KEYW's common stock as a trading marketable equity security to be reported at fair value, with unrealized gains and losses recognized through earnings. Most of the decrease in gain was attributable to additional equity issued by KEYW in connection with its initial public offering of common stock in 2010; no similar event occurred in 2011.

Income Tax Benefit (Expense)

As described above, the income tax benefit in 2011 was due primarily to impairment losses recognized by our taxable REIT subsidiary in connection with the Strategic Reallocation Plan.

Discontinued Operations

The decrease in discontinued operations was due primarily to $67.5 million in impairment losses recognized in connection with the Strategic Reallocation Plan described above.

Net Loss (Income) Attributable to Noncontrolling Interests

The net loss (income) attributable to noncontrolling interests changed due primarily to the decrease in net income available to allocate to noncontrolling holders of common units in the Operating Partnership primarily resulting from the reasons set forth above.

Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ("Adjusted EBITDA") Interest Coverage Ratio and Adjusted EBITDA Fixed Charge Coverage Ratio

Adjusted EBITDA is net (loss) income adjusted for the effects of interest expense, depreciation and amortization, impairment losses, gain on sales of properties, gain or loss on early extinguishment of debt, net gain on unconsolidated entities, operating property acquisition costs, loss on interest rate derivatives and income taxes. We believe that Adjusted EBITDA is a useful supplemental measure for assessing our un-levered performance. We believe that net (loss) income, as reported on our consolidated statements of operations, is the most directly comparable GAAP measure to Adjusted EBITDA. Adjusted EBITDA excludes items that are included in net income, including some that require cash outlays; we compensate for this limitation by using the measure simply as a supplemental measure that is considered alongside other GAAP and non-GAAP measures. It should not be used as an alternative to net income when evaluating our financial performance or to cash flow from operating, investing and financing activities when evaluating our liquidity or ability to make cash distributions or pay debt service.

We use Adjusted EBITDA to calculate Adjusted EBITDA Interest Coverage Ratio and Adjusted EBITDA Fixed Charge Coverage Ratio. We calculate Adjusted EBITDA interest coverage by dividing Adjusted EBITDA by interest expense on continuing and discontinued operations (excluding amortization of deferred financing costs and amortization of debt discounts and premiums, net of amounts capitalized). We calculate Adjusted EBITDA fixed charge coverage ratio by dividing Adjusted EBITDA by the sum of: (1) interest expense on continuing and discontinued operations (excluding amortization of deferred financing costs and amortization of debt discounts and premiums, net of amounts capitalized); (2) dividends on preferred shares; and (3) distributions on preferred units in the Operating Partnership not owned by us.

The tables below set forth the computation of our Adjusted EBITDA interest and fixed charge coverage ratios and reconciliations of Adjusted EBITDA to net income reported on our consolidated statements of operations:

	For the Years Ended December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Net income (loss)	$20,341	$(127,576)	$45,504
Interest expense (1)	96,798	104,301	102,128
Income tax expense (benefit) (2)	381	(6,710)	119
Depreciation and amortization (1)	124,418	136,594	125,819
Impairment losses (1)	66,910	151,021	—
(Gain) loss on early extinguishment of debt (1)	(793)	2,023	—
Gain on sales of operating properties	(20,928)	(4,811)	(1,077)
Non-operating property sales	(33)	(2,717)	(2,840)
Net gain on investments in unconsolidated entities included in interest and other income	(3,589)	(1,820)	(6,408)
Operating property acquisition costs	229	156	3,424
Loss on interest rate swaps	—	29,805	—
Adjusted EBITDA	$283,734	$280,266	$266,669
Interest expense (1)	$96,798	$104,301	$102,128
Less: Amortization of deferred financing costs	(6,243)	(6,596)	(5,871)
Less: Amortization of net debt discounts and premiums, net of amounts capitalized	(2,721)	(4,680)	(4,974)
Denominator for Adjusted EBITDA interest coverage ratio	$87,834	$93,025	$91,283
Preferred share dividends	20,844	16,102	16,102
Preferred distributions	660	660	660

Denominator for Adjusted EBITDA fixed charge coverage ratio	$109,338	$109,787	$108,045
Adjusted EBITDA interest coverage ratio	3.23x	3.01x	2.92x
Adjusted EBITDA fixed charge coverage ratio	2.60x	2.55x	2.47x

(1) Includes amounts included in continuing operations and discontinued operations.
(2) Includes income taxes on continuing operations and gains on sales of real estate.

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Funds from Operations

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

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

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

Diluted FFO available to common share and common unit holders ("Diluted FFO") is Basic FFO adjusted to add back any changes in Basic FFO that would result from the assumed conversion of securities that are convertible or exchangeable into common shares. We believe that Diluted FFO is useful to investors because it is the numerator used to compute Diluted FFO per share, discussed below. We believe that the numerator for diluted EPS is the most directly comparable GAAP measure to Diluted FFO. Since Diluted FFO excludes certain items includable in the numerator to diluted EPS, reliance on the measure has limitations; management compensates for these limitations by using the measure simply as a supplemental measure that is weighed in the balance with other GAAP and non-GAAP measures. Diluted FFO is not necessarily an indication of our cash flow available to fund cash needs. Additionally, it should not be used as an alternative to net income when evaluating our financial performance or to cash flow from operating, investing and financing activities when evaluating our liquidity or ability to make cash distributions or pay debt service.

Diluted FFO, as adjusted for comparability is defined as Diluted FFO adjusted to exclude operating property acquisition costs, gains on sales of, and impairment losses on, properties other than previously depreciated operating properties, net of associated income tax, gain or loss on early extinguishment of debt, loss on interest rate swaps and issuance costs associated with redeemed preferred shares. We believe that the excluded items are not reflective of normal operations and, as a result, we believe that a measure that excludes these items is a useful supplemental measure in evaluating our operating performance. We believe that the numerator to diluted EPS is the most directly comparable GAAP measure to this non-GAAP measure. This measure has essentially the same limitations as Diluted FFO, as well as the further limitation of not reflecting the effects of the excluded items; we compensate for these limitations in essentially the same manner as described above for Diluted FFO.

Diluted FFO per share is (1) Diluted FFO divided by (2) the sum of the (a) weighted average common shares outstanding during a period, (b) weighted average common units outstanding during a period and (c) weighted average number of potential additional common shares that would have been outstanding during a period if other securities that are convertible or exchangeable into common shares were converted or exchanged. We believe that Diluted FFO per share is useful to investors because it provides investors with a further context for evaluating our FFO results in the same manner that investors use

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earnings per share ("EPS") in evaluating net income available to common shareholders. In addition, since most equity REITs provide Diluted FFO per share information to the investment community, we believe that Diluted FFO per share is a useful supplemental measure for comparing us to other equity REITs. We believe that diluted EPS is the most directly comparable GAAP measure to Diluted FFO per share. Diluted FFO per share has most of the same limitations as Diluted FFO (described above); management compensates for these limitations in essentially the same manner as described above for Diluted FFO.

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

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

We use measures called payout ratios as supplemental measures of our ability to make distributions to investors based on each of the following: FFO; Diluted FFO; and Diluted FFO, adjusted for comparability. These measures are defined as (1) the sum of (a) dividends on common shares and (b) distributions to holders of interests in the Operating Partnership and dividends on convertible preferred shares when such distributions and dividends are included in Diluted FFO divided by either (2) FFO, Diluted FFO or Diluted FFO, adjusted for comparability.

The tables appearing below and on the following page sets forth the computation of the above stated measures for the years ended December 31, 2008 through 2012 and provides reconciliations to the GAAP measures associated with such measures:

	For the Years Ended December 31,				
	2012	2011	2010	2009	2008
	(Dollars and shares in thousands, except per share data)				
Net income (loss)	$20,341	$(127,576)	$45,504	$61,299	$61,316
Add: Real estate-related depreciation and amortization	121,937	134,131	123,243	109,386	102,772
Add: Depreciation and amortization on unconsolidated real estate entities allocable to COPT (1)	346	492	631	640	648
Add: Impairment losses on previously depreciated operating properties	70,263	70,512	—	—	—
Less: Gain on sales of previously depreciated operating properties, net of income taxes	(20,928)	(4,811)	(1,077)	—	(2,630)
FFO	191,959	72,748	168,301	171,325	162,106
Less: Noncontrolling interests-preferred units in the Operating Partnership	(660)	(660)	(660)	(660)	(660)
Less: FFO allocable to other noncontrolling interests	(1,989)	(1,887)	(1,370)	(308)	(442)
Less: Preferred share dividends	(20,844)	(16,102)	(16,102)	(16,102)	(16,102)
Less: Issuance costs associated with redeemed preferred shares	(1,827)	—	—	—	—
Basic and Diluted FFO allocable to restricted shares	(919)	(1,037)	(1,524)	(1,629)	(1,310)
Basic and Diluted FFO	$165,720	$53,062	$148,645	$152,626	$143,592
Operating property acquisition costs	229	156	3,424	1,967	—
Gain on sales of non-operating properties, net of income taxes	(33)	(2,717)	(2,829)	—	(988)
Impairment (recoveries) losses on other properties	(3,353)	80,509	—	—	—
Income tax expense on impairment recoveries (losses) on other properties	673	(4,775)	—	—	—
Loss on interest rate derivatives	—	29,805	—	—	—
(Gain) loss on early extinguishment of debt	(793)	2,023			(8,026)
Issuance costs associated with redeemed preferred shares	1,827	—	—	—	—
Diluted FFO, as adjusted for comparability	$164,270	$158,063	$149,240	$154,593	$134,578
Weighted average common shares	73,454	69,382	59,611	55,930	48,132
Conversion of weighted average common units	4,235	4,355	4,608	5,717	8,107
Weighted average common shares/units - Basic FFO	77,689	73,737	64,219	61,647	56,239
Dilutive effect of share-based compensation awards	53	111	333	477	688
Weighted average common shares/units - Diluted FFO	77,742	73,848	64,552	62,124	56,927
Diluted FFO per share	$2.13	$0.72	$2.30	$2.46	$2.52
Diluted FFO per share, as adjusted for comparability	$2.11	$2.14	$2.31	$2.49	$2.36

	For the Years Ended December 31,				
	2012	2011	2010	2009	2008
	(Dollars and shares in thousands, except per share data)				
Numerator for diluted EPS	$(2,163)	$(136,567)	$25,587	$39,217	$37,135
Add: Income allocable to noncontrolling interests-common units in the Operating Partnership	(87)	(8,439)	2,116	4,495	6,519
Add: Real estate-related depreciation and amortization	121,937	134,131	123,243	109,386	102,772
Add: Depreciation and amortization of unconsolidated real estate entities	346	492	631	640	648
Add: Impairment losses on previously depreciated operating properties	70,263	70,512	—	—	—
Add: Numerator for diluted EPS allocable to restricted shares	469	1,037	1,071	1,010	728
Less: Depreciation and amortization allocable to noncontrolling interests in other consolidated entities	(633)	(849)	(1,402)	(493)	(270)
Less: Decrease in noncontrolling interests unrelated to earnings	(2,565)	(1,407)	—	—	—
Less: Basic and diluted FFO allocable to restricted shares	(919)	(1,037)	(1,524)	(1,629)	(1,310)
Less: Gain on sales of previously depreciated operating properties, net of income taxes	(20,928)	(4,811)	(1,077)	—	(2,630)
Basic and Diluted FFO	$165,720	$53,062	$148,645	$152,626	$143,592
Operating property acquisition costs	229	156	3,424	1,967	—
Gain on sales of non-operating properties, net of income taxes	(33)	(2,717)	(2,829)	—	(988)
Impairment (recoveries) losses on other properties	(3,353)	80,509	—	—	—
Income tax expense (benefit) on impairment (recoveries) losses on other properties	673	(4,775)	—	—	—
Loss on interest rate derivatives	—	29,805	—	—	—
(Gain) loss on early extinguishment of debt	(793)	2,023			(8,026)
Issuance costs associated with redeemed preferred shares	1,827	—	—	—	—
Diluted FFO, as adjusted for comparability	$164,270	$158,063	$149,240	$154,593	$134,578
Denominator for diluted EPS	73,454	69,382	59,944	56,407	48,820
Weighted average common units	4,235	4,355	4,608	5,717	8,107
Anti-dilutive EPS effect of share-based compensation awards	53	111	—	—	—
Denominator for diluted FFO per share measures	77,742	73,848	64,552	62,124	56,927
Dividends on common shares	$81,720	$116,717	$98,510	$87,596	$70,836
Common unit distributions	4,617	7,173	7,266	7,962	11,510
Numerator for diluted FFO payout ratio, adjusted for comparability	$86,337	$123,890	$105,776	$95,558	$82,346
FFO payout ratio	45.0 %	170.3 %	62.8 %	55.8 %	50.8 %
Diluted FFO payout ratio	52.1 %	233.5 %	71.2 %	62.6 %	57.3 %
	52.6 %	78.4 %	70.9 %	61.8 %	61.2 %

Diluted FFO payout ratio, as adjusted for comparability

Property Additions

The table below sets forth the major components of our additions to properties for 2012 and 2011:

	For the Years Ended December 31,		
	2012	2011	Variance
	(in thousands)		
Construction, development and redevelopment (1)	$165,523	$240,360	$(74,837)
Acquisition of operating properties (2)	33,684	26,887	6,797
Tenant improvements on operating properties (3)	22,068	47,147	(25,079)
Capital improvements on operating properties	26,827	16,572	10,255
	$248,102	$330,966	$(82,864)

(1) The decrease from 2011 to 2012 was attributable in large part to a slowing in the pace of new construction projects started since we were less inclined to commence construction on projects prior to definitive leasing prospects being in place than we were historically. Estimated remaining costs on existing construction projects totaled $134.7 million at December 31, 2012. We also have a significant pipeline of land, much of which we expect to use for the construction of new projects in the future, although the volume and pace of such new projects occurring will be dependent in large part on the leasing environment.

(2) Excludes intangible assets and liabilities associated with such acquisition. Our level of future acquisitions will be dependent largely on our ability to identify strategic acquisition opportunities that meet our return criteria and our having sufficient capital available to complete such acquisitions.

(3) Tenant improvement costs incurred on newly-constructed properties are classified in this table as construction, development and redevelopment. The decrease from 2011 to 2012 was due in large part to a decrease in leases executed on existing space in 2012 and 2011 including significant costs from leases executed in 2010.

Cash Flows

Net cash flow provided by operating activities increased $39.7 million from 2011 to 2012 due primarily to: an increase in cash flow received from real estate operations, which was affected by the timing of cash receipts; an increase in cash flow associated with the timing of cash flow from third-party construction projects; $19.0 million in proceeds in the current period from the sale of our KEYW common stock, including $5.1 million received from sales completed in 2011; and $17.3 million in previously accreted interest paid in the prior period in connection with our repurchase of exchangeable senior notes; offset in part by $29.7 million paid to cash settle interest rate swaps in the current period.

Net cash flow provided by investing activities increased $274.1 million from 2011 to 2012 due mostly to a $211.0 million increase from sales of properties primarily in connection with the Strategic Reallocation Plan and lower levels of development spending.

Net cash flow used in financing activities in 2012 was $200.5 million and included the following:

- net repayments of debt of $395.0 million;
- proceeds from the issuance of common and preferred shares of $371.1 million;
- payments to redeem the Series G Preferred Shares of $55.0 million; and
- dividends and distributions of $114.1 million.

Net cash flow provided by financing activities in 2011 was $103.7 million and included the following:

- net borrowings of $111.4 million;
- proceeds from the issuance of common shares of $147.8 million; and
- dividends and distributions of $138.6 million.

Liquidity and Capital Resources

Our primary cash requirements are for operating expenses, debt service, development of new properties, improvements to existing properties and acquisitions. We expect to continue to use cash flow provided by operations as the primary source to meeting our short-term capital needs, including property operating expenses, general and administrative expenses, interest expense, scheduled principal amortization of debt, dividends to our shareholders, distributions to our noncontrolling interest holders of preferred and common units in the Operating Partnership and improvements to existing properties. We believe that our liquidity and capital resources are adequate for our near-term and longer-term requirements without necessitating property sales. However, we expect to generate cash by selling properties included in the Strategic Reallocation Plan through 2013.

We have historically relied on fixed-rate, non-recourse mortgage loans from banks and institutional lenders for long-term financing and to restore availability on our Revolving Credit Facility. In recent years, we have relied more on unsecured bank loans and publicly issued, convertible unsecured debt for long-term financing. We also periodically access the public equity markets to raise capital by issuing common and/or preferred shares.

We often use our Revolving Credit Facility to initially finance much of our investing activities. We then pay down the facility using proceeds from long-term borrowings, equity issuances and property sales. The lenders' aggregate commitment under the facility is $800 million, with the ability for us to increase the lenders' aggregate commitment to $1.3 billion, provided that there is no default under the facility and subject to the approval of the lenders. Amounts available under the facility are computed based on 60% of our unencumbered asset value, as defined in the agreement. The Revolving Credit Facility matures on September 1, 2014, and may be extended by one year at our option, provided that there is no default under the facility and we pay an extension fee of 0.20% of the total availability of the facility. As of December 31, 2012, the maximum borrowing capacity under this facility totaled $800.0 million, of which $792.3 million was available.

We also have construction loan facilities that provide for aggregate borrowings of up to $123.8 million, $94.2 million of which was available at December 31, 2012 to fund future construction costs at specific projects.

The following table summarizes our contractual obligations as of December 31, 2012 (in thousands):

	For the Years Ending December 31,						
	2013	2014	2015	2016	2017	Thereafter	Total
Contractual obligations (1)							
Debt (2)							
Balloon payments due upon maturity	$111,289	$151,681	$790,254	$274,605	$550,610	$120,011	$1,998,450
Scheduled principal payments	9,840	6,660	5,548	4,037	778	2,479	29,342
Interest on debt (3)	83,414	74,071	57,850	33,759	7,436	4,725	261,255
New construction and redevelopment obligations (4)(5)	54,937	10,000	—	—	—	—	64,937
Third-party construction and development obligations (5)(6)	46,180	2,430	—	—	—	—	48,610
Capital expenditures for operating properties (5)(7)	16,497	5,000	—	—	—	—	21,497
Operating leases (8)	1,177	1,162	1,040	978	975	81,700	87,032
Other purchase obligations (9)	3,150	2,029	1,088	565	5	98	6,935
Total contractual cash obligations	$326,484	$253,033	$855,780	$313,944	$559,804	$209,013	$2,518,058

(1) The contractual obligations set forth in this table generally exclude property operations contracts that had a value of less than $20,000. Also excluded are contracts associated with the operations of our properties that may be terminated with notice of one month or less, which is the arrangement that applies to most of our property operations contracts.

(2) Represents scheduled principal amortization payments and maturities only and therefore excludes a net discount of $8.6 million. The balloon payment maturities include $17.5 million in 2013 and $411.1 million in 2015 that may each be extended for one year, subject to certain conditions. We expect to refinance the remainder of the balloon payments that are due in 2013 and 2014 using primarily a combination of borrowings under our credit facilities and by accessing the unsecured debt market and/or secured debt market.

(3) Represents interest costs for debt at December 31, 2012 for the terms of such debt. For variable rate debt, the amounts reflected above used December 31, 2012 interest rates on variable rate debt in computing interest costs for the terms of such debt.

(4) Represents contractual obligations pertaining to new construction and redevelopment activities. Construction and redevelopment activities underway or contractually committed at December 31, 2012 included the following:

Activity	Number of Properties	Square Feet (in thousands)	Estimated Remaining Costs(in millions)	Expected Year For Costs to be Incurred Through
Construction of new office properties	11	1,357	$ 134.7	2015
Redevelopment of existing office properties	2	297	19.3	2014

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

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

(7) Represents contractual obligations pertaining to recurring and nonrecurring capital expenditures for our operating properties. We expect to finance these costs primarily using cash flow from operations.

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

(9) Primarily represents contractual obligations pertaining to managed-energy service contracts in place for certain of our operating properties. We expect to pay these items using cash flow from operations.

We expect to spend more than $170.0 million on construction and development costs and approximately $50.0 million on improvements to operating properties (including the commitments set forth in the table above) in 2013. We expect to fund the construction and development costs and our debt maturities in 2013 using primarily a combination of borrowings under our Revolving Credit Facility and existing construction loan facilities. We expect to fund improvements to existing operating properties using cash flow from operations.

Certain of our debt instruments require that we comply with a number of restrictive financial covenants, including maximum leverage ratio, unencumbered leverage ratio, minimum net worth, minimum fixed charge coverage, minimum unencumbered interest coverage ratio, minimum debt service and maximum secured indebtedness ratio. As of December 31, 2012, we were in compliance with these financial covenants.

Off-Balance Sheet Arrangements

During 2012, we owned an investment in an unconsolidated real estate joint venture into which we entered in 2005 to enable us to contribute office properties that were previously wholly owned by us into the joint venture in order to partially dispose of our interest in the properties. We managed the real estate joint venture’s property operations and any required construction projects until January 1, 2013, at which time these responsibilities were assumed by a third party. This real estate joint venture has a two-member management committee that is responsible for making major decisions (as defined in the joint venture agreement) and we control one of the management committee positions.

We and our partner may receive returns in proportion to our investments in the joint venture. As part of our obligations under the joint venture arrangement, we entered into standard nonrecourse loan guarantees (environmental indemnifications and guarantees against fraud and misrepresentation, and springing guarantees of partnership debt in the event of a voluntary bankruptcy of the partnership). The maximum amount we could be required to pay under the guarantees is approximately $65 million. We were entitled to recover 20% of any amounts paid under the guarantees from an affiliate of our partner pursuant to an indemnity agreement so long as we continued to manage the properties; in connection with the transition of our property management responsibilities to a third party effective January 1, 2013, the percentage that we are entitled to recover increased to 80%. In October 2012, the holder of the mortgage debt encumbering all of the joint venture’s properties initiated foreclosure proceedings. Management considered this event and estimates that the aggregate fair value of the guarantees would not exceed the amounts included in distributions received in excess of investment in unconsolidated real estate joint venture reported on the consolidated balance sheets.

While we historically accounted for our investment in this joint venture using the equity method, we discontinued our application of the equity method effective October 2012 due to our having neither the obligation nor intent to support the joint venture. We had distributions in excess of our investment in this unconsolidated real estate joint venture of $6.4 million as of December 31, 2012 due to the following: our deferral of gain in a prior period on our initial contribution of property to the joint venture due to our guarantees described above; and our subsequent recognition of losses under the equity method in excess of our investment due to such guarantees and our continued intent to support the joint venture prior to October 2012. We recognized equity in the losses of this joint venture of $349,000 in 2012.

We had no other material off-balance sheet arrangements during 2012.

Inflation

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

Recent Accounting Pronouncements

We adopted guidance issued by the Financial Accounting Standards Board ("FASB") effective January 1, 2012 related to the presentation of comprehensive income that requires us to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. We adopted this guidance using retrospective application. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of equity. Our adoption of this guidance did not affect our financial position, results of operations, cash flows or measurement of comprehensive income but did change the location of our disclosure pertaining to comprehensive income in our consolidated financial statements.

We adopted guidance issued by the FASB effective January 1, 2012 that amends measurement and disclosure requirements related to fair value measurements to improve consistency with International Financial Reporting Standards. In connection with our adoption of this guidance, we made an accounting policy election to use an exception provided for in the guidance with respect to measuring counterparty credit risk for derivative instruments; this election enables us to continue to measure the fair value of groups of assets and liabilities associated with derivative instruments consistently with how market participants would price the net risk exposure at the measurement date. Our adoption of this guidance did not affect our financial position, results of operations or cash flows but did result in additional disclosure pertaining to our fair value measurements.

We adopted guidance issued by the FASB effective January 1, 2012 relating to the testing of goodwill for impairment that permits us to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform a quantitative impairment test. This guidance eliminates the requirement to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. Our adoption of this guidance did not materially affect our consolidated financial statements or disclosures.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

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

The following table sets forth as of December 31, 2012 our debt obligations and weighted average interest rates for fixed rate debt by expected maturity date (dollars in thousands):

	For the Years Ending December 31,						
	2013	2014	2015	2016	2017	Thereafter	Total
Long term debt: (1)							
Fixed rate debt (2)	$101,866	$157,526	$347,848	$278,642	$301,388	$2,490	$1,189,760
Weighted average interest rate	5.62 %	6.41 %	4.67 %	6.57 %	5.54 %	2.62 %	5.64 %
Variable rate debt	$19,263	$815	$447,954	$—	$250,000	$120,000	$838,032

(1) Maturities include $17.5 million in 2013 and $411.1 million in 2015 that may each be extended for one year, subject to certain conditions.
(2) Represents principal maturities only and therefore excludes net discounts of $8.6 million.

The fair value of our debt was $2.1 billion at December 31, 2012 and $2.4 billion at December 31, 2011. If interest rates had been 1% lower, the fair value of our fixed-rate debt would have increased by approximately $63.0 million at December 31, 2012 and $77.5 million at December 31, 2011.

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The following table sets forth information pertaining to interest rate swap contracts in place as of December 31, 2012 and 2011 and their respective fair values (dollars in thousands):

Notional Amount		Fixed Rate	Floating Rate Index	Effective Date	Expiration Date	Fair Value at December 31, 2012	2011
$100,000		0.6123 %	One-Month LIBOR	1/3/2012	9/1/2014	$(594)	$55
100,000		0.6100 %	One-Month LIBOR	1/3/2012	9/1/2014	(591)	56
100,000		0.8320 %	One-Month LIBOR	1/3/2012	9/1/2015	(1,313)	(66)
100,000		0.8320 %	One-Month LIBOR	1/3/2012	9/1/2015	(1,313)	(49)
38,475	(1)	3.8300 %	One-Month LIBOR + 2.25%	11/2/2010	11/2/2015	(1,268)	(1,054)
100,000		0.8055 %	One-Month LIBOR	9/2/2014	9/1/2016	(263)	—
100,000		0.8100 %	One-Month LIBOR	9/2/2014	9/1/2016	(272)	—
100,000		1.6730 %	One-Month LIBOR	9/1/2015	8/1/2019	(154)	—
100,000		1.7300 %	One-Month LIBOR	9/1/2015	8/1/2019	(417)	—
50,000		0.5025 %	One-Month LIBOR	1/3/2011	1/3/2012	—	(1)
50,000		0.5025 %	One-Month LIBOR	1/3/2011	1/3/2012	—	(1)
120,000		1.7600 %	One-Month LIBOR	1/2/2009	5/1/2012	—	(552)
100,000		1.9750 %	One-Month LIBOR	1/1/2010	5/1/2012	—	(532)
100,000	(2)	3.8415 %	Three-Month LIBOR	9/30/2011	9/30/2021	—	(16,333)
75,000	(2)	3.8450 %	Three-Month LIBOR	9/30/2011	9/30/2021	—	(12,275)
100,000	(2)	2.0525 %	Three-Month LIBOR-Reverse	12/30/2011	9/30/2021	—	345
75,000	(2)	2.0525 %	Three-Month LIBOR-Reverse	12/30/2011	9/30/2021	—	260
						$(6,185)	$(30,147)

(1) The notional amount of this instrument is scheduled to amortize to $36.2 million.
(2) As described further in Note 11 to our consolidated financial statements, we cash settled these instruments, along with interest accrued thereon, for an aggregate of $29.7 million.

Based on our variable-rate debt balances, including the effect of interest rate swap contracts, our interest expense would have increased by $5.0 million in the 2012 and $3.8 million in 2011 if short-term interest rates were 1% higher.

Item 8. Financial Statements and Supplementary Data

This item is included in a separate section at the end of this report beginning on page F-1.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
None.

Item 9A. Controls and Procedures
Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of December 31, 2012. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of December 31, 2012 were functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed or submitted under the Securities Exchange Act of 1934, as amended, is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to our management, including our

principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

I. Internal Control Over Financial Reporting

(a) Management's Annual Report on Internal Control Over Financial Reporting

Management's Annual Report on Internal Control Over Financial Reporting is included in a separate section at the end of this report on page F-2.

