

City Office REIT, Inc.
Form 10-Q
May 08, 2015
Table of Contents

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, 2015

OR

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

For the transition period from _____ to _____

Commission file no: 001-36409

CITY OFFICE REIT, INC.

Maryland
(State or other jurisdiction of
incorporation)

98-1141883
(IRS Employer

Identification No.)

1075 West Georgia Street

Suite 2600

Vancouver, BC V6E 3C9

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (604) 806-3366

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. (Check one):

Large accelerated filer

Accelerated filer

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

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of Common Stock, \$0.01 par value, of the registrant outstanding at May 5, 2015 was 12,404,730.

Table of Contents

City Office REIT, Inc.
Quarterly Report on Form 10-Q
For the Quarter Ended March 31, 2015
Table of Contents

PART I. FINANCIAL INFORMATION

Item 1.	<u>Financial Statements</u>	1
	<u>Condensed Consolidated and Combined Balance Sheets as of March 31, 2015 and December 31, 2014</u>	1
	<u>Condensed Consolidated and Combined Statements of Operations for the Three Months Ended March 31, 2015 and 2014</u>	2
	<u>Condensed Consolidated and Combined Statements of Changes in Equity as of March 31, 2015</u>	3
	<u>Condensed Consolidated and Combined Statements of Cash Flows for the Three Months Ended March 31, 2015 and 2014</u>	4
	<u>Notes to Condensed Consolidated and Combined Financial Statements</u>	5
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	22
Item 4.	<u>Controls and Procedures</u>	22

PART II. OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	24
Item 1A.	<u>Risk Factors</u>	24
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	24
Item 3.	<u>Defaults Upon Senior Securities</u>	24
Item 4.	<u>Mine Safety Disclosures</u>	24
Item 5.	<u>Other Information</u>	24
Item 6.	<u>Exhibits</u>	24
	<u>Signatures</u>	26

Table of Contents**City Office REIT, Inc. and Predecessor****Condensed Consolidated and Combined Balance Sheets (Note 1)****(Unaudited)***(In thousands, except par value and share data)*

	March 31, 2015	December 31, 2014
Assets		
Real estate properties, cost		
Land	\$ 67,510	\$ 66,204
Buildings and improvements	140,933	132,964
Tenant improvement	28,482	27,773
Furniture, fixtures and equipment	198	198
	237,123	227,139
Accumulated depreciation	(17,719)	(15,311)
	219,404	211,828
Cash and cash equivalents	23,985	34,862
Restricted cash	9,227	11,093
Rents receivable, net	9,252	7,981
Deferred financing costs, net of accumulated amortization	2,731	2,901
Deferred leasing costs, net of accumulated amortization	3,003	2,618
Acquired lease intangibles assets, net	28,669	29,391
Prepaid expenses and other assets	322	832
Total Assets	\$ 296,593	\$ 301,506
Liabilities and Equity		
Liabilities:		
Debt	\$ 189,669	\$ 189,940
Accounts payable and accrued liabilities	3,917	4,080
Deferred rent	1,526	2,212
Tenant rent deposits	1,877	1,862
Acquired lease intangibles liability, net	855	606
Dividend distributions payable	3,571	3,571
Earn-out liability	8,000	8,000
Total Liabilities	209,415	210,271

Commitments and Contingencies (Note 9)**Equity:**

Edgar Filing: City Office REIT, Inc. - Form 10-Q

Common stock, \$0.01 par value, 100,000,000 shares authorized, 12,279,110 shares issued and outstanding	123	123
Additional paid-in capital	91,717	91,308
Accumulated deficit	(15,634)	(11,320)
Total Stockholders Equity	76,206	80,111
Operating Partnership unitholders non-controlling interests	11,701	11,878
Non-controlling interests in properties	(729)	(754)
Total Equity	87,178	91,235
Total Liabilities and Equity	\$ 296,593	\$ 301,506

The accompanying notes are an integral part of these condensed consolidated and combined financial statements.

Table of Contents**City Office REIT, Inc. and Predecessor****Condensed Consolidated and Combined Statements of Operations (Note 1)****(Unaudited)***(In thousands, except per share data)*

	Three Months Ended March 31,	
	2015	2014
Revenues:		
Rental income	\$ 10,040	\$ 7,237
Expense reimbursement	891	450
Other	328	295
Total Revenues	11,259	7,982
Operating Expenses:		
Property operating expenses	4,116	3,126
Acquisition costs	209	806
Stock-based compensation	409	
General and administrative	408	
Base management fee	332	
Depreciation and amortization	4,406	3,160
Total Operating Expenses	9,880	7,092
Operating income	1,379	890
Interest Expense:		
Contractual interest expense	(2,009)	(2,169)
Amortization of deferred financing costs	(169)	(992)
	(2,178)	(3,161)
Gain on equity investment		4,475
Net (loss)/income	(799)	2,204
Less:		
Net (income)/loss attributable to non-controlling interests in properties	(121)	10
Net income attributable to Predecessor		2,214
Net loss attributable to Operating Partnership unitholders non-controlling interests	177	
Net loss attributable to stockholders	\$ (743)	

Net loss per share:

Edgar Filing: City Office REIT, Inc. - Form 10-Q

Basic and diluted	\$	(0.06)
Weighted average common shares outstanding:		
Basic and diluted		12,279
Dividend distributions declared per common share and unit	\$	0.235

The accompanying notes are an integral part of these condensed consolidated and combined financial statements.

Table of Contents

City Office REIT, Inc. and Predecessor

Condensed Consolidated and Combined Statements of Changes in Equity (Note 1)

(Unaudited)

(In thousands)

	Number of common shares	Common stock	Additional paid-in capital	Accumulated deficit	Total stockholders' equity	Operating Partnership unitholders' non-controlling interests	Non-controlling interests in properties	Total equity
Balance December 31, 2014	12,279	\$ 123	\$ 91,308	\$ (11,320)	\$ 80,111	\$ 11,878	\$ (754)	\$ 91,235
Restricted stock award grants			409		409			409
Dividend distributions declared				(3,571)	(3,571)			(3,571)
Contributions								
Distributions							(96)	(96)
Net loss				(743)	(743)	(177)	121	(799)
Balance March 31, 2015	12,279	\$ 123	\$ 91,717	\$ (15,634)	\$ 76,206	\$ 11,701	\$ (729)	\$ 87,178

The accompanying notes are an integral part of these condensed consolidated and combined financial statements.

