Hudson Pacific Properties, Inc.
Form 10-Q
November 07, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

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

For the Transition Period from ______ to ______
Commission File Number 001-34789

Hudson Pacific Properties, Inc.
(Exact name of Registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	27-1430478 (I.R.S. Employer Identification Number)
11601 Wilshire Blvd., Sixth Floor Los Angeles, California	90025
(Address of principal executive offices)	(Zip Code)

(310) 445-5700
(Registrant's telephone number, including area code)
(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 o.

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o.

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

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	o

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

The number of shares of common stock outstanding at November 1, 2014 was 67,048,781.

Table of Contents

Hudson Pacific Properties, Inc.
FORM 10-Q
September 30, 2014
TABLE OF CONTENTS

Table of Contents

PART I—FINANCIAL INFORMATION

HUDSON PACIFIC PROPERTIES, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	September 30, 2014 (unaudited)	December 31, 2013 (audited)
ASSETS		
REAL ESTATE ASSETS		
Land	$622,880	$578,787
Building and improvements	1,322,314	1,250,752
Tenant improvements	109,656	107,628
Furniture and fixtures	13,818	14,396
Property under development	80,652	70,128
Total real estate held for investment	2,149,320	2,021,691
Accumulated depreciation and amortization	(133,463)	(114,866)
Investment in real estate, net	2,015,857	1,906,825
Cash and cash equivalents	69,397	30,356
Restricted cash	19,650	16,750
Accounts receivable, net	14,178	8,909
Notes receivable	28,112	—
Straight-line rent receivables	31,550	21,538
Deferred leasing costs and lease intangibles, net	109,476	111,398
Deferred finance costs, net	8,884	8,582
Interest rate contracts	15	192
Goodwill	8,754	8,754
Prepaid expenses and other assets	11,576	5,170
Assets associated with real estate held for sale	—	12,801
TOTAL ASSETS	$2,317,449	$2,131,275
LIABILITIES AND EQUITY		
Notes payable	$920,860	$931,308
Accounts payable and accrued liabilities	35,642	27,490
Below-market leases, net	42,935	45,439
Security deposits	6,411	5,941
Prepaid rent	11,328	7,623
Interest rate contracts	907	—
Liabilities associated with real estate sold	361	133
TOTAL LIABILITIES	1,018,444	1,017,934
6.25% series A cumulative redeemable preferred units of the Operating Partnership	10,177	10,475
EQUITY		
Hudson Pacific Properties, Inc. stockholders' equity:		
Preferred stock, $0.01 par value, 10,000,000 authorized; 8.375% series B cumulative redeemable preferred stock, $25.00 liquidation preference, 5,800,000 shares outstanding at September 30, 2014 and December 31, 2013, respectively	145,000	145,000
	668	572

Common stock, $0.01 par value, 490,000,000 authorized, 66,795,992 shares and 57,230,199 shares outstanding at September 30, 2014 and December 31, 2013, respectively		
Additional paid-in capital	1,080,862	903,984
Accumulated other comprehensive loss	(1,749)	(997)
Accumulated deficit	(32,662)	(45,113)
Total Hudson Pacific Properties, Inc. stockholders' equity	1,192,119	1,003,446
Non-controlling interest—members in Consolidated Entities	43,453	45,683
Non-controlling common units in the Operating Partnership	53,256	53,737
TOTAL EQUITY	1,288,828	1,102,866
TOTAL LIABILITIES AND EQUITY	$2,317,449	$2,131,275

