

City Office REIT, Inc.
Form 10-Q
August 02, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

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 2010
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, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company, and emerging growth 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

Emerging growth company

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

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

The number of shares of Common Stock, \$0.01 par value, of the registrant outstanding at July 30, 2018 was 36,133,271.

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For the Quarter Ended June 30, 2018
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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****City Office REIT, Inc.****Condensed Consolidated Balance Sheets****(Unaudited)***(In thousands, except par value and share data)*

	June 30, 2018	December 31, 2017
Assets		
Real estate properties		
Land	\$ 188,110	\$ 188,110
Building and improvement	581,792	534,473
Tenant improvement	62,796	53,427
Furniture, fixtures and equipment	315	291
	833,013	776,301
Accumulated depreciation	(60,507)	(48,234)
	772,506	728,067
Cash and cash equivalents	14,655	12,301
Restricted cash	17,957	22,713
Rents receivable, net	22,349	20,087
Deferred leasing costs, net	9,231	7,793
Acquired lease intangible assets, net	65,103	65,088
Prepaid expenses and other assets	5,538	2,013
Assets held for sale		38,427
Total Assets	\$ 907,339	\$ 896,489
Liabilities and Equity		
Liabilities:		
Debt	\$ 479,610	\$ 489,509
Accounts payable and accrued liabilities	15,938	17,605
Deferred rent	3,892	4,223
Tenant rent deposits	3,784	3,523
Acquired lease intangible liabilities, net	7,619	8,649
Dividend distributions payable	10,346	10,318
Liabilities related to assets held for sale		2,830
Total Liabilities	521,189	536,657

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

6.625% Series A Preferred stock, \$0.01 par value per share, 5,600,000 shares authorized, 4,480,000 issued and outstanding	112,000	112,000
Common stock, \$0.01 par value, 100,000,000 shares authorized, 36,133,271 and 36,012,086 shares issued and outstanding	361	360
Additional paid-in capital	335,009	334,241
Accumulated deficit	(61,556)	(86,977)
Total Stockholders Equity	385,814	359,624
Non-controlling interests in properties	336	208
Total Equity	386,150	359,832
Total Liabilities and Equity	\$ 907,339	\$ 896,489

Subsequent Events (Note 11)

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

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City Office REIT, Inc.

Condensed Consolidated Statements of Operations

(Unaudited)

(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues:				
Rental income	\$ 25,880	\$ 21,635	\$ 52,894	\$ 43,948
Expense reimbursement	3,545	2,847	7,090	5,141
Other	811	675	1,786	1,466
Total Revenues	30,236	25,157	61,770	50,555
Operating Expenses:				
Property operating expenses	11,748	10,674	23,374	20,284
General and administrative	1,966	1,597	3,943	3,790
Depreciation and amortization	11,771	9,148	23,665	19,646
Total Operating Expenses	25,485	21,419	50,982	43,720
Operating income	4,751	3,738	10,788	6,835
Interest Expense:				
Contractual interest expense	(5,081)	(4,356)	(10,269)	(8,429)
Amortization of deferred financing costs	(354)	(331)	(986)	(655)
	(5,435)	(4,687)	(11,255)	(9,084)
Change in fair value of contingent consideration		2,000		2,000
Net gain on sale of real estate property		12,116	46,980	12,116
Net (loss)/income	(684)	13,167	46,513	11,867
Less:				
Net income attributable to non-controlling interests in properties	(114)	(3,104)	(249)	(3,272)
Net (loss)/income attributable to the Company	(798)	10,063	46,264	8,595
Preferred stock distributions	(1,855)	(1,855)	(3,710)	(3,701)
Net (loss)/income attributable to common stockholders	\$ (2,653)	\$ 8,208	\$ 42,554	\$ 4,894
Net (loss)/income per common share:				
Basic	\$ (0.07)	\$ 0.27	\$ 1.18	\$ 0.16

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Diluted	\$ (0.07)	\$ 0.27	\$ 1.17	\$ 0.16
Weighted average common shares outstanding:				
Basic	36,132	30,257	36,103	29,886
Diluted	36,132	30,563	36,452	30,186
Dividend distributions declared per common share	\$ 0.235	\$ 0.235	\$ 0.470	\$ 0.470

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

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City Office REIT, Inc.

Condensed Consolidated Statements of Changes in Equity

(Unaudited)

(In thousands)

	Number of shares of preferred stock	Number of shares of Preferred stock	Number of shares of common stock	Common stock paid-in	Additional capital	Accumulated deficit	Stockholders' equity	Operating Partnership controlling interests	Non- controlling interests	Total equity
Balance December 31, 2016	4,480	\$ 112,000	24,382	\$ 244	\$ 195,566	\$ (53,608)	\$ 254,202	\$ 108	\$ 1,749	\$ 256,059
Conversion of OP units to shares			40		108		108	(108)		
Restricted stock award grants and vesting			90	1	1,741	(71)	1,671			1,671
Net proceeds from sale of common stock			11,500	115	136,826		136,941			136,941
Common stock dividend distributions declared						(31,148)	(31,148)			(31,148)
Preferred stock dividend distributions declared						(7,906)	(7,906)			(7,906)
Distributions									(4,943)	(4,943)
Net income						5,756	5,756		3,402	9,158
Balance December 31, 2017	4,480	112,000	36,012	360	334,241	(86,977)	359,624		208	359,832
Restricted stock award grants and vesting			121	1	768	(151)	618			618
Common stock dividend						(16,982)	(16,982)			(16,982)

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distributions declared										
Preferred stock dividend distributions declared					(3,710)	(3,710)				(3,710)
Contributions									43	43
Distributions									(164)	(164)
Net income					46,264	46,264			249	46,513

Balance June 30, 2018	4,480	\$ 112,000	36,133	\$ 361	\$ 335,009	\$ (61,556)	\$ 385,814	\$	\$	336	\$ 386,150
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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