(b) Report of Independent Registered Public Accounting Firm

The Report of Independent Registered Public Accounting Firm is included in a separate section at the end of this report on page F-3.

(c) Change in Internal Control over Financial Reporting

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

Item 9B. Other Information
None.

PART III
Items 10, 11, 12, 13 & 14. Directors, Executive Officers and Corporate Governance; Executive Compensation; Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters; Certain Relationships and Related Transactions, and Director Independence; and Principal Accountant Fees and Services
For the information required by Item 10, Item 11, Item 12, Item 13 and Item 14, you should refer to our definitive proxy statement relating to the 2013 Annual Meeting of our Shareholders to be filed with the Securities and Exchange Commission no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

PART IV
Item 15. Exhibits and Financial Statement Schedules
(a) The following documents are filed as exhibits to this Form 10-K:

1. Financial Statements. See “Index to consolidated financial statements” on page F-1 of this Annual Report on Form 10-K.

2. Financial Statement Schedule. See “Index to consolidated financial statements” on page F-1 of this Annual Report on Form 10-K.

3. See section below entitled “Exhibits.”

(b) Exhibits. Refer to the Exhibit Index that follows. Unless otherwise noted, the file number of all documents incorporated by reference is 1-14023.

EXHIBIT NO.	DESCRIPTION
3.1.1	Amended and Restated Declaration of Trust of Registrant (filed with the Registrant's Registration Statement on Form S-4 (Commission File No. 333-45649) and incorporated herein by reference).
3.1.2	Articles of Amendment of Amended and Restated Declaration of Trust (filed on March 22, 2002 with the Company's Annual Report on Form 10-K for the year ended December 31, 2001 and incorporated herein by reference).
3.1.3	Articles of Amendment of Amended and Restated Declaration of Trust (filed with the Company's Current Report on Form 8-K on December 29, 2004 and incorporated herein by reference).
3.1.4	Articles Supplementary of Corporate Office Properties Trust Series B Cumulative Redeemable Preferred Shares, dated July 2, 1999 (filed with the Company's Current Report on Form 8-K on July 7, 1999 and incorporated herein by reference).
3.1.5	Articles Supplementary of Corporate Office Properties Trust relating to the Series B Cumulative Redeemable Preferred Shares (filed with the Company's Current Report on Form 8-K on December 29, 2004 and incorporated herein by reference).
3.1.6	Articles Supplementary of Corporate Office Properties Trust relating to the Series D Convertible Preferred Shares (filed with the Company's Current Report on Form 8-K on December 29, 2004 and incorporated herein by reference).
3.1.7	Articles Supplementary of Corporate Office Properties Trust relating to the Series E Cumulative Redeemable Preferred Shares, dated April 3, 2001 (filed with the Registrant's Current Report on Form 8-K on April 4, 2001 and incorporated herein by reference).
3.1.8	Articles Supplementary of Corporate Office Properties Trust relating to the Series F Cumulative Redeemable Preferred Shares, dated September 13, 2001 (filed with the Registrant's Amended Current Report on Form 8-K on September 14, 2001 and incorporated herein by reference).
3.1.9	Articles Supplementary of Corporate Office Properties Trust relating to the Series G Cumulative Redeemable Preferred Shares, dated August 6, 2003 (filed with the Registrant's Registration Statement on Form 8-A on August 7, 2003 and incorporated herein by reference).
3.1.10	Articles Supplementary of Corporate Office Properties Trust relating to the Series H Cumulative Redeemable Preferred Shares, dated December 11, 2003 (filed with the Company's Current Report on Form 8-K on December 12, 2003 and incorporated herein by reference).
3.1.11	Articles Supplementary of Corporate Office Properties Trust relating to the Series J Cumulative Redeemable Preferred Shares of Beneficial Interest (filed with the Company's Current Report on Form 8-K dated July 19, 2006 and incorporated herein by reference).
3.1.12	Articles Supplementary of Corporate Office Properties Trust relating to the Series K Cumulative Redeemable Convertible Preferred Shares of Beneficial Interest (filed with the Company's Current Report on Form 8-K dated January 16, 2007 and incorporated herein by reference).
3.1.13	Articles Supplementary of Corporate Office Properties Trust relating to the Series L Cumulative Preferred Shares of Beneficial Interest (filed with the Company's Current Report on Form 8-K dated June 25, 2012 and incorporated herein by reference).
3.1.14	Articles of Amendment of Amended and Restated Declaration of Trust (filed with the Company's Current Report on Form 8-K dated May 28, 2008 and incorporated herein by reference).
3.1.15	Articles of Amendment of Amended and Restated Declaration of Trust (filed with the Company's Current Report on Form 8-K dated May 19, 2010 and incorporated herein by reference).
3.1.16	Articles of Amendment of Amended and Restated Declaration of Trust (filed with the Company's Current Report on Form 8-K dated June 19, 2012 and incorporated herein by reference).
3.2.1	Bylaws of the Registrant, as amended and restated on December 3, 2009 (filed with the Company's Current Report on Form 8-K dated December 9, 2009 and incorporated herein by reference).
3.2.2	

	First Amendment to Amended and Restated Bylaws (filed with the Company’s Current Report on Form 8-K dated December 18, 2012 and incorporated herein by reference).
3.3	Form of certificate for the Registrant's Common Shares of Beneficial Interest, $0.01 par value per share (filed with the Registrant's Registration Statement on Form S-4 (Commission File No. 333-45649) and incorporated herein by reference).
4.1	Indenture, dated as of April 7, 2010, among Corporate Office Properties, L.P., as issuer, Corporate Office Properties Trust, as guarantor, and Wells Fargo Bank, National Association, as trustee (filed with the Company’s Current Report on Form 8-K dated April 16, 2010 and incorporated herein by reference).
4.2	4.25% Exchangeable Senior Note due 2030 of Corporate Office Properties, L.P. (filed with the Company’s Current Report on Form 8-K dated April 16, 2010 and incorporated herein by reference).

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EXHIBIT NO.	DESCRIPTION
10.1.1	Second Amended and Restated Limited Partnership Agreement of the Operating Partnership, dated December 7, 1999 (filed on March 16, 2000 with the Company's Annual Report on Form 10-K for the year ended December 31, 1999 and incorporated herein by reference).
10.1.2	First Amendment to Second Amended and Restated Limited Partnership Agreement of the Operating Partnership, dated December 21, 1999 (filed on March 16, 2000 with the Company's Annual Report on Form 10-K for the year ended December 31, 1999 and incorporated herein by reference).
10.1.3	Second Amendment to Second Amended and Restated Limited Partnership Agreement of the Operating Partnership, dated December 21, 1999 (filed with the Company's Post Effective Amendment No. 2 to Form S-3 dated November 1, 2000 (Registration Statement No. 333-71807) and incorporated herein by reference).
10.1.4	Third Amendment to Second Amended and Restated Limited Partnership Agreement of the Operating Partnership, dated September 29, 2000 (filed with the Company's Post Effective Amendment No. 2 to Form S-3 dated November 1, 2000 (Registration Statement No. 333-71807) and incorporated herein by reference).
10.1.5	Fourth Amendment to Second Amended and Restated Limited Partnership Agreement of the Operating Partnership, dated November 27, 2000 (filed on March 27, 2003 with the Company's Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference).
10.1.6	Fifth Amendment to Second Amended and Restated Limited Partnership Agreement of the Operating Partnership, dated January 25, 2001 (filed on March 27, 2003 with the Company's Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference).
10.1.7	Sixth Amendment to Second Amended and Restated Limited Partnership Agreement of the Operating Partnership, dated April 3, 2001 (filed with the Company's Current Report on Form 8-K dated April 4, 2001 and incorporated herein by reference).
10.1.8	Seventh Amendment to Second Amended and Restated Limited Partnership Agreement of the Operating Partnership, dated August 30, 2001 (filed on March 27, 2003 with the Company's Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference).
10.1.9	Eighth Amendment to Second Amended and Restated Limited Partnership Agreement of the Operating Partnership, dated September 14, 2001 (filed with the Company's Amended Current Report on Form 8-K dated September 14, 2001 and incorporated herein by reference).
10.1.10	Ninth Amendment to Second Amended and Restated Limited Partnership Agreement of the Operating Partnership, dated October 16, 2001 (filed on March 27, 2003 with the Company's Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference).
10.1.11	Tenth Amendment to Second Amended and Restated Limited Partnership Agreement of the Operating Partnership, dated December 29, 2001 (filed on March 27, 2003 with the Company's Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference).
10.1.12	Eleventh Amendment to Second Amended and Restated Limited Partnership Agreement of the Operating Partnership, dated December 15, 2002 (filed on March 27, 2003 with the Company's Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference).
10.1.13	Twelfth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated June 2, 2003 (filed on August 12, 2003 with the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 and incorporated herein by reference).
10.1.14	Thirteenth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated August 11, 2003 (filed on March 27, 2003 with the Company's Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference).
10.1.15	Fourteenth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated December 18, 2003 (filed on March 11, 2004 with the Company's Annual Report on Form 10-K for the year ended December 31, 2003 and incorporated herein by reference).

10.1.16	Fifteenth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated January 31, 2004 (filed on March 11, 2004 with the Company's Annual Report on Form 10-K for the year ended December 31, 2003 and incorporated herein by reference).
10.1.17	Sixteenth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated April 15, 2004 (filed on May 7, 2004 with the Company's Form 10-Q for the quarter ended March 31, 2004 and incorporated herein by reference).
10.1.18	Seventeenth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated September 23, 2004 (filed with the Company's Current Report on Form 8-K dated September 23, 2004 and incorporated herein by reference).
10.1.19	Eighteenth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated April 18, 2005 (filed with the Company's Form 8-K on April 22, 2005 and incorporated herein by reference).

EXHIBIT NO.	DESCRIPTION
10.1.20	Nineteenth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated July 8, 2005 (filed with the Company's Current Report on Form 8-K on July 14, 2005 and incorporated herein by reference).
10.1.21	Twentieth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated June 29, 2006 (filed with the Company's Current Report on Form 8-K dated July 6, 2006 and incorporated herein by reference).
10.1.22	Twenty-First Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated July 20, 2006 (filed with the Company's Current Report on Form 8-K dated July 26, 2006 and incorporated herein by reference).
10.1.23	Twenty-Second Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated January 9, 2007 (filed with the Company's Current Report on Form 8-K dated January 16, 2007 and incorporated herein by reference).
10.1.24	Twenty-Third Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated April 6, 2007 (filed with the Company's Current Report on Form 8-K dated April 12, 2007 and incorporated herein by reference).
10.1.25	Twenty-Fourth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated November 2, 2007 (filed with the Company's Current Report on Form 8-K dated November 5, 2007 and incorporated herein by reference).
10.1.26	Twenty-Fifth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated December 31, 2008 (filed with the Company's Current Report on Form 8-K dated January 5, 2009 and incorporated herein by reference).
10.1.27	Twenty-Sixth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated March 4, 2010 (filed with the Company's Current Report on Form 8-K dated March 10, 2010 and incorporated herein by reference).
10.1.28	Twenty-Seventh Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated February 3, 2011 (filed with the Company's Current Report on Form 8-K dated February 3, 2011 and incorporated herein by reference).
10.1.29	Twenty-Eighth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated September 15, 2011 (filed with the Company's Current Report on Form 8-K dated September 16, 2011 and incorporated herein by reference).
10.1.30	Twenty-Ninth Amendment to Second Amended and Restated Limited Partnership Agreement of Corporate Office Properties, L.P., dated June 27, 2012 (filed with the Company's Current Report on Form 8-K dated June 27, 2012 and incorporated herein by reference).
10.2.1*	Corporate Office Properties Trust 1998 Long Term Incentive Plan (filed with the Registrant's Registration Statement on Form S-4 (Commission File No. 333-45649) and incorporated herein by reference).
10.2.2*	Amendment No. 1 to Corporate Office Properties Trust 1998 Long Term Incentive Plan (filed on August 13, 1999 with the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999 and incorporated herein by reference).
10.2.3*	Amendment No. 2 to Corporate Office Properties Trust 1998 Long Term Incentive Plan (filed on March 22, 2002 with the Company's Annual Report on Form 10-K for the year ended December 31, 2001 and incorporated herein by reference).
10.3*	Corporate Office Properties Trust Supplemental Nonqualified Deferred Compensation Plan (filed with the Registrant's Registration Statement on Form S-8 (Commission File No. 333-87384) and incorporated herein by reference).
10.4.1*	Employment Agreement, dated July 13, 2005, between Corporate Office Properties, L.P. Corporate Office Properties Trust and Randall M. Griffin (filed with the Company's Current Report on Form 8-K dated July 19, 2005 and incorporated herein by reference).

10.4.2*	Amendment to Employment Agreement, dated May 30, 2006, between Corporate Office Properties, L.P., Corporate Office Properties Trust and Randall M. Griffin (filed with the Company's Current Report on Form 8-K dated June 1, 2006 and incorporated herein by reference).
10.4.3*	Second Amendment to Employment Agreement, dated December 31, 2008, between Corporate Office Properties, L.P., Corporate Office Properties Trust and Randall M. Griffin (filed with the Company's Current Report on Form 8-K dated January 5, 2009 and incorporated herein by reference).
10.4.4*	Third Amendment to Employment Agreement, dated September 16, 2010, between Corporate Office Properties, L.P., Corporate Office Properties Trust and Randall M. Griffin (filed on October 29, 2010 with the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2010 and incorporated herein by reference).

EXHIBIT NO.	DESCRIPTION
10.5.1*	Employment Agreement, dated September 12, 2002, between the Operating Partnership, COPT and Roger A. Waesche, Jr. (filed on March 27, 2003 with the Company’s Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference).
10.5.2*	Amendment to Employment Agreement, dated March 4, 2005, between the Operating Partnership, COPT and Roger A. Waesche, Jr. (filed on March 16, 2005 with the Company’s Annual Report on Form 10-K for the year ended December 31, 2004 and incorporated herein by reference).
10.5.3*	Second Amendment to Employment Agreement, dated May 30, 2006, between Corporate Office Properties, L.P., Corporate Office Properties Trust, and Roger A. Waesche, Jr. (filed with the Company’s Current Report on Form 8-K dated June 1, 2006 and incorporated herein by reference).
10.5.4*	Third Amendment to Employment Agreement, dated July 31, 2006, between Corporate Office Properties, L.P., Corporate Office Properties Trust, and Roger A. Waesche, Jr. (filed with the Company’s Current Report on Form 8-K dated August 1, 2006 and incorporated herein by reference).
10.5.5*	Fourth Amendment to Employment Agreement, dated March 2, 2007, between Corporate Office Properties, L.P., Corporate Office Properties Trust, and Roger A. Waesche, Jr. (filed with the Company’s Annual Report on Form 10-K dated February 29, 2008 and incorporated herein by reference).
10.5.6*	Fifth Amendment to Employment Agreement, dated September 16, 2010, between Corporate Office Properties, L.P., Corporate Office Properties Trust, and Roger A. Waesche, Jr. (filed on October 29, 2010 with the Company’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2010 and incorporated herein by reference).
10.5.7*	Sixth Amendment to Employment Agreement, dated December 12, 2012, between Corporate Office Properties, L.P., Corporate Office Properties Trust, and Roger A. Waesche, Jr. (filed herewith).
10.6.1*	Employment Agreement, dated July 31, 2006, between Corporate Office Properties, L.P., Corporate Office Properties Trust and Stephen E. Riffee (filed with the Company’s Current Report on Form 8-K dated August 1, 2006 and incorporated herein by reference).
10.6.2*	First Amendment to Employment Agreement, dated December 31, 2008, between Corporate Office Properties, L.P., Corporate Office Properties Trust and Stephen E. Riffee (filed with the Company’s Current Report on Form 8-K dated January 5, 2009 and incorporated herein by reference).
10.6.3*	Second Amendment to Employment Agreement, dated September 16, 2010, between Corporate Office Properties, L.P., Corporate Office Properties Trust and Stephen E. Riffee (filed on October 29, 2010 with the Company’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2010 and incorporated herein by reference).
10.6.4*	Employment Agreement, dated June 14, 2012, between Corporate Office Properties, L.P., Corporate Office Properties Trust and Stephen E. Riffee (filed with the Company’s Current Report on Form 8-K dated June 19, 2012 and incorporated herein by reference).
10.7.1*	Employment Agreement, dated December 31, 2008, between Corporate Development Services, LLC, Corporate Office Properties Trust and Wayne Lingafelter (filed with the Company’s Annual Report on Form 8-K dated January 5, 2009 and incorporated herein by reference).
10.7.2*	First Amendment to Employment Agreement, dated September 16, 2010, between Corporate Development Services, LLC, Corporate Office Properties Trust and Wayne Lingafelter (filed on October 29, 2010 with the Company’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2010 and incorporated herein by reference).
10.8.1*	Employment Agreement, dated September 15, 2011, between Corporate Office Properties, L.P., Corporate Office Properties Trust and Stephen E. Budorick (filed with the Company’s Current Report on Form 8-K dated September 16, 2011 and incorporated herein by reference).
10.9	Amended and Restated Registration Rights Agreement, dated March 16, 1998, for the benefit of certain shareholders of the Company (filed on August 12, 1998 with the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 1998 and incorporated herein by reference).

10.10	Registration Rights Agreement, dated January 25, 2001, for the benefit of Barony Trust Limited (filed on March 22, 2001 with the Company’s Annual Report on Form 10-K for the year ended December 31, 2000 and incorporated herein by reference).
10.11.1*	Corporate Office Properties Trust Supplemental Nonqualified Deferred Compensation Plan (filed with the Company’s Current Report on Form 8-K dated December 10, 2008 and incorporated herein by reference).
10.11.2*	First Amendment to the Corporate Office Properties Trust Supplemental Nonqualified Deferred Compensation Plan dated December 4, 2008 (filed with the Company’s Current Report on Form 8-K dated December 10, 2008 and incorporated herein by reference).

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EXHIBIT NO.	DESCRIPTION
10.12.1*	Corporate Office Properties Trust 2008 Omnibus Equity and Incentive Plan (included in Appendix A to the Company's Definitive Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission on April 9, 2008 and incorporated herein by reference).
10.12.2*	Corporate Office Properties Trust Amended and Restated 2008 Omnibus Equity and Incentive Plan (included in Annex A to the Company's Definitive Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission on March 30, 2010 and incorporated herein by reference).
10.13	Registration Rights Agreement, dated April 7, 2010, among Corporate Office Properties, L.P., Corporate Office Properties Trust, J.P. Morgan Securities Inc. and RBC Capital Markets Corporation (filed with the Company's Current Report on Form 8-K dated April 16, 2010 and incorporated herein by reference).
10.14	Common Stock Delivery Agreement, dated April 7, 2010, among Corporate Office Properties, L.P. and Corporate Office Properties Trust (filed with the Company's Current Report on Form 8-K dated April 16, 2010 and incorporated herein by reference).
10.15	Credit Agreement, dated as of September 1, 2011, by and among Corporate Office Properties, L.P.; Corporate Office Properties Trust; J.P. Morgan Securities LLC; KeyBanc Capital Markets; KeyBank National Association; JPMorgan Chase Bank, N.A.; Bank of America, N.A.; Royal Bank of Canada; Wells Fargo Bank, National Association; Barclays Bank PLC; PNC Bank, National Association; Regions Bank; Manufacturers and Traders Trust Company; and SunTrust Bank (filed with the Company's Current Report on Form 8-K/A dated September 1, 2011 and incorporated herein by reference).
10.16	Term Loan Agreement, dated as of September 1, 2011, by and among Corporate Office Properties, L.P.; Corporate Office Properties Trust; J.P. Morgan Securities LLC; KeyBanc Capital Markets; KeyBank National Association; JPMorgan Chase Bank, N.A.; Bank of America, N.A.; Royal Bank of Canada; Barclays Bank PLC; PNC Bank, National Association; Wells Fargo Bank, National Association; Regions Bank; Manufacturers and Traders Trust Company; and SunTrust Bank (filed with the Company's Current Report on Form 8-K/A dated September 1, 2011 and incorporated herein by reference).
10.17	Term Loan Agreement, dated as of February 14, 2012, by and among Corporate Office Properties, L.P.; Corporate Office Properties Trust; J.P. Morgan Securities LLC; KeyBanc Capital Markets; KeyBank National Association; JPMorgan Chase Bank, N.A.; Bank of America, N.A.; Royal Bank of Canada; and Wells Fargo Bank, National Association (filed with the Company's Quarter Report on Form 10-Q for the quarter ended March 31, 2012 and incorporated herein by reference).
12.1	Statement regarding Computation of Earnings to Combined Fixed Charges and Preferred Share Dividends (filed herewith).
21.1	Subsidiaries of Registrant (filed herewith).
23.1	Consent of Independent Registered Public Accounting Firm (filed herewith).
31.1	Certification of the Chief Executive Officer of Corporate Office Properties Trust required by Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith).
31.2	Certification of the Chief Financial Officer of Corporate Office Properties Trust required by Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith).
32.1	Certification of the Chief Executive Officer of Corporate Office Properties Trust required by Rule 13a-14(b) under the Securities Exchange Act of 1934, as amended. (This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.) (Furnished herewith.)
32.2	Certification of the Chief Financial Officer of Corporate Office Properties Trust required by Rule 13a-14(b) under the Securities Exchange Act of 1934, as amended. (This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by

	reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.) (Furnished herewith.)
101.INS	XBRL Instance Document (furnished herewith).
101.SCH	XBRL Taxonomy Extension Schema Document (furnished herewith).
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document (furnished herewith).
101.LAB	XBRL Extension Labels Linkbase (furnished herewith).
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document (furnished herewith).
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document (furnished herewith).

* - Indicates a compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K.

(c) Not applicable.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

		CORPORATE OFFICE PROPERTIES TRUST
Date: February 12, 2013	By:	/s/ Roger A. Waesche, Jr. Roger A. Waesche, Jr. President and Chief Executive Officer
Date: February 12, 2013	By:	/s/ Stephen E. Riffee Stephen E. Riffee Executive Vice President and Chief Financial Officer

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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

Signatures	Title	Date
/s/ Jay H . Shidler (Jay H. Shidler)	Chairman of the Board and Trustee	February 12, 2013
/s/ Clay W. Hamlin, III (Clay W. Hamlin, III)	Vice Chairman of the Board and Trustee	February 12, 2013
/s/ Roger A. Waesche, Jr. (Roger A. Waesche, Jr.)	President and Chief Executive Officer and Trustee	February 12, 2013
/s/ Stephen E. Riffee (Stephen E. Riffee)	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	February 12, 2013
/s/ Gregory J. Thor (Gregory J. Thor)	Senior Vice President, Controller and Chief Accounting Officer (Principal Accounting Officer)	February 12, 2013
/s/ Thomas F. Brady (Thomas F. Brady)	Trustee	February 12, 2013
/s/ Robert L. Denton (Robert L. Denton)	Trustee	February 12, 2013
/s/ Elizabeth A. Hight (Elizabeth A. Hight)	Trustee	February 12, 2013
/s/ David M. Jacobstein (David M. Jacobstein)	Trustee	February 12, 2013
/s/ Steven D. Kesler (Steven D. Kesler)	Trustee	February 12, 2013
/s/ Richard Szafranski (Richard Szafranski)	Trustee	February 12, 2013
/s/ Kenneth D. Wethe (Kenneth D. Wethe)	Trustee	February 12, 2013

CORPORATE OFFICE PROPERTIES TRUST AND SUBSIDIARIES
INDEX TO FINANCIAL STATEMENTS

CONSOLIDATED FINANCIAL STATEMENTS

Management’s Report On Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, and for performing an assessment of the effectiveness of internal control over financial reporting as of December 31, 2012. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and trustees; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management performed an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2012 based upon criteria in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on our assessment, management determined that our internal control over financial reporting was effective as of December 31, 2012 based on the criteria in Internal Control-Integrated Framework issued by the COSO.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2012 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Report of Independent Registered Public Accounting Firm

To the Board of Trustees and Shareholders of Corporate Office Properties Trust:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Corporate Office Properties Trust and its subsidiaries at December 31, 2012 and December 31, 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company’s management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying “Management's Report on Internal Control over Financial Reporting”. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company’s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Baltimore, MD
February 12, 2013

Corporate Office Properties Trust and Subsidiaries
Consolidated Balance Sheets
(in thousands, except share data)

	December 31, 2012	2011
Assets		
Properties, net:		
Operating properties, net	$ 2,597,666	$ 2,714,056
Projects in development or held for future development	565,378	638,919
Total properties, net	3,163,044	3,352,975
Assets held for sale, net	140,229	116,616
Cash and cash equivalents	10,594	5,559
Restricted cash and marketable securities	21,557	36,232
Accounts receivable (net of allowance for doubtful accounts of $4,694 and $3,546, respectively)	19,247	26,032
Deferred rent receivable	85,802	86,856
Intangible assets on real estate acquisitions, net	75,879	89,120
Deferred leasing and financing costs, net	59,952	66,515
Prepaid expenses and other assets	77,455	83,650
Total assets	$ 3,653,759	$ 3,863,555
Liabilities and equity		
Liabilities:		
Debt, net	$ 2,019,168	$ 2,426,303
Accounts payable and accrued expenses	97,922	95,714
Rents received in advance and security deposits	27,632	29,548
Dividends and distributions payable	28,698	35,038
Deferred revenue associated with operating leases	11,995	15,554
Distributions received in excess of investment in unconsolidated real estate joint venture	6,420	6,071
Interest rate derivatives	6,185	30,863
Other liabilities	8,942	9,657
Total liabilities	2,206,962	2,648,748
Commitments and contingencies (Note 20)		
Redeemable noncontrolling interest	10,298	8,908
Equity:		
Corporate Office Properties Trust’ s shareholders’ equity:		
Preferred Shares of beneficial interest at liquidation preference	333,833	216,333
Common Shares of beneficial interest ($0.01 par value; 125,000,000 shares authorized, shares issued and outstanding of 80,952,986 at December 31, 2012 and 72,011,324 at December 31, 2011)	809	720
Additional paid-in capital	1,653,672	1,451,078
Cumulative distributions in excess of net income	(617,455)	(534,041)
Accumulated other comprehensive loss	(5,435)	(1,733)
Total Corporate Office Properties Trust’s shareholders’ equity	1,365,424	1,132,357
Noncontrolling interests in subsidiaries:		
Common units in the Operating Partnership	52,122	55,183
Preferred units in the Operating Partnership	8,800	8,800
Other consolidated entities	10,153	9,559

Noncontrolling interests in subsidiaries	71,075	73,542
Total equity	1,436,499	1,205,899
Total liabilities and equity	$ 3,653,759	$ 3,863,555

See accompanying notes to consolidated financial statements.

