

Piedmont Office Realty Trust, Inc.  
Form 10-Q  
May 02, 2013  
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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, 2013

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)

11695 Johns Creek Parkway

Ste. 350

Johns Creek, Georgia 30097

(Address of principal executive offices)

(Zip Code)

(770) 418-8800

(Registrant's telephone number, including area code)

N/A

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer", and "smaller reporting 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

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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 May 1, 2013:

167,657,536 shares

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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Certain statements contained in this Form 10-Q and other written or oral statements made by or on behalf of Piedmont Office Realty Trust, Inc. (“Piedmont”) may constitute forward-looking statements within the meaning of the federal securities laws. In addition, Piedmont, 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 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 within the meaning of these laws. 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 report include descriptions of our real estate, financing, and operating objectives; discussions regarding future dividends and stock repurchases; and discussions regarding the potential impact of economic conditions on our portfolio.

These statements are based on beliefs and assumptions of Piedmont’s management, which in turn are based on currently available information. Important assumptions relating to the forward-looking statements include, among others, assumptions regarding the demand for office space in the sectors 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:

Market and economic conditions remain challenging and the demand for office space, rental rates and property values may continue to lag the general economic recovery causing our business, results of operations, cash flows, financial condition and access to capital to be adversely affected or otherwise impact performance, including the potential recognition of impairment charges;

The success of our real estate strategies and investment objectives, including our ability to identify and consummate suitable acquisitions;

Lease terminations or lease defaults, particularly by one of our large lead tenants;

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 of the office market in general and of the specific markets in which we operate, particularly in Chicago, Washington, D.C., and the New York metropolitan area;

Economic and regulatory changes, including accounting standards, that impact the real estate market generally;

Additional risks and costs associated with directly managing properties occupied by government tenants;

Adverse market and economic conditions may continue to adversely affect us and could cause us to recognize impairment charges or otherwise impact our performance;

Availability of financing and our lending banks’ ability to honor existing line of credit commitments;

Costs of complying with governmental laws and regulations;

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;

We may be subject to litigation, which could have a material adverse effect on our financial condition;

Piedmont’s ability to continue to qualify as a REIT under the Internal Revenue Code (the “Code”); and

Other factors, including the risk factors discussed under Item 1A. of Piedmont’s Annual Report on Form 10-K for the year ended December 31, 2012.

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

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PART I. FINANCIAL STATEMENTS

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

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

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, 2012. Piedmont's results of operations for the three months ended March 31, 2013 are not necessarily indicative of the operating results expected for the full year.

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## PIEDMONT OFFICE REALTY TRUST, INC.

## CONSOLIDATED BALANCE SHEETS

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

	(Unaudited)	
	March 31, 2013	December 31, 2012
Assets:		
Real estate assets, at cost:		
Land	\$666,479	\$626,076
Buildings and improvements, less accumulated depreciation of \$902,978 and \$883,008 as of March 31, 2013 and December 31, 2012, respectively	3,059,317	2,887,791
Intangible lease assets, less accumulated amortization of \$67,333 and \$67,940 as of March 31, 2013 and December 31, 2012, respectively	70,752	54,745
Construction in progress	29,487	20,373
Real estate assets held for sale, net	24,954	23,747
Total real estate assets	3,850,989	3,612,732
Investments in unconsolidated joint ventures	37,835	37,226
Cash and cash equivalents	17,575	12,957
Tenant receivables, net of allowance for doubtful accounts of \$375 and \$346 as of March 31, 2013 and December 31, 2012, respectively	153,697	145,148
Due from unconsolidated joint ventures	458	463
Restricted cash and escrows	683	334
Prepaid expenses and other assets	12,724	13,022
Goodwill	180,097	180,097
Interest rate swap	1,712	1,075
Deferred financing costs, less accumulated amortization of \$11,048 and \$10,479 as of March 31, 2013 and December 31, 2012, respectively	5,908	6,454
Deferred lease costs, less accumulated amortization of \$118,673 and \$112,289 as of March 31, 2013 and December 31, 2012, respectively	271,337	240,140
Other assets held for sale, net	5,646	5,227
Total assets	\$4,538,661	\$4,254,875
Liabilities:		
Line of credit and notes payable	\$1,699,525	\$1,416,525
Accounts payable, accrued expenses, and accrued capital expenditures	139,273	127,263
Deferred income	23,585	21,552
Intangible lease liabilities, less accumulated amortization of \$40,744 and \$40,931 as of March 31, 2013 and December 31, 2012, respectively	45,215	40,805
Interest rate swaps	8,443	8,235
Total liabilities	1,916,041	1,614,380
Commitments and Contingencies	—	—
Stockholders' Equity:		
Shares-in-trust, 150,000,000 shares authorized; none outstanding as of March 31, 2013 or December 31, 2012	—	—
Preferred stock, no par value, 100,000,000 shares authorized; none outstanding as of March 31, 2013 or December 31, 2012	—	—
Common stock, \$.01 par value, 750,000,000 shares authorized; 167,555,401 and 167,556,001 shares issued and outstanding as of March 31, 2013 and December 31, 2012, respectively.	1,676	1,676
Additional paid-in capital	3,667,614	3,667,051

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Cumulative distributions in excess of earnings	(1,041,552 )	(1,022,681 )
Other comprehensive loss	(6,731 )	(7,160 )
Piedmont stockholders' equity	2,621,007	2,638,886
Noncontrolling interest	1,613	1,609
Total stockholders' equity	2,622,620	2,640,495
Total liabilities and stockholders' equity	\$4,538,661	\$4,254,875
See accompanying notes		

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

	(Unaudited)	
	Three Months Ended	
	March 31,	
	2013	2012
Revenues:		
Rental income	\$ 108,021	\$ 103,875
Tenant reimbursements	25,652	26,513
Property management fee revenue	631	574
Other rental income	—	124
	134,304	131,086
Expenses:		
Property operating costs	52,892	51,691
Depreciation	29,420	26,852
Amortization	9,117	12,614
General and administrative	4,549	5,257
	95,978	96,414
Real estate operating income	38,326	34,672
Other income (expense):		
Interest expense	(16,373)	(16,537)
Interest and other income (expense)	(1,277)	97
Net casualty loss	(161)	—
Equity in income of unconsolidated joint ventures	395	170
	(17,416)	(16,270)
Income from continuing operations	20,910	18,402
Discontinued operations:		
Operating income	147	999
Impairment loss	(6,402)	—
Gain on sale of real estate assets	—	17,830
Income/(loss) from discontinued operations	(6,255)	18,829
Net income	14,655	37,231
Less: Net income attributable to noncontrolling interest	(4)	(4)
Net income attributable to Piedmont	\$ 14,651	\$ 37,227
Per share information – basic and diluted:		
Income from continuing operations	\$0.13	\$0.11
Income/(loss) from discontinued operations	(0.04)	0.11
Net income available to common stockholders	\$0.09	\$0.22
Weighted-average common shares outstanding – basic	167,555,407	172,629,748
Weighted-average common shares outstanding – diluted	167,810,319	172,873,930
See accompanying notes.		

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

	(Unaudited) Three Months Ended March 31,	
	2013	2012
Net income attributable to Piedmont	\$ 14,651	\$ 37,227
Other comprehensive income/(loss):		
Effective portion of loss on derivative instruments that are designated and qualify as cash flow hedges (See Note 6)	(340 )	(748 )
Less: Reclassification of previously recorded loss included in net income (See Note 6)	769	733
Other comprehensive income/(loss)	429	(15 )
Comprehensive income attributable to Piedmont	\$ 15,080	\$ 37,212

See accompanying notes

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PIEDMONT OFFICE REALTY TRUST, INC.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
FOR THE YEAR ENDED DECEMBER 31, 2012  
AND FOR THE THREE MONTHS ENDED MARCH 31, 2013 (UNAUDITED)  
(in thousands, except per share amounts)

	Common Shares	Stock Amount	Additional Paid-In Capital	Cumulative Distributions in Excess of Earnings	Other Comprehensive Loss	Non- controlling Interest	Total Stockholders' Equity
Balance, December 31, 2011	172,630	\$1,726	\$3,663,662	\$(891,032 )	\$ (2,537 )	\$ 1,609	\$2,773,428
Share repurchases as part of an announced program	(5,255 )	(52 )	—	(88,685 )	—	—	(88,737 )
Offering costs associated with the issuance of common stock	—	—	567	—	—	—	567
Dividends to common stockholders (\$0.80 per share), distributions to noncontrolling interest, and dividends reinvested	—	—	(195 )	(136,168 )	—	(15 )	(136,378 )
Shares issued under the 2007 Omnibus Incentive Plan, net of 181 tax	—	2	3,017	—	—	—	3,019
Net income attributable to noncontrolling interest	—	—	—	—	—	15	15
Net income attributable to Piedmont	—	—	—	93,204	—	—	93,204
Other comprehensive loss	—	—	—	—	(4,623 )	—	(4,623 )
Balance, December 31, 2012	167,556	1,676	3,667,051	(1,022,681 )	(7,160 )	1,609	2,640,495
Share repurchases as part of an announced program	(1 )	—	—	(11 )	—	—	(11 )
Dividends to common stockholders (\$0.20 per share), distributions to noncontrolling interest, and dividends reinvested	—	—	(59 )	(33,511 )	—	—	(33,570 )
Amortization of unvested shares granted under the 2007 Omnibus Incentive Plan	—	—	622	—	—	—	622
Net income attributable to noncontrolling interest	—	—	—	—	—	4	4
Net income attributable to Piedmont	—	—	—	14,651	—	—	14,651
Other comprehensive income	—	—	—	—	429	—	429
Balance, March 31, 2013	167,555	\$1,676	\$3,667,614	\$(1,041,552)	\$ (6,731 )	\$ 1,613	\$2,622,620

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,	
	2013	2012
Cash Flows from Operating Activities:		
Net income	\$14,655	\$37,231
Operating distributions received from unconsolidated joint ventures	463	788
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	29,684	27,606
Amortization of deferred financing costs	594	803
Other amortization	9,516	12,485
Impairment loss on real estate assets	6,402	—
Stock compensation expense	594	334
Equity in income of unconsolidated joint ventures	(395)	(170)
Gain on sale of real estate assets, net	—	(17,832)
Changes in assets and liabilities:		
Increase in tenant receivables, net	(9,685)	(3,216)
Decrease/(increase) in restricted cash and escrows	9	(16,069)
Decrease/(increase) in prepaid expenses and other assets	250	(2,659)
Decrease in accounts payable and accrued expenses	(11,122)	(6,101)
Increase in deferred income	2,033	4,709
Net cash provided by operating activities	42,998	37,909
Cash Flows from Investing Activities:		
Investments in real estate assets and related intangibles	(281,613)	(13,075)
Net sales proceeds from wholly-owned properties	3,403	24,839
Investments in unconsolidated joint ventures	(672)	—
Deferred lease costs paid	(8,870)	(5,874)
Net cash (used in)/provided by investing activities	(287,752)	5,890
Cash Flows from Financing Activities:		
Deferred financing costs paid	(47)	(12)
Proceeds from line of credit and notes payable	294,000	49,000
Repayments of line of credit and notes payable	(11,000)	(169,000)
Costs of issuance of common stock	—	(229)
Share repurchases as part of an announced program	(11)	—
Dividends paid and discount on dividend reinvestments	(33,570)	(34,569)
Net cash provided by/(used in) financing activities	249,372	(154,810)
Net increase/(decrease) in cash and cash equivalents	4,618	(111,011)
Cash and cash equivalents, beginning of period	12,957	139,690
Cash and cash equivalents, end of period	\$17,575	\$28,679
Supplemental Disclosures of Significant Noncash Investing and Financing Activities:		
Accrued capital expenditures and deferred lease costs	\$31,071	\$4,410

See accompanying notes



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PIEDMONT OFFICE REALTY TRUST, INC.  
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2013  
(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 and ownership of commercial real estate properties throughout 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 June of 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 is the sole general partner of Piedmont OP and possesses full legal control and authority over the operations of Piedmont OP. Piedmont OP owns properties directly, through wholly-owned subsidiaries, and through both consolidated and unconsolidated joint ventures. 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, 2013, Piedmont owned interests in 75 consolidated office properties, plus five buildings owned through unconsolidated joint ventures. Our 75 consolidated office properties are located in 17 metropolitan areas across the United States. These office properties comprise approximately 20.9 million square feet of primarily Class A commercial office space, and were approximately 86.0% leased as of March 31, 2013.

