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Piedmont Office Realty Trust, Inc.

Form 10-Q

May 01, 2019

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xbrli:pure iso4217:USD pdm:asset xbrli:shares pdm:category pdm:contract pdm:extension pdm:market utreg:sqft
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2019

OR

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

For the Transition Period From _____ To _____

Commission file number 001-34626

Piedmont Office Realty Trust, Inc.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of incorporation or organization)

58-2328421

(I.R.S. Employer Identification Number)

5565 Glenridge Connector

Ste. 450

Atlanta, Georgia 30342

(Address of principal executive offices)

(Zip Code)

(770) 418-8800

(Registrant's telephone number, including area code)

N/A

(Former name, former address, and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large Accelerated filer

Accelerated filer

Non-Accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

**Number of shares outstanding of the Registrant's
common stock, as of April 30, 2019:**

125,597,374 shares

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

- Economic, regulatory, socio-economic changes, and/or technology changes (including accounting standards) that impact the real estate market generally, or that could affect patterns of use of commercial office space;
- The impact of competition on our efforts to renew existing leases or re-let space on terms similar to existing leases; Changes in the economies and other conditions affecting the office sector in general and specifically the eight markets in which we primarily operate where we have high concentrations of our Annualized Lease Revenue (see definition below);
- Lease terminations, lease defaults, or changes in the financial condition of our tenants, particularly by one of our large lead tenants;
- Adverse market and economic conditions, including any resulting impairment charges on both our long-lived assets or goodwill resulting therefrom;
- The success of our real estate strategies and investment objectives, including our ability to identify and consummate suitable acquisitions and divestitures;
- The illiquidity of real estate investments, including regulatory restrictions to which REITs are subject and the resulting impediment on our ability to quickly respond to adverse changes in the performance of our properties;
- The risks and uncertainties associated with our acquisition and disposition of properties, many of which risks and uncertainties may not be known at the time of acquisition or disposition;
- Development and construction delays and resultant increased costs and risks;
- Our real estate development strategies may not be successful;
- Future acts of terrorism in any of the major metropolitan areas in which we own properties, or future cybersecurity attacks against us or any of our tenants;
- Costs of complying with governmental laws and regulations;
- Additional risks and costs associated with directly managing properties occupied by government tenants, including an increased risk of default by government tenants during periods in which state or federal governments are shut down or on furlough;
- Significant price and volume fluctuations in the public markets, including on the exchange which we listed our common stock;
- Changes in the method pursuant to which the LIBOR rates are determined and the potential phasing out of LIBOR after 2021;

• The effect of future offerings of debt or equity securities or changes in market interest rates on the value of our common stock;

• Uncertainties associated with environmental and other regulatory matters;

• Potential changes in political environment and reduction in federal and/or state funding of our governmental tenants;

• Changes in the financial condition of our tenants directly or indirectly resulting from geopolitical developments that could negatively affect international trade, including the United Kingdom's referendum to withdraw from the

• European Union, the termination or threatened termination of existing international trade agreements, or the

• implementation of tariffs or retaliatory tariffs on imported or exported goods;

• The effect of any litigation to which we are, or may become, subject;

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Changes in tax laws impacting real estate investment trusts ("REITs") and real estate in general, as well as our ability to continue to qualify as a REIT under the Internal Revenue Code of 1986 (the "Code") or otherwise adversely affect our stockholders;

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

• Other factors, including the risk factors discussed under Item 1A. of our Annual Report on Form 10-K for the year ended December 31, 2018.

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

Information Regarding Disclosures Presented

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

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PART I. FINANCIAL STATEMENTS

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

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

The accompanying financial statements should be read in conjunction with the notes to Piedmont's financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this report on Form 10-Q and with Piedmont's Annual Report on Form 10-K for the year ended December 31, 2018. Piedmont's results of operations for the three months ended March 31, 2019 are not necessarily indicative of the operating results expected for the full year.