Corporate Office Properties Trust and Subsidiaries
Consolidated Statements of Operations
(in thousands, except per share data)

	For the Years Ended December 31,		
	2012	2011	2010
Revenues			
Rental revenue	$367,654	$348,006	$316,038
Tenant recoveries and other real estate operations revenue	86,517	80,490	71,521
Construction contract and other service revenues	73,836	84,345	104,675
Total revenues	528,007	512,841	492,234
Expenses			
Property operating expenses	167,161	162,397	146,617
Depreciation and amortization associated with real estate operations	113,480	113,111	97,897
Construction contract and other service expenses	70,576	81,639	102,302
Impairment losses	43,214	83,478	—
General, administrative and leasing expenses	31,900	30,314	28,501
Business development expenses and land carry costs	5,711	6,122	6,403
Total operating expenses	432,042	477,061	381,720
Operating income	95,965	35,780	110,514
Interest expense	(94,624)	(98,222)	(95,729)
Interest and other income	7,172	5,603	9,568
Loss on early extinguishment of debt	(943)	(1,639)	—
Loss on interest rate derivatives	—	(29,805)	—
Income (loss) from continuing operations before equity in (loss) income of unconsolidated entities and income taxes	7,570	(88,283)	24,353
Equity in (loss) income of unconsolidated entities	(546)	(331)	1,376
Income tax (expense) benefit	(381)	6,710	(108)
Income (loss) from continuing operations	6,643	(81,904)	25,621
Discontinued operations	13,677	(48,404)	17,054
Income (loss) before gain on sales of real estate	20,320	(130,308)	42,675
Gain on sales of real estate, net of income taxes	21	2,732	2,829
Net income (loss)	20,341	(127,576)	45,504
Net loss (income) attributable to noncontrolling interests:			
Common units in the Operating Partnership	87	8,439	(2,116)
Preferred units in the Operating Partnership	(660)	(660)	(660)
Other consolidated entities	1,209	369	32
Net income (loss) attributable to Corporate Office Properties Trust	20,977	(119,428)	42,760
Preferred share dividends	(20,844)	(16,102)	(16,102)
Issuance costs associated with redeemed preferred shares	(1,827)	—	—
Net (loss) income attributable to Corporate Office Properties Trust common shareholders	$(1,694)	$(135,530)	$26,658
Net income (loss) attributable to Corporate Office Properties Trust:			
Income (loss) from continuing operations	$8,051	$(73,884)	$27,029
Discontinued operations, net	12,926	(45,544)	15,731
Net income (loss) attributable to Corporate Office Properties Trust	$20,977	$(119,428)	$42,760
Basic earnings per common share (1)			
(Loss) income from continuing operations	$(0.21)	$(1.31)	$0.17
Discontinued operations	0.18	(0.66)	0.26
Net (loss) income attributable to COPT common shareholders	$(0.03)	$(1.97)	$0.43

Diluted earnings per common share (1)			
(Loss) income from continuing operations	$(0.21)	$(1.31)	$0.17
Discontinued operations	0.18	(0.66)	0.26
Net (loss) income attributable to COPT common shareholders	$(0.03)	$(1.97)	$0.43

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

See accompanying notes to consolidated financial statements.

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

	For the Years Ended December 31,		
	2012	2011	2010
Net income (loss)	$20,341	$(127,576)	$45,504
Other comprehensive (loss) income			
Unrealized losses on interest rate derivatives	(7,676)	(31,531)	(5,473)
Losses on interest rate derivatives included in net income (loss)	3,697	4,601	3,689
Loss on interest rate derivatives upon discontinuing hedge accounting	—	28,430	—
Other comprehensive (loss) income	(3,979)	1,500	(1,784)
Comprehensive income (loss)	16,362	(126,076)	43,720
Comprehensive loss (income) attributable to noncontrolling interests	961	8,132	(2,591)
Comprehensive income (loss) attributable to COPT	$17,323	$(117,944)	$41,129

See accompanying notes to consolidated financial statements.

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

	Preferred Shares	Common Shares	Additional Paid-in Capital	Cumulative Distributions in Excess of Net Income	Accumulated Other Comprehensive Loss	Noncontrolling Interests	Total
Balance at December 31, 2009 (58,342,673 common shares outstanding)	$216,333	$ 583	$1,022,452	$ (209,941)	$ (1,907)	$ 93,112	$1,120,632
Issuance of 4.25% Exchangeable Senior Notes	—	—	18,149	—	—	—	18,149
Conversion of common units to common shares (663,498 shares)	—	6	9,561	—	—	(9,567)	—
Common shares issued to the public (7,475,000 shares)	—	75	245,546	—	—	—	245,621
Exercise of share options (278,656 shares)	—	3	4,572	—	—	—	4,575
Share-based compensation	—	2	11,843	—	—	—	11,845
Restricted common share redemptions (105,215 shares)	—	—	(3,913)	—	—	—	(3,913)
Adjustments to noncontrolling interests resulting from changes in Operating Partnership ownership	—	—	(10,274)	—	—	10,274	—
Comprehensive income	—	—	—	42,760	(2,256)	3,216	43,720
Dividends	—	—	—	(114,613)	—	—	(114,613)
Distributions to owners of common and preferred units in the Operating Partnership	—	—	—	—	—	(7,926)	(7,926)
Contributions from noncontrolling interests in other consolidated entities	—	—	—	—	—	510	510
Acquisition of noncontrolling interests in other consolidated entities	—	—	(2,344)	—	—	(2,118)	(4,462)
Balance at December 31, 2010 (66,931,582 common shares outstanding)	216,333	669	1,295,592	(281,794)	(4,163)	87,501	1,314,138
Conversion of common units to common shares (100,939 shares)	—	1	1,520	—	—	(1,521)	—
Common shares issued to the public (4,600,000 shares)	—	46	145,321	—	—	—	145,367
Exercise of share options (191,264 shares)	—	2	2,459	—	—	—	2,461
Share-based compensation	—	2	14,265	—	—	—	14,267
	—	—	(3,990)	—	—	—	(3,990)

Restricted common share redemptions (114,687 shares)							
Adjustments to noncontrolling interests resulting from changes in Operating Partnership ownership	—	—	(2,798)	—	—	2,798	—
Comprehensive loss	—	—	—	(119,428)	2,430	(7,671)	(124,669)
Dividends	—	—	—	(132,819)	—	—	(132,819)
Distributions to owners of common and preferred units in the Operating Partnership	—	—	—	—	—	(7,833)	(7,833)
Contributions from noncontrolling interests in other consolidated entities	—	—	(23)	—	—	284	261
Distributions to noncontrolling interest in other consolidated entities	—	—	—	—	—	(16)	(16)
Adjustment to arrive at fair value of noncontrolling interest	—	—	(1,315)	—	—	—	(1,315)
Increase in tax benefit from share-based compensation	—	—	47	—	—	—	47
Balance at December 31, 2011 (72,011,324 common shares outstanding)	216,333	720	1,451,078	(534,041)	(1,733)	73,542	1,205,899
Conversion of common units to common shares (234,246 shares)	—	2	2,812	—	—	(2,814)	—
Preferred shares issued to the public (6,900,000 shares)	172,500	—	(6,848)	—	—	—	165,652
Common shares issued to the public (8,625,000 shares)	—	86	204,610	—	—	—	204,696
Redemption of preferred shares (2,200,000 shares)	(55,000)	—	1,827	(1,827)	—	—	(55,000)
Exercise of share options (61,624 shares)	—	—	928	—	—	—	928
Share-based compensation	—	1	11,183	—	—	—	11,184
Restricted common share redemptions (139,851 shares)	—	—	(3,379)	—	—	—	(3,379)
Adjustments to noncontrolling interests resulting from changes in Operating Partnership ownership	—	—	(4,627)	—	—	4,627	—
Comprehensive income	—	—	—	20,977	(3,702)	1,652	18,927
Dividends	—	—	—	(102,564)	—	—	(102,564)
Distributions to owners of common and preferred units in the Operating Partnership	—	—	—	—	—	(5,277)	(5,277)
Distributions to noncontrolling interests in other consolidated entities	—	—	—	—	—	(655)	(655)
	—	—	(3,955)	—	—	—	(3,955)

Adjustment to arrive at fair value of noncontrolling interest							
Increase in tax benefit from share-based compensation	—	—	43	—	—	—	43
Balance at December 31, 2012 (80,952,986 common shares outstanding)	$333,833	$ 809	$1,653,672	$ (617,455)	$ (5,435)	$ 71,075	$1,436,499

See accompanying notes to consolidated financial statements.

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

	For the Years Ended December 31,		
	2012	2011	2010
Cash flows from operating activities			
Revenues from real estate operations received	$483,421	$476,762	$453,847
Construction contract and other service revenues received	77,831	88,433	112,644
Property operating expenses paid	(174,683)	(180,041)	(173,625)
Construction contract and other service expenses paid	(67,952)	(94,140)	(124,867)
General, administrative, leasing, business development and land carry costs paid	(22,904)	(28,027)	(23,969)
Interest expense paid	(87,394)	(93,715)	(87,917)
Previously accreted interest expense paid	—	(17,314)	—
Settlement of interest rate derivatives	(29,738)	—	—
Proceeds from sale of trading marketable securities	18,975	—	—
Exit costs on property dispositions	(4,146)	—	—
Payments in connection with early extinguishment of debt	(2,637)	(353)	—
Interest and other income received	1,073	698	323
Income taxes paid	(8)	(160)	—
Net cash provided by operating activities	191,838	152,143	156,436
Cash flows from investing activities			
Purchases of and additions to properties			
Construction, development and redevelopment	(165,275)	(232,667)	(303,064)
Acquisitions of operating properties	(48,308)	(32,856)	(146,275)
Tenant improvements on operating properties	(27,103)	(37,195)	(20,826)
Other capital improvements on operating properties	(20,066)	(16,906)	(10,422)
Proceeds from sales of properties	290,603	79,638	27,576
Proceeds from sale of equity method investment	—	5,773	—
Mortgage and other loan receivables funded or acquired	(14,232)	(23,377)	(5,588)
Mortgage and other loan receivables payments received	10,113	16,759	1,568
Leasing costs paid	(13,278)	(15,997)	(14,403)
Investment in unconsolidated entities	(250)	(250)	(6,600)
Other	1,540	(3,309)	(1,133)
Net cash provided by (used in) investing activities	13,744	(260,387)	(479,167)
Cash flows from financing activities			
Proceeds from debt			
Revolving Credit Facility	329,000	1,180,000	663,000
Other debt proceeds	403,117	456,206	359,912
Repayments of debt			
Revolving Credit Facility	(991,000)	(813,000)	(733,000)
Scheduled principal amortization	(11,684)	(13,755)	(13,996)
Other debt repayments	(124,386)	(698,100)	(66,663)
Deferred financing costs paid	(3,371)	(13,113)	(8,570)
Net proceeds from issuance of preferred shares	165,652	—	—
Net proceeds from issuance of common shares	205,425	147,828	250,196
Redemption of preferred shares	(55,000)	—	—
Acquisition of noncontrolling interests in consolidated entities	—	—	(4,462)
Common share dividends paid	(89,161)	(114,643)	(93,792)

Preferred share dividends paid	(19,087)	(16,102)	(16,102)
Distributions paid to noncontrolling interests in the Operating Partnership	(5,828)	(7,875)	(8,099)
Restricted share redemptions	(3,379)	(3,990)	(3,913)
Other	(845)	245	60
Net cash (used in) provided by financing activities	(200,547)	103,701	324,571
Net increase (decrease) in cash and cash equivalents	5,035	(4,543)	1,840
Cash and cash equivalents			
Beginning of period	5,559	10,102	8,262
End of period	$10,594	$5,559	$10,102

See accompanying notes to consolidated financial statements.

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

	For the Years Ended December 31,		
	2012	2011	2010
Reconciliation of net income (loss) to net cash provided by operating activities:			
Net income (loss)	$20,341	$(127,576)	$45,504
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and other amortization	124,418	136,594	125,819
Impairment losses	62,702	151,021	—
Loss on interest rate derivatives	—	29,805	—
Settlement of previously accreted interest expense	—	(17,314)	—
Amortization of deferred financing costs	6,243	6,596	5,871
Increase in deferred rent receivable	(11,776)	(10,102)	(5,706)
Amortization of net debt discounts	3,155	5,540	5,841
Gain on sales of real estate	(20,961)	(7,528)	(3,917)
Gain on equity method investment	—	(2,452)	(6,406)
Share-based compensation	9,982	11,920	11,845
(Gain) loss on early extinguishment of debt	(3,430)	1,670	—
Other	(3,195)	(314)	(3,872)
Changes in operating assets and liabilities:			
Decrease (increase) in accounts receivable	6,693	(7,094)	(1,680)
Decrease (increase) in restricted cash and marketable securities	14,934	2,160	(4,875)
Decrease (increase) in prepaid expenses and other assets	8,550	(687)	8,674
Increase (decrease) in accounts payable, accrued expenses and other liabilities	4,101	(18,041)	(19,644)
Decrease in rents received in advance and security deposits	(1,916)	(2,055)	(1,018)
Decrease in interest rate derivatives in connection with cash settlement	(28,003)	—	—
Net cash provided by operating activities	$191,838	$152,143	$156,436
Supplemental schedule of non-cash investing and financing activities:			
(Decrease) increase in accrued capital improvements, leasing and other investing activity costs	$(1,227)	$11,719	$4,576
Increase in property, debt and other liabilities in connection with acquisitions	$—	$3,040	$74,244
Decrease in property in connection with surrender of property in settlement of debt	$12,042	$—	$—
Decrease in debt in connection with surrender of property in settlement of debt	$16,304	$—	$—
Increase in property and noncontrolling interests in connection with property contribution by a noncontrolling interest in a joint venture	$—	$—	$9,000
Increase (decrease) in fair value of derivatives applied to AOCL and noncontrolling interests	$4,040	$1,438	$(1,846)
Dividends/distribution payable	$28,698	$35,038	$32,986
Decrease in noncontrolling interests and increase in shareholders' equity in connection with the conversion of common units into common shares	$2,814	$1,521	$9,567
Adjustments to noncontrolling interests resulting from changes in Operating Partnership ownership	$4,627	$2,798	$10,274
Increase in redeemable noncontrolling interest and decrease in shareholders' equity in connection with adjustment to arrive at fair value of noncontrolling	$3,955	$1,315	$—

interest

See accompanying notes to consolidated financial statements.

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements

1. Organization

Corporate Office Properties Trust ("COPT") and subsidiaries (collectively, the "Company," "we" or "us") is a fully-integrated and self-managed real estate investment trust ("REIT") that focuses primarily on serving the specialized requirements of United States Government agencies and defense contractors, most of whom are engaged in defense information technology and national security related activities. We generally acquire, develop, manage and lease office and data center properties concentrated in large office parks located near knowledge-based government demand drivers and/or in targeted markets or submarkets in the Greater Washington, DC/Baltimore region. As of December 31, 2012, our investments in real estate included the following:

- 208 operating office properties totaling 18.8 million square feet;
- 13 office properties under construction or redevelopment, or for which we were contractually committed to construct, that we estimate will total approximately 1.7 million square feet upon completion, including two partially operational properties included above;
- land held or under pre-construction totaling 1,694 acres (including 561 controlled but not owned) that we believe are potentially developable into approximately 19.3 million square feet; and
- a partially operational, wholesale data center which upon completion and stabilization is expected to have a critical load of 18 megawatts.

We conduct almost all of our operations through our operating partnership, Corporate Office Properties, L.P. (the "Operating Partnership"), of which we are the managing general partner. The Operating Partnership owns real estate both directly and through subsidiary partnerships and limited liability companies ("LLCs"). A summary of our Operating Partnership's forms of ownership and the percentage of those ownership forms owned by COPT as of December 31, 2012 and 2011 follows:

	December 31,			
	2012		2011	
Common Units	95	%	94	%
Series G Preferred Units	N/A		100	%
Series H Preferred Units	100	%	100	%
Series I Preferred Units	0	%	0	%
Series J Preferred Units	100	%	100	%
Series K Preferred Units	100	%	100	%
Series L Preferred Units	100	%	N/A	

Three of our trustees also controlled, either directly or through ownership by other entities or family members, an additional 4% of the Operating Partnership's common units ("common units") as of December 31, 2012.

In addition to owning real estate, the Operating Partnership also owns subsidiaries that provide real estate services such as property management and construction and development services primarily for our properties but also for third parties.

2. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of COPT, the Operating Partnership, their subsidiaries and other entities in which we have a majority voting interest and control. We also consolidate certain entities when control of such entities can be achieved through means other than voting rights (“variable interest entities” or “VIEs”) if we are deemed to be the primary beneficiary of such entities. We eliminate all significant intercompany balances and transactions in consolidation.

We use the equity method of accounting when we own an interest in an entity and can exert significant influence over the entity’s operations but cannot control the entity’s operations. We discontinue equity method accounting if our investment in an entity (and net advances) is reduced to zero unless we have guaranteed obligations of the entity or are otherwise committed to provide further financial support for the entity.

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

We use the cost method of accounting when we own an interest in an entity and cannot exert significant influence over its operations.

Revisions

During 2012, we identified the following errors:

- the misapplication of accounting guidance related to the recognition of a deferred tax asset resulting from an impairment of assets in the fourth quarter of 2011 that failed to consider a partial reversal of that asset that would result from a cancellation of related inter-company debt in the first quarter of 2012. The effect of this error was an overstatement of our income tax benefit and an understatement of our net loss for the year ended December 31, 2011 of $4.0 million. Based on an evaluation against our projected annual net income at that time, this error was previously reported as an out-of-period adjustment in the three months ended March 31, 2012;
- an over-accrual of incentive compensation cost, the effect of which was an overstatement of general and administrative expenses and an overstatement of net loss for the calendar quarter and year ended December 31, 2011 of $700,000. Based on an evaluation against our projected annual net income at that time, this error was previously reported as an out-of-period adjustment in the three months ended March 31, 2012;
- the misapplication of accounting guidance requiring that we recognize loss allocations to a noncontrolling interest holder in a consolidated real estate joint venture associated with decreases in such holder's claim on the book value of the joint venture’s assets, despite the fact that the real estate held by the joint venture was under development and the joint venture had no underlying losses. The effect of this error was an understatement of losses attributable to noncontrolling interests in other consolidated entities of $1.8 million for the nine months ended September 30, 2012 and $1.4 million for the year ended December 31, 2011; and
- the misapplication of accounting guidance pertaining to our reporting for a noncontrolling interest in a consolidated real estate joint venture formed in March 2010 for which the holder of such interest has the right to require us to acquire the interest at fair value. Accounting guidance requires that this noncontrolling interest be classified outside of permanent equity and reported at fair value as of the end of each reporting period, with changes in such fair value reported as equity transactions with no impact to net income or comprehensive income. This error resulted in an overstatement of equity and offsetting understatement of the line entitled “redeemable noncontrolling interest” in the mezzanine section of our consolidated balance sheet of $8.9 million as of December 31, 2011. This error had no effect on our consolidated statements of operations, including our reported net income (losses) or earnings per share.

With respect to the errors in the first two bullets above, we assessed the materiality of these errors on the financial statements in connection with previously filed periodic reports, in accordance with ASC 250 (SEC’s Staff Accounting Bulletin No. 99, “Materiality”), and concluded at such time that the errors were not material to any prior annual or interim periods. In assessing the cumulative effect of all such errors, we have since concluded that correction of the errors in 2012 could be considered material to our 2012 net income. Accordingly, in accordance with ASC 250 (SEC Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements,”), the financial statements as of, and for the year ended, December 31, 2011 have been revised. We will revise amounts pertaining to each of the 2012 calendar quarters from January 1, 2012 through September 30, 2012 in future quarterly filings on Form 10-Q. The following are selected line items from our financial statements as of, and for the year ended, December 31, 2011 illustrating the affect of adjustments to revise the financial statements (the “As Previously Reported” columns include the effects of other reclassifications and retrospective changes in presentation discussed below)(in thousands):

Consolidated Balance Sheet as of December 31, 2011

	As Previously Reported	Adjustment	As Revised
Prepaid expenses and other assets	$ 87,619	$ (3,969)	$ 83,650
Accounts payable and accrued expenses	96,425	(711)	95,714
Redeemable noncontrolling interest	—	8,908	8,908
Additional paid-in capital	1,452,393	(1,315)	1,451,078
Cumulative distributions in excess of net income	(532,288)	(1,753)	(534,041)
Noncontrolling interests in common units in the Operating Partnership	55,281	(98)	55,183
Noncontrolling interests in other consolidated entities	18,559	(9,000)	9,559

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Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

	Consolidated Statements of Operations for the Year Ended December 31, 2011		
	As Previously Reported	Adjustment	As Revised
General, administrative and leasing expenses	$31,025	$(711)	$30,314
Income tax benefit	$10,679	$(3,969)	$6,710
Net loss	$(124,318)	$(3,258)	$(127,576)
Net loss attributable to noncontrolling interests in common units in the Operating Partnership	$8,341	$98	$8,439
Net (income) loss attributable to noncontrolling interests in other consolidated entities	$(1,038)	$1,407	$369
Net loss attributable to Corporate Office Properties Trust	$(117,675)	$(1,753)	$(119,428)
Net loss attributable to Corporate Office Properties Trust common shareholders	$(133,777)	$(1,753)	$(135,530)
Basic and diluted earnings per common share:			
Loss from continuing operations	$(1.29)	$(0.02)	$(1.31)
Net loss attributable to COPT common shareholders	$(1.94)	$(0.03)	$(1.97)

Reclassifications

We reclassified certain amounts from prior periods to conform to the current period presentation of our consolidated financial statements with no effect on previously reported net income or equity. Included among these reclassifications are retrospective changes in the presentation of:

- our preferred shares of beneficial interest; these shares are reported on our consolidated balance sheets at their liquidation preference value after having been reported at par value in our 2011 Annual Report on Form 10-K;
- costs expensed in connection with properties not in operations; these costs are included in the line on our consolidated statements of operations entitled “business development expenses and land carry costs,” after having been included in property operating expenses in our 2011 Annual Report on Form 10-K; and
- costs expensed in connection with marketing space for lease to prospective tenants; these costs are included in the line on our consolidated statements of operations entitled “general, administrative and leasing expenses,” after having been included in property operating expenses in our 2011 Annual Report on Form 10-K.

Use of Estimates in the Preparation of Financial Statements

We make estimates and assumptions when preparing financial statements under generally accepted accounting principles (“GAAP”). These estimates and assumptions affect various matters, including:

- the reported amounts of assets and liabilities in our consolidated balance sheets at the dates of the financial statements;
- the disclosure of contingent assets and liabilities at the dates of the financial statements; and
- the reported amounts of revenues and expenses in our consolidated statements of operations during the reporting periods.

Significant estimates are inherent in the presentation of our financial statements in a number of areas, including the evaluation of the collectability of accounts and notes receivable, the allocation of property acquisition costs, the determination of estimated useful lives of assets, the determination of lease terms, the evaluation of impairment of long-lived assets, the amount of revenue recognized relating to tenant improvements and the level of expense recognized in connection with share-based compensation. Actual results could differ from these and other estimates.

Acquisitions of Properties

Upon completion of property acquisitions, we allocate the purchase price to tangible and intangible assets and liabilities associated with such acquisitions based on our estimates of their fair values. We determine these fair values by using market

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

data and independent appraisals available to us and making numerous estimates and assumptions. We allocate property acquisitions to the following components:

- properties based on a valuation performed under the assumption that the property is vacant upon acquisition (the "if vacant value"). The if-vacant value is allocated between land and buildings or, in the case of properties under development, construction in progress. We also allocate additional amounts to properties for in-place tenant improvements based on our estimate of improvements per square foot provided under market leases that would be attributable to the remaining non-cancellable terms of the respective leases;
- above- and below-market lease intangible assets or liabilities based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between: (1) the contractual amounts to be received pursuant to the in-place leases; and (2) our estimate of fair market lease rates for the corresponding space, measured over a period equal to the remaining non-cancelable term of the lease. The capitalized above- and below-market lease values are amortized as adjustments to rental revenue over the remaining non-cancellable terms of the respective leases;
- in-place lease value based on our estimates of: (1) the present value of additional income to be realized as a result of leases being in place on the acquired properties; and (2) costs to execute similar leases. Our estimate of additional income to be realized includes carrying costs, such as real estate taxes, insurance and other operating expenses, and revenues during the expected lease-up periods considering current market conditions. Our estimate of costs to execute similar leases includes leasing commissions, legal and other related costs;
- tenant relationship value based on our evaluation of the specific characteristics of each tenant's lease and our overall relationship with that respective tenant. Characteristics we consider in determining these values include the nature and extent of our existing business relationships with the tenant, growth prospects for developing new business with the tenant, the tenant's credit quality and expectations of lease renewals, among other factors; and
- above- and below- market cost arrangements (such as real estate tax treaties or above- or below- market ground leases) based on the present value of the expected benefit from any such arrangements in place on the property at the time of acquisition.

Properties

We report properties to be developed or held and used in operations at our depreciated cost, reduced for impairment losses. The preconstruction stage of the development or redevelopment of an operating property includes efforts and related costs to secure land control and zoning, evaluate feasibility and complete other initial tasks which are essential to development. We capitalize interest expense, real estate taxes and direct and indirect project costs (including related compensation and other indirect costs) associated with properties, or portions thereof, undergoing construction, development and redevelopment activities. We continue to capitalize these costs while construction, development or redevelopment activities are underway until a property becomes "operational," which occurs upon the earlier of when leases commence or one year after the cessation of major construction activities. When leases commence on portions of a newly-constructed or redeveloped property in the period prior to one year from the cessation of major construction activities, we consider that property to be "partially operational." When a property is partially operational, we allocate the costs associated with the property between the portion that is operational and the portion under construction. We start depreciating newly-constructed and redeveloped properties as they become operational.
Most of our leases involve some form of improvements to leased space. When we are required to provide improvements under the terms of a lease, we determine whether the improvements constitute landlord assets or tenant assets. We capitalize the cost of the improvements when we deem the improvements to be landlord assets. In determining whether improvements constitute landlord or tenant assets, we consider numerous factors, including: whether the improvements are unique to the tenant or reusable by other tenants; whether the tenant is permitted to

alter or remove the improvements without our consent or without compensating us for any lost fair value; whether the ownership of the improvements remains with us or remains with the tenant at the end of the lease term; and whether the economic substance of the lease terms is properly reflected.

We depreciate our fixed assets using the straight-line method over their estimated useful lives as follows:

	Estimated Useful Lives
Buildings and building improvements	10-40 years
Land improvements	10-20 years
Tenant improvements on operating properties	Related lease term
Equipment and personal property	3-10 years

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Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

We assess each of our operating properties for impairment quarterly using cash flow projections and estimated fair values that we derive for each of the properties. We update the leasing and other assumptions used in these projections regularly, paying particular attention to properties that have experienced chronic vacancy or face significant market challenges. We review our plans and intentions for our development projects and land parcels quarterly. Each quarter, we also review the reasonableness of changes in our estimated operating property fair values from amounts estimated in the prior quarter. If events or changes in circumstances indicate that the carrying values of certain operating properties, properties in development or land held for future development may be impaired, we perform a recovery analysis for such properties. For long-lived assets to be held and used, we analyze recoverability based on the estimated undiscounted future cash flows expected to be generated from the operations and eventual disposition of the assets over, in most cases, a ten-year holding period. If we believe there is a significant possibility that we might dispose of the assets earlier, we analyze recoverability using a probability weighted analysis of the estimated undiscounted future cash flows expected to be generated from the operations and eventual disposition of the assets over the various possible holding periods. If the recovery analysis indicates that the carrying value of a tested property is not recoverable from estimated future cash flows, it is written down to its estimated fair value and an impairment loss is recognized. If and when our plans change, we revise our recoverability analyses to use the cash flows expected from the operations and eventual disposition of each asset using holding periods that are consistent with our revised plans. Changes in holding periods may require us to recognize significant impairment losses.

Property fair values are determined based on contract prices, indicative bids, discounted cash flow analyses or yield analyses. Estimated cash flows used in such analyses are based on our plans for the property and our views of market and economic conditions. The estimates consider items such as current and future rental rates, occupancies for the tested property and comparable properties, estimated operating and capital expenditures and recent sales data for comparable properties; most of these items are influenced by market data obtained from third party sources such as CoStar Group and real estate leasing and brokerage firms and our direct experience with the properties and their markets.

When we determine that a property is held for sale, we discontinue the recording of depreciation expense on the property and estimate the fair value, net of selling costs; if we then determine that the estimated fair value, net of selling costs, is less than the net book value of the property, we recognize an impairment loss equal to the difference and reduce the net book value of the property.
When we sell an operating property, or determine that an operating property is held for sale, and determine that we have no significant continuing involvement in such property, we classify the results of operations for such property as discontinued operations. Interest expense that is specifically identifiable to properties included in discontinued operations is used in the computation of interest expense attributable to discontinued operations.

Sales of Interests in Real Estate

We recognize gains from sales of interests in real estate using the full accrual method, provided that various criteria relating to the terms of sale and any subsequent involvement by us with the real estate sold are met. We recognize gains relating to transactions that do not meet the requirements of the full accrual method of accounting when the full accrual method of accounting criteria are met.
Cash and Cash Equivalents

Cash and cash equivalents include all cash and liquid investments that mature three months or less from when they are purchased. Cash equivalents are reported at cost, which approximates fair value. We maintain our cash in bank accounts in amounts that may exceed Federally insured limits at times. We have not experienced any losses in these accounts in the past and believe that we are not exposed to significant credit risk because our accounts are deposited with major financial institutions.