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

Table of Contents

HUDSON PACIFIC PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(in thousands, except share and per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues				
Office				
Rental	$39,503	$33,575	$115,418	$89,665
Tenant recoveries	12,084	6,520	23,643	17,617
Parking and other	5,140	3,426	16,632	10,472
Total office revenues	56,727	43,521	155,693	117,754
Media & entertainment				
Rental	6,239	5,977	17,646	17,162
Tenant recoveries	267	500	971	1,241
Other property-related revenue	4,583	3,170	11,028	11,368
Other	339	180	542	616
Total media & entertainment revenues	11,428	9,827	30,187	30,387
Total revenues	68,155	53,348	185,880	148,141
Operating expenses				
Office operating expenses	23,969	16,766	58,469	44,191
Media & entertainment operating expenses	7,401	6,136	19,244	18,133
General and administrative	6,802	5,020	19,157	15,195
Depreciation and amortization	17,361	20,256	51,973	53,069
Total operating expenses	55,533	48,178	148,843	130,588
Income from operations	12,622	5,170	37,037	17,553
Other expense (income)				
Interest expense	6,550	7,319	19,519	18,673
Interest income	(1)	(22)	(21)	(262)
Acquisition-related expenses	214	483	319	992
Other expenses	(56)	(13)	(43)	41
	6,707	7,767	19,774	19,444
Income (loss) from continuing operations before gain on sale of real estate	5,915	(2,597)	17,263	(1,891)
Gain on sale of real estate	5,538	—	5,538	—
Income (loss) from continuing operations	11,453	(2,597)	22,801	(1,891)
(Loss) income from discontinued operations	(38)	(10)	(164)	1,608
Impairment loss from discontinued operations	—	(145)	—	(5,580)
Net loss from discontinued operations	(38)	(155)	(164)	(3,972)
Net income (loss)	11,415	(2,752)	22,637	(5,863)
Net income attributable to preferred stock and units	(3,195)	(3,231)	(9,590)	(9,693)
Net income attributable to restricted shares	(68)	(71)	(206)	(229)
Net (income) loss attributable to non-controlling interest in consolidated entities	(259)	118	(155)	399
Net (income) loss attributable to common units in the Operating Partnership	(273)	242	(441)	636
	$7,620	$(5,694)	$12,245	$(14,750)

Net income (loss) attributable to Hudson Pacific Properties, Inc. common stockholders				
Basic and diluted per share amounts:				
Net income (loss) from continuing operations attributable to common stockholders	0.11	(0.10)	$0.19	$(0.20)
Net loss from discontinued operations	—	—	—	(0.07)
Net income (loss) attributable to common stockholders' per share—basic and diluted	$0.11	$(0.10)	$0.19	$(0.27)
Weighted average shares of common stock outstanding—basic and diluted	66,506,179	56,144,099	65,549,741	54,815,763
Dividends declared per share of common stock	$0.1250	$0.1250	$0.3750	$0.3750

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

4

Table of Contents

HUDSON PACIFIC PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(in thousands, except share and per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income (loss)	$11,415	$(2,752)	$22,637	$(5,863)
Other comprehensive (loss) income: cash flow hedge adjustment	584	(846)	(780)	(731)
Comprehensive income (loss)	11,999	(3,598)	21,857	(6,594)
Comprehensive income attributable to preferred stock and units	(3,195)	(3,231)	(9,590)	(9,693)
Comprehensive income attributable to restricted shares	(68)	(71)	(206)	(229)
Comprehensive loss attributable to non-controlling interest in consolidated real estate entities	(259)	118	(155)	399
Comprehensive (income) loss attributable to common units in the Operating Partnership	(293)	276	(413)	665
Comprehensive income (loss) attributable to Hudson Pacific Properties, Inc. stockholders	$8,184	$(6,506)	$11,493	$(15,452)

The accompanying notes are an integral part of these consolidated financial statements.
5

Table of Contents

HUDSON PACIFIC PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF EQUITY
(Unaudited)
(in thousands, except share and per share amounts)

