

Defining The COPT Way

Corporate Office Properties Trust 2006 Annual Report



Our
values

• •
vision

core purpose

A REIT WITH A MISSION: THE COPT WAY

Since 1998, Corporate Office Properties Trust (COPT) has been a leader in shareholder return, dividend growth and tenant satisfaction.

During 2006, in the midst of another year of strong performance, we began the process of ensuring this growth and success would continue. We asked ourselves the following:

What kind of corporate culture made this growth possible? What are the values that led us here? What is our core purpose? And where will it take us from here?

The answers identified “The COPT Way” as a means for sustaining our track record and continuing to improve our performance.



OUR CULTURE, CORE VALUES & VISION

The COPT Way begins with a corporate culture that is committed to caring, trust and respect for all. A culture that encourages both individual and professional growth. A culture that is guided by five core values:

Integrity: delivering and expecting the highest ethical conduct.

Service: exceeding expectations by paying attention to details.

Innovation: identifying and seizing opportunities through creative solutions.

Teamwork: supporting each other to enhance our collective strengths.

Excellence: passionately dedicated to being the best.

integrity, service, innovation,

By following these principles, we believe we will achieve our Vision 2025: To have The COPT Way be recognized as the standard of real estate excellence. Specifically, our goals are:

- To be ranked #1 or #2 in every meaningful industry evaluation.
- To be one of the top 50 places to work.
- To be a leading contributor in improving the fabric of the communities where we live and work.

If we strive to be the best at everything we do, financial success will take care of itself.

teamwork & excellence
The Copt Way

our core purpose...

Providing the road map to reach our goals is a core purpose that is powerful, compelling and virtually limitless in scope.

“*Creating Environments That Inspire Success*” means building spaces that are strategically located, architecturally pleasing and unmistakably functional. It means adding art to the hardscape to inspire thought and motivate performance. It means building green to benefit the environment. And, it means making our communities better places to live. Not just by adding attractive buildings, but by improving social services, educational opportunities and recreational amenities.

Ultimately, it means doing everything we can to help our tenants, our employees and our communities succeed. For when they succeed, so do we.

By pursuing our core purpose, our leadership inspires others—our tenants, communities and employees—to improve, do their best and be successful.

Opposite page (left to right): 304 NBP, a LEED Silver-certified building leased to Booz Allen Hamilton. George Swintz (COPT) and Joe Wysocki (Scitor) cut the ribbon on COPT’s first build-to-suit in Colorado Springs. An interior space in COPT’s new Columbia headquarters.*

**Leadership in Energy & Environmental Design, a program of the U.S. Green Building Council.*



creating
environments that
inspire



success

2006 marked the seventh straight year that REITs outperformed other indices—ending the year up 33.5% versus the Dow Jones at 15.6%. And as usual, Corporate Office Properties Trust was among the leaders.

With a total shareholder return of 46%, we finished among the top six in this banner year for office REITs, outperforming the average office REIT by 38%. We delivered a five-year total shareholder return of 426%, second highest among office REITs and fourth highest among all equity REITs. We significantly increased our enterprise value by 32%—from \$3.3 to \$4.3 billion. And we ended the year with the fourth highest multiple in the office sector and tenth highest among all 134 equity REITs.

We are also proud of our 2006 performance in a number of other areas:

We purchased a former army base, closing on 500 acres of the 591-acre Fort Ritchie United States Army base in Cascade, Maryland. The site contains a mix of office, residential, recreational and woodland areas. Our redevelopment plan, anticipated to cover a 10 to 15 year timeframe, includes 1.7 million square feet of office space, and will be a significant driver of future earnings.

We strengthened our presence in Baltimore County and Columbia. We diligently pursued our largest company merger, closing in early 2007 on the Nottingham Properties office portfolio of 56 buildings containing 2.4 million

a letter to our shareholders



square feet, 187 acres of land, and bringing 19 employees into the Company. This makes us the largest office owner in another major core submarket, with future development capacity of a minimum of 2 million square feet.

We expanded our presence in Colorado Springs. We acquired six office buildings plus additional land, making us the largest owner of office properties in that market after entering it only one year ago. We now own 12 office buildings totaling 842,000 square feet, 94% of which are leased, and we have an additional four buildings under development totaling 292,000 square feet. We also own, directly or through joint ventures, sufficient entitled ground to build approximately 2.6 million square feet.

We positioned the company to double in size. With the acquisition of Fort Ritchie and Nottingham, we now have approximately 14 million square feet of entitled land development capacity. This gives us the potential to nearly double our company size over the next 5–7 years, based on development alone. We are strategically focused on adding to our presence in each of our core markets, and have done so at below market pricing.

We moved into new corporate headquarters and strengthened our senior management team, strategically positioning us for the future. We now have space to accommodate our expanding operations with a headquarters that reflects the level of quality space we build for our tenants.

We launched *The COPT Way*, the culmination of a process to define our core purpose, core values and vision for our future. We strongly believe that a unified vision—for our employees, our tenants and our shareholders—will guide us to new levels of growth and success. That’s why we’ve made it the theme of this year’s annual report.

The above accomplishments combine to position the company for annual double digit growth of FFO per share over the next several years, which is at the high end of the office sector. This growth is bolstered by our government and defense niche, which accounts for 54% of our revenues and continues to grow.



In 2006, COPT was again recognized nationally among all office owners as the winner of the CEL & Associates, Inc. award for quality service and tenant satisfaction for the large owner category as determined in a survey of tenants nationwide. This is our third year in a row as winner of this award.

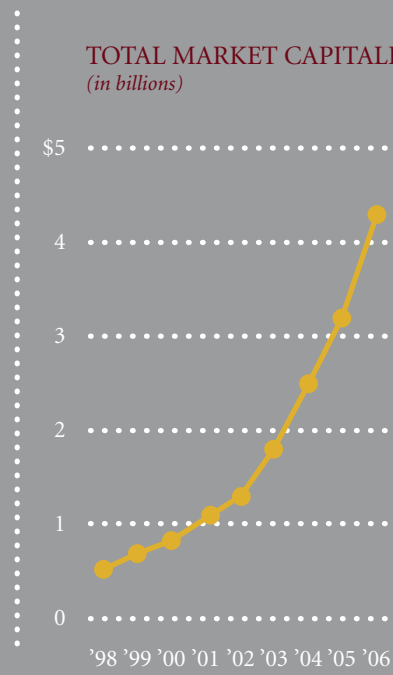
I would like to personally thank the Board of Trustees for their guidance during 2006, our shareholders for their continued support, and our employees for their hard work and dedication throughout the year. We look forward to continued growth and excellence in 2007.

Sincerely yours,

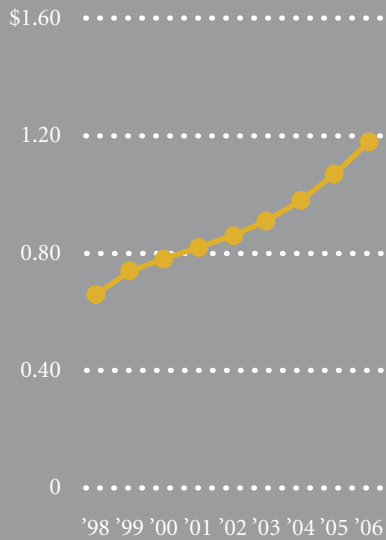
Randall M. Griffin
President and Chief Executive Officer

2006 results

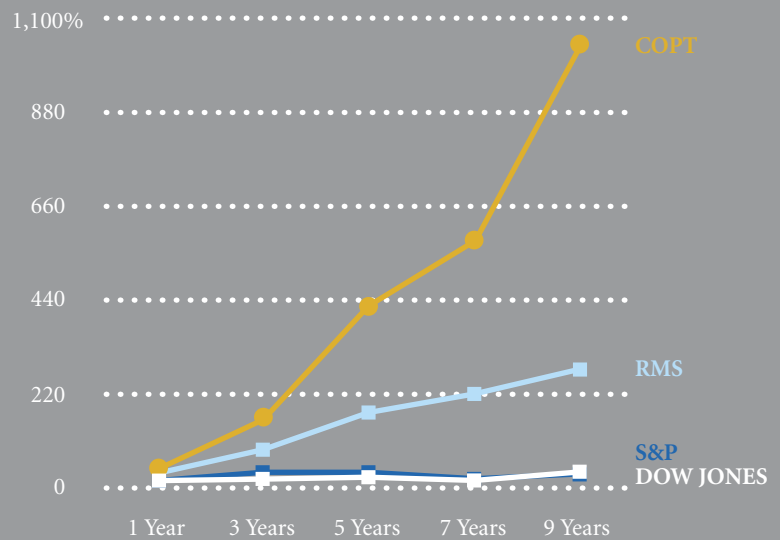
TOTAL MARKET CAPITALIZATION
(in billions)



DIVIDEND GROWTH
(in dollars)



TOTAL SHAREHOLDER RETURN
(in percent)



We are proud of our ability to generate strong financial growth and stability for our shareholders over our almost nine-year history as a NYSE public company and are focused on continuing this growth in the future.

2006 WAS ANOTHER GREAT YEAR FOR COPT SHAREHOLDERS. Our stock price hit an historic high of \$50.47 at the end of 2006, increasing almost \$15 over the year. Our strong performance enabled us to deliver a total return to shareholders of 46% for 2006, 165% for the past three years and 426% over the past five years. For the tenth consecutive year, we increased our dividend—providing a 10.7% annualized increase from 2005 for our shareholders. Our total market capitalization grew from \$523.1 million for year end 1998 to \$4.3 billion for year end 2006, a remarkable increase.





living the COPT way

You will see The COPT Way when you visit our new corporate headquarters in Columbia, Maryland. In July, we moved into our new building in Columbia Gateway office park, where we own 26 buildings totaling over 2 million square feet. We currently occupy two floors of the building, with the building over 75% leased. The space reflects our quality standards, attention to detail and appreciation for our team members. And, the interior space meets LEED Silver certification standards for green buildings. It's an environment that truly inspires success.



Opposite page: 6711 Columbia Gateway Drive. *Above (l to r):* A “collaboration area” outside the COPT Café. Peg Ohrt, SVP, Human Resources; Dwight S. Taylor, President, COPT Development & Construction Services; and Connie Epperlein, Corporate Designer and Programmer, select finishes for the space. The COPT awards wall, off our main reception lobby.

ensuring the future



DURING 2006, WE STRENGTHENED OUR TEAM to ensure a successful future. Changes included: the promotions of Roger A. Waesche, Jr., to EVP & COO, Karen M. Singer to SVP, General Counsel & Secretary, and Mary Ellen Fowler to VP & Treasurer, as well as the additions of Stephen E. Riffie as EVP & CFO (formerly CFO of CarrAmerica), Stephen B. Kutzer as CIO and Colleen M. Crews as VP & Controller.

Above (l to r): Rand Griffin, President and CEO; Roger Waesche; and Steve Riffie.

Steve Kutzer

Chief Information Officer

Mr. Kutzer is the first CIO at COPT. Formerly, he was SVP of Information Technology with CarrAmerica Realty Corporation and has held positions with KPMG Consulting and The World Health Organization.



Colleen Crews

Vice President and Controller

A CPA, Ms. Crews brings 15 years of real estate experience to COPT where she oversees all accounting department functions. Previous employers include The Town & Country Trust and Ernst & Young.



Mary Ellen Fowler

Vice President and Treasurer

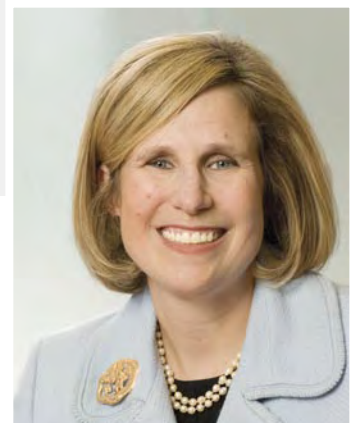
In her newly created position, Ms. Fowler is now responsible for cash management and capital markets in addition to her responsibilities for investor relations and marketing. She has been with COPT for five years, after 20 years of banking industry experience.



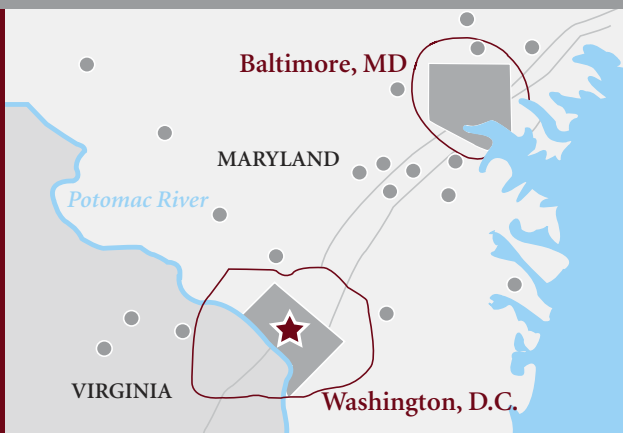
Karen Singer

Senior Vice President, General Counsel and Secretary

Ms. Singer, who was promoted to SVP, manages our legal and internal audit departments. She is responsible for all leases, contracts, financing documents and other legal instruments. She has been with COPT for ten years.



property & asset management



Each of our five **core values** is demonstrated by our property and asset management team in a number of key areas.

CUSTOMER SERVICE. For the third year in a row, COPT was recognized as the winner of the annual CEL & Associates, Inc. award for customer service among all office owners in the “large owner” category, based on the national survey of tenant satisfaction. Success in meeting our tenants’ needs every day is only possible with a team that is dedicated to excellence, attention to detail and service.

TENANT RELATIONSHIPS. The integrity and strength of our team are evidenced by our expanding tenant relationships. Despite significant earlier vacancies, we brought our Northern Virginia portfolio to 99% leased at year end. In Colorado Springs, where we entered the market only one year ago, we are 94% leased within our 842,000 square foot portfolio at year end. And, our customer service performance continues to provide new opportunities such as the Northrop Grumman VITA contract in Virginia, that resulted in two buildings with anticipated construction costs totaling \$86 million. Such teamwork is key to our success. That’s The COPT Way.



COPT’s 2006
National
Commercial Real
Estate Customer
Service Award for
Excellence



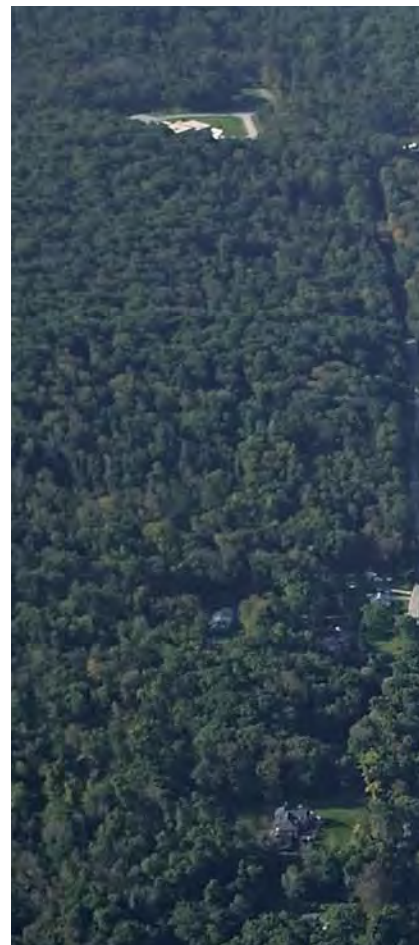
Opposite page (l to r): COPT’s market concentration is the Greater Washington, DC, area. Regional Directors include Michael A. Riley, Jeffrey L. Marquina and Gregory B. White. Members of the asset management/leasing team include VPs Derrick C. Boegner and William S. Barroll, and SVP S. Judson Williams.

acquisitions

Our innovative approach to development is illustrated through the purchase of 500 acres of the 591-acre Fort Ritchie, a former U.S. Army base located near the Maryland-Pennsylvania border. The purchase reflects a strategy to capture tenant demand for major facilities outside of Washington, DC. It's also an excellent opportunity to create an environment that inspires success.

We plan to develop 1.7 million square feet of office space and 673 residential units—from apartments and condos to single-family homes. We will develop lots and select high quality builders to carry out our vision. Residents and workers will enjoy a quality of life that includes 24 acres of lakes, a 67-acre historic area, 20 acres for community use and 257 acres of woodlands. Included in our plan is a new community center, expanded athletic facilities and retail and service amenities. We expect to turn a closed army base into an economic engine that will generate at least 4,500 jobs while revitalizing a community.

fort ritchie



Above (l & r): The historic “Castle Building” will become COPT’s Fort Ritchie sales and marketing center. *Opposite page:* Aerial overview of the 591-acre Fort Ritchie. *Far right:* Frank W. Ziegler, VP, Government & Construction Services; Catherine M. Ward, SVP, Asset Management/Leasing; and Charles J. Fiala, Jr., SVP, Government Services, lead the Fort Ritchie development and leasing team.



Fort Ritchie represents a great opportunity for our clients and shareholders, a growth driver for the company and a revitalizing force for the surrounding communities. That's The COPT Way.





IN A TRANSACTION THAT BEGAN IN 2006 and closed in January 2007, COPT acquired 56 office buildings and 187 acres of land from the Nottingham Properties portfolio, located primarily in the I-95 corridor north of Baltimore. We brought onboard 19 of the Nottingham employees to continue to serve our new tenants' requirements.

We believe that the purchase is very accretive to our future earnings and strategically important for several reasons. First, we are now the largest owner of office properties in White Marsh, a submarket located 18 miles from the U.S. Army's Aberdeen Proving Ground, which is preparing to accept thousands of jobs on and off post as a result of BRAC. Second, we are now the largest office owner in Baltimore County. And third, the acquisition enhances our dominance in key Maryland submarkets including Columbia and around BWI Airport.

Our strategy is to aggressively lease and manage the portfolio—as the buildings were 86% leased at the time of purchase—and to expand our relationship with strong existing tenants such as Comcast Corporation, Orbital Sciences Corporation, MedStar Health, Inc. and The Johns Hopkins University. We believe this transaction creates a value-add opportunity as we were able to purchase the buildings at below replacement cost. It also gives us a minimum of 2 million square feet of future development at prices significantly below market.

nottingham properties



Opposite page (l to r): Corporate Place I, in White Marsh; 216 Schilling Circle in Hunt Valley. *Above (l to r):* Campbell Corporate Center in White Marsh. Members of the Baltimore County properties' leasing and property management team: John T. Hermann, VP, Asset Management/Leasing; Sandi Haertig, Regional Director; Susan Roger, Senior Property Manager; and Janeann Streat, Leasing Representative.

OUR EXPANSION IN COLORADO SPRINGS is representative of The COPT Way. In 2005, COPT followed a tenant-centric expansion strategy and entered the Colorado Springs market to bring our clients closer to Peterson Air Force Base. In 2006, through acquisitions, development and value-add opportunities, we became the market's #1 owner of office space.

We purchased a 60,000 square foot facility for \$2.6 million—well below market value—renovated it so that it now has 74,749 square feet, and leased it to a growing client, The Spectranectics Corporation. Subsequent to year end, we began construction on a 60,000 square foot building, pre-leased in its entirety to SI International, Inc.

We've invested \$175 million in Colorado Springs and have grown our staff there to ten. We now own 12 buildings totaling 842,000 square feet, which were 94% leased at year end, and have four buildings under construction or development, adding another 292,000 square feet. We own or control, through a joint venture, sufficient entitled land to build an additional 2.6 million square feet.

Colorado Springs offers tremendous potential for both our clients and our shareholders. Again—The COPT Way.

colorado springs



Above (l to r): Members of the Colorado Springs team: Harold Martinez, Senior Property Manager; George Swintz, VP, Asset Management/Leasing; and Frank Melara, Senior Construction Manager. Scitor's new building at Patriot Park. *Opposite page (l to r):* North Creek office complex; the lobby of Patriot Park V.





development

Development produces greater returns than any other part of our business. Yet even by our standards, the gains in 2006 were significant.

A LANDMARK YEAR IN DEVELOPMENT. By year end, we placed seven buildings totaling 792,762 square feet into service. Another 831,066 square feet of strategically located office space is currently under construction and approximately 2 million square feet are in development/re-development. With a land inventory at year end of 1,388 acres, plus the additional acreage acquired in January, we have the potential for 14 million square feet of development, positioning us for a decade of continuous growth.



Top: 306 NBP. Above (l to r): Carl M. Nelson, VP, Construction Services; Peter Z. Garver, Director, Development Services; and George J. Marcin, VP, Interior Construction and Renovation. Center and far right: Washington Technology Park II in Chantilly, Virginia.

Highlights include:

- The purchase of 178 acres adjacent to The National Business Park which will allow for increased capacity and expansion of NBP over time to meet our largest tenants' needs.
- The development of two data centers totaling 296,000 square feet for Northrop Grumman in Virginia.
- Partnerships with the University of Maryland, Baltimore County and the University of Maryland, College Park to develop their technology parks.
- Our commitment to build to LEED Silver certification level. Already two new buildings have been certified at the Silver level, two at the Gold level, and 19 more are registered in the LEED program. Additionally, we now have six COPT employees who are LEED certified professionals. Green construction is the future. Our clients demand it and our environment depends on it. It is part of The COPT Way.



Above (l to r): Lobby of 6711 Columbia Gateway Drive. The U.S. Green Building Council's Silver Certification medallion.

2006 financials

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selected financial data corporate office properties trust and subsidiaries

The following table sets forth summary financial data as of and for each of the years ended December 31, 2002 through 2006. The table illustrates the significant growth our Company experienced over the periods reported. Most of this growth, particularly pertaining to revenues, operating income and total assets, was attributable to our addition of properties through acquisition and development activities. We financed most of the acquisition and development activities by incurring debt and issuing preferred and common equity, as indicated by the growth in our interest expense, preferred share dividends and weighted average common shares outstanding. The growth in our general and administrative expenses reflects, in large part, the growth in management resources required to support the increased size of our portfolio. Since this information is only a summary, you should refer to our Consolidated Financial Statements and notes thereto and the section of this report entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for additional information.

(in thousands, except per share data and number of properties)	2006	2005	2004	2003	2002
Revenues					
Revenues from real estate operations ⁽¹⁾	\$ 301,319	\$ 242,073	\$ 203,944	\$ 164,053	\$ 139,428
Construction contract and other service operations revenues	60,084	79,234	28,903	31,740	4,704
Total revenues	361,403	321,307	232,847	195,793	144,132
Expenses					
Property operating expenses ⁽¹⁾	94,504	72,253	58,982	47,564	40,186
Depreciation and other amortization associated with real estate operations ⁽¹⁾	78,712	61,049	49,289	34,599	28,452
Construction contract and other service operations expenses	57,345	77,287	26,996	30,933	5,008
General and administrative expenses	16,936	13,534	10,938	7,893	6,697
Total operating expenses	247,497	224,123	146,205	120,989	80,343
Operating income	113,906	97,184	86,642	74,804	63,789
Interest expense and amortization of deferred financing costs ⁽¹⁾	(74,225)	(57,101)	(44,568)	(41,487)	(38,991)
Income from continuing operations before equity in loss of unconsolidated entities, income taxes and minority interests	39,681	40,083	42,074	33,317	24,798
Equity in loss of unconsolidated entities	(92)	(88)	(88)	(98)	(402)
Income tax (expense) benefit	(887)	(668)	(795)	169	347
Income from continuing operations before minority interests	38,702	39,327	41,191	33,388	24,743
Minority interests in income from continuing operations ⁽¹⁾	(4,584)	(5,245)	(5,473)	(6,260)	(5,996)
Income from continuing operations	34,118	34,082	35,718	27,128	18,747
Income from discontinued operations, net of minority interests ⁽¹⁾⁽²⁾	14,377	4,681	1,427	3,413	2,778
Gain (loss) on sales of real estate, net ⁽¹⁾⁽³⁾	732	268	(113)	336	1,776
Net income	49,227	39,031	37,032	30,877	23,301
Preferred share dividends	(15,404)	(14,615)	(16,329)	(12,003)	(10,134)
Issuance costs associated with redeemed preferred shares ⁽⁴⁾	(3,896)	—	(1,813)	—	—
Repurchase of preferred units in excess of recorded book value ⁽⁵⁾	—	—	—	(11,224)	—
Net income available to common shareholders	\$ 29,927	\$ 24,416	\$ 18,890	\$ 7,650	\$ 13,167

(continued)

(in thousands, except per share data and number of properties)	2006	2005	2004	2003	2002
Basic earnings per common share					
Income from continuing operations	\$ 0.37	\$ 0.53	\$ 0.53	\$ 0.16	\$ 0.46
Net income available to common shareholders	\$ 0.72	\$ 0.65	\$ 0.57	\$ 0.29	\$ 0.59
Diluted earnings per common share					
Income from continuing operations	\$ 0.36	\$ 0.51	\$ 0.50	\$ 0.15	\$ 0.44
Net income available to common shareholders	\$ 0.69	\$ 0.63	\$ 0.54	\$ 0.27	\$ 0.56
Weighted average common shares outstanding—basic	41,463	37,371	33,173	26,659	22,472
Weighted average common shares outstanding—diluted	43,262	38,997	34,982	28,021	23,350
Balance Sheet Data (as of year end):					
Investment in real estate	\$2,111,310	\$1,888,106	\$1,544,501	\$1,189,258	\$1,042,955
Total assets	\$2,419,601	\$2,129,759	\$1,732,026	\$1,332,076	\$1,138,721
Debt	\$1,498,537	\$1,348,351	\$1,022,688	\$ 738,698	\$ 705,056
Total liabilities	\$1,629,111	\$1,442,036	\$1,111,224	\$ 801,899	\$ 749,338
Minority interests	\$ 116,187	\$ 105,210	\$ 98,878	\$ 79,796	\$ 100,886
Shareholders' equity	\$ 674,303	\$ 582,513	\$ 521,924	\$ 450,381	\$ 288,497
Other Financial Data (for the year ended):					
Cash flows provided by (used in):					
Operating activities	\$ 113,151	\$ 95,944	\$ 84,494	\$ 67,783	\$ 62,242
Investing activities	\$ (253,834)	\$ (419,093)	\$ (263,792)	\$ (172,949)	\$ (128,571)
Financing activities	\$ 137,822	\$ 320,112	\$ 183,638	\$ 108,656	\$ 65,680
Numerator for diluted EPS	\$ 29,927	\$ 24,416	\$ 18,911	\$ 7,650	\$ 13,711
Diluted funds from operations ⁽⁶⁾	\$ 98,937	\$ 88,801	\$ 76,248	\$ 61,268	\$ 52,854
Diluted funds from operations per share ⁽⁶⁾	\$ 1.91	\$ 1.86	\$ 1.74	\$ 1.56	\$ 1.44
Cash dividends declared per common share	\$ 1.18	\$ 1.07	\$ 0.98	\$ 0.91	\$ 0.86
Property Data (as of year end):					
Number of properties owned ⁽¹⁾⁽⁷⁾	170	165	143	118	110
Total rentable square feet owned ⁽¹⁾⁽⁷⁾	15,050	13,708	11,765	9,876	8,942

(1) Certain prior period amounts have been reclassified to conform with the current presentation. These reclassifications did not affect consolidated net income or shareholders' equity.

(2) Reflects income derived from one operating real estate property that we sold in 2003, three operating real estate properties that we sold in 2005 and seven operating real estate properties we sold in 2006 (see Note 18 to our Consolidated Financial Statements).

(3) Reflects gain (loss) from sales of properties and unconsolidated real estate joint ventures not associated with discontinued operations.

(4) Reflects a decrease to net income available to common shareholders pertaining to the original issuance costs recognized upon the redemption of the Series E and Series F Preferred Shares of beneficial interest in 2006 and the Series B Preferred Shares of beneficial interest in 2004.

(5) Reflects a decrease to net income available to common shareholders representing the excess of the repurchase price of the Series C Preferred Units in our Operating Partnership over the sum of the recorded book value of the units and the accrued and unpaid return to the unitholder.

(6) For definitions of diluted funds from operations per share and diluted funds from operations and reconciliations of these measures to their comparable measures under generally accepted accounting principles, you should refer to the section entitled "Funds from Operations" within the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations."

(7) Amounts reported reflect only wholly owned properties.

management's discussion and analysis of financial condition and results of operations

You should refer to our Consolidated Financial Statements and the notes thereto and our Selected Financial Data table as you read this section.

This section contains “forward-looking” statements, as defined in the Private Securities Litigation Reform Act of 1995, that are based on our current expectations, estimates and projections about future events and financial trends affecting the financial condition and operations of our business. Forward-looking statements can be identified by the use of words such as “may,” “will,” “should,” “expect,” “estimate” or other comparable terminology. Forward-looking statements are inherently subject to risks and uncertainties, many of which we cannot predict with accuracy and some of which we might not even anticipate. Although we believe that the expectations, estimates and projections reflected in such forward-looking statements are based on reasonable assumptions at the time made, we can give no assurance that these expectations, estimates and projections will be achieved. Future events and actual results may differ materially from those discussed in the forward-looking statements. Important factors that may affect these expectations, estimates and projections include, but are not limited to:

- our ability to borrow on favorable terms;
- general economic and business conditions, which will, among other things, affect office property demand and rents, tenant creditworthiness, interest rates and financing availability;
- adverse changes in the real estate markets, including, among other things, increased competition with other companies;
- risks of real estate acquisition and development activities, including, among other things, risks that development projects may not be completed on schedule, that tenants may not take occupancy or pay rent or that development and operating costs may be greater than anticipated;
- risks of investing through joint venture structures, including risks that our joint venture partners may not fulfill their financial obligations as investors or may take actions that are inconsistent with our objectives;
- our ability to satisfy and operate effectively under federal income tax rules relating to real estate investment trusts and partnerships;
- governmental actions and initiatives; and
- environmental requirements.

We undertake no obligation to update or supplement forward-looking statements.

OVERVIEW

We are a real estate investment trust (“REIT”) that focuses on the acquisition, development, ownership, management and leasing of primarily Class A suburban office properties in select, demographically strong submarkets where we can achieve critical mass, operating synergies and key competitive advantages, including attracting high quality tenants and securing acquisition and development opportunities. We also have a core customer expansion strategy that is built on meeting, through acquisitions and development, the multilocation requirements of our strategic tenants. As of December 31, 2006, our investments in real estate included the following:

- 170 wholly owned operating properties in our portfolio totaling 15.1 million square feet;
- 16 wholly owned office properties under construction or development that we estimate will total approximately 1.8 million square feet upon completion, and two wholly owned office properties totaling approximately 129,000 square feet that were under redevelopment;
- wholly owned land parcels totaling 1,048 acres that we believe are potentially developable into approximately 8.4 million square feet; and
- partial ownership interests in a number of other real estate projects in operations or under development or redevelopment.

REITs were created by the United States Congress in order to provide large numbers of investors with the ability to make investments into entities that own large scale commercial real estate. One unique aspect of a REIT is that the entity typically does not pay corporate income tax, provided that the entity distributes 100% of its taxable income to its shareholders and meets a number of other strict requirements of the Internal Revenue Code of 1986, as amended (it is noteworthy that REITs are required to distribute a minimum of only 90% of taxable income to maintain their tax status as a REIT, although any differential between the 90% and 100% would be taxable). Most of our revenues relating to our real estate operations are derived from rents and property operating expense reimbursements earned from tenants leasing space in our properties. Most of our expenses relating to our real estate operations take the form of (1) property operating costs, such as real estate taxes, utilities and repairs and maintenance; (2) financing costs, such as interest and loan costs; and (3) depreciation and amortization associated with our operating properties.