Investments in Marketable Securities

We classify marketable securities as trading securities when we have the intent to sell such securities in the near term, and classify other marketable securities as available-for-sale securities. We determine the appropriate classification of investments in marketable securities at the acquisition date and re-evaluate the classification at each balance sheet date. We report investments in marketable securities classified as trading securities at fair value, with unrealized gains and losses recognized through earnings. We report investments in marketable securities classified as available-for-sale securities at fair value, with net

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

unrealized gains or losses deferred to AOCL and realized gains and losses resulting from sales of such investments recognized through earnings.

Accounts and Deferred Rents Receivable and Mortgage and Other Investing Receivables

We maintain allowances for estimated losses resulting from the failure of our customers or borrowers to satisfy their payment obligations. We use judgment in estimating these allowances based primarily upon the payment history and credit status of the entities associated with the individual receivables. We write off these receivables when we believe the facts and circumstances indicate that continued pursuit of collection is no longer warranted. When we earn interest income in connection with receivables for which we have established allowances, we establish allowances in connection with such interest income that is unpaid. When cash is received in connection with receivables for which we have established allowances, we reduce the amount of losses recognized in connection with the receivables' allowance.

Intangible Assets and Deferred Revenue on Real Estate Acquisitions

We capitalize intangible assets and deferred revenue on real estate acquisitions as described in the section above entitled "Acquisitions of Properties." We amortize the intangible assets and deferred revenue as follows:

	Amortization Period
Above- and below-market leases	Related lease terms
In-place lease value	Related lease terms
Tenant relationship value	Estimated period of time that tenant will lease space in property
Above- and below-market cost arrangements	Term of arrangements
Market concentration premium	40 years

We recognize the amortization of acquired above-market and below-market leases as adjustments to rental revenue. We recognize the amortization of above- and below- market cost arrangements as adjustments to property operating expenses. We recognize the amortization of other intangible assets on property acquisitions as amortization expense.

Deferred Leasing and Financing Costs, Net

We defer costs incurred to obtain new tenant leases or extend existing tenant leases, including related compensation costs. We amortize these costs evenly over the lease terms. When tenant leases are terminated early, we expense any unamortized deferred leasing costs associated with those leases over the shortened term of the lease.
We defer costs of financing arrangements and recognize these costs as interest expense over the related loan terms on a straight-line basis, which approximates the amortization that would occur under the effective interest method of amortization. We expense any unamortized loan costs when loans are retired early.

Noncontrolling Interests

Our consolidated noncontrolling interests are comprised of interests in our Operating Partnership and consolidated real estate joint ventures. We evaluate whether noncontrolling interests are subject to redemption features outside of our control. For noncontrolling interests that are currently redeemable or deemed probable to eventually become redeemable, we classify such interests as redeemable noncontrolling interests in the mezzanine section of our consolidated balance sheets; we adjust these interests each period to the greater of their fair value or carrying amount (initial amount as adjusted for allocations of income and losses and future contributions and distributions), with a corresponding offset to additional paid-in capital on our consolidated balance sheets, and only recognize reductions in such interests to the extent of their carrying amount. Our other noncontrolling interests are reported in the equity section of our consolidated balance sheets. The amounts reported for noncontrolling interests on our consolidated statements of operations represent the portion of these entities' income or losses not attributable to us.

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

Common units of the Operating Partnership are substantially similar economically to our common shares. Common units not owned by us are also exchangeable into our common shares, subject to certain conditions.

The Operating Partnership has 352,000 Series I Preferred Units issued to an unrelated party that have an aggregate liquidation preference of $8.8 million ($25.00 per unit), plus any accrued and unpaid distributions of return thereon (as described below), and may be redeemed for cash by the Operating Partnership at our option any time after September 22, 2019. The owner of these units is entitled to a priority annual cumulative return equal to 7.5% of their liquidation preference through September 22, 2019; the annual cumulative preferred return increases for each subsequent five-year period, subject to certain maximum limits. These units are convertible into common units on the basis of 0.5 common units for each Series I Preferred Unit; the resulting common units would then be exchangeable for common shares in accordance with the terms of the Operating Partnership's agreement of limited partnership.

The table below sets forth activity in our redeemable noncontrolling interest (in thousands):

	Year Ended December 31,	
	2012	2011
Beginning balance	$8,908	$9,000
Net loss attributable to noncontrolling interest	(2,565)	(1,407)
Adjustment to arrive at fair value of interest	3,955	1,315
Ending balance	$10,298	$8,908

Revenue Recognition

We recognize minimum rents, net of abatements, on a straight-line basis over the non-cancelable term of tenant leases (including periods under bargain renewal options). The non-cancelable term of a lease includes periods when a tenant: (1) may not terminate its lease obligation early; or (2) may terminate its lease obligation early in exchange for a fee or penalty that we consider material enough such that termination would not be probable. We report the amount by which our minimum rental revenue recognized on a straight-line basis under leases exceeds the contractual rent billings associated with such leases as deferred rent receivable on our consolidated balance sheets. Amounts by which our minimum rental revenue recognized on a straight-line basis under leases are less than the contractual rent billings associated with such leases are included in deferred revenue associated with operating leases on our consolidated balance sheets.

In connection with a tenant's entry into, or modification of, a lease, if we make cash payments to, or on behalf of, the tenant for purposes other than funding the construction of landlord assets, we defer the amount of such payments as lease incentives. We amortize lease incentives as a reduction of rental revenue over the term of the lease.

We recognize tenant recovery revenue in the same periods in which we incur the related expenses. Tenant recovery revenue includes payments from tenants as reimbursement for property taxes, utilities and other property operating expenses.

We recognize fees received for lease terminations as revenue and write off against such revenue any (1) deferred rents receivable, and (2) deferred revenue, lease incentives and intangible assets that are amortizable into rental revenue associated with the leases; the resulting net amount is the net revenue from the early termination of the leases. When a tenant's lease for space in a property is terminated early but the tenant continues to lease such space under a new or modified lease in the property, the net revenue from the early termination of the lease is recognized evenly over the remaining life of the new or modified lease in place on that property.

We recognize fees for services provided by us once services are rendered, fees are determinable and collectability is assured. We recognize revenue under construction contracts using the percentage of completion method when the revenue and costs for such contracts can be estimated with reasonable accuracy; when these criteria do not apply to a contract, we recognize revenue on that contract using the completed contract method. Under the percentage of completion method, we recognize a percentage of the total estimated revenue on a contract based on the cost of services provided on the contract as of a point in time relative to the total estimated costs on the contract.

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

Interest Rate Derivatives

Our primary objectives in using interest rate derivatives are to add stability to interest expense and to manage exposure to interest rate movements. To accomplish this objective, we primarily use interest rate swaps as part of our interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for our making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. Derivatives are used to hedge the cash flows associated with interest rates on existing debt as well as future debt. We recognize all derivatives as assets or liabilities in the balance sheet at fair value. We defer the effective portion of changes in fair value of the designated cash flow hedges to accumulated other comprehensive loss ("AOCL") and reclassify such deferrals to interest expense as interest expense is recognized on the hedged forecasted transactions. We recognize the ineffective portion of the change in fair value of interest rate derivatives directly in interest expense. When an interest rate swap designated as a cash flow hedge no longer qualifies for hedge accounting, we recognize changes in fair value of the hedge previously deferred to AOCL, along with any changes in fair value occurring thereafter, through earnings. We do not use interest rate derivatives for trading or speculative purposes. We manage counter-party risk by only entering into contracts with major financial institutions based upon their credit ratings and other risk factors.

We use standard market conventions and techniques such as discounted cash flow analysis, option pricing models, replacement cost and termination cost in computing the fair value of derivatives at each balance sheet date.

Please refer to Note 11 for additional information pertaining to interest rate derivatives.

Expense Classification
We classify as property operations expense costs incurred for property taxes, ground rents, utilities, property management, insurance, repairs, exterior and interior maintenance and tenant revenue collection losses, as well as associated labor and indirect costs attributable to these costs.

We classify as general and administrative and leasing expenses costs incurred for corporate-level management, public company administration, asset management, leasing, investor relations, marketing and corporate-level insurance (including general business, director and officers and key man life) and leasing prospects, as well as associated labor and indirect costs attributable to these costs.

Share-Based Compensation
We issued two forms of share-based compensation: restricted common shares ("restricted shares") and performance share units ("PSUs"). We also issued options to purchase common shares of beneficial interest ("options") in prior years. We account for share-based compensation in accordance with authoritative guidance provided by the FASB that establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, focusing primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. The guidance requires us to measure the cost of employee services received in exchange for an award of equity instruments based generally on the fair value of the award on the grant date; such cost is then recognized over the period during which the employee is required to provide service in exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. The guidance also requires that share-based compensation be computed based on awards that are ultimately expected to vest; as a result, future forfeitures of awards are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. If an award is voluntarily cancelled by an employee, we recognize the previously unrecognized cost associated with the original award on the date of such

cancellation. We capitalize costs associated with share-based compensation attributable to employees engaged in construction and development activities.

When we adopted the authoritative guidance on accounting for share-based compensation, we elected to adopt the alternative transition method for calculating the tax effects of share-based compensation. The alternative transition method enabled us to use a simplified method to establishing the beginning balance of the additional paid-in capital pool related to the tax effects of employee share-based compensation, which was available to absorb tax deficiencies recognized subsequent to the adoption of this guidance.

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

We compute the fair value of options using the Black-Scholes option-pricing model. Under that model, the risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected option life is based on our historical experience of employee exercise behavior. Expected volatility is based on historical volatility of our common shares of beneficial interest ("common shares"). Expected dividend yield is based on the average historical dividend yield on our common shares over a period of time ending on the grant date of the options.

We compute the fair value of PSUs using a Monte Carlo model. Under that model, the baseline common share value is based on the market value on the grant date. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. Expected volatility is based on historical volatility of our common shares.

Recent Accounting Pronouncements

We adopted guidance issued by the Financial Accounting Standards Board ("FASB") effective January 1, 2012 related to the presentation of comprehensive income that requires us to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. We adopted this guidance using retrospective application. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of equity. Our adoption of this guidance did not affect our financial position, results of operations, cash flows or measurement of comprehensive income but did change the location of our disclosure pertaining to comprehensive income in our consolidated financial statements.

We adopted guidance issued by the FASB effective January 1, 2012 that amends measurement and disclosure requirements related to fair value measurements to improve consistency with International Financial Reporting Standards. In connection with our adoption of this guidance, we made an accounting policy election to use an exception provided for in the guidance with respect to measuring counterparty credit risk for derivative instruments; this election enables us to continue to measure the fair value of groups of assets and liabilities associated with derivative instruments consistently with how market participants would price the net risk exposure at the measurement date. Our adoption of this guidance did not affect our financial position, results of operations or cash flows but did result in additional disclosure pertaining to our fair value measurements.

We adopted guidance issued by the FASB effective January 1, 2012 relating to the testing of goodwill for impairment that permits us to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform a quantitative impairment test. This guidance eliminates the requirement to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. Our adoption of this guidance did not materially affect our consolidated financial statements or disclosures.

3. Fair Value Measurements

Accounting standards define fair value as the exit price, or the amount that would be received upon sale of an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. The standards also establish a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability developed based on market data obtained from sources independent of us. Unobservable inputs are inputs that reflect our assumptions about the factors market participants would use in valuing the asset or liability developed based upon the best information available in the circumstances. The hierarchy of these inputs is broken down into three levels: Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities; Level 2 inputs include (1) quoted prices for similar assets or liabilities in active markets, (2) quoted prices for identical or similar assets or liabilities in markets that are not active and (3) inputs (other than quoted prices) that are observable for the asset or liability, either directly or indirectly; and Level 3 inputs are unobservable inputs for the asset or liability. Categorization within the valuation hierarchy is based upon the lowest level of input that is most significant to the fair value measurement.

The assets held in connection with our non-qualified elective deferred compensation plan (comprised primarily of mutual funds and equity securities) and the corresponding liability to the participants are measured at fair value on a recurring basis on our consolidated balance sheet using quoted market prices, as are other marketable securities that we hold. The deferred compensation plan assets and other marketable securities are included in the line entitled restricted cash and marketable securities on our consolidated balance sheets. The offsetting liability associated with the deferred compensation plan is

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Notes to Consolidated Financial Statements (Continued)

adjusted to fair value at the end of each accounting period based on the fair value of the plan assets and reported in other liabilities on our consolidated balance sheets. The assets and corresponding liability of our non-qualified elective deferred compensation plan and other marketable securities that we hold are classified in Level 1 of the fair value hierarchy.

The fair values of our interest rate derivatives are determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate market data and implied volatilities in such interest rates. While we determined that the majority of the inputs used to value our derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with our interest rate derivatives also utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default. However, as of December 31, 2012, we assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our derivatives and determined that these adjustments are not significant. As a result, we determined that our interest rate derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

At December 31, 2012 and 2011, we owned warrants to purchase 50,000 common shares in The KEYW Holding Corporation (“KEYW”) at an exercise price of $9.25 per share. KEYW is an entity supporting the intelligence community's operations and transformation to Cyber Age mission by providing engineering services and integrated platforms that support the intelligence process. We acquired these warrants in March 2010 and began accounting for such warrants as derivatives in November 2010 when KEYW became a publicly-traded company. We compute the fair value of these warrants using the Black-Scholes option-pricing model. Under that model, the risk-free interest rate is based on the U.S. Treasury yield curve in effect as of the valuation date. The expected life is based on the period of time until the expiration of the warrants. Expected volatility is based on an average of the historical volatility of companies in KEYW's industry that we deem to be comparable. Expected dividend yield is based on the dividend yield on KEYW's common shares as of the date of valuation. The warrants are classified in Level 2 of the fair value hierarchy.

In addition to the warrants in KEYW described above, we also owned 1.9 million shares, or approximately 7%, of KEYW's common stock at December 31, 2011 and 3.1 million shares, or approximately 12%, at December 31, 2010. Our investment in these common shares had a fair value of $13.8 million at December 31, 2011 based on the closing price of KEYW's common stock on the NASDAQ Stock Market on that date and is included in the line entitled "restricted cash and marketable securities" on our consolidated balance sheet. We sold 1.2 million of these shares in 2011, resulting in $2.1 million in gain recognized. We used the equity method of accounting for our investment in the common stock until the resignation of our then Chief Executive Officer from the Board of Directors of KEYW effective July 1, 2011, at which time we began accounting for our investment in KEYW's common stock as a trading marketable equity security to be reported at fair value, with unrealized gains and losses recognized through earnings. We sold our remaining 1.9 million shares in 2012 for $14.0 million. We recognized revenue from a lease with KEYW in one of our properties of $2.4 million in 2012, $780,000 in 2011 and $668,000 in 2010.

As discussed further in Note 6, our partner in a real estate joint venture has the right to require us to acquire its interest at fair value beginning in March 2020; accordingly, we classify the fair value of our partner’s interest as a redeemable noncontrolling interest in the mezzanine section of our consolidated balance sheet. We determine the fair value of the interest based on unobservable inputs after considering the assumptions that market participants would make in pricing the interest. We apply a discount rate to the estimated future cash flows allocable to our partner from the properties underlying the joint venture. Estimated cash flows used in such analyses are based on our plans for the properties and our views of market and economic conditions, and consider items such as current and future rental rates, occupancies for the properties and comparable properties and estimated operating and capital expenditures. In determining the fair value of our partner's interest, we used a discount rate of 15.6%, which factored in risk appropriate to the level of future property development expected to be undertaken by the joint venture; a significant increase (decrease) in the discount rate used in determining the fair value would result in a significantly (lower) higher fair value. Given our reliance on the unobservable inputs, the valuations are classified in Level 3 of the fair value hierarchy.

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

Recurring Fair Value Measurements

The tables below set forth our financial assets and liabilities that are accounted for at fair value on a recurring basis as of December 31, 2012 and 2011 and the hierarchy level of inputs used in measuring their respective fair values under applicable accounting standards (in thousands):

Description	Quoted Prices in Active Markets for Identical Assets(Level 1)	Significant Other Observable Inputs(Level 2)	Significant Unobservable Inputs(Level 3)	Total
December 31, 2012:				
Assets:				
Marketable securities in deferred compensation plan (1)				
Mutual funds	$ 6,275	$ —	$ —	$6,275
Common stocks	298	—	—	298
Other	203	—	—	203
Common stock (1)	809	—	—	809
Warrants to purchase common shares in KEYW (2)	—	294	—	294
Assets	$ 7,585	$ 294	$ —	$7,879
Liabilities:				
Deferred compensation plan liability (3)	$ 6,776	$ —	$ —	$6,776
Interest rate derivatives	—	6,185	—	6,185
Liabilities	$ 6,776	$ 6,185	$ —	$12,961
Redeemable noncontrolling interest	$ —	$ —	$ 10,298	$10,298
December 31, 2011:				
Assets:				
Marketable securities in deferred compensation plan (1)				
Mutual funds	$ 5,878	$ —	$ —	$5,878
Common stocks	909	—	—	909
Other	801	—	—	801
Common stock (1)	13,928	—	—	13,928
Interest rate derivative (2)	—	716		716
Warrants to purchase common shares in KEYW (2)	—	125	—	125
Assets	$ 21,516	$ 841	$ —	$22,357
Liabilities:				
Deferred compensation plan liability (3)	$ 7,588	$ —	$ —	$7,588
Interest rate derivatives	—	30,863	—	30,863
Liabilities	$ 7,588	$ 30,863	$ —	$38,451
Redeemable noncontrolling interest	$ —	$ —	$ 8,908	$8,908

(1) Included in the line entitled “restricted cash and marketable securities” on our consolidated balance sheet.

(2) Included in the line entitled “prepaid expenses and other assets” on our consolidated balance sheet.
(3) Included in the line entitled “other liabilities” on our consolidated balance sheet.

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, other assets (excluding mortgage loans receivable) and accounts payable and accrued expenses are reasonable estimates of their fair values because of the short maturities of these instruments. We estimated the fair values of our mortgage loans receivable as discussed in Note 9 based on the discounted estimated future cash flows of the loans (categorized within Level 3 of the fair value hierarchy); the discount rates used approximate current market rates for loans with similar maturities and credit quality, and the estimated cash payments include scheduled principal and interest payments. For our disclosure of debt fair values in Note 10 to the consolidated financial statements, we estimated the fair value of our exchangeable senior notes based on quoted market prices for publicly-traded debt (categorized within Level 2 of the fair value hierarchy) and estimated the fair value of our other debt based on the discounted estimated future cash payments to be made on such debt (categorized within Level 3 of the fair value hierarchy); the discount rates used approximate current market rates for loans, or groups of loans, with similar maturities and credit quality, and the estimated future payments include scheduled principal and interest payments. Fair value estimates are

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

made at a specific point in time, are subjective in nature and involve uncertainties and matters of significant judgment. Settlement of such fair value amounts may not be possible and may not be a prudent management decision.

For additional fair value information, please refer to Note 9 for mortgage loans receivable, Note 10 for debt and Note 11 for interest rate derivatives.

Nonrecurring Fair Value Measurements

We recognized impairment losses on certain properties and other assets associated with such properties in 2011 and 2012. Accordingly, certain properties and related assets were adjusted to fair value. The table below sets forth the fair value hierarchy of the valuation techniques used by us in determining such fair values for the year ended December 31, 2012 (dollars in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Impairment Losses Recognized in 2012 (1)
Assets (2):					
Properties, net	$—	$—	$379,684	$379,684	$62,702

(1) Represents impairment losses, excluding exit costs incurred of $4.2 million in 2012.
(2) Reflects balance sheet classifications of assets at time of fair value measurement, excluding the effect of held for sale classifications.

The table below sets forth quantitative information about significant unobservable inputs used for the Level 3 fair value measurements reported above (dollars in thousands):

Description	Fair Value on Measurement Date	Valuation Technique	Unobservable Input	Range (Weighted Average)
Properties on which impairment losses were recognized	$379,684	Bid for properties indicative of value	Indicative bid (1)	(1)
		Contract of sale	Contract price (1)	(1)
		Discounted cash flow	Discount rate	10.0% to 11.0% (10.4%)
			Terminal capitalization rate	8.7% to 10.0% (8.9%)
			Market rent growth rate	3.0% (2)
			Expense growth rate	3.0% (2)
		Yield Analysis	Yield	12% (2)
			Market rent rate	$8.50 per square foot (2)
			Leasing costs	$20.00 per square foot (2)

(1) These fair value measurements were developed by third party sources, subject to our corroboration for reasonableness.
(2) Only one value applied for this unobservable input.

The table below sets forth the fair value hierarchy of the valuation techniques used by us in determining such fair values for the year ended December 31, 2011 (dollars in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Impairment Losses Recognized in 2011
Assets (1):					
Properties, net	$ —	$ —	$ 320,894	$ 320,894	$ 150,093
Prepaid and other assets	—	—	163	163	928

(1) Reflects balance sheet classifications of assets at time of fair value measurement, excluding the effect of held for sale classifications.

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

4. Concentration of Rental Revenue

We derived large concentrations of our revenue from real estate operations from certain tenants during the periods set forth in our consolidated statements of operations. The following table summarizes the percentage of our rental revenue (which excludes tenant recoveries and other real estate operations revenue) earned from (1) individual tenants that accounted for at least 5% of our rental revenue from continuing and discontinued operations and (2) the aggregate of the five tenants from which we recognized the most rental revenue in the respective years:

	For the Years Ended December 31,					
	2012		2011		2010	
United States Government	18	%	17	%	16	%
Northrop Grumman Corporation (1)	7	%	8	%	9	%
Booz Allen Hamilton, Inc.	6	%	6	%	5	%
Computer Sciences Corporation	5	%	N/A		N/A	
Five largest tenants	39	%	38	%	35	%

(1) Includes affiliated organizations and agencies and predecessor companies.

We also derived in excess of 90% of our construction contract revenue from the United States Government in each of the years set forth on the consolidated statements of operations.

In addition, we derived large concentrations of our total revenue from real estate operations (defined as the sum of rental revenue and tenant recoveries and other real estate operations revenue) from certain geographic regions. These concentrations are set forth in the segment information provided in Note 15. Several of these regions, including the Baltimore/Washington Corridor, Northern Virginia, Washington, DC - Capitol Riverfront, St. Mary's & King George Counties, Greater Baltimore, Maryland (“Greater Baltimore”) and Suburban Maryland, are within close proximity to each other, and all but two of our regions with real estate operations (San Antonio, Texas (“San Antonio”) and Colorado Springs, Colorado (“Colorado Springs”)) are located in the Mid-Atlantic region of the United States.

5. Properties, net

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

	December 31,			
	2012		2011	
Land	$427,766		$472,483	
Buildings and improvements	2,725,875		2,801,252	
Less: accumulated depreciation	(555,975	)	(559,679	)
Operating properties, net	$2,597,666		$2,714,056	

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

	December 31,	
	2012	2011
Land	$236,324	$229,833
Construction in progress, excluding land	329,054	409,086
Projects in development or held for future development	$565,378	$638,919

2012 Dispositions and Impairments

In April 2011, we completed a review of our portfolio and identified a number of properties that are no longer closely aligned with our strategy, and our Board of Trustees approved a plan by Management to dispose of some of these properties (the “Strategic Reallocation Plan”). In December 2011, we identified additional properties for disposal, and our Board of Trustees approved a plan by management to increase the scope of the Strategic Reallocation Plan to include the disposition of

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Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

additional properties. We completed dispositions of the following properties in 2012 primarily in connection with the Strategic Reallocation Plan (dollars in thousands):

Project Name	Location	Date of Sale	Number of Buildings	Total Rentable Square Feet	Transaction Value	Gain on Disposition
White Marsh Portfolio Disposition	White Marsh, Maryland	1/30/2012	5	163,000	$ 19,100	$ 2,445
1101 Sentry Gateway	San Antonio, Texas	1/31/2012	1	95,000	13,500	1,739
222 and 224 Schilling Circle	Hunt Valley, Maryland	2/10/2012	2	56,000	4,400	102
15 and 45 West Gude Drive	Rockville, Maryland	5/2/2012	2	231,000	49,107	—
11800 Tech Road	Silver Spring, Maryland	6/14/2012	1	240,000	21,300	—
400 Professional Drive	Gaithersburg, Maryland	7/2/2012	1	130,000	16,198	—
July 2012 Portfolio Disposition	Baltimore/Washington Corridor and Greater Baltimore	7/24/2012	23	1,387,000	161,901	16,900
			35	2,302,000	$ 285,506	$ 21,186

Each of the above dispositions represent property sales except for 400 Professional Drive, the disposition of which was completed in connection with a debt extinguishment, as described further below. We also had dispositions of non-operating properties during the year ended December 31, 2012 for aggregate transaction values totaling $28.1 million; in addition to the gain on sales reflected above, we also recognized impairment losses on certain of these sales that are disclosed below.

On July 2, 2012, the mortgage lender on a $15 million nonrecourse mortgage loan that was secured by our 400 Professional Drive property accepted a deed in lieu of foreclosure on the property. As a result, we transferred title to the property to the mortgage lender and we were relieved of the debt obligation plus accrued interest. As of the transfer date, the property had an estimated fair value of $11 million. Upon completion of this transfer, we recognized a gain on extinguishment of debt of $3.7 million, representing the difference between the mortgage loan and interest payable extinguished over the carrying value of the property transferred as of the transfer date, which included the effect of previous impairments taken.

We recognized impairment losses in 2012 in connection with the following:

- our office properties and developable land in Greater Philadelphia, Pennsylvania. Our Board of Trustees approved a plan by Management to shorten the holding period for these properties because they no longer meet our strategic investment criteria. We determined that the carrying amounts of these properties will not likely be recovered from the cash flows from the operations and sales of such properties over the likely remaining holding period. Accordingly, we recognized aggregate non-cash impairment losses of $46.1 million in 2012 for the amounts by which the carrying values of the properties exceeded their respective estimated fair values. These losses contemplate our expectation that we will incur future cash expenditures of approximately $25 million to complete the redevelopment of certain of these properties;
- the Strategic Reallocation Plan of $19.0 million ($23.7 million classified as discontinued operations and including $4.2 million in exit costs), including $6.9 million pertaining to certain properties in Colorado Springs, Colorado classified as held for sale at December 31, 2012 and approximately $5.1 million related to our disposition of an

additional property from which the cash flows were not sufficient to recover its carrying value; and
- construction costs incurred on a property held for future development of $1.9 million.

The table below sets forth the impairment losses and exit costs recognized in 2012 by period of recognition and by property classification (in thousands):

	Three Months Ended				
	3/31/2012	6/30/2012	9/30/2012	12/31/2012	Total
Operating properties	$ 11,833	$ 2,354	$ 55,829	$ 247	$ 70,263
Non-operating properties	(5,246)	—	—	1,893	(3,353)
Total	$ 6,587	$ 2,354	$ 55,829	$ 2,140	$ 66,910

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

2012 Acquisition

On July 11, 2012, we acquired 13857 McLearen Road, a 202,000 square foot office property in Herndon, Virginia that was 100% leased, for $48.3 million. The table below sets forth the allocation of the acquisition costs of this property (in thousands):

Land, operating properties	$3,507
Building and improvements	30,177
Intangible assets on real estate acquisitions	14,993
Total assets	48,677
Below-market leases	(369)
Total acquisition cost	$48,308

Intangible assets recorded in connection with the above acquisition included the following (dollars in thousands):

		Weighted Average Amortization Period (in Years)
Tenant relationship value	$7,472	10
In-place lease value	7,109	5
Above-market leases	412	5
	$14,993	7

We expensed $229,000 in operating property acquisition costs in 2012 that are included in business development expenses and land carry costs on our consolidated statements of operations.