2. Summary of Significant Accounting Policies  
Basis of Presentation

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 U.S. generally accepted accounting principles (“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 and certain prior period amounts have been reclassified to conform to the current period financial statement presentation. The reclassifications relate to the required presentation of income from discontinued operations for properties sold and properties held for sale during the quarter ended March 31, 2013 and during the year ended December 31, 2012, respectively. Please refer to Note 10 for further details. None of these reclassifications affect net income attributable to Piedmont as presented in previous periods. Piedmont’s consolidated financial statements include the accounts of Piedmont, Piedmont’s wholly-owned subsidiaries, any variable interest entity of which Piedmont or any of its wholly-owned subsidiaries is considered the primary beneficiary, or any entity in which Piedmont or any of its wholly-owned subsidiaries owns a controlling interest. 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, 2012.

Further, Piedmont has formed special purpose entities to acquire and hold real estate. Each special purpose entity is a separate legal entity and consequently the assets of the 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.

Income Taxes

Piedmont has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the “Code”), 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. 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, which have been provided for in the financial statements.



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## 3.Acquisitions

During the quarter ended March 31, 2013, Piedmont acquired the following properties:

Property	Metropolitan Statistical Area	Date of Acquisition	Rentable Square Feet	Percentage Leased as of Acquisition	Purchase Price (in millions)
Arlington Gateway	Washington, D.C.	March 4, 2013	333,948	99 %	\$175.6
5 & 15 Wayside Road	Boston, MA	March 22, 2013	271,434	95 %	\$69.3

## 4.Tenant Receivables

Tenant receivables as of March 31, 2013 and December 31, 2012, respectively, were comprised of the following (in thousands):

	March 31, 2013	December 31, 2012
Tenant receivables, net of allowance for doubtful accounts of \$375 and \$346 as of March 31, 2013 and December 31, 2012, respectively	\$29,237	\$25,038
Cumulative rental revenue recognized on a straight-line basis in excess of cash received in accordance with lease terms	124,460	120,110
Tenant receivables, net	\$153,697	\$145,148

## 5.Line of Credit and Notes Payable

During the three months ended March 31, 2013, Piedmont incurred net borrowings of approximately \$283.0 million on its \$500 Million Unsecured Line of Credit. Piedmont also made interest payments on all debt facilities, including interest rate swap cash settlements related to certain of its debt facilities, totaling approximately \$15.7 million and \$15.8 million for the three months ended March 31, 2013 and 2012, respectively.

See Note 8 for a description of Piedmont's estimated fair value of debt as of March 31, 2013.

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The following table summarizes the terms of Piedmont's indebtedness outstanding as of March 31, 2013 and December 31, 2012 (in thousands):

Facility	Collateral	Rate <sup>(1)</sup>		Maturity	Amount Outstanding as of	
					March 31, 2013	December 31, 2012
Secured (Fixed)						
\$200.0 Million Mortgage Note	Aon Center	4.87	%	5/1/2014	\$200,000	\$200,000
\$25.0 Million Mortgage Note	Aon Center	5.70	%	5/1/2014	25,000	25,000
\$350.0 Million Secured Pooled Facility	Nine Property Collateralized Pool <sup>(2)</sup>	4.84	%	6/7/2014	350,000	350,000
\$105.0 Million Fixed-Rate Loan	US Bancorp Center	5.29	%	5/11/2015	105,000	105,000
\$125.0 Million Fixed-Rate Loan	Four Property Collateralized Pool <sup>(3)</sup>	5.50	%	4/1/2016	125,000	125,000
\$42.5 Million Fixed-Rate Loan	Las Colinas Corporate Center I & II	5.70	%	10/11/2016	42,525	42,525
\$140.0 Million WDC Mortgage Notes	1201 & 1225 Eye Street	5.76	%	11/1/2017	140,000	140,000
Subtotal/Weighted Average <sup>(4)</sup>		5.17	%		987,525	987,525
Unsecured (Variable)						
\$300 Million Unsecured Term Loan		LIBOR + 1.45%	<sup>(5)</sup>	11/22/2016	300,000	300,000
\$500 Million Unsecured Line of Credit		1.39	% <sup>(6)</sup>	8/19/2016	412,000	129,000
Subtotal/Weighted Average <sup>(4)</sup>		1.93	%		712,000	429,000
Total/ Weighted Average <sup>(4)</sup>		3.81	%		\$1,699,525	\$1,416,525

(1) All of Piedmont's outstanding debt as of March 31, 2013 and December 31, 2012 is interest-only debt.

Nine property collateralized pool includes: 1200 Crown Colony Drive, Braker Pointe III, 2 Gatehall Drive, One and Two Independence Square, 2120 West End Avenue, 400 Bridgewater Crossing, 200 Bridgewater Crossing, and Fairway Center II.

(2) and Four property collateralized pool includes 1430 Enclave Parkway, Windy Point I and II, and 1055 East Colorado Boulevard.

(3) Weighted average is based on contractual balance of outstanding debt and interest rates in the table as of March 31, 2013.

The \$300 Million Unsecured Term Loan has a stated variable rate; however, Piedmont entered into interest rate swap agreements which effectively fix, exclusive of changes to Piedmont's credit rating, the rate on this facility to 2.69%.

Piedmont may select from multiple interest rate options with each draw, including the prime rate and various-length LIBOR locks. All LIBOR selections are subject to an additional spread (1.175% as of March 31, 2013) over the selected rate based on Piedmont's current credit rating. The outstanding balance as of March 31, 2013 consisted of 30-day LIBOR draws at 0.21% (subject to the additional spread mentioned above).

## 6. 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.

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## 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 changing the underlying notional amount. During the three months ended March 31, 2013, Piedmont used interest rate swap agreements to hedge the variable cash flows associated with its \$300 Million Unsecured Term Loan.

Additionally, during the three months ended March 31, 2013, Piedmont entered into a forward starting swap with a total notional value of \$70 million to hedge the risk of changes in the interest-related cash flows associated with the potential issuance of long-term debt. Piedmont is hedging its exposure to the variability in future cash flows for forecasted transactions over a maximum period of 131 months (excluding forecasted transactions related to the payment of variable interest on existing financial instruments). As of March 31, 2013, \$140 million has been hedged associated with Piedmont's potential incurrence of long-term debt.

A detail of Piedmont's interest rate derivatives outstanding as of March 31, 2013 is as follows:

Interest Rate Derivative	Notional Amount (in millions)	Effective Date	Maturity Date
Interest rate swap	\$ 125	11/22/2011	11/22/2016
Interest rate swap	75	11/22/2011	11/22/2016
Interest rate swap	50	11/22/2011	11/22/2016
Interest rate swap	50	11/22/2011	11/22/2016
Interest rate swap	70	3/3/2014	3/3/2024
Interest rate swap	70	3/3/2014	3/3/2024
Total	\$ 440		

Piedmont has elected to present its interest rate derivatives on its consolidated balance sheets on a gross basis as interest rate swap asset and interest rate swap liabilities. A detail of Piedmont's interest rate derivatives on a gross and net basis as of March 31, 2013 and December 31, 2012, respectively, is as follows:

Interest rate swaps classified as:	March 31, 2013	December 31, 2012
Gross derivative assets	\$1,712	\$1,075
Gross derivative liabilities	(8,443)	(8,235)
Net derivative asset/(liability)	\$(6,731)	\$(7,160)

All of Piedmont's interest rate derivative agreements outstanding for the periods presented were designated as cash flow hedges of interest rate risk. As such, the effective portion of changes in the fair value of these derivatives designated as, and that qualify as, cash flow hedges is recorded in other comprehensive income ("OCI") and is reclassified into earnings as interest expense in the period that the hedged forecasted transaction affects earnings. The effective portion of Piedmont's interest rate derivatives that was recorded in the accompanying consolidated statements of income for the three months ended March 31, 2013 and 2012, respectively, is follows:

Derivative in Cash Flow Hedging Relationships (Interest Rate Swaps) (in thousands)	Three Months Ended	
	March 31, 2013	March 31, 2012
Amount of loss recognized in OCI on derivative	\$ 340	\$ 748
Amount of previously recorded loss reclassified from accumulated OCI into interest expense	\$(769)	\$(733)

Piedmont estimates that approximately \$3.2 million will be reclassified from accumulated other comprehensive loss to interest expense over the next twelve months. No gain or loss was recognized related to hedge ineffectiveness or to amounts excluded from effectiveness testing on Piedmont's cash flow hedges during the three months ended March 31, 2013 or 2012.

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Additionally, see Note 8 for fair value disclosures of Piedmont's derivative instruments.

Credit-risk-related Contingent Features

Piedmont has agreements with its derivative counterparties that contain a provision whereby if Piedmont defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then Piedmont could also be declared in default on its derivative obligations. If Piedmont were to breach any of the contractual provisions of the derivative contracts, it would be required to settle its obligations under the agreements at their termination value of the fair values plus accrued interest, or approximately \$8.7 million. Additionally, Piedmont does have rights of set-off under certain of its derivative agreements related to potential termination fees and amounts payable under the agreements, if a termination were to occur.

