Douglas Emmett Inc
Form 10-Q
November 07, 2013

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13

OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

Commission file number 001-33106
Douglas Emmett, Inc.

(Exact name of registrant as specified in its charter)

MARYLAND	20-3073047
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
808 Wilshire Boulevard, Suite 200, Santa Monica, California	90401
(Address of principal executive offices)	(Zip Code)

(310) 255-7700
(Registrant’s telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at	October 31, 2013
Common Stock, $0.01 par value per share	142,601,390	shares

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
Douglas Emmett, Inc.
Consolidated Balance Sheets
(in thousands, except shares and per share data)

	September 30, 2013 (unaudited)	December 31, 2012
Assets		
Investment in real estate:		
Land	$867,284	$851,679
Buildings and improvements	5,381,017	5,244,738
Tenant improvements and lease intangibles	745,555	690,120
Investment in real estate, gross	6,993,856	6,786,537
Less: accumulated depreciation	(1,445,996)	(1,304,468)
Investment in real estate, net	5,547,860	5,482,069
Cash and cash equivalents	148,811	373,203
Tenant receivables, net	1,594	1,331
Deferred rent receivables, net	67,909	63,192
Acquired lease intangible assets, net	3,899	4,707
Investment in unconsolidated real estate funds	186,282	149,478
Other assets	30,055	29,827
Total assets	$5,986,410	$6,103,807
Liabilities		
Secured notes payable	$3,351,140	$3,441,140
Interest payable, accounts payable and accrued liabilities	63,402	45,171
Security deposits	35,410	34,284
Acquired lease intangible liabilities, net	63,420	67,035
Interest rate contracts	71,114	100,294
Dividends payable	25,668	25,424
Total liabilities	3,610,154	3,713,348
Equity		
Douglas Emmett, Inc. stockholders' equity:		
Common Stock, $0.01 par value 750,000,000 authorized, 142,601,390 and 141,245,896 outstanding at September 30, 2013 and December 31, 2012, respectively	1,426	1,412
Additional paid-in capital	2,653,852	2,635,408
Accumulated other comprehensive income (loss)	(57,624)	(82,991)
Accumulated deficit	(614,703)	(574,173)
Total Douglas Emmett, Inc. stockholders' equity	1,982,951	1,979,656
Noncontrolling interests	393,305	410,803
Total equity	2,376,256	2,390,459
Total liabilities and equity	$5,986,410	$6,103,807

See notes to consolidated financial statements.

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Douglas Emmett, Inc.
Consolidated Statements of Operations
(unaudited and in thousands, except per share data)

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Revenues				
Office rental				
Rental revenues	$99,795	$98,608	$296,275	$295,361
Tenant recoveries	11,867	11,337	34,170	33,099
Parking and other income	18,677	17,478	55,979	52,428
Total office revenues	130,339	127,423	386,424	380,888
Multifamily rental				
Rental revenues	17,929	17,165	53,146	50,865
Parking and other income	1,418	1,405	4,290	4,096
Total multifamily revenues	19,347	18,570	57,436	54,961
Total revenues	149,686	145,993	443,860	435,849
Operating Expenses				
Office expense	46,494	44,293	130,525	127,684
Multifamily expense	5,157	4,999	15,108	14,860
General and administrative	6,546	6,610	20,724	20,051
Depreciation and amortization	47,402	46,546	141,528	139,071
Total operating expenses	105,599	102,448	307,885	301,666
Operating income	44,087	43,545	135,975	134,183
Other income	2,138	626	4,165	2,027
Other expenses	(1,402)	(436)	(2,777)	(1,445)
Income (loss) including depreciation, from unconsolidated real estate funds	811	(663)	3,335	(2,764)
Interest expense	(32,601)	(36,844)	(97,832)	(110,996)
Acquisition-related expenses	(290)	—	(533)	—
Net income	12,743	6,228	42,333	21,005
Less: Net income attributable to noncontrolling interests	(1,992)	(1,173)	(5,865)	(4,037)
Net income attributable to common stockholders	$10,751	$5,055	$36,468	$16,968
Net income attributable to common stockholders per share – basic	$0.08	$0.04	$0.26	$0.12
Net income attributable to common stockholders per share – diluted	$0.07	$0.04	$0.25	$0.12
Dividends declared per common share	$0.18	$0.15	$0.54	$0.45

See notes to consolidated financial statements.