2012 Construction Activities

During 2012, we placed into service an aggregate of 371,000 square feet in four newly constructed office properties, including two properties in the Baltimore/Washington Corridor, one in Greater Baltimore and one in Northern Virginia. As of December 31, 2012, we had 11 office properties under construction, or for which we were contractually committed to construct, that we estimate will total 1.4 million square feet upon completion, including four in the Baltimore/Washington Corridor, four in Huntsville, Alabama and three in Northern Virginia. We also had redevelopment underway on two office properties in Greater Philadelphia that we estimate will total 297,000 square feet upon completion.

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Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

2011 Dispositions and Impairment

As discussed above, we implemented the Strategic Reallocation Plan in 2011 to dispose of office properties and land that are no longer closely aligned with our strategy. We determined that the carrying amounts of certain of the properties included in the Strategic Reallocation Plan (the "Impaired Properties") were not likely to be recovered from the cash flows from the operations and sales of such properties over the shorter holding periods. Accordingly, we recognized aggregate non-cash impairment losses in 2011 of $122.5 million (including $67.5 million classified as discontinued operations and excluding $4.8 million in related income tax benefit) for the amounts by which the carrying values of the Impaired Properties exceeded their respective estimated fair values. We completed the sale of the following properties under the Strategic Reallocation Plan in 2011 (dollars in thousands):

Project Name	Location	Date of Sale	Number of Buildings	Total Rentable Square Feet	Transaction Value	Gain on Disposition
1344 & 1348 Ashton Road and 1350 Dorsey Road	Hanover, Maryland	5/24/2011	3	39,000	$3,800	$150
216 Schilling Circle	Hunt Valley, Maryland	8/23/2011	1	36,000	4,700	175
Towson Portfolio	Towson, Maryland	9/29/2011	4	179,000	16,000	1,134
11011 McCormick Road	Hunt Valley, Maryland	11/1/2011	1	57,000	3,450	822
10001 Franklin Square Drive	White Marsh, Maryland	12/13/2011	1	218,000	16,250	305
Rutherford Business Center Portfolio	Woodlawn, Maryland	12/15/2011	13	365,000	32,460	2,221
			23	894,000	$76,660	$4,807

On February 15 and 17, 2011, the United States Army (the "Army") provided us disclosures regarding the past testing and use of tactical defoliants/herbicides at a property we owned and subsequently disposed of in Cascade, Maryland that was formerly an Army base known as Fort Ritchie ("Fort Ritchie"). Upon receipt of these disclosures, we commenced a review of our development plans and prospects for the property. We believed that these disclosures by the Army were likely to cause further delays in the resolution of certain existing litigation related to the property, and that they also increased the level of uncertainty as to our ultimate development rights at the property and future residential and commercial demand for the property. We analyzed various possible outcomes and resulting cash flows expected from the operations and ultimate disposition of the property. After determining that the carrying amount of the property was not likely to be recovered from those cash flows, we recognized a non-cash impairment loss of $27.7 million in March 2011 for the amount by which the carrying value of the property exceeded its estimated fair value.

In 2011, we also recognized additional impairment losses of $803,000 on goodwill associated with operating properties.

The table below sets forth the impairment losses recognized in 2011 by period of recognition and by property classification (in thousands):

	Three Months Ended			
	3/31/2011	6/30/2011	12/31/2011	Total
Non-operating properties	$27,742	$13,574	$ 39,193	$80,509
Operating properties	—	31,031	39,481	70,512

Total	$ 27,742	$ 44,605	$ 78,674	$ 151,021

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

2011 Acquisition

On August 9, 2011, we acquired 310 The Bridge Street, a 138,000 square foot office property in Huntsville, Alabama that was 100% leased, for $33.4 million. The table below sets forth the allocation of the acquisition costs of this property (in thousands):

Land, operating properties	$ 261
Building and improvements	26,577
Intangible assets on real estate acquisitions	6,575
Total acquisition cost	$ 33,413

Intangible assets recorded in connection with the above acquisitions included the following (in thousands):

		Weighted Average Amortization Period (in Years)
Tenant relationship value	$ 3,187	8
In-place lease value	2,904	3
Above-market leases	484	3
	$ 6,575	6

We expensed $156,000 in 2011 in connection with acquisitions of operating properties that are included in business development expenses on our consolidated statements of operations.

2011 Construction Activities

During 2011, we placed into service an aggregate of 566,000 square feet in seven newly constructed office properties, including three in the Baltimore/Washington Corridor, two in Greater Baltimore, one in San Antonio and one in St. Mary's County.

6. Real Estate Joint Ventures

During the periods included herein, we had an investment in one unconsolidated real estate joint venture accounted for using the equity method of accounting. Information pertaining to this joint venture investment is set forth below (dollars in thousands):

Investment Balance at (1)		Date		Nature of	Maximum Exposure
December 31, 2012	December 31, 2011	Acquired	Ownership	Activity	to Loss (2)
$ (6,420)	$ (6,071)	9/29/2005	20%	Operates 16 Buildings	$—

(1) The carrying amount of our investment in this joint venture was lower than our share of the equity in the joint venture by $4.5 million at December 31, 2012 and $5.2 million at December 31, 2011 due to our deferral of gain on the contribution by us of real estate into the joint venture upon its formation and our discontinuance of the equity method effective October 2012, as discussed below. A difference will continue to exist to the extent the nature of our continuing involvement in the joint venture remains the same.
(2) Derived from the sum of our investment balance and maximum additional unilateral capital contributions or loans required from us. Not reported above are additional amounts that we and our partner are required to fund when

needed by this joint venture; these funding requirements are proportional to our respective ownership percentages. Also not reported above are additional unilateral contributions or loans from us, the amounts of which are uncertain, that we would be required to make if certain contingent events occur (see Note 20).

Net cash flows of the joint venture are distributed to the partners in proportion to their respective ownership interests. We did not recognized fees from the joint venture for property management, construction and leasing services we provided in 2012, 2011 and 2010.

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

The following table sets forth condensed balance sheets for this unconsolidated real estate joint venture (in thousands):

	December 31, 2012	2011
Properties, net	$58,460	$59,792
Other assets	4,376	3,529
Total assets	$62,836	$63,321
Liabilities (primarily debt)	$72,693	$67,710
Owners' equity	(9,857)	(4,389)
Total liabilities and owners' equity	$62,836	$63,321

The following table sets forth condensed statements of operations for this unconsolidated real estate joint venture (in thousands):

	For the Years Ended December 31, 2012	2011	2010
Revenues	$7,316	$7,577	$8,405
Property operating expenses	(2,829)	(3,673)	(3,600)
Interest expense	(7,672)	(3,913)	(3,937)
Depreciation and amortization expense	(2,283)	(2,463)	(3,154)
Net loss	$(5,468)	$(2,472)	$(2,286)

We historically accounted for the investment in our one unconsolidated real estate joint venture using the equity method of accounting primarily because: (1) we share with our partner the power to direct the matters that most significantly impact the activities of the joint venture, including the management and operations of the properties and disposal rights with respect to such properties; and (2) our partner has the right to receive benefits and absorb losses that could be significant to the VIE through its proportionately larger investment. We deferred gain in a prior period on our initial contribution of property to the joint venture due to certain guarantees described in Note 20, and we subsequently recognized losses in excess of our investment due to such guarantees and our intent to support the joint venture. During the fourth quarter of 2012, the holder of mortgage debt encumbering all of the joint venture's properties notified us of the debt's default, initiated foreclosure proceedings and terminated our property management responsibilities; accordingly, we discontinued our application of the equity method to this investment effective in October 2012 due to our having neither the obligation nor intent to support the joint venture.

The table below sets forth information pertaining to our investments in consolidated real estate joint ventures at December 31, 2012 (dollars in thousands):

	Date Acquired	Nominal Ownership % at 12/31/2012	Nature of Activity	December 31, 2012 (1) Total Assets	Encumbered Assets	Total Liabilities
LW Redstone Company, LLC	3/23/2010	85%	Developing business park (2)	$76,295	$16,809	$12,990
M Square Associates, LLC	6/26/2007	50%	Operating two buildings and developing others (3)	60,798	47,360	43,149
Arundel Preserve #5, LLC	7/2/2007	50%	Operating one building (4)	39,581	36,811	17,722

COPT-FD Indian Head, LLC	10/23/2006	75%	Holding land parcel (5)	6,436	—	16
MOR Forbes 2 LLC	12/24/2002	50%	Operating one building (6)	3,879	—	96
				$186,989	$100,980	$73,973

(1) Excludes amounts eliminated in consolidation.
(2) This joint venture's property is in Huntsville, Alabama.
(3) This joint venture's properties are in College Park, Maryland (in the Suburban Maryland region).
(4) This joint venture's property is in Hanover, Maryland (in the Baltimore/Washington Corridor).
(5) This joint venture's property is in Charles County, Maryland. In 2012, the joint venture exercised its option under a development agreement to require Charles County to repurchase the land parcel at its original acquisition cost. Under the terms of the agreement with Charles County, the repurchase is expected to occur by August 2014.
(6) This joint venture's property is in Lanham, Maryland (in the Suburban Maryland region).

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Notes to Consolidated Financial Statements (Continued)

With regard to our consolidated joint ventures:

- For LW Redstone, LLC, we anticipate funding certain infrastructure costs (up to a maximum of $76.0 million) that we expect will be reimbursed by the City of Huntsville; as of December 31, 2012, we had advanced $33.3 million to the City to fund such costs (included in prepaid expenses and other assets on our consolidated balance sheet). We also expect to fund additional development and construction costs through equity contributions to the extent that third party financing is not obtained. Our partner was credited with a $9.0 million capital account upon formation and is not required to make any future equity contributions. While net cash flow distributions to the partners vary depending on the source of the funds distributed, cash flows are generally distributed as follows:
  - cumulative preferred returns on capital invested to fund the project’s infrastructure costs on a pro rata basis to us and our partner;
  - cumulative preferred returns on our capital invested to fund the project’s vertical construction;
  - return of our invested capital;
  - return of our partner’s capital;
  - any remaining residual 85% to us and 15% to our partner.

  Our partner has the right to require us to acquire its interest for fair value beginning in March 2020; accordingly, we classify the fair value of our partner’s interest as redeemable noncontrolling interests in the mezzanine section of our consolidated balance sheet. We have the right to purchase our partner’s interest at fair value upon the earlier of five years following the project’s achievement of a construction commencement threshold of 4.4 million square feet or March 2040.
- For M Square Associates, LLC, net cash flows of this entity will be distributed to the partners as follows: (1) member loans and accrued interest; (2) our preferred return and capital contributions used to fund infrastructure costs; (3) the partners' preferred returns and capital contributions used to fund all other costs, including the base land value credit, in proportion to the accrued returns and capital accounts; and (4) residual amounts distributed 50% to each member.
- For Arundel Preserve #5, LLC, net cash flows will be distributed to the partners as follows: (1) member loans and accrued interest; (2) preferred returns in proportion to the partners' respective capital accounts; (3) repayment of any building operating reserves funded by us; and (4) residual cash flows in proportion to the partners' respective ownership interests.
- For COPT-FD Indian Head, LLC, net cash flows will be distributed to the partners in proportion to their respective ownership interests.
- For MOR Forbes 2 LLC, net cash flows will be distributed to the partners in proportion to their respective ownership interests.

We consolidate these real estate joint ventures because we have: (1) the power to direct the matters that most significantly impact the activities of the joint ventures, including development, leasing and management of the properties constructed by the VIEs; and (2) the right to receive returns on our fundings and, in many cases, the obligation to fund the activities of the ventures to the extent that third-party financing is not obtained, both of which could be potentially significant to the VIEs.

Our commitments and contingencies pertaining to our real estate joint ventures are disclosed in Note 20.

7. Intangible Assets on Real Estate Acquisitions

Intangible assets on real estate acquisitions consisted of the following (in thousands):

	December 31, 2012			December 31, 2011		
			Net			Net

	Gross Carrying Amount	Accumulated Amortization	Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Carrying Amount
In-place lease value	$134,964	$ 93,362	$41,602	$151,361	$ 97,594	$53,767
Tenant relationship value	46,828	23,346	23,482	45,940	23,246	22,694
Above-market cost arrangements	12,416	4,100	8,316	12,416	2,857	9,559
Above-market leases	8,925	7,432	1,493	10,118	8,037	2,081
Market concentration premium	1,333	347	986	1,333	314	1,019
	$204,466	$ 128,587	$75,879	$221,168	$ 132,048	$89,120

Amortization of the intangible asset categories set forth above totaled $21.4 million in 2012, $28.3 million in 2011 and $28.3 million in 2010. The approximate weighted average amortization periods of the categories set forth above follow: in-place lease value: seven years; tenant relationship value: eight years; above-market cost arrangements: 28 years; above-market leases: four years; and market concentration premium: 30 years. The approximate weighted average amortization period for all of the

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categories combined is ten years. Estimated amortization expense associated with the intangible asset categories set forth above for the next five years is: $14.4 million for 2013; $12.3 million for 2014; $10.6 million for 2015; $9.5 million for 2016; and $7.1 million for 2017.

8. Deferred Leasing and Financing Costs

Deferred leasing and financing costs, net consisted of the following (in thousands):

	December 31, 2012	2011
Deferred leasing costs	$97,852	$96,140
Deferred financing costs	30,520	44,159
Accumulated amortization	(68,420)	(73,784)
Deferred leasing and financing costs, net	$59,952	$66,515

9. Prepaid Expenses and Other Assets

Prepaid expenses and other assets consisted of the following (in thousands):

	December 31, 2012	2011
Mortgage and other investing receivables	$33,396	$27,998
Prepaid expenses	19,270	20,035
Furniture, fixtures and equipment, net	7,991	10,177
Deferred tax asset	6,612	6,923
Lease incentives	5,578	5,233
Other assets	4,608	13,284
Prepaid expenses and other assets	$77,455	$83,650

Mortgage and Other Investing Receivables

Mortgage and other investing receivables consisted of the following (in thousands):

	December 31, 2012	2011
Notes receivable from City of Huntsville	$33,252	$17,741
Mortgage loans receivable	144	10,257
	$33,396	$27,998

Our notes receivable from the City of Huntsville funded infrastructure costs in connection with our LW Redstone Company, LLC joint venture (see Note 6). As of December 31, 2012, our mortgage loans receivable reflected above consisted of one loan secured by a property in Greater Baltimore. We did not have an allowance for credit losses in connection with these receivables at December 31, 2012 or December 31, 2011. The fair value of our mortgage and other investing receivables totaled $33.4 million at December 31, 2012 and $28.0 million at December 31, 2011.

Operating Notes Receivable

We had operating notes receivable due from tenants with terms exceeding one year totaling $271,000 at December 31, 2012 and $530,000 at December 31, 2011. We carried allowances for estimated losses for most of these balances.

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Notes to Consolidated Financial Statements (Continued)

10. Debt

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

	Maximum Availability at	Carrying Value at		Stated Interest Rates at	Scheduled Maturity Dates at
	December 31, 2012	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2012
Mortgage and Other Secured Loans:					
Fixed rate mortgage loans (1)	N/A	$948,414	$ 1,052,421	5.20% - 7.87% (2)	2013-2034
Variable rate secured loans	N/A	38,475	39,213	LIBOR + 2.25% (3)	2015
Other construction loan facilities	$ 123,802	29,557	40,336	LIBOR + 1.95% to 2.75% (4)	2013-2015
Total mortgage and other secured loans		1,016,446	1,131,970		
Revolving Credit Facility	800,000	—	662,000	LIBOR + 1.75% to 2.50%	September 1, 2014
Term Loan Facilities	770,000	770,000	400,000	LIBOR + 1.65% to 2.60% (5)	2015-2019
Unsecured notes payable	N/A	1,788	5,050	0% (6)	2026
4.25% Exchangeable Senior Notes	N/A	230,934	227,283	4.25%	April 2030 (7)
Total debt		$2,019,168	$ 2,426,303		

(1) Several of the fixed rate mortgages carry interest rates that were above or below market rates upon assumption and therefore were recorded at their fair value based on applicable effective interest rates. The carrying values of these loans reflect net unamortized premiums totaling $1.3 million at December 31, 2012 and $2.4 million at December 31, 2011.
(2) The weighted average interest rate on these loans was 6.01% at December 31, 2012.
(3) The interest rate on the loan outstanding was 2.46% at December 31, 2012.
(4) The weighted average interest rate on these loans was 2.66% at December 31, 2012.
(5) The weighted average interest rate on these loans was 2.17% at December 31, 2012.
(6) These notes carry interest rates that were below market rates upon assumption and therefore were recorded at their fair value based on applicable effective interest rates. The carrying value of these notes reflects an unamortized discount totaling $873,000 at December 31, 2012 and $1.8 million at December 31, 2011.
(7) Refer to the paragraph below for descriptions of provisions for early redemption and repurchase of these notes.

Effective September 1, 2011, we entered into a credit agreement providing for an unsecured revolving credit facility (the “Revolving Credit Facility”) with a group of lenders for which J.P. Morgan Securities LLC and KeyBanc Capital Markets acted as join lead arrangers and joint book runners, KeyBank National Association acted as administrative agent and JPMorgan Chase Bank, N.A. and Bank of America, N.A. acted as co-syndication agents. The lenders’ aggregate commitment under the facility was $1.0 billion, with the ability for us to increase the lenders’ aggregate commitment to $1.5 billion, provided that there is no default under the facility and subject to the approval of the lenders. Effective August 10, 2012, we exercised our right to reduce the lenders’ aggregate commitment under the facility from $1.0 billion to $800 million, with the ability for us to increase the lenders' aggregate commitment to $1.3 billion, provided that there is no default under the facility and subject to the approval of the lenders. Amounts available under the facility are computed based on 60% of our unencumbered asset value, as defined in the agreement. The facility matures on September 1, 2014, and may be extended by one year at our option, provided that there is no default under the facility and we pay an extension fee of 0.20% of the total availability of the facility. The interest rate on the facility is based on LIBOR (customarily the 30-day rate) plus 1.75% to 2.50%, as determined by our leverage levels. The facility also carries a quarterly fee that is based on the unused amount of the facility multiplied by a per annum rate of 0.25% to 0.35%, as determined by the level of our unused amount. As of December 31, 2012, the maximum borrowing capacity under this facility totaled $800.0 million, of which $792.3 million was available.

Effective September 1, 2011, we entered into an unsecured term loan agreement with the same group of lenders as the Revolving Credit Facility under which we borrowed $400.0 million, with a right for us to borrow an additional $100.0 million, provided that there is no default under the agreement. The term loan matures on September 1, 2015, and may be extended by one year at our option, provided that there is no default and we pay an extension fee of 0.20% of the total availability of the agreement. The variable interest rate on the term loan is based on LIBOR rate (customarily the 30-day rate) plus 1.65% to 2.40%, as determined by our leverage levels.

Upon entry into the Revolving Credit Facility and term loan on September 1, 2011, we repaid and extinguished our previously existing Revolving Credit Facility and Revolving Construction Facility and used most of the remaining proceeds to repay two variable rate secured loans totaling $270.3 million. Upon the early extinguishment of this debt, we recognized a loss of $1.7 million, representing unamortized issuance costs.

Effective February 14, 2012, we entered into an unsecured term loan agreement with a group of lenders for which J.P. Morgan Securities LLC and KeyBank Capital Markets acted as joint lead arrangers and joint book runners, KeyBank National Association acted as administrative agent and JPMorgan Chase Bank, N.A. acted as syndication agent. We borrowed $250.0 million under the term loan. The term loan matures on February 14, 2017. The variable interest rate on the loan is based on the LIBOR rate (customarily the 30-day rate) plus 1.65% to 2.40%, as determined by our leverage levels.

Effective August 3, 2012, we entered into an unsecured term loan agreement with a group of lenders for which Wells Fargo Securities, LLC acted as sole arranger and sole book runner, Wells Fargo Bank, National Association acted as administrative agent and Capital One, N.A. acted as documentation agent. We borrowed $120.0 million under the term loan, with the ability for us to borrow an additional $80.0 million, provided that there is no default under the loan and subject to the approval of the lenders. The term loan matures on August 2, 2019. The variable interest rate on the loan is based on the LIBOR rate (customarily the 30-day rate) plus 2.10% to 2.60%, as determined by our leverage levels.

In 2010, the Operating Partnership issued a $240.0 million aggregate principal amount of 4.25% Exchangeable Senior Notes due 2030. Interest on the notes is payable on April 15 and October 15 of each year. These notes have an exchange settlement feature that provides that the notes may, under certain circumstances, be exchangeable for cash and, at the Operating Partnership's discretion, our common shares at an exchange rate (subject to adjustment) of 20.8513 shares per one thousand dollar principal amount of the notes (exchange rate is as of December 31, 2012 and is equivalent to an exchange price of $47.96 per common share) (the initial exchange rate of the notes was based on a 20% premium over the closing price on the NYSE on the transaction pricing date). On or after April 20, 2015, the Operating Partnership may redeem the notes in cash in whole or in part. The holders of the notes have the right to require us to repurchase the notes in cash in whole or in part on each of April 15, 2015, April 15, 2020 and April 15, 2025, or in the event of a "fundamental change," as defined under the terms of the notes, for a repurchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest. The notes are general unsecured senior obligations of the Operating Partnership and rank equally in right of payment with all other senior unsecured indebtedness of the Operating Partnership and are guaranteed by us. The carrying value of these notes included a principal amount of $240 million and an unamortized discount totaling $9.1 million at December 31, 2012 and $12.7 million at December 31, 2011. The effective interest rate under the notes, including amortization of the issuance costs, was 6.05%. Because the closing price of our common shares at December 31, 2012 and 2011 was less than the exchange price per common share applicable to these notes, the if-converted value of the notes did not exceed the principal amount. The table below sets forth interest expense recognized on these notes before deductions for amounts capitalized (in thousands):

	For the Years Ended December 31,		
	2012	2011	2010
Interest expense at stated interest rate	$10,200	$10,200	$7,480
Interest expense associated with amortization of discount	3,651	3,437	2,445
Total	$13,851	$13,637	$9,925

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Until September 15, 2011, the Operating Partnership had $162.5 million aggregate principal amount of 3.50% Exchangeable Senior Notes due 2026. These notes had an exchange settlement feature that provided that the notes were, under certain circumstances, exchangeable for cash (up to the principal amount of the notes) and, with respect to any excess exchange value, were exchangeable into (at our option) cash, our common shares or a combination of cash and our common shares. On September 15, 2011, we repurchased these notes at 100% of the principal amount of $162.5 million after the holders of such notes surrendered them for repurchase pursuant to the terms of the notes and the related Indenture. The effective interest rate under the notes, including amortization of the issuance costs, was 5.97%. Because the closing price of our common shares at December 31, 2011 was less than the exchange price per common share applicable to these notes, the if-converted value of the notes did not exceed the principal amount. The table below sets forth interest expense recognized on these notes before deductions for amounts capitalized:

	For the Years Ended December 31,	
	2011	2010
Interest expense at stated interest rate	$4,013	$5,687
Interest expense associated with amortization of discount	2,617	3,736
Total	$6,630	$9,423

Certain of our debt instruments require that we comply with a number of restrictive financial covenants, including maximum leverage ratio, unencumbered leverage ratio, minimum net worth, minimum fixed charge coverage, minimum unencumbered interest coverage ratio, minimum debt service and maximum secured indebtedness ratio. As of December 31, 2012, we were within the compliance requirements of these financial covenants.

Our debt matures on the following schedule (in thousands):

2013	$121,129	(1)
2014	158,341	
2015	795,802	(2)
2016	278,642	
2017	551,388	
Thereafter	122,490	
Total	$2,027,792	(3)

(1) Includes $17.5 million that may be extended for one year, subject to certain conditions.
(2) Includes $411.1 million that may be extended for one year, subject to certain conditions.
(3) Represents scheduled principal amortization and maturities only and therefore excludes net discounts of $8.6 million.

Weighted average borrowings under our Revolving Credit Facilities totaled $276.5 million in 2012 and $482.3 million in 2011. The weighted average interest rate on our Revolving Credit Facilities was 2.27% in 2012 and 1.65% in 2011.

We capitalized interest costs of $13.9 million in 2012, $17.4 million in 2011 and $16.5 million in 2010.

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

	December 31, 2012		December 31, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Fixed-rate debt				

4.25% Exchangeable Senior Notes	$230,934	$240,282	$227,283	$238,077
Other fixed-rate debt	950,202	968,180	1,057,471	1,054,424
Variable-rate debt	838,032	845,558	1,141,549	1,139,856
	$2,019,168	$2,054,020	$2,426,303	$2,432,357

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11. Interest Rate Derivatives

The following table sets forth the key terms and fair values of our interest rate swap derivatives (dollars in thousands):

Notional Amount		Fixed Rate	Floating Rate Index	Effective Date	Expiration Date	Fair Value at December 31, 2012	Fair Value at December 31, 2011
$100,000		0.6123%	One-Month LIBOR	1/3/2012	9/1/2014	$(594)	$55
100,000		0.6100%	One-Month LIBOR	1/3/2012	9/1/2014	(591)	56
100,000		0.8320%	One-Month LIBOR	1/3/2012	9/1/2015	(1,313)	(66)
100,000		0.8320%	One-Month LIBOR	1/3/2012	9/1/2015	(1,313)	(49)
38,475	(1)	3.8300%	One-Month LIBOR + 2.25%	11/2/2010	11/2/2015	(1,268)	(1,054)
100,000		0.8055%	One-Month LIBOR	9/2/2014	9/1/2016	(263)	—
100,000		0.8100%	One-Month LIBOR	9/2/2014	9/1/2016	(272)	—
100,000		1.6730%	One-Month LIBOR	9/1/2015	8/1/2019	(154)	—
100,000		1.7300%	One-Month LIBOR	9/1/2015	8/1/2019	(417)	—
50,000		0.5025%	One-Month LIBOR	1/3/2011	1/3/2012	—	(1)
50,000		0.5025%	One-Month LIBOR	1/3/2011	1/3/2012	—	(1)
120,000		1.7600%	One-Month LIBOR	1/2/2009	5/1/2012	—	(552)
100,000		1.9750%	One-Month LIBOR	1/1/2010	5/1/2012	—	(532)
100,000	(2)	3.8415%	Three-Month LIBOR	9/30/2011	9/30/2021	—	(16,333)
75,000	(2)	3.8450%	Three-Month LIBOR	9/30/2011	9/30/2021	—	(12,275)
100,000	(2)	2.0525%	Three-Month LIBOR-Reverse	12/30/2011	9/30/2021	—	345
75,000	(2)	2.0525%	Three-Month LIBOR-Reverse	12/30/2011	9/30/2021	—	260
						$(6,185)	$(30,147)

(1) The notional amount of this instrument is scheduled to amortize to $36.2 million.

(2) As described below, we settled these instruments on January 5, 2012, along with interest accrued thereon, for an aggregate of $29.7 million. Our policy is to present payments to terminate interest rate swaps entered into in order to hedge forecasted interest payments as operating activities on our consolidated statement of cash flows. Accordingly, the payments to settle these instruments were included in net cash provided by operating activities on our consolidated statement of cash flows.

Each of the one-month LIBOR interest rate swaps set forth in the table above was designated as a cash flow hedge of interest rate risk.

On April 5, 2011, we entered into the two forward starting three-month LIBOR swaps set forth above with an effective date of September 30, 2011 for an aggregate notional amount of $175 million. We designated these swaps as cash flow hedges of interest payments on ten-year, fixed-rate borrowings forecasted to occur between August 2011 and April 2012. After meeting with our Board of Trustees on December 21, 2011, we determined that we would pursue other financing options and concluded that the originally forecasted borrowings were expected not to occur. Accordingly, the swaps no longer qualified for hedge accounting. On December 22, 2011, we entered into the two reverse three-month LIBOR swaps set forth above with an effective date of December 30, 2011 for an aggregate notional amount of $175 million in order to remove the majority of the variability in the termination value of the forward starting swaps entered into on April 5, 2011. We recognized aggregate net losses of $29.8 million on these interest rate swaps in December 2011. On January 5, 2012, we settled all of the forward starting swaps entered into on April 5, 2011 and December 22, 2011 and interest accrued thereon for an aggregate of $29.7 million.