7. Variable Interest Entities

Variable interest holders who have the power to direct the activities of the VIE that most significantly impact the entity's economic performance and have the obligation to absorb the majority of losses of the entity or the right to receive significant benefits of the entity are considered to be the primary beneficiary and must consolidate the VIE. A summary of Piedmont's interests in and consolidation treatment of its VIEs as of March 31, 2013 is as follows (net carrying amount in millions):

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Entity	Piedmont's % Ownership of Entity	Related Building	Consolidated/ Unconsolidated	Net Carrying Amount as of March 31, 2013	Net Carrying Amount as of December 31, 2012	Primary Beneficiary Considerations
1201 Eye Street NW Associates, LLC	49.5%	1201 Eye Street	Consolidated	\$ (5.4 )	\$ (5.7 )	In accordance with the partnership's governing documents, Piedmont is entitled to 100% of the cash flow of the entity and has sole discretion in directing the management and leasing activities of the building.
1225 Eye Street NW Associates, LLC	49.5%	1225 Eye Street	Consolidated	\$ 0.6	\$ (0.1 )	In accordance with the partnership's governing documents, Piedmont is entitled to 100% of the cash flow of the entity and has sole discretion in directing the management and leasing activities of the building.
Piedmont 500 W. Monroe Fee, LLC	100%	500 W. Monroe	Consolidated	\$ 208.4	\$ 194.0	The Omnibus Agreement with the previous owner includes equity participation rights for the previous owner, if certain financial returns are achieved; however, Piedmont has sole decision making authority and is entitled to the economic benefits of the property until such returns are met.
Suwanee Gateway One, LLC	100%	Suwanee Gateway One	Consolidated	\$ 7.5	\$ 7.6	The fee agreement includes equity participation rights for the incentive manager, if certain returns on investment are achieved; however, Piedmont has sole decision making authority and is entitled to the economic benefits of the property until such returns are met.
Medici Atlanta, LLC	100%	The Medici	Consolidated	\$ 14.3	\$ 13.7	The fee agreement includes equity

400 TownPark, LLC	100%	400 TownPark	Consolidated	\$ 23.2	\$ 23.5	<p>participation rights for the incentive manager, if certain returns on investment are achieved; however, Piedmont has sole decision making authority and is entitled to the economic benefits of the property until such returns are met.</p> <p>The fee agreement includes equity participation rights for the incentive manager, if certain returns on investment are achieved; however, Piedmont has sole decision making authority and is entitled to the economic benefits of the property until such returns are met.</p>
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Each of the VIEs described above has the sole purpose of holding office buildings and their resulting operations, and are classified in the accompanying consolidated balance sheets in the same manner as Piedmont's wholly-owned properties.

8.Fair Value Measurement of Financial Instruments

Piedmont considers its cash, accounts receivable, restricted cash and escrows, accounts payable and accrued expenses, interest rate swap agreements, and line of credit and notes payable to meet the definition of financial instruments. The following table sets forth the carrying and estimated fair value for each of Piedmont's financial instruments as of March 31, 2013 and December 31, 2012, respectively (in thousands):



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Financial Instrument	2013			2012		
	Carrying Value	Estimated Fair Value	Level Within Fair Value Hierarchy	Carrying Value	Estimated Fair Value	Level Within Fair Value Hierarchy
<b>Assets:</b>						
Cash and cash equivalents <sup>(1)</sup>	\$ 17,575	\$ 17,575	Level 1	\$ 12,957	\$ 12,957	Level 1
Tenant receivables, net <sup>(1)</sup>	\$ 156,367	\$ 156,367	Level 1	\$ 147,337	\$ 147,337	Level 1
Restricted cash and escrows <sup>(1)</sup>	\$ 683	\$ 683	Level 1	\$ 334	\$ 334	Level 1
Interest rate swap asset	\$ 1,712	\$ 1,712	Level 2	\$ 1,075	\$ 1,075	Level 2
<b>Liabilities:</b>						
Accounts payable and accrued expenses <sup>(1)</sup>	\$ 21,103	\$ 21,103	Level 1	\$ 23,113	\$ 23,113	Level 1
Interest rate swap liability	\$ 8,443	\$ 8,443	Level 2	\$ 8,235	\$ 8,235	Level 2
Line of credit and notes payable	\$ 1,699,525	\$ 1,750,284	Level 2	\$ 1,416,525	\$ 1,470,002	Level 2

<sup>(1)</sup> For the periods presented, the carrying value approximates estimated fair value due to its short-term maturity.

Piedmont's line of credit and notes payable were carried at book value as of March 31, 2013 and December 31, 2012; however, Piedmont's estimate of their fair value is disclosed in the table above. Piedmont uses widely accepted valuation techniques including discounted cash flow analysis based on the contractual terms of the debt facilities, including the period to maturity of each instrument, and uses observable market-based inputs for similar debt facilities which have transacted recently in the market. Therefore, the fair values determined are considered to be based on significant other observable inputs (Level 2). Scaling adjustments are made to these inputs to make them applicable to the remaining life of Piedmont's outstanding debt. Piedmont has not changed its valuation technique for estimating the fair value of its line of credit and notes payable.

Piedmont's interest rate swap agreements discussed in Note 6 above are classified as "Interest rate swap" assets and liabilities in the accompanying consolidated balance sheets and were carried at fair value as of March 31, 2013 and December 31, 2012. The valuation of these derivative instruments was determined using widely accepted valuation techniques including discounted cash flow analysis based on the contractual terms of the derivatives, including the period to maturity of each instrument, and uses observable market-based inputs, including interest rate curves and implied volatilities. Therefore, the fair values determined are considered to be based on significant other observable inputs (Level 2). In addition, Piedmont considered both its own and the respective counterparties' risk of nonperformance in determining the fair value of its derivative financial instruments by estimating the current and potential future exposure under the derivative financial instruments that both Piedmont and the counterparties were at risk for as of the valuation date. The credit risk of Piedmont and its counterparties was factored into the calculation of the estimated fair value of the interest rate swaps; however, as of March 31, 2013 and December 31, 2012, this credit valuation adjustment did not comprise a material portion of the estimated fair value. Therefore, Piedmont believes that any unobservable inputs used to determine the fair values of its derivative financial instruments are not significant to the fair value measurements in their entirety, and does not consider any of its derivative financial instruments to be Level 3 assets or liabilities.

## 9. Commitments and Contingencies

### Commitments Under Existing Agreements

Certain lease agreements include provisions that, at the option of the tenant, may obligate Piedmont to provide funding for capital improvements. Under its existing lease agreements, Piedmont may be required to fund significant tenant improvements, leasing commissions, and building improvements. In addition, certain agreements contain provisions that require Piedmont to issue corporate or property guarantees to provide funding for capital improvements or other financial obligations. Further, Piedmont classifies such tenant and building improvements into two classes: (i) improvements which incrementally enhance the building's asset value by expanding its revenue generating capacity ("incremental capital expenditures") and (ii) improvements which maintain the building's existing asset value and its revenue generating capacity ("non-incremental capital expenditures"). As of March 31, 2013, Piedmont anticipates funding potential non-incremental capital expenditures for tenant improvements of approximately \$98.5 million related to its existing lease portfolio over the respective lease terms, the majority of which Piedmont estimates may be required to be funded over the next several years. For most of Piedmont's leases, the timing of the actual funding of these tenant improvements is largely dependent upon tenant requests for reimbursement. In some cases, these obligations may expire with the leases without further recourse to Piedmont.

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Additionally, as of March 31, 2013, commitments for incremental capital expenditures associated with new leases, primarily at value-add properties, totaled approximately \$42.3 million.

## Contingencies Related to Tenant Audits/Disputes

Certain lease agreements include provisions that grant tenants the right to engage independent auditors to audit their annual operating expense reconciliations. Such audits may result in the re-interpretation of language in the lease agreements which could result in the refund of previously recognized tenant reimbursement revenues, resulting in financial loss to Piedmont. Piedmont recorded no significant reserves as additional expense related to such tenant audits/disputes during the three months ended March 31, 2013 or 2012, respectively.

## Letters of Credit

As of March 31, 2013, Piedmont was subject to the following letters of credit, which reduce the total outstanding capacity under its \$500 Million Unsecured Line of Credit:

Amount	Expiration of Letter of Credit <sup>(1)</sup>
\$ 10,000,000	July 2013
\$9,033,164	July 2013
\$382,556	July 2013

<sup>(1)</sup> These letter of credit agreements automatically renew for consecutive, one-year periods each anniversary, subject to the satisfaction of the credit obligation and certain other limitations.

## Agreements to Resolve Legal Actions

Piedmont and certain of its current and former officers and directors were party to two separate securities class action lawsuits

which challenged various disclosures made in connection with Piedmont's April 2007 internalization transaction in one case and a response to a May 2007 tender offer for Piedmont's shares and an October 2007 proxy statement seeking approval of amendments to Piedmont's charter in the other case. (Please refer to Part II, Item 1, "Legal Proceedings" for a complete description of the chronology of the two lawsuits). During the year ended December 31, 2012, after receiving favorable rulings including the dismissal of all claims in both cases, Piedmont reached agreement in principle to settle both lawsuits, thus avoiding additional legal expense associated with any further appeals by the plaintiffs. As a result, during the year ended December 31, 2012, Piedmont recorded a \$7.5 million litigation settlement charge. Following notice to the classes, the settlements were granted final approval by the court on April 18, 2013. The time period for appealing the final approval expires May 20, 2013, at which time the cases will be fully and finally concluded except for administration of the settlement. Until the appeals period expires, the possibility of further financial loss does exist; however, management has concluded that such risk of loss is remote.

## 10. Discontinued Operations

Piedmont has classified the results of operations related to the following properties as discontinued operations (in thousands):

Building(s) Sold	Location	Date of Sale	Gain/(Loss) on Sale	Net Sales Proceeds
Portland Portfolio <sup>(1)</sup>	Beaverton, Oregon	March 19, 2012	\$17,823	\$43,832
26200 Enterprise Way	Lake Forest, California	May 31, 2012	\$10,013	\$24,412
110 & 112 Hidden Lake Circle Buildings	Duncan, South Carolina	September 21, 2012	\$(259	) \$25,595

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1111 Durham Avenue	South Plainfield, New Jersey	March 28, 2013	\$—	\$3,403
1200 Enclave Parkway <sup>(2)</sup>	Houston, Texas	Held for Sale <sup>(2)</sup>	N/A	N/A

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- (1) The Portland Portfolio consisted of four office properties known as the Deschutes building, the Rhein building, the Rogue building, and the Willamette building, as well as 18.19 acres of adjoining, undeveloped land. On March 22, 2013, Piedmont entered into a binding agreement to sell the 1200 Enclave Parkway building with an expected close of May 2013, and in accordance with GAAP, Piedmont reclassified the building from real estate
- (2) assets held-for-use to real estate assets held-for-sale on its consolidated balance sheet as of March 31, 2013. As such, Piedmont reclassified the operational results of the property as income from discontinued operations for prior periods to conform with current period presentation.