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Douglas Emmett, Inc.
Consolidated Statements of Comprehensive Income
(unaudited and in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	$12,743	$6,228	$42,333	$21,005
Other comprehensive income (loss): cash flow hedges	(1,060)	(827)	31,359	(230)
Comprehensive income	11,683	5,401	73,692	20,775
Less comprehensive income attributable to noncontrolling interests	(1,818)	(1,685)	(11,857)	(6,536)
Comprehensive income attributable to common stockholders	$9,865	$3,716	$61,835	$14,239

See notes to consolidated financial statements.

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Douglas Emmett, Inc.
Consolidated Statements of Cash Flows
(unaudited and in thousands)

	Nine Months Ended September 30,	
	2013	2012
Operating Activities		
Net income	$42,333	$21,005
Adjustments to reconcile net income to net cash provided by operating activities:		
(Income) loss, including depreciation, from unconsolidated real estate funds	(3,335)	2,764
Depreciation and amortization	141,528	139,071
Net accretion of acquired lease intangibles	(11,970)	(13,963)
Amortization of deferred loan costs	2,972	3,289
Amortization of loan premium	—	(1,060)
Non-cash market value adjustments on interest rate contracts	67	8,930
Non-cash amortization of stock-based compensation	4,560	4,624
Operating distributions received from unconsolidated real estate funds	558	580
Change in working capital components:		
Tenant receivables	(263)	366
Deferred rent receivables	(4,717)	(4,284)
Interest payable, accounts payable and accrued liabilities	20,288	6,907
Security deposits	1,126	268
Other	(2,423)	(2,515)
Net cash provided by operating activities	190,724	165,982
Investing Activities		
Capital expenditures for improvements to real estate	(49,908)	(44,363)
Property acquisitions	(150,000)	—
Loan to related party	(2,882)	—
Contributions to unconsolidated real estate funds	(26,405)	(2,604)
Acquisitions of additional interests in unconsolidated real estate funds	(8,004)	(33,454)
Capital distributions received from unconsolidated real estate funds	4,755	3,453
Net cash used in investing activities	(232,444)	(76,968)
Financing Activities		
Proceeds from long-term borrowings	—	440,000
Deferred loan cost payments	(157)	(2,122)
Refund of loan deposit	—	1,575
Repayment of borrowings	(90,000)	(621,956)
Contributions by noncontrolling interests	584	—
Distributions to noncontrolling interests	(15,993)	(13,768)
Distributions of capital to noncontrolling interests	—	(10)
Repurchase of operating partnership units	(352)	—
Cash dividends to common stockholders	(76,754)	(58,943)
Issuance of common stock, net	—	128,257
Net cash used in financing activities	(182,672)	(126,967)
Decrease in cash and cash equivalents	(224,392)	(37,953)
Cash and cash equivalents at beginning of period	373,203	406,977
Cash and cash equivalents at end of period	$148,811	$369,024

See notes to consolidated financial statements.

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Douglas Emmett, Inc.
Notes to Consolidated Financial Statements
(unaudited)

1. Overview

Organization and Description of Business
Douglas Emmett, Inc. is a fully integrated, self-administered and self-managed Real Estate Investment Trust (REIT). We are one of the largest owners and operators of high-quality office and multifamily properties in Los Angeles County, California and Honolulu, Hawaii. We focus on owning and acquiring a substantial share of top-tier office properties and premier multifamily communities in neighborhoods that possess significant supply constraints, high-end executive housing and key lifestyle amenities.

Through our interest in Douglas Emmett Properties, LP (our operating partnership) and its subsidiaries, as well as our investment in our institutional unconsolidated real estate funds (Funds), we own or partially own, manage, lease, acquire and develop real estate, consisting primarily of office and multifamily properties in Los Angeles County, California and Honolulu, Hawaii. As of September 30, 2013, we owned a consolidated portfolio of fifty-two office properties (including ancillary retail space) and nine multifamily properties, as well as the fee interests in two parcels of land subject to ground leases. Alongside our consolidated portfolio, we also manage and own equity interests in our Funds which, at September 30, 2013, owned eight additional office properties, for a combined sixty office properties in our total portfolio.

The terms "us," "we" and "our" as used in these financial statements refer to Douglas Emmett, Inc. and its subsidiaries.