Table of Contents**City Office REIT, Inc. and Predecessor****Condensed Consolidated and Combined Statements of Cash Flows (Note 1)****(Unaudited)***(In thousands)*

	Three Months Ended March 31,	
	2015	2014
Cash Flows from Operating Activities:		
Net (loss)/income	\$ (799)	\$ 2,204
Adjustments to reconcile net (loss)/income to net cash provided by operating activities:		
Depreciation and amortization	4,406	3,160
Amortization of deferred financing costs	169	992
Amortization of above/below market leases	128	124
Increase in straight-line rent	(83)	(709)
Non-cash stock compensation	409	
Gain on equity investment		(4,475)
Changes in non-cash working capital:		
Rents receivable, net	(1,188)	(53)
Prepaid expenses and other assets	510	(350)
Accounts payable and accrued liabilities	(210)	1,750
Deferred rent	(686)	(578)
Tenant rent deposits	15	122
Net Cash Provided By Operating Activities	2,671	2,187
Cash Flows to Investing Activities:		
Additions to real estate properties	(485)	(320)
Acquisition of real estate, net of cash assumed	(10,423)	(12,021)
Deferred leasing cost	(568)	(65)
Net Cash Used In Investing Activities	(11,476)	(12,406)
Cash Flows from Financing Activities:		
Debt issuance and extinguishment costs		(3,844)
Proceeds from mortgage loans payable		50,000
Repayment of mortgage loans payable	(271)	(36,528)
Contributions from partners and members		2,569
Contributions from non-controlling interests in properties		20
Distributions to partners and members		(1,347)
Distributions to non-controlling interests in properties	(96)	(153)
Dividend distributions paid to stockholders and Operating Partnership unitholders	(3,571)	
Change in restricted cash	1,866	(1,097)

Net Cash (Used)/Provided By Financing Activities	(2,072)	9,620
Net Decrease in Cash and Cash Equivalents	(10,877)	(599)
Cash and Cash Equivalents, Beginning of Period	34,862	7,128
Cash and Cash Equivalents, End of Period	\$ 23,985	\$ 6,529
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$ 2,097	\$ 1,957
Accrued dividend distributions payable	\$ 3,571	\$

The accompanying notes are an integral part of these condensed consolidated and combined financial statements.

Table of Contents

City Office REIT, Inc. and Predecessor

Notes to the Condensed Consolidated and Combined Financial Statements

1. Organization and Description of Business

City Office REIT, Inc. (the Company) was organized in the state of Maryland on November 26, 2013. On April 21, 2014, the Company completed its initial public offering (IPO) of shares of the Company's common stock. The Company contributed the net proceeds of the IPO to City Office REIT Operating Partnership, L.P., a Maryland limited partnership (the Operating Partnership), in exchange for common units in the Operating Partnership. Both the Company and the Operating Partnership commenced operations upon completion of the IPO and certain related formation transactions (the Formation Transactions).

The Company's interest in the Operating Partnership entitles the Company to share in distributions from, and allocations of profits and losses of, the Operating Partnership in proportion to the Company's percentage ownership of common units. As the sole general partner of the Operating Partnership, the Company has the exclusive power under the partnership agreement to manage and conduct the Operating Partnership's business, subject to limited approval and voting rights of the limited partners.

City Office REIT, Inc. Predecessor (the Predecessor) represents the combination of the six properties outlined below (the Properties). The Predecessor does not represent a legal entity. The Predecessor and its related assets and liabilities are under common control and were contributed to a newly formed Operating Partnership in connection with the IPO of the Company on April 21, 2014.

Unless the context suggests otherwise, references in this Annual Report on Form 10-K to Our Advisor refers to our external advisor, City Office Real Estate Management Inc. Second City refers to Second City Capital Partners II, Limited Partnership. Second City GP refers to Second City General Partner II, Limited Partnership. Gibralt refers to Gibralt US, Inc. GCC Amberglen refers to GCC Amberglen Investments Limited Partnership. CIO OP refers to CIO OP Limited Partnership. CIO REIT refers to CIO REIT Stock Limited Partnership and CIO REIT Stock GP Limited Partnership. The Second City Group refers to Second City, any future real estate funds created by the principals of Second City, Second City GP, Gibralt, GCC Amberglen, CIO OP, CIO REIT and Daniel Rapaport.

The historical financial results in these financial statements and the accompanying notes thereto for periods prior to April 21, 2014 relate to the Predecessor. The Predecessor is comprised of the following properties:

City Center: Property in St. Petersburg, Florida, acquired in December 2010.

Central Fairwinds: Property in Orlando, Florida, acquired in May 2012.

AmberGlen: Property in Portland, Oregon, acquired in December 2009.

Washington Group Plaza: Property in downtown Boise, Idaho, acquired in June 2013.

Corporate Parkway: Property in Allentown, Pennsylvania, acquired in May 2013.

Cherry Creek: Property in Denver, Colorado, acquired in January 2014.

The Company intends to elect to be taxed and to continue to operate in a manner that will allow it to qualify as a real estate investment trust (REIT) commencing with its initial taxable year ended December 31, 2014. Subject to qualification as a REIT, the Company will be permitted to deduct dividend distributions paid to its stockholders, eliminating the U.S. federal taxation of income represented by such distributions at the Company level. REITs are subject to a number of organizational and operational requirements. If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to U.S. federal and state income tax on its taxable income at regular corporate tax rates and any applicable alternative minimum tax.

Table of Contents

Initial Public Offering and Formation Transactions

The Company's operations are carried on primarily through the Operating Partnership and wholly owned subsidiaries of the Operating Partnership. Both the Company and the Operating Partnership commenced operations upon completion of the IPO and certain related Formation Transactions.

On April 21, 2014, the Company closed the IPO, pursuant to which it sold 5,800,000 shares of common stock to the public at a public offering price of \$12.50 per share. The Company raised \$72.5 million in gross proceeds, resulting in net proceeds to us of approximately \$63.4 million after deducting approximately \$5.1 million in underwriting discounts and approximately \$4.0 million in other expenses relating to the IPO. On May 9, 2014, the underwriters of the IPO exercised their overallotment option to purchase an additional 782,150 shares of the Company's common stock at the IPO price of \$12.50 a share resulting in additional gross proceeds of approximately \$9.8 million. The net proceeds to the Company were \$9.1 million after deducting approximately \$0.7 million in underwriting discounts. The Company's common stock began trading on the New York Stock Exchange under the symbol "CIO" on April 15, 2014.

The Company contributed the net proceeds of the IPO to the Operating Partnership in exchange for common units in the Operating Partnership. The Operating Partnership utilized a portion of the net proceeds of the IPO to pay fees in connection with the assumption of the indebtedness, pay expenses incurred in connection with the IPO and Formation Transactions and repay loans that were made to several of the contributing entities by certain investors in such entities. The remaining funds were used for general working capital purposes and to fund acquisitions. All net proceeds from the overallotment option were used to redeem common stock and units issued to the Second City Group in the Formation Transactions.