Of the 170 wholly owned operating properties in our portfolio, 157 were located in the Mid-Atlantic region of the United States. Our primary regions as of December 31, 2006 are set forth below:

- Baltimore/Washington Corridor (defined as the Maryland counties of Howard and Anne Arundel);
- Northern Virginia (defined as Fairfax County, Virginia);
- Suburban Maryland (defined as the Maryland counties of Montgomery, Prince George's and Frederick);
- St. Mary's & King George Counties (located in Maryland and Virginia, respectively);
- Suburban Baltimore, Maryland;
- Colorado Springs, Colorado;
- San Antonio, Texas;
- Northern/Central New Jersey (as of December 31, 2006, all of our properties in this segment were located in Central New Jersey); and
- Greater Philadelphia, Pennsylvania.

As of December 31, 2006, 124 of our properties were located in what is widely known as the Greater Washington, D.C. region, which includes the first four regions set forth above, and 23 were located in neighboring Suburban Baltimore. The core customer expansion strategy that we began implementing in 2004 led us into the next two regions set forth above: Colorado Springs and San Antonio, Texas. The last two regions set forth above are considered non-core to the Company. We discuss further the geographic concentrations of our property ownership in the section below entitled "Concentration of Operations."

Our strategy for operations and growth revolves around our goal to be the landlord of choice for select high quality tenants. As a result of this strategy, a large concentration of our revenue is derived from several large tenants. Our largest tenants are also heavily concentrated in the United States defense industry. Several noteworthy statistics that demonstrate our tenant and industry concentrations are set forth below:

	Percentage of Annualized Rental Revenue⁽¹⁾ of Wholly Owned Properties at December 31, 2006
Largest tenant, United States Government	16.3%
Five largest tenants	34.2%
Twenty largest tenants	56.7%
Tenants in the United States defense industry	54.4%

(1) Defined below in the section entitled "Concentration of Operations" in the subsection entitled "Geographic Concentration of Property Operations."

We discuss further our lease concentrations in the section below entitled "Concentration of Operations."

In order to maximize the revenue potential of our properties, we try to maintain high levels of occupancy; as a result, we consider occupancy rates to be an important measure of the productivity of our properties. One way that we attempt to maximize occupancy rates is by renewing a high percentage of our existing tenants; accordingly, tenant renewal rates are important to us in monitoring our leasing activities and tenant relationships. In managing the effect of our leasing activities on our financial position and future operating performance stability, we also monitor the timing of our lease maturities with the objective that the timing of such maturities not be highly concentrated in a given one-year or five-year period. The table below sets forth certain occupancy and leasing information as of or for the year ended December 31, 2006 for our portfolio of wholly owned properties:

Occupancy	92.8%
Renewal rate of square footage for scheduled lease expirations during year	55.4%
Average contractual annual rental rate per square foot ⁽¹⁾	\$20.90
Weighted average lease term (in years) ⁽²⁾	5.0

(1) Includes estimated expense reimbursements.

(2) See assumption relating to our United States Government leases in section entitled "Results of Operations" in the subsection entitled "Occupancy and Leasing."

We discuss further in the section below entitled "Results of Operations" in the subsection entitled "Occupancy and Leasing."

Achieving optimal performance from our properties is highly important to our Company. We evaluate the performance of our properties by focusing on changes in revenues from real estate operations (comprised of (1) rental revenue and (2) tenant recoveries and other real estate operations revenue) and property operating expenses. However, since we experienced significant growth in number of operating properties between 2004 and 2006, our growth in revenues from real estate operations and property operating expenses over that time frame can be misleading. Therefore, we evaluate (1) changes in revenues from real estate operations and property operating expenses attributable to property additions separately from (2) the changes attributable to properties that were owned and operational throughout any two periods being compared, properties that we collectively refer to as the Same-Office Properties. During 2006, we:

- experienced significant growth from 2005 in revenues from real estate operations and property operating expenses due primarily to the addition of properties through acquisition and construction activities since January 1, 2005;

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- had a \$6.5 million, or 2.9%, increase in revenues from the Same-Office Properties compared to 2005 due primarily to increased rental revenue and operating expense reimbursements at such properties; and
- had a \$4.7 million, or 6.8%, increase in property operating expenses from the Same-Office Properties compared to 2005 due in large part to increased utilities, real estate taxes and repairs and maintenance expenses, partially offset by decreased snow removal expenses.

We discuss these changes further in the section below entitled "Results of Operations" in the subsection entitled "Revenues from Real Estate Operations and Property Operating Expenses."

In addition to owning real estate properties, we provide real estate-related services that include (1) property management; (2) construction and development management; and (3) heating and air conditioning services and controls. The gross revenue and costs associated with these services generally bear little relationship to the level of our activity from these operations since a substantial portion of the costs are subcontracted costs that are reimbursed to us by the customer at no mark up. As a result, the operating margins from these operations are small relative to the revenue. We use the net of such revenues and expenses to evaluate the performance of our service operations. For 2006, the operating margins of our service operations increased \$792,000 compared to 2005. These operations are discussed further in the section below entitled "Results of Operations" in the subsection entitled "Construction Contract and Other Service Revenue and Expenses."

Our 2006 net income available to common shareholders increased 22.6% and our diluted earnings per share increased 9.5% compared to 2005. We discuss significant factors contributing to these changes within subsections of the section below entitled "Results of Operations."

The investment portion of our growth strategy focuses primarily on two activities: acquisitions and development. These activities typically target suburban office properties in our existing geographic regions, neighboring regions or new regions meeting our investment criteria, but they may also target other properties as a result of our core customer expansion strategy. Since we take an opportunistic yet disciplined approach to our investment activities, the volume of these activities and allocation between acquisitions versus development naturally change from year to year. Highlights of our 2006 acquisition and development activities are set forth below:

- we acquired in our primary geographic regions set forth above six operating properties totaling 1.0 million square feet, a building to be redeveloped totaling 74,749 square

feet and seven parcels of land that we believe can support up to 2.3 million developable square feet, for a total of \$169.7 million;

- we acquired 500 acres of the 591-acre former Fort Ritchie United States Army base located in Cascade, Washington County, Maryland for a value of \$5.6 million with an initial cash outlay of \$2.5 million and expect to acquire the remaining 91 acres in 2007. The 591-acre parcel is anticipated to accommodate a total of 1.7 million square feet of office space and 673 residential units, including approximately 306,000 square feet of existing office space and 110 existing rentable residential units;
- we had seven newly-constructed properties totaling 866,000 square feet become fully operational. We also had 68,196 square feet placed into service in one partially operational property; and
- we had eight properties under construction (seven wholly owned), four properties under redevelopment (two wholly owned) and 11 properties under development (nine wholly owned) at December 31, 2006.

While we generally do not acquire properties with the intent of selling them, we do sell properties from time to time when we believe that most of the earnings growth potential in that property has been realized, or determine that the property no longer fits within our strategic plans due to its type and/or location. During 2006, we sold seven operating properties, including three from one of our non-core regions, a newly constructed property and a parcel of land for a total of \$83.0 million, resulting in recognized gains before minority interest totaling \$17.3 million.

Our financing policy is aimed at maintaining a flexible capital structure in order to facilitate consistent growth and performance in the face of differing market conditions in the most cost-effective way possible. As part of this policy, we monitor (1) levels of debt relative to our overall capital structure; (2) the relationship of certain measures of earnings to certain financing cost requirements (coverage ratios); (3) the relationship of our total variable-rate debt to our total debt; and (4) the timing of our debt maturities to ensure that the maximum maturities of debt in any year do not exceed a defined percentage of total assets. We also pursue opportunities, when we believe market conditions to be favorable, to: (1) reduce financing costs by refinancing existing debt or redeeming existing preferred equity; (2) issue common and preferred shares of beneficial interest ("common shares" and "preferred shares"); and (3) issue equity units in our Operating Partnership. Highlights of our 2006 financing activities are set forth below:

- we sold 2.0 million common shares to an underwriter at a net price of \$41.31 per share, for net proceeds of \$82.4 million;
- we sold 3,390,000 Series J Cumulative Redeemable Preferred Shares (the “Series J Preferred Shares”) at a price of \$25 per share for net proceeds of \$81.9 million;
- we redeemed the Series E Cumulative Redeemable Preferred Shares of beneficial interest (the “Series E Preferred Shares”) and the Series F Cumulative Redeemable Preferred Shares of beneficial interest (the “Series F Preferred Shares”) for a redemption price of \$25 per share, resulting in a total payment of \$64.4 million. We recognized a \$3.9 million decrease to net income available to common shareholders pertaining to the original issuance costs of these shares;
- we issued a \$200.0 million aggregate principal amount of 3.50% Exchangeable Senior Notes due 2026. The notes are redeemable by us on or after September 20, 2011. The notes also contain an exchange settlement feature, which provides that the notes may, under certain circumstances, be exchangeable for cash (up to the principal amount of the notes) and, with respect to any excess exchange value, may be exchangeable into (at our option) cash, our common shares or a combination of cash and common shares at an initial exchange rate of 18.4162 shares per \$1,000 principal amount of the notes; and
- we borrowed \$146.5 million under a 10-year mortgage payable requiring payments of interest only at a fixed rate of 5.43%.

We discuss our 2006 investing and financing activities further in the section below entitled “Liquidity and Capital Resources,” along with discussions of, among other things, the following:

- our cash flows;
- how we expect to generate cash for short- and long-term capital needs;
- our off-balance sheet arrangements in place that are reasonably likely to affect our financial condition; and
- our commitments and contingencies.

On January 9 and 10, 2007, we completed a series of transactions that resulted in the acquisition of 56 operating properties totaling 2.4 million square feet and land parcels totaling 187 acres. We refer to this transaction as the Nottingham Acquisition. All of the acquired properties are located in Maryland, with 36 of the operating properties, totaling 1.6 million square feet, and land parcels totaling 175 acres, located in White Marsh, Maryland and the remaining properties and land parcels located in other regions in Northern Baltimore County and the

Baltimore/Washington Corridor. We believe that the land parcels totaling 187 acres can support at least 2.0 million developable square feet. We completed the Nottingham Acquisition for an aggregate cost of approximately \$363.9 million. We financed the acquisition by issuing \$26.6 million in Series K Cumulative Redeemable Convertible Preferred Shares of beneficial interest (the “Series K Preferred Shares”) to the seller, issuing \$154.9 million in common shares to the seller at a deemed value of \$49 per share, using \$20.1 million from an escrow funded by proceeds from one of our property sales and using debt borrowings for the remainder. We discuss this transaction further in the section below entitled “Liquidity and Capital Resources,” and the section entitled “Results of Operations” in the subsection entitled “Occupancy and Leasing.”

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our Consolidated Financial Statements are prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”), which require us to make certain estimates and assumptions. A summary of our significant accounting policies is provided in Note 2 to our Consolidated Financial Statements. The following section is a summary of certain aspects of those accounting policies involving estimates and assumptions that (1) require our most difficult, subjective or complex judgments in accounting for highly uncertain matters or matters that are susceptible to change and (2) materially affect our reported operating performance or financial condition. It is possible that the use of different reasonable estimates or assumptions in making these judgments could result in materially different amounts being reported in our Consolidated Financial Statements. While reviewing this section, you should refer to Note 2 to our Consolidated Financial Statements, including terms defined therein.

- When we acquire real estate properties, we allocate the acquisition to numerous tangible and intangible components. Most of the terms in this bullet section are defined in the section of Note 2 to the Consolidated Financial Statements entitled “Acquisitions of Real Estate.” Our process for determining the allocation to these components is very complex and requires many estimates and assumptions. Included among these estimates and assumptions are the following: (1) determination of market rental rates; (2) estimate of leasing and tenant improvement costs associated with the remaining term of acquired leases for deemed cost avoidance; (3) leasing assumptions used in determining the lease-up value, as-if vacant value and tenant relationship value, including the rental rates, period of time that it will take to lease vacant space and estimated tenant improvement and leasing costs; (4) estimate of the

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property's future value in determining the as-if vacant value; (5) estimate of value attributable to market concentration premiums and tenant relationship values; and (6) allocation of the as-if vacant value between land and building. A change in any of the above key assumptions, most of which are extremely subjective, can materially change not only the presentation of acquired properties in our Consolidated Financial Statements but also reported results of operations. The allocation to different components affects the following:

- the amount of the acquisition costs allocated among different categories of assets and liabilities on our balance sheet, the amount of costs assigned to individual properties in multiple property acquisitions and the amount of costs assigned to individual tenants at the time of acquisition;
 - where the amortization of the components appear over time in our statements of operations. Allocations to the lease to market value component are amortized into rental revenue, whereas allocations to most of the other components (the one exception being the land component of the as-if vacant value) are amortized into depreciation and amortization expense. As a REIT, this is important to us since much of the investment community evaluates our operating performance using non-GAAP measures such as funds from operations, the computation of which includes rental revenue but does not include depreciation and amortization expense; and
 - the timing over which the items are recognized as revenue or expense in our statements of operations. For example, for allocations to the as-if vacant value, the land portion is not depreciated and the building portion is depreciated over a longer period of time than the other components (generally 40 years). Allocations to lease to market value, deemed cost avoidance, lease-up value and tenant relationship value are amortized over significantly shorter time frames, and if individual tenants' leases are terminated early, any unamortized amounts remaining associated with those tenants are generally expensed upon termination. These differences in timing can materially affect our reported results of operations. In addition, we establish lives for lease-up value and tenant relationship value based on our estimates of how long we expect the respective tenants to remain in the properties; establishing these lives requires estimates and assumptions that are very subjective.
- When events or circumstances indicate that a property may be impaired, we perform an undiscounted cash flow analysis. We consider an asset to be impaired when its undiscounted expected future cash flows are less than its depreciated cost. If such impairment is present, an impairment loss is recognized based on the excess of the carrying amount of the asset over its fair value. We compute a real estate asset's undiscounted expected future cash flows and fair value using certain estimates and assumptions. As a result, these estimates and assumptions impact whether an impairment is deemed to have occurred and the amount of impairment loss that we recognize.
 - We generally use three different accounting methods to report our investments in entities: the consolidation method, the equity method and the cost method (see Note 2 to our Consolidated Financial Statements). We generally use the consolidation method when we own most of the outstanding voting interests in an entity and can control its operations. In accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 46(R), "Consolidation of Variable Interest Entities" ("FIN 46(R)"), we also consolidate certain entities when control of such entities can be achieved through means other than voting rights ("variable interest entities" or "VIEs") if we are deemed to be the primary beneficiary. Generally, FIN 46(R) applies when either (1) the equity investors (if any) lack one or more of the essential characteristics of a controlling financial interest; (2) the equity investment at risk is insufficient to finance that entity's activities without additional subordinated financial support; or (3) the equity investors have voting rights that are not proportionate to their economic interests and the activities of the entity involve or are conducted on behalf of an investor with a disproportionately small voting interest. We generally use the equity method of accounting when we own an interest in an entity and can exert significant influence over, but cannot control, the entity's operations. In making these determinations, we typically need to make subjective estimates and judgments regarding the entity's future operating performance, financial condition, future valuation and other variables that may affect the partners' share of cash flow from the entity over time. We also need to estimate the probability of different scenarios taking place over time and project the effect that each of those scenarios would have on variables affecting the partners' cash flows. The conclusion reached as a result of this process affects whether or not we use the consolidation method in accounting for our investment or either the equity or financing method of accounting. Whether or not we consolidate an investment can materially affect our Consolidated Financial Statements.

- We issue share options and restricted shares to many of our employees. Prior to January 1, 2006, very little expense was required to be recognized in our financial statements for share options under GAAP. On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123(R), “Share-Based Payment” (“SFAS 123(R)”). SFAS 123(R) requires us to measure the cost of employee services received in exchange for an award of equity instruments based generally on the fair value of the award on the grant date; such cost should then be recognized over the period during which the employee is required to provide service in exchange for the award (generally the vesting period). We compute the grant-date fair value of share options using the Black-Scholes option-pricing model, which requires the following input assumptions: risk-free interest rate, expected life, expected volatility and expected dividend yield. SFAS 123(R) also requires that share-based compensation be computed based on awards that are ultimately expected to vest; as a result, future forfeitures of our share options and restricted shares are to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The input assumptions used under the Black-Scholes option-pricing model and the estimates used in deriving the forfeiture rates for share options and restricted shares are subjective and require a fair amount of judgment. As a result, these estimates and assumptions can affect the amount of expense that we recognize in our Consolidated Financial Statements for options and restricted shares.

CONCENTRATION OF OPERATIONS

Geographic Concentration of Property Operations

During 2005 and 2006, we:

- increased our portfolio of wholly owned properties in the Baltimore/Washington Corridor, Northern Virginia, Suburban Baltimore and Suburban Maryland regions through acquisitions and newly constructed properties placed into service;
- made our initial entry into the San Antonio, Texas and Colorado Springs, Colorado regions through acquisitions in 2005 and further expanded our presence in Colorado Springs through additional acquisitions in 2006;
- sold 80% of the ownership interest in our Greater Harrisburg portfolio by contributing it into a real estate joint venture in 2005;
- sold three wholly owned properties in Northern/Central New Jersey, two in Suburban Baltimore and two in Suburban Maryland in 2006; and
- sold three wholly owned properties in Northern/Central New Jersey and one in the Baltimore/Washington Corridor in 2005.

The table below sets forth the changes in the regional allocation of our annualized rental revenue occurring primarily as a result of these acquisition and development activities and changes in leasing activity:

REGION	% of Annualized Rental Revenue of Wholly Owned Properties as of December 31,		
	2006	2005	2004
Baltimore/Washington Corridor	51.2%	47.8%	49.4%
Northern Virginia	20.5%	21.5%	23.2%
Suburban Baltimore	7.5%	10.1%	4.1%
St. Mary’s and King George Counties	4.2%	4.3%	4.7%
Colorado Springs, Colorado	4.2%	1.7%	N/A
Suburban Maryland	4.1%	5.2%	3.6%
Greater Philadelphia	3.7%	4.0%	4.6%
San Antonio, Texas	2.4%	1.5%	N/A
Northern/Central New Jersey	2.2%	3.9%	6.5%
Greater Harrisburg	N/A	N/A	3.9%
	100.0%	100.0%	100.0%

Annualized rental revenue is a measure that we use to evaluate the source of our rental revenue as of a point in time. It is computed by multiplying by 12 the sum of monthly contractual base rents and estimated monthly expense reimbursements under active leases as of a point in time. We consider annualized rental revenue to be a useful measure for analyzing revenue sources because, since it is point-in-time based, it does not contain increases and decreases in revenue associated with periods in which lease terms were not in effect; historical revenue under GAAP does contain such fluctuations. We find the measure particularly useful for leasing, tenant, segment and industry analysis.

With the completion of the Nottingham Acquisition in January 2007, the percentage of annualized revenue derived from wholly owned properties in the Suburban Baltimore region increased to approximately twice what it was prior to the acquisition.

Concentration of Leases with Certain Tenants

We experienced changes in our tenant base during 2006 and 2005 due primarily to acquisitions, development and leasing activity. The following schedule lists our 20 largest tenants in our portfolio of wholly owned properties based on percentage of annualized rental revenue:

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	Percentage of Annualized Rental Revenue of Wholly Owned Properties for 20 Largest Tenants as of December 31,		
	2006	2005	2004
TENANT			
United States Government	16.3%	15.2%	13.3%
Booz Allen Hamilton, Inc.	6.9%	5.0%	5.5%
Northrop Grumman Corporation	4.2%	4.5%	3.6%
Computer Sciences Corporation ⁽¹⁾	3.8%	4.1%	5.2%
AT&T Corporation ⁽¹⁾	3.0%	2.7%	4.2%
Unisys ⁽²⁾	3.0%	3.1%	3.5%
L-3 Communications Holdings, Inc. ⁽¹⁾	3.0%	3.4%	3.9%
General Dynamics Corporation	2.4%	2.6%	3.8%
The Aerospace Corporation	2.1%	2.2%	2.3%
Wachovia Bank	2.1%	2.1%	2.3%
The Boeing Company ⁽¹⁾	1.4%	1.6%	1.8%
Ciena Corporation	1.2%	1.3%	1.4%
Science Applications International Corporation	1.1%	N/A	N/A
Lockheed Martin Corporation	1.0%	1.0%	N/A
Magellan Health Services, Inc.	1.0%	1.1%	1.2%
BAE Systems PLC	1.0%	N/A	1.0%
Merck & Co., Inc. ⁽²⁾	0.8%	0.9%	1.1%
Wyle Laboratories, Inc.	0.8%	0.9%	N/A
Harris Corporation	0.8%	N/A	N/A
EDO Corporation	0.8%	N/A	N/A
VeriSign, Inc.	N/A	1.3%	1.4%
PricewaterhouseCoopers LLP	N/A	1.0%	1.3%
Johns Hopkins University ⁽¹⁾	N/A	1.0%	1.1%
Carefirst, Inc. and Subsidiaries ⁽¹⁾	N/A	0.9%	1.0%
Commonwealth of Pennsylvania ⁽¹⁾	N/A	N/A	1.3%
Subtotal of 20 largest tenants	56.7%	55.9%	60.2%
All remaining tenants	43.3%	44.1%	39.8%
Total	100.0%	100.0%	100.0%

(1) Includes affiliated organizations and agencies and predecessor companies.

(2) Unisys subleases space to Merck and Co., Inc.; revenue from this subleased space is classified as Merck & Co., Inc. revenue.

One aspect of our strategy involves focusing on the formation of strategic alliances with certain of our tenants from the standpoint of fulfilling their real estate needs in multiple locations. This strategy influences not only our leasing activities but also our acquisition and construction activities. As a result, our revenue concentration with individual tenants could continue to grow over time as a result of this strategy.

Most of the leases with the United States Government provide for a series of one-year terms or provide for early termination rights. The government may terminate its leases if, among other reasons, the United States Congress fails to provide funding.

Industry Concentration of Tenants

The percentage of total annualized rental revenue in our wholly owned properties derived from the United States defense industry increased in 2005 and 2006. One reason for this increase is the continuing expansion of the industry in the Greater Washington, D.C. region and, in particular, in our submarkets since the events of September 11, 2001. Another reason for the increase is that certain of the properties we acquired or constructed in 2005 and 2006 have leases with the United States Government and defense contractors. The table below sets forth the percentage of annualized rental revenue in our portfolio of wholly owned properties derived from that industry and, by doing so, demonstrates our increasing concentration:

	% of Annualized Rental Revenue of Wholly Owned Properties from Defense Industry Tenants as of December 31,		
	2006	2005	2004
Total Portfolio	54.4%	49.7%	47.4%
Baltimore/Washington Corridor	66.7%	65.7%	63.4%
Northern Virginia	54.5%	50.4%	50.3%
Suburban Baltimore	9.8%	6.8%	N/A
Suburban Maryland	13.3%	2.2%	3.6%
St. Mary's and King George Counties	89.8%	90.7%	90.6%
Colorado Springs	39.4%	74.1%	N/A
San Antonio	100.0%	100.0%	N/A

As noted above, one aspect of our strategy involves focusing on the formation of strategic alliances with certain of our tenants from the standpoint of fulfilling their real estate needs in multiple locations. Many of the tenants on which this strategy concentrates are in the United States defense industry. As a result of this strategy, our revenue concentration from that industry could continue to grow over time.

We classify the revenue from our leases into industry groupings based solely on our knowledge of the tenants' operations in leased space. Occasionally, classifications require subjective and complex judgments. For example, we have a tenant that is considered by many to be in the computer industry; however, since the nature of that tenant's operations in the space leased

from us is focused on providing service to the United States Government's defense department, we classify the revenue we earn from the lease as United States defense industry revenue. We do not use independent sources such as Standard Industrial Classification codes for classifying our revenue into industry groupings and if we did, the resulting groupings would be materially different.

RESULTS OF OPERATIONS

While reviewing this section, you should refer to the tables in the section entitled "Selected Financial Data." You should also refer to the section below entitled "Liquidity and Capital Resources" for certain factors that could negatively affect various aspects of our operations.

Occupancy and Leasing

The table below sets forth leasing information pertaining to our portfolio of wholly owned operating properties:

	December 31,		
	2006	2005	2004
Occupancy rates at year end			
Total	92.8%	94.0%	94.3%
Baltimore/Washington Corridor	95.1%	96.2%	95.6%
Northern Virginia	90.9%	96.4%	94.5%
Suburban Baltimore	81.1%	84.7%	91.0%
Suburban Maryland	83.2%	79.8%	82.8%
St. Mary's and King George Counties	92.1%	95.4%	96.9%
Greater Philadelphia	100.0%	100.0%	100.0%
Northern/Central New Jersey	97.2%	96.4%	92.7%
Colorado Springs, Colorado	92.8%	85.8%	N/A
San Antonio, Texas	100.0%	100.0%	N/A
Greater Harrisburg	N/A	N/A	85.4%
Renewal rate of square footage for scheduled lease expirations during year	55.4%	66.6%	71.4%
Average contractual annual rental rate per square foot at year end ⁽¹⁾	\$20.90	\$20.28	\$20.32

(1) Includes estimated expense reimbursements.

As shown in the above table, our portfolio of wholly owned properties posted an occupancy rate of approximately 92.8% at December 31, 2006, down from a year end occupancy rate of approximately 94% in 2005 and 2004; this decrease reflects the adverse impact of two large building spaces in Northern Virginia that we have under leases scheduled to commence in

early 2007. We believe that our occupancy rates have benefited in each of the last three years from the expansion of the United States defense industry in our largest submarkets. We also believe that these rates benefited from a national economic recovery in the real estate industry in 2005 and the stabilization that followed in 2006. In addition, our wholly owned property rates were impacted by our acquisition activity; acquisitions of wholly owned operating properties in 2006 positively impacted 2006 year end occupancy rates, with such properties carrying a weighted average occupancy rate of 95.1% at December 31, 2006, while 2005 acquisitions adversely affected 2005 year end occupancy rates, with such properties carrying a weighted average occupancy rate of 85.7% at December 31, 2005.

Our renewal rates of square footage for scheduled lease expirations decreased in each of the last two years; the 2006 rate in particular was low in comparison to the 2000 through 2005 calendar years, when the annual renewal rate ranged from 66% to 76% and averaged 70%. The 2006 renewal rate was adversely affected by large amounts of space that we knew were not going to be renewed when we acquired the properties, including 197,000 square feet in two properties; our renewal rates would have been in the low to mid 60% range without the effect of this space. While we believe that the ability for us to retain tenants at the rates that we did in the 2000 through 2005 period is a challenging task, particularly as we continue to grow, we believe that our strategy of positioning to be the landlord of choice for select high quality tenants will enable us to outperform our competitors in tenant retention in the long run.

Our average contractual annual rent per square foot increased approximately 3.0% from December 31, 2005 to December 31, 2006 despite the fact that acquisitions completed during 2006 had rents per square foot at December 31, 2006 of \$14.12, 32% below our wholly owned portfolio rate. The increase in this rate can be attributed primarily to the effect of new leases entered into at a higher rate during the year and scheduled increases that took place at leases remaining in place. The decrease in our average contractual annual rent per square foot from December 31, 2004 to December 31, 2005 was due primarily to our acquisition in 2005 of properties with rents per square foot that averaged \$15.71 at December 31, 2005. The lower rent per square foot on acquisitions in 2006 and 2005 can be attributed primarily to the following: (1) lower rents in geographic areas where certain acquisitions took place; (2) lower costs for operating expenses and tenant improvements associated with underlying leases in certain acquisitions; and (3) lower rents associated with lower grade space in certain acquisitions.

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We believe that there is a fair amount of uncertainty surrounding the outlook for leasing activity in 2007. Certain key economic indicators, including employment growth, seem to favor continued strength in our regions' real estate markets. However, the recent and scheduled addition of new square footage in our regions along with continued strong competition from existing properties in these regions present challenges to the Company's ability to meet our 2007 leasing objectives. As we discussed above, we believe that our occupancy rates have benefited from the expansion of the United States defense industry in our largest submarkets. Reporting by the Base Realignment and Closure Commission of the United States Congress favors continued expansion in the regions in which our properties are located. However, while we viewed this reporting as favorable for the Company's future leasing outlook, there is uncertainty, particularly in today's political environment, over the level of and timing of such expansion.

Despite any uncertainty regarding our 2007 leasing outlook, we believe that we are somewhat protected in the short run from a slow down in leasing activity since the weighted average lease term for our wholly owned properties at December 31, 2006 was five years. In addition, only 12.4% of our annualized rental revenues at December 31, 2006 were from leases scheduled to expire by the end of 2007. Looking longer term, 60.6% of our annualized rental revenues on leases in place as of December 31, 2006 were from leases scheduled to expire by the end of 2011, with no more than 16% scheduled to expire in any one calendar year between 2007 and 2011.

The Nottingham Acquisition will initially have an adverse effect on our leasing and occupancy measures. At December 31, 2006, the operating properties included in the transaction were approximately 86% occupied with average rents per square foot of approximately \$17.00. In addition, approximately one-third of annualized rental revenue at these properties as of December 31, 2006 were from leases scheduled to expire by the end of 2007; we expect to renew a majority of the square footage scheduled to expire in 2007.

As noted above, most of the leases with our largest tenant, the United States Government, provide for consecutive one-year terms or provide for early termination rights; all of the leasing statistics set forth above assume that the United States Government will remain in the space that they lease through the end of the respective arrangements, without ending consecutive one-year leases prematurely or exercising early termination rights. We report the statistics in this manner since we

manage our leasing activities using these same assumptions and believe these assumptions to be probable. Please refer to the section entitled "Liquidity and Capital Resources" where we further discuss our leases with the United States Government and the underlying risks.

The table below sets forth occupancy information pertaining to properties in which we have a partial ownership interest:

Geographic Region	Ownership Interest	Occupancy Rates at December 31,		
		2006	2005	2004
Suburban Maryland	50.0%	47.9%	47.9%	47.9%
Northern Virginia	92.5%	100.0% ⁽¹⁾	100.0% ⁽¹⁾	N/A
Greater Harrisburg	20.0%	91.2%	89.4%	N/A
Northern/Central New Jersey	20.0%	N/A ⁽²⁾	80.9%	84.2%

(1) Excludes the effect of 62,000 unoccupied square feet undergoing redevelopment at year end.

(2) The property in this geographic region was sold in July 2006.

Revenues from Real Estate Operations and Property Operating Expenses

We typically view our changes in revenues from real estate operations and property operating expenses as being comprised of three main components:

- Changes attributable to the operations of properties owned and 100% operational throughout the two years being compared. We define these as changes from "Same-Office Properties." For example, when comparing 2005 and 2006, Same-Office Properties would be properties owned and 100% operational from January 1, 2005 through December 31, 2006. For further discussion of the concept of "operational," you should refer to the section of Note 2 of the Consolidated Financial Statements entitled "Commercial Real Estate Properties."
- Changes attributable to operating properties acquired during the two years being compared and newly-constructed properties that were placed into service and not 100% operational throughout the two years being compared. We define these as changes from "Property Additions."
- Changes attributable to properties sold during the two years being compared that are not reported as discontinued operations. We define these as changes from "Sold Properties."