Basis of Presentation
The accompanying consolidated financial statements as of September 30, 2013 and December 31, 2012 and for the three and nine months ended September 30, 2013 and 2012 are the consolidated financial statements of Douglas Emmett, Inc. and our subsidiaries, including our operating partnership. All significant intercompany balances and transactions have been eliminated in our consolidated financial statements, and certain prior period amounts have been reclassified to conform with the current period presentation.

The accompanying unaudited interim financial statements have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) may have been condensed or omitted pursuant to SEC rules and regulations, although we believe that the disclosures are adequate to make their presentation not misleading. The accompanying unaudited financial statements include, in our opinion, all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial information set forth therein. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the year ended December 31, 2013. The interim financial statements should be read in conjunction with the consolidated financial statements in our 2012 Annual Report on Form 10-K and the notes thereto. Any references to the number of properties and square footage are unaudited and outside the scope of our independent registered public accounting firm’s review of our financial statements in accordance with the standards of the United States Public Company Accounting Oversight Board.

The preparation of financial statements in conformity with GAAP requires us to make certain estimates and assumptions, including, for example, with respect to the allocation of the purchase price of acquisitions among land, buildings, improvements, equipment and any related intangible assets and liabilities. These estimates and assumptions are subjective and affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates.

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Douglas Emmett, Inc.
Notes to Consolidated Financial Statements (continued)
(unaudited)

2. Summary of Significant Accounting Policies

During the period covered by this report, we have not made any material changes to our significant accounting policies included in our 2012 Annual Report on Form 10-K.

Income Taxes
We have elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended. Provided that we qualify for taxation as a REIT, we are generally not subject to corporate-level income tax on the earnings distributed currently to our stockholders that we derive from our REIT qualifying activities. We are subject to corporate-level tax on the earnings that we derive through our taxable REIT subsidiaries (TRS).

Recently Issued Accounting Literature
Changes to GAAP are established by the Financial Accounting Standards Board (FASB) in the form of Accounting Standard Updates (ASUs). We consider the applicability and impact of all ASUs.

In February 2013, the FASB issued ASU No. 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date (Topic 405), which provides guidance for the recognition, measurement and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this ASU is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. GAAP. ASU No. 2013-04 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013, which for us means the first quarter of 2014. When adopted, ASU 2013-04 applies retroactively for existing joint and several liability arrangements within the scope of Subtopic 405-40. Although earlier application is permitted, we do not intend to adopt the ASU before the effective date. We do not expect this ASU to have a material impact on our financial position or results of operations, as we do not currently have any obligations within the scope of this ASU.

In July 2013, the FASB issued ASU No. 2013-10, Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes (Topic 815), which permits for the inclusion of the Fed Funds Effective Swap Rate (OIS) as a U.S. benchmark interest rate for hedge accounting purposes, in addition to interest rates on direct Treasury obligations of the U.S. government (UST), and the London Interbank Offered Rate (LIBOR). The ASU amendments also remove the restriction on using different benchmark interest rates for similar hedges. ASU No. 2013-10 is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. We do not expect this ASU to have a material impact on our financial position or results of operations.

The FASB has not issued any other ASUs during 2013 that we expect to be applicable and have a material impact on our future financial position or results of operations.

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Douglas Emmett, Inc.
Notes to Consolidated Financial Statements (continued)
(unaudited)

3. Investment in Real Estate

On May 15, 2013, we used a portion of our cash on hand to purchase a 225,000 square foot Class A office building located at 8484 Wilshire Blvd. in Beverly Hills for a contract price of $89.0 million, or approximately $395 per square foot. On August 15, 2013, we purchased a 191,000 square foot Class A office building located at 16501 Ventura Blvd. in Encino for a contract price of $61.0 million, or approximately $319 per square foot. The results of operations for these properties after the date of acquisition are included in our consolidated statements of operations. We did not acquire any properties during the nine months ended September 30, 2012.