	Hudson Pacific Properties, Inc. Stockholders' Equity									
	Shares of Common Stock	Stock Amount	Series B Cumulative Redeemable Preferred Stock	Additional Paid in Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss) Income	Non-controlling Interests — Common units in the Operating Partnership	Non-controlling Interest — Members in Consolidated Entities	Total Equity	Non-controlling Interests — Series A Cumulative Redeemable Preferred Units
Balance at January 1, 2013	47,496,732	$475	$145,000	$726,605	$(30,580)	$(1,287)	$55,549	$1,460	$897,222	$12,475
Contributions	—	—	—	—	—	—	—	45,704	45,704	—
Distributions	—	—	—	—	—	—	—	(1,160)	(1,160)	(2,000)
Proceeds from sale of common stock, net of underwriters' discount	9,812,644	98	—	202,444	—	—	—	—	202,542	—
Common stock issuance transaction costs	—	—	—	(577)	—	—	—	—	(577)	—
Issuance of unrestricted stock	5,756	—	—	—	—	—	—	—	—	—
Issuance of restricted stock	44,219	—	—	—	—	—	—	—	—	—
Forfeiture of restricted stock	(3,415)	—	—	—	—	—	—	—	—	—
Shares repurchased	(125,737)	(1)	—	(2,755)	—	—	—	—	(2,756)	—
Declared dividend	—	—	(12,144)	(28,415)	—	—	(1,192)	—	(41,751)	(749)
Amortization of stock-based compensation	—	—	—	6,682	—	—	—	—	6,682	—
Net income (loss)	—	—	12,144	—	(14,533)		(633)	(321)	(3,343)	749
Cash flow hedge adjustment	—	—	—	—	—	290	13	—	303	—

Balance at December 31, 2013	57,230,199	$572	$145,000	$903,984	$(45,113)	$(997)	$53,737	$45,683	$1,102,866	$10,475
Distributions	—	—	—	—	—	—	—	(2,385)	(2,385)	—
Proceeds from sale of common stock, net of underwriters' discount	9,563,500	96	—	197,372	—	—	—	—	197,468	—
Common stock issuance transaction costs	—	—	—	(674)	—	—	—	—	(674)	—
Redemption of Series A Cumulative Redeemable Preferred Units	—	—	—	—	—	—	—	—	—	(298)
Issuance of unrestricted stock	5,098	—	—	—	—	—	—	—	—	—
Shares repurchased	(2,805)	—	—	—	—	—	—	—	—	—
Declared Dividend	—	—	(9,108)	(25,140)	—	—	(894)		(35,142)	(482)
Amortization of stock-based compensation	—	—	—	5,320	—	—	—	—	5,320	—
Net income	—	—	9,108	—	12,451	—	441	155	22,155	482
Cash Flow Hedge Adjustment	—	—	—	—	—	(752)	(28)	—	(780)	—
Balance at September 30, 2014	66,795,992	$668	$145,000	$1,080,862	$(32,662)	$(1,749)	$53,256	$43,453	$1,288,828	$10,177

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

6

Table of Contents

HUDSON PACIFIC PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

	Nine Months Ended September 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$22,637	$(5,863)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	51,973	53,858
Amortization of deferred financing costs and loan premium, net	635	421
Amortization of stock-based compensation	5,047	4,974
Straight-line rent receivables	(9,830)	(7,632)
Amortization of above-market leases	1,543	1,999
Amortization of below-market leases	(5,821)	(6,343)
Amortization of lease incentive costs	246	37
Bad debt expense	(326)	176
Amortization of ground lease	186	185
(Gain) / Loss from Sale of Real Estate	(5,538)	—
Impairment loss	—	5,580
Change in operating assets and liabilities:		
Restricted cash	(2,900)	(122)
Accounts receivable	(4,925)	344
Deferred leasing costs and lease intangibles	(11,509)	(13,440)
Prepaid expenses and other assets	(3,532)	(1,764)
Accounts payable and accrued liabilities	16,394	16,774
Security deposits	389	(439)
Prepaid rent	3,677	(4,813)
Net cash provided by operating activities	58,346	43,932
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to investment property	(79,154)	(53,576)
Property acquisitions	(75,580)	(389,883)
Acquisition of notes receivable	(28,112)	—
Proceeds from sale of real estate	18,629	52,994
Deposits for property acquisitions	(2,500)	—
Net cash used in investing activities	(166,717)	(390,465)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from notes payable	332,886	369,361
Payments of notes payable	(341,636)	(167,255)
Proceeds from issuance of common stock	197,468	189,888
Common stock issuance transaction costs	(674)	(392)
Dividends paid to common stock and unit holders	(26,034)	(22,161)
Dividends paid to preferred stock and unit holders	(9,590)	(9,693)
Redemption of 6.25% series A cumulative redeemable preferred units	(298)	—
Distribution to non-controlling member in consolidated real estate entity	(2,385)	(425)
Repurchase of vested restricted stock	—	(650)
Payment of loan costs	(2,325)	(1,703)
Net cash provided by financing activities	147,412	356,970