	Six Months Ended June 30,	
	2018	2017
Cash Flows from Operating Activities:		
Net income	\$ 46,513	\$ 11,867
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	23,665	19,646
Amortization of deferred financing costs	986	655
Amortization of above/below market leases	(140)	(77)
Increase in straight-line rent	(1,842)	(1,960)
Non-cash stock compensation	705	1,179
Earn-out termination payment		(2,400)
Net gain on sale of real estate property	(46,980)	(12,116)
Changes in non-cash working capital:		
Rents receivable, net	(93)	(1,135)
Prepaid expenses and other assets	(3,034)	(26)
Accounts payable and accrued liabilities	(6,467)	(764)
Deferred rent	(2,042)	(2,620)
Tenant rent deposits	89	(313)
Net Cash Provided By Operating Activities	11,360	11,936
Cash Flows from/(to) Investing Activities:		
Additions to real estate properties	(9,156)	(4,038)
Acquisition of real estate	(55,453)	(46,035)
Net proceeds from sale of real estate	84,839	16,993
Deferred leasing costs	(2,057)	(1,810)
Net Cash Provided By/(Used In) Investing Activities	18,173	(34,890)
Cash Flows (to)/from Financing Activities:		
Proceeds from sale of common stock		67,991
Debt issuance and extinguishment costs	(1,942)	(753)
Proceeds from mortgage loans payable		119,340
Repayment of mortgage loans payable	(34,121)	(25,836)
Proceeds from credit facility	82,000	57,000
Repayment of credit facility	(57,000)	(109,500)
Shares withheld for payment of taxes on restricted stock unit vesting	(86)	
Contributions from non-controlling interests in properties	43	

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Distributions to non-controlling interests in properties	(165)	(4,418)
Dividend distributions paid to stockholders and Operating Partnership unitholders	(20,664)	(18,323)
Net Cash (Used In)/Provided By Financing Activities	(31,935)	85,501
Net (Decrease)/Increase in Cash, Cash Equivalents and Restricted Cash	(2,402)	62,547
Cash, Cash Equivalents and Restricted Cash, Beginning of Period	35,014	29,651
Cash, Cash Equivalents and Restricted Cash, End of Period	\$ 32,612	\$ 92,198
Reconciliation of Cash, Cash Equivalents and Restricted Cash:		
Cash and Cash Equivalents, End of Period	14,655	68,149
Restricted Cash, End of Period	17,957	24,049
Cash, Cash Equivalents and Restricted Cash, End of Period	\$ 32,612	\$ 92,198
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$ 9,962	\$ 8,596
Purchases of additions in real estate properties included in accounts payable	\$ 3,380	\$ 677
Purchases of deferred leasing costs included in accounts payable	\$ 158	\$ 223

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

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City Office REIT, Inc.

Notes to the Condensed Consolidated 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 of limited partnership interest in the Operating Partnership (*common units*).

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 Operating Partnership's partnership agreement to manage and conduct the Operating Partnership's business, subject to limited approval and voting rights of the limited partners.

The Company has elected to be taxed and will continue to operate in a manner that will allow it to continue to qualify as a real estate investment trust (*REIT*) under the Internal Revenue Code of 1986, as amended (the *Code*). 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, for tax years beginning before 2018, any applicable alternative minimum tax.

2. Summary of Significant Accounting Policies

Basis of Preparation and Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated 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 condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

New Accounting Pronouncements

Adopted in the Current Year

Effective January 1, 2018, the Company adopted FASB ASU 2014-09, Revenue From Contracts with Customers, on a modified retrospective basis. 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 it expects to be entitled in

exchange for those goods or services. The Company has reviewed its revenue streams to note that the majority are under the guidance of ASU 2016-02, Leases. Net gain on sale of real estate is under the guidance of ASU 2017-05, Other Income. The adoption of this guidance did not have a material impact to the Company's condensed consolidated financial statements or notes to our condensed consolidated financial statements.

Effective January 1, 2018, the Company adopted FASB ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in ASU 2016-01 address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The adoption of this guidance did not have a material impact to the Company's condensed consolidated financial statements.

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Effective January 1, 2018, the Company adopted FASB ASU 2016-15, Statement of Cash Flow: Classification of Certain Cash Receipts and Cash Payments, on a retrospective basis. The adoption of this guidance did not have a material impact to the Company's condensed consolidated financial statements.

Effective January 1, 2018, the Company adopted FASB ASU 2016-18, Statement of Cash Flows: Restricted Cash, on a retrospective basis. The update required the statement of cash flows to explain the changes during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents.

To be Adopted in Future Years

In February 2016, the FASB issued ASU 2016-02, Leases. The update amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. The standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. ASU 2016-02 will be effective for annual reporting periods beginning after December 15, 2018. Early adoption is permitted. On July 30, 2018, the FASB released ASU 2018-11 which allows lessors to elect, as a practical expedient, to not separate lease and non-lease components and allow these components to be accounted for as a single lease component if both (i) the timing and pattern of transfer to the lessee of the lease component and the related non-lease component are the same and (ii) the lease component, if accounted for separately, would be classified as an operating lease. In addition, a company is permitted to use its effective date as the date of initial application. Therefore, a company electing this option will not restate comparative period financial information, will not make the new required lease disclosures in comparative periods beginning before the effective date and will recognize its cumulative effect transition adjustment as of the effective date. The Company is in the process of evaluating whether it will elect to apply the practical expedient. If the Company elects to apply the practical expedient we expect expense reimbursement that qualify as non-lease components will be presented under a single lease component. If the Company does not elect to apply the practical expedient we expect that certain non-lease components of expense reimbursement may be subject to ASC 606.

3. Real Estate Investments*Acquisitions*

During the six months ended June 30, 2018 and 2017 the Company acquired the following properties:

Property	Date Acquired	Percentage Owned
Pima Center	April 2018	100%
2525 McKinnon	January 2017	100%

Pima Center and 2525 McKinnon were accounted for as asset acquisitions.

The following table summarizes the Company's allocations of the purchase price of assets acquired and liabilities assumed during the six months ended June 30, 2018 (in thousands):

	Pima Center
Buildings and improvements	\$ 42,235

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Tenant improvements	2,898
Acquired intangible assets	10,691
Prepaid expenses and other assets	95
Accounts payable and other liabilities	(337)
Lease intangible liabilities	(129)
Total consideration	\$ 55,453

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The following table summarizes the Company's allocations of the purchase price of assets acquired and liabilities assumed during the six months ended June 30, 2017 (in thousands):

	2525 McKinnon
Land	\$ 10,629
Buildings and improvements	33,357
Tenant improvements	1,158
Acquired intangible assets	3,267
Accounts payable and other liabilities	(190)
Lease intangible liabilities	(2,186)
Total consideration	\$ 46,035

Sale of Real Estate Property

On March 8, 2018, the Company sold the Washington Group Plaza property in Boise, Idaho for \$86.5 million, resulting in an aggregate net gain of \$47.0 million, net of \$1.7 million in costs, which has been classified as net gain on sale of real estate property in the condensed consolidated statements of operations. In connection with the sale of the property, certain debt repayments were made.