Pursuant to the Formation Transactions, the Operating Partnership acquired a 100% interest in each of the Washington Group Plaza, Cherry Creek and Corporate Parkway properties and acquired an approximate 76% economic interest in the AmberGlen property, 90% interest in the Central Fairwinds property and 95% interest in the City Center property. These initial property interests were contributed in exchange for 3,731,209 common units, 1,858,860 common stock and \$19.4 million of cash. On May 9, 2014, the Company used the \$9.1 million of net proceeds from the exercise of the underwriters' overallotment option to redeem, 479,305 common units and 248,095 common stock from the Second City Group.

In connection with the IPO and Formation Transactions, the Company, through its Operating Partnership, extinguished the loan on the Central Fairwinds property and completed a refinancing of three properties (Cherry Creek, City Center and Corporate Parkway) with a new \$95 million non-recourse mortgage loan and proceeds from the IPO. The loan bears a fixed interest rate of 4.34% and matures on May 6, 2021.

All balances for the three months ended March 31, 2014 are those of the Predecessor.

2. Summary of Significant Accounting Policies

Basis of Preparation and Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated and combined financial statements have been prepared by the Company in accordance with Securities and Exchange Commission rules and regulations and generally accepted accounting principles in the United States of America ("US GAAP") and in the opinion of management contain all adjustments (including normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows for the periods presented. The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial

statements and accompanying notes. These interim consolidated financial statements should read in conjunction with the consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2014.

The Predecessor represents a combination of certain entities holding interests in real estate that were commonly controlled prior to the Formation Transactions. Due to their common control, the financial statements of the separate entities which own the properties are presented on a combined basis in the Predecessor financial statements.

Table of Contents***New Accounting Pronouncements***

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which creates a new Topic Accounting Standards Codification (Topic 606). The standard is principle-based and provides a five-step model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which we expect to be entitled in exchange for those goods or services. This standard is effective for interim or annual periods beginning after December 15, 2017, and allows for either full retrospective or modified retrospective adoption. Early adoption of this standard is not allowed. We are currently evaluating the impact the adoption of Topic 606 will have on our financial statements.

In January 2015, the FASB issued ASU No. 2015-01, Income Statement Extraordinary and Unusual Items. ASU 2015-01 eliminates the concept of extraordinary items. However, the presentation and disclosure requirements for items that are either unusual or in nature or infrequent in occurrence remain and will be expanded to include items that are both unusual in nature and infrequent in occurrence. ASU 2015-01 is effective for periods beginning after December 15, 2015. We are currently evaluating the impact of adopting this new accounting standard on our financial statements.

In February 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-02, Consolidation (Topic 810) Amendments to the Consolidation Analysis, which amends the criteria for determining which entities are considered variable interest entities (VIE), amends the criteria for determining if a service provider possesses a variable interest in a VIE and ends the deferral granted to investment companies for application of the VIE consolidation model. ASU 2015-02 is effective for annual periods, and interim periods therein, beginning after December 15, 2015. We are currently evaluating the impact the adoption of Topic 810 will have on our financial statements.

3. Real Estate Investments***Acquisitions***

During the three months ended March 31, 2015 and 2014, the Company acquired the following properties:

Property	Date Acquired	Percentage Owned
Logan Tower	February 2015	100%
Cherry Creek	January 2014	100%

The above acquisitions have been accounted for as business combinations.

On January 2, 2014, the Predecessor acquired the remaining 57.7% interest it did not already own in ROC-SCCP Cherry Creek I, LP (Cherry Creek) for approximately \$12.0 million. The acquisition was financed through a new \$50 million mortgage loan, the proceeds of which were used to repay \$36 million of existing debt of Cherry Creek, fund the payment of \$12.0 million to the seller, pay \$1.2 million of deferred financing costs and \$0.8 million in transactions costs.

The following table summarizes the Company's allocation of the purchase price of assets acquired and liabilities assumed during the three months ended March 31, 2014 (in thousands):

	Cherry Creek
Land	\$ 25,745
Buildings and improvements	15,771
Tenant improvements	4,372
Acquired intangible assets	12,009
Accounts payable and other liabilities	(815)
Lease intangible liabilities	(249)
Fair value of assets and liabilities at acquisition	\$ 56,833

Table of Contents

The Company recognized expenses relating to the Cherry Creek acquisition of \$806,344 for the three months ended March 31, 2014. A gain of \$4.5 million was recognized from the fair value adjustment associated with the Predecessor's original ownership due to a change in control, calculated as follows (in thousands):

Fair value of assets and liabilities acquired	\$ 56,833
Less existing mortgage in Cherry Creek	(36,000)
	20,833
Less cash paid to seller	(12,021)
Fair value of 42.3% equity interest	8,812
Carrying value of investment in Cherry Creek	(4,337)
Gain on existing 42.3% equity interest	\$ 4,475

On February 4, 2015, the Company, through the Operating Partnership, acquired 100% of Logan Tower, a property in Denver, Colorado, for \$10.4 million. The following table summarizes the Company's allocation of the purchase price of assets acquired and liabilities assumed during the period ended March 31, 2015 (in thousands):

	Logan Tower
Land	\$ 1,306
Buildings and improvements	7,844
Tenant improvements	353
Acquired intangible assets	1,274
Accounts payable and other liabilities	(48)
Lease intangible liabilities	(306)
Total consideration	\$ 10,423

The operating results of the Logan Tower property since the date of acquisition have been included in the Company's consolidated and combined financial statements for the three months ended March 31, 2015. The following table represents the results of the property's operations since the date of acquisition on a stand-alone basis (in thousands).