## Sale of 1111 Durham Avenue building

In accordance with GAAP during the quarter ended March 31, 2013, Piedmont re-classified the 1111 Durham Avenue building in South Plainfield, New Jersey from real estate assets held-for-use (at cost) to real estate assets held for sale (at estimated fair value) and recorded an impairment charge of \$6.4 million, which represents the difference in carrying value of the asset at the time the asset met the held for sale criteria. The fair value measurement used in the evaluation of this non-financial asset is considered to be a Level 1 valuation within the fair value hierarchy as defined by GAAP, as there are direct observations and transactions involving the asset. After assessing the age of the building (constructed in 1975) and leasing prospects, Piedmont determined that the sales price should appropriately represent the land value of the asset. As a result, Piedmont disposed of the 1111 Durham Avenue building for a gross sale price of approximately \$4.0 million, exclusive of closing costs. The transaction closed on March 28, 2013.

## Assets Held-for-Sale

The details comprising assets held for sale, consisting solely of the 1200 Enclave Parkway building, are presented below (in thousands):

	March 31, 2013	December 31, 2012
Real estate assets held for sale, net:		
Land	\$3,460	\$3,460
Building and improvements, less accumulated depreciation of \$1,155 and \$949 as of March 31, 2013 and December 31, 2012, respectively	21,136	20,287
Construction in progress	358	—
Total real estate assets held for sale, net	\$24,954	\$23,747
Other assets held for sale:		
Straight-line rent	\$2,670	\$2,189
Deferred lease costs, less accumulated amortization of \$268 and \$207 as of March 31, 2013 and December 31, 2012, respectively	2,976	3,038
Total other assets held for sale, net	\$5,646	\$5,227

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## Income/(loss) from Discontinued Operations

The details comprising income/(loss) from discontinued operations are presented below (in thousands):

	March 31, 2013	2012
Revenues:		
Rental income	\$962	\$2,680
Tenant reimbursements	247	459
Property management fee revenue	—	—
Other rental income	—	—
	1,209	3,139
Expenses:		
Property operating costs	749	1,197
Depreciation	264	754
Amortization of deferred leasing costs	61	186
General and administrative expenses	—	3
	1,074	2,140
Other income (expense):		
Interest expense	—	—
Interest and other income	12	—
Net income attributable to noncontrolling interest	—	—
	12	—
Operating income, excluding gain/(loss) on sale	147	999
Impairment loss	(6,402	) —
Gain/(loss) on sale of real estate assets	—	17,830
Income/(loss) from discontinued operations	\$(6,255	) \$18,829

## 11. Stock Based Compensation

## Deferred Stock Awards

Piedmont has granted deferred stock awards in the form of restricted stock to its employees. The awards are determined by the Compensation Committee of the board of directors of Piedmont on an annual basis and typically vest over a three-year period beginning on the grant date. In addition, Piedmont has adopted a multi-year performance share program for certain of its employees. Restricted shares are earned based on the relative performance of Piedmont's total stockholder return as compared with a predetermined peer group's total stockholder return over a three-year period. Typically, shares are not awarded until after the end of the third year in the performance period and vest immediately upon award; however, the inaugural performance share program, which covers the fiscal 2010-2012 performance period, contains three interim performance periods whereby shares may be awarded.

A rollforward of Piedmont's deferred stock award activity for the three months ended March 31, 2013 is as follows:

Unvested Deferred Stock Awards as of January 1, 2013	Deferred Stock Awards Granted During Three	Adjustment to Estimated Future Grants of Performance Share	Deferred Stock Awards Vested During Three Months Ended March 31, 2013	Deferred Stock Awards Forfeited During Three Months Ended March 31,	Unvested Deferred Stock Awards as of March 31, 2013
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		Months Ended March 31, 2013	Awards During Three Months Ended March 31, 2013		2013	
Shares	318,893	—	50,155	—	(456	) 368,592
Weighted-Average Grant Date Fair Value (per share)	\$18.41	\$—	\$18.27	\$—	\$17.60	\$18.39

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A detail of Piedmont's outstanding employee deferred stock awards as of March 31, 2013 is as follows:

Date of grant	Type of Award	Net Shares Granted <sup>(1)</sup>	Grant Date Fair Value	Vesting Schedule	Unvested Shares as of March 31, 2013	
May 11, 2010	Fiscal Year 2010-2012 Performance Share Program	56,875	<sup>(2)</sup> \$28.44	Shares vest immediately upon determination of award in 2013.	5,266	<sup>(3)</sup>
May 24, 2010	Annual Deferred Stock Award	161,148	\$18.71	Of the shares granted, 25% vested on the date of grant, and 25% vested or will vest on May 24, 2011, 2012, and 2013, respectively.	52,964	
May 24, 2010	One-Time Special Deferred Stock Award in Recognition of Piedmont's Initial Public Offering	40,085	\$18.71	Of the shares granted, 33.33% vested or will vest on May 24, 2011, 2012, and 2013, respectively.	17,457	
April 5, 2011	Annual Deferred Stock Award	128,986	\$19.40	Of the shares granted, 25% vested on the date of grant, and 25% vested or will vest on April 5, 2012, 2013, and 2014, respectively.	74,470	
April 5, 2011	Fiscal Year 2011-2013 Performance Share Program	—	\$18.27	Shares awarded, if any, will vest immediately upon determination of award in 2014.	50,155	<sup>(4)</sup>
April 4, 2012	Annual Deferred Stock Award	209,876	\$17.49	Of the shares granted, 25% vested on the date of grant, and 25% will vest on April 4, 2013, 2014, and 2015, respectively.	168,280	
April 4, 2012	Fiscal Year 2012-2014 Performance Share Program	—	\$17.42	Shares awarded, if any, will vest immediately upon determination of award in 2015.	—	<sup>(4)</sup>
Total					368,592	

<sup>(1)</sup> Amounts reflect the total grant, net of shares surrendered upon vesting to satisfy required minimum tax withholding obligations through March 31, 2013.

<sup>(2)</sup> Represents net shares granted as of the end of the second interim performance period ended December 31, 2011.

<sup>(3)</sup> Calculated based on Piedmont's cumulative total stockholder return for the respective performance period through December 31, 2012.

Estimated based on Piedmont's cumulative total stockholder return for the respective performance period through

<sup>(4)</sup> March 31, 2013. Such estimates are subject to change in future periods based on both Piedmont's and its peers' stock performance and dividends paid.



During the three months ended March 31, 2013 and 2012, respectively, Piedmont recognized approximately \$0.6 million and \$0.3 million of compensation expense related to stock awards, all of which related to the amortization of nonvested shares. As of March 31, 2013, approximately \$1.6 million of unrecognized compensation cost related to nonvested, annual deferred stock awards remained, which Piedmont will record in its consolidated statements of income over a weighted-average vesting period of approximately one year.

## 12.Earnings Per Share

There are no adjustments to “Net income attributable to Piedmont” or “Income from continuing operations” for the diluted earnings per share computations.

Net income per share-basic is calculated as net income available to common stockholders divided by the weighted average number of common shares outstanding during the period. Net income per share-diluted is calculated as net income available to common stockholders divided by the diluted weighted average number of common shares outstanding during the period, including nonvested restricted stock. Diluted weighted average number of common shares is calculated to reflect the potential dilution under the treasury

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stock method that would occur as if the remaining unvested restricted stock awards has vested and resulted in additional common shares outstanding.

The following table reconciles the denominator for the basic and diluted earnings per share computations shown on the consolidated statements of income for the three months ended March 31, 2013 and 2012, respectively:

	Three Months Ended March 31,	
	2013	2012
Weighted-average common shares – basic	167,555	172,630
Plus incremental weighted-average shares from time-vested conversions:		
Restricted stock awards	255	244
Weighted-average common shares – diluted	167,810	172,874

### 13. Other Subsequent Events

#### Second Quarter Dividend Declaration

On May 2, 2013, the board of directors of Piedmont declared dividends for the second quarter of 2013 in the amount of \$0.20 per common share outstanding to stockholders of record as of the close of business on May 31, 2013. Such dividends are to be paid on June 21, 2013.

#### Sale of the 1200 Enclave Building

On May 1, 2013, Piedmont closed on the sale of the 1200 Enclave Parkway building in Houston, Texas, for approximately \$48.8 million with an unrelated, third-party purchaser. The building, which was purchased by Piedmont in March 2011, contains approximately 150,000 square feet and is approximately 100% leased. Further, Piedmont was engaged by the purchaser to manage the property for a five-year term at a market-based fee.

#### Final Approval of Litigation Settlement Agreements

Following notice to the classes, the litigation settlement agreements were granted final approval by the court on April 18, 2013. See Note 9 for further detail.

#### Additional Interest Rate Derivative Agreements

During April 2013, Piedmont entered into four additional forward starting swaps with a total notional value of \$390 million to hedge the risk of changes in the interest-related cash flows associated with the potential incurrence of long-term debt.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the accompanying consolidated financial statements and notes thereto of Piedmont Office Realty Trust, Inc. ("Piedmont"). See also "Cautionary Note Regarding Forward-Looking Statements" preceding Part I, as well as the notes to our consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2012.

Liquidity and Capital Resources

We intend to use cash flows generated from the operation of our wholly-owned properties, distributions from our joint ventures, proceeds from selective property dispositions, and proceeds from our \$500 Million Unsecured Line of Credit as our primary sources of immediate liquidity. Depending on the timing and volume of our property acquisition and disposition activities and debt maturities, we may also seek other financing opportunities (such as issuance of additional equity or debt securities or additional borrowings from third-party lenders) afforded to us based on our relatively low leverage and quality asset base as additional sources of capital; however, the availability and attractiveness of terms for these sources of capital is highly dependent on market conditions. As of the time of this filing, we had \$422.0 million outstanding under our \$500 Million Unsecured Line of Credit. As a result, we had approximately \$58.6 million under this facility available for future borrowing (approximately \$19.4 million of capacity is reserved as security for outstanding letters of credit required by various third parties).

We estimate that our most consistent use of capital will be to fund capital expenditures for our existing portfolio of properties. These expenditures include two types of specifically identified building improvement projects: (i) general repair and maintenance projects that we as the owner may choose to perform at our discretion at any of our various properties and (ii) tenant improvement allowances and leasing commissions that we have committed to as part of executed leases with our tenants. Due to the high lease rollover that we have experienced over the last several years, the majority of our expected capital expenditures relate to leasing commissions and tenant improvement allowances as we complete tenant build outs in preparation for the commencement of recently executed leases. During the year ended December 31, 2012 and the three months ended March 31, 2013, we incurred obligations totaling approximately \$5.39 and \$2.91 per square foot per year of lease term, respectively, for such capital expenditures. As of March 31, 2013, unrecorded contractual obligations for non-incremental tenant improvements related to our existing lease portfolio totaled \$98.5 million. The timing of the funding of these commitments is largely dependent upon tenant requests for reimbursement; however, we would anticipate that the majority of this amount would be requested over the next 24-36 months as certain significant leases commence. In some instances, these obligations may expire with the respective lease, without further recourse to us. Additionally, commitments for incremental capital expenditures associated with new leases, primarily at value-add properties, total approximately \$42.3 million.