The tables below set forth the components of our changes in revenues from real estate operations and property operating expenses from continuing operations (dollars in thousands):

	Changes from 2005 to 2006					
	Property Additions Dollar Change ⁽¹⁾	Same-Office Properties		Sold Properties Dollar Change ⁽²⁾	Other Dollar Change ⁽³⁾	Total
		Dollar Change	Percentage Change			
Revenues from real estate operations						
Rental revenue	\$51,649	\$ 3,839	1.9%	\$(5,586)	\$(1,419)	\$48,483
Tenant recoveries and other real estate operations revenue	8,232	2,698	9.9%	(1,025)	858	\$10,763
Total	\$59,881	\$ 6,537	2.9%	\$(6,611)	\$(561)	\$59,246
Property operating expenses	\$20,022	\$ 4,681	6.8%	\$(2,259)	\$(193)	\$22,251
Straight-line rental revenue adjustments included in rental revenue	\$ 5,194	\$(2,068)	N/A	\$ (56)	\$(826)	\$ 2,244
Amortization of deferred market rental revenue	\$ 1,272	\$ 27	N/A	\$ —	\$(27)	\$ 1,272
Number of operating properties included in component category	53	118	N/A	16	1	188

(1) Includes 43 acquired properties and ten newly-constructed properties.

(2) Includes sold properties that are not reported as discontinued operations.

(3) Includes, among other things, the effects of amounts eliminated in consolidation. Certain amounts eliminated in consolidation are attributable to the Property Additions and Same-Office Properties.

	Changes from 2004 to 2005					
	Property Additions Dollar Change ⁽¹⁾	Same-Office Properties		Sold Properties Dollar Change ⁽²⁾	Other Dollar Change ⁽³⁾	Total
		Dollar Change	Percentage Change			
Revenues from real estate operations						
Rental revenue	\$34,228	\$(1,678)	(1.1)%	\$(1,991)	\$(1,409)	\$29,150
Tenant recoveries and other real estate operations revenue	4,088	4,332	22.5%	(257)	816	\$ 8,979
Total	\$38,316	\$ 2,654	1.5%	\$(2,248)	\$(593)	\$38,129
Property operating expenses	\$ 9,954	\$ 5,344	10.5%	\$(691)	\$(1,336)	\$13,271
Straight-line rental revenue adjustments included in rental revenue	\$ 2,968	\$(4,913)	N/A	\$ 238	\$(4)	\$(1,711)
Amortization of deferred market rental revenue	\$ 240	\$(451)	N/A	\$ —	\$(294)	\$(505)
Number of operating properties included in component category	65	93	N/A	16	1	175

(1) Includes 58 acquired properties and seven newly-constructed properties.

(2) Includes sold properties that are not reported as discontinued operations.

(3) Includes, among other things, the effects of amounts eliminated in consolidation. Certain amounts eliminated in consolidation are attributable to the Property Additions and Same-Office Properties.

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The analysis set forth below in this section pertains to properties included in continuing operations.

As the tables above indicate, our total increase in revenues from real estate operations and property operating expenses from 2005 to 2006 and from 2004 to 2005 was attributable primarily to the Property Additions.

The real estate operations in 2005 and 2006 associated with our property additions were adversely affected somewhat by our 2005 acquisitions carrying occupancy rates that were lower than the average occupancy rate of our previously existing properties. Acquisitions in 2005 with particularly low occupancy rates upon acquisition included the following: (1) a 1.1 million square foot portfolio acquired in December 2005 that has had an occupancy rate averaging approximately 80% since its acquisition; (2) a 118,000 square foot property acquired in October 2005 that has been 58% occupied since its acquisition through the end of 2006; and (3) a 113,000 square foot property acquired in April 2005 that was 23% occupied from its acquisition until December 2005, when it became 100% operational. We occasionally acquire lower occupancy properties such as these for what we view to be the potential for particularly high rates of return on our investment in these properties if we are successful in stabilizing their operations.

With regard to changes in the Same-Office Properties' revenues from real estate operations:

- the increase in rental revenue from the Same-Office Properties from 2005 to 2006 included the following:
 - an increase of \$2.6 million, or 1.4%, in rental revenue from the Same-Office Properties attributable primarily to changes in occupancy and rental rates between the two periods; and
 - an increase of \$1.2 million, or 26.8%, in net revenue from the early termination of leases. To explain further the term net revenue from the early termination of leases, when tenants terminate their lease obligations prior to the end of the agreed lease terms, they typically pay fees to break these obligations. We recognize such fees as revenue and write off against such revenue any (1) deferred rents receivable and (2) deferred revenue and deferred assets that are amortizable into rental revenue associated with the leases; the resulting net amount is the net revenue from the early termination of the leases.

- the change in rental revenue from the Same-Office Properties from 2004 to 2005 included the following:
 - a decrease of \$6.4 million, or 66.2%, in net revenue from the early termination of leases, which was attributable primarily to two properties; and
 - an increase of \$4.7 million, or 3.2%, attributable to changes in occupancy and rental rates between the two periods; and
- tenant recoveries and other revenue from the Same-Office Properties increased from 2005 to 2006 and from 2004 to 2005 due primarily to the increase in property operating expenses described below. While we do have some lease structures under which tenants pay for 100% of properties' operating expenses, our most prevalent lease structure is for tenants to pay for a portion of property operating expenses to the extent that such expenses exceed amounts established in their respective leases that are based on historical expense levels. As a result, while there is an inherent direct relationship between our tenant recoveries and property operating expenses, this relationship does not result in a dollar for dollar increase in tenant recoveries as property operating expenses increase.

With regard to changes in the Same-Office Properties' property operating expenses:

- the increase in the Same-Office Properties' property operating expenses from 2005 to 2006 included the following:
 - an increase of \$2.0 million, or 13.3%, in utilities due primarily to (1) rate increases that we believe are the result of (a) increased oil prices and (b) energy deregulation in Maryland and (2) our assumption of responsibility for payment of utilities at certain properties due to changes in occupancy and lease structure;
 - an increase of \$1.3 million, or 10.3%, in real estate taxes reflecting primarily an increase in the assessed value of many of our properties;
 - an increase of \$651,000, or 8.5%, in repairs and maintenance labor due in large part to higher labor hour rates resulting from an increase in the underlying costs for labor. The higher labor rates were attributable in part to an inflationary trend but also to the increased need for us to employ individuals with specialized skills who command higher rates;

- an increase of \$548,000, or 6.1%, in cleaning expenses due primarily to (1) increased rates for services at certain of our properties requiring specialized services and (2) our assumption of responsibility for payment of such costs at certain properties due to changes in occupancy and lease structures;
 - an increase of \$528,000, or 24.1%, in grounds maintenance due in large part to increased parking lot maintenance projects undertaken in the current period;
 - an increase of \$353,000, or 42.5%, in electric expense, \$154,000 of which pertained to one property which had a large repair project take place; and
 - a decrease of \$1.6 million, or 69.1%, due to decreased snow removal expenses due to less snow and ice precipitation in 2006.
- the increase in the Same-Office Properties' property operating expenses from 2004 to 2005 included the following:
 - an increase of \$3.7 million, or 43.6%, in utilities due again primarily to (1) changes in occupancy and lease structures and (2) rate increases;
 - an increase of \$915,000, or 84.4%, in snow removal expense due to greater snow and ice precipitation in 2005; and
 - an increase of \$572,000, or 8.2%, in building cleaning expenses due primarily to our assumption of responsibility for payment of such costs at certain properties due to changes in occupancy and lease structure.

Construction Contract and Other Service Revenues and Expenses

The table below sets forth changes in our construction contract and other service revenues and expenses:

	Changes from 2005 to 2006			Changes from 2004 to 2005		
	Construction Contract Dollar Change	Other Service Operations Dollar Change	Total Dollar Change	Construction Contract Dollar Change	Other Service Operations Dollar Change	Total Dollar Change
Service operations						
Revenues	\$(22,175)	\$3,025	\$(19,150)	\$49,339	\$ 992	\$50,331
Expenses	(22,573)	2,631	(19,942)	48,801	1,490	50,291
Income from service operations	\$ 398	\$ 394	\$ 792	\$ 538	\$ (498)	\$ 40

We use the net amount of service operations revenues over related expenses to evaluate performance. We believe that the changes in net amounts reflected above were not significant.

Construction contract revenues were significantly higher in 2005 compared to 2006 and 2004 due primarily to a large volume of activity for certain existing contracts in 2005. It is noteworthy that our revenue from construction contract activity is highly concentrated, with five contracts representing approximately 81% of our 2006 construction contract revenue and four contracts representing approximately 81% of our construction contract revenue in 2005.

Other service operations revenue increased 62.0% from 2005 to 2006 due primarily to a higher volume of work for heating and air conditioning controls and plumbing. Much of the revenue contributing to this increase was attributable to one client relationship. We do not expect revenue from other service operations to increase in the future and it may in fact decrease.

Depreciation and Amortization

Our increase in depreciation and other amortization expense from 2005 to 2006 was due primarily to a \$19.7 million increase

attributable to the Property Additions, offset in part by a \$1.6 million decrease attributable to the absence of depreciation and amortization in 2006 on the Harrisburg portfolio due to its contribution into an unconsolidated real estate joint venture in September 2005.

Our increase in depreciation and other amortization expense from 2004 to 2005 was due primarily to a \$9.7 million increase attributable to the Property Additions and a \$2.1 million, or 4.9%, increase attributable to the Same-Office Properties.

General and Administrative Expenses

General and administrative expenses increased as a percentage of operating income from 12.6% in 2004 to 13.9% in 2005 and to 14.9% in 2006. Much of this trend can be attributed to an increase in the size of our employee base in response to the continued growth of the Company. We expect this trend to continue in the next one to two years and perhaps longer until we determine that the Company's employee base and processes are positioned appropriately in anticipation of our future growth expectations.

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The increase in general and administrative expense from 2005 to 2006 was attributable primarily to an increase of \$2.5 million, or 21.5%, in compensation expense due to the increased number of employees, increased salaries and bonuses for existing employees and increased expense associated with employee stock options attributable to our adoption of SFAS 123(R) on January 1, 2006.

The increase in general and administrative expense from 2004 to 2005 was attributable primarily to an increase of \$2.2 million, or 23.3%, in compensation expense due to the increased number of employees, increased expenses associated with employee restricted share grants and increased salaries and bonuses for existing employees.

Interest Expense and Amortization of Deferred Financing Costs

Our interest expense and amortization of deferred financing costs included in continuing operations increased \$17.1 million, or 30.0%, from 2005 to 2006. This increase included the effects of the following:

- a 20.7% increase in our average outstanding debt balance, resulting primarily from our 2005 and 2006 acquisition and construction activities;
- an increase in our weighted average interest rates from 5.8% to 6.2%; and
- a partial offset attributable to a \$4.7 million increase in interest capitalized to construction and development projects due to increased construction and development activity.

Our interest expense and amortization of deferred financing costs included in continuing operations increased \$12.5 million, or 28.1%, from 2004 to 2005. This increase is due primarily to a 33.4% increase in our average outstanding debt balance resulting primarily from our 2004 and 2005 acquisition and construction activities, offset in part by a \$4.8 million increase in interest capitalized to construction and development projects due to increased construction and development activity.

Interest expense and deferred financing costs as a percentage of net operating income increased from 51.4% in 2004 to 58.8% in 2005 and to 65.2% in 2006 due in large part to a higher proportion of our investing and financing activities having been funded by debt versus equity and the reasons discussed above for the changes in interest expense.

We historically have financed our long-term capital needs, including property acquisition and development activities, through a combination of the following:

- borrowings under our Revolving Credit Facility;
- borrowings from new debt;
- issuances of common shares, preferred shares and common units and/or preferred units in our Operating Partnership;
- contributions from outside investors into real estate joint ventures;
- proceeds from sales of real estate; and
- any available residual cash flow from operations.

Many factors go into our decisions regarding when to finance investing and financing activities using debt versus equity. We generally use long-term borrowing as attractive financing conditions arise and equity issuances as attractive equity market conditions arise. As a result, the change in the proportion of our investing and financing activities funded by debt versus equity described above is not a trend that necessarily should be expected to continue.

As of December 31, 2006, 93.1% of our fixed-rate debt was scheduled to mature after 2007. As of December 31, 2006, 11.7% of our total debt had variable interest rates, including the effect of interest rate swaps. For a more comprehensive presentation of our fixed-rate loan maturities, please refer to the section below entitled "Quantitative and Qualitative Disclosures About Market Risk."

Minority Interests

Interests in our Operating Partnership are in the form of preferred and common units. The line entitled "minority interests in income from continuing operations" includes primarily income before continuing operations allocated to preferred and common units not owned by us; for the amount of this line attributable to preferred units versus common units, you should refer to our Consolidated Statements of Operations. Income is allocated to minority interest preferred unitholders in an amount equal to the priority return from the Operating Partnership to which they are entitled. Income is allocated to minority interest common unitholders based on the income earned by the Operating Partnership after allocation to preferred unitholders multiplied by the percentage of the common units in the Operating Partnership owned by those common unitholders.

As of December 31, 2006, we owned 95.6% of the outstanding preferred units and 82.8% of the outstanding common units. The percentage of the Operating Partnership owned by minority interests during the last three years decreased in the aggregate due primarily to the effect of the following transactions:

- the issuance of additional units to us as we issued new preferred shares and common shares during 2004 through 2006 due to the fact that we receive preferred units and common units in the Operating Partnership each time we issue preferred shares and common shares;
- the exchange of common units for our common shares by certain minority interest holders of common units;
- our redemption of the Series B Cumulative Redeemable Preferred Shares of beneficial interest (the “Series B Preferred Shares”) in July 2004;
- our issuance of common units to third parties totaling 181,097 in 2006 and 232,655 in 2005 in connection with acquisitions;
- our issuance of the Series I Preferred Units to a third party in 2004 (as discussed in Note 2 to the Consolidated Financial Statements); and
- the redemption by us of the Series E and Series F Preferred Shares in 2006.

Our income allocated to minority interest holders of preferred units increased from 2004 to 2005 due to our issuance of the Series I Preferred Units in September 2004. Our income from continuing operations allocated to minority interest holders of common units decreased from 2004 to 2005 and from 2005 to 2006 due primarily to our increasing ownership of common units (from 75% at December 31, 2003 to 83% at December 31, 2006) and preferred units.

Income from Discontinued Operations

Our income from discontinued operations increased from 2005 to 2006 and from 2004 to 2005 due primarily to increased gain from sales of properties. See Note 18 to the Consolidated Financial Statements for a summary of income from discontinued operations.

Adjustments to Net Income to Arrive at Net Income Available to Common Shareholders

Preferred share dividends increased from 2005 to 2006 due to the additional dividends attributable to the newly issued Series J Preferred Shares exceeding the decrease in dividends attributable to the redemption of the Series E and Series F Preferred Shares. Preferred share dividends decreased from 2004 to 2005 due primarily to the redemption of the Series B Preferred Shares.

In 2006, we recognized a \$3.9 million decrease to net income available to common shareholders pertaining to the original issuance costs incurred on the Series E and Series F Preferred Shares redeemed during the year. In 2004, we recognized a \$1.8 million decrease to net income available to common shareholders pertaining to the original issuance costs incurred on the Series B Preferred Shares redeemed during the year.

Diluted Earnings per Common Share

Diluted earnings per common share on net income available to common shareholders increased both from 2005 to 2006 and from 2004 to 2005 due to the effects of increases in net income available to common shareholders, attributable primarily to the reasons set forth above, offset somewhat by the higher numbers of common shares outstanding due to share issuances from 2004 to 2006.

LIQUIDITY AND CAPITAL RESOURCES

In our discussion of liquidity and capital resources set forth below, we describe certain of the risks and uncertainties relating to our business. However, they may not be the only ones that we face.

Cash and Cash Equivalents

Our cash and cash equivalents balance as of December 31, 2006 totaled \$7.9 million, a decrease of 26.5% from the balance as of December 31, 2005. The balance of cash and cash equivalents that we carried as of the end of each of the eight calendar quarters during the two years ended December 31, 2006 ranged from \$5.7 million to \$21.5 million and averaged \$12.6 million. The cash and cash equivalents balances that we carry as of a point in time can vary significantly due in part to the inherent variability of the cash needs of our acquisition and development activities. We maintain sufficient cash and cash equivalents to meet our operating cash requirements and short-term investing and financing cash requirements. When we determine that the amount of cash and cash equivalents on hand is more than we need to meet such requirements, we may pay down our Revolving Credit Facility or forgo borrowing under construction loan credit facilities to fund development activities.

Operating Activities

We generate most of our cash from the operations of our properties. A review of our Consolidated Statements of Operations indicates that over the last three years, approximately 29% to 31% of our revenues from real estate operations (defined as the sum of (1) rental revenue and (2) tenant recoveries and other real estate operations revenue) were used for property operating expenses. Most of the amount by which our revenues from real estate operations exceeded property operating expenses was cash flow; we applied most of this cash flow towards interest

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expense, scheduled principal amortization on debt, dividends to our shareholders, distributions to minority interest holders of preferred and common units in the Operating Partnership, capital improvements and leasing costs for our operating properties and general and administrative expenses.

Our cash flow from operations determined in accordance with GAAP increased \$17.2 million, or 17.9%, from 2005 to 2006; this increase is attributable primarily to the additional cash flow from operations generated by our newly-acquired and newly-constructed properties. We expect to continue to use cash flow provided by operations to meet our short-term capital needs, including all property operating expenses, general and administrative expenses, interest expense, scheduled principal amortization of debt, dividends and distributions and capital improvements and leasing costs. We do not anticipate borrowing to meet these requirements. Factors that could negatively affect our ability to generate cash flow from operations in the future include the following:

- We earn revenue from renting our properties. Our operating costs do not necessarily fluctuate in relation to changes in our rental revenue. This means that our costs will not necessarily decline and may increase even if our revenue declines.
 - For new tenants or upon lease expiration for existing tenants, we generally must make improvements and pay other tenant related costs for which we may not receive increased rents. We also may make building related capital improvements for which tenants may not reimburse us.
 - When leases for our properties expire, our tenants may not renew or may renew on terms less favorable to us than the terms of their original leases. If a tenant leaves, we can expect to experience a vacancy for some period of time as well as higher tenant improvement and leasing costs than if a tenant renews. As a result, our financial performance could be adversely affected if we experience a high volume of tenant departures at the end of their lease terms.
 - As discussed earlier, we are dependent on a highly concentrated number of tenants for a large percentage of our revenue. Most of the leases of one of these tenants, the United States Government, provide for a series of one-year terms or provide for early termination rights. Our cash flow from operations would be adversely affected if our larger tenants failed to make rental payments to us, or if the United States Government elects to terminate several of its leases and the affected space cannot be re-leased on satisfactory terms.
 - As discussed earlier, a high concentration of our revenues comes from tenants in the United States defense industry. A reduction in government spending for defense could affect the ability of our tenants in the defense industry to fulfill lease obligations or decrease the likelihood that these tenants will renew their leases. In the case of the United States Government, a reduction in government spending could result in the early termination of leases.
- Our performance depends on the ability of our tenants to fulfill their lease obligations by paying their rental payments in a timely manner. In addition, as noted above, we rely on a relatively small number of tenants for a large percentage of our revenue from real estate operations. If one of our major tenants or a number of our smaller tenants were to experience financial difficulties, including bankruptcy, insolvency or general downturn of business, there could be an adverse effect on our results of operations and financial condition.
 - We provide construction management services for third-party clients. When providing these services, we usually pay for the costs of construction and subsequently bill our clients for the costs of construction plus a construction management fee. When we provide construction management services, the costs of construction can amount to millions of dollars. If any of our clients for these services fail to reimburse us for costs incurred under a significant construction management contract, it could have an adverse effect on our results of operations and financial condition.
 - Since our properties are primarily located in the Mid-Atlantic region of the United States, especially in the Greater Washington, D.C. region, and are also typically concentrated in office parks in which we own most of the properties, we do not have a broad geographic distribution of our properties. As a result, a decline in the real estate market or general economic conditions in the Mid-Atlantic region, the Greater Washington, D.C. region or the office parks in which our properties are located could have an adverse effect on our financial position, results of operations and cash flows.
 - The commercial real estate market is highly competitive. We compete for the purchase of commercial property with many entities, including other publicly traded commercial REITs. Many of our competitors have substantially greater financial resources than we do. If our competitors prevent us from buying properties that we target for acquisition, we may not be able to meet our property acquisition and development goals. Moreover, numerous commercial properties compete for tenants with our properties. Some of the properties competing with ours may have newer or more desirable locations or the competing properties' owners may be willing to accept lower rates than are acceptable to us. Competition for property acquisitions, or

for tenants in properties that we own, could have an adverse effect on our financial performance.

- If short-term interest rates were to increase, the interest payments on our variable-rate debt would increase, although this increase may be reduced to the extent that we have interest rate swap and cap agreements outstanding. If longer-term interest rates were to increase, we may not be able to refinance our existing indebtedness on terms as favorable as the terms of our existing indebtedness and we would pay more for interest expense on new indebtedness that we incur for future property additions.
- Our portfolio of properties is insured for losses under our property, casualty and umbrella insurance policies through September 2007. These policies include coverage for acts of terrorism. Although we believe that we adequately insure our properties, we are subject to the risk that our insurance may not cover all of the costs to restore properties damaged by a fire or other catastrophic event. In addition, changes in the insurance industry could occur in the future that may increase the cost of insuring our properties and decrease the scope of insurance coverage, either of which could adversely affect our financial position and operating results.
- As a REIT, we must distribute at least 90% of our annual taxable income (excluding capital gains), which limits the amount of cash we have available for other business purposes, including amounts to fund our growth. Also, it is possible that because of the differences between the time that we actually receive revenue or pay expenses and the period we report those items for distribution purposes, we may have to borrow funds on a short-term basis to meet the 90% distribution requirement. We may become subject to tax liabilities that adversely affect our operating cash flow.

Investing and Financing Activities During the Year Ended December 31, 2006

In our primary geographic regions, we acquired six office properties totaling 1.0 million square feet, a building to be redeveloped totaling 74,749 square feet and seven parcels of land that we believe can support up to 2.3 million developable square feet for \$169.7 million. These acquisitions were financed using the following:

- \$93.4 million in borrowings under our Revolving Credit Facility;
- \$37.5 million from an assumed mortgage loan;
- \$7.5 million from the issuance of common units in the Operating Partnership;

- \$2.4 million using an escrow funded by proceeds from one of our property sales discussed below; and
- cash reserves for the balance.

Highlights of these acquisitions include the following:

- we acquired a 611,379 square foot building and land parcels that we believe can support up to 1.4 million developable square feet in the Baltimore/Washington Corridor; and
- after making our initial entry in San Antonio, Texas and Colorado Springs in 2005, we added to our positions in each of these regions by acquiring land parcels in each of these regions and five operational properties totaling 400,000 square feet and a 74,749 square foot redevelopment property in Colorado Springs.

We also acquired approximately 500 acres of the 591-acre former Fort Ritchie United States Army base located in Cascade, Washington County, Maryland for a value of \$5.6 million using an initial cash outlay of \$2.5 million, and expect to acquire the remaining 91 acres in 2007. The 591-acre parcel is anticipated to accommodate a total of 1.7 million square feet of office space and 673 residential units, including approximately 306,000 square feet of existing office space and 110 existing rentable residential units, with development expected to occur over a period of 10 to 15 years. In connection with the aggregate acquisition, we expect to initially make the following future cash payments to the seller: (1) \$465,000 in 2007 in connection with the acquisition of the remaining 91 acres; and (2) an additional \$2.0 million over the period from 2007 through 2009. We could incur an additional cash obligation to the seller after that of up to \$4.0 million; this obligation is subject to reduction by an amount ranging between \$750,000 and \$4.0 million, with the amount of such reduction to be determined based on defined levels of (1) job creation resulting from the future development of the property and (2) future real estate taxes generated by the property. We are also obligated under the terms of the acquisition agreement to incur \$7.5 million in development and construction costs for the property by 2011.

In addition, we acquired, using cash reserves, the following properties through joint venture structures:

- a land parcel located in the Baltimore/Washington Corridor, with a value upon our acquisition of approximately \$4.6 million, through Commons Office 6-B, LLC, a 50% owned consolidated joint venture constructing an office property totaling approximately 44,000 square feet. Our initial cash investment in this joint venture was \$1.6 million; and

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- a 153-acre parcel of land located near the Indian Head Naval Surface War Center in Charles County, Maryland, with a value upon our acquisition of \$2.9 million, through COPT-FD Indian Head, LLC, a 75% owned consolidated joint venture. Our initial cash investment in this joint venture was \$2.2 million.

As part of our core customer expansion strategy, we also entered into lease agreements with Northrop Grumman Corporation to develop two data and call centers totaling 296,000 square feet. The terms of these lease agreements call for the land parcels on which the centers are being developed to be conveyed to us for no cash payment other than closing costs. One of these centers is located in Greater Richmond, Virginia and the other in Southwest Virginia. The land parcel in Greater Richmond, Virginia was conveyed to us in 2006 and we expect the land parcel in Southwest Virginia to be conveyed in 2007.

We had seven newly-constructed properties totaling 866,000 square feet become fully operational in 2006. These properties, which were 94.6% leased in the aggregate at December 31, 2006, were located in the following geographic regions: four properties totaling 532,000 square feet in the Baltimore/Washington Corridor; one property totaling 223,610 square feet in Northern Virginia; one property totaling 50,000 square feet in Colorado Springs; and one property totaling 60,029 square feet in St. Mary's County, Maryland. Costs incurred on these properties through December 31, 2006 totaled \$144.2 million, \$30.6 million of which was incurred in 2006. We financed the 2006 costs using primarily borrowings under existing construction loan facilities and proceeds from our Revolving Credit Facility.

At December 31, 2006, we had construction activities underway on eight office properties totaling 831,000 rentable square feet that were 79.5% pre-leased, including 68,196 square feet already placed into service in a partially operational property. One of these properties is owned through a consolidated joint venture in which we have a 50% interest. Six of these properties totaling 535,000 square feet are located in our primary geographic regions, including four properties totaling 452,000 square feet in the Baltimore/Washington Corridor, and the other two properties totaling 296,000 square feet are the Northrop Grumman Corporation data and call centers in Virginia discussed above. Costs incurred on these properties through December 31, 2006 totaled approximately \$194.0 million, of which approximately \$79.1 million was incurred in 2006. We have construction loan facilities in place totaling \$73.7 million to finance the construction of four of these properties; borrowings under these facilities totaled \$52.4 million at December 31, 2006, \$43.8 million of which was borrowed in 2006. The remaining costs incurred in 2006 were funded using primarily borrowings from our Revolving Credit Facility and cash reserves.

The table below sets forth the major components of our additions to the line entitled "Total Commercial Real Estate Properties" on our Consolidated Balance Sheet for 2006 (in thousands):

Acquisitions	\$166,416
Construction and development	132,565
Capital improvements on operating properties	20,767
Tenant improvements on operating properties	20,414 ⁽¹⁾
	<hr/>
	\$340,162

(1) Tenant improvement costs incurred on newly-constructed properties are classified in this table as construction and development.

We sold the following during 2006:

- seven operational properties totaling 531,000 square feet, a newly-constructed property and a land parcel for a total of \$83.0 million, resulting in recognized gain of \$17.3 million. The net proceeds from these sales after transaction costs totaled \$80.4 million. We used \$36.1 million of these proceeds to fund escrows to be applied towards future acquisitions and \$4.8 million to repay a mortgage loan on a property and applied most of the balance to pay down our Revolving Credit Facility; and
- a 157,394 square foot property, which was owned by an unconsolidated real estate joint venture in which we had a 20% interest, for \$27.0 million, resulting in a recognized gain to us of \$563,000. The net proceeds to us from this transaction were approximately \$1.5 million.

On September 18, 2006, the Operating Partnership issued a \$200.0 million aggregate principal amount of 3.50% Exchangeable Senior Notes due 2026. Interest on the notes is payable on March 15 and September 15 of each year. The notes have an exchange settlement feature that provides that the notes may, under certain circumstances, be exchangeable for cash (up to the principal amount of the notes) and, with respect to any excess exchange value, may be exchangeable into (at our option) cash, our common shares or a combination of cash and our common shares at an exchange rate (subject to adjustment) of 18.4284 shares per \$1,000 principal amount of the notes (exchange rate is as of December 31, 2006 and is equivalent to an exchange price of \$54.30 per common share). On or after September 20, 2011, the Operating Partnership may redeem the notes in cash in whole or in part. The holders of the notes have the right to require us to repurchase the notes in cash in whole or in part on each of September 15, 2011, September 15, 2016 and September 15, 2021, or in the event of a "fundamental change," as defined under the terms of the notes, for a repurchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest. Prior to September 11, 2011, subject to certain exceptions, if (1) a "fundamental change" occurs as a result of certain forms of transactions or series of

transactions and (2) a holder elects to exchange its notes in connection with such “fundamental change,” we will increase the applicable exchange rate for the notes surrendered for exchange by a number of additional shares of our common shares as a “make whole premium.” The notes are general unsecured senior obligations of the Operating Partnership and rank equally in right of payment with all other senior unsecured indebtedness of the Operating Partnership. The Operating Partnership’s obligations under the notes are fully and unconditionally guaranteed by us. We used the \$195.7 million in net proceeds available after transaction costs from this issuance as follows:

- \$134.0 million to pay down borrowings under our Revolving Credit Facility;
- \$52.5 million to repay other debt; and
- applied the balance to cash reserves.

On December 28, 2006, we borrowed \$146.5 million under a mortgage loan with a 10-year term at a fixed rate of 5.43%. We used the proceeds from this loan to pay down borrowings under our Revolving Credit Facility.

During 2006, we entered into three interest rate swaps to hedge the risk of changes in interest rates on certain of our one-month LIBOR-based variable rate borrowings until their respective maturities, information for which is set forth below (dollars in thousands):

Nature of Derivative	Notional Amount	One-Month LIBOR Base	Effective Date	Expiration Date
Interest rate swap	\$50,000	5.0360%	3/28/2006	3/30/2009
Interest rate swap	25,000	5.2320%	5/1/2006	5/1/2009
Interest rate swap	25,000	5.2320%	5/1/2006	5/1/2009

During 2006, we completed the following sales of equity:

- 2.0 million common shares in April 2006 to an underwriter at a net price of \$41.31 per share for net proceeds of \$82.4 million. We contributed the net proceeds to our Operating Partnership in exchange for 2.0 million common units. The proceeds were used primarily to pay down our Revolving Credit Facility.
- 3,390,000 Series J Preferred Shares on July 20, 2006 at a price of \$25.00 per share for net proceeds of \$81.9 million. These shares are nonvoting and redeemable for cash at \$25.00 per share at our option on or after July 20, 2011. Holders of these shares are entitled to cumulative dividends, payable quarterly (as and if declared by the Board of Trustees). Dividends accrue from the date of issue at the annual rate of \$1.90625 per share, which is equal to

7.625% of the \$25.00 per share redemption price. We contributed the net proceeds from the sale to our Operating Partnership in exchange for 3,390,000 Series J Preferred Units. The Series J Preferred Units carry terms that are substantially the same as the Series J Preferred Shares. The Operating Partnership used most of the net proceeds to pay down our Revolving Credit Facility.