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Table of Contents**PIEDMONT OFFICE REALTY TRUST, INC.
CONSOLIDATED BALANCE SHEETS**

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

	(Unaudited) March 31, 2019	December 31, 2018
Assets:		
Real estate assets, at cost:		
Land	\$507,369	\$507,422
Buildings and improvements, less accumulated depreciation of \$797,112 and \$772,093 as of March 31, 2019 and December 31, 2018, respectively	2,293,629	2,305,096
Intangible lease assets, less accumulated amortization of \$91,235 and \$87,391 as of March 31, 2019 and December 31, 2018, respectively	71,274	77,676
Construction in progress	13,225	15,848
Real estate assets held for sale, net	—	110,552
Total real estate assets	2,885,497	3,016,594
Cash and cash equivalents	4,625	4,571
Tenant receivables	11,693	10,800
Straight-line rent receivables	167,346	162,589
Restricted cash and escrows	1,433	1,463
Prepaid expenses and other assets	23,529	25,356
Goodwill	98,918	98,918
Interest rate swaps	554	1,199
Deferred lease costs, less accumulated amortization of \$192,949 and \$183,611 as of March 31, 2019 and December 31, 2018, respectively	239,847	250,148
Other assets held for sale, net	—	20,791
Total assets	\$3,433,442	\$3,592,429
Liabilities:		
Unsecured debt, net of discount and unamortized debt issuance costs of \$9,354 and \$9,879 as of March 31, 2019 and December 31, 2018, respectively	\$1,375,646	\$1,495,121
Secured debt, net of premiums and unamortized debt issuance costs of \$569 and \$645 as of March 31, 2019 and December 31, 2018, respectively	190,109	190,351
Accounts payable, accrued expenses and accrued capital expenditures	81,309	102,519
Dividends payable	—	26,972
Deferred income	27,053	28,779
Intangible lease liabilities, less accumulated amortization of \$61,382 and \$59,144 as of March 31, 2019 and December 31, 2018, respectively	33,360	35,708
Interest rate swaps	2,443	839
Total liabilities	1,709,920	1,880,289
Commitments and Contingencies (Note 6)	—	—
Stockholders' Equity:		
Shares-in-trust, 150,000,000 shares authorized; none outstanding as of March 31, 2019 or December 31, 2018	—	—
Preferred stock, no par value, 100,000,000 shares authorized; none outstanding as of March 31, 2019 or December 31, 2018	—	—
Common stock, \$.01 par value, 750,000,000 shares authorized; 125,597,374 and 126,218,554 shares issued and outstanding as of March 31, 2019 and December 31, 2018, respectively	1,256	1,262
Additional paid-in capital	3,686,017	3,683,186
Cumulative distributions in excess of earnings	(1,971,184)	(1,982,542)

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Other comprehensive income	5,667	8,462
Piedmont stockholders' equity	1,721,756	1,710,368
Noncontrolling interest	1,766	1,772
Total stockholders' equity	1,723,522	1,712,140
Total liabilities and stockholders' equity	\$3,433,442	\$3,592,429
<i>See accompanying notes</i>		

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

	(Unaudited)	
	Three Months Ended	
	March 31,	
	2019	2018
Revenues:		
Rental and tenant reimbursement revenue	\$126,166	\$ 124,448
Property management fee revenue	1,992	309
Other property related income	4,778	5,143
	132,936	129,900
Expenses:		
Property operating costs	51,805	51,859
Depreciation	26,525	27,145
Amortization	17,700	16,733
General and administrative	9,368	6,552
	105,398	102,289
Other income (expense):		
Interest expense	(15,493)	(13,758)
Other income	277	446
Loss on extinguishment of debt	—	(1,680)
Gain on sale of real estate assets	37,887	45,209
Net income	50,209	57,828
Net (income)/loss applicable to noncontrolling interest	(1)	2
Net income applicable to Piedmont	\$50,208	\$ 57,830
Per share information – basic:		
Net income applicable to common stockholders	\$0.40	\$ 0.43
Per share information – diluted:		
Net income applicable to common stockholders	\$0.40	\$ 0.42
Weighted-average common shares outstanding – basic	125,573,528	35,876,652
Weighted-average common shares outstanding – diluted	126,180,558	36,182,728

See accompanying notes

Table of Contents**PIEDMONT OFFICE REALTY TRUST, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(in thousands)