We also anticipate incurring market-based concession packages, typically consisting of the tenant allowances described above and/or rent abatement periods, and paying broker commissions in conjunction with the commencement of recently executed leases. In addition, we anticipate continuing to grant such concession packages as we negotiate future leases. Given our average lease size of between 35,000 and 40,000 square feet, some of the concession packages that we grant can result in significant capital outlays. In particular, during 2013 there are three blocks of space in excess of 200,000 square feet in our Washington, D.C portfolio that will become subject to re-leasing negotiations, and we may grant similar concession packages to secure new, or renew existing, tenants for those buildings. Both the timing and magnitude of these amounts have yet to be determined and are highly dependent on competitive market conditions at the time of lease negotiations.

Subject to the identification and availability of attractive investment opportunities and our ability to consummate additional acquisitions on satisfactory terms, acquiring new assets compatible with our investment strategy could also be a significant use of capital. During the three months ended March 31, 2013, we acquired two properties, Arlington

Gateway in the Washington, D.C. market and 5 & 15 Wayside Road in the Boston, Massachusetts market. Both purchases were funded using our \$500 Million Unsecured Line of Credit and resulted in a combined draw of approximately \$247.0 million. Further, our board of directors has authorized a repurchase program for our common stock for use when we believe that our stock is trading at a meaningful discount to what we believe the fair value of our assets to be. From the initial authorization in November 2011 through March 31, 2013, we have expended approximately \$92.0 million under the stock repurchase program (including transactions fees) and may continue to make additional purchases as market conditions warrant. Approximately \$208.0 million of authorized capacity remains on the program which could be spent prior to the program's expiration on November 2, 2013.

On a longer term basis, we expect to use capital to repay debt when obligations become due. We currently have no debt maturing in 2013; however, as mentioned above, we currently have \$422.0 million outstanding on our line of credit primarily as the result of our recent property acquisitions and we have \$575 million of secured debt maturing in 2014. Subject to our assessment of

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market conditions, we currently anticipate refinancing these amounts with unsecured debt. In anticipation of such an incurrence and considering the recent historically low interest rate environment, we have entered into several forward starting interest rate swaps cumulatively totaling a notional value of \$530 million to partially protect the Company against rising interest rates and to lock a portion of the interest rate on any future unsecured debt. Again, subject to our assessment of market conditions, we may enter into additional similar swaps during the next twelve months.

The amount and form of payment (cash or stock issuance) of future dividends to be paid to our stockholders will continue to be

largely dependent upon (i) the amount of cash generated from our operating activities; (ii) our expectations of future cash flows; (iii) our determination of near-term cash needs for debt repayments and selective acquisitions of new properties; (iv) the timing of significant expenditures for tenant improvements and general property capital improvements; (v) long-term payout ratios for comparable companies; (vi) our ability to continue to access additional sources of capital, including potential sales of our properties; and (vii) the amount required to be distributed to maintain our status as a REIT. Given the fluctuating nature of cash flows and expenditures, we may periodically borrow funds on a short-term basis to cover timing differences in cash receipts and cash disbursements.

## Results of Operations

## Overview

Our income from continuing operations increased from \$0.11 per share for the three months ended March 31, 2012 to \$0.13 per share for the three months ended March 31, 2013 primarily due to higher rental income in the current period as a result of new leases commencing in our existing portfolio of properties, as well as leases acquired upon the acquisition in March 2013 of the Arlington Gateway building in Arlington, Virginia.

Comparison of the three months ended March 31, 2013 versus the three months ended March 31, 2012

The following table sets forth selected data from our consolidated statements of income for the three months ended March 31, 2013 and 2012, respectively, as well as each balance as a percentage of total revenues for the same periods presented (dollars in millions):

	March 31, 2013	%	March 31, 2012	%	\$ Increase (Decrease)
Revenue:					
Rental income	\$108.0		\$103.9		\$4.1
Tenant reimbursements	25.7		26.5		(0.8 )
Property management fee revenue	0.6		0.6		—
Other rental income	—		0.1		(0.1 )
Total revenues	134.3	100	% 131.1	100	% 3.2
Expense:					
Property operating costs	52.9	39	% 51.7	39	% 1.2
Depreciation	29.4	22	% 26.9	20	% 2.5
Amortization	9.1	7	% 12.6	10	% (3.5 )
General and administrative expense	4.5	3	% 5.3	4	% (0.8 )
Real estate operating income	38.4	29	% 34.6	27	% 3.8
Other income (expense):					
Interest expense	(16.4 )	(12 )	% (16.5 )	(13 )	% 0.1
Interest and other income	(1.3 )	(1 )	% 0.1	—	% (1.4 )

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Net casualty loss	(0.2	) —	% —	—	% (0.2	)
Equity in income of unconsolidated joint ventures	0.4	—	% 0.2	—	% 0.2	
Income from continuing operations	\$20.9	16	% \$18.4	14	% \$2.5	
Income/(loss) from discontinued operations	\$(6.3	)	\$18.8		\$(25.1	)

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### Continuing Operations

#### Revenue

Rental income increased from approximately \$103.9 million for the three months ended March 31, 2012 to approximately \$108.0 million for the three months ended March 31, 2013. Approximately \$2.9 million of the increase is attributable to new leases commencing and lease renewals at our Piedmont Pointe II building in Bethesda, Maryland, our Aon Center and 500 W. Monroe buildings in Chicago, Illinois, and our River Corporate Center building in Tempe, Arizona subsequent to January 1, 2012. Properties acquired during the current period, mainly the Arlington Gateway building in Arlington, Virginia, provided an additional \$1.2 million of rental income.

Tenant reimbursements decreased from approximately \$26.5 million for the three months ended March 31, 2012 to approximately \$25.7 million for the three months ended March 31, 2013. The variance is mainly attributable to an approximate \$1.0 million reduction in tenant reimbursements as a result of reimbursement abatements granted on a large lease renewal at the 500 W. Monroe building.

#### Expense

Property operating costs increased approximately \$1.2 million for the three months ended March 31, 2013 compared to the same period in the prior year as the result of an increase in property taxes across our portfolio of properties.

Depreciation expense increased approximately \$2.5 million for the three months ended March 31, 2013 compared to the same period in the prior year. The variance is largely attributable to depreciation on additional tenant and building improvements placed in service subsequent to January 1, 2012 which contributed approximately \$2.1 million of the increase. The remainder of the increase is due to new properties acquired during the current period.

Amortization expense decreased approximately \$3.5 million for the three months ended March 31, 2013 compared to the same period in the prior year. The variance is primarily attributable to reduced amortization expense as a result of lease intangible assets becoming fully amortized at certain of our existing properties subsequent to January 1, 2012. However, this decrease was partially offset by approximately \$1.4 million of additional amortization expense related to intangible assets assumed upon the acquisition of the Arlington Gateway building during the current period.

General and administrative expenses decreased approximately \$0.8 million for the three months ended March 31, 2013 compared to the same period in the prior year. The decrease is primarily attributable to increased recoveries from our insurance carriers related to our litigation defense, partially offset by the non-recurrence of bad debt recoveries from the prior year.

#### Other Income (Expense)

Interest and other income decreased approximately \$1.4 million for the three months ended March 31, 2013 compared to the same period in the prior year. The decrease reflects approximately \$1.2 million of costs associated with the acquisitions of the Arlington Gateway building and the 5 & 15 Wayside Road building during the current period.

### Discontinued Operations

In accordance with GAAP, the operations of the Portland Portfolio, the 26200 Enterprise Way building in Lake Forest, California, and the 110 and 112 Hidden Lake Circle buildings in Duncan, South Carolina, the 1111 Durham Avenue building in South Plainfield, New Jersey and the 1200 Enclave Parkway building in Houston, Texas (which is held for sale) are classified as discontinued operations for all periods presented. Income from discontinued operations

decreased approximately \$25.1 million for the three months ended March 31, 2013 compared to the same period in the prior year. The decrease is primarily due to the net gain realized on the sale of the Portland Portfolio in the prior period of approximately \$17.8 million. Additionally, we recorded an impairment charge of approximately \$6.4 million in the current period to reflect the difference in carrying value of the 1111 Durham Avenue building at the time the asset met the held for sale criteria and its estimated fair value. We do not expect that income from discontinued operations will be comparable to future periods, as such income is subject to the timing and existence of future property dispositions.



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Funds From Operations (“FFO”), Core FFO, and Adjusted Funds from Operations (“AFFO”)

Net income calculated in accordance with GAAP is the starting point for calculating FFO, Core FFO, and AFFO. FFO, Core FFO, and AFFO are non-GAAP financial measures and should not be viewed as an alternative measurement of our operating performance to net income. Management believes that accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values have historically risen or fallen with market conditions, many industry investors and analysts have considered the presentation of operating results for real estate companies that use historical cost accounting to be insufficient by themselves. As a result, we believe that the use of FFO, Core FFO, and AFFO, together with the required GAAP presentation, provides a more complete understanding of our performance relative to our competitors and a more informed and appropriate basis on which to make decisions involving operating, financing, and investing activities.

We calculate FFO in accordance with the current NAREIT definition as follows: Net income (computed in accordance with GAAP), excluding gains or losses from sales of property and impairment charges (including our proportionate share of any impairment charges and/or gains or losses from sales of property related to investments in unconsolidated joint ventures), plus depreciation and amortization on real estate assets (including our proportionate share of depreciation and amortization related to investments in unconsolidated joint ventures). Other REITs may not define FFO in accordance with the National Association of Real Estate Investment Trusts (“NAREIT”) definition, or may interpret the current NAREIT definition differently than we do; therefore, our computation of FFO may not be comparable to such other REITs.

We calculate Core FFO as FFO (calculated as set forth above) exclusive of the net effects of acquisition costs and significant, non-recurring items.

We calculate AFFO as Core FFO (calculated as set forth above) exclusive of the net effects of: (i) amortization associated with deferred financing costs; (ii) depreciation of non real estate assets; (iii) straight-line lease revenue/expense; (iv) amortization of above and below-market lease intangibles; (v) stock-based and other non-cash compensation expense; (vi) amortization of mezzanine discount income; (vii) acquisition costs, and (viii) non-incremental capital expenditures (as defined below). Our proportionate share of such adjustments related to investments in unconsolidated joint ventures are also included when calculating AFFO.