During 2006, we completed the following preferred share redemptions using borrowings under our Revolving Credit Facility:

- all of our outstanding Series E Preferred Shares, which had carried an annual dividend yield of 10.25%, for \$28.8 million on July 15, 2006; and
- all of our outstanding Series F Preferred Shares, which had carried an annual dividend yield of 9.875%, for \$35.6 million on October 15, 2006.

Analysis of Cash Flow Associated with Investing and Financing Activities

Our net cash flow used in investing activities decreased \$166.5 million, or 39.6%, from 2005 to 2006. This decrease was due primarily to the following:

- a \$217.8 million, or 43.6%, decrease in purchases of and additions to commercial real estate. This decrease is due primarily to a decrease in property acquisitions. We found the market for acquisitions to be extremely competitive in 2006, with potential target properties selling to our competitors at what we believed to be very aggressive prices; this contributed somewhat to the decrease in property acquisitions, although timing played a part as well since the Nottingham Acquisition, to which we had dedicated considerable time in 2006, closed in January 2007. Our ability to locate and complete acquisitions is dependent on numerous variables and, as a result, is inherently subject to significant fluctuation from period to period; and
- a \$49.9 million, or 50.8%, decrease in proceeds from sales of properties and unconsolidated real estate joint ventures and contributions of assets to an unconsolidated real estate joint venture. Since our real estate sales activity is driven by transactions unrelated to our core operations, our proceeds from sales of properties are subject to significant fluctuation from period to period and, therefore, we do not believe that the change described above is necessarily indicative of a trend. While we expect to reduce or eliminate our real estate investments in certain of our non-core markets in the future, we cannot predict when and if these dispositions will occur.

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Our cash flow provided by financing activities decreased \$183.5 million, or 57.1%, from 2005 to 2006. This decrease included the following:

- a \$181.9 million, or 31.3%, increase in repayments of mortgage and other loans payable. This increase is attributable primarily to our use of proceeds from additional equity offerings and the 3.5% Exchangeable Senior Notes to pay down these loans;
- \$64.4 million in cash used to redeem our Series E and Series F Preferred Shares in 2006; and
- a \$216.2 million, or 24.3%, decrease in proceeds from mortgage and other loans payable due to a larger volume of refinancing activity; offset in part by
- \$200.0 million in proceeds from the 3.5% Exchangeable Senior Notes in 2006; and
- a \$91.5 million, or 115.1%, increase in proceeds from the issuance of common and preferred shares.

Off-Balance Sheet Arrangements

During 2006, we owned investments in two unconsolidated joint ventures: Harrisburg Corporate Gateway Partners, L.P. and Route 46 Partners. We accounted for these joint venture investments using the equity method of accounting. These joint ventures were entered into in prior years to enable us to contribute office properties that were previously wholly owned by us into the joint ventures in order to partially dispose of our interests. We managed the joint ventures' property operations and any required construction projects and earned fees for these services. Both of these joint ventures have a two-member management committee that is responsible for making major decisions (as defined in the joint venture agreements), and we control one of the management committee positions in each case.

Route 46 Partners sold its property in July 2006, resulting in the dissolution of the joint venture and our recognition of a \$563,000 gain. Upon its dissolution, our partner received a preferential distribution of cash flows for a defined return and once our partner received its defined return, we received the remainder.

For Harrisburg Corporate Gateway Partners, L.P., we and our partner receive returns in proportion to our investments. As part of our obligations under the joint venture, we may be required to make unilateral payments to fund rent shortfalls on behalf of a tenant that was in bankruptcy at the time the joint venture was formed; our total unilateral commitment under this guaranty is approximately \$306,000, although the tenant's

account was current as of December 31, 2006. We also agreed to indemnify the partnership's lender for 80% of losses under standard nonrecourse loan guarantees (environmental indemnifications and guarantees against fraud and misrepresentation) during the period of time in which we manage the partnership's properties; we do not expect to incur any losses under these loan guarantees.

The table below sets forth certain additional information regarding these unconsolidated joint ventures (in thousands):

Investment Balance at 12/31/06 ⁽¹⁾	Net Cash Inflow in 2006	Income Recognized from Investment in 2006 ⁽²⁾	Fees Earned from Joint Ventures in 2006 ⁽³⁾	Obligation to Unilaterally Fund Additional Project Costs (if necessary) ⁽⁴⁾
\$(3,614)	\$2,438	\$471	\$619	\$306

(1) This amount represents distributions in excess of our investment in Harrisburg Corporate Gateway Partners, L.P. at December 31, 2006 due to our not recognizing gain on the contribution of properties into the joint venture. We did not recognize a gain on the contribution since we have contingent obligations, as described above, that may exceed our proportionate interest remaining in effect as long as we continue to manage the joint venture's properties.

(2) This amount includes a gain of \$563 on the dissolution of Route 46 Partners.

(3) Fees earned by us for construction, asset management and property management services provided to unconsolidated joint ventures.

(4) Amounts reported in this column represent additional investments we could be required to fund on a unilateral basis, including the rent shortfall payments and lender indemnifications discussed above. We and our partner are also required to fund proportionally (based on our ownership percentage) additional amounts when needed. Since the additional fundings described in this footnote are uncertain in dollar amount and we do not expect that they will be necessary, they are not included in the table.

During 2006, we also owned investments in four joint ventures that we accounted for using the consolidation method of accounting. We use joint ventures such as these from time to time for reasons that include the following: (1) they can provide a facility to access new markets and investment opportunities while enabling us to benefit from the expertise of our partners; (2) they are an alternative source for raising capital to put towards acquisition or development activities; and (3) they can reduce our exposure to risks associated with a property and its activities. Our consolidated and unconsolidated joint ventures are discussed in Note 5 to our Consolidated Financial Statements, and certain commitments and contingencies related to these joint ventures are discussed in Note 19.

We had no other material off-balance sheet arrangements during 2006.

Contractual Obligations

The following table summarizes our contractual obligations as of December 31, 2006 (in thousands):

	For the Years Ended December 31,				Total
	2007	2008 to 2009	2010 to 2011	Thereafter	
CONTRACTUAL OBLIGATIONS⁽¹⁾⁽²⁾					
Debt ⁽³⁾	\$140,950	\$436,999	\$181,982	\$738,396	\$1,498,327
Interest on debt ⁽⁴⁾	76,500	112,284	87,654	204,327	480,765
Acquisitions of properties ⁽⁵⁾	370,865	310	—	4,000	375,175
New construction and development contracts and obligations ⁽⁶⁾⁽⁷⁾	77,595	—	—	—	77,595
Third-party construction and development contracts ⁽⁷⁾⁽⁸⁾	59,597	—	—	—	59,597
Capital expenditures for operating properties ⁽⁷⁾⁽⁹⁾	4,283	—	—	—	4,283
Operating leases ⁽¹⁰⁾	2,615	1,028	268	—	3,911
Other purchase obligations ⁽¹¹⁾	2,334	4,545	4,482	9,714	21,075
Total contractual cash obligations	\$734,739	\$555,166	\$274,386	\$956,437	\$2,520,728

- (1) The contractual obligations set forth in this table generally exclude individual contracts that had a value of less than \$20 thousand. Also excluded are contracts associated with the operations of our properties that may be terminated with notice of one month or less, which is the arrangement that applies to most of our property operations contracts.
- (2) Not included in this section are amounts contingently payable by us to acquire the membership interests of certain real estate joint venture partners. See Note 19 to our Consolidated Financial Statements for further discussion of such amounts.
- (3) Represents principal maturities only and therefore excludes a net premium of \$210,000. Our loan maturities in 2007 include \$48.8 million that may be extended until 2008, subject to certain conditions, and approximately \$75.8 million that we expect to refinance; the balance of the 2007 maturities represent primarily scheduled principal amortization payments that we expect to pay using cash flow from operations.
- (4) Represents interest costs for debt at December 31, 2006 for the terms of such debt. For variable rate debt, the amounts reflected above used December 31, 2006 interest rates on variable rate debt in computing interest costs for the terms of such debt. For construction loan facilities where the interest payments are not payable as incurred but, rather, are added to the balance of the loan during the construction period, the amounts reflected above assumed that such interest costs are paid monthly as incurred.
- (5) Represents contractual obligations at December 31, 2006 to (1) complete the Nottingham Acquisition, which was completed in January 2007 as described below in "Investing and Financing Activities Subsequent to December 31, 2006"; (2) acquire a parcel of land located in Aberdeen, Maryland, which we expect to complete in 2007 using borrowings under the Revolving Credit Facility; and (3) complete the acquisition of the remaining 91 acres of the Fort Ritchie Project. A \$4.0 million final payment on the Fort Ritchie acquisition included in the "Thereafter" column could be reduced by a range of \$750,000 to the full \$4.0 million; the amount of such decrease will be determined based on (1) defined levels of job creation resulting from the future development of the property taking place and (2) future real estate taxes generated by the property.
- (6) Represents contractual obligations pertaining to new construction and development activities. We expect to finance these costs primarily using proceeds from our Revolving Credit Facility and construction loans.
- (7) Because of the long-term nature of certain construction and development contracts, some of these costs will be incurred beyond 2007.
- (8) Represents contractual obligations pertaining to projects for which we are acting as construction manager on behalf of unrelated parties who are our clients. We expect to be reimbursed in full for these costs by our clients.
- (9) Represents contractual obligations pertaining to capital expenditures for our operating properties. We expect to finance all of these costs using cash flow from operations.
- (10) We expect to pay these items using cash flow from operations.
- (11) Primarily represents contractual obligations pertaining to managed-energy service contracts in place for certain of our operating properties. We expect to pay these items using cash flow from operations.

Certain of our debt instruments require that we comply with a number of restrictive financial covenants, including leverage ratio, minimum net worth, minimum fixed charge coverage, minimum debt service and maximum secured indebtedness. As of December 31, 2006, we were in compliance with these financial covenants.

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Investing and Financing Activities Subsequent to December 31, 2006

On January 9 and 10, 2007, we completed the Nottingham Acquisition, which resulted in the acquisition of 56 operating properties totaling 2.4 million square feet and land parcels totaling 187 acres. All of the acquired properties are located in Maryland, with 36 of the operating properties, totaling 1.6 million square feet, and land parcels totaling 175 acres, located in White Marsh, Maryland and the remaining properties and land parcels located in other regions in Northern Baltimore County and the Baltimore/Washington Corridor. We believe that the land parcels totaling 187 acres can support at least 2.0 million developable square feet. We completed the Nottingham Acquisition for an aggregate cost of approximately \$363.9 million, including approximately \$1.4 million in transaction costs. We financed the acquisition by (1) issuing \$26.6 million in Series K Preferred Shares to the seller; (2) issuing \$154.9 million in common shares to the seller, at a deemed value of \$49 per share; (3) assuming existing mortgage loans totaling \$38.0 million, with an average interest rate of approximately 6.0%; (4) assuming an existing mortgage loan totaling \$10.3 million, which we repaid on January 11, 2007 using borrowings under our Revolving Credit Facility; (5) assuming an existing unsecured loan totaling \$89.1 million, with a variable interest rate of LIBOR plus 1.15% to 1.55% depending on our leverage levels at different points in time; (6) using \$20.1 million from an escrow funded by proceeds from one of our property sales; and (7) using borrowings under the Revolving Credit Facility for the balance.

We believe that the Nottingham Acquisition has the following strategic benefits:

- we become the largest owner of office properties in White Marsh, Maryland, a submarket located in the Baltimore/Washington Corridor, which we believe will be efficiently integrated into our operations in that region. White Marsh is also located off of Interstate 95, approximately 18 miles from Aberdeen Proving Ground, a United States Army base; we believe that this proximity could potentially benefit certain of our existing and future tenants in the United States defense industry;
- it increases our critical mass of property holdings in the Baltimore/Washington Corridor and Suburban Baltimore;
- it adds future development capacity of approximately 2.0 million square feet in submarkets in which we have significant operating property holdings; and
- we were able to hire a number of individuals who were members of the selling parties' property management team.

The Series K Preferred Shares issued in the Nottingham Acquisition are valued at, and carry a liquidation preference equal to, \$50 per share. The Series K Preferred Shares are nonvoting, redeemable for cash at \$50 per share at our option on or after January 9, 2017, and are convertible, subject to certain conditions, into common shares on the basis of 0.8163 common shares for each preferred share, in accordance with the terms of the Articles Supplementary describing the Series K Preferred Shares. Holders of the Series K Preferred Shares are entitled to cumulative dividends, payable quarterly (as and if declared by our Board of Trustees). Dividends will accrue from the date of issue at the annual rate of \$2.80 per share, which is equal to 5.6% of the \$50 per share liquidation preference.

Other Future Cash Requirements for Investing and Financing Activities

As previously discussed, as of December 31, 2006, we had construction activities underway on eight office properties totaling 831,000 square feet that were 79.5% pre-leased (one of these properties is owned through a consolidated joint venture in which we have a 50% interest). We estimate remaining costs to be incurred will total approximately \$85.6 million upon completion of these properties; we expect to incur these costs primarily in 2007 and 2008. We have \$21.3 million remaining to be borrowed under construction loan facilities totaling \$73.7 million for four of these properties. We expect to fund the remaining portion of these costs using borrowings from new construction loan facilities and our Revolving Credit Facility.

As of December 31, 2006, we had development activities underway on 11 new office properties estimated to total 1.3 million square feet (we own a 50% interest in two of these properties). We estimate that costs for these properties will total approximately \$258.2 million. As of December 31, 2006, costs incurred on these properties totaled \$25.7 million and the balance is expected to be incurred from 2007 through 2009. We expect to fund most of these costs using borrowings from new construction loan facilities.

As of December 31, 2006, we had redevelopment activities underway on four properties totaling 740,000 square feet (two of these properties are owned through a consolidated joint venture in which we own a 92.5% interest). We estimate that remaining costs of the redevelopment activities will total approximately \$48.3 million. We expect to fund most of these costs using borrowings under new construction loan facilities.

During 2007 and beyond, we expect to complete other acquisitions of properties and commence construction and development activities in addition to the ones previously described. We expect to finance these activities as we have in the past, using mostly a combination of borrowings from new debt, borrowings under our Revolving Credit Facility, proceeds from sales of existing properties and additional equity issuances of common and/or preferred shares or units.

We often use our Revolving Credit Facility initially to finance much of our investing and financing activities. We then pay down our Revolving Credit Facility using proceeds from long-term borrowings as attractive financing conditions arise and equity issuances as attractive equity market conditions arise. The maximum principal amount on our Revolving Credit is \$500.0 million (increased from \$400.0 million in July 2006), with a right to further increase the maximum principal amount in the future to \$600.0 million, subject to certain conditions. The facility has a scheduled maturity date in March 2008, with a one-year extension available, subject to certain conditions, and carries a fee of 0.125% to 0.25% on the amount of the credit facility that is unused. The borrowing capacity under this Revolving Credit Facility is generally computed based on 65% of the value of assets identified by us to support repayment of the loan. As of February 26, 2007, the borrowing capacity under the Revolving Credit Facility was \$500.0 million, of which \$234.0 million was available.

Factors that could negatively affect our ability to finance our long-term financing and investing needs in the future include the following:

- Our strategy is to operate with slightly higher debt levels than many other REITs. However, these higher debt levels could make it difficult to obtain additional financing when required and could also make us more vulnerable to an economic downturn. Most of our properties have been mortgaged or encumbered for indebtedness. In addition, we rely on borrowings to fund some or all of the costs of new property acquisitions, construction and development activities and other items.

- We may not be able to refinance our existing indebtedness.
- Much of our ability to raise capital through the issuance of preferred shares, common shares or securities that are convertible into our common shares is dependent on the value of our common and preferred shares. As is the case with any publicly traded securities, certain factors outside of our control could influence the value of our common and preferred shares. These conditions include, but are not limited to: (1) market perception of REITs in general and office REITs in particular; (2) market perception of REITs relative to other investment opportunities; (3) the level of institutional investor interest in our company; (4) general economic and business conditions; (5) prevailing interest rates; and (6) market perception of our financial condition, performance, dividends and growth potential.
- In 2005 and 2006, we completed acquisitions of properties in regions where we did not previously own properties. Moreover, we expect to continue to pursue selective acquisitions of properties in new regions. These acquisitions may entail risks in addition to those we have faced in past acquisitions, such as the risk that we do not correctly anticipate conditions or trends in a new region and are therefore not able to operate the acquired property profitably.
- When we develop and construct properties, we assume the risk that actual costs will exceed our budgets, that we will experience construction or development delays and that projected leasing will not occur, any of which could adversely affect our financial performance and our ability to make distributions to our shareholders. In addition, we generally do not obtain construction financing commitments until the development stage of a project is complete and construction is about to commence. We may find that we are unable to obtain financing needed to continue with the construction activities for such projects.
- We invest in certain entities in which we are not the exclusive investor or principal decision maker. Aside from our inability to unilaterally control the operations of these joint ventures, our investments entail the additional risks that (1) the other parties to these investments may not fulfill their financial obligations as investors, in which case we may need to fund such parties' share of additional capital requirements and (2) the other parties to these investments may take actions that are inconsistent with our objectives.

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- Real estate investments can be difficult to sell and convert to cash quickly, especially if market conditions are depressed. Such illiquidity will tend to limit our ability to vary our portfolio of properties promptly in response to changes in economic or other conditions. Moreover, under certain circumstances, the Internal Revenue Code imposes certain penalties on a REIT that sells property held for less than four years. In addition, for certain of our properties that we acquired by issuing units in our Operating Partnership, we are restricted by agreements with the sellers of the properties for a certain period of time from entering into transactions (such as the sale or refinancing of the acquired property) that will result in a taxable gain to the sellers without the sellers' consent. Due to all of these factors, we may be unable to sell a property at an advantageous time to fund our long-term capital needs.
- We are subject to various federal, state and local environmental laws. These laws can impose liability on property owners or operators for the costs of removal or remediation of hazardous substances released on a property, even if the property owner was not responsible for the release of the hazardous substances. Costs resulting from environmental liability could be substantial. The presence of hazardous substances on our properties may also adversely affect occupancy and our ability to sell or borrow against those properties. In addition to the costs of government claims under environmental laws, private plaintiffs may bring claims for personal injury or other reasons. Additionally, various laws impose liability for the costs of removal or remediation of hazardous substances at the disposal or treatment facility. Anyone who arranges for the disposal or treatment of hazardous substances at such a facility is potentially liable under such laws. These laws often impose liability on an entity even if the facility was not owned or operated by the entity.

Management Changes

We implemented the following management changes effective on August 14, 2006:

- Roger A. Waesche, Jr., an Executive Vice President who had been our Chief Financial Officer since March 1999, was appointed Executive Vice President and Chief Operating Officer and, at the same time, ceased to serve as our Chief Financial Officer; and
- Stephen E. Riffie commenced service as our Executive Vice President and Chief Financial Officer.

FUNDS FROM OPERATIONS

Funds from operations ("FFO") is defined as net income computed using GAAP, excluding gains (or losses) from sales of real estate, plus real estate-related depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. Gains from sales of newly-developed properties less accumulated depreciation, if any, required under GAAP are included in FFO on the basis that development services are the primary revenue generating activity; we believe that inclusion of these development gains is in accordance with the National Association of Real Estate Investment Trusts ("NAREIT") definition of FFO, although others may interpret the definition differently.

Accounting for real estate assets using historical cost accounting under GAAP assumes that the value of real estate assets diminishes predictably over time. NAREIT stated in its April 2002 White Paper on Funds from Operations that "since real estate asset values have historically risen or fallen with market conditions, many industry investors have considered presentations of operating results for real estate companies that use historical cost accounting to be insufficient by themselves." As a result, the concept of FFO was created by NAREIT for the REIT industry to "address this problem." We agree with the concept of FFO and believe that FFO is useful to management and investors as a supplemental measure of operating performance because, by excluding gains and losses related to sales of previously depreciated operating real estate properties and excluding real estate-related depreciation and amortization, FFO can help one compare our operating performance between periods. In addition, since most equity REITs provide FFO information to the investment community, we believe that FFO is useful to investors as a supplemental measure for comparing our results to those of other equity REITs. We believe that net income is the most directly comparable GAAP measure to FFO.

Since FFO excludes certain items includable in net income, reliance on the measure has limitations; management compensates for these limitations by using the measure simply as a supplemental measure that is weighed in the balance with other GAAP and non-GAAP measures. FFO is not necessarily an indication of our cash flow available to fund cash needs. Additionally,

it should not be used as an alternative to net income when evaluating our financial performance or to cash flow from operating, investing and financing activities when evaluating our liquidity or ability to make cash distributions or pay debt service. The FFO we present may not be comparable to the FFO presented by other REITs since they may interpret the current NAREIT definition of FFO differently or they may not use the current NAREIT definition of FFO.

Basic funds from operations (“Basic FFO”) is FFO adjusted to (1) subtract preferred share dividends and (2) add back GAAP net income allocated to common units in the Operating Partnership not owned by us. With these adjustments, Basic FFO represents FFO available to common shareholders and common unitholders. Common units in the Operating Partnership are substantially similar to our common shares and are exchangeable into common shares, subject to certain conditions. We believe that Basic FFO is useful to investors due to the close correlation of common units to common shares. We believe that net income is the most directly comparable GAAP measure to Basic FFO. Basic FFO has essentially the same limitations as FFO; management compensates for these limitations in essentially the same manner as described above for FFO.

Diluted funds from operations (“Diluted FFO”) is Basic FFO adjusted to add back any convertible preferred share dividends and any other changes in Basic FFO that would result from the assumed conversion of securities that are convertible or exchangeable into common shares. However, the computation of Diluted FFO does not assume conversion of securities other than common units in the Operating Partnership that are convertible into common shares if the conversion of those securities would increase Diluted FFO per share in a given period. We believe that Diluted FFO is useful to investors because it is the numerator used to compute Diluted FFO per share, discussed below. In addition, since most equity REITs provide Diluted FFO information to the investment community, we believe Diluted FFO is a useful supplemental measure for comparing us to other equity REITs. We believe that the numerator for diluted earnings per share (“EPS”) is the most directly comparable

GAAP measure to Diluted FFO. Since Diluted FFO excludes certain items includable in the numerator to diluted EPS, reliance on the measure has limitations; management compensates for these limitations by using the measure simply as a supplemental measure that is weighed in the balance with other GAAP and non-GAAP measures. Diluted FFO is not necessarily an indication of our cash flow available to fund cash needs. Additionally, it should not be used as an alternative to net income when evaluating our financial performance or to cash flow from operating, investing and financing activities when evaluating our liquidity or ability to make cash distributions or pay debt service. The Diluted FFO that we present may not be comparable to the Diluted FFO presented by other REITs.

Diluted funds from operations per share (“Diluted FFO per share”) is (1) Diluted FFO divided by (2) the sum of the (a) weighted average common shares outstanding during a period, (b) weighted average common units outstanding during a period and (c) weighted average number of potential additional common shares that would have been outstanding during a period if other securities that are convertible or exchangeable into common shares were converted or exchanged. However, the computation of Diluted FFO per share does not assume conversion of securities other than common units in the Operating Partnership that are convertible into common shares if the conversion of those securities would increase Diluted FFO per share in a given period. We believe that Diluted FFO per share is useful to investors because it provides investors with a further context for evaluating our FFO results in the same manner that investors use EPS in evaluating net income available to common shareholders. In addition, since most equity REITs provide Diluted FFO per share information to the investment community, we believe Diluted FFO per share is a useful supplemental measure for comparing us to other equity REITs. We believe that diluted EPS is the most directly comparable GAAP measure to Diluted FFO per share. Diluted FFO per share has most of the same limitations as Diluted FFO (described above); management compensates for these limitations in essentially the same manner as described above for Diluted FFO.

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Our Basic FFO, Diluted FFO and Diluted FFO per share for 2002 through 2006 and reconciliations of (1) net income to FFO, (2) the numerator for diluted EPS to diluted FFO and (3) the denominator for diluted EPS to the denominator for diluted FFO per share are set forth in the following table:

(in thousands, except per share data)	For the Years Ended December 31,				
	2006	2005	2004	2003	2002
Net income	\$ 49,227	\$ 39,031	\$ 37,032	\$ 30,877	\$ 23,301
Add: Real estate-related depreciation and amortization	78,631	62,850	51,371	36,681	30,832
Add: Depreciation and amortization on unconsolidated real estate entities	910	182	106	295	165
Less: Depreciation and amortization allocable to minority interests in other consolidated entities	(163)	(114)	(86)	—	—
Less: Gain on sales of real estate, excluding development portion ⁽¹⁾	(17,644)	(4,422)	(95)	(2,897)	(268)
Funds from operations ("FFO")	110,961	97,527	88,328	64,956	54,030
Add: Minority interests—common units in the Operating Partnership	7,276	5,889	5,659	6,712	5,800
Less: Preferred share dividends	(15,404)	(14,615)	(16,329)	(12,003)	(10,134)
Less: Issuance costs associated with redeemed preferred shares	(3,896)	—	(1,813)	—	—
Funds from Operations—basic ("Basic FFO")	98,937	88,801	75,845	59,665	49,696
Add: Preferred unit distributions	—	—	—	1,049	2,287
Add: Expense on dilutive share-based compensation	—	—	382	10	327
Add: Convertible preferred share dividends	—	—	21	544	544
Funds from Operations—diluted ("Diluted FFO")	\$ 98,937	\$ 88,801	\$ 76,248	\$ 61,268	\$ 52,854
Weighted average common shares	41,463	37,371	33,173	26,659	22,472
Conversion of weighted average common units	8,511	8,702	8,726	8,932	9,282
Weighted average common shares/units—Basic FFO	49,974	46,073	41,899	35,591	31,754
Dilutive effect of share-based compensation awards	1,799	1,626	1,896	1,405	1,262
Assumed conversion of weighted average convertible preferred units	—	—	—	1,101	2,421
Assumed conversion of weighted average convertible preferred shares	—	—	134	1,197	1,197
Weighted average common shares/units—Diluted FFO	51,773	47,699	43,929	39,294	36,634
Diluted FFO per common share	\$ 1.91	\$ 1.86	\$ 1.74	\$ 1.56	\$ 1.44
Numerator for diluted EPS	\$ 29,927	\$ 24,416	\$ 18,911	\$ 7,650	\$ 13,167
Add: Minority interests—common units in the Operating Partnership	7,276	5,889	5,659	6,712	5,800
Add: Real estate-related depreciation and amortization	78,631	62,850	51,371	36,681	30,832
Add: Depreciation and amortization on unconsolidated real estate entities	910	182	106	295	165
Less: Depreciation and amortization allocable to minority interests in other consolidated entities	(163)	(114)	(86)	—	—
Less: Gain on sales of real estate, excluding development portion ⁽¹⁾	(17,644)	(4,422)	(95)	(2,897)	(268)
Add: Convertible preferred share dividends	—	—	—	544	544
Add: Preferred unit distributions	—	—	—	1,049	2,287
Add: Expense on dilutive share-based compensation	—	—	382	10	327
Add: Repurchase of Series C Preferred Units in excess of recorded book value	—	—	—	11,224	—
Diluted FFO	\$ 98,937	\$ 88,801	\$ 76,248	\$ 61,268	\$ 52,854
Denominator for diluted EPS	43,262	38,997	34,982	28,021	23,350
Weighted average common units	8,511	8,702	8,726	8,932	9,282
Assumed conversion of weighted average convertible preferred shares	—	—	—	1,197	1,197
Assumed conversion of weighted average convertible preferred units	—	—	—	1,101	2,421
Dilutive effect of share-based compensation awards	—	—	221	43	384
Denominator for Diluted FFO per share	51,773	47,699	43,929	39,294	36,634

(1) Gains from the sale of real estate that are attributable to sales of non-operating properties are included in FFO. Gains from newly-developed or redeveloped properties less accumulated depreciation, if any, required under GAAP are also included in FFO on the basis that development services are the primary revenue generating activity; we believe that inclusion of these development gains is in compliance with the NAREIT definition of FFO, although others may interpret the definition differently.

INFLATION

Most of our tenants are obligated to pay their share of a building's operating expenses to the extent such expenses exceed amounts established in their leases, based on historical expense levels. Some of our tenants are obligated to pay their full share of a building's operating expenses. These arrangements somewhat reduce our exposure to increases in such costs resulting from inflation. In addition, since our average lease life is approximately five years, we generally expect to be able to compensate for increased operating expenses through increased rental rates upon lease renewal or expiration.

Our costs associated with constructing buildings and completing renovation and tenant improvement work increased due to higher cost of materials. We expect to recover a portion of these costs through higher tenant rents and reimbursements for tenant improvements. The additional costs that we do not recover increase depreciation expense as projects are completed and placed into service.

RECENT ACCOUNTING PRONOUNCEMENTS

For disclosure regarding recent accounting pronouncements and the anticipated impact they will have on our operations, you should refer to Note 2 to our Consolidated Financial Statements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to certain market risks, the most predominant of which is change in interest rates. Increases in interest rates can result in increased interest expense under our Revolving Credit Facility and our other debt carrying variable interest rate terms. Increases in interest rates can also result in increased interest expense when our debt carrying fixed interest rate terms mature and need to be refinanced. Our debt strategy favors long-term, fixed-rate, secured debt over variable-rate debt to minimize the risk of short-term increases in interest rates. As of December 31, 2006, 93.1% of our fixed-rate debt was scheduled to mature after 2007. As of December 31, 2006, 7.2% of our total debt had variable interest rates, including the effect of interest rate swaps. As of December 31, 2006, the percentage of variable-rate debt, including the effect of interest rate swaps, relative to total assets was 11.4%.

The following table sets forth our long-term debt obligations by scheduled maturity and weighted average interest rates at December 31, 2006 (dollars in thousands):

	For the Years Ended December 31,						Total
	2007	2008	2009	2010	2011	Thereafter	
Long-term debt:							
Fixed rate ⁽¹⁾	\$83,818	\$156,761	\$61,791	\$73,128	\$108,854	\$738,396	\$1,222,748
Average interest rate	6.49%	6.42%	6.20%	5.98%	5.76%	7.27%	6.82%
Variable rate	\$57,132	\$218,447	\$ —	\$ —	\$ —	\$ —	\$ 275,579
Average interest rate	7.20%	6.83%	—	—	—	—	7.05%

(1) Represents principal maturities only and therefore excludes net premiums of \$210,000.

The fair market value of our debt was \$1.50 billion at December 31, 2006 and \$1.35 billion at December 31, 2005. If interest rates on our fixed-rate debt had been 1% lower, the fair value of this debt would have increased by \$48.4 million at December 31, 2006 and \$41.9 million at December 31, 2005.