	Period from date of acquisition on February 4, 2015 to March 31, 2015	
Operating revenues	\$	243
Operating expenses		(417)
Interest		
	\$	(174)

Table of Contents

The following table presents the unaudited revenues and income from continuing operations for Logan Tower on a pro forma basis as if the Company had completed the acquisition of the properties as of January 1, 2014 (in thousands):

	Three Months Ended March 31, 2015	Three Months Ended March 31, 2014
Total revenues as reported by City Office REIT, Inc. and Predecessor	\$ 11,259	\$ 7,982
Plus: Logan Tower	148	391
Pro forma total revenues	\$ 11,407	\$ 8,373
Total operating income as reported by the City Office REIT, Inc. and Predecessor	\$ 1,379	\$ 890
Property acquisition costs	100	(100)
Plus: Logan Tower	(106)	(279)
Pro forma operating income	\$ 1,373	\$ 511

4. Lease Intangibles

Lease intangibles and the value of assumed lease obligations as of March 31, 2015 and December 31, 2014 were comprised as follows (in thousands):

	Above Market Leases	In Place Leases	Leasing Commissions	Total	Below Market Leases	Market Ground Lease	Total
March 31, 2015							
Cost	\$ 4,762	29,512	13,103	47,377	(1,052)	(138)	(1,190)
Accumulated amortization	(2,170)	(12,360)	(4,178)	(18,708)	314	21	335
	\$ 2,592	17,152	8,925	28,669	(738)	(117)	(855)

	Above Market Leases	In Place Leases	Leasing Commissions	Total	Below Market Leases	Market Ground Lease	Total
December 31, 2014							
Cost	\$ 4,762	28,505	12,926	46,193	(746)	(138)	(884)
Accumulated amortization	(1,985)	(11,159)	(3,658)	(16,802)	258	20	278
	\$ 2,777	17,346	9,268	29,391	(488)	(118)	(606)

Table of Contents

The estimated aggregate amortization expense for lease intangibles for the five succeeding years and in the aggregate are as follows (in thousands):

2015	\$ 5,548
2016	6,932
2017	4,334
2018	2,838
2019	2,625
Thereafter	5,537
	\$ 27,814

5. Debt

The following table summarizes the secured indebtedness as of March 31, 2015 and December 31, 2014 (in thousands):

Property	March 31, 2015	December 31, 2014	Interest Rate as of March 31, 2015	Maturity
Revolving Credit Facility ⁽¹⁾	\$	\$	LIBOR +2.75% ⁽²⁾	April 2016
AmberGlen Mortgage Loan ⁽³⁾	25,053	25,158	4.38	May 2019
Midland Life Insurance ⁽⁴⁾	95,000	95,000	4.34	May 2021
Lake Vista Pointe ⁽⁵⁾	18,460	18,460	4.28	August 2024
Florida Research Park ⁽⁵⁾⁽⁶⁾	17,000	17,000	4.44	December 2024
Washington Group Plaza ⁽⁵⁾	34,156	34,322	3.85	July 2018
Total	\$ 189,669	\$ 189,940		

All interest rates are fixed interest rates with the exception of the revolving credit facility (Revolving Credit Facility) as explained in footnote 1 below.

- (1) The Revolving Credit Facility currently has \$30 million authorized and available. In addition, the Revolving Credit Facility has an accordion feature that will permit the Company to borrow up to \$150 million, subject to additional collateral availability and lender approval. The Company shall have the right and option to extend the Revolving Credit Facility to April 21, 2017 subject to satisfaction of certain conditions. The Revolving Credit Facility requires the Company to maintain a fixed charge coverage ratio of no less than 1.60x. At March 31, 2015, the Revolving Credit Facility is cross-collateralized by Central Fairwinds, Plaza 25 and Logan Tower.
- (2) As of March 31, 2015, the one month LIBOR rate was 0.18%.
- (3) We are required to maintain a minimum net worth of \$25 million and a minimum liquidity of \$2 million.
- (4) The mortgage loan is cross-collateralized by Corporate Parkway, Cherry Creek and City Center. Interest only until June 2016 then interest payable monthly plus principal based on 360 months of amortization. The loan bears

Edgar Filing: City Office REIT, Inc. - Form 10-Q

a fixed interest rate of 4.34% and matures on May 6, 2021.

- (5) Interest on mortgage loan is payable monthly plus principal based on 360 months of amortization.
- (6) The Company is required to maintain a minimum net worth of \$17 million, minimum liquidity of \$1.7 million and a debt service coverage ratio of no less than 1.15x.

The scheduled principal repayments of mortgage payable as of March 31, 2015 are as follows (in thousands):

2015	\$ 811
2016	2,034
2017	2,918
2018	34,783
2019	25,414
Thereafter	123,709
Total	\$ 189,669

Table of Contents

6. Fair Value of Financial Instruments

Fair value measurements are based on assumptions that market participants would use in pricing an asset or a liability. The hierarchy for inputs used in measuring fair value is as follows:

Level 1 Inputs quoted prices in active markets for identical assets or liabilities

Level 2 Inputs observable inputs other than quoted prices in active markets for identical assets and liabilities

Level 3 Inputs unobservable inputs

Earn-Out Liability

The fair value of the Central Fairwinds earn-out (note 9) was derived by making assumptions on the timing of the lease up of vacant space and the net effective rents of those new leases and then applying an 8% discount rate to the resulting cash-flows to obtain a present value. The earn-out valuation assumes that approximately 14,000 square feet of additional leasing is completed between the date of the valuation and the end of the calculation period which would take the existing occupancy from 74% signed and committed at March 31, 2015 to 80% by July 2016 and stabilized at that level thereafter. The average net effective rent and incremental operating costs per square foot is assumed to be \$14 and \$4, respectively.

As of March 31, 2015 and December 31, 2014, the estimated fair value of the earn-out liability is \$8.0 million. There was no change in fair value for the three months ended March 31, 2015.

Level 3 sensitivity analysis:

The Company applies judgment in determining unobservable inputs used to calculate the fair value of Level 3 instruments. Level 3 instruments held by the Company include the earn-out. The unobservable inputs used in the valuation of the earn-out primarily include the net effective rent assumptions. A sensitivity analysis has been performed to determine the potential gain or loss by varying the significant unobservable inputs by increasing or decreasing them by 10%. The impact of applying these other reasonably possible inputs is a potential loss of \$0.1 million and a potential gain of \$0.1 million. This potential gain or loss would be recorded through profit and loss.

Cash Equivalents, Restricted Cash, Accounts Receivable, Accounts Payable and Accrued Liabilities

The Company estimates that the fair value approximates carrying value due to the relatively short-term nature of these instruments.

Fair Value of Financial Instruments Not Carried at Fair Value

With the exception of fixed rate mortgage loans payable, the carrying amounts of the Company's financial instruments approximate their fair value. The Company determines the fair value of its fixed rate mortgage loan payable based on a discounted cash flow analysis using a discount rate that approximates the current borrowing rates for instruments of similar maturities. Based on this, the Company has determined that the fair value of these instruments was \$195,100,000 and \$192,500,000 as of March 31, 2015 and December 31, 2014, respectively. Although the Company has determined the majority of the inputs used to value its fixed rate debt fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its fixed rate debt utilize Level 3 inputs, such as estimates of current credit spreads. Accordingly, mortgage loans payable have been classified as Level 3 fair value

measurements.