Reconciliations of net income to FFO, Core FFO, and AFFO are presented below (in thousands except per share amounts):

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	Three Months Ended March 31,			
	2013	Per Share <sup>(1)</sup>	2012	Per Share <sup>(1)</sup>
Net income attributable to Piedmont	\$ 14,651	\$0.09	\$37,227	\$0.22
Depreciation of real assets <sup>(2)</sup>	29,886	0.18	27,809	0.16
Amortization of lease-related costs <sup>(2)</sup>	9,220	0.05	12,840	0.07
Impairment loss	6,402	0.04	—	—
(Gain)/loss on sale - wholly-owned properties	—	—	(17,830)	(0.10)
Funds From Operations	\$60,159	\$0.36	\$60,046	\$0.35
Adjustment:				
Net casualty loss	161	—	—	—
Acquisition costs	1,244	0.01	(3)	—
Core Funds From Operations	\$61,564	\$0.37	\$60,043	\$0.35
Adjustments:				
Deferred financing cost amortization	594	—	803	—
Depreciation of non real estate assets	98	—	93	—
Straight-line effects of lease revenue <sup>(2)</sup>	(4,032)	(0.02)	(1,565)	(0.01)
Stock-based and other non-cash compensation	594	—	334	—
Net effect of amortization of below-market in-place lease intangibles <sup>(2)</sup>	(1,065)	(0.01)	(1,532)	(0.01)
Acquisition costs	(1,244)	(0.01)	3	—
Non-incremental capital expenditures <sup>(3)</sup>	(19,920)	(0.12)	(8,066)	(0.05)
Adjusted Funds From Operations	\$36,589	\$0.22	\$50,113	\$0.29
Weighted-average shares outstanding – diluted	167,810		172,874	

<sup>(1)</sup> Based on weighted average shares outstanding – diluted.

<sup>(2)</sup> Includes amounts for wholly-owned properties, as well as such amounts for our proportionate ownership in unconsolidated joint ventures.

Piedmont defines non-incremental capital expenditures as capital expenditures of a recurring nature related to tenant improvements, leasing commissions, and building capital that do not incrementally enhance the underlying assets' income generating capacity. Tenant improvements, leasing commissions, building capital and deferred lease incentives incurred to lease space that was vacant at acquisition, leasing costs for spaces vacant for greater than one

<sup>(3)</sup> year, leasing costs for spaces at newly acquired properties for which in-place leases expire shortly after acquisition, improvements associated with the expansion of a building, and renovations that either change the underlying classification from a Class B to a Class A property or enhance the marketability of a building are excluded from this measure. All data for prior periods presented have been calculated in accordance with this definition for comparability.

#### Property and Same Store Net Operating Income (Cash Basis)

Property Net Operating Income ("Property NOI") (cash basis) is a non-GAAP measure which we use to assess our operating results. It is calculated as real estate operating income with the add-back of corporate general and administrative expense, acquisition costs, depreciation and amortization, and impairment losses and the deduction of income and expense associated with lease terminations and income associated with property management performed by Piedmont for other organizations. We present this measure on a cash basis, which eliminates the effects of straight lined rents and fair value lease revenue. The company uses this measure as a proxy for the cash generated by our real estate properties. Same Store Net Operating Income ("Same Store NOI") is another non-GAAP measure very similar to Property NOI, however, Same Store NOI only reflects Property NOI attributable to the properties owned or placed in service during the entire span of the current and prior year reporting periods. Same Store NOI excludes amounts

attributable to unconsolidated joint venture assets. We believe Same Store NOI is an important measure because it allows us to compare the cash flows generated by our same real estate properties from one period to another. Other REITs may calculate Same Store NOI differently and our calculation should not be compared to that of other REITs.

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The following table sets forth our Property NOI (cash basis) and Same Store NOI (cash basis) with a reconciliation to net income attributable to Piedmont (GAAP basis) for the three months ended March 31, 2013 and 2012, respectively (in thousands):

	March 31, 2013	March 31, 2012
Net income attributable to Piedmont	\$ 14,651	\$ 37,227
Net income attributable to noncontrolling interest	4	4
Interest expense	16,373	16,537
Depreciation <sup>(1)</sup>	29,984	27,902
Amortization <sup>(1)</sup>	9,220	12,840
Acquisition costs	1,244	(3
Impairment loss <sup>(1)</sup>	6,402	—
Net casualty (gain)/loss	161	—
(Gain) / loss on sale of properties <sup>(1)</sup>	—	(17,830
General & administrative expenses <sup>(1)</sup>	4,609	5,318
Management fee revenue	(631	) (574
Interest and other (income)/expense <sup>(1)</sup>	21	(94
Lease termination income	—	(123
Lease termination expense - straight line rent & acquisition intangibles write-offs	25	99
Straight line rent adjustment <sup>(1)</sup>	(4,057	) (1,664
Net effect of amortization of below-market in-place lease intangibles <sup>(1)</sup>	(1,065	) (1,532
Property NOI (cash basis)	\$ 76,941	\$ 78,107
Net operating income from:		
Acquisitions <sup>(2)</sup>	(836	) —
Dispositions <sup>(3)</sup>	166	(1,928
Unconsolidated joint ventures	(744	) (590
Same Store NOI (cash basis)	\$ 75,527	\$ 75,589
Change period over period in Same Store NOI	(0.1	)% N/A

<sup>(1)</sup> Includes amounts attributable to consolidated properties, including discontinued operations, and our proportionate share of amounts attributable to unconsolidated joint ventures.

Acquisitions consist of the Gavitello Land in Atlanta, GA, purchased on June 28, 2012; Glenridge Highlands III

<sup>(2)</sup> Land in Atlanta, GA purchased on October 15, 2012; Arlington Gateway in Arlington, VA, purchased on March 4, 2013; and 5 & 15 Wayside Road in Burlington, MA, purchased on March 22, 2013.

Dispositions consist of Deschutes, Rhein, Rogue, Willamette, and Portland Land Parcels in Beaverton, OR, sold on

<sup>(3)</sup> March 19, 2012; 26200 Enterprise Way in Lake Forest, CA, sold on May 31, 2012; 110 and 112 Hidden Lake Circle in Duncan, SC, sold on September 21, 2012; and 1111 Durham Avenue in South Plainfield, NJ, sold on March 28, 2013.

Same store net operating income (on a cash basis) for the three months ended March 31, 2013 of \$75.5 million was comparable to the three months ended March 31, 2012, reflecting the expiration of certain significant leases over the previous twelve months, directly offset by the commencement and/or end of abatement periods for other significant

leases during that same time period. Although much of the space associated with recently expired leases has been re-leased, many of these replacement leases do not commence until future periods after refurbishment of the space has occurred or, even if the lease has commenced, after any applicable rent abatement period expires. Such items negatively impact Same Store NOI on a cash basis; however, as our executed but not commenced leases begin and rental abatement periods expire, we expect there will be greater Same Store NOI growth than might otherwise be expected based on changes in our overall leased percentage alone. As of March 31, 2013, we had approximately 0.4 million square feet of signed leases that have yet to commence for vacant spaces and an additional 2.0 million square feet of commenced leases that were in some form of abatement.

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### Election as a REIT

We have elected to be taxed as a REIT under the Code and have operated as such beginning with our taxable year ended December 31, 1998. To qualify as a REIT, we must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of our adjusted REIT taxable income, computed without regard to the dividends-paid deduction and by excluding net capital gains attributable to our stockholders, as defined by the Code. As a REIT, we generally will not be subject to federal income tax on income that we distribute to our stockholders. If we fail to qualify as a REIT in any taxable year, we may be subject to federal income taxes on our taxable income for that year and for the four years following the year during which qualification is lost and/or penalties, unless the IRS grants us relief under certain statutory provisions. Such an event could materially adversely affect our net income and net cash available for distribution to our stockholders. However, we believe that we are organized and operate in such a manner as to qualify for treatment as a REIT and intend to continue to operate in the foreseeable future in such a manner that we will remain qualified as a REIT for federal income tax purposes. We have elected to treat Piedmont Office Holdings, Inc. ("POH"), a wholly-owned subsidiary of Piedmont, as a taxable REIT subsidiary. We perform non-customary services for tenants of buildings that we own, including solar power generation, real estate and non-real estate related-services; however, any earnings related to such services performed by our taxable REIT subsidiary are subject to federal and state income taxes. In addition, for us to continue to qualify as a REIT, our investments in taxable REIT subsidiaries cannot exceed 25% of the value of our total assets.

### Inflation

We are exposed to inflation risk, as income from long-term leases is the primary source of our cash flows from operations. There are provisions in the majority of our tenant leases that are intended to protect us from, and mitigate the risk of, the impact of inflation. These provisions include rent steps, reimbursement billings for operating expense pass-through charges, real estate tax, and insurance reimbursements on a per square-foot basis, or in some cases, annual reimbursement of operating expenses above certain per square-foot allowance. However, due to the long-term nature of the leases, the leases may not readjust their reimbursement rates frequently enough to fully cover inflation.

### Off-Balance Sheet Arrangements

We are not dependent on off-balance sheet financing arrangements for liquidity. Our off-balance sheet arrangements consist of our investments in unconsolidated joint ventures and operating lease obligations related to ground leases at certain of our properties. The unconsolidated joint ventures in which we currently invest are prohibited by their governing documents from incurring debt. For further information regarding our commitments under operating lease obligations, see the Contractual Obligations table below.

### Application of Critical Accounting Policies

Our accounting policies have been established to conform with GAAP. The preparation of financial statements in conformity with GAAP requires management to use judgment in the application of accounting policies, including making estimates and assumptions. These judgments affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions had been different, it is possible that different accounting policies would have been applied, thus, resulting in a different presentation of the financial statements. Additionally, other companies may utilize different estimates that may impact comparability of our results of operations to those of companies in similar businesses. The critical accounting policies outlined below have been discussed with members of the Audit Committee of the board of directors.

Investment in Real Estate Assets

We are required to make subjective assessments as to the useful lives of our depreciable assets. We consider the period of future benefit of the asset to determine the appropriate useful lives. These assessments have a direct impact on net income attributable to Piedmont. The estimated useful lives of our assets by class are as follows:

Buildings	40 years
Building improvements	5-25 years
Land improvements	20-25 years
Tenant improvements	Shorter of economic life or lease term
Intangible lease assets	Lease term

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### Allocation of Purchase Price of Acquired Assets

Upon the acquisition of real properties, it is our policy to allocate the purchase price of properties to acquired tangible assets, consisting of land and building, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, other value of in-place leases, and value of tenant relationships, based in each case on their estimated fair values.

The fair values of the tangible assets of an acquired property (which includes land and buildings) are determined by valuing the property as if it were vacant, and the “as-if-vacant” value is then allocated to land and building based on our determination of the fair value of these assets. We determine the as-if-vacant fair value of a property using methods similar to those used by independent appraisers. Factors considered by us in performing these analyses include an estimate of carrying costs during the expected lease-up periods considering current market conditions and costs to execute similar leases. In estimating carrying costs, we include real estate taxes, insurance, and other operating expenses and estimates of lost rental revenue during the expected lease-up periods based on current market demand. We also estimate the cost to execute similar leases including leasing commissions, legal, and other related costs.

The fair values of above-market and below-market in-place lease values are recorded based on the present value (using an interest rate that reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) our estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining noncancelable term of the lease. The above-market and below-market lease values are capitalized as intangible lease assets and liabilities and amortized as an adjustment of rental income over the remaining terms of the respective leases.