We occasionally use derivative instruments such as interest rate swaps to further reduce our exposure to changes in interest rates. The following table sets forth information pertaining to our derivative contracts in place as of December 31, 2006 and 2005, and their respective fair values (dollars in thousands):

Nature of Derivative	Notional Amount	One-Month LIBOR Base	Effective Date	Expiration Date	Fair Value at December 31,	
					2006	2005
Interest rate swap	\$50,000	5.0360%	3/28/2006	3/30/2009	\$ (42)	N/A
Interest rate swap	25,000	5.2320%	5/1/2006	5/1/2009	(133)	N/A
Interest rate swap	25,000	5.2320%	5/1/2006	5/1/2009	(133)	N/A
					\$(308)	\$ —

Based on our variable-rate debt balances, our interest expense would have increased by \$3.2 million in 2006 and \$3.6 million in 2005 if short-term interest rates were 1% higher. Interest expense in 2006 was less sensitive to a change in interest rates than 2005 due primarily to our having a lower average variable-rate debt balance in 2006.

management's report on internal control over financial reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, and for performing an assessment of the effectiveness of internal control over financial reporting as of December 31, 2006. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and trustees; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management performed an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 based upon criteria in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on our assessment, management determined that our internal control over financial reporting was effective as of December 31, 2006 based on the criteria in *Internal Control—Integrated Framework* issued by the COSO.

Our management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Dated: March 1, 2007



Randall M. Griffin
President and
Chief Executive Officer



Stephen E. Riffe
Executive Vice President
and Chief Financial Officer

report of independent registered public accounting firm

To Board of Trustees and Shareholders of
Corporate Office Properties Trust:

We have completed integrated audits of Corporate Office Properties Trust's consolidated financial statements and of its internal control over financial reporting as of December 31, 2006, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated Financial Statements and Financial Statement Schedule

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, shareholders' equity and cash flows present fairly, in all material respects, the financial position of Corporate Office Properties Trust and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal Control over Financial Reporting

Also, in our opinion, management's assessment, included in the accompanying "Management's Report on Internal Control over Financial Reporting," that the Company maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining

effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Baltimore, Maryland
March 1, 2007

consolidated balance sheets corporate office properties trust and subsidiaries

(Dollars in thousands)	December 31,	
	2006	2005
ASSETS		
Investment in real estate:		
Operating properties, net	\$1,812,883	\$1,631,038
Projects under construction or development	298,427	255,617
Total commercial real estate properties, net	2,111,310	1,886,655
Investments in and advances to unconsolidated real estate joint ventures	—	1,451
Investment in real estate, net	2,111,310	1,888,106
Cash and cash equivalents	7,923	10,784
Restricted cash	52,856	21,476
Accounts receivable, net	26,367	15,606
Deferred rent receivable	41,643	32,579
Intangible assets on real estate acquisitions, net	87,325	90,984
Deferred charges, net	43,710	35,046
Prepaid and other assets	48,467	35,178
Total assets	\$2,419,601	\$2,129,759
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Mortgage and other loans payable	\$1,298,537	\$1,348,351
3.5% Exchangeable Senior Notes	200,000	—
Accounts payable and accrued expenses	68,190	41,693
Rents received in advance and security deposits	20,237	14,774
Dividends and distributions payable	19,164	16,703
Deferred revenue associated with acquired operating leases	11,120	12,707
Distributions in excess of investment in unconsolidated real estate joint venture	3,614	3,081
Fair value of derivatives	308	—
Other liabilities	7,941	4,727
Total liabilities	1,629,111	1,442,036
Minority interests:		
Common units in the Operating Partnership	104,934	95,014
Preferred units in the Operating Partnership	8,800	8,800
Other consolidated real estate joint ventures	2,453	1,396
Total minority interests	116,187	105,210
Commitments and contingencies (Note 19)		
Shareholders' equity:		
Preferred Shares of beneficial interest (\$0.01 par value; shares authorized of 15,000,000, issued and outstanding of 7,590,000 at December 31, 2006 and 6,775,000 at December 31, 2005 (Note 11))	76	67
Common Shares of beneficial interest (\$0.01 par value; 75,000,000 shares authorized, shares issued and outstanding of 42,897,639 at December 31, 2006 and 39,927,316 at December 31, 2005)	429	399
Additional paid-in capital	758,032	657,339
Cumulative distributions in excess of net income	(83,541)	(67,697)
Value of unearned restricted common share grants	—	(7,113)
Accumulated other comprehensive loss	(693)	(482)
Total shareholders' equity	674,303	582,513
Total liabilities and shareholders' equity	\$2,419,601	\$2,129,759

See accompanying notes to consolidated financial statements.

consolidated statements of operations corporate office properties trust and subsidiaries

(Dollars in thousands, except per share data)	For the Years Ended December 31,		
	2006	2005	2004
Revenues			
Rental revenue	\$260,493	\$212,010	\$182,860
Tenant recoveries and other real estate operations revenue	40,826	30,063	21,084
Construction contract revenues	52,182	74,357	25,018
Other service operations revenues	7,902	4,877	3,885
Total revenues	361,403	321,307	232,847
Expenses			
Property operating expenses	94,504	72,253	58,982
Depreciation and other amortization associated with real estate operations	78,712	61,049	49,289
Construction contract expenses	49,961	72,534	23,733
Other service operations expenses	7,384	4,753	3,263
General and administrative expenses	16,936	13,534	10,938
Total operating expenses	247,497	224,123	146,205
Operating income	113,906	97,184	86,642
Interest expense	(71,378)	(54,872)	(42,148)
Amortization of deferred financing costs	(2,847)	(2,229)	(2,420)
Income from continuing operations before equity in loss of unconsolidated entities, income taxes and minority interests	39,681	40,083	42,074
Equity in loss of unconsolidated entities	(92)	(88)	(88)
Income tax expense	(887)	(668)	(795)
Income from continuing operations before minority interests	38,702	39,327	41,191
Minority interests in income from continuing operations			
Common units in the Operating Partnership	(4,060)	(4,670)	(5,306)
Preferred units in the Operating Partnership	(660)	(660)	(179)
Other consolidated entities	136	85	12
Income from continuing operations	34,118	34,082	35,718
Income from discontinued operations, net of minority interests	14,377	4,681	1,427
Income before gain (loss) on sales of real estate	48,495	38,763	37,145
Gain (loss) on sales of real estate, net of minority interests	732	268	(113)
Net income	49,227	39,031	37,032
Preferred share dividends	(15,404)	(14,615)	(16,329)
Issuance costs associated with redeemed preferred shares	(3,896)	—	(1,813)
Net income available to common shareholders	\$ 29,927	\$ 24,416	\$ 18,890
Basic earnings per common share			
Income from continuing operations	\$ 0.37	\$ 0.53	\$ 0.53
Discontinued operations	0.35	0.12	0.04
Net income available to common shareholders	\$ 0.72	\$ 0.65	\$ 0.57
Diluted earnings per common share			
Income from continuing operations	\$ 0.36	\$ 0.51	\$ 0.50
Discontinued operations	0.33	0.12	0.04
Net income available to common shareholders	\$ 0.69	\$ 0.63	\$ 0.54

See accompanying notes to consolidated financial statements.

consolidated statements of shareholders' equity

corporate office properties trust and subsidiaries

(Dollars in thousands)	Preferred Shares	Common Shares	Additional Paid-in Capital	Cumulative Distributions in Excess of Net Income	Value of Unearned Restricted Common Share Grants	Accumulated Other Comprehensive Loss	Total
Balance at December 31, 2003							
(29,397,267 common shares outstanding)	\$ 85	\$294	\$492,886	\$(38,483)	\$(4,107)	\$(294)	\$450,381
Conversion of common units to common shares (326,108 shares)	—	3	8,038	—	—	—	8,041
Common shares issued to the public (5,033,600 shares)	—	50	115,184	—	—	—	115,234
Common shares issued to employees (4,000 shares)	—	—	91	—	—	—	91
Series B Preferred Shares redemption	(13)	—	(31,238)	—	—	—	(31,251)
Series D Preferred Shares conversion	(5)	12	(7)	—	—	—	—
Increase in fair value of derivatives	—	—	—	—	—	294	294
Restricted common share grants issued (99,935 shares)	—	1	2,270	—	(2,271)	—	—
Value of earned restricted share grants	—	—	388	—	997	—	1,385
Exercise of share options (784,398 shares)	—	8	7,502	—	—	—	7,510
Expense associated with share options	—	—	519	—	—	—	519
Adjustments to minority interests resulting from changes in ownership of Operating Partnership by COPT	—	—	(19,360)	—	—	—	(19,360)
Increase in tax benefit from share-based compensation	—	—	1,955	—	—	—	1,955
Net income	—	—	—	37,032	—	—	37,032
Dividends	—	—	—	(49,907)	—	—	(49,907)
Balance at December 31, 2004							
(36,842,108 common shares outstanding)	67	368	578,228	(51,358)	(5,381)	—	521,924
Conversion of common units to common shares (253,575 shares)	—	3	9,117	—	—	—	9,120
Common shares issued to the public (2,300,000 shares)	—	23	75,118	—	—	—	75,141
Decrease in fair value of derivatives	—	—	—	—	—	(482)	(482)
Restricted common share grants issued (130,975 shares)	—	1	3,480	—	(3,481)	—	—
Restricted common share cancellations (10,422 shares)	—	—	(205)	—	205	—	—
Value of earned restricted share grants	—	—	536	—	1,544	—	2,080
Exercise of share options (411,080 shares)	—	4	4,394	—	—	—	4,398
Expense associated with share options	—	—	93	—	—	—	93
Adjustments to minority interests resulting from changes in ownership of Operating Partnership by COPT	—	—	(12,888)	—	—	—	(12,888)
Decrease in tax benefit from share-based compensation	—	—	(534)	—	—	—	(534)
Net income	—	—	—	39,031	—	—	39,031
Dividends	—	—	—	(55,370)	—	—	(55,370)
Balance at December 31, 2005							
(39,927,316 common shares outstanding)	67	399	657,339	(67,697)	(7,113)	(482)	582,513
Conversion of common units to common shares (245,793 shares)	—	3	11,075	—	—	—	11,078
Common shares issued to the public (2,000,000 shares)	—	20	82,413	—	—	—	82,433
Series J Preferred Shares issued to the public (3,390,000 shares)	34	—	81,823	—	—	—	81,857
Series E Preferred Shares redemption	(11)	—	(28,739)	—	—	—	(28,750)
Series F Preferred Shares redemption	(14)	—	(35,611)	—	—	—	(35,625)
Decrease in fair value of derivatives	—	—	—	—	—	(211)	(211)
Reversal of unearned restricted common share grants upon adoption of SFAS 123(R)	—	1	(5,169)	—	7,113	—	1,945
Exercise of share options (581,932 shares)	—	6	6,761	—	—	—	6,767
Expense associated with share-based compensation	—	—	3,833	—	—	—	3,833
Adjustments to minority interests resulting from changes in ownership of Operating Partnership by COPT	—	—	(16,255)	—	—	—	(16,255)
Increase in tax benefit from share-based compensation	—	—	562	—	—	—	562
Net income	—	—	—	49,227	—	—	49,227
Dividends	—	—	—	(65,071)	—	—	(65,071)
Balance at December 31, 2006							
(42,897,639 common shares outstanding)	\$ 76	\$429	\$758,032	\$(83,541)	\$ —	\$(693)	\$674,303

See accompanying notes to consolidated financial statements.

consolidated statements of cash flows corporate office properties trust and subsidiaries

(Dollars in thousands)	For the Years Ended December 31,		
	2006	2005	2004
Cash flows from operating activities			
Net income	\$ 49,227	\$ 39,031	\$ 37,032
Adjustments to reconcile net income to net cash provided by operating activities:			
Minority interests	7,800	6,464	5,826
Depreciation and other amortization	80,074	63,555	51,904
Amortization of deferred financing costs	2,981	2,240	2,431
Amortization of deferred market rental revenue	(1,904)	(426)	(931)
Equity in loss of unconsolidated entities	92	88	88
(Gain) loss on sales of real estate	(17,920)	(4,690)	150
Share-based compensation	3,833	2,173	1,904
Excess income tax benefits from share-based compensation	(562)	—	—
Changes in operating assets and liabilities:			
Increase in deferred rent receivable	(10,004)	(6,922)	(8,372)
(Increase) decrease in accounts receivable	(10,844)	1,165	(3,579)
Increase in restricted cash and prepaid and other assets	(7,098)	(14,260)	(7,859)
Increase in accounts payable, accrued expenses and other liabilities	13,544	5,953	3,528
Increase in rents received in advance and security deposits	4,181	1,993	2,322
Other	(249)	(420)	50
Net cash provided by operating activities	113,151	95,944	84,494
Cash flows from investing activities			
Purchases of and additions to commercial real estate properties	(282,099)	(499,926)	(251,982)
Proceeds from sales of properties	46,704	29,467	—
Proceeds from sale of unconsolidated real estate joint venture	1,524	—	—
Proceeds from contribution of assets to unconsolidated real estate joint venture	—	68,633	—
Acquisition of partner interests in consolidated joint ventures	(5,250)	(1,208)	(4,928)
Investments in and advances from (to) unconsolidated entities	454	(130)	(146)
Distributions from unconsolidated entities	499	250	—
Leasing costs paid	(10,480)	(9,272)	(11,024)
Advances to certain real estate joint ventures	—	—	(515)
Decrease (increase) in restricted cash associated with investing activities	5,260	(5,620)	1,183
Purchases of furniture, fixtures and equipment	(8,109)	(2,434)	(1,308)
Other	(2,337)	(61)	—
Net cash used in investing activities	(253,834)	(420,301)	(268,720)
Cash flows from financing activities			
Proceeds from mortgage and other loans payable	673,176	889,399	573,879
Proceeds from 3.5% Exchangeable Senior Notes	200,000	—	—
Repayments of mortgage and other loans payable	(762,590)	(580,642)	(421,621)
Deferred financing costs paid	(6,605)	(4,307)	(3,436)
Increase in other liabilities associated with financing activities	—	—	4,000
Distributions paid to partners in consolidated joint ventures	(787)	—	—
Net proceeds from issuance of common shares	89,202	79,539	122,744
Net proceeds from issuance of preferred shares	81,857	—	—
Redemption of preferred shares	(64,375)	—	(31,251)
Dividends paid	(62,845)	(53,587)	(47,551)
Distributions paid	(10,422)	(9,677)	(8,435)
Excess income tax benefits from share-based compensation	562	—	—
Other	649	595	237
Net cash provided by financing activities	137,822	321,320	188,566
Net (decrease) increase in cash and cash equivalents	(2,861)	(3,037)	4,340
Cash and cash equivalents			
Beginning of period	10,784	13,821	9,481
End of period	\$ 7,923	\$ 10,784	\$ 13,821

See accompanying notes to consolidated financial statements.

notes to consolidated financial statements corporate office properties trust and subsidiaries

(Dollars in thousands, except per share data)

1. ORGANIZATION

Corporate Office Properties Trust (“COPT”) and subsidiaries (collectively, the “Company”) is a fully-integrated and self-managed real estate investment trust (“REIT”) that focuses on the acquisition, development, ownership, management and leasing of primarily Class A suburban office properties in the Greater Washington, D.C. region and other select submarkets. We also have a core customer expansion strategy that is built on meeting, through acquisitions and development, the multi-location requirements of our strategic tenants. As of December 31, 2006, our investments in real estate included the following:

- 170 wholly owned operating properties in our portfolio totaling 15.1 million square feet;
- 16 wholly owned office properties under construction or development that we estimate will total approximately 1.8 million square feet upon completion and two wholly owned office properties totaling approximately 129,000 square feet that were under redevelopment;
- wholly owned land parcels totaling 1,048 acres that we believe are potentially developable into approximately 8.4 million square feet; and
- partial ownership interests in a number of other real estate projects in operations or under development or redevelopment.

We conduct almost all of our operations through our operating partnership, Corporate Office Properties, L.P. (the “Operating Partnership”), for which we are the managing general partner. The Operating Partnership owns real estate both directly and through subsidiary partnerships and limited liability companies (“LLCs”). A summary of our Operating Partnership’s forms of ownership and the percentage of those ownership forms owned by COPT as of December 31, 2006 and 2005 follows:

	December 31,	
	2006	2005
Common Units	83%	82%
Series E Preferred Units ⁽¹⁾	N/A	100%
Series F Preferred Units ⁽¹⁾	N/A	100%
Series G Preferred Units	100%	100%
Series H Preferred Units	100%	100%
Series I Preferred Units	0%	0%
Series J Preferred Units ⁽²⁾	100%	N/A

(1) These preferred units were redeemed in 2006.

(2) These preferred units were issued in 2006.

Two of our trustees controlled, either directly or through ownership by other entities or family members, an additional 14% of the Operating Partnership’s common units.

In addition to owning interests in real estate, the Operating Partnership also owns 100% of Corporate Office Management, Inc. (“COMI”) and owns, either directly or through COMI, 100% of the consolidated subsidiaries that are set forth below (collectively defined as the “Service Companies”):

Entity Name	Type of Service Business
COPT Property Management Services, LLC (“CPM”)	Real Estate Management
COPT Development & Construction Services, LLC (“CDC”)	Construction and Development
Corporate Development Services, LLC (“CDS”)	Construction and Development
COPT Environmental Systems, LLC (“CES”) ⁽¹⁾	Heating and Air Conditioning

(1) Prior to 2007, CES’s name was Corporate Cooling and Controls, LLC.

Most of the services that CPM provides are for us. CDC, CDS and CES provide services to us and to third parties.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

We generally use three different accounting methods to report our investments in entities: the consolidation method, the equity method and the cost method. These methods are described below.

Consolidation Method

We generally use the consolidation method when we own most of the outstanding voting interests in an entity and can control its operations. In accordance with Financial Accounting Standards Board (“FASB”) Interpretation No. 46(R), “Consolidation of Variable Interest Entities” (“FIN 46(R)”), we also consolidate certain entities when control of such entities can be achieved through means other than voting rights (“variable interest entities” or “VIEs”) if we are deemed to be the primary beneficiary. Generally, FIN 46(R) applies when either (1) the equity investors (if any) lack one or more of the essential characteristics of a controlling financial interest; (2) the equity investment at risk is insufficient to finance that entity’s activities without additional subordinated financial support; or (3) the equity investors have voting rights that are not proportionate to their economic interests and the activities of the entity involve or are conducted on behalf of an investor with a disproportionately small voting interest.

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(Dollars in thousands, except per share data)

Under the consolidation method of accounting, the accounts of the entity being consolidated are combined with our accounts. We eliminate balances and transactions between companies when we consolidate these accounts. For all of the periods presented, our Consolidated Financial Statements include the accounts of:

- COPT;
- the Operating Partnership and its subsidiary partnerships and LLCs;
- the Service Companies; and
- Corporate Office Properties Holdings, Inc. (of which we own 100%).

Equity Method

We generally use the equity method of accounting when we own an interest in an entity and can exert significant influence over the entity's operations but cannot control the entity's operations. FIN 46(R) affects our determination of when to use the equity method of accounting since we would generally use the equity method for VIEs of which we are not the primary beneficiary. Under the equity method, we report:

- our ownership interest in the entity's capital as an investment on our Consolidated Balance Sheets; and
- our percentage share of the earnings or losses from the entity in our Consolidated Statements of Operations.

Cost Method

We use the cost method of accounting when we own an interest in an entity and cannot exert significant influence over the entity's operations. Under the cost method, we report:

- the cost of our investment in the entity as an investment on our Consolidated Balance Sheets; and
- distributions to us of the entity's earnings in our Consolidated Statements of Operations.

Use of Estimates in the Preparation of Financial Statements

We make estimates and assumptions when preparing financial statements under generally accepted accounting principles ("GAAP"). These estimates and assumptions affect various matters, including:

- the reported amounts of assets and liabilities in our Consolidated Balance Sheets at the dates of the financial statements;
- the disclosure of contingent assets and liabilities at the dates of the financial statements; and
- the reported amounts of revenues and expenses in our Consolidated Statements of Operations during the reporting periods.

These estimates include such items as depreciation, allocation of real estate acquisition costs and allowances for doubtful accounts. Actual results could differ from those estimates. These estimates involve judgments with respect to, among other things, future economic factors that are difficult to predict and are often beyond management's control. As a result, actual amounts could differ from these estimates.

Acquisitions of Real Estate

We allocate the costs of real estate acquisitions to assets acquired and liabilities assumed based on the relative fair values at the date of acquisition pursuant to the provisions of Statement of Financial Accounting Standards No. 141, "Business Combinations." In estimating the fair value of the tangible and intangible assets acquired, we consider, among other things, information obtained about each property as a result of our due diligence, leasing activities and knowledge of the markets in which the properties are located. We utilize various valuation methods, such as estimated cash flow projections utilizing discount and capitalization rate assumptions and available market information. We allocate the costs of real estate acquisitions to the following components:

- Real estate based on a valuation of the acquired property performed with the assumption that the property is vacant upon acquisition (the "as if vacant value"). We then allocate the real estate value derived using this approach between land and building and improvements using our estimates and assumptions.
- In-place operating leases to the extent that the present value of future rents under the contractual lease terms are above or below the present value of market rents at the time of acquisition (the "lease to market value"). For example, if we acquire a property and the leases in place for that property carry rents below the market rent for such leases at the time of acquisition, we classify the amount equal to the difference between (1) the present value of the future rental revenue under the lease using market rent assumptions and (2) the present value of future rental revenue under the terms of the lease as deferred revenue. Conversely, if the leases in place for that property carry rents above the market rent, we classify the difference as an intangible asset. Deferred revenue or deferred assets recorded in connection with in-place operating leases of acquired properties are amortized into rental revenue over the terms of the leases.
- Existing tenants in a property (the "lease-up value"). This amount represents the value associated with acquiring a built-in revenue stream on a leased building. It is computed as the difference between the present value of the property's (1) revenues less operating expenses as if the

property was vacant upon acquisition and (2) revenues less operating expenses as if the property was acquired with leases in place at market rents.

- Deemed cost avoidance of acquiring in-place operating leases (“deemed cost avoidance”). For example, when a new lease is entered into, the lessor typically incurs a number of origination costs in connection with the leases; such costs include tenant improvements and leasing costs. When a property is acquired with in-place leases, the origination costs for such leases were already incurred by the prior owner. Therefore, to recognize the value of these costs in recording a property acquisition, we assign value to the tenant improvements and leasing costs associated with the remaining term of in-place operating leases.
- Tenant relationship value equal to the additional amount that we pay for a property in connection with the presence of a particular tenant in that property (the “tenant relationship value”). Our valuation of this component is affected by, among other things, our tenant lease renewal assumptions and evaluation of existing relationships with tenants.
- Market concentration premium equal to the additional amount that we pay for a property over the fair value of assets in connection with our strategy of increasing our presence in regional submarkets (the “market concentration premium”).

Commercial Real Estate Properties

We report commercial real estate properties at our depreciated cost. The amounts reported for our commercial real estate properties include our costs of:

- acquisitions;
- development and construction;
- building and land improvements; and
- tenant improvements paid by us.

We capitalize interest expense, real estate taxes, direct internal labor (including allocable overhead costs) and other costs associated with real estate undergoing construction and development activities to the cost of such activities. We continue to capitalize these costs while construction and development activities are underway until a property becomes “operational,” which occurs upon the earlier of when leases commence on space or one year after the cessation of major construction activities. When leases commence on portions of a newly-constructed property’s space in the period prior to one year from the cessation of major construction activities, we consider that property to be “partially operational.” When a property is

partially operational, we allocate the costs associated with the property between the portion that is operational and the portion under construction. We start depreciating newly-constructed properties as they become operational.

We depreciate our assets evenly over their estimated useful lives as follows:

• Buildings and building improvements	10–40 years
• Land improvements	10–20 years
• Tenant improvements on operating properties	Related lease terms
• Equipment and personal property	3–10 years

When events or circumstances indicate that a property may be impaired, we perform an undiscounted cash flow analysis. We consider an asset to be impaired when its undiscounted expected future cash flows are less than its depreciated cost. When we determine that an asset is impaired, we utilize methods similar to those used by independent appraisers in estimating the fair value of the asset; this process requires us to make certain estimates and assumptions. We then recognize an impairment loss based on the excess of the carrying amount of the asset over its fair value. We have not recognized impairment losses on our real estate assets to date.

When we determine that a real estate asset will be held for sale, we discontinue the recording of depreciation expense of the asset and estimate the sales price, net of selling costs; if we then determine that the estimated sales price, net of selling costs, is less than the net book value of the asset, we recognize an impairment loss equal to the difference and reduce the carrying amounts of assets.

When we sell an operating property, or determine that an operating property is held for sale, and determine that we have no significant continuing involvement in such property, we classify the results of operations for such property as discontinued operations. Interest expense that is specifically identifiable to properties included in discontinued operations is used in the computation of interest expense attributable to discontinued operations. When properties included in the borrowing base to support lines of credit are classified as discontinued operations, we allocate a portion of such credit lines’ interest expense to discontinued operations; we compute this allocation based on the percentage that the related properties represent of all properties included in the borrowing base to support such credit lines.

We expense property maintenance and repair costs when incurred.

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(Dollars in thousands, except per share data)

Sales of Interests in Real Estate

We recognize gains from sales of interests in real estate using the full accrual method, provided that various criteria relating to the terms of sale and any subsequent involvement by us with the real estate sold are met. We recognize gains relating to transactions that do not meet the requirements of the full accrual method of accounting when the full accrual method of accounting criteria are met.

Cash and Cash Equivalents

Cash and cash equivalents include all cash and liquid investments that mature three months or less from when they are purchased. Cash equivalents are reported at cost, which approximates fair value. We maintain our cash in bank accounts in amounts that may exceed federally insured limits at times. We have not experienced any losses in these accounts in the past and believe that we are not exposed to significant credit risk because our accounts are deposited with major financial institutions.

Accounts Receivable

Our accounts receivable are reported net of an allowance for bad debts of \$252 at December 31, 2006 and \$421 at December 31, 2005.

Revenue Recognition

We recognize rental revenue evenly over the terms of tenant leases. When our leases provide for contractual rent increases, which is most often the case, we average the non-cancelable rental revenues over the lease terms to evenly recognize such revenues; we refer to the adjustments resulting from this process as straight-line rental revenue adjustments. We consider rental revenue under a lease to be non-cancelable when a tenant (1) may not terminate its lease obligation early or (2) may terminate its lease obligation early in exchange for a fee or penalty that we consider material enough such that termination would not be probable. We report these straight-line rental revenue adjustments recognized in advance of payments received as deferred rent receivable on our Consolidated Balance Sheets. We report prepaid tenant rents as rents received in advance on our Consolidated Balance Sheets.

When tenants terminate their lease obligations prior to the end of their agreed lease terms, they typically pay fees to cancel these obligations. We recognize such fees as revenue and write off against such revenue any (1) deferred rents receivable and (2) deferred revenue and intangible assets that are amortizable into rental revenue associated with the leases; the resulting net amount is the net revenue from the early termination of the leases. When a tenant's lease for space in a property is terminated early but the tenant continues to lease such space under a new or modified lease in the property, the net revenue

from the early termination of the lease is recognized evenly over the remaining life of the new or modified lease in place on that property.

We recognize tenant recovery revenue in the same periods in which we incur the related expenses. Tenant recovery revenue includes payments from tenants as reimbursement for property taxes, utilities and other property operating expenses.

We recognize fees for services provided by us once services are rendered, fees are determinable and collectibility is assured. We generally recognize revenue under construction contracts using the percentage of completion method when the contracts call for services to be provided over a period of time exceeding six months and the revenue and costs for such contracts can be estimated with reasonable accuracy; when these criteria do not apply to a contract, we recognize revenue on that contract once the services under the contract are complete. Under the percentage of completion method, we recognize a percentage of the total estimated revenue on a contract based on the cost of services provided on the contract as of a point in time relative to the total estimated costs on the contract.

Intangible Assets and Deferred Revenue on Real Estate Acquisitions

We capitalize intangible assets and deferred revenue on real estate acquisitions as described in the section above entitled "Acquisitions of Real Estate." We amortize the intangible assets and deferred revenue as follows:

- | | |
|--------------------------------|--|
| • Lease to market value | Related lease terms |
| • Lease-up value | Related lease terms or estimated period of time that tenant will lease space in property |
| • Deemed cost avoidance | Related lease terms |
| • Tenant relationship value | Estimated period of time that tenant will lease space in property |
| • Market concentration premium | 40 years |

We recognize the amortization of lease to market value assets and deferred revenues as adjustments to rental revenue reported in our Consolidated Statements of Operations; we refer to this amortization as amortization of origination value of leases on acquired properties. We recognize the amortization of other intangible assets on real estate acquisitions as depreciation and amortization expense on our Consolidated Statements of Operations.

Deferred Charges

We defer costs that we incur to obtain new tenant leases or extend existing tenant leases. We amortize these costs evenly over the lease terms. When tenant leases are terminated early, we expense any unamortized deferred leasing costs associated with those leases.

We also defer costs for long-term financing arrangements and amortize these costs over the related loan terms on a straight-line basis, which approximates the amortization that would occur under the effective interest method of amortization. We expense any unamortized loan costs when loans are retired early.

When the costs of acquisitions exceed the fair value of tangible and identifiable intangible assets and liabilities, we record goodwill in connection with such acquisitions. We test goodwill annually for impairment and in interim periods if certain events occur indicating that the carrying value of goodwill may be impaired. We recognize an impairment loss when the discounted expected future cash flows associated with the related reporting unit are less than its unamortized cost.

Derivatives

We are exposed to the effect of interest rate changes in the normal course of business. We use interest rate swap, interest rate cap and forward starting swap agreements in order to attempt to reduce the impact of such interest rate changes. Interest rate differentials that arise under interest rate swap and interest rate cap contracts are recognized in interest expense over the life of the respective contracts. Interest rate differentials that arise under forward starting swaps are recognized in interest expense over the life of the respective loans for which such swaps are obtained. We do not use such derivatives for trading or speculative purposes. We manage counter-party risk by only entering into contracts with major financial institutions based upon their credit ratings and other risk factors.

We recognize all derivatives as assets or liabilities in the balance sheet at fair value with the offset to:

- the accumulated other comprehensive loss component of shareholders' equity ("AOCL"), net of the share attributable to minority interests, for any derivatives designated as cash flow hedges to the extent such derivatives are deemed effective in hedging risks (risk in the case of our existing derivatives being defined as changes in interest rates);
- interest expense on our Statements of Operations for any derivatives designated as cash flow hedges to the extent such derivatives are deemed ineffective in hedging risks; or

- other revenue on our Statements of Operations for any derivatives designated as fair value hedges.

We use standard market conventions and techniques such as discounted cash flow analysis, option pricing models, replacement cost and termination cost in computing the fair value of derivatives at each balance sheet date.

Minority Interests

As discussed previously, we consolidate the accounts of our Operating Partnership and its subsidiaries into our financial statements. However, we do not own 100% of the Operating Partnership. We also do not own 100% of certain consolidated real estate joint ventures. The amounts reported for minority interests on our Consolidated Balance Sheets represent the portion of these consolidated entities' equity that we do not own. The amounts reported for minority interests on our Consolidated Statements of Operations represent the portion of these consolidated entities' net income not allocated to us.

Common units of the Operating Partnership ("common units") are substantially similar economically to our common shares of beneficial interest ("common shares"). Common units not owned by us are also exchangeable into our common shares, subject to certain conditions.

