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Equity Commonwealth
Form 10-Q
May 05, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended March 31, 2016
OR

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

Commission File Number 1-9317

EQUITY COMMONWEALTH

(Exact Name of Registrant as Specified in Its Charter)

Maryland

04-6558834

(State or Other Jurisdiction of Incorporation or Organization) (IRS Employer Identification No.)

Two North Riverside Plaza, Suite 2100, Chicago, IL 60606

(Address of Principal Executive Offices) (Zip Code)

(312) 646-2800

(Registrant's Telephone Number, Including Area Code)

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 ☐

Smaller reporting company ☐

(Do not check if a 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 ☒

Number of registrant's common shares of beneficial interest, \$0.01 par value per share, outstanding as of April 30, 2016: 125,502,209.

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EQUITY COMMONWEALTH

FORM 10-Q

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EXPLANATORY NOTE

References in this Quarterly Report on Form 10-Q to the Company, EQC, we, us or our, refer to Equity Commonwealth and its consolidated subsidiaries as of March 31, 2016, unless the context indicates otherwise.

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PART I. Financial Information

Item 1. Financial Statements.

EQUITY COMMONWEALTH

CONDENSED CONSOLIDATED BALANCE SHEETS

(amounts in thousands, except share data)

(unaudited)

	March 31, 2016	December 31, 2015 (audited)
ASSETS		
Real estate properties:		
Land	\$372,714	\$389,410
Buildings and improvements	3,399,909	3,497,942
	3,772,623	3,887,352
Accumulated depreciation	(880,678)	(898,939)
	2,891,945	2,988,413
Properties held for sale	20,347	—
Acquired real estate leases, net	83,121	88,760
Cash and cash equivalents	1,742,128	1,802,729
Restricted cash	36,190	32,245
Rents receivable, net of allowance for doubtful accounts of \$4,193 and \$7,715, respectively	176,740	174,676
Other assets, net	152,678	144,341
Total assets	\$5,103,149	\$5,231,164
LIABILITIES AND SHAREHOLDERS' EQUITY		
Senior unsecured debt, net	\$1,312,148	\$1,450,606
Mortgage notes payable, net	245,691	246,510
Liabilities related to properties held for sale	169	—
Accounts payable and accrued expenses	120,888	123,587
Assumed real estate lease obligations, net	3,624	4,296
Rent collected in advance	23,588	27,340
Security deposits	9,670	10,338
Total liabilities	1,715,778	1,862,677
Shareholders' equity:		
Preferred shares of beneficial interest, \$0.01 par value: 50,000,000 shares authorized; Series D preferred shares; 6 1/2% cumulative convertible; 4,915,196 shares issued and outstanding, aggregate liquidation preference of \$122,880	119,263	119,263
Series E preferred shares; 7 1/4% cumulative redeemable on or after May 15, 2016; 11,000,000 shares issued and outstanding, aggregate liquidation preference \$275,000	265,391	265,391
Common shares of beneficial interest, \$0.01 par value: 350,000,000 shares authorized; 125,502,748 and 126,349,914 shares issued and outstanding, respectively	1,255	1,263
Additional paid in capital	4,393,409	4,414,611
Cumulative net income	2,380,111	2,333,709
Cumulative other comprehensive loss	(3,014)	(3,687)

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Cumulative common distributions	(3,111,868)	(3,111,868)
Cumulative preferred distributions	(657,176)	(650,195)
Total shareholders' equity	3,387,371	3,368,487
Total liabilities and shareholders' equity	\$5,103,149	\$5,231,164
See accompanying notes.		