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The table below sets forth the fair value of our interest rate derivatives as well as their classification on our consolidated balance sheet (in thousands):

	December 31, 2012		December 31, 2011	
Derivatives	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Interest rate swaps designated as cash flow hedges	Prepaid expenses and other assets	$ —	Prepaid expenses and other assets	$ 111
Interest rate swaps not designated as hedges	N/A	—	Prepaid expenses and other assets	605
Interest rate swaps designated as cash flow hedges	Interest rate derivatives	(6,185)	Interest rate derivatives	(2,255)
Interest rate swaps not designated as hedges	N/A	—	Interest rate derivatives	(28,608)

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

	For the Years Ended December 31,		
	2012	2011	2010
Amount of loss recognized in accumulated other comprehensive loss (“AOCL”) (effective portion)	$(7,676)	$(31,531)	$(5,473)
Amount of loss reclassified from AOCL into interest expense (effective portion)	(3,697)	(4,601)	(3,689)
Amount of loss reclassified from AOCL to loss on interest rate derivatives upon discontinuing hedge accounting	—	28,430	—
Amount of loss on interest rate derivatives recognized subsequent to such derivatives no longer being designated as hedges	—	1,375	—

Over the next 12 months, we estimate that approximately $2.6 million will be reclassified from AOCL as an increase to interest expense.

We have agreements with each of our interest rate derivative counterparties that contain provisions under which, if we default or are capable of being declared in default on any of our indebtedness, we could also be declared in default on our derivative obligations. These agreements also incorporate the loan covenant provisions of our indebtedness with a lender affiliate of the derivative counterparties. Failure to comply with the loan covenant provisions could result in our being declared in default on any derivative instrument obligations covered by the agreements. As of December 31, 2012, the fair value of interest rate derivatives in a liability position related to these agreements was $6.2 million, excluding the effects of accrued interest. As of December 31, 2012, we had not posted any collateral related to these agreements. We are not in default with any of these provisions. If we breached any of these provisions, we could be required to settle our obligations under the agreements at their termination value of $6.4 million.

12. Shareholders’ Equity

Preferred Shares

At December 31, 2012, we had 25.0 million preferred shares of beneficial interest (“preferred shares”) authorized at $0.01 par value. The table below sets forth additional information pertaining to our preferred shares (dollars in thousands, except per share data):

Series	# of Shares Issued	Aggregate Liquidation Preference	Month of Issuance	Annual Dividend Yield		Annual Dividend Per Share	Earliest Redemption Date
Series H	2,000,000	$50,000	December 2003	7.500	%	$1.87500	12/18/2008
Series J	3,390,000	84,750	July 2006	7.625	%	$1.90625	7/20/2011
Series K	531,667	26,583	January 2007	5.600	%	$2.80000	1/9/2017
Series L	6,900,000	172,500	June 2012	7.375	%	$1.84375	6/27/2017
	12,821,667	$333,833					

Each series of preferred shares is nonvoting and redeemable for cash in the amount of its liquidation preference at our option on or after the earliest redemption date. The Series K Cumulative Redeemable Preferred Shares are also convertible,

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subject to certain conditions, into common shares on the basis of 0.8163 common shares for each preferred share. Holders of all preferred shares are entitled to cumulative dividends, payable quarterly (as and if declared by our Board of Trustees). In the case of each series of preferred shares, there is a series of preferred units in the Operating Partnership owned by us that carries substantially the same terms.

On June 27, 2012, we completed the public offering of 6.9 million Series L Cumulative Preferred Shares of beneficial interest (“Series L Preferred Shares”) at a price of $25.00 per share for net proceeds of $165.7 million after underwriting discounts but before offering expenses. We contributed the net proceeds from the sale to our Operating Partnership in exchange for 6.9 million Series L Preferred Units. The Series L Preferred Units carry terms that are substantially the same as the Series L Preferred Shares.

On August 6, 2012, we redeemed all of our outstanding 8% Series G Preferred Shares of beneficial interest (the “Series G Preferred Shares”) at a price of $25.00 per share, or $55.0 million in the aggregate, plus accrued and unpaid dividends thereon through the date of redemption. We recognized a $1.8 million decrease to net income available to common shareholders pertaining to the original issuance costs incurred on the Series G Preferred Shares at the time of the redemption.

Common Shares

During 2011 and 2012, we completed the following public offerings of common shares:

- 4.6 million common shares in May 2011 at a public offering price of $33.00 per share for net proceeds of $145.7 million after underwriter discounts but before offering expenses; and
- 8.6 million common shares in October 2012 at a public offering price of $24.75 per share for net proceeds of $204.9 million after underwriter discounts but before offering expenses.

In October 2012, we established an at-the-market (“ATM”) stock offering program under which we may, from time to time, offer and sell common shares in “at the market” stock offerings having an aggregate gross sales price of up to $150.0 million. We completed no sales of shares under this program in 2012.

Holders of common units in our Operating Partnership converted their units into common shares on the basis of one common share for each common unit in the amount of 234,246 in 2012 and 100,939 in 2011.

We declared dividends per common share of $1.10 in 2012, $1.65 in 2011 and $1.61 in 2010.

See Note 13 for disclosure of common share activity pertaining to our share-based compensation plans.

13. Share-Based Compensation and Employee Benefit Plans

Share-Based Compensation Plans

In May 2010, we adopted the Amended and Restated 2008 Omnibus Equity and Incentive Plan. We may issue equity-based awards under this plan to officers, employees, non-employee trustees and any other key persons of us and our subsidiaries, as defined in the plan. The plan provides for a maximum of 5,900,000 common shares of beneficial interest to be issued in the form of options, share appreciation rights, deferred share awards, restricted share awards, unrestricted share awards, performance shares, dividend equivalent rights and other equity-based awards and for the granting of cash-based awards. The plan expires on May 13, 2020.

In March 1998, we adopted a long-term incentive plan for our Trustees and employees. This plan, which expired in March 2008, provided for the award of options, restricted shares and dividend equivalents.

Grants of restricted shares and options under these plans to nonemployee Trustees generally vest on the first anniversary of the grant date provided that the Trustee remains in his or her position. Restricted shares and options granted to employees vest based on increments and over periods of time set forth under the terms of the respective awards provided that the employees remain employed by us. Options expire ten years after the date of grant. Shares for each of our share-based compensation plans are issued under registration statements on Form S-8 that became effective upon filing with the Securities and Exchange Commission.

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The following table summarizes restricted share transactions under our share-based compensation plans for 2010, 2011 and 2012:

	Shares		Weighted Average Grant Date Fair Value
Unvested at December 31, 2009	668,990		$30.43
Granted	290,956		37.74
Forfeited	(13,986	)	34.38
Vested	(276,102	)	32.24
Unvested at December 31, 2010	669,858		32.77
Granted	320,284		33.68
Forfeited	(18,058	)	34.23
Vested	(323,706	)	32.86
Unvested at December 31, 2011	648,378		33.13
Granted	177,662		23.64
Forfeited	(17,019	)	31.43
Vested	(374,378	)	32.72
Unvested at December 31, 2012	434,643		$29.67
Restricted shares expected to vest	419,014		$29.73

The aggregate intrinsic value of restricted shares that vested was $9.0 million in 2012, $11.2 million in 2011 and $10.3 million in 2010.

Our Board of Trustees made the following grants of Performance Share Units ("PSUs") to executives:

- 100,645 PSUs on March 4, 2010 (the "2010 PSU Grants") with an aggregate grant date fair value of $5.4 million. Certain executives voluntarily cancelled 58,105 of these PSUs in 2011; we recognized a non-cash compensation charge of $1.2 million in 2011 in connection with these PSU cancellations. The remaining PSUs at December 31, 2011 were held by Mr. Randall M. Griffin, our former Chief Executive Officer, and were terminated upon his retirement on March 31, 2012; based on the Company's total shareholder return relative to its peer group of companies, there was no payout value in connection with the termination of the PSUs;
- 56,883 PSUs on March 3, 2011 (the "2011 PSU Grants") with an aggregate grant date fair value of $2.8 million which were all outstanding at December 31, 2012; and
- 54,070 PSUs on March 1, 2012, (the "2012 PSU Grants") with an aggregate grant date fair value of $1.8 million which were all outstanding at December 31, 2012.

The PSUs have a performance period beginning on the respective grant dates and concluding on the earlier of three years from the respective grant dates or the date of: (1) termination by the Company without cause, death or disability of the executive or constructive discharge of the executive (collectively, "qualified termination"); or (2) a sale event. The number of PSUs earned ("earned PSUs") at the end of the performance period will be determined based on the percentile rank of the Company's total shareholder return relative to a peer group of companies, as set forth in the following schedule:

Percentile Rank	Earned PSUs Payout %
75th or greater	200% of PSUs granted
50th or greater	100% of PSUs granted

25th	50% of PSUs granted
Below 25th	0% of PSUs granted

If the percentile rank exceeds the 25th percentile and is between two of the percentile ranks set forth in the table above, then the percentage of the earned PSUs will be interpolated between the ranges set forth in the table above to reflect any performance between the listed percentiles. At the end of the performance period, we, in settlement of the award, will issue a number of fully-vested common shares equal to the sum of:

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- the number of earned PSUs in settlement of the award plan; plus
- the aggregate dividends that would have been paid with respect to the common shares issued in settlement of the earned PSUs through the date of settlement had such shares been issued on the grant date, divided by the share price on such settlement date, as defined under the terms of the agreement.

If a performance period ends due to a sale event or qualified termination, the number of earned PSUs is prorated based on the portion of the three-year performance period that has elapsed. If employment is terminated by the employee or by the Company for cause, all PSUs are forfeited. PSUs do not carry voting rights.

We computed grant date fair values for PSUs using Monte Carlo models and are recognizing these values over three-year periods that commenced on the respective grant dates. The grant date fair value and certain of the assumptions used in the Monte Carlo models for PSUs granted in 2010, 2011 and 2012 are set forth below:

	For the Years Ended December 31,		
	2012	2011	2010
Grant date fair value	$32.77	$49.15	$53.31
Baseline common share value	$24.39	$35.17	$37.84
Expected volatility of common shares	43.2%	61.1%	62.2%
Risk-free interest rate	0.41%	1.32%	1.38%

The following table summarizes option transactions under our share-based compensation plans for 2010, 2011 and 2012 (dollars in thousands, except per share data):

	Shares	Range of Exercise Price per Share	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2009	1,501,906	$8.63 - $57.00	$30.29	5	$14,579
Forfeited/Expired – 2010	(34,966)	$41.33 - $49.60	$46.59		
Exercised – 2010	(278,656)	$8.63 - $42.07	$16.42		
Outstanding at December 31, 2010	1,188,284	$9.54 - $57.00	$33.07	5	$7,987
Forfeited/Expired – 2011	(51,598)	$22.49 - $50.59	$42.82		
Exercised – 2011	(191,264)	$9.54 - $30.25	$12.82		
Outstanding at December 31, 2011	945,422	$13.40 - $57.00	$36.63	4	$510
Forfeited/Expired – 2012	(85,588)	$25.52 - $57.00	$42.98		
Exercised – 2012	(61,624)	$13.40 - $22.49	$15.08		
Outstanding at December 31, 2012	798,210	$13.60 - $57.00	$37.62	3	$325
Exercisable at December 31, 2010	1,188,284	(1)	$33.07		
Exercisable at December 31, 2011	945,422	(2)	$36.63		
Exercisable at December 31, 2012	798,210	(3)	$37.62		

(1) 231,946 of these options had an exercise price ranging from $9.54 to $16.73; 246,103 had an exercise price ranging from $16.74 to $30.04; 205,012 had an exercise price ranging from $30.05 to $41.28; 253,607 had an exercise price ranging from $41.29 to $45.24; and 251,616 had an exercise price ranging from $45.25 to $57.00.

(2)

53,957 of these options had an exercise price ranging from $13.40 to $16.73; 225,903 had an exercise price ranging from $16.74 to $30.04; 198,762 had an exercise price ranging from $30.05 to $41.28; and 466,800 had an exercise price ranging from $41.29 to $57.00.

(3) 9,500 of these options had an exercise price ranging from $13.60 to $16.73; 204,736 had an exercise price ranging from $16.74 to $30.04; 180,962 had an exercise price ranging from $30.05 to $41.28; and 403,012 had an exercise price ranging from $41.29 to $57.00.

The aggregate intrinsic value of options exercised was $553,000 in 2012, $4.0 million in 2011 and $5.9 million in 2010.

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Notes to Consolidated Financial Statements (Continued)

We own a taxable REIT subsidiary that is subject to Federal and state income taxes. We realized a windfall tax benefit of $43,000 in 2012 and $47,000 in 2011 on options exercised and vesting restricted shares in connection with employees of that subsidiary.

The table below sets forth our reporting for share based compensation expense (in thousands):

	For the Years Ended December 31,		
	2012	2011	2010
General, administrative and leasing expenses	$8,611	$9,077	$7,511
Property operating expenses	1,371	2,843	2,543
Capitalized to development activities	1,202	2,347	1,791
Share-based compensation expense	$11,184	$14,267	$11,845

The amounts included in our consolidated statements of operations for share-based compensation reflected an estimate of pre-vesting forfeitures of: 0% for all PSUs; 0% to 5% for restricted shares for 2012; and 0% to 4% for restricted shares for 2011 and 2010.

As of December 31, 2012, all of our options are vested and fully expensed. As of December 31, 2012, there was $6.8 million of unrecognized compensation cost related to unvested restricted shares that is expected to be recognized over a weighted average period of approximately two years. As of December 31, 2012, there was $2.3 million of unrecognized compensation cost related to PSUs that is expected to be recognized over a weighted average performance period of approximately two years.

401(k) Plan

We have a 401(k) defined contribution plan covering substantially all of our employees that permits participants to contribute up to 90% of their compensation, as defined in the Plan, per pay period on a before-tax basis or after-tax basis, or a combination of both, subject to limitations under the Internal Revenue Code of 1986 (the “IRC”), as amended. Participants who are 50 years of age or older by the end of a particular plan year and have contributed the maximum 401(k) deferral amount allowed under the plan for that year are eligible to contribute an additional portion of their annual compensation on a before-tax basis as catch-up contributions, up to the annual limit under the IRC. We match 100% of the first 1% of pre-tax and/or after-tax contributions that participants contribute to the plan and 50% of the next 5% in participant contributions to the plan (representing an aggregate match by us of 3.5% on the first 6% of participant pre-tax and/or after-tax contributions to the plan). Participants’ contributions are fully vested. Participants are 50% vested in Company matching contributions after one year of credited service and 100% vested after two years of credited service. We fund all contributions with cash. Our matching contributions under the plan totaled approximately $1.1 million in 2012, $1.1 million in 2011 and $1.0 million in 2010. The 401(k) plan is fully funded at December 31, 2012.

Deferred Compensation Plan

We have a non-qualified elective deferred compensation plan for certain members of our management team that permits participants to defer up to 100% of their compensation on a pre-tax basis and receive a tax-deferred return on such deferrals. The balance of the plan, which was fully funded, totaled $6.8 million at December 31, 2012 and $7.6 million at December 31, 2011, and is included in the accompanying consolidated balance sheets.

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14. Operating Leases

We lease our properties to tenants under operating leases with various expiration dates extending to the year 2025. Gross minimum future rentals on noncancelable leases in our properties at December 31, 2012 were as follows (in thousands):

Year Ending December 31,	
2013	$352,149
2014	310,422
2015	261,123
2016	208,483
2017	168,585
Thereafter	373,283
	$1,674,045

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Notes to Consolidated Financial Statements (Continued)

15. Information by Business Segment

We have ten reportable operating office property segments (comprised of: the Baltimore/Washington Corridor; Northern Virginia; San Antonio; Washington, DC — Capitol Riverfront; St. Mary's and King George Counties; Greater Baltimore; Suburban Maryland; Colorado Springs; Greater Philadelphia; and other). We also have an operating wholesale data center segment. On January 1, 2012, we revised our reportable segments to include only operating properties. Accordingly, we revised net operating income from real estate operations ("NOI from real estate operations") to exclude operating expenses not related to operating properties, revised our definition of segment assets to include only long-lived assets associated with operating properties and revised our definition of additions to long-lived assets to include only additions to existing operating properties (excluding acquisitions and transfers from non-operating properties). In 2012, we also reclassified costs expensed in connection with marketing space for lease to prospective tenants from property operating expenses to general, administrative and leasing expenses, the result of which is the exclusion of such expenses from NOI from real estate operations. Financial information for prior periods has been presented in conformity with these revisions.

The table below reports segment financial information for our reportable segments (in thousands). We measure the performance of our segments through the measure we define as NOI from real estate operations, which is derived by subtracting property operating expenses from revenues from real estate operations.

	Operating Office Property Segments										
	Baltimore/ Washington Corridor	Northern Virginia	San Antonio	Washington, DC - Capitol Riverfront	St. Mary's & King George Counties	Greater Baltimore	Suburban Maryland	Colorado Springs	Greater Philadelphia	Other	C W D
Year Ended December 31, 2012											
Revenues from real estate operations	$224,959	$79,574	$32,018	$16,697	$16,392	$52,616	$15,016	$25,189	$9,698	$14,294	$
Property operating expenses	77,295	29,103	16,499	7,555	4,745	19,917	6,295	9,283	2,562	2,666	4
NOI from real estate operations	$147,664	$50,471	$15,519	$9,142	$11,647	$32,699	$8,721	$15,906	$7,136	$11,628	$
Additions to long-lived assets	$24,599	$65,157	$280	$317	$1,844	$9,690	$1,319	$2,977	$286	$133	$
Transfers from non-operating properties	$64,318	$44,250	$468	$—	$289	$37,558	$790	$4,295	$10,626	$394	$
Segment assets at December 31, 2012	$1,214,105	$569,860	$119,369	$104,544	$98,027	$320,548	$53,252	$176,726	$78,798	$109,924	$

Year Ended December 31, 2011											
Revenues from real estate operations	$218,051	$74,214	$30,066	$17,878	$14,366	$70,668	$21,982	$23,860	$7,458	$12,235	$
Property operating expenses	78,631	28,518	14,371	6,762	4,142	29,543	9,174	8,800	1,402	3,048	3
NOI from real estate operations	$139,420	$45,696	$15,695	$11,116	$10,224	$41,125	$12,808	$15,060	$6,056	$9,187	$
Additions to long-lived assets	$20,974	$14,770	$—	$2,794	$1,638	$21,086	$12,267	$4,116	$516	$26,889	$
Transfers from non-operating properties	$67,357	$4	$17,638	$—	$16,858	$16,307	$395	$214	$5,446	$—	$
Segment assets at December 31, 2011	$1,216,770	$484,392	$131,412	$111,318	$100,818	$402,067	$148,635	$182,758	$102,572	$115,048	$
Year Ended December 31, 2010											
Revenues from real estate operations	$207,456	$75,063	$21,673	$4,678	$13,967	$71,850	$21,759	$24,897	$6,299	$13,024	$
Property operating expenses	74,365	26,688	10,260	1,736	4,176	30,406	9,455	8,231	2,131	4,105	1
NOI from real estate operations	$133,091	$48,375	$11,413	$2,942	$9,791	$41,444	$12,304	$16,666	$4,168	$8,919	$
Additions to long-lived assets	$21,629	$91,919	$17	$92,827	$1,103	$11,501	$1,959	$1,626	$30	$(2,012)	$
Transfers from non-operating properties	$48,549	$(42)	$40,500	$—	$—	$15,289	$5,623	$32,438	$23,119	$14	$
Segment assets at December 31, 2010	$1,182,659	$492,005	$114,850	$119,927	$88,221	$473,977	$145,646	$215,801	$99,701	$85,633	$

Corporate Office Properties Trust and Subsidiaries
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The following table reconciles our segment revenues to total revenues as reported on our consolidated statements of operations (in thousands):

	For the Years Ended December 31,		
	2012	2011	2010
Segment revenues from real estate operations	$493,100	$495,832	$461,728
Construction contract and other service revenues	73,836	84,345	104,675
Less: Revenues from discontinued operations (Note 17)	(38,929)	(67,336)	(74,169)
Total revenues	$528,007	$512,841	$492,234

The following table reconciles our segment property operating expenses to property operating expenses as reported on our consolidated statements of operations (in thousands):

	For the Years Ended December 31,		
	2012	2011	2010
Segment property operating expenses	$180,735	$187,820	$172,769
Less: Property operating expenses from discontinued operations (Note 17)	(13,574)	(25,423)	(26,152)
Total property operating expenses	$167,161	$162,397	$146,617

As previously discussed, we provide real estate services such as property management and construction and development services primarily for our properties but also for third parties. The primary manner in which we evaluate the operating performance of our service activities is through a measure we define as net operating income from service operations ("NOI from service operations"), which is based on the net of revenues and expenses from these activities. Construction contract and other service revenues and expenses consist primarily of subcontracted costs that are reimbursed to us by the customer along with a management fee. The operating margins from these activities are small relative to the revenue. We believe NOI from service operations is a useful measure in assessing both our level of activity and our profitability in conducting such operations. The table below sets forth the computation of our NOI from service operations (in thousands):

	For the Years Ended December 31,		
	2012	2011	2010
Construction contract and other service revenues	$73,836	$84,345	$104,675
Construction contract and other service expenses	(70,576)	(81,639)	(102,302)
NOI from service operations	$3,260	$2,706	$2,373

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

	For the Years Ended December 31,		
	2012	2011	2010
NOI from real estate operations	$312,365	$308,012	$288,959
NOI from service operations	3,260	2,706	2,373
Interest and other income	7,172	5,603	9,568
Equity in (loss) income of unconsolidated entities	(546)	(331)	1,376
Income tax (expense) benefit	(381)	6,710	(108)
Other adjustments:	—		
Depreciation and other amortization associated with real estate operations	(113,480)	(113,111)	(97,897)
Impairment losses	(43,214)	(83,478)	—
General, administrative and leasing expenses	(31,900)	(30,314)	(28,501)

Business development expenses and land carry costs	(5,711)	(6,122)	(6,403)
Interest expense on continuing operations	(94,624)	(98,222)	(95,729)
NOI from discontinued operations	(25,355)	(41,913)	(48,017)
Loss on interest rate derivatives	—	(29,805)	—
Loss on early extinguishment of debt	(943)	(1,639)	—
Income (loss) from continuing operations	$6,643	$(81,904)	$25,621

Corporate Office Properties Trust and Subsidiaries
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The following table reconciles our segment assets to total assets (in thousands):

	As of December 31,	
	2012	2011
Segment assets	$2,945,930	$3,039,440
Non-operating property assets	570,402	658,900
Other assets	137,427	165,215
Total assets	$3,653,759	$3,863,555

The accounting policies of the segments are the same as those used to prepare our consolidated financial statements, except that discontinued operations are not presented separately for segment purposes. In the segment reporting presented above, we did not allocate interest expense, depreciation and amortization and impairment losses to our real estate segments since they are not included in the measure of segment profit reviewed by management. We also did not allocate general and administrative expenses, business development expenses and land carry costs, interest and other income, equity in loss of unconsolidated entities, income taxes and noncontrolling interests because these items represent general corporate or non-operating property items not attributable to segments.

16. Income Taxes

We elected to be treated as a REIT under Sections 856 through 860 of the Internal Revenue Code. To qualify as a REIT, we must meet a number of organizational and operational requirements, including a requirement that we distribute at least 90% of our adjusted taxable income to our shareholders. As a REIT, we generally will not be subject to Federal income tax on taxable income that we distribute to our shareholders. If we fail to qualify as a REIT in any tax year, we will be subject to Federal income tax on our taxable income at regular corporate rates and may not be able to qualify as a REIT for four subsequent tax years.

The differences between taxable income reported on our income tax return (estimated 2012 and actual 2011 and 2010) and net income as reported on our consolidated statements of operations are set forth below (in thousands):

	For the Years Ended December 31,		
	2012 (Estimated)	2011	2010
Net income (loss)	$20,341	$(127,576)	$45,504
Adjustments:			
Rental revenue recognition	(12,575)	(10,708)	(9,192)
Compensation expense recognition	(2,098)	(1,298)	(4,820)
Operating expense recognition	1,148	751	280
Gain on sales of properties	(45,323)	1,154	6,548
Impairment losses	66,910	151,021	—
Loss on interest rate derivatives	(29,805)	29,805	—
Gains from non-real estate investments	2,843	4,447	(6,994)
Income from service operations	1,500	(12,078)	(1,628)
Income tax expense	381	6,710	119
Depreciation and amortization	25,410	44,070	42,365
Discounts/premiums included in interest expense	3,194	5,548	5,841
Income from unconsolidated entities	(725)	(374)	(244)

Noncontrolling interests, gross	(463)	(7,502)	(3,288)
Other	836	80	2,173
Taxable income	$ 31,574	$ 84,050	$ 76,664

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Notes to Consolidated Financial Statements (Continued)

For Federal income tax purposes, dividends to shareholders may be characterized as ordinary income, capital gains or return of capital. The characterization of dividends declared on our common and preferred shares during each of the last three years was as follows:

	Common Shares						Preferred Shares					
	For the Years Ended December 31,						For the Years Ended December 31,					
	2012		2011		2010		2012		2011		2010	
Ordinary income	33.2	%	56.9	%	59.7	%	100.0	%	85.9	%	88.3	%
Long term capital gain	0.0	%	9.4	%	8.0	%	0.0	%	14.1	%	11.7	%
Return of capital	66.8	%	33.7	%	32.3	%	0.0	%	0.0	%	0.0	%

We distributed all of our REIT taxable income in 2012, 2011 and 2010 and, as a result, did not incur Federal income tax in those years on such income.

The net basis of our consolidated assets and liabilities for tax reporting purposes is approximately $387 million lower than the amount reported on our consolidated balance sheet at December 31, 2012, which is primarily related to differences in basis for net properties, intangible assets on property acquisitions and deferred rent receivable.

We own a taxable REIT subsidiary (“TRS”) that is subject to Federal and state income taxes. Our TRS had income (loss) before income taxes under GAAP of $11.3 million in 2012, $(27.7) million in 2011 and $345,000 in 2010. Our TRS’ provision for income tax consisted of the following (in thousands):

	For the Years Ended December 31,					
	2012		2011		2010	
Deferred						
Federal	$(312	)	$5,510		$64	
State	(69	)	1,219		14	
	(381	)	6,729		78	
Current						
Federal	—		(16	)	(161	)
State	—		(3	)	(36	)
	—		(19	)	(197	)
Total income tax (expense) benefit	$(381	)	$6,710		$(119	)
Reported on line entitled income tax (expense) benefit	$(381	)	$6,710		$(108	)
Reported on line entitled gain on sales of real estate, net	—		—		(11	)
Total income tax (expense) benefit	$(381	)	$6,710		$(119	)

A reconciliation of our TRS’ Federal statutory rate to the effective tax rate for income tax reported on our statements of operations is set forth below:

	For the Years Ended December 31,					
	2012		2011		2010	
Income taxes at U.S. statutory rate	34.0	%	34.0	%	34.0	%
State and local, net of U.S. Federal tax benefit	4.6	%	4.6	%	4.2	%
Other	0.0	%	0.0	%	(3.5	)%
Effective tax rate	38.6	%	38.6	%	34.7	%

Items in our TRS contributing to temporary differences that lead to deferred taxes include depreciation and amortization, share-based compensation, certain accrued compensation, compensation paid in the form of contributions to a deferred nonqualified compensation plan, impairment losses and net operating losses that are not deductible until future periods. As of December 31, 2012, our TRS had a net operating loss carryforward for federal income tax purposes of approximately $16 million expiring in 2033.

The table below sets forth the tax effects of temporary differences and carry forwards included in the net deferred tax asset of our TRS (in thousands):

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	December 31,	
	2012	2011
Operating loss and interest deduction carry forwards	$6,014	$1,758
Share-based compensation	598	497
Property (1)	—	4,668
Net deferred tax asset	$6,612	$6,923

(1) Difference primarily pertains to depreciation and amortization, basis of contributed assets and the capitalization of interest and certain other costs.