The fair values of in-place leases include direct costs associated with obtaining a new tenant, opportunity costs associated with lost rentals that are avoided by acquiring an in-place lease, and tenant relationships. Direct costs associated with obtaining a new tenant include commissions, tenant improvements, and other direct costs and are estimated based on management’s consideration of current market costs to execute a similar lease. These direct costs are included in deferred lease costs in the accompanying consolidated balance sheets and are amortized to expense over the remaining terms of the respective leases. The value of opportunity costs is calculated using the contractual amounts to be paid pursuant to the in-place leases over a market absorption period for a similar lease. Customer relationships are valued based on expected renewal of a lease or the likelihood of obtaining a particular tenant for other locations. These lease intangibles are included in intangible lease assets in the accompanying consolidated balance sheets and are amortized to expense over the remaining terms of the respective leases.

Estimates of the fair values of the tangible and intangible assets require us to estimate market lease rates, property operating expenses, carrying costs during lease-up periods, discount rates, market absorption periods, and the number of years the property is held for investment. The use of inappropriate estimates would result in an incorrect assessment of our purchase price allocations, which could impact the amount of our reported net income attributable to us.

### Valuation of Real Estate Assets and Investments in Joint Ventures Which Hold Real Estate Assets

We continually monitor events and changes in circumstances that could indicate that the carrying amounts of the real estate and related intangible assets, both operating properties and properties under construction, in which we have an ownership interest, either directly or through investments in joint ventures, may not be recoverable. When indicators of potential impairment are present which indicate that the carrying amounts of real estate and related intangible assets may not be recoverable, we assess the recoverability of these assets by determining whether the carrying value will be recovered through the undiscounted future operating cash flows expected from the use of the asset and its eventual disposition. In the event that such expected undiscounted future cash flows do not exceed the carrying value, we adjust the real estate and related intangible assets to the fair value and recognize an impairment loss.



Projections of expected future cash flows require that we estimate future market rental income amounts subsequent to the expiration of current lease agreements, property operating expenses, the number of months it takes to re-lease the property, and the number of years the property is held for investment, among other factors. The subjectivity of assumptions used in the future cash flow analysis, including capitalization and discount rates, could result in an incorrect assessment of the property's fair value and, therefore, could result in the misstatement of the carrying value of our real estate and related intangible assets and our net income attributable to us. We have determined that other than the impairment charge recognized upon reclassifying the 1111 Durham Avenue building for subsequent disposition of approximately \$6.4 million, there has been no impairment in the carrying value of real estate assets owned by us or any of our unconsolidated joint ventures as of March 31, 2013. See Note 10 of our accompanying consolidated financial statements for more detail on the 1111 Durham Avenue building.

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### Goodwill

Goodwill is the excess of cost of an acquired entity over the amounts specifically assigned to assets acquired and liabilities assumed in purchase accounting for business combinations, as well as costs incurred as part of the acquisition. We test the carrying value of our goodwill for impairment on an annual basis, or on an interim basis if an event occurs or circumstances change that would indicate the carrying amount may be impaired. Such interim circumstances may include, but are not limited to, significant adverse changes in legal factors or in the general business climate, adverse action or assessment by a regulator, unanticipated competition, the loss of key personnel, or persistent declines in an entity's stock price below carrying value of the entity. We have the option, should we choose to use it, to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, we conclude that the estimated fair value is greater than the carrying amount, then performing the two-step impairment test is unnecessary. However, if we chose to forgo the availability of the qualitative analysis, the test prescribed by authoritative accounting guidance is a two-step test. The first step involves comparing the estimated fair value of the entity to its carrying value, including goodwill. Fair value is determined by adjusting the trading price of the stock for various factors including, but not limited to: (i) liquidity or transferability considerations, (ii) control premiums, and/or (iii) fully distributed premiums, if necessary, multiplied by the common shares outstanding. If such calculated fair value exceeds the carrying value, no further procedures or analysis is required. However, if the carrying value exceeds the calculated fair value, goodwill is potentially impaired and step two of the analysis would be required. Step two of the test involves calculating the implied fair value of goodwill by deducting the fair value of all tangible and intangible net assets of the entity from the entity's fair value calculated in step one of the test. If the implied value of the goodwill (the remainder left after deducting the fair values of the entity from its calculated overall fair value in step one of the test) is less than the carrying value of goodwill, an impairment loss would be recognized. We have determined that there have been no events or circumstances that would indicate that the carrying amount may be impaired as of March 31, 2013.

### Investment in Variable Interest Entities

VIEs are defined by GAAP as entities in which equity investors do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. If an entity is determined to be a VIE, it must be consolidated by the primary beneficiary. The primary beneficiary is the enterprise that has the power to direct the activities of the VIE that most significantly impact the VIE's economic performance, absorbs the majority of the entity's expected losses, or receives a majority of the entity's expected residual returns. Generally, expected losses and expected residual returns are the anticipated negative and positive variability, respectively, in the fair value of the VIE's net assets. When we make an investment, we assess whether the investment represents a variable interest in a VIE and, if so, whether we are the primary beneficiary of the VIE. Incorrect assumptions or assessments may result in an inaccurate determination of the primary beneficiary. The result could be the consolidation of an entity acquired or formed in the future that would otherwise not have been consolidated or the non-consolidation of such an entity that would otherwise have been consolidated.

We evaluate each investment to determine whether it represents variable interests in a VIE. Further, we evaluate the sufficiency of the entities' equity investment at risk to absorb expected losses, and whether as a group, the equity has the characteristics of a controlling financial interest. See Note 7 of our accompanying consolidated financial statements for more detail on our VIEs as of March 31, 2013.

### Interest Rate Derivatives

We periodically enter into interest rate derivative agreements to hedge our exposure to changing interest rates on variable rate debt instruments. As required by GAAP, we record all derivatives on the balance sheet at fair value. We

reassess the effectiveness of our derivatives designated as cash flow hedges on a regular basis to determine if they continue to be highly effective and also to determine if the forecasted transactions remain highly probable. Currently, we do not use derivatives for trading or speculative purposes.

The changes in fair value of interest rate swap agreements designated as effective cash flow hedges are recorded in other comprehensive income ("OCI"), and subsequently reclassified to earnings when the hedged transactions occur. Changes in the fair values of derivatives designated as cash flow hedges that do not qualify for hedge accounting treatment, if any, would be recorded as gain/(loss) on interest rate swap in the consolidated statements of income. The fair value of the interest rate derivative agreement is recorded as interest rate derivative asset or as interest rate derivative liability in the accompanying consolidated balance sheets. Amounts received or paid under interest rate derivative agreements are recorded as interest expense in the consolidated income statements as incurred. All of our interest rate derivative agreements as of March 31, 2013 are designated as cash flow hedges. See Note 6 of our accompanying consolidated financial statements for more detail on our derivative agreements as of March 31, 2013.

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## Stock-based Compensation

We have issued stock-based compensation in the form of restricted stock to our employees and directors. For employees, such compensation has been issued pursuant to our Long-term Incentive Compensation ("LTIC") program. The LTIC program is comprised of an annual restricted stock grant component and a multi-year performance share component. Awards granted pursuant to the annual restricted stock component are considered equity awards and expensed straight-line over the vesting period, with issuances recorded as a reduction to additional paid in capital. Awards granted pursuant to the performance share component are considered liability awards and are expensed over the service period, with issuances recorded as a reduction to accrued expense. The compensation expense recognized related to both of these award types is recorded as property operating costs for those employees whose job is related to property operation and as general and administrative expense for all other employees and directors in the accompanying consolidated statements of income.

## Contractual Obligations

Our contractual obligations as of March 31, 2013 are as follows (in thousands):

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt <sup>(1)</sup>	\$1,699,525	\$—	\$680,000	\$1,019,525	<sup>(2)</sup> \$—
Operating lease obligations <sup>(3)</sup>	77,790	753	1,506	1,506	74,025
Total	\$1,777,315	\$753	\$681,506	\$1,021,031	\$74,025

Amounts include principal payments only. We made interest payments, including payments under our interest rate swaps, of approximately \$15.7 million during the three months ended March 31, 2013, and expect to pay interest in future periods on outstanding debt obligations based on the rates and terms disclosed herein and in Note 5 of our accompanying consolidated financial statements.

Includes the \$300 Million Unsecured Term Loan which has a stated variable rate; however, we entered into interest rate swap agreements which effectively fix, exclusive of changes to our credit rating, the rate on this facility to 2.69% through maturity. As such, we estimate incurring, exclusive of changes to our credit rating, approximately \$8.1 million per annum in total interest (comprised of combination of variable contractual rate and settlements under interest rate swap agreements) through maturity in November 2016.

Three properties (the River Corporate Center building in Tempe, Arizona; the 8700 South Price Road building in Tempe, Arizona; and the 2001 NW 64th Street building in Ft. Lauderdale, Florida) are subject to ground leases with expiration dates ranging between 2048 and 2101. The aggregate remaining payments required under the terms of these operating leases as of March 31, 2013 are presented above.

## Commitments and Contingencies

We are subject to certain commitments and contingencies with regard to certain transactions. Refer to Note 9 of our consolidated financial statements for further explanation. Examples of such commitments and contingencies include:

- Commitments Under Existing Lease Agreements;
- Contingencies Related to Tenant Audits/Disputes;
- Letters of Credit; and
- Agreements to Resolve Legal Actions.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our future income, cash flows, and fair values of our financial instruments depend in part upon prevailing market interest rates. Market risk is the exposure to loss resulting from changes in interest rates, foreign currency, exchange rates, commodity prices, and equity prices. Our exposure to market risk includes interest rate fluctuations in connection with any borrowings under our \$500 Million Unsecured Line of Credit and our \$300 Million Unsecured Term Loan. As a result, the primary market risk to which we believe we are exposed is interest rate risk. Many factors, including governmental monetary and tax policies, domestic and international economic and political considerations, and other factors that are beyond our control contribute to interest rate risk. Our interest rate risk management objectives are to limit the impact of interest rate changes on earnings and cash flow primarily through a low-to-moderate level of overall borrowings, as well as managing the variability in rate fluctuations on our outstanding debt. As such, a significant portion of our debt is based on fixed interest rates to hedge against instability in the credit markets, and we have effectively fixed the interest rate on our \$300 Million Unsecured Term Loan through interest rate swap agreements,

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provided that we maintain our corporate credit rating. We do not enter into derivative or interest rate transactions for speculative purposes.

All of our debt was entered into for other than trading purposes, and the estimated fair value of our debt as of March 31, 2013 was approximately \$1.8 billion. Our interest rate swap agreements in place as of March 31, 2013 carried notional amounts totaling \$440 million. Of these interest rate swap agreements, the agreements which hedge the cash flows under our \$300 Million Unsecured Term Loan have fixed interest rates of 2.69%, exclusive of changes to our credit rating. See Notes 5, 6 and 8 of our accompanying consolidated financial statements for further detail.

As of March 31, 2013, all of our outstanding debt, except for amounts outstanding under our \$500 Million Unsecured Line of Credit, is subject to fixed, or effectively fixed, interest rates. Our total outstanding debt subject to fixed or effectively fixed interest rates has an average effective interest rate of approximately 4.59% per annum with expirations ranging from 2014 to 2017. A change in the market interest rate impacts the net financial instrument position of our fixed-rate debt portfolio but has a minimal impact on interest incurred or cash flows.