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EQUITY COMMONWEALTH

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(amounts in thousands, except per share data)

(unaudited)

	Three Months Ended March 31,	
	2016	2015
Revenues:		
Rental income	\$109,888	\$167,972
Tenant reimbursements and other income	27,247	45,083
Total revenues	137,135	213,055
Expenses:		
Operating expenses	57,258	97,871
Depreciation and amortization	36,251	62,699
General and administrative	13,312	16,558
Loss on asset impairment	—	1,904
Total expenses	106,821	179,032
Operating income	30,314	34,023
Interest and other income	1,967	3,448
Interest expense (including net amortization of debt discounts, premiums and deferred financing fees of \$983 and \$29, respectively)	(22,347)	(29,842)
Loss on early extinguishment of debt	(118)	(428)
Foreign currency exchange loss	(5)	—
Gain on sale of properties	36,666	5,868
Income before income taxes	46,477	13,069
Income tax (expense) benefit	(75)	561
Net income	46,402	13,630
Preferred distributions	(6,981)	(6,981)
Net income attributable to Equity Commonwealth common shareholders	\$39,421	\$6,649
Weighted average common shares outstanding — basic	125,840	129,696
Weighted average common shares outstanding — diluted	127,522	129,874
Earnings per common share attributable to Equity Commonwealth common shareholders:		
Basic	\$0.31	\$0.05
Diluted	\$0.31	\$0.05

See accompanying notes.

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EQUITY COMMONWEALTH

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(amounts in thousands)

(unaudited)

	Three Months Ended March 31,	
	2016	2015
Net income	\$46,402	\$13,630
Other comprehensive income (loss), net of tax:		
Unrealized gain (loss) on derivative instruments and other assets	673	(2,622)
Foreign currency translation adjustments	—	(16,390)
Total comprehensive income (loss)	\$47,075	\$(5,382)

See accompanying notes.

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EQUITY COMMONWEALTH
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in thousands)
(unaudited)

	Three Months Ended March 31,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$46,402	\$13,630
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	28,582	46,418
Net amortization of debt discounts, premiums and deferred financing fees	983	29
Straight line rental income	(3,831)	) 187
Amortization of acquired real estate leases	4,629	10,304
Other amortization	4,161	7,346
Share-based compensation	4,353	3,958
Loss on asset impairment	—	1,904
Loss on early extinguishment of debt	118	428
Foreign currency exchange loss	5	—
Net gain on sale of properties	(36,666)	) (5,868)
Change in assets and liabilities:		
Restricted cash	(458)	) 2,366
Rents receivable and other assets	(15,486)	) (28,678)
Accounts payable and accrued expenses	(6,361)	) (11,134)
Rent collected in advance	(3,255)	) (620)
Security deposits	(192)	) 51
Cash provided by operating activities	22,984	40,321
CASH FLOWS FROM INVESTING ACTIVITIES:		
Real estate improvements	(25,963)	) (12,163)
Principal payments received from direct financing lease	—	1,883
Proceeds from sale of properties, net	118,391	19,841
Proceeds from sale of securities	—	27,068
Increase in restricted cash	(3,487)	) (3,458)
Cash provided by investing activities	88,941	33,171
CASH FLOWS FROM FINANCING ACTIVITIES:		
Purchase and retirement of common shares	(25,563)) —
Payments on borrowings	(139,922)	) (1,589)
Deferred financing fees	(52)	) (7,143)
Distributions to preferred shareholders	(6,981)	) (6,981)
Cash used in financing activities	(172,518)	) (15,713)
Effect of exchange rate changes on cash	(8)	) (559)
(Decrease) increase in cash and cash equivalents	(60,601)	) 57,220
Cash and cash equivalents at beginning of period	1,802,729	364,516
Cash and cash equivalents at end of period	\$1,742,128	\$421,736
See accompanying notes.		

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

(amounts in thousands)

(unaudited)

	Three Months Ended March 31,	
	2016	2015
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$28,542	\$33,479
Taxes (refunded) paid	(72)	2,251

NON-CASH INVESTING ACTIVITIES:

(Decrease) increase in capital expenditures recorded as liabilities \$(6,312) \$1,139

See accompanying notes.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation

The accompanying condensed consolidated financial statements of EQC have been prepared without audit. Certain information and footnote disclosures required by U.S. generally accepted accounting principles, or GAAP, for complete financial statements have been condensed or omitted. We believe the disclosures made are adequate to make the information presented not misleading. However, the accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes contained in our Annual Report on Form 10-K (Annual Report) for the year ended December 31, 2015. Capitalized terms used, but not defined in this Quarterly Report, have the same meanings as in our Annual Report.