On May 2, 2017, the Company sold the 1400 and 1600 buildings at the AmberGlen property in Portland, Oregon, and its related assets and liabilities, for a sales price of \$18.9 million, resulting in an aggregate net gain of \$12.1 million, net of \$2.0 million in costs, which has been classified as net gain on sale of real estate property in the condensed consolidated statements of operations. In connection with the sale of the property, certain debt repayments were made.

4. Lease Intangibles

Lease intangibles and the value of assumed lease obligations as of June 30, 2018 and December 31, 2017 were comprised as follows (in thousands):

	Lease Intangible Assets					Lease Intangible Liabilities		
	Above Market		Below Market		Total	Below Market		Total
	Market Leases	Ground Lease ⁽¹⁾	In Place Leases	Leasing Commissions		Market Leases	Ground Lease ⁽¹⁾	
June 30, 2018								
Cost	\$ 9,862	\$ 1,855	\$ 71,309	\$ 27,770	\$ 110,796	\$ (10,998)	\$ (138)	\$ (11,136)
Accumulated amortization	(4,039)	(6)	(31,000)	(10,648)	(45,693)	3,483	34	3,517
	\$ 5,823	\$ 1,849	\$ 40,309	\$ 17,122	\$ 65,103	\$ (7,515)	\$ (104)	\$ (7,619)

December 31, 2017	Lease Intangible Assets				Total	Lease Intangible Liabilities		Total
	Market Leases	Ground Lease ⁽¹⁾	In Place Leases	Leasing Commissions		Market Leases	Ground Lease ⁽¹⁾	

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	Above Market Leases	Below Market Ground Lease	In Place Leases	Leasing Commissions		Below Market Leases	Below Market Ground Lease⁽¹⁾	
Cost	\$ 9,082	\$	\$ 71,426	\$ 27,706	\$ 108,214	\$ (11,608)	\$ (138)	\$ (11,746)
Accumulated amortization	(3,215)		(30,613)	(9,298)	(43,126)	3,065	32	3,097
	\$ 5,867	\$	\$ 40,813	\$ 18,408	\$ 65,088	\$ (8,543)	\$ (106)	\$ (8,649)

(1) For the below market ground lease asset the Company is the lessee, whereas, for the below market ground lease liability the Company is the lessor.

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

2018	\$ 8,486
2019	16,140
2020	14,018
2021	10,953
2022	3,434
Thereafter	4,453
	\$ 57,484

5. Debt

The following table summarizes the indebtedness as of June 30, 2018 and December 31, 2017 (in thousands):

Property	June 30, 2018	December 31, 2017	Interest Rate as of June 30, 2018	Maturity
Unsecured Credit Facility ⁽¹⁾	\$ 58,500	\$	LIBOR +1.40% ⁽²⁾	March 2022
Midland Life Insurance ⁽³⁾	87,787	88,582	4.34	May 2021
Mission City	47,000	47,000	3.78	November 2027
190 Office Center ⁽⁴⁾	41,250	41,250	4.79	October 2025
SanTan ⁽⁴⁾	34,962	35,100	4.56	March 2027
Intellicenter ⁽⁴⁾	33,563	33,563	4.65	October 2025
FRP Collection ⁽⁴⁾	29,884	30,174	3.85	September 2023
2525 McKinnon	27,000	27,000	4.24	April 2027
5090 N 40th St	22,000	22,000	3.92	January 2027
AmberGlen ⁽⁴⁾	20,000	20,000	3.69	May 2027
Lake Vista Pointe ⁽⁵⁾	18,203	18,358	4.28	August 2024
FRP Ingenuity Drive ⁽⁵⁾⁽⁶⁾	17,000	17,000	4.44	December 2024
Plaza 25 ⁽⁴⁾⁽⁵⁾	16,734	16,882	4.10	July 2025
Carillon Point ⁽⁴⁾	16,501	16,671	3.50	October 2023
Central Fairwinds ⁽⁴⁾	14,972	15,107	4.00	June 2024
Washington Group Plaza		32,290		
Secured Credit Facility ⁽¹⁾		33,500		
Total Principal	485,356	494,477		
Deferred financing costs, net	(5,746)	(4,968)		
Total	\$ 479,610	\$ 489,509		

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

- (1) As of June 30, 2018, the Unsecured Credit Facility had \$250 million authorized and \$58.5 million was drawn. On March 15, 2018, the Company entered into a \$250 million Unsecured Credit Facility which includes an accordion feature that will permit the Company to borrow up to \$500 million, subject to customary terms and conditions. The Company's previous secured credit facility was replaced and repaid in full. The Unsecured Credit Facility matures in March 2022, which may be extended to March 2023 at the Company's option upon meeting certain conditions. Borrowings under the Unsecured Credit Facility will bear an interest at a rate equal to the LIBOR rate plus a margin of between 140 to 225 basis points depending upon the Company's consolidated leverage ratio. The Unsecured Credit Facility requires the Company to maintain a fixed charge coverage ratio of no less than 1.50x.
- (2) As of June 30, 2018, the one month LIBOR rate was 2.09%.
- (3) The mortgage loan is cross-collateralized by DTC Crossroads, Cherry Creek and City Center. Interest on mortgage loan is payable monthly plus principal based on 360 months of amortization. The loan bears a fixed interest rate of 4.34% and matures on May 6, 2021.
- (4) The Company is subject to various debt covenants including debt service coverage ratios (DSCR) that under certain conditions must be maintained no less than 1.15x, 1.20x, 1.20x, 1.40x, 1.15x, 1.45x, 1.35x and 1.35x respectively for each of 190 Office Center, SanTan, Intellicenter, FRP Collection, AmberGlen, Plaza 25, Carillon Point and Central Fairwinds. The DSCR covenant contained in the loan agreements for Plaza 25, allows for the posting of additional collateral reserves in the event the test is not met. As at June 30, 2018, the covenant was not met and thus the Company has posted all required collateral reserves and is not subject to the test while those reserves are held.
- (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 DSCR of no less than 1.15x.

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The scheduled principal repayments of debt as of June 30, 2018 are as follows (in thousands):

2018	\$ 60,589
2019	5,049
2020	6,091
2021	88,110
2022	4,772
Thereafter	320,745
	\$ 485,356

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

As of June 30, 2018 and December 31, 2017, the Company did not have any hedges or derivatives.