The tables below (in thousands) summarize our preliminary purchase price allocations for the acquired properties (these allocations are subject to adjustment within twelve months of the acquisition date):

	8484 Wilshire
Investment in real estate:	
Land	$8,847
Buildings and improvements	77,158
Tenant improvements and other in-place lease assets	6,485
Acquired lease intangibles, net	(3,490)
Net assets and liabilities acquired	$89,000

	16501 Ventura
Investment in real estate:	
Land	$6,759
Buildings and improvements	55,179
Tenant improvements and other in-place lease assets	4,736
Acquired lease intangibles, net	(5,674)
Net assets and liabilities acquired	$61,000

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Douglas Emmett, Inc.
Notes to Consolidated Financial Statements (continued)
(unaudited)

4. Acquired Lease Intangibles

The table below (in thousands) summarizes our acquired lease intangibles related to above/below-market leases:

	September 30, 2013	December 31, 2012
Above-market tenant leases	$34,998	$34,968
Accumulated amortization	(33,764)	(32,985)
Below-market ground leases	3,198	3,198
Accumulated amortization	(533)	(474)
Acquired lease intangible assets, net	$3,899	$4,707
Below-market tenant leases	$272,412	$263,220
Accumulated accretion	(221,597)	(208,939)
Above-market ground leases	16,200	16,200
Accumulated accretion	(3,595)	(3,446)
Acquired lease intangible liabilities, net	$63,420	$67,035

5. Other Assets

Other assets consist of the following (in thousands):

	September 30, 2013	December 31, 2012
Deferred loan costs, net of accumulated amortization of $11,217 and $8,245 at September 30, 2013 and December 31, 2012, respectively	$16,547	$19,362
Restricted cash	194	2,379
Prepaid expenses	8,433	4,049
Other indefinite-lived intangible	1,988	1,988
Other	2,893	2,049
Total other assets	$30,055	$29,827

We incurred deferred loan cost amortization expense of $913 thousand and $1.2 million for the three months ended September 30, 2013 and 2012, respectively, and $3.0 million and $3.3 million for the nine months ended September 30, 2013 and 2012, respectively. Deferred loan cost amortization is included as a component of interest expense in the consolidated statements of operations.

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Douglas Emmett, Inc.
Notes to Consolidated Financial Statements (continued)
(unaudited)

6. Secured Notes Payable

The following table (in thousands) summarizes our secured notes payable:

Description [1]	Maturity Date	Outstanding Principal Balance as of September 30, 2013	Outstanding Principal Balance as of December 31, 2012	Variable Interest Rate	Effective Annual Fixed Interest Rate [2]	Swap Maturity Date
Term Loan [3]	3/3/2014	$16,140	$16,140	LIBOR + 1.85%	N/A	--
Fannie Mae Loan [4]	2/1/2015	111,920	111,920	DMBS + 0.707%	N/A	--
Term Loan	4/1/2015	150,000	240,000	LIBOR +1.50%	N/A	--
Fannie Mae Loan	3/1/2016	82,000	82,000	LIBOR + 0.62%	N/A	--
Fannie Mae Loan	6/1/2017	18,000	18,000	LIBOR + 0.62%	N/A	--
Term Loan	10/2/2017	400,000	400,000	LIBOR + 2.00%	4.45%	7/1/2015
Term Loan	4/2/2018	510,000	510,000	LIBOR + 2.00%	4.12%	4/1/2016
Term Loan	8/1/2018	530,000	530,000	LIBOR + 1.70%	3.74%	8/1/2016
Term Loan [5]	8/5/2018	355,000	355,000	N/A	4.14%	--
Term Loan [6]	2/1/2019	155,000	155,000	N/A	4.00%	--
Term Loan [7]	6/5/2019	285,000	285,000	N/A	3.85%	--
Term Loan [8]	3/1/2020 [9]	350,000	350,000	N/A	4.46%	--
Fannie Mae Loans	11/2/2020	388,080	388,080	LIBOR + 1.65%	3.65%	11/1/2017
Aggregate loan principal [10]		$3,351,140	$3,441,140			
Aggregate amount of swapped to fixed rate loans		$1,828,080	$2,168,080		3.98%	
Aggregate amount of fixed rate loans		1,145,000	1,145,000		4.15%	
Aggregate amount of variable rate loans		378,060	128,060		N/A	
Aggregate loan principal [10]		$3,351,140	$3,441,140			

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(1) As of September 30, 2013, (i) the weighted average remaining life of our outstanding debt was 4.9 years; (ii) of the $2.97 billion of debt on which the interest rate was fixed under the terms of the loan or a swap, the weighted average remaining life was 5.3 years , the weighted average remaining period during which interest was fixed was 3.6 years and the weighted average annual interest rate was 4.05%; and (iii) including the non-cash amortization of prepaid loan fees, the effective weighted average interest rate was 4.17%. Except as otherwise noted below, each loan is secured by a separate collateral pool consisting of one or more properties, requiring monthly payments of interest only, with the outstanding principal due upon maturity.