In the opinion of our management, all adjustments, which include only normal recurring adjustments considered necessary for a fair presentation, have been included. All intercompany transactions and balances with or among our subsidiaries have been eliminated. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year. Reclassifications have been made to the prior years' financial statements to conform to the current year's presentation.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect reported amounts. Actual results could differ from those estimates. Significant estimates in the condensed consolidated financial statements include the allowance for doubtful accounts, purchase price allocations, useful lives of fixed assets and impairment of real estate and intangible assets.

Share amounts are presented in whole numbers, except where noted.

Note 2. Recent Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This update is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods, but early adoption is permitted. We are currently in the process of evaluating the impact the adoption of this ASU will have on our condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases, which amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets. The ASU also requires lessees or lessors to capitalize only initial direct costs of leases. This update is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, but early adoption is permitted. We are currently in the process of evaluating the impact the adoption of this ASU will have on our condensed consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which provides guidance for revenue recognition. This update is effective for interim and annual reporting periods beginning after December 15, 2017. We are currently in the process of evaluating the impact, if any, the adoption of this ASU will have on our condensed consolidated financial statements.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

In April 2015, the FASB issued ASU No. 2015-03, Simplifying the Presentation of Debt Issuance Costs. This standard amends existing guidance to require the presentation of debt issuance costs in the balance sheet as a deduction from the carrying amount of the related debt liability instead of as a deferred charge. It is effective for annual reporting periods beginning after December 15, 2015, but early adoption is permitted. We adopted this standard on January 1, 2016 and made the following reclassifications to the prior years' consolidated balance sheet to conform to the current year's presentation (in thousands):

Balance Sheet as of December 31, 2015	Originally Reported	Effect of Change	As Adjusted
Other assets, net	157,549	(13,208)	144,341
Senior unsecured debt, net	1,460,592	(9,986)	1,450,606
Mortgage notes payable, net	249,732	(3,222)	246,510

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, or ASU 2014-08. ASU 2014-08 changes the criteria for reporting a discontinued operation. Under the new pronouncement, a disposal of a part of an organization that has a major effect on its operations and financial results is a discontinued operation. We adopted ASU 2014-08 on January 1, 2015, and determined that our 2016 dispositions, 2015 dispositions and properties held for sale as of March 31, 2016 do not individually represent a strategic shift, as defined by the standard, that has or will have a major effect on our operations and financial results. As a result, the 2016 and 2015 dispositions and properties held for sale have not been presented as discontinued operations in the statements of operations.

Note 3. Real Estate Properties

During the three months ended March 31, 2016 and 2015, we made improvements, excluding tenant-funded improvements, to our properties totaling \$31.9 million and \$10.9 million, respectively.

Properties Held For Sale:

We classify all properties that meet the criteria outlined in the Property, Plant and Equipment Topic of the FASB Accounting Standards Codification (Codification) as held for sale on our condensed consolidated balance sheets. As of December 31, 2015, we had no properties classified as held for sale. As of March 31, 2016, we classified the following properties as held for sale (dollars in thousands):

Asset	Date Sold	Number of Properties	Number of Buildings	Square Footage	Gross Sales Price
1525 Locust Street	April 2016	1	1	98,009	\$17,700
633 Ahua Street	April 2016	1	1	93,141	29,000
		2	2	191,150	\$46,700

Summarized balance sheet information for all properties classified as held for sale is as follows (in thousands):

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	March 31, 2016
Real estate properties	\$ 19,568
Rents receivable, net of allowance for doubtful accounts of \$159	21
Other assets, net	758
Properties held for sale	\$ 20,347
Rent collected in advance	\$ 10
Security deposits	159
Liabilities related to properties held for sale	\$ 169