	(Unaudited)	
	Three Months Ended	
	March 31, 2019	2018
Net income applicable to Piedmont	\$50,208	\$57,830
Other comprehensive income:		
Effective portion of gain/(loss) on derivative instruments that are designated and qualify as cash flow hedges (See <u>Note 4</u>)	(2,024)	1,517
Plus: Reclassification of net (gain)/loss included in net income (See <u>Note 4</u>)	(771)	1,052
Other comprehensive income	(2,795)	2,569
Comprehensive income applicable to Piedmont	\$47,413	\$60,399

See accompanying notes

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PIEDMONT OFFICE REALTY TRUST, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE THREE MONTHS ENDED
MARCH 31, 2018 (UNAUDITED) AND MARCH 31, 2019 (UNAUDITED)
(in thousands, except per share amounts)

	Common Shares	Stock Amount	Additional Paid-In Capital	Cumulative Distributions in Excess of Earnings	Other Comprehensive Income/(Loss)	Non- controlling Interest	Total Stockholders' Equity
Balance, December 31, 2017	142,359	\$ 1,424	\$ 3,677,360	\$ (1,702,281)	\$ 8,164	\$ 1,822	\$ 1,986,489
Cumulative effect of accounting change (adoption of ASU 2016-01)	—	—	—	94	(94)	—	—
Share repurchases as part of an announced plan	(12,482)	(125)	—	(231,763)	—	—	(231,888)
Dividends to common stockholders (\$0.21 per share), stockholders of subsidiaries, and dividends reinvested	—	—	(19)	(28,284)	—	(8)	(28,311)
Shares issued and amortized under the 2007 Omnibus Incentive Plan, net of tax	148	1	2,900	—	—	—	2,901
Net loss applicable to noncontrolling interest	—	—	—	—	—	(2)	(2)
Net income applicable to Piedmont	—	—	—	57,830	—	—	57,830
Other comprehensive income	—	—	—	—	2,569	—	2,569
Balance, March 31, 2018	130,025	\$ 1,300	\$ 3,680,241	\$ (1,904,404)	\$ 10,639	\$ 1,812	\$ 1,789,588
Balance, December 31, 2018	126,219	\$ 1,262	\$ 3,683,186	\$ (1,982,542)	\$ 8,462	\$ 1,772	\$ 1,712,140
Share repurchases as part of an announced plan	(728)	(7)	—	(12,475)	—	—	(12,482)
Dividends to common stockholders (\$0.21 per share), stockholders of subsidiaries, and dividends reinvested	—	—	(48)	(26,375)	—	(7)	(26,430)
Shares issued and amortized under the 2007 Omnibus Incentive Plan, net of tax	106	1	2,879	—	—	—	2,880
Net income applicable to noncontrolling interest	—	—	—	—	—	1	1
Net income applicable to Piedmont	—	—	—	50,208	—	—	50,208
Other comprehensive loss	—	—	—	—	(2,795)	—	(2,795)
Balance, March 31, 2019	125,597	\$ 1,256	\$ 3,686,017	\$ (1,971,184)	\$ 5,667	\$ 1,766	\$ 1,723,522

See accompanying notes

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

	(Unaudited)	
	Three Months Ended	
	March 31,	
	2019	2018
Cash Flows from Operating Activities:		
Net income	\$ 50,209	\$ 57,828
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	26,525	27,145
Amortization of debt issuance costs net of favorable settlement of interest rate swaps	100	(201)
Other amortization	16,427	15,984
Loss on extinguishment of debt	—	1,665
Stock compensation expense	3,835	1,025
Gain on sale of real estate assets	(37,887)	(45,209)
Changes in assets and liabilities:		
Increase in tenant and straight-line rent receivables	(4,333)	(5,048)
Decrease in prepaid expenses and other assets	1,570	1,975
Cash received upon settlement of interest rate swaps	—	807
Decrease in accounts payable and accrued expenses	(14,440)	(22,716)
(Decrease)/increase in deferred income	(1,762)	55
Net cash provided by operating activities	40,244	33,310
Cash Flows from Investing Activities:		
Return of escrowed purchase price/(acquisition of real estate assets and intangibles)	700	(28,147)
Capitalized expenditures	(15,435)	(12,760)
Net sales proceeds from wholly-owned properties	168,341	415,078
Note receivable issuance	—	(3,200)
Deferred lease costs paid	(2,145)	(2,596)
Net cash provided by investing activities	151,461	368,375
Cash Flows from Financing Activities:		
Debt issuance and other costs paid	(36)	(101)
Proceeds from debt	115,000	716,225
Repayments of debt	(235,289)	(754,359)
Value of shares withheld for payment of taxes related to employee stock compensation	(1,055)	(737)
Repurchases of common stock as part of announced plan	(16,899)	(233,164)
Dividends paid and discount on dividend reinvestments	(53,402)	(130,111)
Net cash used in financing activities	(191,681)	(402,247)
Net increase/(decrease) in cash, cash equivalents, and restricted cash and escrows	24	(562)
Cash, cash equivalents, and restricted cash and escrows, beginning of period	6,034	8,755
Cash, cash equivalents, and restricted cash and escrows, end of period	\$ 6,058	\$ 8,193