Cash, Cash Equivalents, Restricted Cash, Rents 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 \$417.4 million and \$462.3 million as of June 30, 2018 and December 31, 2017, respectively. Accordingly, the fair value of mortgage loans payable have been classified as Level 3 fair value measurements.

7. Related Party Transactions

Administrative Services Agreement

For the six months ended June 30, 2018 and 2017, the Company earned \$0.4 million and \$0.6 million, respectively, in administrative services performed for Second City Real Estate II Corporation and its affiliates (Second City).

Earn-Out Payment

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For the six months ended June 30, 2017, the Company paid \$2.4 million to Second City to terminate the Company's earn-out payment obligation under the Termination and Mutual Release Agreement.

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Future minimum lease payments to be received as of June 30, 2018 under non-cancellable operating leases for the next five years and thereafter are as follows (in thousands):

2018	49,021
2019	92,328
2020	81,055
2021	70,733
2022	54,263
Thereafter	103,646
	\$ 451,046

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.

Ten state government tenants currently have the exercisable right to terminate their leases if the applicable state legislature does not appropriate rent in its annual budget. The Company has determined that the occurrence of any government tenant not being appropriated the rent in the applicable 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 11.4% of the Company's total future minimum lease payments as of June 30, 2018.

9. Commitments and Contingencies

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 June 30, 2018 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. Stockholders' Equity

Common Stock and Common Unit Distributions

On June 15, 2018, the Company's Board of Directors approved and the Company declared a cash dividend distribution of \$0.235 per share for the quarterly period ended June 30, 2018. The dividend was paid subsequent to quarter end on July 25, 2018 to common stockholders and common unitholders of record as of July 11, 2018 for an aggregate of \$8.5 million.

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Preferred Stock Distributions

On June 15, 2018 the Company's Board of Directors approved and the Company declared a cash dividend of \$0.4140625 per share for an aggregate amount of \$1.9 million. The dividend was paid subsequent to quarter end on July 25, 2018.

Restricted Stock Units

The Company has an equity incentive plan (Equity Incentive Plan) for executive officers, directors and certain non-executive employees, and with approval of the Board of Directors, for subsidiaries 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 six months ended June 30, 2018, 156,375 restricted stock units (RSUs) were granted to executive officers, directors and certain non-executive employees with a fair value of \$1.9 million. The awards will vest in three equal, annual installments on each of the first three anniversaries of the date of grant. For the six months ended June 30, 2018 the Company recognized net compensation expense of \$0.7 million related to the RSUs.

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 RSUs. The Plan Administrator may provide for a grant of dividend equivalent rights in connection with the grant of RSU; provided, however, that if the RSUs 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 vests.

11. Subsequent Events

On July 9, 2018, the Company, through a wholly-owned subsidiary of the Operating Partnership, acquired a 272,000 square foot property in Denver, Colorado for \$59.8 million.

On July 31, 2018, the Company, through a wholly-owned subsidiary of the Operating Partnership, acquired a 163,000 square foot property in Phoenix, Arizona for \$51.0 million.

On August 1, 2018, the Company entered into an agreement with Second City Capital Partners II, Limited Partnership whereby Second City agreed to sell its seven percent minority interest in Central Fairwinds Limited Partnership to the Company for \$1.1 million.

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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 financial statements and the related notes thereto of the City Office REIT, Inc. contained in this Quarterly Report on Form 10-Q.

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.

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. These forward looking statements may be identified by the use of 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:

adverse economic or real estate developments in the office sector or the markets in which we operate;

changes in local, regional, national and international economic conditions;

our inability to compete effectively;

our inability to collect rent from tenants or renew tenants' leases on attractive terms if at all;

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

defaults on or non-renewal of leases by tenants;

increased interest rates and any resulting increase in financing or operating costs;

decreased rental rates or increased vacancy rates;

our failure to obtain necessary financing or access the capital markets on favorable terms or at all;

changes in the availability of acquisition opportunities;

availability of qualified personnel;

our inability to successfully complete real estate acquisitions or dispositions on the terms and timing we expect, or at all;

our failure to successfully operate acquired properties and operations;

changes in our business, financing or investment strategy or the markets in which we operate;

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our failure to generate sufficient cash flows to service our outstanding indebtedness;

environmental uncertainties and risks related to adverse weather conditions and natural disasters;

our failure to qualify and maintain our status as a real estate investment trust (REIT);

government approvals, actions and initiatives, including the need for compliance with environmental requirements;

outcome of claims and litigation involving or affecting us;

financial market fluctuations; and

changes in real estate, taxation and zoning laws and other legislation and government activity and changes to real property tax rates and the taxation of REITs in general; and other factors described in our news releases and filings with the Securities and Exchange Commission (the SEC), including but not limited to those described in our Annual Report on Form 10-K for the year ended December 31, 2017 under the heading Risk Factors and in our subsequent reports filed with the SEC.

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.

Revenue Base

As of June 30, 2018, we owned 22 properties comprised of 46 office buildings with a total of approximately 4.9 million square feet of net rentable area (NRA). As of June 30, 2018, our properties were approximately 89.6% occupied.

Office Leases

Historically, most leases for our 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 triple 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. All tenants in the Lake Vista Pointe, FRP Ingenuity Drive, Sorrento Mesa and Superior Pointe properties have triple net leases. Certain tenants of AmberGlen, FRP Collection and 2525 McKinnon have leases on a triple net basis. 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.

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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 management'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.

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. 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.

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As of June 30, 2018, we owned 22 office complexes comprised of 46 office buildings with a total of approximately 4.9 million square feet of NRA in the metropolitan areas of Dallas, Denver, Orlando, Phoenix, Portland, San Diego and Tampa. The following table presents an overview of our portfolio as of June 30, 2018 (properties listed by descending NRA by market).