7. Related Party Transactions

Formation and Equity Transactions

The Formation Transactions were completed on April 21, 2014 through the contribution of the initial properties by Second City Capital Partners II, Limited Partnership, Second City General Partner II, Limited Partnership, Gibralt US, Inc., GCC Amberglen Investments Limited Partnership and Daniel Rapaport (collectively, the Second City Group). The Second City Group received as consideration for its contribution approximately \$19.4 million in cash in accordance with the terms of its contribution agreement to acquire various non-controlling interests and eliminate economic incentives in the initial properties. Additional payments to the Second City Group included \$4.9 million for reimbursement of IPO costs and \$1.8 million for working capital. On May 9, 2014, subsequent to the underwriters exercise of the overallotment option, the Company used the \$9.1 million of net proceeds from the underwriters exercise of the overallotment option to redeem 479,305 common units and 248,095 shares of common stock from the Second City Group.

Table of Contents

On December 23, 2014, the underwriters of the secondary public offering exercised their overallotment option to purchase an additional 512,664 shares of the Company's common stock at the offering price of \$12.50 a share resulting in additional net proceeds to the Company of \$6.1 million after deducting underwriting discounts. The Company used the \$6.1 million of net proceeds from exercise of the overallotment option to redeem 336,195 common units and 176,469 shares of common stock from the Second City Group.

Property Management Fees

Three of the Company's properties (City Center, Central Fairwinds and AmberGlen) engaged related parties to perform asset and property management services for a fee ranging from 1.75% to 3.5% of gross revenue.

The property manager of Washington Group Plaza is also entitled to an additional incentive commission equal to the lesser of (a) 15% of net operating income in excess of \$5 million in 2013, \$5.45 million in 2014 and \$5.6 million in 2015; or unless terminated (b) 1% of all monthly gross revenue. The asset and management agreement has an initial term of three years and will automatically renew for successive two year periods. This agreement can be terminated by the Company or the property manager upon thirty days prior written notice to the other party.

8. Future Minimum Rent Schedule

Future minimum lease payments to be received as of March 31, 2015 under noncancellable operating leases for the next five years and thereafter are as follows (in thousands):

2015	\$ 29,358
2016	32,941
2017	26,692
2018	22,708
2019	17,868
Thereafter	62,037
	\$ 191,604

The above minimum lease payments to be received do not include reimbursements from tenants for certain operating expenses and real estate taxes and do not include early termination payments provided for in certain leases.

Two state government tenants currently have the exercisable right to terminate their lease if the state does not appropriate rent in its annual budgets. The Company has determined that the occurrence of the government tenant not appropriating the rent in its annual budget is a remote contingency and accordingly recognizes lease revenue on a straight-line basis over the respective lease term. These tenants represent approximately 40.7% of the Company's total future minimum lease payments as of March 31, 2015.

9. Commitments and Contingencies***Earn-Out***

As part of the Formation Transactions and contribution agreement with respect to the Central Fairwinds property (which is approximately 74.1% leased at March 31, 2015, including committed tenants), the Company is obligated to

make additional payments to Second City (each, an Earn-Out Payment). Earn-Out Payments are contingent on the property reaching certain specified occupancy levels through new leases to qualified tenants and exceeding a net operating income threshold, which grows annually. Second City will be entitled to receive an Earn-Out Payment (net of the associated leasing costs and inclusive of leasing commissions and tenant improvements/allowances and free rent) as and when the occupancy of Central Fairwinds reaches each of 70%, 80% and 90% (each, an Earn-Out Threshold) based on the incremental cash flow generated by new leases and a 7.75% stabilized capitalization rate. The Company will make any additional Earn-Out Payment within 30 days of the end of the Earn-Out Term based on new qualified leases entered into since the achievement of the last Earn-Out Threshold. Earn-Out Payments will be subject to a claw-back if a qualified tenant defaults in the payment of rent and is not replaced with another qualified tenant (see note 6).

Table of Contents

As of March 31, 2015 and December 31, 2014, the estimated fair value of the earn-out liability is \$8.0 million. There was no change in fair value for the three months ended March 31, 2015.

Other

The Company is obligated under certain tenant leases to fund tenant improvements and the expansion of the underlying leased properties.

Under various federal, state and local laws, ordinances and regulations relating to the protection of the environment, a current or previous owner or operator of real estate may be liable for the cost of removal or remediation of certain hazardous or toxic substances disposed, stored, generated, released, manufactured or discharged from, on, at, under, or in a property. As such, the Company may be potentially liable for costs associated with any potential environmental remediation at any of its formerly or currently owned properties.

The Company believes that it is in compliance in all material respects with all federal, state and local ordinances and regulations regarding hazardous or toxic substances. Management is not aware of any environmental liability that it believes would have a material adverse impact on the Company's financial position or results of operations. Management is unaware of any instances in which the Company would incur significant environmental costs if any or all properties were sold, disposed of or abandoned. However, there can be no assurance that any such non-compliance, liability, claim or expenditure will not arise in the future.

The Company is involved from time to time in lawsuits and other disputes which arise in the ordinary course of business. As of March 31, 2015 management believes that these matters will not have a material adverse effect, individually or in the aggregate, on the Company's financial position or results of operations.

10. Stockholder's Equity

The Company issued 5,800,000 shares in the IPO resulting in net proceeds of \$63.4 million after deducting the underwriters' discount and offering expenses. The underwriters of the IPO exercised their overallotment option to purchase an additional 782,150 shares of the Company's common stock resulting in additional net proceeds of \$9.1 million after deducting underwriting discounts.

On December 10, 2014, the Company completed a follow-on public offering pursuant to which the Company sold 3,750,000 shares of our common stock at a price of \$12.50 per share. The Company raised \$46.9 million in gross proceeds, resulting in net proceeds to the Company of approximately \$43.7 million after deducting approximately \$2.6 million in underwriting discounts and approximately \$0.6 million in other expenses relating to the offering. On December 23, 2014, the underwriters of the offering exercised their overallotment option to purchase an additional 512,664 shares of our common stock at the offering price of \$12.50 a share for additional gross proceeds to the Company of approximately \$6.4 million resulting in net proceeds to the Company of \$6.1 million after deducting approximately \$0.3 million in underwriting discounts. All net proceeds from the underwriters' exercise of the overallotment option were used to redeem 336,195 common units and 176,469 common stock held by the Second City Group.