See accompanying notes

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PIEDMONT OFFICE REALTY TRUST, INC.
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2019
(unaudited)

1. Organization

Piedmont Office Realty Trust, Inc. ("Piedmont") (NYSE: PDM) is a Maryland corporation that operates in a manner so as to qualify as a real estate investment trust ("REIT") for federal income tax purposes and engages in the acquisition, development, redevelopment, management, and ownership of commercial real estate properties located primarily in eight major office markets in the Eastern-half of the United States, including properties that are under construction, are newly constructed, or have operating histories. Piedmont was incorporated in 1997 and commenced operations in 1998. Piedmont conducts business primarily through Piedmont Operating Partnership, L.P. ("Piedmont OP"), a Delaware limited partnership, as well as performing the management of its buildings through two wholly-owned subsidiaries, Piedmont Government Services, LLC and Piedmont Office Management, LLC. Piedmont owns 99.9% of, and is the sole general partner of, Piedmont OP and as such, possesses full legal control and authority over the operations of Piedmont OP. The remaining 0.1% ownership interest of Piedmont OP is held indirectly by Piedmont through its wholly-owned subsidiary, Piedmont Office Holdings, Inc. ("POH"), the sole limited partner of Piedmont OP. Piedmont OP owns properties directly, through wholly-owned subsidiaries, and through various joint ventures which it controls. References to Piedmont herein shall include Piedmont and all of its subsidiaries, including Piedmont OP and its subsidiaries and joint ventures.

As of March 31, 2019, Piedmont owned 53 in-service office properties and one 487,000-square foot redevelopment asset. As of March 31, 2019, Piedmont's 53 in-service office properties comprised approximately 15.9 million square feet of primarily Class A commercial office space and were approximately 93.3% leased. As of March 31, 2019, 93% of Piedmont's Annualized Lease Revenue was generated from select sub-markets located within eight major office markets: Atlanta, Boston, Chicago, Dallas, Minneapolis, New York, Orlando, and Washington, D.C.

Piedmont internally evaluates all of its real estate assets as one operating segment, and accordingly does not report segment information.

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The consolidated financial statements of Piedmont have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the "SEC"), including the instructions to Form 10-Q and Article 10 of Regulation S-X, and do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the statements for the unaudited interim periods presented include all adjustments, which are of a normal and recurring nature, necessary for a fair presentation of the results for such periods. Results for these interim periods are not necessarily indicative of a full year's results.

Piedmont's consolidated financial statements include the accounts of Piedmont, Piedmont's wholly-owned subsidiaries, any variable interest entity ("VIE") for which Piedmont or any of its wholly-owned subsidiaries is considered to have the power to direct the activities of the entity and the obligation to absorb losses/right to receive benefits, or any entity in which Piedmont or any of its wholly-owned subsidiaries owns a controlling interest. In determining whether Piedmont or Piedmont OP has a controlling interest, the following factors, among others, are considered: equity ownership, voting rights, protective rights of investors, and participatory rights of investors. For further information, refer to the financial statements and footnotes included in Piedmont's Annual Report on Form 10-K for the year ended December 31, 2018.