Metropolitan Area	Property	Economic Interest	NRA (000s Square Feet)	In Place Occupancy	Annualized Gross Rent per Square Foot		Annualized Base Rent ⁽²⁾ (\$000s)
					Foot	Foot ⁽¹⁾	
Tampa, FL (21.2% of NRA)	Park Tower	94.8%	470	85.0%	\$ 24.03	\$ 24.03	\$ 9,599
	City Center	95.0%	241	98.5%	\$ 24.96	\$ 24.96	\$ 5,930
	Intellicenter	100.0%	204	100.0%	\$ 23.36	\$ 23.36	\$ 4,754
	Carillon Point	100.0%	124	100.0%	\$ 27.36	\$ 27.36	\$ 3,398
Denver, CO (19.7%)	Cherry Creek	100.0%	356	100.0%	\$ 18.10	\$ 18.10	\$ 6,438
	Plaza 25	100.0%	196	59.8%	\$ 20.14	\$ 20.14	\$ 2,359
	DTC						
	Crossroads	100.0%	189	71.7%	\$ 25.12	\$ 25.12	\$ 3,407
	Superior Pointe	100.0%	151	92.1%	\$ 16.88	\$ 28.88	\$ 2,342
San Diego, CA (13.7%)	Logan Tower	100.0%	71	76.9%	\$ 20.33	\$ 20.33	\$ 1,105
	Sorrento Mesa	100.0%	385	76.2%	\$ 24.04	\$ 29.04	\$ 7,041
	Mission City	100.0%	286	88.3%	\$ 34.38	\$ 34.38	\$ 8,680
Phoenix, AZ (17.9%)	Pima Center	100.0%	272	99.4%	\$ 26.70	\$ 26.70	\$ 7,214
	SanTan	100.0%	267	98.6%	\$ 27.13	\$ 27.13	\$ 7,131
	5090 N 40th St	100.0%	175	92.4%	\$ 28.62	\$ 28.62	\$ 4,622
	Papago Tech	100.0%	163	98.0%	\$ 20.17	\$ 20.17	\$ 3,219
Dallas, TX (11.8%)	190 Office Center	100.0%	303	88.9%	\$ 24.64	\$ 24.64	\$ 6,645
	Lake Vista						
	Pointe	100.0%	163	100.0%	\$ 15.50	\$ 23.50	\$ 2,532
	2525 McKinnon	100.0%	111	93.0%	\$ 27.01	\$ 42.32	\$ 2,795
Orlando, FL (11.6%)	FRP Collection	95.0%	272	75.5%	\$ 25.19	\$ 27.12	\$ 5,165
	Central						
	Fairwinds	90.0%	168	95.6%	\$ 24.31	\$ 24.31	\$ 3,908
Portland, OR (4.1%)	FRP Ingenuity Drive	100.0%	125	100.0%	\$ 21.00	\$ 29.00	\$ 2,615
	AmberGlen	76.0%	201	94.8%	\$ 19.99	\$ 22.64	\$ 3,813
Total / Weighted Average June 30, 2018³⁾			4,893	89.6%	\$ 23.89	\$ 25.69	\$ 104,712

(1)

For Superior Pointe, FRP Ingenuity Drive, Lake Vista Pointe, and Sorrento Mesa the annualized base rent per square foot on a triple net basis was increased by \$12, \$8, \$8, and \$5 respectively, to estimate a gross equivalent base rent. AmberGlen has a net lease for one tenant which has been grossed-up by \$7 on a pro rata basis. FRP Collection has net leases for three tenants which have been grossed up by \$8 on a pro-rata basis. 2525 McKinnon has net leases for nine tenants which have been grossed up by \$16 on a pro-rata basis.

- (2) Annualized base rent is calculated by multiplying (i) rental payments (defined as cash rents before abatements) for the month ended June 30, 2018 by (ii) 12.
- (3) Averages weighted based on the property's NRA, adjusted for occupancy.

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.

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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 condensed consolidated financial statements follow the same policies and procedures as outlined in the audited consolidated financial statements for the year ended December 31, 2017 included in our Annual Report on Form 10-K for the year ended December 31, 2017 except for the adoption of ASU 2014-09 Revenue From Contracts with Customers, ASU 2016-01 Recognition and Measurement of Financial Assets and Financial Liabilities, ASU 2016-15 Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments and ASU 2016-18 Statement of Cash Flows: Restricted Cash as outlined in Note 2 of the condensed consolidated financial statements.

Results of Operations

Comparison of Three Months Ended June 30, 2018 to June 30, 2017

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 \$5.0 million, or 20%, to \$30.2 million for the three months ended June 30, 2018 compared to \$25.2 million in the corresponding period in 2017. \$2.3 million of this increase was attributed to the acquisition of Mission City in September 2017, \$2.3 million from the acquisition of Sorrento Mesa in September 2017, \$1.0 million from the acquisition of Papago Tech in October 2017 and \$1.8 million from the acquisition of Pima Center in April 2018. Offsetting these increases AmberGlen decreased by \$0.1 million primarily due to the sale of two of the five buildings in the complex in May 2017 and Washington Group Plaza decreased by \$2.3 million due to the sale of the property in March 2018. The remaining properties' revenues were relatively unchanged in comparison to three months ended June 30, 2017.

Rental Income. Rental income includes net rental income and income from a ground lease. Total rental income increased \$4.3 million, or 20%, to \$25.9 million for the three months ended June 30, 2018 compared to \$21.6 million for the three months ended June 30, 2017. The increase in rental income was primarily due to the acquisitions described above. The acquisitions of Mission City, Sorrento Mesa, Papago Tech and Pima Center contributed an additional \$2.0 million, \$1.9 million, \$0.9 million, and \$1.7 million in rental income, respectively, to the 2018 period rental income. AmberGlen decreased by \$0.1 million primarily due to the sale of two of the five buildings in the complex in May 2017 and Washington Group Plaza decreased by \$2.1 million due to the sale of that property in March 2018.

Expense Reimbursement. Total expense reimbursement increased \$0.7 million, or 25%, to \$3.5 million for the three month period ended June 30, 2018 compared to \$2.8 million for the same period in 2017, primarily due to the acquisition of the Mission City, Sorrento Mesa, Papago Tech and Pima Center properties described above.

Other. Other revenue includes parking, signage and other miscellaneous income. Total other revenues increased \$0.1 million, or 20%, to \$0.8 million for the three month period ended June 30, 2018 compared to \$0.7 million for the same period in 2017. Nominal other income was generated by City Center, Central Fairwinds, Logan Tower, DTC Crossroads, 5090 N 40th St, SanTan, 2525 McKinnon, Park Tower, Mission City and Sorrento Mesa with the largest contribution from City Center and Park Tower parking income.