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Property Dispositions:

During the three months ended March 31, 2016, we sold the following properties (dollars in thousands):

Asset	Date Disposed	Number of Properties	Number of Buildings	Square Footage	Gross Sales Price	Gain on Sale
Executive Park	February 2016	1	9	427,443	\$50,865	\$16,532
3330 N Washington Boulevard	March 2016	1	1	55,719	11,250	5,457
111 East Kilbourn Avenue	March 2016	1	1	373,669	60,500	14,677
		3	11	856,831	\$122,615	\$36,666

During the year ended December 31, 2015, we disposed of 91 properties (135 buildings) and one land parcel with a combined 18.9 million square feet for an aggregate gross sales price of \$2.0 billion, excluding closing costs.

Note 4. Real Estate Mortgages Receivable

As of March 31, 2016 and December 31, 2015, we had total real estate mortgages receivable with an aggregate carrying value of \$8.1 million included in other assets in our condensed consolidated balance sheets. We provided mortgage financing totaling \$7.7 million at 6.0% per annum in connection with our sale of three suburban office and industrial properties (18 buildings) in January 2013 in Dearborn, MI; this real estate mortgage requires monthly interest payments and matures on January 24, 2023. We also provided mortgage financing totaling \$0.4 million at 6.0% per annum in connection with our sale of a suburban office property in Salina, NY in April 2012. This real estate mortgage requires monthly interest payments and matures on April 30, 2019.

We monitor the payment history of the borrowers and have determined that no allowance for losses related to these real estate mortgages receivable were necessary at March 31, 2016, and December 31, 2015.

Note 5. Indebtedness

Unsecured Revolving Credit Facility and Term Loan:

We are party to a credit agreement, pursuant to which the lenders agreed to provide a \$750.0 million unsecured revolving credit facility, a \$200.0 million 5-year term loan facility, and a \$200.0 million 7-year term loan facility. The revolving credit facility has a scheduled maturity date of January 28, 2019, which maturity date may be extended for up to two additional periods of six months at our option subject to satisfaction of certain conditions and the payment of an extension fee of 0.075% of the aggregate amount available under the revolving credit facility. The 5-year term loan and the 7-year term loan have scheduled maturity dates of January 28, 2020 and January 28, 2022, respectively.

The credit agreement permits us to utilize up to \$100.0 million of the revolving credit facility for the issuance of letters of credit. Amounts outstanding under the credit agreement generally may be prepaid at any time without premium or penalty, subject to certain exceptions. We have the right to request increases in the aggregate maximum amount of borrowings available under the revolving credit facility and term loans up to an additional \$1.15 billion, subject to certain conditions.

Borrowings under the 5-year term loan and 7-year term loan will, subject to certain exceptions, bear interest at a LIBOR rate plus a margin of 90 to 180 basis points for the 5-year term loan and 140 to 235 basis points for the 7-year term loan, in each case depending on our credit rating. Borrowings under the revolving credit facility will, subject to certain exceptions, bear interest at a rate equal to, at our option, either a LIBOR rate or a base rate plus a margin of 87.5 to 155 basis points for LIBOR rate advances and 0 to 55 basis points for base rate advances, in each case depending on our credit rating. In addition, we are required to pay a facility fee of 12.5 to 30 basis points, depending on our credit rating, on the borrowings available under the revolving credit facility, whether or not utilized.

Borrowings under our revolving credit facility currently bear interest at LIBOR plus a spread, which was 125 basis points as of March 31, 2016. As of March 31, 2016, the interest rate payable on borrowings under our revolving credit facility was 1.69%. As of March 31, 2016, we had no balance outstanding and \$750.0 million available under our revolving credit facility

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

and the facility fee as of March 31, 2016 was 0.25%. Our term loans currently bear interest at a rate of LIBOR plus a spread, which was 140 and 180 basis points for the 5-year and 7-year term loan, respectively, as of March 31, 2016. As of March 31, 2016, the interest rates for the amounts outstanding under our 5-year term loan and 7-year term loan were 1.84% and 2.24%, respectively. As of March 31, 2016, we had \$200.0 million outstanding under each of our 5-year and 7-year term loans.