Table of Contents

Non-controlling Interests

Non-controlling interests in the Company represent common units of the Operating Partnership held by the Predecessor's prior investors. Non-controlling interests consisted of 2,915,709 Operating Partnership common units and represented an approximately 19.2% interest in the Operating Partnership as of March 31, 2015. Operating Partnership units and shares of common stock have essentially the same economic characteristics, as they share equally in the total net income or loss distributions of the Operating Partnership. Beginning on or after the date which is 12 months after the later of the completion of the initial public offering or the date on which a person first became a holder of common units, each limited partner and assignees of limited partners will have the right, subject to the terms and conditions set forth in the partnership agreement, to require the Operating Partnership to redeem all or a portion of the common units held by such limited partner or assignee in exchange for a cash amount per common unit equal to the value of one share of common stock, determined in accordance with and subject to adjustment under the partnership agreement. The Company has the sole option at its discretion to redeem the common units by issuing common stock on a one-for-one basis. The Operating Partnership unitholders are entitled to share in cash distributions from the Operating Partnership in proportion to its percentage ownership of common units.

Common Stock and Common Unit Distributions

On March 19, 2015, the Company's board of directors declared a cash dividend distribution of \$0.235 per share for the quarterly period ended March 31, 2015. The dividend was payable on April 17, 2015 to stockholders and common unitholders of record on April 3, 2015. Subsequent to March 31, 2015, \$2.9 million in dividends was paid to stockholders and \$0.7 million to common unitholders, totaling \$3.6 million.

Restricted Stock Units

The Company has an equity incentive plan (Equity Incentive Plan) for certain officers, directors, advisors and personnel, and, with approval of the board of directors, for subsidiaries, the Advisor and their respective affiliates. The Equity Incentive Plan provides for grants of restricted common stock, restricted stock units, phantom shares, stock options, dividend equivalent rights and other equity-based awards (including LTIP Units), subject to the total number of shares available for issuance under the plan. The Equity Incentive Plan is administered by the compensation committee of the board of directors (the plan administrator).

The maximum number of shares of common stock that may be issued under the Equity Incentive Plan is 1,263,580 shares. To the extent an award granted under the Equity Incentive Plan expires or terminates, the shares subject to any portion of the award that expires or terminates without having been exercised or paid, as the case may be, will again become available for the issuance of additional awards.

During the three months ended March 31, 2015, 50,864 RSUs were granted to directors and non-executive employees of the Advisor with a fair value of \$0.4 million. The awards will vest in three equal, annual installments on each of the first three anniversaries of the date of grant. For the three months ended March 31, 2015, the Company recognized net compensation expense of \$0.4 million related to the RSUs. Subsequent to March 31, 2015, 125,620 restricted stock units vested.

A RSU award represents the right to receive shares of the Company's common stock in the future, after the applicable vesting criteria, determined by the plan administrator, has been satisfied. The holder of an award of RSU has no rights as a stockholder until shares of common stock are issued in settlement of vested restricted stock units. The plan administrator may provide for a grant of dividend equivalent rights in connection with the grant of RSU; provided, however, that if the restricted stock units do not vest solely upon satisfaction of continued employment or service, any

payment in respect to the related dividend equivalent rights will be held by the Company and paid when, and only to the extent that, the related RSU vest.

11. Subsequent Events

On April 20, 2015, the Company, through the Operating Partnership, entered into an Agreement of Purchase and Sale to acquire a property in Denver, Colorado for \$25.8 million. The principal conditions to the acquisition have been satisfied and the transaction is anticipated to close, subject to customary closing conditions, in June 2015. However, there can be no assurance as to the timing of the closing or whether the closing will actually occur.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis is based on, and should be read in conjunction with, the condensed, consolidated and combined financial statements and the related notes thereto of the City Office REIT, Inc. for the three months ended March 31, 2015 and the City Office Predecessor (as defined in this section) for the three months ended March 31, 2014.

As used in this section, unless the context otherwise requires, references to we, our, us, and our company refer to City Office REIT, Inc., a Maryland corporation, together with our consolidated subsidiaries, including City Office REIT Operating Partnership L.P., a Maryland limited partnership, of which we are the sole general partner and which we refer to in this section as our Operating Partnership, except where it is clear from the context that the term only means City Office REIT, Inc. References to the City Office Predecessor are to the real estate activity and holdings of the entities that own the historical interests in the AmberGlen, Central Fairwinds, City Center, Cherry Creek, Corporate Parkway and Washington Group Plaza properties.

Cautionary Statement Regarding Forward-Looking Statements

This quarterly report on Form 10-Q, including Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition, contains both historical and forward-looking statements. All statements, other than statements of historical fact are, or may be deemed to be, forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward looking statements are not based on historical facts, but rather reflect our current expectations and projections about our future results, performance, prospects and opportunities. We have tried to identify these forward looking statements by using words including anticipate, believe, expect, intend, may, might, plan, estimate, project, should, will, result and similar terms and phrases. These forward looking statements are subject to a number of known and unknown risks, uncertainties and other factors that are difficult to predict and which could cause our actual future results, performance, prospects or opportunities to differ materially from those expressed in, or implied by, these forward looking statements. These risks, uncertainties and other factors include, among others:

changes in the real estate industry and in performance of the financial markets;

competition in the leasing market;

the demand for and market acceptance of our properties for rental purposes;

the amount and growth of our expenses;

tenant financial difficulties and general economic conditions, including interest rates, as well as economic conditions in our geographic markets;

defaults or non-renewal of leases; risks associated with joint venture partners; the risks associated with the ownership and development of real property, including risks related to natural disasters;

risks associated with property acquisitions, the failure to acquire or sell properties as and when anticipated;

the outcome of claims and litigation involving or affecting the Company;

the ability to satisfy conditions necessary to close pending transactions;

our failure to maintain our status as real estate investment trust, or REIT; and

other factors described in our news releases and filings with the Securities and Exchange Commission (the SEC), including but not limited to our reports on Form 8-K.

Table of Contents

The forward looking statements included in this report are made only as of the date of this report, and except as otherwise required by federal securities law, we do not have any obligation to publicly update or revise any forward looking statements to reflect subsequent events or circumstances.

Overview

Company

We were formed as a Maryland corporation on November 26, 2013. On April 21, 2014, we completed our initial public offering (IPO) of shares of common stock. We contributed the net proceeds of the IPO to our Operating Partnership in exchange for common units in our Operating Partnership. Both we and our Operating Partnership commenced operations upon completion of the IPO and certain related formation transactions (the Formation Transactions).

The Company upon completion of the Formation Transactions entered into the Advisory Agreement with our Advisor pursuant to which the Advisor will provide management and advisory services to the Company. The Advisory Agreement requires our Advisor to manage our business affairs in conformity with policies and investment guidelines that are approved and monitored by our board of directors.