(2) Includes the effect of interest rate contracts as of September 30, 2013, and excludes amortization of loan fees, all shown on an actual/360-day basis.

(3) The borrower is a consolidated entity in which our operating partnership owns a two-thirds interest.

(4) The loan has a $75.0 million tranche bearing interest at DMBS + 0.76% and a $36.9 million tranche bearing interest at DMBS + 0.60%.

(5) Interest-only until February 2016, with principal amortization thereafter based upon a thirty-year amortization schedule.

(6)

Interest-only until February 2015, with principal amortization thereafter based upon a thirty-year amortization schedule.

(7) Interest only until February 2017, with principal amortization thereafter based upon a thirty-year amortization schedule.

(8) Interest at a fixed interest rate until March 1, 2018 and a floating rate thereafter, with interest-only payments until March 2014 and with principal amortization thereafter based upon a thirty-year amortization schedule.

(9) We have two one-year extension options which would extend the maturity to March 1, 2020 from March 1, 2018, subject to meeting certain conditions.

(10) See Note 11 for our fair value disclosures.

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Douglas Emmett, Inc.
Notes to Consolidated Financial Statements (continued)
(unaudited)

The table below (in thousands) presents the minimum future principal payments due (excluding any available extension options) on our secured notes payable at September 30, 2013:

Twelve months ending September 30:	
2014	$18,951
2015	269,542
2016	94,411
2017	36,504
2018	2,122,465
Thereafter	809,267
Total future principal payments	$3,351,140

7. Interest Payable, Accounts Payable and Accrued Liabilities

Interest payable, accounts payable and accrued liabilities consist of the following (in thousands):

	September 30, 2013	December 31, 2012
Interest payable	$9,093	$10,203
Accounts payable and accrued liabilities	37,516	19,168
Deferred revenue	16,793	15,800
Total interest payable, accounts payable and accrued liabilities	$63,402	$45,171

8. Interest Rate Contracts

Cash Flow Hedges of Interest Rate Risk
We make use of interest rate swap and interest rate cap contracts to manage the risk associated with changes in the interest rates on our floating-rate borrowings. When we enter into a floating-rate term loan, we generally enter into an interest rate swap agreement for the equivalent principal amount, for a period covering the majority of the loan term, which effectively converts our floating-rate debt to a fixed-rate basis during that time. In limited instances, we make use of interest rate caps to limit our exposure to interest rate increases on underlying floating-rate debt.

We may enter into derivative contracts that are intended to hedge certain economic risks, even though hedge accounting does not apply, or for which we elect to not apply hedge accounting. We do not use any other derivative instruments.

As of September 30, 2013, the totals of our existing swaps and caps that qualified as highly effective cash flow hedges were as follows:

Interest Rate Derivative	Number of Instruments	Notional (in thousands)
Interest Rate Swaps	7	$1,828,080
Interest Rate Caps	2	$111,920

Non-designated Hedges
Derivatives not designated as hedges are not speculative. As of September 30, 2013, we had the following outstanding interest rate derivatives that were not designated for accounting purposes as hedging instruments, but were used to hedge our economic exposure to interest rate risk:

Interest Rate Derivative	Number of Instruments	Notional (in thousands)
Purchased Caps	4	$100,000

Credit-risk-related Contingent Features
We have agreements with each of our derivative counterparties that contain a provision under which we could also be declared in default on our derivative obligations if we default on the underlying indebtedness that we are hedging, including any default where repayment of the indebtedness has not been accelerated by the lender. There have been no events of default with respect to any of our derivatives.

As of September 30, 2013 and December 31, 2012, the fair value of derivatives in a net liability position, when aggregated by counterparty, was $75.3 million and $107.4 million, respectively, which includes accrued interest but excludes any adjustment for nonperformance risk related to these agreements.