Debt Covenants:

Our public debt indenture and related supplements, our revolving credit facility agreement and our term loan agreement contain a number of financial and other covenants, including covenants that restrict our ability to incur indebtedness or to make distributions under certain circumstances and require us to maintain financial ratios and a minimum net worth. At March 31, 2016, we believe we were in compliance with all of our respective covenants under our public debt indenture and related supplements, our revolving credit facility and our term loan agreements.

Senior Unsecured Notes:

On February 16, 2016, we redeemed at par \$139.1 million of our 6.25% senior unsecured notes due 2016 and recognized a loss on early extinguishment of debt of \$0.1 million from the write-off of an unamortized discount and unamortized deferred financing fees for the three months ended March 31, 2016.

Mortgage Notes Payable:

At March 31, 2016, five of our properties (8 buildings) with an aggregate net book value of \$288.7 million had secured mortgage notes totaling \$245.7 million (including net premiums and discounts and unamortized deferred financing fees) maturing from 2017 through 2026.

Note 6. Shareholders' Equity

Common Share Issuances:

See Note 10 for information regarding equity issuances related to share-based compensation.

Common Share Repurchases:

On August 24, 2015, our Board of Trustees approved a common share repurchase plan, which authorizes the repurchase of up to \$100.0 million of our outstanding common shares over the twelve month period following the date of authorization. On September 14, 2015, our Board of Trustees authorized the repurchase of up to an additional \$100.0 million of our outstanding common shares over the twelve month period following the date of authorization. On March 17, 2016, our Board of Trustees authorized the repurchase of up to an additional \$150.0 million of our outstanding common shares over the next twelve month period following the date of authorization. During the three months ended March 31, 2016, we purchased and retired 983,789 of our common shares at a weighted average price of \$25.94 per share.

Preferred Share Distributions:

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In 2016, our Board of Trustees declared distributions on our series D preferred shares and series E cumulative redeemable preferred shares to date as follows:

Declaration Date	Record Date	Payment Date	Series D	Series E
			Dividend Per Share	Dividend Per Share
January 26, 2016	February 5, 2016	February 16, 2016	\$0.40625	\$0.453125

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 7. Cumulative Other Comprehensive Loss

The following tables present the amounts recognized in cumulative other comprehensive loss for the three months ended March 31, 2016 (in thousands):

	Unrealized Loss on Derivative Instruments
Balances as of January 1, 2016	\$ (3,687)
Other comprehensive loss before reclassifications	(445)
Amounts reclassified from cumulative other comprehensive loss to net income	1,118
Net current period other comprehensive income	673
Balances as of March 31, 2016	\$ (3,014)

The following tables present reclassifications out of cumulative other comprehensive loss for the three months ended March 31, 2016 (in thousands):

Details about Cumulative Other Comprehensive Loss Components	Amounts Reclassified from Cumulative Other Comprehensive Loss to Net Income Three Months Ended March 31, 2016	Affected Line Items in the Statement of Operations
Interest rate swap contracts	\$ 1,118	Interest expense

Note 8. Income Taxes

We have elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, and are generally not subject to federal and state income taxes provided we distribute a sufficient amount of our taxable income to our shareholders and meet other requirements for qualifying as a REIT. We are also subject to certain state and local taxes without regard to our REIT status. In prior periods, we were subject to Australian taxes.