As of March 31, 2013, we had \$412.0 million outstanding on our \$500 Million Unsecured Line of Credit, which is the only debt facility subject to variable interest rates. Our \$500 Million Unsecured Line of Credit currently has a stated rate of LIBOR plus 1.175% per annum or the prime rate, at the our discretion. Draws outstanding as of March 31, 2013 were subject to a blended rate of 1.39% as of March 31, 2013. To the extent that we borrow additional funds in the future under the \$500 Million Unsecured Line of Credit or potential future variable-rate lines of credit, we would have exposure to increases in interest rates, which would potentially increase our cost of debt. Additionally, a 1.0% increase in variable interest rates on borrowings outstanding as of March 31, 2013 would increase interest expense approximately \$4.1 million on a per annum basis.

## ITEM 4. CONTROLS AND PROCEDURES

### Management's Conclusions Regarding the Effectiveness of Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of management, including the Principal Executive Officer and the Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 15d-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act") as of the end of the quarterly period covered by this report. Based upon that evaluation, the Principal Executive Officer and the Principal Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report in providing a reasonable level of assurance that information we are required to disclose in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in applicable SEC rules and forms, including providing a reasonable level of assurance that information required to be disclosed by us in the reports we file under the Exchange Act is accumulated and communicated to our management, including the Principal Executive Officer and the Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

### Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended March 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Assertions of Legal Actions and Settlements

In Re Wells Real Estate Investment Trust, Inc. Securities Litigation, Civil Action No. 1:07-cv-00862-CAP

On March 12, 2007, a stockholder filed a class action and derivative complaint in the United States District Court for the District of Maryland against, among others, Piedmont, Piedmont's previous advisors, and certain officers and directors of Piedmont. Upon motion by the defendants, the case was transferred to the United States District Court for the Northern District of Georgia on April 17, 2007.

As subsequently amended and dismissed in part, the complaint alleges violations of Section 14(a), including Rule 14a-9 thereunder, and Section 20(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), based upon allegations that the proxy statement for Piedmont's 2007 internalization transaction (the "Internalization") contains false and misleading statements or omits to state material facts. On February 9, 2011, the plaintiff dismissed its claim for violation of Section 20(a) of the Exchange Act.

As subsequently amended and dismissed in part, the complaint seeks, among other things, (i) certification of the class action; (ii) a judgment declaring the proxy statement false and misleading; (iii) unspecified monetary damages; (iv) to nullify any stockholder approvals obtained during the proxy process; (v) to nullify the Internalization; (vi) cancellation and rescission of any stock issued as consideration in the Internalization, or, in the alternative, rescissory damages; and (vii) the payment of reasonable attorneys' fees and experts' fees. On September 16, 2009, the court granted the plaintiff's motion for class certification.

On December 4, 2009, the parties filed motions for summary judgment. On August 2, 2010, the court entered an order denying the defendants' motion for summary judgment and granting, in part, the plaintiff's motion for partial summary judgment.

On November 17, 2011, the court issued rulings granting several of the plaintiff's pre-trial motions to prohibit the defendants from introducing certain evidence, including evidence of the defendants' reliance on advice from their outside legal and financial advisors, and limiting the defendants' ability to relate their subjective views, considerations, and observations during the trial of the case.

On February 23, 2012, the court granted several of defendants' motions, including a motion for reconsideration regarding a motion plaintiff had filed seeking exclusion of certain evidence impacting damages, and motions seeking exclusion of certain evidence proposed to be submitted by plaintiff.

On March 20, 2012, the court granted the defendants leave to file a motion for summary judgment. On April 5, 2012, the defendants filed a motion for summary judgment. On September 26, 2012, the court granted the defendants' motion for summary judgment and entered judgment in favor of the defendants. Plaintiff appealed to the Eleventh Circuit Court of Appeals on October 12, 2012.

In Re Piedmont Office Realty Trust, Inc. Securities Litigation, Civil Action No. 1:07-cv-02660-CAP

On October 25, 2007, the same stockholder mentioned above filed a second purported class action in the United States District Court for the Northern District of Georgia against Piedmont and its board of directors. The complaint attempts to assert class action claims on behalf of (i) those persons who were entitled to tender their shares pursuant to the tender offer filed with the SEC by Lex-Win Acquisition LLC, a former stockholder, on May 25, 2007, and (ii) all

persons who are entitled to vote on the proxy statement filed with the SEC on October 16, 2007.

As subsequently amended and dismissed in part, the complaint alleges, among other things, violations of the federal securities laws, including Sections 14(a) and 14(e) of the Exchange Act and Rules 14a-9 and 14e-2(b) promulgated thereunder based upon allegations regarding (i) the failure to disclose certain information in our amended response to the Lex-Win tender offer and (ii) purported misstatements or omissions in our proxy statement concerning then-existing market conditions, the alternatives to a listing or extension that were explored by the defendants, the results of conversations with potential buyers as to our valuation, and certain details of our share redemption program.

On June 10, 2009, the plaintiffs filed a motion for class certification. The court granted the plaintiffs' motion for class certification on March 10, 2010. Defendants sought and received permission from the Eleventh Circuit Court of Appeals to appeal the class certification order on an interlocutory basis. On April 11, 2011, the Eleventh Circuit Court of Appeals invalidated the district court's order certifying a class and remanded the case to the district court for further proceedings.



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Following remand, plaintiffs filed a third amended complaint pursuant to leave granted on September 27, 2011. On October 21, 2011, the defendants filed a motion to dismiss the third amended complaint. On August 27, 2012, the court granted the defendants' motion to dismiss the third amended complaint and entered judgment in favor of the defendants. On September 26, 2012, the plaintiffs filed a notice of appeal with the Eleventh Circuit Court of Appeals.

## Agreements to Resolve Legal Actions

On October 11, 2012, Piedmont reached agreement in principle to settle both of the above lawsuits. Under the terms of the settlement of the first suit, Plaintiff will dismiss the appeal and release all defendants from liability in exchange for total payment of \$4.9 million in cash by Piedmont and its insurer. In the second case, Plaintiffs will dismiss the appeal and release all defendants from liability in exchange for total payment of \$2.6 million in cash by Piedmont and its insurer. On December 31, 2012, Plaintiffs filed unopposed motions for preliminary approval of the settlements, which were granted by the Court on January 2, 2013. Pursuant to the terms of the settlements and the Court's orders preliminarily approving the settlements, notice of the lawsuits and proposed settlements was given to the classes. On March 21, 2013, Plaintiffs filed motions for final approval of the settlements and for award of attorneys' fees and expenses. On April 18, 2013, the Court entered an order granting final approval of the settlements, dismissing the lawsuits with prejudice, and awarding attorneys' fees and expenses.

## ITEM 1A. RISK FACTORS

There have been no known material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) There were no unregistered sales of equity securities during the first quarter 2013.

(b) Not applicable.

During the quarter ended March 31, 2013, Piedmont repurchased shares of its common stock in the open market, in order to reissue such shares under its dividend reinvestment plan (the "DRP"), as well as repurchasing and retiring shares as part of our previously announced stock repurchase program.

Of the 151,866 shares repurchased during the first quarter 2013, 600 shares (at an average price of \$17.95 per share) related to repurchases of our common stock pursuant to our previously announced stock repurchase program, and 151,266 shares (at an average price of \$19.01 per share) related to shares purchased and conveyed to participants in the DRP. The aggregate stock repurchases for the quarter ended March 31, 2013 are as follows:

Period	Total Number of Shares Purchased (in 000's)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program (in 000's) <sup>(1)</sup>	Maximum Approximate Dollar Value of Shares Available That May Yet Be Purchased Under the Program (in 000's) <sup>(1)</sup>
January 1, 2013 to January 31, 2013	1	\$ 17.95	1	\$ 208,008
February 1, 2013 to February 28, 2013	—	\$ —	—	\$ 208,008
March 1, 2013 to March 31, 2013	151	\$ 19.01	—	\$ 208,008
Total	152	\$ 19.01	1	

<sup>(1)</sup> Under our amended and restated DRP announced in our Current Report on Form 8-K filed February 24, 2011, we have the option to either issue shares that we purchase in the open market or issue shares directly from Piedmont from authorized but unissued shares. Such election will take place at the settlement of each quarterly dividend in which there are participants in our DRP, and may change from quarter to quarter based on our judgment of the best

use of proceeds for Piedmont. Therefore, the "Maximum Approximate Dollar Value of Shares Available That May Yet Be Purchased Under the Program" relates only to the stock repurchase program. The stock repurchase program was previously announced in our Quarterly Report on Form 10-Q filed November 3, 2011, and authorizes the repurchase of up to \$300 million of shares of our common stock, expiring on November 2, 2013. The stock repurchase program is separate from shares purchased for DRP issuance.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The Exhibits required to be filed with this report are set forth on the Exhibit Index to First Quarter 2013 Form 10-Q of Piedmont Office Realty Trust, Inc. attached hereto.

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SIGNATURES

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

PIEDMONT OFFICE REALTY TRUST, INC.  
(Registrant)

Dated: May 2, 2013

By: /s/ Robert E. Bowers  
Robert E. Bowers  
Chief Financial Officer and Executive Vice President  
(Principal Financial Officer and Duly Authorized  
Officer)

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EXHIBIT INDEX  
TO  
FIRST QUARTER 2013  
FORM 10-Q

OF  
PIEDMONT OFFICE REALTY TRUST, INC.

Exhibit Number	Description of Document
3.1	Third Articles of Amendment and Restatement of Piedmont Office Realty Trust, Inc. (the “Company”) (incorporated by reference to Exhibit 3.1 to the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2009 filed on March 16, 2010)
3.2	Articles of Amendment of the Company effective June 30, 2011 (incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed on July 6, 2011)
3.3	Articles Supplementary of the Company effective June 30, 2011 (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on July 6, 2011)
3.4	Amended and Restated Bylaws of the Company (incorporated by reference to Exhibit 3.2 to the Company’s current Report on Form 8-K filed on January 22, 2010)
31.1	Rule 13a-14(a)/15d-14(a) Certification, executed by Donald A. Miller, CFA, Principal Executive Officer of the Company
31.2	Rule 13a-14(a)/15d-14(a) Certification, executed by Robert E. Bowers, Principal Financial Officer of the Company
32.1	Certification required by Rule 13a-14(b)/15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, executed by Donald A. Miller, CFA, Chief Executive Officer and President of the Company
32.2	Certification required by Rule 13a-14(b)/15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, executed by Robert E. Bowers, Chief Financial Officer and Executive Vice-President of the Company
101.INS	XBRL Instance Document *
101.SCH	XBRL Taxonomy Extension Schema *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase *
101.DEF	XBRL Taxonomy Extension Definition Linkbase *
101.LAB	XBRL Taxonomy Extension Label Linkbase *
101.PRE	XBRL Taxonomy Extension Presentation Linkbase *
*	Furnished with this Form 10-Q