Net increase in cash and cash equivalents	39,041	10,437
Cash and cash equivalents—beginning of period	30,356	18,904
Cash and cash equivalents—end of period	$69,397	$29,341

The accompanying notes are an integral part of these consolidated financial statements.
7

Table of Contents

HUDSON PACIFIC PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS—(Continued)
(Unaudited)
(in thousands)

	Nine Months Ended September 30,	
	2014	2013
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Cash paid for interest, net of amounts capitalized	$23,824	$19,589
NON-CASH INVESTING ACTIVITIES:		
Accounts payable and accrued liabilities for investment in property	$8,906	$6,204
Assumption of secured debt in connection with property acquisitions (Notes 3 and 5)	$—	$102,299
Non-controlling interest in consolidated real estate entity (Note 3)	$—	$45,704
Assumption of other (assets) and liabilities in connection with property acquisitions, net (Note 3)	$(449)	$(2,423)

The accompanying notes are an integral part of these consolidated financial statements.
8

Table of Contents

Hudson Pacific Properties, Inc.
Notes to Consolidated Financial Statements
(Unaudited, tabular amounts in thousands, except square footage and share data or as otherwise noted)

1. Organization

Hudson Pacific Properties, Inc. (which is referred to in these financial statements as the “Company,” “we,” “us,” or “our”) is a Maryland corporation formed on November 9, 2009 that did not have any meaningful operating activity until the consummation of our initial public offering and the related acquisition of our predecessor and certain other entities on June 29, 2010 (“IPO”).

Since the completion of the IPO, we have been a fully integrated, self-administered, and self-managed real estate investment trust (“REIT”). Through our controlling interest in Hudson Pacific Properties, L.P. (our “Operating Partnership”) and its subsidiaries, we own, manage, lease, acquire and develop real estate, consisting primarily of office and media and entertainment properties. As of September 30, 2014, we owned a portfolio of 25 office properties and two media and entertainment properties. These properties are located in California and Washington. The results of operations for properties acquired after our IPO are included in our consolidated statements of operations from the date of each such acquisition.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements of the Company are prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). The effect of all significant intercompany balances and transactions has been eliminated.

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 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, 2014. The interim financial statements should be read in conjunction with the consolidated financial statements in our 2013 Annual Report on Form 10-K and the notes thereto. Any reference 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.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of commitments and contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, the Company evaluates its estimates, including those related to acquiring, developing and assessing the carrying values of its real estate properties, its accrued liabilities, and its performance-based equity compensation awards. The Company bases its estimates on historical experience, current market conditions, and various other assumptions that are believed to be reasonable under the circumstances. Actual results could materially differ from these estimates.

Investment in Real Estate Properties

The properties are carried at cost less accumulated depreciation and amortization. The Company assigns the cost of an acquisition, including the assumption of liabilities, to the acquired tangible assets and identifiable intangible assets and liabilities based on their estimated fair values in accordance with GAAP. The Company assesses fair value based on estimated cash flow projections that utilize discount and/or capitalization rates and available market information. Estimates of future cash flows are based on a number of factors, including historical operating results, known and anticipated trends, and market and economic conditions. The fair value of tangible assets of an acquired property considers the value of the property as if it was vacant.