Our provision for income taxes consists of the following (in thousands):

Three
Months
Ended
March 31,
20162015

Current:

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State	\$75	\$90
Foreign	—	(46)
	75	44
Deferred:		
Foreign	—	(605)
	—	(605)
Income tax expense (benefit)	\$75	\$(561)

Note 9. Derivative Instruments

Risk Management Objective of Using Derivatives

We are exposed to certain risks relating to our ongoing business operations, including the effect of changes in interest rates. The only risk we currently manage by using derivative instruments is related to our interest rate risk.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

We may use derivative financial instruments, including interest rate swaps, caps, options, floors and other interest rate derivative contracts, to hedge all or a portion of the interest rate risk associated with our borrowings. The principal objective of such arrangements is to minimize the risks and/or costs associated with our operating and financial structure as well as to hedge specific anticipated transactions. We do not intend to utilize derivatives for speculative or other purposes other than interest rate risk management. The use of derivative financial instruments carries certain risks, including the risk that the counterparties to these contractual arrangements are not able to perform under the agreements. To mitigate this risk, we only enter into derivative financial instruments with counterparties with high credit ratings and with major financial institutions with which we and our affiliates may also have other financial relationships. We do not anticipate that any of the counterparties will fail to meet their obligations.

Cash Flow Hedges of Interest Rate Risk

Our objectives in using interest rate derivatives are to add stability to interest expense and to manage our exposure to interest rate movements. To accomplish this objective, we periodically use interest rate swaps, caps, or other similar instruments as part of our interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for us making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in cumulative other comprehensive loss and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. During 2016, such derivatives were used to hedge the variable cash flows associated with variable-rate debt. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings.

Amounts reported in cumulative other comprehensive loss related to derivatives will be reclassified to interest expense as interest payments are made on our variable-rate debt. During the next twelve months, we estimate that an additional \$2.9 million will be reclassified from cumulative other comprehensive loss as an increase to interest expense.

We have interest rate swap agreements to manage our interest rate risk exposure on \$169.2 million of mortgage debt due 2019, which require interest at a spread over LIBOR. The interest rate swap agreements utilized by us qualify as cash flow hedges and effectively modify our exposure to interest rate risk by converting our floating interest rate debt to a fixed interest rate basis for this loan through December 1, 2016, thus reducing the impact of interest rate changes on future interest expense.

On March 4, 2016, we purchased an interest rate cap with a LIBOR strike price of 2.50%. The interest rate cap, effective April 1, 2016, has a notional amount of \$400.0 million and a maturity date of March 1, 2019.

As of March 31, 2016, we had the following outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk:

Interest Rate Derivative	Number of Instruments	Notional Amount (in thousands)
Interest rate swap	2	\$ 169,119
Interest rate cap	1	\$ 400,000

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The table below presents the fair value of our derivative financial instruments as well as their classification on the condensed consolidated balance sheets as of March 31, 2016 and December 31, 2015 (amounts in thousands):

Interest Rate Derivative Designated as Hedging Instrument	Balance Sheet Location	Fair Value as of	
		March 31, 2016	December 31, 2015
Pay-fixed swaps	Accounts payable and accrued expenses	\$(2,850)	\$ (3,687)
Interest rate cap	Other assets	\$358	\$ —

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EQUITY COMMONWEALTH

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The table below details the location in the financial statements of the gain or loss recognized on interest rate derivatives designated as cash flow hedges for the three months ended March 31, 2016 and 2015 (amounts in thousands):

	Three Months Ended March 31,	
	2016	2015
Balance at beginning of period	\$(3,687)	\$(7,462)
Amount of (loss) gain recognized in cumulative other comprehensive loss	(445)	(686)
Amount of loss reclassified from cumulative other comprehensive loss into interest expense	1,118	1,227
Unrealized gain on derivative instruments	673	541
Balance at end of period	\$(3,014)	\$(6,921)

Credit-risk-related Contingent Features

We have agreements with each of our derivative counterparties that contain a provision where if we either default or are capable of being declared in default on any of our indebtedness, then we could also be declared in default on our derivative obligations.

As of March 31, 2016, the fair value of derivatives in a net liability position including accrued interest but excluding any adjustment for nonperformance risk related to these agreements was \$3.2 million. As of March 31, 2016, we have not posted any collateral related to these agreements and were not in breach of any agreement provisions. If we had breached any of these provisions, we could have been required to settle our obligations under the agreements at their aggregate termination value of \$3.2 million at