Operating Expenses

Total Operating Expenses. Total operating expenses consist of property operating expenses, general and administrative expenses and depreciation and amortization. Total operating expenses increased by \$4.1 million, or 19%, to \$25.5 million for the three months ended June 30, 2018, from \$21.4 million for the same period in 2017, primarily due to acquisitions described above. Total operating expenses increased by \$2.1 million, \$1.8 million, \$0.7 million, and \$1.7 million, respectively, from the acquisitions of Mission City, Sorrento Mesa, Papago Tech and Pima Center properties. Washington Group Plaza operating expenses decreased by \$1.2 million due to its sale in

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March 2018. AmberGlen decreased by \$0.1 million primarily due to the sale of two of the five buildings in the complex in May 2017. The remaining operating expenses aggregated to an overall \$0.9 million decrease in comparison to the prior year primarily related to a decrease in depreciation at 190 Center and FRP Collection.

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 10%, to \$11.7 million for the three months ended June 30, 2018 from \$10.7 million for the same period in 2017. The increase in property operating expenses was primarily due to the acquisitions described above. The acquisition of the Mission City, Sorrento Mesa, Papago Tech and Pima Center contributed an additional \$1.0 million, \$0.6 million, \$0.3 million, and \$0.6 million in additional property operating expenses, respectively. AmberGlen decreased by \$0.1 million primarily due to the sale of two of the five buildings in the complex in May 2017, and Washington Group Plaza decreased by \$1.2 million due to the sale of that property in March 2018. The remaining property operating expenses aggregate to an overall \$0.2 million decrease in comparison to the prior year.

General and Administrative. General and administrative expenses comprise of public company reporting costs and the compensation of our management team and board of directors as well as non-cash stock-based compensation expenses. General and administrative expenses increased \$0.4 million, or 23%, to \$2.0 million for the three month period ended June 30, 2018 compared to \$1.6 million for the same period in 2017. The increase was primarily attributable to higher payroll costs.

Depreciation and Amortization. Depreciation and amortization increased \$2.7 million, or 29%, to \$11.8 million for the three month period ended June 30, 2018 compared to \$9.1 million for the same period in 2017, primarily due to the addition of the Mission City, Sorrento Mesa, Papago Tech and Pima Center properties offset by a decrease at Washington Group Plaza and AmberGlen due to the sale of those properties.

Other Expense (Income)

Interest Expense, Net. Interest expense increased \$0.7 million, or 16%, to \$5.4 million for the three month period ended June 30, 2018, compared to \$4.7 million for the corresponding period in 2017. The increase was primarily due to interest expense related to acquisitions. Interest expense for the Mission City property level debt increased by \$0.4 million, and the interest on the line of credit increased by \$0.6 million as a result of acquisitions funded by that facility. These increases were offset by a \$0.3 million decrease in the Washington Group Plaza debt as a result of the sale of that building and the extinguishment of its property level debt.

Net Gain on the Sale of Real Estate Property. In the prior year, net gain on the sale of real estate property relates to the sale of 2 buildings in our AmberGlen complex in May 2017.

Comparison of Six Months Ended June 30, 2018 to Six Months Ended June 30, 2017

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 \$11.2 million, or 22%, to \$61.8 million for the six months ended June 30, 2018 compared to \$50.6 million in the corresponding period in 2017. \$0.2 million of this increase was attributed to the acquisition of 2525 McKinnon in January 2017, \$4.7 million from the acquisition of Mission City in September 2017, \$5.8 million from the acquisition of Sorrento Mesa in September

2017, \$1.9 million from the acquisition of Papago Tech in October 2017 and \$1.9 million from the acquisition of Pima Center in April 2018. Offsetting these increases AmberGlen decreased by \$0.7 million primarily due to the sale of two of the five buildings in the complex in May 2017 and Washington Group Plaza decreased by \$2.6 million due to the sale of the property in March 2018. The remaining properties' revenues were relatively unchanged in comparison to six months ended June 30, 2017.

Rental Income. Rental income includes net rental income and income from a ground lease. Total rental income increased \$9.0 million, or 20%, to \$52.9 million for the six months ended June 30, 2018 compared to \$43.9 million for the six months ended June 30, 2017. The increase in rental income was primarily due to the

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acquisitions described above. The acquisitions of Mission City, Sorrento Mesa, Papago Tech and Pima Center contributed an additional \$4.0 million, \$5.0 million, \$1.7 million and \$1.6 million in rental income, respectively, to the 2018 period rental income. AmberGlen decreased by \$0.6 million primarily due to the sale of two of the five buildings in the complex in May 2017 and Washington Group Plaza decreased by \$2.7 million due to the sale of that property in March 2018.

Expense Reimbursement. Total expense reimbursement increased \$2.0 million, or 38%, to \$7.1 million for the six month period ended June 30, 2018 compared to \$5.1 million for the same period in 2017, primarily due to the acquisition of the 2525 McKinnon, Mission City, Sorrento Mesa, Papago Tech and Pima Center properties described above.

Other. Other revenue includes parking, signage and other miscellaneous income. Total other revenues increased \$0.3 million, or 22%, to \$1.8 million for the six month period ended June 30, 2018 compared to \$1.5 million for the same period in 2017. The increase can be attributed to the net proceeds of an auction of a former tenant's equipment at FRP Collection which vacated unexpectedly late in 2017. Nominal other income was also generated by City Center, Central Fairwinds, Logan Tower, DTC Crossroads, 5090 N 40th St, SanTan, 2525 McKinnon, Park Tower, Mission City and Sorrento Mesa with the largest contribution from City Center and Park Tower parking income.

Operating Expenses

Total Operating Expenses. Total operating expenses consist of property operating expenses, general and administrative expenses and depreciation and amortization. Total operating expenses increased by \$7.3 million, or 17%, to \$51.0 million for the six months ended June 30, 2018, from \$43.7 million for the same period in 2017, primarily due to acquisitions described above. Total operating expenses increased by \$4.3 million, \$4.3 million, \$1.3 million, and \$1.7 million, respectively, from the acquisitions of Mission City, Sorrento Mesa, Papago Tech and Pima Center properties. AmberGlen decreased by \$0.5 million primarily due to the sale of two of the five buildings in the complex in May 2017. Washington Group Plaza operating expenses decreased by \$2.5 million due to its sale in March 2018. The remaining operating expenses aggregated to an overall \$1.3 million decrease in comparison to the prior year primarily related to a decrease in depreciation at 190 Center and FRP Collection.