Our interest in our Operating Partnership entitles us to share in distributions from, and allocations of profits and losses of, our Operating Partnership in proportion to our percentage ownership of common units. As the sole general partner of our Operating Partnership, we have the exclusive power under the partnership agreement to manage and conduct our Operating Partnership's business, subject to limited approval and voting rights of the limited partners.

On April 21, 2014, we closed the IPO, pursuant to which we sold 5,800,000 shares of common stock to the public at a public offering price of \$12.50 per share. We raised \$72.5 million in gross proceeds, resulting in net proceeds to us of approximately \$63.4 million after deducting approximately \$5.1 million in underwriting discounts and approximately \$4.0 million in other expenses relating to the IPO. On May 9, 2014, the underwriters of the IPO partially exercised their overallotment option with respect to an additional 782,150 shares of our common stock at the IPO price of \$12.50 a share resulting in additional gross proceeds of approximately \$9.8 million. The net proceeds to us were \$9.1 million after deducting approximately \$0.7 million in underwriting discounts. Our common stock began trading on the NYSE under the symbol CIO on April 15, 2014.

Pursuant to the Formation Transactions and exercise of the underwriters' over-allotment option, our Operating Partnership acquired a 100% interest in each of the Washington Group Plaza, Cherry Creek and Corporate Parkway properties and acquired an approximate 76% economic interest in the AmberGlen property, 90% interest in the Central Fairwinds property and 95% interest in the City Center property. These initial property interests were contributed in exchange for 3,731,209 common units, 1,858,860 shares of our common stock and \$19.4 million of cash. On May 9, 2014, subsequent to the exercise of the underwriters' over-allotment option, 479,305 common units and 248,095 common stock were redeemed for \$9.1 million in cash.

On December 10, 2014, we completed a public offering pursuant to which we sold 3,750,000 of our common stock to the public at a price of \$12.50 per share. We raised \$46.9 million in gross proceeds, resulting in net proceeds to us of approximately \$43.7 million after deducting approximately \$2.6 million in underwriting discounts and approximately \$0.6 million in other expenses relating to the offering. On December 23, 2014, the underwriters of the offering exercised their overallotment option to purchase an additional 512,664 shares of our common stock at the offering price of \$12.50 a share resulting in additional gross proceeds to us of approximately \$6.4 million resulting in net proceeds to us of \$6.1 million after deducting approximately \$0.3 million in underwriting discounts. The net proceeds

were used entirely to redeem 336,195 common units and 176,469 common stock held by the Operating Partnerships non-controlling interest.

We intend to elect to be taxed and to continue to operate in a manner that will allow us to qualify as a REIT commencing with our taxable year ended December 31, 2014. So long as we qualify as a REIT, we will be permitted to deduct distributions paid to our stockholders, eliminating the U.S. federal taxation of income represented by such distributions at the company level. REITs are subject to a number of organizational and operational requirements. If we fail to qualify as a REIT in any taxable year, we will be subject to U.S. federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate tax rates.

Table of Contents

Indebtedness

In connection with the IPO and the related Formation Transactions, we extinguished the mortgage loan secured by the Central Fairwinds property and completed a refinancing of three properties (Cherry Creek, City Center and Corporate Parkway) with a new \$95 million non-recourse mortgage loan and proceeds from the IPO. On April 29, 2014, we completed a \$25.4 million refinancing of the AmberGlen property. Following the Formation Transactions, the Washington Group Plaza property remained subject to the existing mortgage loan.

For additional information regarding the new mortgage loan, the AmberGlen Mortgage loan, the Washington Mortgage loan and the Secured Credit Facility, please refer to *Liquidity and Capital Resources* below.

Revenue Base

As of March 31, 2015, we owned 10 properties comprised of 22 office buildings with a total of approximately 2.4 million square feet of net rentable area (NRA). As of March 31, 2015, our properties were approximately 94% leased.

Office Leases

Historically, most leases for our initial properties were on a full-service gross or net lease basis, and we expect to continue to use such leases in the future. A full-service gross lease generally has a base year expense stop, whereby we pay a stated amount of expenses as part of the rent payment while future increases (above the base year stop) in property operating expenses are billed to the tenant based on such tenant's proportionate square footage in the property. The property operating expenses are reflected in operating expenses; however, only the increased property operating expenses above the base year stop recovered from tenants are reflected as tenant recoveries in our statements of operations. In a net lease, the tenant is typically responsible for all property taxes and operating expenses. As such, the base rent payment does not include any operating expenses, but rather all such expenses are billed to or paid by the tenant. The full amount of the expenses for this lease type is reflected in operating expenses, and the reimbursement is reflected in tenant recoveries. The tenants in the Corporate Parkway property and the Lake Vista Pointe property have net leases. We are also a lessor for a fee simple ground lease at the AmberGlen property. All of our remaining leases are full-service gross leases.

Interest Rate Contracts

As of March 31, 2015, we did not have any interest rate contracts.

Factors That May Influence Our Operating Results and Financial Condition

Business and Strategy

We focus on owning and acquiring office properties in our target markets. Our target markets generally possess what we believe are favorable economic growth trends, growing populations with above-average employment growth forecasts, a large number of government offices, large international, national and regional employers across diversified industries, are generally low-cost centers for business operations, and exhibit favorable occupancy trends. We utilize our Advisor's market-specific knowledge and relationships as well as the expertise of local real estate operators and our investment partners to identify acquisition opportunities that we believe will offer cash flow stability and long-term value appreciation. Our target markets are attractive, among other reasons, because we believe that ownership is often concentrated among local real estate operators that typically do not benefit from the same

access to capital as public REITs and there is a relatively low level of participation of large institutional investors. We believe that these factors result in attractive pricing levels and risk-adjusted returns.

Table of Contents

Rental Revenue and Tenant Recoveries

The amount of net rental revenue generated by our properties will depend principally on our ability to maintain the occupancy rates of currently leased space and to lease currently available space and space that becomes available from lease terminations. As of March 31, 2015, our properties were approximately 94% leased. The amount of rental revenue generated also depends on our ability to maintain or increase rental rates at our properties. We believe that the average rental rates for our portfolio of properties are generally in-line or slightly below the current average quoted market rates. Negative trends in one or more of these factors could adversely affect our rental revenue in future periods. Future economic downturns or regional downturns affecting our markets or submarkets or downturns in our tenants' industries that impair our ability to renew or re-let space and the ability of our tenants to fulfill their lease commitments, as in the case of tenant bankruptcies, could adversely affect our ability to maintain or increase rental rates at our properties. In addition, growth in rental revenue will also partially depend on our ability to acquire additional properties that meet our investment criteria.