On September 23, 2004, we issued 352,000 Series I Preferred Units in the Operating Partnership to an unrelated party in connection with our acquisition of two properties in Northern Virginia. These units have a liquidation preference of \$25.00 per unit, plus any accrued and unpaid distributions of return thereon (as described below), and may be redeemed for cash by the Operating Partnership at our option any time after September 22, 2019. The owner of these units is entitled to a priority annual cumulative return equal to 7.5% of their liquidation preference through September 22, 2019; the annual cumulative preferred return increases for each subsequent five-year period, subject to certain maximum limits. These units are convertible into common units on the basis of 0.5 common units for each Series I Preferred Unit; the resulting common units would then be exchangeable for common shares in accordance with the terms of the Operating Partnership's agreement of limited partnership.

Earnings Per Share ("EPS")

We present both basic and diluted EPS. We compute basic EPS by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the year. Our computation of diluted EPS is similar except that:

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(Dollars in thousands, except per share data)

- the denominator is increased to include: (1) the weighted average number of potential additional common shares that would have been outstanding if securities that are convertible into our common shares were converted; and (2) the effect of dilutive potential common shares outstanding during the period attributable to share-based compensation using the treasury stock method; and
- the numerator is adjusted to add back any convertible preferred dividends and any other changes in income or loss that would result from the assumed conversion into common shares.

Our computation of diluted EPS does not assume conversion of securities into our common shares if conversion of those securities would increase our diluted EPS in a given year. A summary of the numerator and denominator for purposes of basic and diluted EPS calculations is set forth below (dollars and shares in thousands, except per share data):

	For the Years Ended December 31,		
	2006	2005	2004
Numerator:			
Income from continuing operations	\$ 34,118	\$ 34,082	\$ 35,718
Add (less): Gain (loss) on sales of real estate, net	732	268	(113)
Less: Preferred share dividends	(15,404)	(14,615)	(16,329)
Less: Issuance costs associated with redeemed preferred shares	(3,896)	—	(1,813)
Numerator for basic EPS from continuing operations	15,550	19,735	17,463
Add: Convertible preferred share dividends	—	—	21
Numerator for diluted EPS from continuing operations	15,550	19,735	17,484
Add: Income from discontinued operations, net	14,377	4,681	1,427
Less: Convertible preferred share dividends	—	—	(21)
Numerator for basic EPS on net income available to common shareholders	29,927	24,416	18,890
Add: Convertible preferred share dividends	—	—	21
Numerator for diluted EPS on net income available to common shareholders	\$ 29,927	\$ 24,416	\$ 18,911
Denominator (all weighted averages):			
Denominator for basic EPS (common shares)	41,463	37,371	33,173
Dilutive effect of share-based compensation awards	1,799	1,626	1,675
Assumed conversion of convertible preferred shares	—	—	134
Denominator for diluted EPS	43,262	38,997	34,982
Basic EPS:			
Income from continuing operations	\$ 0.37	\$ 0.53	\$ 0.53
Income from discontinued operations	0.35	0.12	0.04
Net income available to common shareholders	\$ 0.72	\$ 0.65	\$ 0.57
Diluted EPS			
Income from continuing operations	\$ 0.36	\$ 0.51	\$ 0.50
Income from discontinued operations	0.33	0.12	0.04
Net income available to common shareholders	\$ 0.69	\$ 0.63	\$ 0.54

Our diluted EPS computations do not include the effects of the following securities since the conversions of such securities would increase diluted EPS for the respective periods:

	Weighted Average Shares in Denominator for the Years Ended December 31,		
	2006	2005	2004
Conversion of weighted average common units	8,511	8,702	8,726
Conversion of weighted average convertible preferred units	176	176	48
Share-based compensation awards	—	206	226

As discussed in Note 9, the Operating Partnership issued on September 18, 2006 a \$200,000 aggregate principal amount of 3.50% Exchangeable Senior Notes due 2026. The notes have an exchange settlement feature that provides that the notes may, under certain circumstances, be exchangeable for cash (up to the principal amount of the notes) and, with respect to any excess exchange value, may be exchangeable into (at our option) cash, our common shares or a combination of cash and our common shares at an exchange rate of 18.4284 shares per \$1,000 principal amount of the notes (exchange rate is as of December 31, 2006 and is equivalent to an exchange price of \$54.30 per common share). The Exchangeable Senior Notes did not affect our diluted EPS reported above since the weighted average closing price of our common shares during the period over which the notes were outstanding was less than \$54.30.

Share-Based Compensation

We have historically issued two forms of share-based compensation: share options and restricted shares. Prior to January 1, 2006, our general method for accounting for these forms of share-based compensation was as follows:

- Share options: These awards were accounted for using the intrinsic value method. Under this method, we recorded compensation expense only when the exercise price of a grant was less than the market price of our common shares on the option grant date; when this occurred, we recognized compensation expense equal to the difference between the exercise price and the grant-date market price over the service period to which the options related.
- Restricted shares: We computed compensation expense for restricted share grants based on the value of such grants, as determined by the value of our common shares on the applicable measurement date (generally the date of grant). We recognized compensation expense for such grants over the service periods to which the grants related based on the vesting schedules for such grants.

In December 2004, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 123(R), “Share-Based Payment” (“SFAS 123(R)”). The statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, focusing primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. The statement requires us to measure the cost of employee services received in exchange for an award of equity instruments based generally on the fair value of the award on the grant date; such cost should then be recognized over the period during which the employee is required to provide service in exchange for the award (generally the vesting period). No compensation cost is recognized for equity instruments for which employees do not render the requisite service. In 2005, the FASB also issued several FASB Staff Positions that clarify certain aspects of SFAS 123(R). SFAS 123(R) became effective for us on January 1, 2006, applying to all awards granted after January 1, 2006 and to awards modified, repurchased or cancelled after that date. We used the modified prospective application approach to adoption provided for under SFAS 123(R); under this approach, we recognized compensation cost on or after January 1, 2006 for the portion of outstanding awards for which the requisite service was not yet rendered, based on the fair value of those awards on the date of grant.

The primary effect of our adoption of SFAS 123(R) on our Consolidated Financial Statements is that beginning January 1, 2006 we are: (1) incurring higher expense associated with share options issued to employees relative to what we would have recognized under the intrinsic value method; (2) recognizing expenses associated with restricted common shares over the life of the grant using a straight-line basis methodology over the service period; and (3) reporting the benefits of tax deductions in excess of recognized compensation costs as cash flow from financing activities (such benefits were previously reported as operating cash flows).

Prior to our adoption of SFAS 123(R), we provided disclosures in our financial statements for years prior to 2006 that summarized what our operating results would have been if we had elected to account for our share-based compensation under the fair value provisions of Statement of Financial Accounting Standards No. 123, “Accounting for Stock-Based Compensation” (“SFAS 123”). In computing the amounts that appeared in these disclosures, we accounted for forfeitures as they occurred. SFAS 123(R) requires that share-based compensation be computed based on awards that are ultimately expected to vest. As a result, future forfeitures of awards are to be estimated at the

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time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. SFAS 123(R) also requires that companies make a one-time cumulative effect adjustment upon adoption of the standard to record the effect that estimated future forfeitures of outstanding awards would have on expenses previously recognized in the companies' financial statements; we did not record such a cumulative effect adjustment since we determined that the effect of pre-vesting forfeitures on our recorded expense has historically been negligible. The amounts included in our Consolidated Statements of Operations for share-based compensation in the twelve months ended December 31, 2006 reflected an estimate of pre-vesting forfeitures of approximately 5%.

In the disclosures that we provided in our financial statements for years prior to 2006 that summarized what our operating results would have been if we had elected to account for our share-based compensation under the fair value provisions of SFAS 123, we did not capitalize costs associated with share-based compensation. Effective upon our adoption of SFAS 123(R), we began capitalizing costs associated with share-based compensation attributable to employees engaged in construction and development activities.

On November 10, 2005, the FASB issued FASB Staff Position No. FAS 123(R)-3, "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards." We elected to adopt the alternative transition method provided in this FASB Staff Position for calculating the tax effects of share-based compensation pursuant to SFAS 123(R). The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of SFAS 123(R).

We compute the fair value of share options under SFAS 123(R) using the Black-Scholes option-pricing model. Under that model, the risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected option life is based on our historical experience of employee exercise behavior. Expected volatility is based on historical volatility of our common shares. Expected dividend yield is based on the average historical dividend yield on our common shares over a period of time ending on the grant date of the options.

Fair Value of Financial Instruments

Our financial instruments include primarily notes receivable, debt and interest rate derivatives. The carrying or contract values of notes receivable approximated their fair values at December 31, 2006 and 2005. You should refer to Notes 9 and 10 for fair value of debt and derivative information.

Reclassification

We reclassified certain amounts from the prior periods to conform to the current period presentation of our Consolidated Financial Statements. These reclassifications did not affect previously reported consolidated net income or shareholders' equity.

Recent Accounting Pronouncement

See the section above entitled "Stock-Based Compensation" for disclosure pertaining to SFAS 123(R).

In June 2005, the FASB ratified the consensus reached by the Emerging Issues Task Force ("EITF") regarding EITF 04-05, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights." The conclusion provided a framework for addressing the question of when a general partner, as defined in EITF 04-05, should consolidate a limited partnership. Under the consensus, a general partner is presumed to control a limited partnership (or similar entity) and should consolidate that entity unless the limited partners possess kick-out rights or other substantive participating rights as described in EITF 96-16, "Investor's Accounting for an Investee When the Investor has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights." This EITF was initially effective for all new limited partnerships formed and for existing limited partnerships for which the partnership agreements were modified after June 29, 2005, and, as of January 1, 2006, for existing limited partnership agreements. The EITF did not impact us in 2005. The adoption of this EITF in 2006 for existing limited partnership agreements did not have a material effect on our financial position, results of operations or cash flows.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are in the process of evaluating the effect, if any, that implementing FIN 48 will have on our financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, “Fair Value Measurements” (“SFAS 157”). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The Statement does not require any new fair value measurements but does apply under other accounting pronouncements that require or permit fair value measurements. The changes to current practice resulting from the Statement relate to the definition of fair value, the methods used to measure fair value and the expanded disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with earlier application encouraged. We do not expect that the adoption of this Statement will have a material effect on our financial position, results of operations or cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 (“SAB 108”), which addresses diversity in practice in quantifying financial statement misstatements and the potential under current practice for the build up of improper amounts on the balance sheet. There have historically been two widely recognized methods for quantifying the effects of financial statement errors: the “roll-over” method and the “iron curtain” method. The roll-over method focuses primarily on the impact of a misstatement on the income statement, including the reversing effect of prior year misstatements, but its use can lead to the accumulation of misstatements on the balance sheet. Conversely, the iron-curtain method focuses primarily on the effect of correcting the period end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. SAB 108 establishes an approach that requires quantification of financial statement errors based on the effects of the error on each of the company’s financial statements and the related financial statement disclosures. This model is commonly referred to as a “dual approach” because it requires quantification of errors under both the iron-curtain and the roll-over methods. SAB 108 was effective for financial statements for fiscal years ending after November 15, 2006. Our adoption of SAB 108 did not have a material effect on our financial position, results of operations or cash flows.

3. CONCENTRATION OF RENTAL REVENUE

Major Tenants

The following table summarizes the percentage of our total rental revenue earned from (1) individual tenants that accounted for at least 5% of our total rental revenue and (2) the aggregate of the five tenants from which we recognized the most rental revenue in the respective years:

	For the Years Ended December 31,		
	2006	2005	2004
United States Government	13%	11%	11%
Booz Allen Hamilton, Inc.	7%	6%	5%
Computer Sciences Corporation	N/A	5%	6%
AT&T Local Services ⁽¹⁾	N/A	N/A	6%
Five largest tenants	32%	30%	33%

(1) Includes affiliated organizations and agencies.

Geographical Concentration

We derived large concentrations of our total revenue from real estate operations (defined as the sum of rental revenue and tenant recoveries and other real estate operations revenue) from certain geographic regions. The table below sets forth certain of these concentrations:

	Percentage of Total Rental Revenue from Real Estate Operations for the Years Ended December 31,		
	2006	2005	2004
Mid-Atlantic	95%	99%	100%
Greater Washington, D.C. ⁽¹⁾	78%	83%	79%
Baltimore/Washington Corridor	48%	49%	49%

(1) Comprised of our properties in the Baltimore/Washington Corridor (defined as the Maryland counties of Howard and Anne Arundel), Northern Virginia (defined as Fairfax County, Virginia), Suburban Maryland (defined as the Maryland counties of Montgomery, Prince George’s and Frederick) and St. Mary’s and King George Counties (located in Maryland and Virginia, respectively).

Substantially all of our construction contract and service operations revenues were derived from operations in the Greater Washington, D.C. region.

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(Dollars in thousands, except per share data)

4. COMMERCIAL REAL ESTATE PROPERTIES

Operating properties consisted of the following:

	December 31,	
	2006	2005
Land	\$ 343,098	\$ 314,719
Buildings and improvements	1,689,359	1,491,254
	2,032,457	1,805,973
Less: accumulated depreciation	(219,574)	(174,935)
	\$1,812,883	\$1,631,038

Projects we had under construction or development consisted of the following:

	December 31,	
	2006	2005
Land	\$ 153,436	\$ 117,434
Construction in progress	144,991	138,183
	\$ 298,427	\$ 255,617

2006 Acquisitions

We acquired the following office properties in 2006:

Project Name	Location	Date of Acquisition	Number of Buildings	Total Rentable Square Feet	Initial Cost
North Creek	Colorado Springs, CO	5/18/2006	3	324,549	\$ 41,508
1915 & 1925 Aerotech Drive	Colorado Springs, CO	6/8/2006	2	75,892	8,378
7125 Columbia Gateway Drive	Columbia, MD ⁽¹⁾	6/29/2006	1	611,379	74,168
			6	1,011,820	\$124,054

(1) Located in the Baltimore/Washington Corridor.

The table below sets forth the allocation of the acquisition costs of the properties described above:

	North Creek	1915 & 1925 Aerotech Drive	7125 Columbia Gateway Drive	Total
Land, operating properties	\$ 2,735	\$1,113	\$17,126	\$ 20,974
Building and improvements	34,161	6,161	46,964	87,286
Intangible assets on real estate acquisitions	5,694	1,235	11,959	18,888
Total assets	42,590	8,509	76,049	127,148
Deferred revenue associated with acquired operating leases	(1,082)	(131)	(1,881)	(3,094)
Total acquisition cost	\$41,508	\$8,378	\$74,168	\$124,054

We also acquired the following properties in 2006:

- a property located in Colorado Springs, Colorado containing a 74,749 square foot building that will be redeveloped and a four-acre parcel of land that we believe can support approximately 30,000 developable square feet for \$2,602 on January 19, 2006;
- a 31-acre parcel of land located in San Antonio, Texas that we believe can support approximately 375,000 developable square feet for \$7,430 on January 20, 2006;
- a six-acre parcel of land located in Hanover, Maryland that we believe can support approximately 60,000 developable square feet for \$2,141 on February 28, 2006 (Hanover, Maryland is located in the Baltimore/Washington Corridor);
- a 20-acre parcel of land located in Colorado Springs, Colorado that we believe can support approximately 300,000 developable square feet for \$1,060 on April 21, 2006;

- a 13-acre parcel of land located in Colorado Springs, Colorado that we believe can support approximately 150,000 developable square feet for \$2,263 on May 19, 2006;
- a 178-acre parcel of land located in Annapolis Junction, Maryland, located adjacent to the National Business Park, that we believe can support approximately 1.25 million developable square feet for \$26,833 on June 29, 2006 (Annapolis Junction, Maryland is located in the Baltimore/Washington Corridor);
- a five-acre parcel of land located in Columbia, Maryland that we believe can support approximately 120,000 developable square feet for \$3,361 on June 29, 2006;
- a 28-acre parcel of land located in Chesterfield, Virginia on September 15, 2006 that was acquired under the terms of a lease for a 193,000 square foot building that we are constructing on the property (Chesterfield, Virginia, which is located in Greater Richmond, Virginia, is included in our “other” business segment). The fair value of the land and closing costs associated with the title transfer totaled \$1,303; and
- approximately 500 acres of the 591-acre former Fort Ritchie United States Army base located in Cascade, Washington County, Maryland for a value of \$5,576 (Washington County, Maryland is included in our “other” business segment); we expect to acquire the remaining 91 acres in 2007. The 591-acre parcel is anticipated to accommodate a total of 1.7 million square feet of office space and 673 residential units, including approximately 306,000 square feet of existing office space and 110 existing rentable residential units.

In addition, we acquired the following properties through consolidated real estate joint ventures in 2006:

- a land parcel located in the Baltimore/Washington Corridor, with a value upon our acquisition of \$4,564, on February 10, 2006 through Commons Office 6-B, LLC, a 50% owned consolidated joint venture constructing an office property totaling approximately 44,000 square feet; and

- a 153-acre parcel of land located near the Indian Head Naval Surface War Center in Charles County, Maryland, with a value upon our acquisition of \$2,905, on October 23, 2006 through COPT-FD Indian Head, LLC, a 75% owned consolidated joint venture (Charles County, Maryland is included in our “other” business segment).

We describe these joint ventures further in Note 5.

2006 Construction and Development Activities

During 2006, we had seven properties totaling 866,000 square feet (four located in the Baltimore/Washington Corridor and one each in Northern Virginia, Colorado Springs, Colorado and St. Mary’s County, Maryland) become fully operational and had one property in the Baltimore/Washington Corridor become partially operational due to 68,196 square feet being placed into service.

As of December 31, 2006, we had construction underway on four new buildings in the Baltimore/Washington Corridor (including the partially operational property discussed above and one property owned through a 50% joint venture) and one each in Suburban Baltimore, Colorado Springs, Colorado, Chesterfield, Virginia and Southwest Virginia. We also had development activities underway on five new buildings located in the Baltimore/Washington Corridor (including one owned through a joint venture), two each in Suburban Maryland and Colorado Springs, Colorado (one of which we own a 50% undivided interest) and one each in Suburban Baltimore and King George County, Virginia. In addition, we had redevelopment underway on two wholly owned existing buildings (one is located in the Baltimore/Washington Corridor and one in Colorado Springs) and two buildings owned by a joint venture (one is located in Northern Virginia and one in the Baltimore/Washington Corridor).

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2006 Dispositions

We sold the following operating properties in 2006:

Project Name	Location	Date of Sale	Number of Buildings	Total Rentable Square Feet	Sale Price	Gain on Sale
Lakeview at the Greens	Laurel, MD ⁽¹⁾	2/6/2006	2	141,783	\$17,000	\$ 2,087
68 Culver Road	Dayton, NJ	3/8/2006	1	57,280	9,700	335
710 Route 46	Fairfield, NJ	7/26/2006	1	101,263	15,750	4,498
230 Schilling Circle	Hunt Valley, MD ⁽²⁾	8/9/2006	1	107,348	13,795	951
7 Centre Drive	Monroe, NJ	8/30/2006	1	19,468	3,000	684
Brown's Wharf	Baltimore, MD	9/28/2006	1	104,203	20,300	8,476
			7	531,345	\$79,545	\$17,031

(1) Located in the Suburban Maryland region.

(2) Located in the Suburban Baltimore region.

We also sold the following in 2006:

- A newly constructed property in Columbia, Maryland for \$2,530 on January 17, 2006. We recognized a gain of \$111 on this sale; and
- A two-acre parcel of land located in Linthicum Heights, Maryland for \$900 on September 7, 2006. We recognized a gain of \$165 on this sale.

2005 Acquisitions

We acquired the following office properties in 2005:

Project Name	Location	Date of Acquisition	Number of Buildings	Total Rentable Square Feet	Initial Cost
8611 Military Drive	San Antonio, TX	3/30/2005	2	468,994	\$ 30,845
Rockville Corporate Center	Rockville, MD ⁽¹⁾	4/7/2005	2	221,702	37,617
7175 Riverwood Drive	Columbia, MD ⁽²⁾	7/27/2005	1	26,500	2,456
Gateway Crossing 95	Columbia, MD ⁽²⁾	9/19/2005	5	188,819	26,060
Patriot Park I & II	Colorado Springs, CO	9/28/2005	2	135,907	17,949
1670 N. Newport Road	Colorado Springs, CO	9/30/2005	1	67,500	9,056
110 Thomas Johnson Drive	Frederick, MD ⁽¹⁾	10/21/2005	1	117,803	16,099
7015 Albert Einstein Drive	Columbia, MD ⁽²⁾	12/1/2005	1	61,203	9,428
Interquest 3 & 4	Colorado Springs, CO	12/22/2005	2	113,170	11,443
Hunt Valley/Rutherford portfolios	Hunt Valley/Woodlawn, MD ⁽³⁾	12/22/2005	21	1,106,866	123,988
			38	2,508,464	\$284,941

(1) Located in the Suburban Maryland region.

(2) Located in the Baltimore/Washington Corridor region.

(3) Located in the Suburban Baltimore region.

During 2005, we entered into a joint venture called COPT Opportunity Invest I, LLC in which we have a 92.5% ownership interest. This joint venture identifies and acquires properties to renovate into Class A office space and completes such renovations. We use the consolidation method of accounting to account for our investment in this entity. On December 20, 2005, we acquired the following properties through this joint venture:

- 2900 Towerview Road, located in Herndon, Virginia (which is in the Northern Virginia region), for an initial cost of \$12,372. The property includes a 61,000 square foot office building with an attached 79,000 square foot warehouse building that the joint venture plans to convert to office space. The property also includes an additional four-acre land parcel that can support the future development; and
- 7468 Candlewood Road, located in Columbia, Maryland (which is in the Baltimore/Washington Corridor), for an initial cost of \$19,222. The property includes a 472,000 square foot warehouse building that the joint venture plans to convert into two office buildings totaling 325,000 square feet.

The table below sets forth the allocation of the acquisition costs of the properties described above:

	8611 Military Drive	Rockville Corporate Center	7175 Riverwood Drive	Gateway Crossing 95	Patriot Park I & II	1670 N. Newport Road	110 Thomas Johnson Drive	7015 Albert Einstein Drive	9950 & Federal Drive	Hunt Valley/ Rutherford	2900 Towerview Road	7468 Candlewood Road	Total
Land, operating properties	\$11,007	\$ 6,222	\$1,788	\$ 5,533	\$ 1,303	\$ 851	\$ 2,810	\$2,054	\$ 1,572	\$ 18,715	\$ 3,207	\$ —	\$ 55,062
Land, construction or development	—	—	—	—	—	—	—	—	—	—	1,261	5,598	6,859
Building and improvements	19,838	28,925	763	17,582	14,333	6,989	12,075	6,084	8,913	87,933	4,467	—	207,902
Construction in progress	—	—	—	—	—	—	—	—	—	—	3,526	13,624	17,150
Intangible assets on real estate acquisitions	—	4,004	113	3,317	2,358	1,216	1,214	1,290	1,678	20,527	1,412	—	37,129
Total assets	30,845	39,151	2,664	26,432	17,994	9,056	16,099	9,428	12,163	127,175	13,873	19,222	324,102
Deferred revenue associated with acquired operating leases	—	(1,534)	(208)	(372)	(45)	—	—	—	(720)	(3,187)	(1,501)	—	(7,567)
Total acquisition cost	\$30,845	\$37,617	\$2,456	\$26,060	\$17,949	\$9,056	\$16,099	\$9,428	\$11,443	\$123,988	\$12,372	\$19,222	\$316,535

We also acquired the following in 2005:

- a 19-acre parcel of land located in Chantilly, Virginia that is adjacent to existing properties we own for \$7,141 on January 27, 2005 (Chantilly, Virginia is located in the Northern Virginia region). We expect to develop this land parcel in the future;
- a 32-acre parcel of land located in Dahlgren, Virginia that is adjacent to one of our office properties for \$1,227 on March 16, 2005 (Dahlgren, Virginia is located in the St. Mary's and King George Counties region). We expect to develop this land parcel in the future;
- a 16-acre parcel of land adjacent to 8611 Military Drive in San Antonio, Texas for \$3,013 on March 30, 2005. We expect to operate this land parcel as part of the campus that includes 8611 Military Drive;
- a 10-acre parcel of land adjacent to the Rockville Corporate Center for \$6,234 on April 7, 2005. We commenced development on a portion of this land parcel in 2006;
- a 27-acre parcel of land adjacent to 8611 Military Drive in San Antonio, Texas for \$5,893 on June 14, 2005. We expect to develop this land parcel in the future;
- a two-acre parcel of land located in Linthicum, Maryland that is adjacent to one of our office properties for \$735 on July 6, 2005;
- a 64-acre land parcel located in Colorado Springs, Colorado, five acres of which is undergoing construction of a 50,000 square foot, fully-leased building, for a purchase price of \$9,408 on July 8, 2005. We expect to develop this land parcel in the future;
- a four-acre parcel of land located in Columbia, Maryland that is adjacent to 7175 Riverwood Drive for \$1,367 on July 27, 2005. We commenced development on a portion of this land parcel in 2006;
- a 50% undivided interest in a 132-acre land parcel, subject to a cotenancy agreement, in Colorado Springs, Colorado for \$10,757 on September 28, 2005. We commenced development on a portion of this land parcel in 2006; and
- a six-acre parcel of land located in Frederick, Maryland that is adjacent to 110 Thomas Johnson Drive for \$1,092 on October 21, 2005. We commenced development on a portion of this land parcel in 2006.

In 2004, we sold a land parcel in Columbia, Maryland and a land parcel in Linthicum, Maryland for an aggregate of \$9,600. We issued to the buyer a \$5,600 mortgage loan; the balance of the acquisition was in the form of cash from the buyer. The buyer in this transaction had an option to contribute the two land parcels into our Operating Partnership between January 1, 2005 and February 28, 2005 in exchange for extinguishment of the \$5,600 mortgage loan with us and common units in

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our Operating Partnership; the buyer exercised its option in February 2005 and, as a result, on April 18, 2005, the debt from us was essentially extinguished and the buyer received 142,776 common units in the Operating Partnership valued at \$3,697. We accounted for the 2004 transaction using the financing method of accounting; as a result, the 2004 sale transaction was not recorded as a sale and the \$4,000 in net proceeds received from the buyer was recorded as a liability prior to the contribution of the land parcels back into the Operating Partnership in April 2005.

2005 Construction and Pre-Construction Activities

During 2005, we placed into service two buildings located in Annapolis Junction, Maryland and one in Columbia, Maryland.

As of December 31, 2005, we had construction underway on six new buildings in the Baltimore/Washington Corridor, one in Northern Virginia, one in St. Mary's County, Maryland and one in Colorado Springs, Colorado. We also had pre-construction activities underway on four new buildings located in the Baltimore/Washington Corridor, one in King George County, Virginia, and one in Colorado Springs, Colorado. We had redevelopment underway on (1) one wholly owned existing building in the Baltimore/Washington Corridor and (2) two buildings owned by a joint venture (one is located in Northern Virginia and the other in the Baltimore/Washington Corridor).

2005 Dispositions

On June 10, 2005, we sold a four-acre parcel of land located in Columbia, Maryland for \$2,571. We recognized a gain of \$186 on this sale.

On August 31, 2005, we sold a newly constructed property in Columbia, Maryland for \$4,794. We recognized a gain of \$82 on this sale.

On September 8, 2005, we sold three office properties totaling 152,731 square feet located in the Northern/Central New Jersey region for a total sale price of \$22,458. We recognized a total gain of \$4,324 on this sale.

On September 29, 2005, we contributed our portfolio of properties in Harrisburg, Pennsylvania, consisting of 16 office properties, one unimproved land parcel and an option to acquire a land parcel, into a real estate joint venture at a value of \$73,000. In exchange for our contribution, we received \$69,587 in cash (after closing costs and operating prorations) and a 20% interest in Harrisburg Corporate Gateway Partners, L.P. As part of this transaction, we entered into an agreement to manage the operations of the joint venture's properties for a five-year term. We did not recognize a gain on this transaction since we have certain contingent obligations that may exceed our proportionate interest remaining in effect as long as we continue to manage the properties; these contingent obligations are described below in Note 19.

5. REAL ESTATE JOINT VENTURES

Our investments in and advances to unconsolidated real estate joint ventures accounted for using the equity method of accounting included the following:

	Balance at December 31,		Date Acquired	Ownership	Nature of Activity	Total Assets at 12/31/2006	Maximum Exposure to Loss ⁽¹⁾
	2006	2005					
Harrisburg Corporate Gateway Partners, L.P.	\$(3,614) ⁽²⁾	\$(3,081) ⁽²⁾	9/29/2005	20%	Operates 16 buildings ⁽³⁾	\$75,895	\$—
Route 46 Partners	—	1,451 ⁽⁴⁾	3/14/2003	20%	Operates one building ⁽⁵⁾	\$ —	N/A

(1) Derived from the sum of our investment balance and maximum additional unilateral capital contributions or loans required from us. Not reported above are additional amounts that we and our partner are required to fund when needed by this joint venture; these funding requirements are proportional to our respective ownership percentages. Also not reported above are additional unilateral contributions or loans from us, the amounts of which are uncertain, that would be due if certain contingent events occurred.

(2) The carrying amount of our investment in this joint venture is lower than our share of the equity in the joint venture by \$5,072 at December 31, 2006 and \$5,204 at December 31, 2005 due to our deferral of gain on the contribution by us of real estate into the joint venture upon its formation. This difference will continue to exist to the extent the nature of our continuing involvement in the joint venture does not change.

(3) This joint venture's property is located in Greater Harrisburg, Pennsylvania.

(4) As discussed further below, the joint venture sold the property on July 26, 2006, after which the joint venture was dissolved. The carrying amount of our investment in this joint venture was lower than our share of the equity in the joint venture by \$1,370 at December 31, 2005 due to our deferral of gain on the contribution by us of real estate into the joint venture upon its formation.

(5) This joint venture's property was located in Fairfield, New Jersey.

On July 26, 2006, Route 46 Partners sold its property for \$27,000. After the sale, the joint venture was dissolved. We recognized a gain of \$563 on the disposition of our joint venture interest.

A two-member management committee is responsible for making major decisions (as defined in the joint venture agreement) for Harrisburg Corporate Gateway Partners, L.P., and we control one of its management committee positions. We have additional commitments pertaining to our real estate joint venture that are disclosed in Note 19.

The following table sets forth a combined condensed balance sheet for our unconsolidated joint ventures:

	December 31,	
	2006	2005
Commercial real estate property	\$72,688	\$ 94,552
Other assets	3,207	8,006
Total assets	\$75,895	\$102,558
Liabilities	\$67,350	\$ 82,550
Owners' equity	8,545	20,008
Total liabilities and owners' equity	\$75,895	\$102,558

The following table sets forth a combined condensed statement of operations for Harrisburg Corporate Gateway Partners, L.P. and Route 46 Partners:

	For the Years Ended December 31,		
	2006	2005	2004
Revenues	\$11,521	\$ 5,850	\$ 3,054
Property operating expenses	(4,067)	(2,351)	(1,461)
Interest expense	(4,224)	(1,843)	(847)
Depreciation and amortization expense	(4,464)	(1,490)	(514)
Gain on sale	4,032	—	—
Net income	\$ 2,798	\$ 166	\$ 232

The table above includes net income from Route 46 Partners of \$3,501 for 2006, the year in which it was dissolved. Our joint venture partner in Route 46 Partners had preference in receiving distributions of cash flows for a defined return. We were not entitled to receive distributions for a defined return until our partner received its defined return. We did not recognize income from our investment in Route 46 Partners in 2004, 2005 and 2006 until the dissolution of the entity since the income earned by the entity in those periods did not exceed our partner's defined return until that point in time. Upon dissolution of the entity, we recognized income from our investment of \$60, excluding the \$563 gain on disposition of the joint venture interest discussed above.