Accounting for Interest Rate Contracts
For hedging instruments designated as cash flow hedges, gain or loss recognition are generally matched to the earnings effect of the related hedged item or transaction, with any resulting hedge ineffectiveness recorded as interest expense. Hedge ineffectiveness is determined by comparing the changes in the fair value or cash flows of the hedge to the changes in the fair value or cash flows of the related hedged item or transaction. All other changes in the fair value of these hedges are recorded in accumulated other comprehensive income (loss) (AOCI), which is a component of

equity outside of earnings. Amounts reported in AOCI related to our hedges are then reclassified to interest expense as interest payments are made on the hedged item or transaction. Amounts reported in AOCI related to our Funds' hedges are reclassified to income including depreciation, from unconsolidated real estate funds as interest payments are made by our Funds on their hedged items or transactions. We estimate that $35.3 million of our AOCI related to our derivatives designated as cash flow hedges will be reclassified as an increase to interest expense during the next twelve months, and $846 thousand of our AOCI related to our Funds derivatives designated as cash flow hedges will be reclassified as a decrease to income (loss) including depreciation, from unconsolidated real estate funds during the next twelve months. Changes in fair value of derivatives not designated as hedges are recognized as interest expense.

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Douglas Emmett, Inc.
Notes to Consolidated Financial Statements (continued)
(unaudited)

The table below (in thousands) presents the effect of our derivative instruments on our consolidated statements of operations for the nine months ended September 30:

	2013	2012
Derivatives Designated as Cash Flow Hedges:		
Gain (loss) recognized in other comprehensive income (OCI) (effective portion)	$2,151	$(48,450)
Gain (loss) from unconsolidated investment in real estate funds recognized in other comprehensive income (OCI) (effective portion)	$1,810	$(1,356)
Gain (loss) reclassified from AOCI into interest expense (effective portion) [1]	$(27,093)	$(44,066)
Gain (loss) from unconsolidated investment in real estate funds reclassified from AOCI into Income (loss), including depreciation, from unconsolidated real estate funds (effective portion)	$(305)	$(5,535)
Gain (loss) reclassified from AOCI into interest expense (ineffective portion and amount excluded from effectiveness testing)	$—	$25
Amount of gain (loss) on derivatives recognized in earnings under "interest expense" (ineffective portion and amount excluded from effectiveness testing)	$—	$(64)
Derivatives Not Designated as Cash Flow Hedges:		
Realized and unrealized gain (loss) recognized in interest expense	$(3)	$(37)

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(1) The nine months ended September 30, 2012 includes a non-cash expense of $8.8 million related to the amortization of accumulated other comprehensive income balances on previously terminated swaps.

Fair Value Measurement

We record all derivatives on the balance sheet at fair value using the framework for measuring fair value established by the FASB. The fair value of these hedges is obtained through independent third-party valuation sources that use conventional valuation algorithms. All of our derivative contracts are subject to enforceable master netting arrangements, and we have elected to present the fair value of our derivatives on a gross basis. See Note 11 for our fair value disclosures.

The table below (in thousands) presents the fair values of derivative instruments:

	September 30, 2013	December 31, 2012
Derivative assets disclosed within "Other Assets" [(1)]:		
Derivatives designated as accounting hedges	$—	$—
Derivatives not designated as accounting hedges	1	4
Total derivative assets	$1	$4
Derivative liabilities disclosed as "Interest Rate Contracts":		
Derivatives designated as accounting hedges	$71,114	$100,294
Derivatives not designated as accounting hedges	—	—
Total derivative liabilities	$71,114	$100,294

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(1) Included in the "other" line item of other assets. See Note 5.

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9. Equity

Noncontrolling Interests

Noncontrolling interests in our operating partnership relate to interests that are not owned by us. Noncontrolling interests represented approximately 17% of our operating partnership at September 30, 2013. A unit in our operating partnership and a share of our common stock have essentially the same economic characteristics, as they share equally in the total net income or loss distributions of our operating partnership. Investors who own units in our operating partnership have the right to cause our operating partnership to redeem any or all of their units in our operating partnership for an amount of cash per unit equal to the then current market value of one share of common stock, or, at our election, shares of our common stock on a one-for-one basis. Noncontrolling interests also include a one-third interest of a minority partner in a consolidated joint venture which owns an office building in Honolulu, Hawaii.