Acquisition-related expenses associated with acquisition of operating properties are expensed in the period incurred.

The Company records acquired above- and below- market leases at fair value using discount rates that reflect the risks associated with the leases acquired. The amount recorded is based on the present value of the difference between (i) the contractual amounts to be paid pursuant to each in-place lease and (ii) management's estimate of fair market lease rates for each in-place lease, measured over a period equal to the remaining term of the lease for above-market leases and the initial term plus the extended term for any leases with below-market renewal options. Other intangible assets acquired include amounts for in-place lease values that are based on the Company's evaluation of the specific characteristics of each tenant's lease. Factors considered include estimates of carrying costs during hypothetical expected lease-up periods, market conditions and costs to execute similar leases. In estimating carrying costs, the Company includes estimates of lost rents at market rates during the hypothetical expected lease-up periods, which are dependent on local market conditions. In estimating costs to execute similar leases, the Company considers leasing commissions, legal and other related costs.

The Company capitalizes direct construction and development costs, including predevelopment costs, interest, property taxes, insurance and other costs directly related and essential to the acquisition, development or construction of a real estate project. Indirect development costs, including salaries and benefits, office rent, and associated costs for those individuals directly responsible for and who spend their time on development activities are also capitalized and allocated to the projects to which they relate. Capitalized personnel costs for the three and nine months ended September 30, 2014 were approximately $0.8 million and $2.1 million, respectively, and $0.5 million and $1.5 million for the three and nine months ended September 30, 2013, respectively. Interest is capitalized on the construction in progress at a rate equal to the Company's weighted average cost of debt. Capitalized interest for the three and nine months ended September 30, 2014 was approximately $1.9 million and $5.2 million, respectively, and $1.1 million and $2.8 million for the three and nine months ended September 30, 2013, respectively. Construction and development costs are capitalized while substantial activities are ongoing to prepare an asset for its intended use. The Company considers a construction project as substantially complete and held available for occupancy upon the completion of tenant improvements but no later than one year after cessation of major construction activity. Costs incurred after a project is substantially complete and ready for its intended use, or after development activities have ceased, are expensed as they are incurred. Costs previously capitalized related to abandoned acquisitions or developments are charged to earnings. Expenditures for repairs and maintenance are expensed as they are incurred.

The Company computes depreciation using the straight-line method over the estimated useful lives of 39 years for building and improvements, 15 years for land improvements, 5 to 7 years for furniture and fixtures and equipment, and over the shorter of asset life or life of the lease for tenant improvements. Above- and below-market lease intangibles are amortized to revenue over the remaining non-cancellable lease terms and bargain renewal periods, if applicable. Other in-place lease intangibles are amortized to expense over the remaining non-cancellable lease term. Depreciation is discontinued when a property is identified as held for sale.

Impairment of Long-Lived Assets

The Company assesses the carrying value of real estate assets and related intangibles whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable in accordance with GAAP. Impairment losses are recorded on real estate assets held for investment when indicators of impairment are present and the future undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. The Company recognizes impairment losses to the extent the carrying amount exceeds the fair value of the properties. Properties held for sale are recorded at the lower of cost or estimated fair value less cost to sell. There were no properties held for sale at September 30, 2014 and December 31, 2013. The Company recorded $5.6 million of impairment charges related to a property held for sale during the nine months ended September 30, 2013 with no comparable charge for the nine months ended September 30, 2014.

Goodwill

Goodwill represents the excess of acquisition cost over the fair value of net tangible and identifiable intangible assets acquired and liabilities assumed in business combinations. Our goodwill balance as of September 30, 2014 was $8.8 million. We do not amortize this asset but instead analyze it on an annual basis for impairment. No impairment indicators have been noted during the three and nine months ended September 30, 2014 and 2013.

Hudson Pacific Properties, Inc.
Notes to Consolidated Financial Statements—(Continued)
(Unaudited, tabular amounts in thousands, except square footage and share data)

Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand and in banks, plus all short-term investments with a maturity of three months or less when purchased.