As described in Note 4, we acquired the following interests in consolidated real estate joint ventures in 2005 and 2006:

- a 92.5% interest in COPT Opportunity Invest I, LLC. This joint venture identifies and acquires properties to renovate into Class A office space and complete such renovations. On December 20, 2005, we acquired two properties through this joint venture;
- a 50% interest in Commons Office 6-B, LLC. On February 10, 2006, this entity acquired a land parcel located in Hanover, Maryland, on which an office property totaling approximately 44,000 square feet is under construction; and
- a 75% interest in COPT-FD Indian Head, LLC. This entity acquired a 153-acre land parcel located near the Indian Head Naval Surface War Center in Charles County, Maryland on October 23, 2006.

The table below sets forth information pertaining to our investments in consolidated joint ventures at December 31, 2006:

	Date Acquired	Ownership % at 12/31/2006	Nature of Activity	Total Assets at 12/31/2006	Collateralized Assets at 12/31/2006
COPT Opportunity Invest I, LLC	12/20/2005	92.5%	Redeveloping two properties ⁽¹⁾	\$41,696	\$ —
Commons Office 6-B, LLC	2/10/2006	50.0%	Developing land parcel ⁽²⁾	7,287	7,287
MOR Forbes 2 LLC	12/24/2002	50.0%	Developing land parcel ⁽³⁾	4,155	3,734
COPT-FD Indian Head, LLC	10/23/2006	75.0%	Developing land parcel ⁽⁴⁾	2,969	—
				\$56,107	\$11,021

(1) This joint venture owns one property in the Northern Virginia region and one in the Baltimore/Washington Corridor region.

(2) This joint venture's property is located in Hanover, Maryland (located in the Baltimore/Washington Corridor region).

(3) This joint venture's property is located in Lanham, Maryland (located in the Suburban Maryland region).

(4) This joint venture's property is located in Charles County, Maryland (included in our "other" business segment).

Our commitments and contingencies pertaining to our real estate joint ventures are disclosed in Note 19.

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6. INTANGIBLE ASSETS ON REAL ESTATE ACQUISITIONS

Intangible assets on real estate acquisitions consisted of the following:

	December 31, 2006			December 31, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Lease-up value	\$105,719	\$38,279	\$67,440	\$ 92,812	\$20,824	\$71,988
Lease cost portion of deemed cost avoidance	12,880	5,819	7,061	11,054	3,991	7,063
Lease to market value	10,623	7,178	3,445	9,772	5,277	4,495
Tenant relationship value	9,371	1,178	8,193	6,349	130	6,219
Market concentration premium	1,333	147	1,186	1,333	114	1,219
	\$139,926	\$52,601	\$87,325	\$121,320	\$30,336	\$90,984

Amortization of the intangible asset categories set forth above totaled \$20,675 in 2006, \$12,525 in 2005 and \$9,739 in 2004. The approximate weighted average amortization periods of the categories set forth below follow: lease-up value: 11 years; lease cost portion of deemed cost avoidance: six years; lease to market value: five years; tenant relationship value: nine years; and market concentration premium: 36 years. The approximate weighted average amortization period for all of the categories combined is 10 years. Estimated amortization expense associated with the intangible asset categories set forth above for 2007 is \$14.3 million, 2008 is \$12.7 million, 2009 is \$11.4 million, 2010 is \$8.4 million and 2011 is \$6.6 million.

7. DEFERRED CHARGES

Deferred charges consisted of the following:

	December 31,	
	2006	2005
Deferred leasing costs	\$ 52,263	\$ 42,752
Deferred financing costs	28,275	21,574
Goodwill	1,853	1,853
Deferred other	155	155
	82,546	66,334
Accumulated amortization	(38,836)	(31,288)
Deferred charges, net	\$ 43,710	\$ 35,046

8. PREPAID AND OTHER ASSETS

Prepaid and other assets consisted of the following:

	December 31,	
	2006	2005
Construction contract costs incurred in excess of billings	\$18,324	\$15,277
Furniture, fixtures and equipment	10,495	4,302
Prepaid expenses	9,059	7,007
Other assets	10,589	8,592
Prepaid and other assets	\$48,467	\$35,178

9. DEBT

Our debt consisted of the following:

	Maximum Principal Amount Under Debt at December 31, 2006	Carrying Value at December 31,		Stated Interest Rates at December 31, 2006	Scheduled Maturity Dates at December 31, 2006
		2006	2005		
Mortgage and other loans payable:					
Revolving Credit Facility					
Wachovia Bank, N.A. Revolving Credit Facility	\$500,000	\$ 185,000	\$ 273,000	LIBOR + 1.15% to 1.55%	March 2008 ⁽¹⁾
Mortgage Loans					
Fixed rate mortgage loans ⁽²⁾	N/A	1,020,619	921,265	3.00%–9.48% ⁽³⁾	2007–2034 ⁽⁴⁾
Variable rate construction loan facilities	72,207	56,079	70,238	LIBOR + 1.40% to 2.20%	2007–2008 ⁽⁵⁾
Other variable rate mortgage loans	N/A	34,500	82,800	LIBOR + 1.20% to 1.50%	September 2007 ⁽⁶⁾
Total mortgage loans		\$1,111,198	1,074,303		
Note Payable					
Unsecured seller notes	N/A	2,339	1,048	0%–5.95%	2007–2008
Total mortgage and other loans payable		1,298,537	1,348,351		
3.5% Exchangeable Senior Notes	N/A	200,000	—	3.50%	September 2026 ⁽⁷⁾
Total debt		\$1,498,537	\$1,348,351		

(1) The Revolving Credit Facility may be extended for a one-year period, subject to certain conditions.

(2) Several of the fixed rate mortgages carry interest rates that were above or below market rates upon assumption and therefore are recorded at their fair value based on applicable effective interest rates. The carrying values of these loans reflect net premiums totaling \$210 at December 31, 2006 and \$1,391 at December 31, 2005.

(3) The weighted average interest rate on these loans was 5.6% at December 31, 2006.

(4) A loan with a balance of \$4,893 at December 31, 2006 that matures in 2034 may be repaid in March 2014, subject to certain conditions.

(5) At December 31, 2006, \$33,447 in loans scheduled to mature in 2008 may be extended for a one-year period, subject to certain conditions.

(6) At December 31, 2006, the \$34,500 loan scheduled to mature in 2007 may be extended for a one-year period, subject to certain conditions.

(7) Refer to the paragraph below for descriptions of provisions for early redemption and repurchase of these notes.

On September 18, 2006, the Operating Partnership issued a \$200,000 aggregate principal amount of 3.50% Exchangeable Senior Notes due 2026. Interest on the notes is payable on March 15 and September 15 of each year. The notes have an exchange settlement feature that provides that the notes may,

under certain circumstances, be exchangeable for cash (up to the principal amount of the notes) and, with respect to any excess exchange value, may be exchangeable into (at our option) cash, our common shares or a combination of cash and our common shares at an exchange rate (subject to adjustment)

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of 18.4284 shares per \$1,000 principal amount of the notes (exchange rate is as of December 31, 2006 and is equivalent to an exchange price of \$54.30 per common share). On or after September 20, 2011, the Operating Partnership may redeem the notes in cash in whole or in part. The holders of the notes have the right to require us to repurchase the notes in cash in whole or in part on each of September 15, 2011, September 15, 2016 and September 15, 2021, or in the event of a “fundamental change,” as defined under the terms of the notes, for a repurchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest. Prior to September 11, 2011, subject to certain exceptions, if (1) a “fundamental change” occurs as a result of certain forms of transactions or series of transactions and (2) a holder elects to exchange its notes in connection with such “fundamental change,” we will increase the applicable exchange rate for the notes surrendered for exchange by a number of additional shares of our common shares as a “make whole premium.” The notes are general unsecured senior obligations of the Operating Partnership and rank equally in right of payment with all other senior unsecured indebtedness of the Operating Partnership. The Operating Partnership’s obligations under the notes are fully and unconditionally guaranteed by us.

In the case of each of our mortgage loans, we have pledged certain of our real estate assets as collateral. As of December 31, 2006, a majority of our real estate properties were collateralized on loan obligations or, in the case of our Revolving Credit Facility with Wachovia Bank, National Association (the “Revolving Credit Facility”), identified by us to support repayment of the loan. Certain of our debt instruments require that we comply with a number of restrictive financial covenants, including adjusted consolidated net worth, minimum property interest coverage, minimum property hedged interest coverage, minimum consolidated interest coverage, maximum consolidated unhedged floating rate debt and maximum consolidated total indebtedness. As of December 31, 2006, we were in compliance with these financial covenants.

Our debt matures on the following schedule:

2007	\$ 140,950
2008	375,208
2009	61,791
2010	73,128
2011	108,854
Thereafter	738,396
Total	<u>\$1,498,327⁽¹⁾</u>

(1) Represents principal maturities only and therefore excludes net premiums of \$210.

We estimate that the fair value of our debt was \$1,510,698 at December 31, 2006 and \$1,345,789 at December 31, 2005.

Weighted average borrowings under our Revolving Credit Facility totaled \$290,660 in 2006 and \$272,267 in 2005. The weighted average interest rate on this credit facility was 6.42% in 2006 and 4.62% in 2005.

On June 24, 2005, we amended our Revolving Credit Facility. Under the amendment, the maximum principal amount was increased from \$300,000 to \$400,000, with a right to further increase the maximum principal amount in the future to \$600,000, subject to certain conditions. In addition, the scheduled maturity date was extended for one year to March 2008, with a one-year extension available, subject to certain conditions. On July 3, 2006, we exercised our right to increase the borrowing capacity under our Revolving Credit Facility from \$400,000 to \$500,000. The borrowing capacity under the Revolving Credit Facility is generally computed based on 65% of the value of assets identified by us to support repayment of the loan. As of December 31, 2006, the maximum amount of borrowing capacity under this line of credit totaled \$431,500, of which \$245,500 was available.

We capitalized interest costs of \$14,559 in 2006, \$9,871 in 2005 and \$5,112 in 2004.

10. DERIVATIVES

The following table sets forth our derivative contracts and their respective fair values:

Nature of Derivative	Notional Amount	One-Month LIBOR Base	Effective Date	Expiration Date	Fair Value at December 31,	
					2006	2005
Interest rate swap	\$50,000	5.0360%	3/28/2006	3/30/2009	\$ (42)	N/A
Interest rate swap	25,000	5.2320%	5/1/2006	5/1/2009	(133)	N/A
Interest rate swap	25,000	5.2320%	5/1/2006	5/1/2009	(133)	N/A
Forward starting swap	73,400	5.0244%	7/15/2005	N/A	N/A	N/A
					<u>\$ (308)</u>	<u>\$—</u>

We designated these derivatives as cash flow hedges. The first three contracts set forth above hedge the risk of changes in interest rates on certain of our one-month LIBOR-based variable rate borrowings until their respective maturities. The last contract set forth above represents a forward starting swap into which we entered to lock in the 10-year LIBOR swap rate in contemplation of our obtaining a long-term, fixed rate financing later in 2005. We obtained this long-term financing in October 2005 and cash settled the swap at that time for a payment of \$603. This payment represented the present value of the basis point differential between 5.0244% and the 10-year LIBOR swap rate at the time we cash settled the swap, plus accrued interest.

The table below sets forth our accounting application of changes in derivative fair values:

	For the Years Ended December 31,		
	2006	2005	2004
(Decrease) increase in fair value applied to AOCL ⁽¹⁾ and minority interests	\$(308)	\$—	\$390
Increase in fair value recognized as gain ⁽²⁾	—	—	77

(1) AOCL is defined in Note 2.

(2) Included in interest expense on our Consolidated Statements of Operations.

The \$603 discussed above that we paid to cash settle the forward starting swap was recorded to AOCL and will be amortized into interest expense over the 10-year term of the loan it was hedging.

11. SHAREHOLDERS' EQUITY

Preferred Shares

Preferred shares of beneficial interest ("preferred shares") consisted of the following:

	December 31,	
	2006	2005
1,265,000 designated as Series E Cumulative Redeemable Preferred Shares of beneficial interest (1,150,000 shares issued with an aggregate liquidation preference of \$28,750)	\$—	\$11
1,425,000 designated as Series F Cumulative Redeemable Preferred Shares of beneficial interest (1,425,000 shares issued with an aggregate liquidation preference of \$35,625)	—	14
2,200,000 designated as Series G Cumulative Redeemable Preferred Shares of beneficial interest (2,200,000 shares issued with an aggregate liquidation preference of \$55,000)	22	22
2,000,000 designated as Series H Cumulative Redeemable Preferred Shares of beneficial interest (2,000,000 shares issued with an aggregate liquidation preference of \$50,000)	20	20
3,390,000 designated as Series J Cumulative Redeemable Preferred Shares of beneficial interest (3,390,000 shares issued with an aggregate liquidation preference of \$84,750)	34	—
Total preferred shares	\$76	\$67

Set forth below is a summary of additional information pertaining to our preferred shares of beneficial interest:

Series of Preferred Shares of Beneficial Interest	# of Shares Issued	Month of Issuance	Annual Dividend Yield ⁽¹⁾	Annual Dividend per Share	Earliest Redemption Date
Series E	1,150,000	April 2001	10.250%	2.56250	NA ⁽²⁾
Series F	1,425,000	September 2001	9.875%	2.46875	NA ⁽³⁾
Series G	2,200,000	August 2003	8.000%	2.00000	8/11/2008
Series H	2,000,000	December 2003	7.500%	1.87500	12/18/2008
Series J	3,390,000	July 2006	7.625%	1.90625	7/20/2011

(1) Yield computed based on \$25 per share redemption price.

(2) All outstanding Series E Preferred Shares were redeemed on July 15, 2006.

(3) All outstanding Series F Preferred Shares were redeemed on October 15, 2006.

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(Dollars in thousands, except per share data)

All of the classes of preferred shares set forth in the table above are nonvoting and redeemable for cash at \$25.00 per share at our option on or after the earliest redemption date. Holders of these shares are entitled to cumulative dividends, payable quarterly (as and if declared by the Board of Trustees). In the case of each series of preferred shares, there is a series of preferred units in the Operating Partnership owned by us that carries substantially the same terms.

On July 15, 2006, we redeemed all of the outstanding 10.25% Series E Cumulative Redeemable Preferred Shares of beneficial interest (the "Series E Preferred Shares") at a price of \$25 per share, or \$28,750. On October 15, 2006, we redeemed all of the outstanding Series F Cumulative Redeemable Preferred Shares of beneficial interest (the "Series F Preferred Shares") at a price of \$25 per share, or \$35,625. We recognized a \$3,896 decrease to net income available to common shareholders pertaining to the original issuance costs incurred on the Series E and Series F Preferred Shares at the time of the redemption.

On July 20, 2006, we completed the sale of 3.39 million Series J Cumulative Redeemable Preferred Shares (the "Series J Preferred Shares") at a price of \$25.00 per share. We contributed the net proceeds after offering costs totaling \$81,857 to our Operating Partnership in exchange for 3.39 million Series J Preferred Units. The Series J Preferred Units carry terms that are substantially the same as the Series J Preferred Shares.

Common Shares

In September 2005, we sold 2.3 million common shares to an underwriter at a net price of \$32.76 per share. We contributed the net proceeds after offering costs totaling \$75,170 to our Operating Partnership in exchange for 2.3 million common units.

In April 2006, we sold 2.0 million common shares to an underwriter at a net price of \$41.31 per share. We contributed the net proceeds after offering costs totaling \$82,433 to our Operating Partnership in exchange for 2.0 million common units.

Over the three years ended December 31, 2006, common units in our Operating Partnership were converted into common shares on the basis of one common share for each common unit in the amount of 245,793 in 2006, 253,575 in 2005 and 326,108 in 2004.

See Note 12 for disclosure of common share activity pertaining to our share-based compensation plans.

Accumulated Other Comprehensive Loss

The table below sets forth activity in the accumulated other comprehensive loss component of shareholders' equity:

	For the Years Ended December 31,		
	2006	2005	2004
Beginning balance	\$ (482)	\$ —	\$ (294)
Unrealized (loss) gain on derivatives, net of minority interests	(262)	(482)	294
Realized loss on derivatives, net of minority interests	51	—	—
Ending balance	\$ (693)	\$ (482)	\$ —

The table below sets forth our comprehensive income:

	For the Years Ended December 31,		
	2006	2005	2004
Net income	\$49,227	\$39,031	\$37,032
Unrealized (loss) gain on derivatives, net of minority interests	(262)	(482)	294
Realized loss on derivatives, net of minority interests	51	—	—
Total comprehensive income	\$49,016	\$38,549	\$37,326

12. SHARE-BASED COMPENSATION AND EMPLOYEE BENEFIT PLANS

Share-based Compensation Plans

In 1993, we adopted a share option plan for our Trustees under which we have 75,000 common shares reserved for issuance. These options expire ten years after the date of grant and are all exercisable. Shares for this plan are issued under a registration statement on Form S-8 that became effective upon filing with the Securities and Exchange Commission. As of December 31, 2006, there were no awards available for future grant under this plan.

In March 1998, we adopted a long-term incentive plan for our Trustees and employees. This plan provides for the award of options to acquire our common shares ("share options"), common shares subject to forfeiture restrictions ("restricted shares") and dividend equivalents. We are authorized to issue awards under the plan amounting to no more than 13% of the total of (1) our common shares outstanding plus (2) the number of shares that would be outstanding upon redemption

of all units of the Operating Partnership or other securities that are convertible into our common shares. Trustee options under this plan become exercisable beginning on the first anniversary of their grant. The vesting periods for employees' options under this plan range from immediately to five years, although they generally are three years. Options expire ten years after the date of grant. Restricted shares generally vest annually in the following increments: 16% upon the first

anniversary following the date of grant, 18% upon the second anniversary, 20% upon the third anniversary, 22% upon the fourth anniversary and 24% upon the fifth anniversary. Shares for this plan are issued under a registration statement on Form S-8 that became effective upon filing with the Securities and Exchange Commission. As of December 31, 2006, we had 711,844 awards available for future grant under this plan.

The following table summarizes share option transactions under the plans described above:

	Shares	Range of Exercise Price per Share	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2003	3,202,026	\$5.25–\$14.30	\$10.03		
Granted—2004	290,450	\$15.93–\$28.69	\$22.30		
Forfeited/Expired—2004	(20,994)	\$8.63–\$25.05	\$17.81		
Exercised—2004	(784,398)	\$5.63–\$17.25	\$ 9.57		
Outstanding at December 31, 2004	2,687,084	\$5.38–\$28.69	\$11.43		
Granted—2005	521,588	\$25.52–\$36.08	\$28.38		
Forfeited/Expired—2005	(87,665)	\$10.00–\$34.89	\$23.60		
Exercised—2005	(411,080)	\$5.38–\$25.05	\$10.70		
Outstanding at December 31, 2005	2,709,927	\$5.63–\$36.08	\$14.41		
Granted—2006	503,800	\$36.24–\$50.59	\$42.84		
Forfeited/Expired—2006	(68,107)	\$13.60–\$47.79	\$33.43		
Exercised—2006	(589,101)	\$5.63–\$34.76	\$11.49		
Outstanding at December 31, 2006	2,556,519	\$7.38–\$50.59	\$20.18	6	\$77,447
Exercisable at December 31, 2004	1,617,080	(1)	\$10.26		
Exercisable at December 31, 2005	2,054,919	(2)	\$10.58		
Exercisable at December 31, 2006	1,753,428	(3)	\$12.65	4	\$66,318
Options expected to vest	762,936	\$20.34–\$50.59	\$36.61	9	\$10,573

(1) 312,650 of these options had an exercise price ranging from \$5.38 to \$7.99; 704,238 had an exercise price ranging from \$8.00 to \$10.99; and 600,192 had an exercise price ranging from \$11.00 to \$18.08.

(2) 486,250 of these options had an exercise price ranging from \$5.63 to \$7.99; 854,027 had an exercise price ranging from \$8.00 to \$10.99; 590,104 had an exercise price ranging from \$11.00 to \$16.99; and 124,538 had an exercise price ranging from \$17.00 to \$28.69.

(3) 234,082 of these options had an exercise price ranging from \$7.38 to \$7.99, 754,068 had an exercise price ranging from \$8.00 to \$10.99, 456,732 had an exercise price ranging from \$11.00 to \$16.99, 198,241 had an exercise price ranging from \$17.00 to \$25.99 and 110,305 had an exercise price range of \$26.00 to \$36.08.

The total intrinsic value of options exercised was \$19,748 in 2006, \$8,366 in 2005 and \$11,578 in 2004.

We received proceeds from the exercise of share options of \$6,767 in 2006, \$4,398 in 2005 and \$7,510 in 2004.

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(Dollars in thousands, except per share data)

We computed share-based compensation expense under the fair value method using the Black-Scholes option-pricing model; the weighted average assumptions we used in that model are set forth below:

	For the Years Ended December 31,		
	2006	2005	2004
Weighted average fair value of grants on grant date	\$8.99	\$2.82	\$2.18
Risk-free interest rate	4.91% ⁽¹⁾	3.97%	3.15%
Expected life-years	6.82	6.00	4.21
Expected volatility	23.69% ⁽²⁾	22.70%	22.89%
Expected dividend yield	3.82% ⁽³⁾	6.90%	7.60%

(1) Ranged from 4.38% to 5.30%.

(2) Ranged from 22.37% to 25.11%.

(3) Ranged from 3.36% to 4.25%.

A summary of the weighted average grant-date fair value per option granted is as follows:

	For the Years Ended December 31,		
	2006	2005	2004
Weighted average grant-date fair value	\$8.99	\$2.82	\$2.18
Weighted average grant-date fair value-exercise price equals market price on grant-date	\$8.99	\$2.83	\$2.15
Weighted average grant-date fair value-exercise price exceeds market price on grant-date	N/A	\$2.51	\$1.65
Weighted average grant-date fair value-exercise price less than market price on grant-date	N/A	N/A	\$2.24

The weighted average grant-date fair value of option issuances increased significantly in 2006 over previous years due in large part to a large decrease in the weighted average dividend yield assumption from 2006 to 2005. We derive our dividend yield assumption from the average historical dividend yield on our common shares over a period of time ending on the grant-date of options. Prior to 2006, we used a longer historical time frame for purposes of estimating our dividend yield assumption. In response to the trading price for our common shares having increased significantly in recent years, which has had a decreasing effect on our dividend yield, we concluded that the use of a shorter historical time frame for estimating the dividend yield assumption was appropriate.

The following table summarizes restricted share transactions under the plans described above for 2006:

	Shares	Weighted Average Grant Date Fair Value
Unvested at December 31, 2005	395,609	\$19.88
Granted	163,420	\$42.65
Forfeited	(20,822)	\$23.67
Vested	(124,517)	\$17.16
Unvested at December 31, 2006	413,690	\$29.51
Restricted shares expected to vest	395,662	

The total fair value of restricted shares that vested during the year ended December 31, 2006 was \$5,319.

We realized a windfall tax benefit of \$562 in 2006 on options exercised and restricted shares vested by employees of our subsidiaries that are subject to income tax.

The table below sets forth information relating to expenses from share-based compensation included in our Consolidated Statements of Operations for 2006:

	For the Year Ended December 31, 2006
Increase in general and administrative expenses	\$2,659
Increase in construction contract and other service operations expenses	964
Share-based compensation expense	3,623
Income taxes	(107)
Minority interests	(617)
Net share-based compensation expense	\$2,899
Net share-based compensation expense per share	
Basic	\$ 0.07
Diluted	\$ 0.07

We also capitalized share-based compensation costs of approximately \$212 in 2006.

As of December 31, 2006, there was \$3,769 of unrecognized compensation cost related to nonvested options that is expected to be recognized over a weighted average period of approximately two years. As of December 31, 2006, there was \$8,571 of unrecognized compensation cost related to unvested restricted shares that is expected to be recognized over a weighted average period of approximately three years.

Disclosure for Periods Prior to 2006, Including Pro Forma Financial Information Under SFAS 123

Expenses from share-based compensation reflected in our Consolidated Statements of Operations for the year ended December 31, 2005 and 2004 were as follows:

	For the Years Ended December 31,	
	2005	2004
Increase in general and administrative expenses	\$ 1,903	\$ 1,579
Increase in construction contract and other service operations expenses	230	552

The following table summarizes our operating results for the years ended December 31, 2005 and 2004 as if we elected to account for our share-based compensation under the fair value provisions of SFAS 123 in those periods:

	For the Years Ended December 31,	
	2005	2004
Net income, as reported	\$39,031	\$37,032
Add: Share-based compensation expense, net of related tax effects and minority interests, included in the determination of net income	1,670	1,824
Less: Share-based compensation expense determined under the fair value based method, net of related tax effects and minority interests	(1,671)	(1,500)
Net income, pro forma	\$39,030	\$37,356
Basic EPS on net income available to common shareholders, as reported	\$ 0.65	\$ 0.57
Basic EPS on net income available to common shareholders, pro forma	\$ 0.65	\$ 0.58
Diluted EPS on net income available to common shareholders, as reported	\$ 0.63	\$ 0.54
Diluted EPS on net income available to common shareholders, pro forma	\$ 0.63	\$ 0.55

401(k) Plan

We have a 401(k) defined contribution plan covering substantially all of our employees that permits participants to defer up to a maximum of 15% of their compensation. We match a participant's contribution in an amount equal to 50% of the participant's elective deferral for the plan year up to a maximum of 6% of a participant's annual compensation. Employees' contributions are fully vested and our matching contributions vest in annual one-third increments. Once an employee has been with us for three years, all matching contributions are fully vested. We fund all contributions with cash. Our matching contributions under the plan totaled approximately \$538 in

2006, \$396 in 2005 and \$323 in 2004. The 401(k) plan is fully funded at December 31, 2006.

Deferred Compensation Plan

We have a non-qualified elective deferred compensation plan for certain members of our management team that permits participants to defer up to 100% of their compensation on a pre-tax basis and receive a tax-deferred return on such deferrals. We match the participant's contribution in an amount equal to 50% of the participant's elective deferral for the plan year up to a maximum of 6% of a participant's annual compensation after deducting contributions, if any, made under our 401(k) plan. Deferred compensation related to an employee contribution is charged to expense and is fully vested. Deferred compensation related to the Company's matching contribution is charged to expense and vests in annual one-third increments. Once an employee has been with us for three years, all matching contributions are fully vested. The balance of the plan, which was fully funded, totaled \$5,195 at December 31, 2006 and \$4,166 at December 31, 2005, and is included in the accompanying Consolidated Balance Sheets.

13. RELATED PARTY TRANSACTIONS

We earned fees from unconsolidated joint ventures totaling \$619 in 2006, \$326 in 2005 and \$219 in 2004. These fees were for property management, construction and leasing services performed.

14. OPERATING LEASES

We lease our properties to tenants under operating leases with various expiration dates extending to the year 2025. Gross minimum future rentals on noncancelable leases in our consolidated properties at December 31, 2006 were as follows:

For the Years Ended December 31,	
2007	\$ 243,062
2008	211,470
2009	193,638
2010	155,790
2011	123,461
Thereafter	445,738
Total	\$1,373,159

We consider a lease to be noncancelable when a tenant (1) may not terminate its lease obligation early or (2) may terminate its lease obligation early in exchange for a fee or penalty that we consider material enough such that termination would be highly unlikely.

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15. SUPPLEMENTAL INFORMATION TO STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2006	2005	2004
Interest paid, net of capitalized interest	\$68,617	\$57,100	\$ 43,717
Income taxes paid	\$ 54	\$ —	\$ —
Supplemental schedule of non-cash investing and financing activities:			
Consolidation of real estate joint ventures in connection with adoption of FASB Interpretation FIN 46(R), “Consolidation of Variable Interest Entities”:			
Operating properties	\$ —	\$ —	\$ 2,176
Projects under construction or development	—	—	17,959
Investments in and advances to unconsolidated real estate joint ventures	—	—	(3,957)
Restricted cash	—	—	10
Accounts receivable, net	—	—	145
Deferred rent receivable	—	—	7
Deferred charges, net	—	—	1,026
Prepaid and other assets	—	—	(3,263)
Mortgage and other loans payable	—	—	(10,171)
Accounts payable and accrued expenses	—	—	(2,737)
Rents received in advance and security deposits	—	—	(347)
Other liabilities	—	—	4,650
Minority interests—other consolidated real estate entities	—	—	(5,498)
Net adjustment	\$ —	\$ —	\$ —
Adjustment to purchase of commercial real estate properties by acquiring joint venture interests:			
Operating properties	\$ —	\$ —	\$ (83)
Investments in and advances to unconsolidated real estate joint ventures	—	—	83
Net adjustment	\$ —	\$ —	\$ —
Debt assumed in connection with acquisitions	\$39,011	\$17,347	\$120,817
Property acquired through lease arrangement included in rents received in advance and security deposits	\$ 1,282	\$ —	\$ —
Proceeds from sales of properties invested in restricted cash account	\$33,730	\$ —	\$ —
Increase (decrease) in accrued capital improvements and leasing costs	\$18,181	\$ (9,349)	\$ 17,234
Amortization of discounts and premiums on mortgage loans to commercial real estate properties	\$ 196	\$ 273	\$ 925
Accretion of other liability to commercial real estate properties	\$ —	\$ —	\$ 147
(Decrease) increase in fair value of derivatives applied to AOCL and minority interests	\$ (308)	\$ —	\$ 390
Issuance of common units in the Operating Partnership in connection with contribution of properties accounted for under the financing method of accounting	\$ —	\$ 3,687	\$ —
Issuance of common units in the Operating Partnership in connection with acquisition of properties	\$ 7,497	\$ 2,647	\$ —
Issuance of preferred units in the Operating Partnership in connection with acquisition of properties	\$ —	\$ —	\$ 8,800
Adjustments to minority interests resulting from changes in ownership of Operating Partnership by COPT	\$16,255	\$12,888	\$ 19,360
Dividends/distribution payable	\$19,164	\$16,703	\$ 14,713
Decrease in minority interests and increase in shareholders’ equity in connection with the conversion of common units into common shares	\$11,078	\$ 9,120	\$ 8,041
Conversion of preferred shares adjusted to common shares and paid in capital	\$ —	\$ —	\$ 12
Issuance of restricted shares	\$ —	\$ 3,276	\$ 2,271

16. INFORMATION BY BUSINESS SEGMENT

As of December 31, 2006, we had nine primary office property segments: Baltimore/Washington Corridor; Northern Virginia; Suburban Baltimore; Colorado Springs, Colorado; Suburban Maryland; Greater Philadelphia; St. Mary's and King George Counties; San Antonio, Texas; and Northern/Central New Jersey. We also had an office property segment in Greater Harrisburg, Pennsylvania prior to the contribution of our properties in that region into a real estate joint venture in exchange for cash and a 20% interest in such joint venture on September 29, 2005.