Operating Expenses

Our operating expenses generally consist of utilities, property and ad valorem taxes, insurance and site maintenance costs. Increases in these expenses over tenants' base years (until the base year is reset at expiration) are generally passed along to tenants in our full-service gross leased properties and are generally paid in full by tenants in our net leased properties.

Conditions in Our Markets

Positive or negative changes in economic or other conditions in the markets we operate in, including state budgetary shortfalls, employment rates, natural hazards and other factors, may impact our overall performance.

Summary of Significant Accounting Policies

The interim financial statements follow the same policies and procedures as outlined in the audited combined financial statements for the year ended December 31, 2014 included in the Company's Annual Report on Form 10-K filing for the year ended December 31, 2014.

Results of Operations

Comparison of Three Months Ended March 31, 2015 to Three Months Ended March 31, 2014

The three months ended March 31, 2015 includes our consolidated results whereas the comparable period in 2014 are the results of the City Office Predecessor and accordingly may not be directly comparable due to the impact of the IPO and the Formation Transactions on April 21, 2014 and the absence of any public company and related costs prior to that time. In the forthcoming comparison, we have highlighted the impact of the IPO and Formation Transactions where applicable.

Revenue

Total Revenue. Revenue includes net rental income, including parking, signage and other income, as well as the recovery of operating costs and property taxes from tenants. Total revenues increased \$3.3 million, or 41%, to \$11.3 million for the three month period ended March 31, 2015 compared to \$8.0 million in the corresponding period in 2014. Revenue in 2015 increased by \$1.0 million from the acquisition of the Plaza 25 property in June 2014,

\$0.9 million from the acquisition of the Lake Vista Pointe property in July 2014 and \$0.7 million from the acquisition of Florida Research Park in November 2014 and \$0.3 million from the acquisition of Logan Tower in February 2015. City Center and Central Fairwinds increased total revenues by \$0.3 million and \$0.1 million, respectively due to the increased occupancy at the property over the prior year. AmberGlen and Corporate Parkway, Washington Group Plaza and Cherry Creek revenues were relatively unchanged in comparison to the prior year.

Rental Income. Rental income includes net rental income, income from a ground lease and lease termination income. Total rental income increased \$2.8 million, or 39%, to \$10.0 million for the three month period ended March 31, 2015 compared to \$7.2 million for the three months ended March 31, 2014. The increase in rental income was primarily due to the acquisitions described above. The acquisition of the Plaza 25, Lake Pointe Vista, Florida Research Park and Logan Tower properties contributed an additional \$1.0 million, \$0.6 million, \$0.6 million, and \$0.2 million in rental income, respectively to the 2015 period rental income. City Center and Central Fairwinds increased total rental income by \$0.3 million and \$0.1 million, respectively, due to the increased occupancy at the property over the prior year period.

Table of Contents

Expense Reimbursement. Total expense reimbursement increased \$0.4 million, or 98%, to \$0.9 million for the three month period ended March 31, 2015 compared to \$0.5 million for the same period in 2014, primarily due to the acquisition of the Plaza 25, Lake Vista Pointe, Florida Research Park and Logan Tower properties described above.

Other. Other revenue includes parking, signage and other miscellaneous income. Total other revenues were unchanged at \$0.3 million for the three month period ended March 31, 2015 as compared to the corresponding period in 2014. Nominal other income was generated by Washington Group Plaza, Plaza 25, Lake Vista Pointe, Florida Research Park and Logan Tower.

Operating Expenses

Total Operating Expenses. Total operating expenses consist of property operating expenses, as well as acquisition costs, base management fees, stock-based compensation, and general and administrative expenses and depreciation and amortization. Total operating expenses increased by \$2.8 million, or 39%, to \$9.9 million for the three month period ended March 31, 2015, from \$7.1 million for the same period in 2014, primarily due to the acquisitions described above. Total operating expenses increased by \$1.0 million, \$0.7 million, \$0.4 million, and \$0.4 million, respectively, from the acquisition of the Plaza 25 property in June 2014, the acquisition of the Lake Vista Pointe property in July 2014, the acquisition of Florida Research Park property in November 2014 and the acquisition of the Logan Tower property in February 2015. AmberGlen, City Center, Central Fairwinds, Corporate Parkway, Washington Group Plaza and Cherry Creek operating expenses were relatively unchanged in comparison to the prior year. The remaining increase relates to acquisition fees, stock-based compensation, base management fees and general and administrative expenses following the closing of the IPO and Formation Transactions on April 21, 2014.

Property Operating Expenses. Property operating expenses are comprised mainly of building common area and maintenance expenses, insurance, property taxes, property management fees, as well as certain expenses that are not recoverable from tenants, the majority of which are related to costs necessary to maintain the appearance and marketability of vacant space. In the normal course of business, property expenses fluctuate and are impacted by various factors including, but not limited to, occupancy levels, weather, utility costs, repairs, maintenance and re-leasing costs. Property operating expenses increased \$1.0 million, or 32%, to \$4.1 million for the three month period ended March 31, 2015 from \$3.1 million for the same period in 2014. The increase in property operating expenses was primarily due to the acquisitions described above. The acquisition of the Plaza 25, Florida Research Park, Lake Vista Pointe and Logan Tower properties contributed an additional \$0.5 million, \$0.3 million, \$0.1 million, and \$0.1 million in additional property operating expenses, respectively.

Acquisition Costs. Acquisition costs decreased \$0.6 million, or 74%, to \$0.2 million for the three month period ended March 31, 2015 compared to \$0.8 million for the three months ended March 31, 2014. The acquisition costs in the 2015 period are related to the Logan Tower acquisitions whereas in the prior year period, the acquisition costs were related to Cherry Creek.

Base Management Fee. Base Management Fee was \$0.3 million for the three month period ended March 31, 2015 representing the fee paid to our Advisor. No management fees were payable by the Predecessor for the 2014 period.

Stock-Based Compensation. Stock-based compensation was \$0.4 million for the three month period ended March 31, 2015 representing the amortization of the management equity grants issued as part of the Formation Transactions, upon completion of the IPO.

Table of Contents

General and Administrative. General and administrative expenses were \$0.4 million for the three month period ended March 31, 2015 representing public company costs following completion of the IPO.

Depreciation and Amortization. Depreciation and amortization increased \$1.2 million, or 39%, to \$4.4 million for the three month period ended March 31, 2015 compared to \$3.2 million for the same period in 2014, primarily due to the addition of the Plaza 25, Lake Vista Pointe, Florida Research Park and Logan Tower properties.

Other Expense (Income)

Interest Expense, Net. Interest expense decreased \$1.0 million, or 31%, to \$2.2 million for the three month period ended March 31, 2015, compared to \$3.