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 \$3.1 million, or 15%, to \$23.4 million for the six months ended June 30, 2018 from \$20.3 million for the same period in 2017. The increase in property operating expenses was primarily due to the acquisitions described above. The acquisition of the Mission City, Sorrento Mesa, Papago Tech and Pima Center contributed an additional \$1.9 million, \$1.1 million, \$0.5 million, and \$0.6 million in additional property operating expenses, respectively. AmberGlen decreased by \$0.3 million primarily due to the sale of two of the five buildings in the complex in May 2017, and Washington Group Plaza decreased by \$1.3 million due to the sale of that property in March 2018. The remaining property operating expenses aggregate to an overall \$0.6 million increase in comparison to the prior year.

General and Administrative. General and administrative expenses comprise of public company reporting costs and the compensation of our management team and board of directors as well as non-cash stock-based compensation expenses. General and administrative expenses increased \$0.1 million, or 4%, to \$3.9 million for the six month period ended June 30, 2018 compared to \$3.8 million for the same period in 2017. The increase was primarily attributable to

higher payroll costs.

Depreciation and Amortization. Depreciation and amortization increased \$4.1 million, or 20%, to \$23.7 million for the six month period ended June 30, 2018 compared to \$19.6 million for the same period in 2017, primarily due to the addition of the 2525 McKinnon, Mission City, Sorrento Mesa, Papago Tech and Pima Center properties offset by a decrease at Washington Group Plaza and AmberGlen due to the sale of those properties. The remaining decrease primarily relates to a decrease in depreciation at 190 Center and FRP Collection.

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Other Expense (Income)

Interest Expense, Net. Interest expense increased \$2.2 million, or 24%, to \$11.3 million for the six month period ended June 30, 2018, compared to \$9.1 million for the corresponding period in 2017. The increase was primarily due to interest expense related to acquisitions. Interest expense for the 2525 McKinnon and Mission City property level debt increased by \$0.2 million and \$0.9 million, respectively, as well as interest on the line of credit which increased by \$1.3 million as a result of acquisitions funded by that facility. A new mortgage placed on Central Fairwinds in June 2017 also increased interest expense by a further \$0.2 million over the prior year. These increases were offset by a \$0.4 million decrease in the Washington Group Plaza debt as a result of the sale of that building and the extinguishment of its property level debt.

Net Gain on the Sale of Real Estate Property. Net gain on the sale of real estate property relates to the sale of our Washington Group Plaza property in March 2018. In the prior year, amounts relate to the sale of 2 buildings in our AmberGlen complex in May 2017.

Cash Flows

Comparison of Six Months Ended June 30, 2018 to Six Months Ended June 30, 2017

Cash, cash equivalents and restricted cash were \$32.6 million and \$92.2 million as of June 30, 2018 and June 30, 2017, respectively.

Cash flow from operating activities. Net cash provided by operating activities decreased by \$0.5 million to \$11.4 million for the six months ended June 30, 2018 compared to \$11.9 million for the same period in 2017. The decrease was attributable to changes in working capital predominantly due to the sale of Washington Group Plaza, offset by the earn-out termination payment which occurred in 2017 but not 2018 and increased operating cash flows from acquisitions.

Cash flow from investing activities. Net cash provided by investing activities increased by \$53.1 million to \$18.2 million for the six months ended June 30, 2018 compared to \$34.9 million used in investing activities for the same period in 2017. The increase was primarily due to proceeds from the disposition of the Washington Group Plaza property offset by the acquisition of Pima Center.

Cash flow to financing activities. Net cash used in financing activities increased by \$117.4 million to \$31.9 million for the six months ended June 30, 2018 compared to \$85.5 million provided by the same period in 2017. Cash flow used in financing activities increased primarily due to proceeds from a public offering of our common stock and a new mortgage which both occurred in 2017 but not 2018. Borrowings on the Unsecured Credit Facility were also higher in 2018.

Liquidity and Capital Resources

Analysis of Liquidity and Capital Resources

We had approximately \$14.7 million of cash and cash equivalents and \$18.0 million of restricted cash as of June 30, 2018.

On March 15, 2018 the Company entered into a \$250 million Unsecured Credit Facility which includes an accordion feature that allows the Company to borrow up to \$500 million, subject to customary terms and conditions. The

Company's previous secured credit facility was replaced and repaid in full. The Unsecured Credit Facility matures in March 2022, which may be extended to March 2023 at the Company's option upon meeting certain conditions. Borrowings under the Unsecured Credit Facility bear an interest at a rate equal to the LIBOR rate plus a margin of between 140 to 225 basis points depending upon the Company's consolidated leverage ratio. As of June 30, 2018, we had approximately \$58.5 million outstanding under our Unsecured Credit Facility.

The Company and the Operating Partnership previously entered into separate equity distribution agreements (the Sales Agreements) with each of KeyBanc Capital Markets Inc., Raymond James & Associates, Inc. and BMO Capital Markets Corp. (collectively, the Sales Agents), pursuant to which the Company may issue and sell from time to time up to 6,000,000 shares of its common stock, \$0.01 par value per share, and up to 1,000,000 shares of its 6.625% Series A Cumulative Redeemable Preferred Stock, \$0.01 par value per share

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(collectively, the Shares), through the Sales Agents, acting as agents or principals (the ATM Program). Pursuant to the Sales Agreements, the Shares may be offered and sold through the Sales Agents in transactions that are deemed to be at the market offerings as defined in Rule 415 under the Securities Act including sales made directly on the New York Stock Exchange or sales made to or through a market maker other than on an exchange or, with the prior consent of the Company, in privately negotiated transactions. The Sales Agents will be entitled to compensation of up to 2.0% of the gross proceeds of shares sold through the Sales Agents from time to time under the sales agreements. The Company has no obligation to sell any of the Shares under the Sales Agreements and may at any time suspend solicitations and offers under, or terminate, the Sales Agreements. During the six month period ended June 30, 2018, we did not sell any Shares under the ATM Program.

Our short-term liquidity requirements primarily consist of operating expenses and other expenditures associated with our properties, distributions to our limited partners and distributions to our stockholders required to qualify for REIT status, capital expenditures and, potentially, acquisitions. We expect to meet our short-term liquidity requirements through net cash provided by operations, reserves established from existing cash, proceeds from our public offerings, including under our ATM Program, and borrowings under our mortgage loans and Unsecured Credit Facility.

Our long-term liquidity needs consist primarily of funds necessary for the repayment of debt at maturity, property acquisitions and non-recurring capital improvements. We expect to meet our long-term liquidity requirements with net cash from operations, long-term secured and unsecured indebtedness and the issuance of equity and debt securities. We also may fund property acquisitions and non-recurring capital improvements using our Unsecured Credit Facility pending longer term financing.