The table below reports segment financial information. Our segment entitled "Other" includes assets and operations not specifically associated with the other defined segments, including corporate assets, investments in unconsolidated entities and elimination entries required in consolidation. We measure the performance of our segments based on total revenues less property operating expenses, a measure we define as net operating income ("NOI"). We believe that NOI is an important supplemental measure of operating performance for a REIT's operating real estate because it provides a measure of the core operations that is unaffected by depreciation, amortization, financing and general and administrative expenses; this measure is particularly useful in our opinion in evaluating the performance of geographic segments, same-office property groupings and individual properties.

	Baltimore/ Washington Corridor	Northern Virginia	Suburban Baltimore	Colorado Springs	Suburban Maryland	Greater Philadelphia	St. Mary's & King George Counties	San Antonio	Northern/ Central New Jersey	Greater Harrisburg	Other	Total
Year Ended												
December 31, 2006												
Revenues	\$ 147,648	\$ 63,515	\$ 28,570	\$ 9,776	\$ 15,316	\$ 10,025	\$ 12,087	\$ 7,441	\$ 12,295	\$ (6)	\$ (875)	\$ 305,792
Property operating expenses	45,667	22,727	11,889	3,659	5,710	168	3,116	1,533	3,311	(49)	(1,698)	96,033
NOI	\$ 101,981	\$ 40,788	\$ 16,681	\$ 6,117	\$ 9,606	\$ 9,857	\$ 8,971	\$ 5,908	\$ 8,984	\$ 43	\$ 823	\$ 209,759
Additions to commercial												
real estate properties	\$ 190,038	\$ 21,638	\$ 6,206	\$ 66,628	\$ 4,664	\$ 1,202	\$ 1,823	\$ 8,814	\$ 1,398	\$ 5	\$ 37,746	\$ 340,162
Segment assets at												
December 31, 2006	\$ 1,081,356	\$ 473,540	\$ 162,786	\$ 135,118	\$ 117,573	\$ 97,795	\$ 97,661	\$ 52,661	\$ 48,499	\$ —	\$ 152,612	\$ 2,419,601
Year Ended												
December 31, 2005												
Revenues	\$ 123,819	\$ 60,255	\$ 11,099	\$ 1,006	\$ 12,555	\$ 10,025	\$ 12,852	\$ 1,814	\$ 13,779	\$ 6,605	\$ (1,450)	\$ 252,359
Property operating expenses	37,373	20,348	4,367	407	4,791	157	2,784	334	5,737	2,209	(2,267)	76,240
NOI	\$ 86,446	\$ 39,907	\$ 6,732	\$ 599	\$ 7,764	\$ 9,868	\$ 10,068	\$ 1,480	\$ 8,042	\$ 4,396	\$ 817	\$ 176,119
Additions to commercial												
real estate properties	\$ 144,334	\$ 57,972	\$ 110,085	\$ 57,901	\$ 58,707	\$ 872	\$ 5,739	\$ 42,658	\$ 2,199	\$ 449	\$ 419	\$ 481,335
Segment assets at												
December 31, 2005	\$ 901,718	\$ 463,179	\$ 189,576	\$ 63,767	\$ 130,221	\$ 99,357	\$ 99,191	\$ 42,884	\$ 67,206	\$ —	\$ 72,660	\$ 2,129,759
Year Ended												
December 31, 2004												
Revenues	\$ 105,945	\$ 48,701	\$ 8,406	\$ —	\$ 8,924	\$ 10,025	\$ 5,483	\$ —	\$ 18,793	\$ 8,855	\$ (559)	\$ 214,573
Property operating expenses	33,252	14,323	3,465	—	3,372	165	1,327	—	5,362	2,874	(1,087)	63,053
NOI	\$ 72,693	\$ 34,378	\$ 4,941	\$ —	\$ 5,552	\$ 9,860	\$ 4,156	\$ —	\$ 13,431	\$ 5,981	\$ 528	\$ 151,520
Additions to commercial												
real estate properties	\$ 111,260	\$ 148,400	\$ 17,781	\$ —	\$ 26,513	\$ 1,176	\$ 90,214	\$ —	\$ 2,063	\$ 509	\$ 34	\$ 397,950
Segment assets at												
December 31, 2004	\$ 774,541	\$ 421,434	\$ 60,216	\$ —	\$ 69,213	\$ 101,042	\$ 96,413	\$ —	\$ 85,110	\$ 68,126	\$ 55,931	\$ 1,732,026

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(Dollars in thousands, except per share data)

The following table reconciles our segment revenues to total revenues as reported on our Consolidated Statements of Operations:

	For the Years Ended December 31,		
	2006	2005	2004
Segment revenues	\$305,792	\$252,359	\$214,573
Construction contract revenues	52,182	74,357	25,018
Other service operations revenues	7,902	4,877	3,885
Less: Revenues from discontinued operations (Note 18)	(4,473)	(10,286)	(10,629)
Total revenues	\$361,403	\$321,307	\$232,847

The following table reconciles our segment property operating expenses to property operating expenses as reported on our Consolidated Statements of Operations:

	For the Years Ended December 31,		
	2006	2005	2004
Segment property operating expenses	\$ 96,033	\$ 76,240	\$ 63,053
Less: Property expenses from discontinued real estate operations (Note 18)	(1,529)	(3,987)	(4,071)
Total property operating expenses	\$ 94,504	\$ 72,253	\$ 58,982

The following table reconciles our NOI for reportable segments to income from continuing operations as reported on our Consolidated Statements of Operations:

	For the Years Ended December 31,		
	2006	2005	2004
NOI for reportable segments	\$209,759	\$176,119	\$151,520
Construction contract revenues	52,182	74,357	25,018
Other service operations revenues	7,902	4,877	3,885
Equity in loss of unconsolidated entities	(92)	(88)	(88)
Income tax expense	(887)	(668)	(795)
Less:			
Depreciation and other amortization associated with real estate operations	(78,712)	(61,049)	(49,289)
Construction contract expenses	(49,961)	(72,534)	(23,733)
Other service operations expenses	(7,384)	(4,753)	(3,263)
General and administrative expenses	(16,936)	(13,534)	(10,938)
Interest expense on continuing operations	(71,378)	(54,872)	(42,148)
Amortization of deferred financing costs	(2,847)	(2,229)	(2,420)
Minority interests in continuing operations	(4,584)	(5,245)	(5,473)
NOI from discontinued operations	(2,944)	(6,299)	(6,558)
Income from continuing operations	\$ 34,118	\$ 34,082	\$ 35,718

The accounting policies of the segments are the same as those previously disclosed for Corporate Office Properties Trust and subsidiaries, where applicable. We did not allocate interest expense, amortization of deferred financing costs and depreciation and other amortization to segments since they are not included in the measure of segment profit reviewed by management. We also did not allocate construction contract revenues, other service operations revenues, construction contract expenses, other service operations expenses, equity in loss of unconsolidated entities, general and administrative expenses, income taxes and minority interests because these items represent general corporate items not attributable to segments.

17. INCOME TAXES

Corporate Office Properties Trust elected to be treated as a REIT under Sections 856 through 860 of the Internal Revenue Code. To qualify as a REIT, we must meet a number of organizational and operational requirements, including a requirement that we distribute at least 90% of our adjusted taxable income to our shareholders. As a REIT, we generally will not be subject to Federal income tax if we distribute at least 100% of our taxable income to our shareholders and satisfy certain other requirements (see discussion below). If we fail to qualify as a REIT in any tax year, we will be subject to Federal income tax on our taxable income at regular corporate rates and may not be able to qualify as a REIT for four subsequent tax years.

The differences between taxable income reported on our income tax return (estimated 2006 and actual 2005 and 2004) and net income as reported on our Consolidated Statements of Operations are set forth below (unaudited):

	For the Years Ended December 31,		
	2006	2005	2004
	(Estimated)		
Net income	\$ 49,227	\$39,031	\$37,032
Adjustments:			
Rental revenue recognition	(8,144)	(7,225)	(6,400)
Compensation expense recognition	(17,163)	(5,068)	(9,633)
Operating expense recognition	(169)	(68)	(57)
Gain on sales of properties	(11,045)	7,174	150
Interest income	—	—	84
Losses from service operations	(2,321)	(1,780)	(1,971)
Income tax expense	887	699	795
Depreciation and amortization	29,680	18,668	11,588
Earnings from unconsolidated real estate joint ventures	373	307	41
Minority interests, gross	2,586	(4,828)	1,202
Other	(191)	(737)	7
Taxable income	\$ 43,720	\$46,173	\$32,838

For Federal income tax purposes, dividends to shareholders may be characterized as ordinary income, capital gains or return of capital. The characterization of dividends declared on our common and preferred shares during each of the last three years was as follows:

	Common Shares			Preferred Shares		
	For the Years Ended December 31,			For the Years Ended December 31,		
	2006	2005	2004	2006	2005	2004
Ordinary income	50.3%	70.7%	67.4%	87.4%	79.9%	100.0%
Long-term capital gain	7.2%	17.8%	0.0%	12.6%	20.1%	0.0%
Return of capital	42.5%	11.5%	32.6%	0.0%	0.0%	0.0%

We distributed all of our REIT taxable income in 2006, 2005 and 2004 and, as a result, did not incur Federal income tax in those years on such income.

COMI is subject to Federal and state income taxes. COMI had income before income taxes under GAAP of \$2,288 in 2006, \$1,780 in 2005 and \$1,971 in 2004. COMI's provision for income tax consisted of the following:

	For the Years Ended December 31,		
	2006	2005	2004
Deferred			
Federal	\$641	\$572	\$654
State	141	127	141
	782	699	795
Current			
Federal	86	—	—
State	19	—	—
	105	—	—
Total	\$887	\$699	\$795

A reconciliation of COMI's Federal statutory rate to the effective tax rate for income tax reported on our Statements of Operations is set forth below:

	For the Years Ended December 31,		
	2006	2005	2004
Income taxes at U.S. statutory rate	34.0%	34.0%	35.0%
State and local, net of U.S. Federal tax benefit	4.6%	4.7%	4.6%
Other	0.2%	0.6%	0.7%
Effective tax rate	38.8%	39.3%	40.3%

Items contributing to temporary differences that lead to deferred taxes include net operating losses that are not deductible until future periods, depreciation and amortization, share-based compensation, certain accrued compensation and compensation paid in the form of contributions to a deferred nonqualified compensation plan.

We are subject to certain state and local income and franchise taxes. The expense associated with these state and local taxes is included in general and administrative expenses on our Consolidated Statements of Operations. We did not separately state these amounts on our Consolidated Statements of Operations because they are insignificant.

18. DISCONTINUED OPERATIONS

Income from discontinued operations includes revenues and expenses associated with the following:

- three properties located in the Northern/Central New Jersey region that were sold on September 8, 2005;
- the two Lakeview at the Greens properties that were sold on February 6, 2006;
- the 68 Culver Road property that was sold on March 8, 2006;
- the 710 Route 46 property that was sold on July 26, 2006;
- the 230 Schilling Circle property that was sold on August 9, 2006;
- the 7 Centre Drive property that was sold on August 30, 2006; and
- the Brown's Wharf property that was sold on September 28, 2006.

notes to consolidated financial statements corporate office properties trust and subsidiaries

(Dollars in thousands, except per share data)

The table below sets forth the components of income from discontinued operations:

	For the Years Ended December 31,		
	2006	2005	2004
Revenue from real estate operations	\$ 4,473	\$10,286	\$10,629
Expenses from real estate operations:			
Property operating expenses	1,529	3,987	4,071
Depreciation and amortization	1,362	2,506	2,615
Interest expense	1,042	2,272	2,115
Other	135	11	11
Expenses from real estate operations	4,068	8,776	8,812
Income from discontinued operations before gain on sales of real estate and minority interests	405	1,510	1,817
Gain on sales of real estate	17,031	4,324	—
Minority interests in discontinued operations	(3,059)	(1,153)	(390)
Income from discontinued operations, net of minority interests	\$14,377	\$ 4,681	\$ 1,427

19. COMMITMENTS AND CONTINGENCIES

In the normal course of business, we are involved in legal actions arising from our ownership and administration of properties. Management does not anticipate that any liabilities that may result will have a materially adverse effect on our financial position, operations or liquidity. We are subject to various Federal, state and local environmental regulations related to our property ownership and operation. We have performed environmental assessments of our properties, the results of which have not revealed any environmental liability that we believe would have a materially adverse effect on our financial position, operations or liquidity.

Acquisitions

As of December 31, 2006, we were under contract to acquire the following properties:

- the Nottingham Acquisition, as described in Note 22, for \$362,500, of which we paid a deposit of \$2,000 in 2006. We completed this acquisition in January 2007, as discussed in Note 22;

- a parcel of land in Aberdeen, Maryland for \$10,000, of which we paid a deposit of \$100 in 2006; and
- the remaining 91 acres of land not yet acquired as part of the acquisition of property in Washington County, Maryland discussed in Note 4; we expect to make the following additional future cash payments to the seller for (1) the acquisition of the remaining 91 acres and (2) portions of the contract price on which payment was deferred per the contract: \$1,310 in 2007, \$1,000 in 2008 and \$155 in 2009. We could incur an additional cash obligation to the seller after that of up to \$4,000; this \$4,000 cash obligation is subject to reduction by an amount ranging between \$750 and \$4,000, with the amount of such reduction to be determined based on defined levels of (1) job creation resulting from the future development of the property and (2) future real estate taxes generated by the property. Upon completion of this acquisition, we will be obligated to incur \$7,500 in development and construction costs for the property.

Joint Ventures

As part of our obligations under the partnership agreement of Harrisburg Corporate Gateway Partners, LP, we may be required to make unilateral payments to fund rent shortfalls on behalf of a tenant that was in bankruptcy at the time the partnership was formed. Our total unilateral commitment under this guaranty is approximately \$306; the tenant's account was current as of December 31, 2006. We also agreed to indemnify the partnership's lender for 80% of losses under standard nonrecourse loan guarantees (environmental indemnifications and guarantees against fraud and misrepresentation) during the period of time in which we manage the partnership's properties; we do not expect to incur any losses under these loan guarantees.

We are party to a contribution agreement that formed a joint venture relationship with a limited partnership to develop up to 1.8 million square feet of office space on 63 acres of land located in Hanover, Maryland. Under the contribution agreement, we agreed to fund up to \$2,200 in pre-construction costs associated with the property. As we and the joint venture partner agree to proceed with the construction of buildings in the future, we would make additional cash capital contributions into newly-formed entities and our joint venture partner would contribute land into such entities. We will have a 50% interest in this joint venture relationship.

We may need to make our pro rata share of additional investments in our real estate joint ventures (generally based on our percentage ownership) in the event that additional funds are needed. In the event that the other members of these joint ventures do not pay their share of investments when additional funds are needed, we may then need to make even larger investments in these joint ventures.

In two of the consolidated joint ventures that we owned as of December 31, 2006, we would be obligated to acquire the other members' 50% interests in the joint ventures if defined events were to occur. The amounts we would need to pay for those membership interests are computed based on the amounts that the owners of the interests would receive under the joint venture agreements in the event that office properties owned by the joint ventures were sold for a capitalized fair value (as defined in the agreements) on a defined date. We estimate the aggregate amount we would need to pay for the other members' membership interests in these joint ventures to be \$2,383; however, since the determination of this amount is dependent on the operations of the office properties, which are not both completed and sufficiently occupied, this estimate is preliminary and could be materially different from the actual obligation.

Ground Lease

On April 4, 2006, we entered into a 62-year ground lease agreement on a six-acre land parcel on which we expect to construct a 110,000 square foot property. We paid \$550 to the lessor upon lease execution and expect to pay an additional \$1,870 in rent under the lease in 2007. No other rental payments are required over the life of the lease, although we are responsible for expenses associated with the property. We will recognize the total lease payments incurred under the lease evenly over the term of the lease.

Office Space Operating Leases

We are obligated as lessee under four operating leases for office space. Future minimum rental payments due under the terms of these leases as of December 31, 2006 follow:

2007	\$270
2008	261
2009	175
2010	135
2011	57
	<hr/>
	\$898

Other Operating Leases

We are obligated under various leases for vehicles and office equipment. Future minimum rental payments due under the terms of these leases as of December 31, 2006 follow:

2007	\$ 475
2008	383
2009	209
2010	67
2011	9
	<hr/>
	\$1,143

Environmental Indemnity Agreement

We agreed to provide certain environmental indemnifications in connection with a lease of three properties in our Northern/Central New Jersey region. The prior owner of the properties, a Fortune 100 company which is responsible for groundwater contamination at such properties, previously agreed to indemnify us for (1) direct losses incurred in connection with the contamination and (2) its failure to perform remediation activities required by the State of New Jersey, up to the point that the state declares the remediation to be complete. Under the lease agreement, we agreed to the following:

- to indemnify the tenant against losses covered under the prior owner's indemnity agreement if the prior owner fails to indemnify the tenant for such losses. This indemnification is capped at \$5,000 in perpetuity after the State of New Jersey declares the remediation to be complete;
- to indemnify the tenant for consequential damages (e.g., business interruption) at one of the buildings in perpetuity and another of the buildings for 15 years after the tenant's acquisition of the property from us, if such acquisition occurs. This indemnification is capped at \$12,500; and
- to pay 50% of additional costs related to construction and environmental regulatory activities incurred by the tenant as a result of the indemnified environmental condition of the properties. This indemnification is capped at \$300 annually and \$1,500 in the aggregate.

notes to consolidated financial statements corporate office properties trust and subsidiaries

(Dollars in thousands, except per share data)

20. QUARTERLY DATA (UNAUDITED)

The tables below set forth selected quarterly information for the years ended December 31, 2006 and 2005. Certain of the amounts below have been reclassified to conform to our current presentation of discontinued operations, which is discussed in Note 18.

	For the Year Ended December 31, 2006			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues	\$86,476	\$85,689	\$92,927	\$96,311
Operating income	\$26,693	\$28,419	\$27,631	\$31,163
Income from continuing operations	\$ 7,652	\$ 8,999	\$ 7,799	\$ 9,668
Income (loss) from discontinued operations, net of minority interests	\$ 2,175	\$ 92	\$12,191	\$ (81)
Net income	\$ 9,937	\$ 9,116	\$20,587	\$ 9,587
Preferred share dividends	(3,654)	(3,653)	(4,307)	(3,790)
Issuance costs associated with redeemed preferred shares	—	—	(1,829)	(2,067)
Net income available to common shareholders	\$ 6,283	\$ 5,463	\$14,451	\$ 3,730
Basic earnings per share:				
Income from continuing operations	\$ 0.10	\$ 0.13	\$ 0.05	\$ 0.09
Net income available to common shareholders	\$ 0.16	\$ 0.13	\$ 0.34	\$ 0.09
Diluted earnings per share:				
Income from continuing operations	\$ 0.10	\$ 0.13	\$ 0.05	\$ 0.09
Net income available to common shareholders	\$ 0.15	\$ 0.13	\$ 0.33	\$ 0.08

	For the Year Ended December 31, 2005			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues	\$74,887	\$76,791	\$90,792	\$78,837
Operating income	\$23,816	\$23,965	\$22,354	\$27,049
Income from continuing operations	\$ 8,798	\$ 8,631	\$ 6,660	\$ 9,993
Income from discontinued operations, net of minority interests	\$ 223	\$ 320	\$ 3,870	\$ 268
Net income	\$ 9,040	\$ 9,120	\$10,589	\$10,282
Preferred share dividends	(3,654)	(3,654)	(3,653)	(3,654)
Net income available to common shareholders	\$ 5,386	\$ 5,466	\$ 6,936	\$ 6,628
Basic earnings per share:				
Income from continuing operations	\$ 0.14	\$ 0.14	\$ 0.08	\$ 0.16
Net income available to common shareholders	\$ 0.15	\$ 0.15	\$ 0.19	\$ 0.17
Diluted earnings per share:				
Income from continuing operations	\$ 0.14	\$ 0.13	\$ 0.08	\$ 0.16
Net income available to common shareholders	\$ 0.14	\$ 0.14	\$ 0.18	\$ 0.16

21. PRO FORMA FINANCIAL INFORMATION (UNAUDITED)

We accounted for our acquisitions using the purchase method of accounting. We included the results of operations for our acquisitions in our Consolidated Statements of Operations from their respective purchase dates through December 31, 2006.

We prepared our pro forma condensed consolidated financial information presented below as if our 2005 acquisition of the Hunt Valley/Rutherford portfolios and all of our 2004 acquisitions and dispositions of operating properties had occurred at the beginning of the respective periods. The pro forma financial information is unaudited and is not necessarily indicative of the results that actually would have occurred if these acquisitions and dispositions had occurred at the beginning of the respective periods, nor does it purport to indicate our results of operations for future periods.

	For the Years Ended December 31,	
	2005	2004
Pro forma total revenues	\$347,417	\$274,893
Pro forma net income	\$ 38,233	\$ 36,484
Pro forma net income available to common shareholders	\$ 23,618	\$ 18,342
Pro forma earnings per common share on net income available to common shareholders		
Basic	\$ 0.63	\$ 0.55
Diluted	\$ 0.61	\$ 0.52

22. SUBSEQUENT EVENTS

On January 9 and 10, 2007, we completed a series of transactions that resulted in the acquisition of 56 operating properties totaling 2.4 million square feet and land parcels totaling 187 acres. We refer to this transaction as the Nottingham Acquisition.

All of the acquired properties are located in Maryland, with 36 of the operating properties, totaling 1.6 million square feet, and land parcels totaling 175 acres, located in White Marsh, Maryland and the remaining properties and land parcels located in other regions in Northern Baltimore County and the Baltimore/Washington Corridor. We believe that the land parcels totaling 187 acres can support at least 2.0 million developable square feet. We completed the Nottingham Acquisition for an aggregate cost of approximately \$363.9 million, including approximately \$1.4 million in transaction costs. We financed the acquisition by (1) issuing \$26.6 million in Series K Cumulative Redeemable Convertible Preferred Shares of beneficial interest (the "Series K Preferred Shares") to the seller; (2) issuing \$154.9 million in common shares to the seller, at a deemed value of \$49 per share; (3) assuming existing mortgage loans totaling \$38.0 million, with an average interest rate of approximately 6.0%; (4) assuming an existing mortgage loan totaling \$10.3 million, which we repaid on January 11, 2007 using borrowings under our Revolving Credit Facility; (5) assuming an existing unsecured loan totaling \$89.1 million, with a variable interest rate of LIBOR plus 1.15% to 1.55% depending on our leverage levels at different points in time; (6) using \$20.1 million from an escrow funded by proceeds from one of our property sales; and (7) using borrowings under the Revolving Credit Facility for the balance.

The Series K Preferred Shares issued in the Nottingham Acquisition are valued at, and carry a liquidation preference equal to, \$50 per share. The Series K Preferred Shares are nonvoting, redeemable for cash at \$50 per share at our option on or after January 9, 2017, and are convertible, subject to certain conditions, into common shares on the basis of 0.8163 common shares for each preferred share, in accordance with the terms of the Articles Supplementary describing the Series K Preferred Shares. Holders of the Series K Preferred Shares are entitled to cumulative dividends, payable quarterly (as and if declared by our Board of Trustees). Dividends will accrue from the date of issue at the annual rate of \$2.80 per share, which is equal to 5.6% of the \$50 per share liquidation preference.

market for registrant's common equity,

related shareholder matters and issuer repurchases of equity securities

Our common shares trade on the New York Stock Exchange ("NYSE") under the symbol "OFC." The table below shows the range of the high and low sale prices for our common shares as reported on the NYSE, as well as the quarterly common share dividends per share declared.

2005	Price Range		Dividends per Share
	Low	High	
First Quarter	\$25.14	\$29.30	\$0.255
Second Quarter	\$25.39	\$29.78	\$0.255
Third Quarter	\$29.27	\$35.68	\$0.280
Fourth Quarter	\$32.50	\$37.15	\$0.280

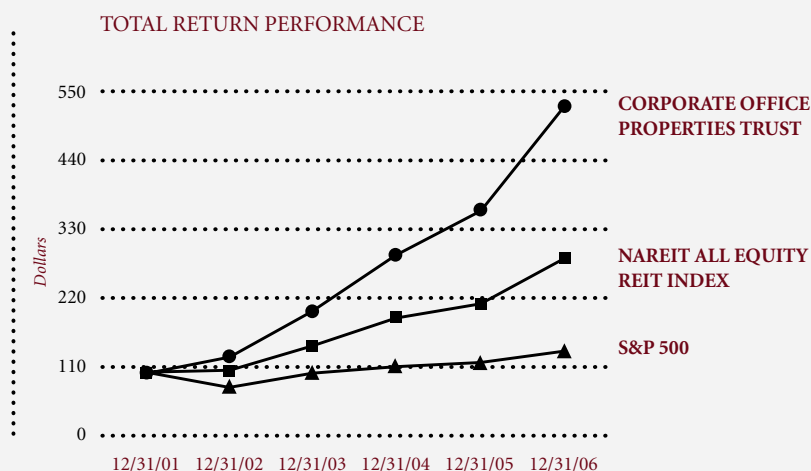
2006	Price Range		Dividends per Share
	Low	High	
First Quarter	\$34.91	\$46.12	\$0.280
Second Quarter	\$37.32	\$45.74	\$0.280
Third Quarter	\$40.65	\$47.54	\$0.310
Fourth Quarter	\$44.21	\$51.45	\$0.310

The number of holders of record of our common shares was 355 as of December 31, 2006. This number does not include shareholders whose shares are held of record by a brokerage house or clearing agency, but does include any such brokerage house or clearing agency as one record holder.

We will pay future dividends at the discretion of our Board of Trustees. Our ability to pay cash dividends in the future will be dependent upon (i) the income and cash flow generated from our operations; (ii) cash generated or used by our financing and investing activities; and (iii) the annual distribution requirements under the REIT provisions of the Code described above and such other factors as the Board of Trustees deems relevant. Our ability to make cash dividends will also be limited by the terms of our Operating Partnership Agreement and our financing arrangements as well as limitations imposed by state law and the agreements governing any future indebtedness.

common shares performance graph

The graph and the table set forth below assume \$100 was invested on December 31, 2001 in the common shares of Corporate Office Properties Trust. The graph and the table compare the cumulative return (assuming reinvestment of dividends) of this investment with a \$100 investment at that time in the S&P 500 Index or the Equity Index of the National Association of Real Estate Investment Trusts ("NAREIT").



Source: SNL Financial LC, Charlottesville, VA ©2007 for Corporate Office Properties Trust & NAREIT All Equity REIT Index data

Source: Standard & Poor's for S&P 500 data

Index	Value at					
	12/31/01	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06
Corporate Office Properties Trust	\$100.00	\$125.79	\$198.28	\$287.84	\$360.82	\$525.99
S&P 500	100.00	77.90	100.24	111.14	116.59	135.00
NAREIT All Equity REIT Index	100.00	103.82	142.37	187.33	210.12	283.78

corporate information

Executive Officers

Randall M. Griffin
President and Chief Executive Officer

Roger A. Waesche, Jr.
Executive Vice President and Chief Operating Officer

Stephen E. Riffe
Executive Vice President and Chief Financial Officer

Karen M. Singer
Senior Vice President, General Counsel and Secretary

Service Company Executive Officer

Dwight S. Taylor
President, COPT Development & Construction Services, LLC

Executive Offices

Corporate Office Properties Trust
6711 Columbia Gateway Drive, Suite 300
Columbia, Maryland 21046
Telephone: (443) 285-5400
Facsimile: (443) 285-7650

Pennsylvania Office
Corporate Office Properties Trust
40 Morris Avenue, Suite 220
Bryn Mawr, Pennsylvania 19010

Registrar and Transfer Agent

Shareholders with questions concerning stock certificates, account information, dividend payments or stock transfers should contact our transfer agent:

Wells Fargo Bank, N.A.
Shareholder Services

161 North Concord Exchange
South St. Paul, Minnesota 55075
Toll-free: (800) 468-9716
www.wellsfargo.com/shareownerservices

Legal Counsel

Morgan, Lewis & Bockius
1701 Market Street
Philadelphia, Pennsylvania 19103

Independent Auditors

PricewaterhouseCoopers LLP
250 West Pratt Street, Suite 2100
Baltimore, Maryland 21201

Dividend Reinvestment Plan

Registered shareholders may reinvest dividends through the Company's dividend reinvestment plan. For more information, please contact Wells Fargo Shareholder Services at (800) 468-9716.

Annual Meeting

The annual meeting of the shareholders will be held at 9:30 a.m. on Thursday, May 17, 2007, at the corporate headquarters of Corporate Office Properties Trust at 6711 Columbia Gateway Drive, Suite 300, Columbia, Maryland 21046.

Investor Relations

For help with questions about the Company, or for additional corporate information, please contact:

Mary Ellen Fowler
Vice President and Treasurer
Corporate Office Properties Trust
6711 Columbia Gateway Drive, Suite 300
Columbia, Maryland 21046
Telephone: (443) 285-5450
Facsimile: (443) 285-7640
Email: ir@copt.com

Shareholder Information

As of March 15, 2007, the Company had 46,743,001 outstanding common shares owned by approximately 421 shareholders of record. This does not include the number of persons whose shares are held in nominee or "street name" accounts through brokers or clearing agencies.

Common and Preferred Shares

The common and preferred shares of Corporate Office Properties Trust are traded on the New York Stock Exchange. Common shares are traded under the symbol OFC, and preferred shares are traded under the symbols OFCPrG, OFCPrH and OFCPrJ.

Website

For additional information on the Company, visit our website at www.copt.com.

Forward-looking Information

This report contains forward-looking information based upon the Company's current best judgment and expectations. Actual results could vary from those presented herein. The risks and uncertainties associated with the forward-looking information include the strength of the commercial office real estate market in which the Company operates, competitive market conditions, general economic growth, interest rates and capital market conditions. For further information, please refer to the Company's filings with the Securities and Exchange Commission.

Corporate Governance Certification

The Company submitted to the New York Stock Exchange in 2006 the Annual CEO Certification required by Section 303A.12 of the New York Stock Exchange corporate governance rules.

Sarbanes-Oxley Act Section 302 Certification

The Company filed with the Securities and Exchange Commission, as an exhibit to its Form 10-K for the year ended December 31, 2006, the Sarbanes-Oxley Act Section 302 certification regarding the quality of the Company's public disclosure.



board of trustees



(left to right)

Jay H. Shidler, Chairman of the Board; Managing Partner, The Shidler Group
Steven D. Kesler, Chief Financial Officer, Chesapeake Commercial Properties, Inc.
Kenneth D. Wethe, Principal, Wethe & Associates
Randall M. Griffin, President and Chief Executive Officer, Corporate Office Properties Trust



(left to right)

Clay W. Hamlin, III, Vice Chairman of the Board
Kenneth S. Sweet, Jr., Managing Partner, Gordon Stuart Associates
Thomas F. Brady, Executive Vice President, Corporate Strategy and Retail Competitive Supply, Constellation Energy Group
Robert L. Denton, Managing Partner, The Shidler Group



CORPORATE OFFICE
PROPERTIES TRUST