We are subject to certain state and local income and franchise taxes. The expense associated with these state and local taxes is included in general and administrative expense and property operating expenses on our consolidated statements of operations. We did not separately state these amounts on our consolidated statements of operations because they are insignificant.

17. Discontinued Operations and Assets Held for Sale

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

- 11101 McCormick Road in Greater Baltimore that was sold on February 1, 2010;
- 431 and 437 Ridge Road in Central New Jersey (included in the Other region) that were sold on September 8, 2010;
- 1344 and 1348 Ashton Road and 1350 Dorsey Road in the Baltimore/Washington Corridor that were sold on May 24, 2011;
- 216 Schilling Circle in Greater Baltimore that was sold on August 23, 2011;
- four properties comprising the Towson Portfolio in Greater Baltimore that were sold on September 29, 2011;
- 11011 McCormick Road in Greater Baltimore that was sold on November 1, 2011;
- 10001 Franklin Square Drive in Greater Baltimore that was sold on December 13, 2011;
- 13 properties comprising the Rutherford Business Center portfolio in Greater Baltimore that were sold on December 15, 2011;
- five properties in White Marsh, Maryland (in the Greater Baltimore region) that were sold on January 30, 2012;
- 1101 Sentry Gateway in San Antonio that was sold on January 31, 2012;
- 222 and 224 Schilling Circle in Greater Baltimore that were sold on February 10, 2012;
- 15 and 45 West Gude Drive in Suburban Maryland that were sold on May 2, 2012;
- 11800 Tech Road in Suburban Maryland that was sold on June 14, 2012;
- 400 Professional Drive in Suburban Maryland for which the title to the property was transferred to the mortgage lender on July 2, 2012 (see Note 5);
- 23 operating properties in the Baltimore/Washington Corridor and Greater Baltimore regions that were sold on July 24, 2012; and
- 16 operating properties in Colorado Springs and an operating property in Suburban Maryland classified as held for sale at December 31, 2012.

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

The table below sets forth the components of discontinued operations reported on our consolidated statements of operations (in thousands):

	For the Years Ended December 31,		
	2012	2011	2010
Revenue from real estate operations	$38,929	$67,336	$74,169
Property operating expenses	(13,574)	(25,423)	(26,152)
Depreciation and amortization	(8,457)	(21,020)	(25,346)
Impairment losses	(23,696)	(67,543)	—
General, administrative and leasing expenses	(3)	(12)	(223)
Business development and land carry costs	(24)	(75)	(72)
Interest expense	(2,174)	(6,079)	(6,399)
Gain on sales of real estate	20,940	4,796	1,077
Gain (loss) on early extinguishment of debt	1,736	(384)	—
Discontinued operations	$13,677	$(48,404)	$17,054

The table below sets forth the components of assets held for sale on our consolidated balance sheets (in thousands):

	As of December 31,	
	2012	2011
Properties, net	$128,740	$108,356
Deferred rent receivable	4,068	2,800
Intangible assets on real estate acquisitions, net	4,409	1,737
Deferred leasing costs, net	2,923	3,723
Lease incentives	89	—
Assets held for sale, net	$140,229	$116,616

18. Earnings Per Share ("EPS")

We present both basic and diluted EPS. We compute basic EPS by dividing net income available to common shareholders allocable to unrestricted common shares under the two-class method by the weighted average number of unrestricted common shares outstanding during the period. Our computation of diluted EPS is similar except that:

- the denominator is increased to include: (1) the weighted average number of potential additional common shares that would have been outstanding if securities that are convertible into our common shares were converted; and (2) the effect of dilutive potential common shares outstanding during the period attributable to share-based compensation using the treasury stock or if-converted methods; and
- the numerator is adjusted to add back any changes in income or loss that would result from the assumed conversion into common shares that we added to the denominator.

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

	For the Years Ended December 31,		
	2012	2011	2010
Numerator:			
Income (loss) from continuing operations	$6,643	$(81,904)	$25,621
Gain on sales of real estate, net	21	2,732	2,829
Preferred share dividends	(20,844)	(16,102)	(16,102)
Issuance costs associated with redeemed preferred shares	(1,827)	—	—
Loss (income) from continuing operations attributable to noncontrolling interests	1,387	5,288	(1,421)
Income from continuing operations attributable to restricted shares	(469)	(1,037)	(1,071)
Numerator for basic and diluted EPS from continuing operations attributable to COPT common shareholders	$(15,089)	$(91,023)	$9,856
Numerator for basic and diluted EPS from continuing operations attributable to COPT common shareholders	$(15,089)	$(91,023)	$9,856
Discontinued operations	13,677	(48,404)	17,054
Discontinued operations attributable to noncontrolling interests	(751)	2,860	(1,323)
Numerator for basic and diluted EPS on net (loss) income attributable to COPT common shareholders	$(2,163)	$(136,567)	$25,587
Denominator (all weighted averages):			
Denominator for basic EPS (common shares)	73,454	69,382	59,611
Dilutive effect of share-based compensation awards	—	—	333
Denominator for diluted EPS	73,454	69,382	59,944
Basic EPS:			
(Loss) income from continuing operations attributable to COPT common shareholders	$(0.21)	$(1.31)	$0.17
Discontinued operations attributable to COPT common shareholders	0.18	(0.66)	0.26
Net (loss) income attributable to COPT common shareholders	$(0.03)	$(1.97)	$0.43
Diluted EPS:			
(Loss) income from continuing operations attributable to COPT common shareholders	$(0.21)	$(1.31)	$0.17
Discontinued operations attributable to COPT common shareholders	0.18	(0.66)	0.26
Net (loss) income attributable to COPT common shareholders	$(0.03)	$(1.97)	$0.43

Our diluted EPS computations do not include the effects of the following securities since the conversions of such securities would increase diluted EPS for the respective periods (in thousands):

	Weighted Average Shares Excluded from Denominator for the Years Ended December 31,		
	2012	2011	2010
Conversion of common units	4,235	4,355	4,608
Conversion of convertible preferred units	176	176	176
Conversion of convertible preferred shares	434	434	434

The following share-based compensation securities were excluded from the computation of diluted EPS because their effect was antidilutive:

- weighted average restricted shares of 461,000 for 2012, 638,000 for 2011 and 666,000 for 2010; and
- weighted average options of 772,000 for 2012, 712,000 for 2011 and 653,000 for 2010, respectively.

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

As discussed in Note 10, we have outstanding senior notes that have an exchange settlement feature but did not affect our diluted EPS reported above since the weighted average closing price of our common shares during each of the periods was less than the exchange prices per common share applicable for such periods.

19. Quarterly Data (Unaudited)

The tables below set forth selected quarterly information for the years ended December 31, 2012 and 2011 (in thousands, except per share data). Certain of the amounts below have been reclassified to conform to the current period presentation of our consolidated financial statements.

	For the Year Ended December 31, 2012			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues	$132,195	$128,163	$130,144	$137,505
Operating income (loss)	$36,192	$33,837	$(8,586)	$34,522
Income (loss) from continuing operations	$12,685	$10,065	$(31,850)	$15,743
Discontinued operations	$(2,450)	$1,775	$11,085	$3,267
Net income (loss)	$10,235	$11,861	$(20,765)	$19,010
Net loss (income) attributable to noncontrolling interests	60	(556)	1,603	(471)
Net income (loss) attributable to COPT	10,295	11,305	(19,162)	18,539
Preferred share dividends	(4,025)	(4,167)	(6,546)	(6,106)
Issuance costs associated with redeemed preferred shares	—	—	(1,827)	—
Net income (loss) attributable to COPT common shareholders	$6,270	$7,138	$(27,535)	$12,433
Basic earnings per common share	$0.09	$0.10	$(0.39)	$0.16
Diluted earnings per common share	$0.09	$0.10	$(0.39)	$0.16

	For the Year Ended December 31, 2011			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues	$126,320	$131,840	$126,707	$127,974
Operating income (loss)	$787	$16,600	$27,400	$(9,007)
(Loss) income from continuing operations	$(22,851)	$(397)	$1,669	$(60,325)
Discontinued operations	$1,584	$(25,008)	$5,801	$(30,781)
Net (loss) income	$(18,566)	$(25,378)	$7,470	$(91,102)
Net loss (income) attributable to noncontrolling interests	1,204	1,964	(626)	5,606
Net (loss) income attributable to COPT	(17,362)	(23,414)	6,844	(85,496)
Preferred share dividends	(4,025)	(4,026)	(4,025)	(4,026)
Net (loss) income attributable to COPT common shareholders	$(21,387)	$(27,440)	$2,819	$(89,522)
Basic earnings per common share	$(0.33)	$(0.40)	$0.04	$(1.26)
Diluted earnings per common share	$(0.33)	$(0.41)	$0.04	$(1.26)

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

The amounts reported above were revised for the error corrections described in Note 2. The tables below set forth the revisions to the selected quarterly information (the "Previously Reported" columns include the effects of other reclassifications and retrospective changes in presentation discussed in Note 2)(in thousands):

	Three Months Ended					
	3/31/2012		6/30/2012		9/30/2012	
	Previously Reported	As Revised	Previously Reported	As Revised	Previously Reported	As Revised
Income (loss) from continuing operations	$9,427	$12,685	$10,065	$10,065	$(31,850)	$(31,850)
Net income (loss)	$6,977	$10,235	$11,861	$11,861	$(20,765)	$(20,765)
Net (income) loss attributable to noncontrolling interests	(300)	60	(1,107)	(556)	993	1,603
Net income (loss) attributable to COPT	$6,677	$10,295	$10,754	$11,305	$(19,772)	$(19,162)
Net income (loss) attributable to COPT common shareholders	$2,652	$6,270	$6,587	$7,138	$(28,145)	$(27,535)
Basic and diluted earnings per common share	$0.04	$0.09	$0.09	$0.10	$(0.39)	$(0.39)

	Three Months Ended							
	3/31/2011		6/30/2011		9/30/2011		12/31/2011	
	Previously Reported	As Revised	Previously Reported	As Revised	Previously Reported	As Revised	Previously Reported	As Revised
(Loss) income from continuing operations	$(22,851)	$(22,851)	$(1,026)	$(397)	$1,669	$1,669	$(56,438)	$(60,325)
Net (loss) income	$(18,566)	$(18,566)	$(26,007)	$(25,378)	$7,470	$7,470	$(87,215)	$(91,102)
Net loss (income) attributable to noncontrolling interests	776	1,204	1,783	1,964	(904)	(626)	4,988	5,606
Net (loss) income attributable to COPT	$(17,790)	$(17,362)	$(24,224)	$(23,414)	$6,566	$6,844	$(82,227)	$(85,496)
Net (loss) income attributable to COPT common shareholders	$(21,815)	$(21,387)	$(28,250)	$(27,440)	$2,541	$2,819	$(86,253)	$(89,522)
Basic earnings per common share	$(0.33)	$(0.33)	$(0.42)	$(0.40)	$0.03	$0.04	$(1.21)	$(1.26)
Diluted earnings per common share	$(0.33)	$(0.33)	$(0.42)	$(0.41)	$0.03	$0.04	$(1.21)	$(1.26)

20. Commitments and Contingencies

Litigation

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

Environmental

We are subject to various Federal, state and local environmental regulations related to our property ownership and operation. We have performed environmental assessments of our properties, the results of which have not revealed any environmental liability that we believe would have a materially adverse effect on our financial position, operations or liquidity.

Joint Ventures

In connection with our 2005 contribution of properties to an unconsolidated partnership in which we hold a partnership interest, we entered into standard nonrecourse loan guarantees (environmental indemnifications and guarantees against fraud and misrepresentation, and springing guarantees of partnership debt in the event of a voluntary bankruptcy of the partnership). The maximum amount we could be required to pay under the guarantees is approximately $64 million. We are entitled to recover 80% of any amounts paid under the guarantees from an affiliate of our partner pursuant to an indemnity agreement. In 2012, the holder of the mortgage debt encumbering all of the joint venture's properties initiated foreclosure proceedings.

Corporate Office Properties Trust and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

Management considered this event and estimates that the aggregate fair value of the guarantees would not exceed the amounts included in distributions received in excess of investment in unconsolidated real estate joint venture reported on the consolidated balance sheets.

We are party to a contribution agreement that formed a joint venture relationship with a limited partnership to develop up to 1.3 million square feet of office space on 92 acres of land located in Hanover, Maryland. As we and the joint venture partner agree to proceed with the construction of buildings in the future, our joint venture partner would contribute land into newly-formed entities and we would make cash capital contributions into such entities to fund development and construction activities for which financing is not obtained. We owned a 50% interest in one such joint venture as of December 31, 2012.

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

Tax Incremental Financing Obligation

In August 2010, Anne Arundel County, Maryland issued $30 million in tax incremental financing bonds to third-party investors in order to finance public improvements needed in connection with our project known as National Business Park North. The real estate taxes on increases in assessed value of a development district encompassing National Business Park North are to be transferred to a special fund pledged to the repayment of the bonds. We recognized a $3.6 million liability through December 31, 2012 representing the estimated fair value of our obligation to fund through a special tax any future shortfalls between debt service on the bonds and real estate taxes available to repay the bonds.

Ground Leases

We are obligated as lessee under ground leases with various lease expiration dates extending to the year 2100. Future minimum rental payments due under the terms of these leases as of December 31, 2012 follow (in thousands):

Year Ending December 31,	
2013	$919
2014	973
2015	974
2016	974
2017	974
Thereafter	81,700
	$86,514

Environmental Indemnity Agreement

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

- to indemnify the tenant against losses covered under the prior owner's indemnity agreement if the prior owner fails to indemnify the tenant for such losses. This indemnification is capped at $5.0 million in perpetuity after the State of New Jersey declares the remediation to be complete;
- to indemnify the tenant for consequential damages (e.g., business interruption) at one of the buildings in perpetuity and another of the buildings through 2025. This indemnification is limited to $12.5 million; and
- to pay 50% of additional costs related to construction and environmental regulatory activities incurred by the tenant as a result of the indemnified environmental condition of the properties. This indemnification is limited to $300,000 annually and $1.5 million in the aggregate.

Corporate Office Properties Trust
Schedule III—Real Estate and Accumulated Depreciation
December 31, 2012
(Dollars in thousands)

			Initial Cost			Gross Amounts Carried At Close of Period					
Property (Type) (1)	Location	Encumbrances (2)	Land	Building and Land Improvements	Costs Capitalized Subsequent to Acquisition	Land	Building and Land Improvements	Total (3)(4)	Accumulated Depreciation (5)	Year Built or Renovated	Date Acquired (6)
1000 Redstone Gateway (O)	Huntsville, AL	$ 11,078	$—	$ 18,582	$—	$—	$ 18,582	$ 18,582	$—	(7)	3/23/2010
1055 North Newport Road (O)(10)	Colorado Springs, CO	—	972	5,708	—	972	5,708	6,680	(178)	2007-2008	5/19/2006
10807 New Allegiance Drive (O)(10)	Colorado Springs, CO	—	1,840	15,439	122	1,840	15,561	17,401	(298)	2009	9/28/2005
1099 Winterson Road (O)	Linthicum, MD	12,012	1,323	5,293	2,499	1,323	7,792	9,115	(3,348)	1988	4/30/1998
1100 Redstone Gateway (O)	Huntsville, AL	—	—	924	—	—	924	924	—	(7)	3/23/2010
114 National Business Parkway (O)	Annapolis Junction, MD	—	364	3,109	21	364	3,130	3,494	(878)	2002	6/30/2000
11751 Meadowville Lane (O)	Richmond, VA	—	1,305	52,098	112	1,305	52,210	53,515	(7,278)	2007	9/15/2006
1190 Winterson Road (O)	Linthicum, MD	11,291	1,335	5,340	4,025	1,335	9,365	10,700	(5,111)	1987	4/30/1998
1199 Winterson Road (O)	Linthicum, MD	18,578	1,599	6,395	3,266	1,599	9,661	11,260	(4,665)	1988	4/30/1998
1200 Redstone Gateway (O)	Huntsville, AL	—	—	2,297	—	—	2,297	2,297	—	(7)	3/23/2010
1201 M Street (O)	Washington, DC	36,659	—	49,785	1,959	—	51,744	51,744	(3,939)	2001	9/28/2010
1201 Winterson Road (O)	Linthicum, MD	—	1,288	5,154	460	1,288	5,614	6,902	(2,068)	1985	4/30/1998
1220 12th Street, SE (O)	Washington, DC	30,153	—	42,464	733	—	43,197	43,197	(3,914)	2003	9/28/2010
1243 Winterson Road (L)	Linthicum, MD	—	630	—	—	630	—	630	—	(8)	12/19/2001
12515 Academy Ridge View (O)(10)	Colorado Springs, CO	—	2,612	6,087	—	2,612	6,087	8,699	(441)	2006	6/26/2009
1302 Concourse Drive (O)	Linthicum, MD	—	2,078	8,313	2,991	2,078	11,304	13,382	(4,626)	1996	11/18/1999
		—	1,999	12,934	1,202	1,999	14,136	16,135	(4,657)	2002	11/18/1999

1304 Concourse Drive (O)	Linthicum, MD										
1306 Concourse Drive (O)	Linthicum, MD	—	2,796	11,186	2,837	2,796	14,023	16,819	(4,998)	1990	11/18/1999
131 National Business Parkway (O)	Annapolis Junction, MD	6,922	1,906	7,623	2,657	1,906	10,280	12,186	(3,876)	1990	9/28/1998
132 National Business Parkway (O)	Annapolis Junction, MD	—	2,917	12,259	2,895	2,917	15,154	18,071	(6,563)	2000	5/28/1999
13200 Woodland Park Road (O)	Herndon, VA	—	10,428	41,711	13,831	10,428	55,542	65,970	(19,432)	2002	6/2/2003
133 National Business Parkway (O)	Annapolis Junction, MD	9,262	2,517	10,068	4,821	2,517	14,889	17,406	(6,167)	1997	9/28/1998
1331 Ashton Road (O)	Hanover, MD	—	587	2,347	677	587	3,024	3,611	(939)	1989	4/28/1999
1334 Ashton Road (O)	Hanover, MD	—	736	1,488	2,301	736	3,789	4,525	(1,468)	1989	4/28/1999
134 National Business Parkway (O)	Annapolis Junction, MD	19,200	3,684	7,517	2,230	3,684	9,747	13,431	(4,138)	1999	11/13/1998
1340 Ashton Road (O)	Hanover, MD	—	905	3,620	1,067	905	4,687	5,592	(1,874)	1989	4/28/1999
1341 Ashton Road (O)	Hanover, MD	—	306	1,223	588	306	1,811	2,117	(727)	1989	4/28/1999
1343 Ashton Road (O)	Hanover, MD	—	193	774	405	193	1,179	1,372	(435)	1989	4/28/1999
13450 Sunrise Valley Road (O)	Herndon, VA	—	1,386	5,576	2,722	1,386	8,298	9,684	(2,853)	1998	7/25/2003
13454 Sunrise Valley Road (O)	Herndon, VA	—	2,899	11,986	3,909	2,899	15,895	18,794	(4,605)	1998	7/25/2003
135 National Business Parkway (O)	Annapolis Junction, MD	9,925	2,484	9,750	2,882	2,484	12,632	15,116	(4,932)	1998	12/30/1998
1362 Mellon Road (O)	Hanover, MD	—	1,706	8,412	18	1,706	8,430	10,136	(841)	2006	2/10/2006
13857 McLearen Road (O)	Herndon, VA	—	3,507	30,177	1,724	3,507	31,901	35,408	(973)	2007	7/11/2012
140 National Business Parkway (O)	Annapolis Junction, MD	—	3,407	24,167	643	3,407	24,810	28,217	(5,748)	2003	12/31/2003

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Property (Type) (1)	Location	Encumbrances (2)	Initial Cost: Land	Initial Cost: Building and Land Improvements	Costs Capitalized Subsequent to Acquisition	Gross Amounts Carried At Close of Period: Land	Gross Amounts Carried At Close of Period: Building and Land Improvements	Total (3)(4)	Accumulated Depreciation (5)	Year Built or Renovated	Date Acquired (6)
141 National Business Parkway (O)	Annapolis Junction, MD	9,725	2,398	9,590	2,389	2,398	11,979	14,377	(4,354)	1990	9/28/1998
14280 Park Meadow Drive (O)	Chantilly, VA	—	3,731	15,953	1,009	3,731	16,962	20,693	(4,529)	1999	9/29/2004
1460 Dorsey Road (L)	Hanover, MD	—	1,800	—	—	1,800	—	1,800	—	(8)	2/28/2006
14840 Conference Center Drive (O)	Chantilly, VA	—	1,572	8,175	508	1,572	8,683	10,255	(3,385)	2000	7/25/2003
14850 Conference Center Drive (O)	Chantilly, VA	—	1,615	8,358	539	1,615	8,897	10,512	(3,434)	2000	7/25/2003
14900 Conference Center Drive (O)	Chantilly, VA	—	3,436	14,402	3,560	3,436	17,962	21,398	(5,796)	1999	7/25/2003
15000 Conference Center Drive (O)	Chantilly, VA	54,000	5,193	47,045	18,198	5,193	65,243	70,436	(20,752)	1989	11/30/2001
1501 South Clinton Street (O)	Baltimore, MD	—	27,964	50,415	5,222	27,964	55,637	83,601	(5,696)	2006	10/27/2009
15010 Conference Center Drive (O)	Chantilly, VA	96,000	3,500	41,921	344	3,500	42,265	45,765	(6,503)	2006	11/30/2001
15049 Conference Center Drive (O)	Chantilly, VA	—	4,415	20,365	726	4,415	21,091	25,506	(7,276)	1997	8/14/2002
15059 Conference Center Drive (O)	Chantilly, VA	—	5,753	13,615	1,423	5,753	15,038	20,791	(4,891)	2000	8/14/2002
1550 West Nursery Road (O)	Linthicum, MD	—	14,071	16,930	—	14,071	16,930	31,001	(1,862)	2009	10/28/2009
1550 Westbranch Drive (O)	McLean, VA	—	5,595	26,212	116	5,595	26,328	31,923	(2,354)	2002	6/28/2010
1560A Cable Ranch Road (O)	San Antonio, TX	—	1,097	3,770	28	1,097	3,798	4,895	(667)	1985/2007	6/19/2008
1560B Cable Ranch Road (O)	San Antonio, TX	—	2,299	6,545	11	2,299	6,556	8,855	(1,120)	1985/2006	6/19/2008
16442 Commerce Drive (O)	Dahlgren, VA	2,305	613	2,582	555	613	3,137	3,750	(761)	2002	12/21/2004
16480 Commerce Drive (O)	Dahlgren, VA	—	1,856	7,425	164	1,856	7,589	9,445	(1,649)	2000	12/28/2004
16501 Commerce Drive (O)	Dahlgren, VA	1,885	522	2,090	185	522	2,275	2,797	(594)	2002	12/21/2004
16539 Commerce Drive (O)	Dahlgren, VA	—	688	2,860	1,443	688	4,303	4,991	(1,224)	1990	12/21/2004
16541 Commerce Drive (O)	Dahlgren, VA	—	773	3,094	1,321	773	4,415	5,188	(1,149)	1996	12/21/2004
16543 Commerce Drive (O)	Dahlgren, VA	1,571	436	1,742	12	436	1,754	2,190	(349)	2002	12/21/2004

1670 North Newport Road (O)(10)	Colorado Springs, CO	4,383	853	5,188	763	853	5,951	6,804	(776)	1986/1987	9/30/2005
1751 Pinnacle Drive (O)	McLean, VA	30,283	10,486	42,339	12,461	10,486	54,800	65,286	(16,190)	1989/1995	9/23/2004
1753 Pinnacle Drive (O)	McLean, VA	24,438	8,275	34,353	8,736	8,275	43,089	51,364	(10,657)	1976/2004	9/23/2004
1915 Aerotech Drive (O)	Colorado Springs, CO	3,394	556	3,094	539	556	3,633	4,189	(1,037)	1985	6/8/2006
1925 Aerotech Drive (O)	Colorado Springs, CO	3,717	556	3,067	343	556	3,410	3,966	(759)	1985	6/8/2006
201 Technology Drive (O)	Lebanon, VA	—	726	31,091	60	726	31,151	31,877	(4,021)	2007	10/5/2007
206 Research Boulevard (O)	Aberdeen, MD	—	1,813	17,334	—	1,813	17,334	19,147	(707)	2012	9/14/2007
209 Research Boulevard (O)	Aberdeen, MD	—	1,045	16,063	—	1,045	16,063	17,108	(859)	2010	9/14/2007
210 Research Boulevard (O)	Aberdeen, MD	—	1,065	13,144	—	1,065	13,144	14,209	(519)	2010	9/14/2007
22289 Exploration Drive (O)	Lexington Park, MD	—	1,422	5,719	1,005	1,422	6,724	8,146	(1,951)	2000	3/24/2004
22299 Exploration Drive (O)	Lexington Park, MD	—	1,362	5,791	682	1,362	6,473	7,835	(2,026)	1998	3/24/2004
22300 Exploration Drive (O)	Lexington Park, MD	—	1,094	5,038	169	1,094	5,207	6,301	(1,569)	1997	11/9/2004
22309 Exploration Drive (O)	Lexington Park, MD	—	2,243	10,419	227	2,243	10,646	12,889	(3,459)	1984/1997	3/24/2004
23535 Cottonwood Parkway (O)	California, MD	—	692	3,051	223	692	3,274	3,966	(789)	1984	3/24/2004
2500 Riva Road (O)	Annapolis, MD	—	2,791	12,145	1	2,791	12,146	14,937	(3,384)	2000	3/4/2003
2691 Technology Drive (O)	Annapolis Junction, MD	24,000	2,098	17,334	5,096	2,098	22,430	24,528	(5,167)	2005	5/26/2000
2701 Technology Drive (O)	Annapolis Junction, MD	13,794	1,737	15,266	306	1,737	15,572	17,309	(5,403)	2001	5/26/2000
2711 Technology Drive (O)	Annapolis Junction, MD	19,359	2,251	21,611	1,075	2,251	22,686	24,937	(7,961)	2002	11/13/2000

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			Initial Cost			Gross Amounts Carried At Close of Period					
Property (Type) (1)	Location	Encumbrances (2)	Land	Building and Land Improvements	Costs Capitalized Subsequent to Acquisition	Land	Building and Land Improvements	Total (3)(4)	Accumulated Depreciation (5)	Year Built or Renovated	Date Acquired (6)
2720 Technology Drive (O)	Annapolis Junction, MD	24,068	3,863	29,272	88	3,863	29,360	33,223	(6,102)	2004	1/31/2002
2721 Technology Drive (O)	Annapolis Junction, MD	—	4,611	14,597	1,497	4,611	16,094	20,705	(4,841)	2000	10/21/1999
2730 Hercules Road (O)	Annapolis Junction, MD	32,734	8,737	31,612	5,277	8,737	36,889	45,626	(11,825)	1990	9/28/1998
2900 Towerview Road (O)	Herndon, VA	—	3,207	16,344	5,607	3,207	21,951	25,158	(3,785)	1982/2008	12/20/2005
300 Sentinel Drive (O)	Annapolis Junction, MD	—	1,517	58,642	119	1,517	58,761	60,278	(4,026)	2009	11/14/2003
302 Sentinel Drive (O)	Annapolis Junction, MD	22,693	2,648	29,398	380	2,648	29,778	32,426	(3,642)	2007	11/14/2003
304 Sentinel Drive (O)	Annapolis Junction, MD	37,280	3,411	24,917	132	3,411	25,049	28,460	(4,361)	2005	11/14/2003
306 Sentinel Drive (O)	Annapolis Junction, MD	20,973	3,260	22,592	110	3,260	22,702	25,962	(3,541)	2006	11/14/2003
308 Sentinel Drive (O)	Annapolis Junction, MD	—	1,422	26,197	—	1,422	26,197	27,619	(1,085)	2010	11/14/2003
310 The Bridge Street (O)	Huntsville, AL	—	261	26,576	26	261	26,602	26,863	(2,028)	2009	8/4/2011
312 Sentinel Way (O)	Annapolis Junction, MD	—	3,138	9,128	—	3,138	9,128	12,266	—	(7)	11/14/2003
3120 Fairview Park Drive (O)	Falls Church, VA	—	6,863	35,606	5,406	6,863	41,012	47,875	(2,247)	2008	11/23/2010
314 Sentinel Way (O)	Annapolis Junction, MD	—	1,254	1,325	—	1,254	1,325	2,579	(149)	2008	11/14/2003
316 Sentinel Way (O)	Annapolis Junction, MD	—	2,748	31,861	131	2,748	31,992	34,740	(830)	2011	11/14/2003
318 Sentinel Way (O)	Annapolis Junction, MD	22,240	2,185	28,426	—	2,185	28,426	30,611	(4,849)	2005	11/14/2003
320 Sentinel Way (O)	Annapolis Junction, MD	—	2,067	21,623	—	2,067	21,623	23,690	(2,688)	2007	11/14/2003
322 Sentinel Way (O)	Annapolis Junction, MD	21,912	2,605	22,827	—	2,605	22,827	25,432	(3,431)	2006	11/14/2003
324 Sentinel Way (O)	Annapolis Junction, MD	—	1,656	23,005	—	1,656	23,005	24,661	(1,352)	2010	6/29/2006
3535 Northrop Grumman Pt. (O)(10)	Colorado Springs, CO	17,982	—	18,388	121	—	18,509	18,509	(1,555)	2008	6/10/2008
375 West Padonia Road (O)	Timonium, MD	—	2,483	10,415	4,821	2,483	15,236	17,719	(5,242)	1986	12/21/1999
		—	1,831	16,569	—	1,831	16,569	18,400	(34)	2012	6/29/2003