All intercompany balances and transactions have been eliminated upon consolidation.

Further, Piedmont has formed special purpose entities to acquire and hold real estate. Each special purpose entity is a separate legal entity. Consequently, the assets of these special purpose entities are not available to all creditors of Piedmont. The assets owned by these special purpose entities are being reported on a consolidated basis with Piedmont's assets for financial reporting purposes only.

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Use of Estimates

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

Income Taxes

Piedmont has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, and has operated as such, beginning with its taxable year ended December 31, 1998. To qualify as a REIT, Piedmont must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of its annual REIT taxable income. As a REIT, Piedmont is generally not subject to federal income taxes, subject to fulfilling, among other things, its taxable income distribution requirement. Piedmont is subject to certain taxes related to the operations of properties in certain locations, as well as operations conducted by its taxable REIT subsidiary, POH, which have been provided for in the financial statements.

Accounting Pronouncements Adopted during the Three Months Ended March 31, 2019

Leases

Piedmont has adopted Accounting Standards Update ("ASU") No. 2016-02, *Leases (Topic 842)*, as well as various associated updates and amendments, which together comprise the requirements for lease accounting under Accounting Standards Codification 842 ("ASC 842"). ASC 842 fundamentally changes the definition of a lease, as well as the accounting for operating leases, by requiring lessees to recognize a liability to make lease payments and a right-of-use asset representing the right to use the leased asset over the term of the lease. ASC 842 also prohibits the capitalization of internal direct payroll costs associated with negotiating and executing leases. Accounting for leases by lessors is substantially unchanged from prior practice as lessors will continue to recognize lease revenue on a straight-line basis. In conjunction with adopting ASC 842, Piedmont has adopted the following optional practical expedients, transition amendments, or made accounting policy elections as follows:

a package of optional practical expedients which: (1) does not require the reassessment of any expired or existing contracts to determine if they contain a lease or to determine lease classification; and (2) does not require the write-off of any unamortized, previously capitalized, initial direct costs for any existing leases;

- an optional practical transition expedient provided by ASU No. 2018-01 which allows Piedmont to exclude certain land easements in place as of January 1, 2019 from the new guidance;

an optional practical expedient provided by ASU No. 2018-11 which allows certain non-lease operating expense reimbursements which are included in the underlying stated lease rate to be accounted for as part of an operating lease where Piedmont is the lessor;

a transitional amendment which allows for the presentation of comparative periods in the year of adoption under ASC 840 (the former leasing guidance), effectively allowing for an initial adoption of ASC 842 (the new leasing guidance) on January 1, 2019 (the "Comparatives Under ASC 840 Option");

an accounting policy election allowed by ASC 842 related to a recognition and measurement exception for short-term leases (defined as leases which are 12 months or less in duration) where Piedmont is the lessee. Piedmont's short-term lease expense reasonably reflects its lease commitments under such leases; and

an accounting policy election allowed by ASU No. 2018-20 which permits Piedmont to exclude sales and other similar taxes from analysis to ascertain whether they are Piedmont's primary obligation (as lessor), and instead exclude such costs from revenue and account for them as costs of the lessee.

The nature of Piedmont's change in accounting principle relates primarily to its accounting for operating leases where Piedmont is a lessee for office space, as prescribed by ASC 842. This change in accounting principle is preferable because it increases transparency and comparability among companies by recognizing lease assets and lease liabilities

on the balance sheet and disclosing key information about leasing arrangements. Due to the adoption of the practical expedients outlined above, Piedmont has not adjusted prior-period information retrospectively, and there is a negligible decrease in net income attributable to Piedmont as a result of accounting for leases where Piedmont is the lessee under ASC 842 as compared to prior operating lease accounting.

Operating leases where Piedmont is the lessee relate primarily to office space in buildings owned by a third party.
Piedmont

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recorded a right to use asset and corresponding lease liability of approximately \$0.2 million using Piedmont's incremental borrowing rate as the lease discount rate. For the three months ended March 31, 2019, Piedmont recognized approximately \$20,000 of operating lease costs. The weighted-average lease term of Piedmont's right of use assets is 3 years, and the weighted-average discount rate is 3.35%.