We believe we have access to multiple sources of capital to fund our long-term liquidity requirements, including the incurrence of additional debt and the issuance of additional equity securities. However, we cannot assure you that this is or will continue to be the case. Our ability to incur additional debt is dependent on a number of factors, including our degree of leverage, the value of our unencumbered assets and borrowing restrictions that may be imposed by lenders. Our ability to access the equity capital markets is dependent on a number of factors as well, including general market conditions for REITs and market perceptions about us.

Contractual Obligations and Other Long-Term Liabilities

The following table provides information with respect to our commitments as of June 30, 2018, including any guaranteed or minimum commitments under contractual obligations. The table does not reflect available debt extension options.

Contractual Obligation	Payments Due by Period (in thousands)				
	Total	2018	2019-2020	2021-2022	More than 5 years
Principal payments on debt	\$ 485,356	\$ 60,589	\$ 11,140	\$ 92,882	\$ 320,745
Interest payments	115,036	9,137	35,586	28,921	41,392
Tenant-related commitments ⁽¹⁾	10,464	8,271	1,582	611	
Total	\$ 610,856	\$ 77,997	\$ 48,308	\$ 122,414	\$ 362,137

(1) Consists principally of commitments for tenant improvements.

Off-Balance Sheet Arrangements

As of June 30, 2018, we did not have any off-balance sheet arrangements.

Inflation

Substantially all of our office leases provide for real estate tax and operating expense escalations. In addition, most of the leases provide for fixed annual rent increases. We believe that inflationary increases may be at least partially offset by these contractual rent increases and expense escalations.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our future income, cash flows and fair values relevant to financial instruments are dependent upon prevailing market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates. We have used, and will use, derivative financial instruments to manage or hedge interest rate risks related to borrowings. We do not use derivatives for trading or speculative purposes and only enter into contracts with major financial institutions based upon their credit rating and other factors. We have entered, and we will only enter into, contracts with major financial institutions based on their credit rating and other factors. As of June 30, 2018, our Company did not have any outstanding derivatives.

The primary market risk to which we are exposed is interest rate risk. Our primary interest rate exposure is LIBOR. We primarily use fixed interest rate financing to manage our exposure to fluctuations in interest rates. We consider our interest rate exposure to be minimal because as of June 30, 2018, approximately \$426.9 million, or 88.0%, of our debt had fixed interest rates and approximately \$58.5 million, or 12.0%, had variable interest rates. A 10% increase in LIBOR would increase our interest costs by approximately \$0.1 million on debt outstanding as of June 30, 2018, and would decrease the fair value of our outstanding debt, as well as increase interest costs associated with future debt issuances or borrowings under our Unsecured Credit Facility. A 10% decrease in LIBOR would decrease our interest costs by approximately \$0.1 million on debt outstanding as of June 30, 2018, and would increase the fair value of our outstanding debt, as well as decrease interest costs associated with future debt issuances or borrowings under our Unsecured Credit Facility.

Interest risk amounts are our management's estimates based on our Company's capital structure and were determined by considering the effect of hypothetical interest rates on our financial instruments. These analyses do not consider the effect of any change in overall economic activity that could occur in that environment. We may take actions to further mitigate our exposure to changes in interest rates. However, due to the uncertainty of the specific actions that would be taken and their possible effects, these analyses assume no changes in our Company's financial structure.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on the most recent evaluation, the Company's Chief Executive Officer and Chief Financial Officer determined that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended) were effective as of June 30, 2018.

Management's Report on Internal Control Over Financial Reporting

There have been no changes to our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We and our subsidiaries are, from time to time, parties to litigation arising from the ordinary course of their business. Our management does not believe that any such litigation will materially affect our financial position or operations.

Item 1A. Risk Factors

The following risk factor replaces the risk factor disclosed under a similar heading in the section entitled Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2017. Except as presented below, there have been no material changes from the risk factors set forth in such Annual Report.

Covenants in our Credit Agreement may cause us to fail to qualify as a REIT.

In order to maintain our qualification as a REIT, we are generally required under the Code to distribute annually at least 90% of our net taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gain. In addition, we will be subject to income tax at regular corporate rates to the extent that we distribute less than 100% of our net taxable income, including any net capital gains. Under our Credit Agreement, dated as of March 15, 2018, we are subject to various financial covenants that may inhibit our ability to make distributions to our stockholders. If we are unable to make distributions to our stockholders, we will not be able to make sufficient distributions to maintain our REIT status.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

**Exhibit
Number**

Description

3.1 Articles of Amendment and Restatement of City Office REIT, Inc., as amended and supplemented (incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K filed on

March 1, 2018).

- 3.2 Second Amended and Restated Bylaws of City Office REIT, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on March 14, 2017).
- 4.1 Certificate of Common Stock of City Office REIT, Inc. (incorporated by reference to Exhibit 4.1 of the Company's Registration Statement on Form S-11/A filed with the Commission on February 18, 2014).
- 4.2 Form of certificate representing the 6.625% Series A Cumulative Redeemable Preferred Stock, \$0.01 par value per share (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form 8-A filed with the Commission on September 30, 2016).

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12.1	<u>Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends</u>
31.1	<u>Certification by Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2	<u>Certification by Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32.1	<u>Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2	<u>Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101.INS	INSTANCE DOCUMENT*
101.SCH	SCHEMA DOCUMENT*
101.CAL	CALCULATION LINKBASE DOCUMENT*
101.LAB	LABELS LINKBASE DOCUMENT*
101.PRE	PRESENTATION LINKBASE DOCUMENT*
101.DEF	DEFINITION LINKBASE DOCUMENT*

Filed herewith.

- * Submitted electronically herewith. Attached as Exhibit 101 to this report are the following documents formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income; (iii) Consolidated Statements of Equity; (iv) Consolidated Statements of Cash Flows; and (v) Notes to Consolidated Financial Statements.

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SIGNATURES

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

CITY OFFICE REIT, INC.

Date: August 2, 2018

By: */s/ James Farrar*
James Farrar
Chief Executive Officer and Director

(Principal Executive Officer)

Date: August 2, 2018

By: */s/ Anthony Maretic*
Anthony Maretic
Chief Financial Officer, Secretary and Treasurer
(Principal Financial Officer and Principal Accounting Officer)