The tables below (in thousands) present our condensed consolidated statements of equity:

	Douglas Emmett, Inc. Stockholders' Equity	Noncontrolling Interests	Total Equity
Balance as of January 1, 2013	$1,979,656	$410,803	$2,390,459
Net income	36,468	5,865	42,333
Cash flow hedge adjustment	25,367	5,992	31,359
Contributions	—	584	584
Dividends and distributions	(76,998)	(15,993)	(92,991)
Conversion of operating partnership units	18,630	(18,630)	—
Repurchase of operating partnership units	(172)	(180)	(352)
Stock compensation	—	4,864	4,864
Balance as of September 30, 2013	$1,982,951	$393,305	$2,376,256

	Douglas Emmett, Inc. Stockholders' Equity	Noncontrolling Interests	Total Equity
Balance as of January 1, 2012	$1,865,106	$450,849	$2,315,955
Net income	16,968	4,037	21,005
Cash flow hedge adjustment	(2,729)	2,499	(230)
Dividends and distributions	(63,017)	(13,768)	(76,785)
Conversion of operating partnership units	38,060	(38,060)	—
Stock compensation	521	7,526	8,047
Sale of common stock, net of offering costs	128,257	—	128,257
Other	—	(10)	(10)
Balance as of September 30, 2012	$1,983,166	$413,073	$2,396,239

Douglas Emmett, Inc.
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The table below (in thousands) presents the changes in our AOCI balance, which consists solely of adjustments related to our cash flow hedges and the cash flow hedges of our unconsolidated Funds:

	Nine Months Ended September 30,			
	2013		2012	
Balance at beginning of period	$(82,991	)	$(89,180	)
Other comprehensive income (loss) before reclassifications [1]	3,961		(49,806	)
Amounts reclassified from accumulated other comprehensive income [2]	27,398		49,576	
Net current period other comprehensive income (loss)	31,359		(230	)
Less other comprehensive (income) loss attributable to noncontrolling interests	(5,992	)	(2,499	)
Other comprehensive income (loss) attributable to common stockholders	25,367		(2,729	)
Balance at end of period	$(57,624	)	$(91,909	)

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(1) Includes (i) fair value adjustments to our derivatives designated as cash flow hedges of $2.2 million and $(48.5) million for the nine months ended September 30, 2013 and 2012, respectively, as well as (ii) our share of the fair value adjustments to derivatives designated as cash flow hedges of our unconsolidated Funds of $1.8 million and $(1.4) million for the nine months ended September 30, 2013 and 2012, respectively.

(2) Includes (i) a reclassification from AOCI to interest expense of $27.1 million and $44.1 million for the nine months ended September 30, 2013 and 2012, respectively, of our derivatives designated as cash flow hedges, as well as (ii) a reclassification from AOCI to income (loss) including depreciation of our unconsolidated real estate funds of $305 thousand and $5.5 million for the nine months ended September 30, 2013 and 2012, respectively, related to derivatives designated as cash flow hedges of our unconsolidated Funds.

Equity Sales, Conversions and Repurchases

During the nine months ended September 30, 2013, approximately 1.4 million units in our operating partnership were exchanged for shares of our common stock, and approximately 13 thousand units were redeemed for cash. We did not sell shares or share equivalents during the nine months ended September 30, 2013. During the nine months ended September 30, 2012, approximately 2.7 million units in our operating partnership were exchanged for shares of our common stock, and we sold 6.9 million shares of our common stock in open market transactions under our "at the market" (ATM) stock offering program for net proceeds of approximately $128.3 million. We did not repurchase shares or share equivalents during the nine months ended September 30, 2012 or September 30, 2013. The table below (in thousands) presents the net income attributable to common stockholders and transfers (to) from the noncontrolling interests:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income attributable to common stockholders	$10,751	$5,055	$36,468	$16,968
Transfers from the noncontrolling interests:				
Increase in common stockholders paid-in capital for redemption of operating partnership units	100	14,100	18,616	38,033
Change from net income attributable to common stockholders and transfers from noncontrolling	$10,851	$19,155	$55,084	$55,001

interest

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Stock-Based Compensation
The Douglas Emmett, Inc. 2006 Omnibus Stock Incentive Plan is administered by the compensation committee of our board of directors. All officers, employees, directors and consultants are eligible to participate in our stock incentive plan. For more information on our stock incentive plan, please refer to the notes to the consolidated financial statements in our 2012 Annual Report on Form 10-K, which was filed with the SEC on February 27, 2013.