Piedmont evaluates contracts at commencement to determine if the contract contains a lease. If a contract is determined to contain a lease, the lease is evaluated to determine whether it is an operating or a financing lease. All of Piedmont's leases where Piedmont is the lessor are for the lessee's use of space in Piedmont's commercial office properties and are classified as operating leases. Lease payments are typically comprised of both fixed base rental payments and separately billed variable lease payments for reimbursement of services performed by Piedmont for the tenant as prescribed by the lease. Fixed base rental payments, as well as any fixed portion of reimbursement income, are recognized on a straight-line basis over the lease term. Tenant reimbursements are recognized as revenue in the period that the related operating cost is incurred. The option to extend or terminate our leases is specific to each underlying tenant agreement; however, generally Piedmont's leases contain penalties for early terminations. None of Piedmont's leases convey the right for the lessee to purchase the underlying property; however, certain leases convey the right of first offer or first refusal on the potential sale of the underlying real estate to the lessee.

Piedmont's future minimum lease payments from lessees under non-cancelable operating leases where Piedmont is the lessor as of March 31, 2019 is presented below (in thousands):

Years ending December 31:	
2019 ⁽¹⁾	\$275,641
2020	344,320
2021	330,010
2022	317,605
2023	284,073
Thereafter	1,188,029
Total	\$2,739,678

⁽¹⁾ Reflects rental payments for the fiscal period April 1, 2019 through December 31, 2019.

As required under the Comparatives Under ASC 840 Option described above, Piedmont's future minimum rental income from lessees under non-cancelable operating leases where Piedmont is the lessor as of December 31, 2018 is also presented below (in thousands):

Years ending December 31:	
2019	\$370,495
2020	352,541
2021	337,951
2022	324,960
2023	291,603
Thereafter	1,247,649
Total	\$2,925,199

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Piedmont recognized the following fixed and variable lease payments, which together comprised rental and tenant reimbursement revenue in the accompanying consolidated statements of income for the three months ended March 31, 2019 as follows (in thousands):

	Three Months Ended March 31, 2019
Fixed payments	\$ 103,659
Variable payments	22,507
Total Rental and Tenant Reimbursement Revenue	\$ 126,166

Additionally, ASU No. 2018-19 clarifies that operating lease receivables are within the scope of ASC 842; therefore, in accordance with ASC 842, effective January 1, 2019, Piedmont began recognizing changes in the collectability assessment of its operating lease receivables as a reduction of rental and tenant reimbursement revenue, rather than as a property operating cost. Consequently, during the three months ended March 31, 2019, Piedmont recognized \$9,000 of uncollectible operating lease receivables as a reduction of rental and reimbursement revenue, and during the three months ended March 31, 2018, Piedmont recognized \$61,000 of recoveries of uncollectible operating lease receivables as a reduction of property operating costs.

Stock Compensation to Non-employees

During the three months ended March 31, 2019, Piedmont adopted ASU No. 2018-07, *Stock Compensation (Topic 718)*, Improvements to Non-employee Share-Based Payment Accounting ("ASU 2018-07"). The provisions of ASU 2018-07 align accounting for stock based compensation for non-employees for goods and services with existing accounting for similar compensation for employees. ASU 2018-07 requires an entity to remeasure liability-classified awards that have not been settled by the date of adoption and equity-classified awards for which a measurement date has not been established through a cumulative-effect adjustment to retained earnings as of January 1, 2019. Piedmont's only awards affected by ASU 2018-07 are equity-classified award grants to its independent board of directors, which have been historically recognized in the same manner prescribed by the newly adopted standard. As such, there were no cumulative effect adjustments recognized in cumulative distributions in excess of earnings upon adoption.

Reclassifications

These amounts included the presentation of approximately \$101.4 million of rental income and \$23.0 million of tenant reimbursements for the three months ended March 31, 2018, respectively, as rental and tenant reimbursement revenue of \$124.4 million. Further, certain subtotals within the accompanying consolidated statements of income for the three months ended March 31, 2018 were removed to conform to the current period presentation.