The Company maintains some of its cash in bank deposit accounts that, at times, may exceed the federally insured limit. No losses have been experienced related to such accounts.

Restricted Cash

Restricted cash consists of amounts held by lenders to provide for future real estate taxes and insurance expenditures, repairs and capital improvements reserves, general and other reserves and security deposits.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due for monthly rents and other charges. The Company maintains an allowance for doubtful accounts for estimated losses resulting from tenant defaults or the inability of tenants to make contractual rent and tenant recovery payments. The Company monitors the liquidity and creditworthiness of its tenants and operators on an ongoing basis. This evaluation considers industry and economic conditions, property performance, credit enhancements and other factors. For straight-line rent amounts, the Company's assessment is based on amounts estimated to be recoverable over the term of the lease. At September 30, 2014 and December 31, 2013, the Company had reserved $0.5 million and $0.3 million, respectively, of straight-line receivables. The Company evaluates the collectability of accounts receivable based on a combination of factors. The allowance for doubtful accounts is based on specific identification of uncollectible accounts and the Company's historical collection experience. The Company recognizes an allowance for doubtful accounts based on the length of time the receivables are past due, the current business environment and the Company's historical experience. Historical experience has been within management's expectations. The Company recognized $(0.3) million and $0.2 million of bad debt (recovery) expense for the nine months ended September 30, 2014 and 2013, respectively.

The following summarizes our accounts receivable net of allowance for doubtful accounts as of:

	September 30, 2014	December 31, 2013
Accounts receivable	$14,944	$10,152
Allowance for doubtful accounts	(766)	(1,243)
Accounts receivable, net	$14,178	$8,909

Revenue Recognition

The Company recognizes rental revenue from tenants on a straight-line basis over the lease term when collectability is reasonably assured and the tenant has taken possession or controls the physical use of the leased asset. If the lease provides for tenant improvements, the Company determines whether the tenant improvements, for accounting purposes, are owned by the tenant or the Company. When the Company is the owner of the tenant improvements, the tenant is not considered to have taken physical possession or have control of the physical use of the leased asset until the tenant improvements are substantially completed. When the tenant is the owner of the tenant improvements, any tenant improvement allowance that is funded is treated as a lease incentive and amortized as a reduction of revenue over the lease term. Tenant improvement ownership is determined based on various factors including, but not limited to:

- whether the lease stipulates how and on what a tenant improvement allowance may be spent;
- whether the tenant or landlord retains legal title to the improvements at the end of the lease term;
- whether the tenant improvements are unique to the tenant or general-purpose in nature; and
- whether the tenant improvements are expected to have any residual value at the end of the lease.

Certain leases provide for additional rents contingent upon a percentage of the tenant's revenue in excess of specified base amounts or other thresholds. Such revenue is recognized when actual results reported by the tenant, or estimates of tenant results, exceed the base amount or other thresholds. Such revenue is recognized only after the contingency has been removed (when the related thresholds are achieved), which may result in the recognition of rental revenue in periods subsequent to when such payments are received.

Other property-related revenue is revenue that is derived from the tenants' use of lighting, equipment rental, parking, power, HVAC and telecommunications (phone and Internet). Other property-related revenue is recognized when these items are provided.

Tenant recoveries related to reimbursement of real estate taxes, insurance, repairs and maintenance, and other operating expenses are recognized as revenue in the period during which the applicable expenses are incurred. The reimbursements are recognized and presented gross, as the Company is generally the primary obligor with respect to purchasing goods and services from third-party suppliers, has discretion in selecting the supplier and bears the associated credit risk.

The Company recognizes gains on sales of properties upon the closing of the transaction with the purchaser. Gains on properties sold are recognized using the full accrual method when (i) the collectability of the sales price is reasonably assured, (ii) the Company is not obligated to perform significant activities after the sale, (iii) the initial investment from the buyer is sufficient and (iv) other profit recognition criteria have been satisfied. Gains on sa