410 National Business Parkway (O)	Annapolis Junction, MD										
420 National Business Parkway (O)	Annapolis Junction, MD	—	2,370	15,673	—	2,370	15,673	18,043	—	(7)	6/29/2006
4230 Forbes Boulevard (O)(10)	Lanham, MD	—	511	4,346	192	511	4,538	5,049	(1,837)	2003	12/24/2002
430 National Business Parkway (O)	Annapolis Junction, MD	—	1,852	21,038	—	1,852	21,038	22,890	(449)	2011	6/29/2006
44408 Pecan Court (O)	California, MD	—	817	1,583	118	817	1,701	2,518	(161)	1986	3/24/2004
44414 Pecan Court (O)	California, MD	—	405	1,619	336	405	1,955	2,360	(475)	1986	3/24/2004
44417 Pecan Court (O)	California, MD	—	434	1,939	88	434	2,027	2,461	(636)	1989	3/24/2004
44420 Pecan Court (O)	California, MD	—	344	890	126	344	1,016	1,360	(90)	1989	11/9/2004
44425 Pecan Court (O)	California, MD	—	1,309	3,506	1,217	1,309	4,723	6,032	(921)	1997	5/5/2004
45310 Abell House Lane (O)	California, MD	—	2,272	13,794	—	2,272	13,794	16,066	(368)	2011	8/30/2010
46579 Expedition Drive (O)	Lexington Park, MD	—	1,406	5,796	1,078	1,406	6,874	8,280	(2,147)	2002	3/24/2004
46591 Expedition Drive (O)	Lexington Park, MD	—	1,200	7,199	656	1,200	7,855	9,055	(1,083)	2005	3/24/2004
4851 Stonecroft Boulevard (O)	Chantilly, VA	—	1,878	11,558	21	1,878	11,579	13,457	(2,379)	2004	8/14/2002
4940 Campbell Drive (O)	White Marsh, MD	—	1,379	3,858	987	1,379	4,845	6,224	(933)	1990	1/9/2007
4969 Mercantile Road (O)	White Marsh, MD	—	1,308	4,456	62	1,308	4,518	5,826	(678)	1983	1/9/2007
4979 Mercantile Road (O)	White Marsh, MD	—	1,299	4,686	84	1,299	4,770	6,069	(727)	1985	1/9/2007
5020 Campbell Boulevard (O)	White Marsh, MD	—	1,014	3,136	781	1,014	3,917	4,931	(673)	1986-1988	1/9/2007
5022 Campbell Boulevard (O)	White Marsh, MD	—	624	1,924	332	624	2,256	2,880	(496)	1986-1988	1/9/2007
5024 Campbell Boulevard (O)	White Marsh, MD	—	767	2,420	250	767	2,670	3,437	(702)	1986-1988	1/9/2007

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			Initial Cost			Gross Amounts Carried At Close of Period					
Property (Type) (1)	Location	Encumbrances (2)	Land	Building and Land Improvements	Costs Capitalized Subsequent to Acquisition	Land	Building and Land Improvements	Total (3)(4)	Accumulated Depreciation (5)	Year Built or Renovated	Date Acquired (6)
5026 Campbell Boulevard (O)	White Marsh, MD	—	700	2,138	45	700	2,183	2,883	(396)	1986-1988	1/9/2007
525 Babcock Road (O)(10)	Colorado Springs, CO	—	355	397	79	355	476	831	(89)	1967	7/12/2007
5325 Nottingham Drive (O)	White Marsh, MD	—	816	3,976	485	816	4,461	5,277	(763)	2002	1/9/2007
5355 Nottingham Drive (O)	White Marsh, MD	—	761	3,562	1,616	761	5,178	5,939	(1,380)	2005	1/9/2007
5520 Research Park Drive (O)	Catonsville, MD	—	—	20,066	—	—	20,066	20,066	(1,679)	2009	4/4/2006
5522 Research Park Drive (O)	Catonsville, MD	—	—	4,550	—	—	4,550	4,550	(614)	2007	3/8/2006
565 Space Center Drive (O)(10)	Colorado Springs, CO	—	644	6,284	352	644	6,636	7,280	(107)	2009	7/8/2005
5725 Mark Dabling Boulevard (O)	Colorado Springs, CO	12,882	900	11,397	2,832	900	14,229	15,129	(4,567)	1984	5/18/2006
5755 Mark Dabling Boulevard (O)	Colorado Springs, CO	10,208	799	10,324	3,597	799	13,921	14,720	(3,464)	1989	5/18/2006
5775 Mark Dabling Boulevard (O)	Colorado Springs, CO	12,477	1,035	12,440	1,658	1,035	14,098	15,133	(4,260)	1984	5/18/2006
5825 University Research Court (O)	College Park, MD	16,292	—	22,190	11	—	22,201	22,201	(2,118)	2008	1/29/2008
5850 University Research Court (O)	College Park, MD	22,183	—	30,273	57	—	30,330	30,330	(2,236)	2008	1/29/2008
655 Space Center Drive (O)(10)	Colorado Springs, CO	—	745	15,445	59	745	15,504	16,249	—	2008	7/8/2005
6700 Alexander Bell Drive (O)	Columbia, MD	4,000	1,755	7,019	4,628	1,755	11,647	13,402	(4,568)	1988	5/14/2001
6708 Alexander Bell Drive (O)	Columbia, MD	6,320	897	3,588	1,592	897	5,180	6,077	(2,440)	1988	5/14/2001
6711 Columbia Gateway Drive (O)	Columbia, MD	—	2,683	23,239	314	2,683	23,553	26,236	(3,503)	2006-2007	9/28/2000
6716 Alexander Bell Drive (O)	Columbia, MD	—	1,242	4,969	2,525	1,242	7,494	8,736	(3,394)	1990	12/31/1998
6721 Columbia Gateway Drive (O)	Columbia, MD	29,252	1,753	34,090	—	1,753	34,090	35,843	(3,233)	2009	9/28/2000
6724 Alexander Bell Drive (O)	Columbia, MD	10,939	449	5,039	579	449	5,618	6,067	(1,787)	2001	5/14/2001
6731 Columbia Gateway Drive (O)	Columbia, MD	—	2,807	19,098	1,648	2,807	20,746	23,553	(6,546)	2002	3/29/2000
	Columbia, MD	—	1,424	5,696	3,045	1,424	8,741	10,165	(3,933)	1992	12/31/1998

6740 Alexander Bell Drive (O)											
6741 Columbia Gateway Drive (O)	Columbia, MD	—	675	1,711	114	675	1,825	2,500	(195)	2008	9/28/2000
6750 Alexander Bell Drive (O)	Columbia, MD	—	1,263	12,461	3,351	1,263	15,812	17,075	(5,893)	2001	12/31/1998
6760 Alexander Bell Drive (O)	Columbia, MD	—	890	3,561	1,979	890	5,540	6,430	(2,582)	1991	12/31/1998
6940 Columbia Gateway Drive (O)	Columbia, MD	17,300	3,545	9,916	3,162	3,545	13,078	16,623	(5,274)	1999	11/13/1998
6950 Columbia Gateway Drive (O)	Columbia, MD	—	3,596	14,269	1,033	3,596	15,302	18,898	(5,975)	1998	10/22/1998
7000 Columbia Gateway Drive (O)	Columbia, MD	15,800	3,131	12,103	622	3,131	12,725	15,856	(3,246)	1999	5/31/2002
7015 Albert Einstein Drive (O)	Columbia, MD	2,486	2,058	6,093	826	2,058	6,919	8,977	(2,179)	1999	12/1/2005
7061 Columbia Gateway Drive (O)	Columbia, MD	—	729	3,094	571	729	3,665	4,394	(1,460)	2000	8/30/2001
7063 Columbia Gateway Drive (O)	Columbia, MD	—	902	3,684	1,043	902	4,727	5,629	(2,058)	2000	8/30/2001
7065 Columbia Gateway Drive (O)	Columbia, MD	—	919	3,763	1,263	919	5,026	5,945	(1,923)	2000	8/30/2001
7067 Columbia Gateway Drive (O)	Columbia, MD	—	1,829	11,823	2,415	1,829	14,238	16,067	(4,340)	2001	8/30/2001
7125 Columbia Gateway Drive (L)	Columbia, MD	—	3,361	128	279	3,361	407	3,768	—	1973/1999(8)	6/29/2006
7125 Columbia Gateway Drive (O)	Columbia, MD	33,779	17,126	46,994	6,583	17,126	53,577	70,703	(10,556)	1973/1999	6/29/2006
7130 Columbia Gateway Drive (O)	Columbia, MD	6,519	1,350	4,359	1,784	1,350	6,143	7,493	(1,577)	1989	9/19/2005
7134 Columbia Gateway Drive (O)	Columbia, MD	2,949	704	1,971	299	704	2,270	2,974	(499)	1990	9/19/2005
7138 Columbia Gateway Drive (O)	Columbia, MD	5,406	1,104	3,518	1,961	1,104	5,479	6,583	(2,174)	1990	9/19/2005
7142 Columbia Gateway Drive (O)	Columbia, MD	6,280	1,342	3,978	1,326	1,342	5,304	6,646	(1,406)	1994	9/19/2005
7150 Columbia Gateway Drive (O)	Columbia, MD	4,850	1,032	3,429	321	1,032	3,750	4,782	(867)	1991	9/19/2005

			Initial Cost			Gross Amounts Carried At Close of Period					
Property (Type) (1)	Location	Encumbrances (2)	Land	Building and Land Improvements	Costs Capitalized Subsequent to Acquisition	Land	Building and Land Improvements	Total (3)(4)	Accumulated Depreciation (5)	Year Built or Renovated	Date Acquired (6)
7150 Riverwood Drive (O)	Columbia, MD	—	1,821	4,388	972	1,821	5,360	7,181	(1,163)	2000	1/10/2007
7160 Riverwood Drive (O)	Columbia, MD	—	2,732	7,006	1,503	2,732	8,509	11,241	(2,688)	2000	1/10/2007
7170 Riverwood Drive (O)	Columbia, MD	—	1,283	3,096	594	1,283	3,690	4,973	(726)	2000	1/10/2007
7175 Riverwood Drive (O)	Columbia, MD	—	1,788	4,133	—	1,788	4,133	5,921	—	1996(7)	7/27/2005
7200 Redstone Gateway (O)	Huntsville, MD	—	—	4,531	—	—	4,531	4,531	—	(7)	3/23/2010
7200 Riverwood Road (O)	Columbia, MD	—	4,089	16,356	3,001	4,089	19,357	23,446	(6,741)	1986	10/13/1998
7205 Riverwood Drive (O)	Columbia, MD	—	1,367	14,300	—	1,367	14,300	15,667	—	(7)	7/27/2005
7272 Park Circle Drive (O)	Hanover, MD	5,232	1,479	6,300	1,798	1,479	8,098	9,577	(1,663)	1991/1996	1/10/2007
7318 Parkway Drive (O)	Hanover, MD	—	972	3,888	812	972	4,700	5,672	(1,582)	1984	4/16/1999
7320 Parkway Drive (O)	Hanover, MD	7,000	905	3,570	1,575	905	5,145	6,050	(1,557)	1983	4/4/2002
745 Space Center Drive (O)(10)	Colorado Springs, CO	—	654	7,521	15	654	7,536	8,190	(171)	2006	7/8/2005
7467 Ridge Road (O)	Hanover, MD	—	1,629	6,517	1,924	1,629	8,441	10,070	(3,346)	1990	4/28/1999
7700 Potranco Road (O)	San Antonio, TX	—	14,020	38,804	7	14,020	38,811	52,831	(15,703)	1982/1985	3/30/2005
7700-1 Potranco Road (O)	San Antonio, TX	—	—	1,066	—	—	1,066	1,066	(108)	2007	3/30/2005
7700-5 Potranco Road (O)	San Antonio, TX	—	—	1,884	—	—	1,884	1,884	(154)	2009	3/30/2005
7740 Milestone Parkway (O)	Hanover, MD	17,548	3,825	34,363	61	3,825	34,424	38,249	(2,265)	2009	7/2/2007
7770 Backlick Road (O)	Springfield, VA	931	6,387	71,600	8	6,387	71,608	77,995	(157)	2012(7)	3/10/2010
800 International Drive (O)	Linthicum, MD	8,408	775	3,099	947	775	4,046	4,821	(1,662)	1988	4/30/1998
8000 Potranco Road (O)	San Antonio, TX	—	1,964	21,178	—	1,964	21,178	23,142	(1,149)	2010	1/20/2006
8003 Corporate Drive (O)	White Marsh, MD	—	611	1,611	53	611	1,664	2,275	(311)	1999	1/9/2007
8007 Corporate Drive (O)	White Marsh, MD	—	1,434	3,336	307	1,434	3,643	5,077	(727)	1995	1/9/2007

8010 Corporate Drive (O)	White Marsh, MD	—	1,349	3,262	1,672	1,349	4,934	6,283	(842)	1998	1/9/2007
8013 Corporate Drive (O)	White Marsh, MD	—	642	1,536	1,809	642	3,345	3,987	(432)	1990	1/9/2007
8015 Corporate Drive (O)	White Marsh, MD	—	446	1,116	243	446	1,359	1,805	(306)	1990	1/9/2007
8019 Corporate Drive (O)	White Marsh, MD	—	680	1,898	738	680	2,636	3,316	(555)	1990	1/9/2007
8020 Corporate Drive (O)	White Marsh, MD	—	2,184	3,767	2,199	2,184	5,966	8,150	(954)	1997	1/9/2007
8023 Corporate Drive (O)	White Marsh, MD	—	651	1,603	5	651	1,608	2,259	(267)	1990	1/9/2007
8030 Potranco Road (O)	San Antonio, TX	—	1,964	21,298	—	1,964	21,298	23,262	(1,148)	2010	1/20/2006
8094 Sandpiper Circle (O)	White Marsh, MD	—	1,960	3,716	369	1,960	4,085	6,045	(820)	1998	1/9/2007
8098 Sandpiper Circle (O)	White Marsh, MD	—	1,797	3,651	633	1,797	4,284	6,081	(558)	1998	1/9/2007
8100 Potranco Road (L)	San Antonio, TX	—	1,964	1,396	—	1,964	1,396	3,360	—	(8)	6/14/2005
8110 Corporate Drive (O)	White Marsh, MD	—	2,285	10,117	489	2,285	10,606	12,891	(2,202)	2001	1/9/2007
8140 Corporate Drive (O)	White Marsh, MD	—	2,158	8,457	2,018	2,158	10,475	12,633	(3,046)	2003	1/9/2007
849 International Drive (O)	Linthicum, MD	11,692	1,356	5,426	3,081	1,356	8,507	9,863	(4,043)	1988	2/23/1999
8621 Robert Fulton Drive (O)	Columbia, MD	11,000	2,317	12,642	199	2,317	12,841	15,158	(2,314)	2005-2006	6/10/2005
8661 Robert Fulton Drive (O)	Columbia, MD	6,200	1,510	3,764	1,042	1,510	4,806	6,316	(1,518)	2002	12/30/2003
8671 Robert Fulton Drive (O)	Columbia, MD	7,600	1,718	4,280	1,941	1,718	6,221	7,939	(2,148)	2002	12/30/2003
870 Elkridge Landing Road (O)	Linthicum, MD	18,900	2,003	9,442	6,689	2,003	16,131	18,134	(7,148)	1981	8/3/2001
881 Elkridge Landing Road (O)	Linthicum, MD	11,812	1,034	4,137	1,049	1,034	5,186	6,220	(1,991)	1986	4/30/1998

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Property (Type) (1)	Location	Encumbrances (2)	Initial Cost: Land	Initial Cost: Building and Land Improvements	Costs Capitalized Subsequent to Acquisition	Gross Amounts Carried At Close of Period: Land	Gross Amounts Carried At Close of Period: Building and Land Improvements	Total (3)(4)	Accumulated Depreciation (5)	Year Built or Renovated	Date Acquired (6)
891 Elkridge Landing Road (O)	Linthicum, MD	—	1,165	4,772	1,777	1,165	6,549	7,714	(2,674)	1984	7/2/2001
900 Elkridge Landing Road (O)	Linthicum, MD	—	1,993	7,972	2,887	1,993	10,859	12,852	(4,722)	1982	4/30/1998
900 International Drive (O)	Linthicum, MD	8,008	981	3,922	834	981	4,756	5,737	(1,964)	1986	4/30/1998
901 Elkridge Landing Road (O)	Linthicum, MD	—	1,156	4,437	1,558	1,156	5,995	7,151	(2,148)	1984	7/2/2001
911 Elkridge Landing Road (O)	Linthicum, MD	—	1,215	4,861	2,024	1,215	6,885	8,100	(2,789)	1985	4/30/1998
920 Elkridge Landing Road (O)	Linthicum, MD	—	2,081	9,683	687	2,081	10,370	12,451	(4,084)	1982	7/2/2001
921 Elkridge Landing Road (O)	Linthicum, MD	—	1,044	4,176	639	1,044	4,815	5,859	(1,989)	1983	4/30/1998
930 International Drive (O)	Linthicum, MD	8,488	1,013	4,053	1,100	1,013	5,153	6,166	(2,203)	1986	4/30/1998
938 Elkridge Landing Road (O)	Linthicum, MD	—	1,209	4,748	476	1,209	5,224	6,433	(1,615)	1984	7/2/2001
939 Elkridge Landing Road (O)	Linthicum, MD	—	939	3,756	1,790	939	5,546	6,485	(2,452)	1983	4/30/1998
940 Elkridge Landing Road (L)	Linthicum, MD	—	1,104	4,718	170	1,104	4,888	5,992	(4,884)	(8)	7/2/2001
9651 Hornbaker Road (D)	Manassas, VA	—	6,050	196,428	253	6,050	196,681	202,731	(2,809)	2010	9/14/2010
9690 Deereco Road (O)	Timonium, MD	—	3,415	13,723	5,833	3,415	19,556	22,971	(7,927)	1988	12/21/1999
980 Technology Court (O)(10)	Colorado Springs, CO	—	526	2,046	442	526	2,488	3,014	(585)	1995	9/28/2005
985 Space Center Drive (O)(10)	Colorado Springs, CO	—	777	12,287	1,569	777	13,856	14,633	(2,948)	1989	9/28/2005
9900 Franklin Square Drive (O)	White Marsh, MD	—	979	3,466	202	979	3,668	4,647	(734)	1999	1/9/2007
9910 Franklin Square Drive (O)	White Marsh, MD	5,040	1,219	6,590	65	1,219	6,655	7,874	(1,457)	2005	1/9/2007
9920 Franklin Square Drive (O)	White Marsh, MD	—	1,058	5,293	1,429	1,058	6,722	7,780	(1,470)	2006	1/9/2007
9925 Federal Drive (O)(10)	Colorado Springs, CO	—	1,129	4,334	80	1,129	4,414	5,543	(97)	2008	9/28/2005
9930 Franklin Square Drive (O)	White Marsh, MD	—	1,137	3,921	36	1,137	3,957	5,094	(795)	2001	1/9/2007
		—	1,052	3,382	281	1,052	3,663	4,715	(732)	2000	1/9/2007

9940 Franklin Square Drive (O)	White Marsh, MD										
9945 Federal Drive (O)(10)	Colorado Springs, CO	—	1,854	849	—	1,854	849	2,703	(13)	2009	9/28/2005
9950 Federal Drive (O)(10)	Colorado Springs, CO	—	877	5,045	1,501	877	6,546	7,423	(1,944)	2001	12/22/2005
9960 Federal Drive (O)(10)	Colorado Springs, CO	—	695	2,286	291	695	2,577	3,272	(256)	2001	12/22/2005
9965 Federal Drive (L)(10)	Colorado Springs, CO	—	466	—	—	466	—	466	—	(8)	12/22/2005
9965 Federal Drive (O)(10)	Colorado Springs, CO	—	1,401	6,061	565	1,401	6,626	8,027	(907)	1983/2007	1/19/2006
999 Corporate Boulevard (O)	Linthicum, MD	13,533	1,187	8,332	556	1,187	8,888	10,075	(3,230)	2000	8/1/1999
Aerotech Commerce (L)	Colorado Springs, CO	—	900	—	—	900	—	900	—	(8)	5/19/2006
Arborcrest (O)	Blue Bell, PA	—	21,969	83,529	1,094	21,969	84,623	106,592	(22,686)	1991(6)(7)	10/14/1997
Arundel Preserve (L)	Hanover, MD	—	—	5,886	—	—	5,886	5,886	—	(8)	(9)
Ashburn Crossing - DC-8 (O)	Ashburn, VA	—	7,291	—	—	7,291	—	7,291	—	(7)	12/27/2012
Ashburn Crossing - DC-9 (O)	Ashburn, VA	—	4,192	—	—	4,192	—	4,192	—	(7)	12/27/2012
Ashburn Crossing (L)	Ashburn, VA	—	4,309	3	—	4,309	3	4,312	—	(8)	12/27/2012
Canton Crossing Land (L)	Baltimore, MD	—	16,085	1,820	—	16,085	1,820	17,905	—	(8)	10/27/2009
Canton Crossing Util Distr Ctr (O)	Baltimore, MD	—	7,300	15,550	722	7,300	16,272	23,572	(1,655)	2005	10/27/2009
Columbia Gateway - Southridge (L)	Columbia, MD	—	6,387	2,938	—	6,387	2,938	9,325	—	(8)	9/20/2004
Dahlgren Technology Center (L)	Dahlgren, VA	—	1,083	178	—	1,083	178	1,261	—	(8)	3/16/2005
Expedition VII (L)	Lexington Park, MD	—	705	726	—	705	726	1,431	—	(8)	3/24/2004
Indian Head (L)	Bryans Road, MD	—	6,436	—	—	6,436	—	6,436	—	(8)	10/23/2006

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			Initial Cost			Gross Amounts Carried At Close of Period				
Property (Type) (1)	Location	Encumbrances (2)	Land	Building and Land Improvements	Costs Capitalized Subsequent to Acquisition	Land	Building and Land Improvements	Total (3)(4)	Accumulated Depreciation (5)	Year Built or Renova
InterQuest (L)	Colorado Springs, CO	—	14,515	8	—	14,515	8	14,523	—	(8)
M Square Research Park (L)	College Park, MD	—	—	3,602	—	—	3,602	3,602	—	(8)
National Business Park (L)	Annapolis Junction, MD	—	2,372	6,354	—	2,372	6,354	8,726	—	(8)
National Business Park North (L)	Jessup, MD	—	25,654	25,069	—	25,654	25,069	50,723	—	(8)
North Gate Business Park (L)	Aberdeen, MD	—	6,486	10,717	—	6,486	10,717	17,203	—	(8)
Northwest Crossroads (L)	San Antonio, TX	—	7,430	836	—	7,430	836	8,266	—	(8)
Old Annapolis Road (O)	Columbia, MD	—	1,637	5,500	2,103	1,637	7,603	9,240	(2,333)	1974/1
Patriot Park (L)	Colorado Springs, CO	—	8,768	248	—	8,768	248	9,016	—	(8)
Patriot Ridge (L)	Springfield, VA	—	18,517	10,873	—	18,517	10,873	29,390	—	(8)
Redstone Gateway (L)	Huntsville, AL	—	—	13,700	—	—	13,700	13,700	—	(8)
Route 15/Biggs Ford Road (L)	Frederick, MD	—	8,703	526	—	8,703	526	9,229	—	(8)
Sentry Gateway (L)	San Antonio, TX	—	8,275	3,621	—	8,275	3,621	11,896	—	(8)
West Nursery Road (L)	Linthicum, MD	—	1,441	53	—	1,441	53	1,494	—	(8)
Westfields - Park Center (L)	Herndon, VA	—	3,609	2,640	—	3,609	2,640	6,249	—	(8)
Westfields Corporate Center (L)	Herndon, VA	—	7,141	1,342	—	7,141	1,342	8,483	—	(8)
White Marsh (L)	White Marsh, MD	—	30,322	10,385	—	30,322	10,385	40,707	—	(8)
		—	9,614	81	—	9,614	81	9,695	—	(8)

Woodland Park (L)	Herndon, VA									
Other Developments, including intercompany eliminations (V)	Various	—	7	(152)	(438)	7	(590)	(583)	689	Variou
		$1,015,130	$681,001	$2,893,547	$285,412	$681,001	$3,178,959	$3,859,960	$(568,176)	

(1) A legend for the Property Type follows: (O) = Office Property; (L) = Land held or pre-construction; (D) = Data Center; and (V) = Various.
(2) Excludes our term loan facilities of $770.0 million, senior exchangeable notes of $230.9 million, unsecured notes payable of $1.8 million, and net premiums on the remaining loans of $1.3 million.
(3) The aggregate cost of these assets for Federal income tax purposes was approximately $3.4 billion at December 31, 2012.
(4) As discussed in Note 5 to our Consolidated Financial Statements, we recognized impairment losses of $46.1 million in connection with our property in Greater Philadelphia, Pennsylvania and $19.0 million, including exit costs, in connection with certain properties included in our Strategic Reallocation Plan.
(5) The estimated lives over which depreciation is recognized follow: Building and land improvements: 10-40 years; and tenant improvements: related lease terms.
(6) The acquisition date of multi-parcel properties reflects the date of the earliest parcel acquisition.
(7) Under construction or redevelopment at December 31, 2012.
(8) Held or under pre-construction at December 31, 2012.
(9) Development in progress in anticipation of acquisition at December 31, 2012.
(10) Included in our Strategic Reallocation Plan and classified as held for sale as of December 31, 2012.

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The following table summarizes our changes in cost of properties for the years ended December 31, 2012, 2011 and 2010 (in thousands):

	2012	2011	2010
Beginning balance	$4,038,932	$3,948,487	$3,452,512
Acquisitions of operating properties	33,684	26,887	187,052
Improvements and other additions	214,418	304,079	338,358
Sales	(291,491)	(75,315)	(29,430)
Impairments	(121,557)	(165,206)	—
Other dispositions	(13,891)	—	—
Other	(135)	—	(5)
Ending balance	$3,859,960	$4,038,932	$3,948,487

The following table summarizes our changes in accumulated depreciation for the same time periods (in thousands):

	2012	2011	2010
Beginning balance	$577,601	$503,032	$422,612
Depreciation expense	93,158	99,173	88,048
Sales	(40,346)	(9,640)	(7,764)
Impairments	(58,855)	(15,039)	—
Other dispositions	(3,247)	—	—
Other	(135)	75	136
Ending balance	$568,176	$577,601	$503,032