Other Recent Accounting Pronouncements

The FASB has issued ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326)*, *Measurement of Credit Losses on Financial Instruments* ("ASU 2016-13"). The provisions of ASU 2016-13 replace the "incurred loss"

approach with an "expected loss" model for impairing trade and other receivables, held-to-maturity debt securities, net investment in leases, and off-balance-sheet credit exposures, which will generally result in earlier recognition of allowances for credit losses. Additionally, the provisions change the classification of credit losses related to available-for-sale securities to an allowance, rather than a direct reduction of the amortized cost of the securities. Further, the FASB has issued ASU No. 2018-19 *Codification Improvements to Topic 326, Financial Instruments - Credit Losses*, which is effective concurrent with ASU 2016-13, and excludes receivables arising from operating leases from the scope of ASU 2016-13. ASU 2016-13 is effective in the first quarter of 2020, with early adoption permitted as of January 1, 2019. Piedmont is currently evaluating the potential impact of adoption; however, substantially all of Piedmont's receivables are operating lease receivables and as such, Piedmont does not anticipate any material impact to its consolidated financial statements as a result of adoption.

Table of Contents**3. Debt**

The following table summarizes the terms of Piedmont's indebtedness outstanding as of March 31, 2019 and December 31, 2018 (in thousands):

Facility ⁽¹⁾	Stated Rate	Effective Rate ⁽²⁾	Maturity	Amount Outstanding as of March 31, 2019	December 31, 2018
<i>Secured (Fixed)</i>					
\$35 Million Fixed-Rate Loan ⁽³⁾	5.55	% 3.75%	9/1/2021	\$29,540	\$29,706
\$160 Million Fixed-Rate Loan ⁽⁴⁾	3.48	% 3.58%	7/5/2022	160,000	160,000
Net premium and unamortized debt issuance costs				569	645
Subtotal/Weighted Average ⁽⁵⁾	3.80	%		190,109	190,351
<i>Unsecured (Variable and Fixed)</i>					
Amended and Restated \$300 Million Unsecured 2011 Term Loan	LIBOR + 1.00%	3.20% ⁽⁷⁾	11/30/2021	300,000	300,000
\$500 Million Unsecured 2018 Line of Credit ⁽⁶⁾	LIBOR + 0.90%	3.40%	9/30/2022 ⁽⁸⁾	85,000	205,000
\$350 Million Unsecured Senior Notes	3.40	% 3.43%	6/01/2023	350,000	350,000
\$400 Million Unsecured Senior Notes	4.45	% 4.10%	3/15/2024	400,000	400,000
\$250 Million Unsecured 2018 Term Loan	LIBOR + 1.60%	4.11% ⁽⁹⁾	3/31/2025	250,000	250,000
Discounts and unamortized debt issuance costs				(9,354)	(9,879)
Subtotal/Weighted Average ⁽⁵⁾	3.79	%		1,375,646	1,495,121
Total/Weighted Average ⁽⁵⁾	3.79	%		\$1,565,755	\$1,685,472

⁽¹⁾ Other than the \$35 Million Fixed-Rate Loan, all of Piedmont's outstanding debt as of March 31, 2019 and December 31, 2018 is interest-only.

⁽²⁾ Effective rate after consideration of settled or in-place interest rate swap agreements, issuance premiums/discounts, and/or fair market value adjustments upon assumption of debt.

⁽³⁾ Collateralized by the 5 Wall Street building in Burlington, Massachusetts.

⁽⁴⁾ Collateralized by the 1901 Market Street building in Philadelphia, Pennsylvania.

⁽⁵⁾ Weighted average is based on contractual balance of outstanding debt and the stated or effectively fixed interest rates as of March 31, 2019.

⁽⁶⁾ On a periodic basis, Piedmont may select from multiple interest rate options, including the prime rate and various-length LIBOR locks on all or a portion of the principal. All LIBOR selections are subject to an additional spread over the selected rate based on Piedmont's current credit rating.

⁽⁷⁾ The facility has a stated variable rate; however, Piedmont has entered into interest rate swap agreements which effectively fix, exclusive of changes in Piedmont's credit rating, the rate to that shown as the effective rate through the maturity date of the interest rate swap agreements (see [Note 4](#) for more detail).