Total net equity compensation expense for equity grants was $1.5 million and $1.6 million for the three months ended September 30, 2013 and 2012, respectively, and $4.6 million for the nine months ended September 30, 2013 and 2012. These amounts do not include (i) capitalized equity compensation totaling $97 thousand and $133 thousand for the three months ended September 30, 2013 and 2012, respectively, and $304 thousand and $387 thousand for the nine months ended September 30, 2013 and 2012, respectively, and (ii) $3.0 million in immediately vested equity grants issued during the nine months ended September 30, 2012 to satisfy a portion of the annual bonuses that were accrued during the prior year. Compensation expense for our long term incentive plan units which are not immediately vested is recognized using the accelerated recognition method. Compensation expense for options which are not immediately vested is recognized on a straight-line basis over the requisite service period which is equal to the vesting period. Certain amounts of equity compensation expense are capitalized for employees who provide leasing and construction services.

10. Earnings Per Share (EPS)

We calculate basic EPS by dividing the net income attributable to common stockholders for the period by the weighted average number of common shares outstanding during the period. We calculate diluted EPS by dividing the net income attributable to common stockholders and holders of equity in our consolidated operating partnership for the period by the weighted average number of common shares and dilutive instruments outstanding during the period using the treasury stock method. The table below presents the calculation of basic and diluted EPS:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Numerator (in thousands):				
Net income attributable to common stockholders	$10,751	$5,055	$36,468	$16,968
Add back: Net income attributable to noncontrolling interests in our Operating Partnership	2,134	1,072	7,261	3,713
Numerator for diluted net income attributable to all equity holders	$12,885	$6,127	$43,729	$20,681
Denominator (in thousands):				
Weighted average shares of common stock outstanding - basic	142,598	140,301	142,540	139,453
Effect of dilutive securities [1] :				
Operating partnership units and vested long term incentive plan (LTIP) units	28,323	29,908	28,382	30,517
Stock options	3,205	2,942	3,375	2,396
Unvested LTIP units	630	674	577	576
Weighted average shares of common stock and common stock equivalents outstanding - diluted	174,756	173,825	174,874	172,942

Basic earnings per share:				
Net income attributable to common stockholders per share	$0.08	$0.04	$0.26	$0.12
Diluted earnings per share:				
Net income attributable to common stockholders per share	$0.07	$0.04	$0.25	$0.12

(1) Diluted shares are calculated in accordance with GAAP, and represent ownership in our company through shares of common stock, units in our operating partnership, and other convertible equity instruments.

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11. Fair Value of Financial Instruments

Our estimates of the fair value of financial instruments at September 30, 2013 were determined using available market information and appropriate valuation methods. Considerable judgment is necessary to interpret market data and develop an estimated fair value. The use of different market assumptions or estimation methods may have a material effect on the estimated fair value amounts.

The FASB fair value framework includes a hierarchy that distinguishes between assumptions based on market data obtained from sources independent of the reporting entity, and the reporting entity's own assumptions about market-based inputs. Level 1 inputs utilize unadjusted quoted prices in active markets for identical assets or liabilities. Level 2 inputs are observable either directly or indirectly for similar assets and liabilities in active markets. Level 3 inputs are unobservable assumptions generated by the reporting entity.

The carrying amounts for cash and cash equivalents, rents and other receivables, interest payable, accounts payable and accrued liabilities, security deposits, and dividends payable approximate their fair values because of the short-term nature of these instruments.

We have typically financed our capital needs through short-term lines of credit and long-term secured mortgages. See Note 6. We calculate the fair value of our secured notes payable by adjusting their face value for current market interest rates (assuming the loans are outstanding through maturity) and any changes to underlying collateral. We have determined that the fair value of our secured notes payable is calculated using Level 2 inputs under the fair value hierarchy. At September 30, 2013, the aggregate fair value of our secured notes payable was estimated to be approximately $3.40 billion, based on a credit-adjusted present value of the future principal and interest payments related to our debt, compared to their carrying value of $3.35 billion. As of December 31, 2012, the estimated fair value of our secured loans was approximately $3.51 billion compared to their carrying value of $3.44 billion.

We use interest rate swaps and caps to manage interest rate risk resulting from variable interest payments on our floating rate debt. See Note 8. These financial instruments are carried on our balance sheet at fair value based on assumptions