⁽⁸⁾ Piedmont may extend the term for up to one additional year (through two available six month extensions to a final extended maturity date of September 29, 2023) provided Piedmont is not then in default and upon payment of extension fees.

⁽⁹⁾ The facility has a stated variable rate; however, Piedmont has entered into interest rate swap agreements which effectively fix, exclusive of changes to Piedmont's credit rating, \$150 million of the principal balance to 4.11% through March 29, 2020, and \$100 million of the principal balance to 4.21% from March 30, 2020 through the maturity date of the loan. For the remaining variable portion of the loan, Piedmont may periodically select from multiple interest rate options, including the prime rate and various-length LIBOR locks on all or a portion of the principal. All LIBOR selections are subject to an additional spread over the selected rate based on Piedmont's current credit rating. The rate presented is the weighted-average rate for the effectively fixed and variable portions of the debt outstanding as of March 31, 2019.

Piedmont made interest payments on all debt facilities, including interest rate swap cash settlements, of approximately \$17.6 million and \$15.9 million for the three months ended March 31, 2019 and 2018, respectively. Also, Piedmont capitalized interest of approximately \$0.5 million and \$0.1 million for the three months ended March 31, 2019 and 2018, respectively. As of March 31, 2019, Piedmont believes it was in compliance with all financial covenants associated with its debt instruments. See [Note 5](#) for a description of Piedmont's estimated fair value of debt as of March 31, 2019.

Table of Contents**4. Derivative Instruments***Risk Management Objective of Using Derivatives*

In addition to operational risks which arise in the normal course of business, Piedmont is exposed to economic risks such as interest rate, liquidity, and credit risk. In certain situations, Piedmont has entered into derivative financial instruments such as interest rate swap agreements and other similar agreements to manage interest rate risk exposure arising from current or future variable rate debt transactions. Interest rate swap agreements involve the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. Piedmont's objective in using interest rate derivatives is to add stability to interest expense and to manage its exposure to interest rate movements.

Cash Flow Hedges of Interest Rate Risk

Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for Piedmont making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

As of March 31, 2019, Piedmont was party to interest rate swap agreements, all of which are designated as effective cash flow hedges and fully hedge the variable cash flows covering the entire outstanding balance of the Amended and Restated \$300 Million Unsecured 2011 Term Loan, and \$150 million of the \$250 Million Unsecured 2018 Term Loan. The maximum length of time over which Piedmont is hedging its exposure to the variability in future cash flows for forecasted transactions is 72 months.

A detail of Piedmont's interest rate derivatives outstanding as of March 31, 2019 is as follows:

Interest Rate Derivatives:	Number of Swap Agreements	Associated Debt Instrument	Total Notional Amount (in millions)	Effective Date	Maturity Date
Interest rate swaps	3	Amended and Restated \$300 Million Unsecured 2011 Term Loan	\$ 300	11/22/2016	1/15/2020
Interest rate swaps	2	\$250 Million Unsecured 2018 Term Loan	\$ 100	3/29/2018	3/31/2025
Interest rate swaps	1	\$250 Million Unsecured 2018 Term Loan	\$ 50	3/29/2018	3/29/2020
Total			\$ 450		

Piedmont presents its interest rate derivatives on its consolidated balance sheets on a gross basis as interest rate swap assets and interest rate swap liabilities. A detail of Piedmont's interest rate derivatives on a gross and net basis as of March 31, 2019 and December 31, 2018, respectively, is as follows (in thousands):

<u>Interest rate swaps classified as:</u>	March 31, 2019	December 31, 2018
Gross derivative assets	\$554	\$ 1,199
Gross derivative liabilities	(2,443)	(839)
Net derivative asset/(liability)	\$(1,889)	\$ 360

The gain/(loss) on Piedmont's interest rate derivatives, including previously settled forward swaps, that was recorded in other comprehensive income ("OCI") and the accompanying consolidated statements of income as a component of interest expense for the three months ended March 31, 2019 and 2018, respectively, was as follows (in thousands):

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	Three Months Ended	
	March 31, 2019	March 31, 2018
<u>Interest Rate Swaps in Cash Flow Hedging Relationships</u>		
Amount of gain/(loss) recognized in OCI	\$(2,024)	\$