ALEXANDRIA REAL ESTATE EQUITIES INC
Form 10-Q
October 31, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2017

OR

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

For the transition period from ____________ to ____________

Commission file number 1-12993

ALEXANDRIA REAL ESTATE EQUITIES, INC.
(Exact name of registrant as specified in its charter)

Maryland	95-4502084
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

385 East Colorado Boulevard, Suite 299, Pasadena, California 91101
(Address of principal executive offices) (Zip code)

(626) 578-0777
(Registrant's telephone number, including area code)

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

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

Large accelerated filer	Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Emerging growth company

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

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

As of October 16, 2017, 95,717,826 shares of common stock, par value $0.01 per share, were outstanding.

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GLOSSARY

The following abbreviations or acronyms that may be used in this document shall have the adjacent meanings set forth below:

ASU	Accounting Standards Update
ATM	At the Market
CIP	Construction in Progress
EPS	Earnings per Share
FASB	Financial Accounting Standards Board
FFO	Funds from Operations
GAAP	U.S. Generally Accepted Accounting Principles
HVAC	Heating, Ventilation, and Air Conditioning
JV	Joint Venture
LEED®	Leadership in Energy and Environmental Design
LIBOR	London Interbank Offered Rate
NAREIT	National Association of Real Estate Investment Trusts
NAV	Net Asset Value
NYSE	New York Stock Exchange
REIT	Real Estate Investment Trust
RSF	Rentable Square Feet/Foot
SEC	Securities and Exchange Commission
SF	Square Feet/Foot
SoMa	South of Market (submarket of the San Francisco market)
U.S.	United States
VIE	Variable Interest Entity

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

Alexandria Real Estate Equities, Inc.
Consolidated Balance Sheets
(In thousands)
(Unaudited)

	September 30, 2017	December 31, 2016
Assets		
Investments in real estate	$10,046,521	$9,077,972
Investments in unconsolidated real estate joint ventures	33,692	50,221
Cash and cash equivalents	118,562	125,032
Restricted cash	27,713	16,334
Tenant receivables	9,899	9,744
Deferred rent	402,353	335,974
Deferred leasing costs	208,265	195,937
Investments	485,262	342,477
Other assets	213,056	201,197
Total assets	$11,545,323	$10,354,888
Liabilities, Noncontrolling Interests, and Equity		
Secured notes payable	$1,153,890	$1,011,292
Unsecured senior notes payable	2,801,290	2,378,262
Unsecured senior line of credit	314,000	28,000
Unsecured senior bank term loans	547,860	746,471
Accounts payable, accrued expenses, and tenant security deposits	740,070	731,671
Dividends payable	83,402	76,914
Total liabilities	5,640,512	4,972,610
Commitments and contingencies		
Redeemable noncontrolling interests	11,418	11,307
Alexandria Real Estate Equities, Inc.'s stockholders' equity:		
7.00% Series D cumulative convertible preferred stock	74,386	86,914
6.45% Series E cumulative redeemable preferred stock	—	130,000
Common stock	943	877
Additional paid-in capital	5,287,777	4,672,650
Accumulated other comprehensive income	43,864	5,355
Alexandria Real Estate Equities, Inc.'s stockholders' equity	5,406,970	4,895,796
Noncontrolling interests	486,423	475,175
Total equity	5,893,393	5,370,971
Total liabilities, noncontrolling interests, and equity	$11,545,323	$10,354,888

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

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Alexandria Real Estate Equities, Inc.
Consolidated Statements of Income
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues:				
Rental	$216,021	$166,591	$635,156	$486,505
Tenant recoveries	67,058	58,681	188,874	165,385
Other income	2,291	5,107	5,276	20,654
Total revenues	285,370	230,379	829,306	672,544
Expenses:				
Rental operations	83,469	72,002	237,536	205,164
General and administrative	17,636	15,854	56,099	46,426
Interest	31,031	25,850	92,563	75,730
Depreciation and amortization	107,788	77,133	309,069	218,168
Impairment of real estate	—	8,114	203	193,237
Loss on early extinguishment of debt	—	3,230	670	3,230
Total expenses	239,924	202,183	696,140	741,955
Equity in earnings (losses) of unconsolidated real estate joint ventures	14,100	273	15,050	(270)
Gain on sales of real estate – rental properties	—	—	270	—
Gain on sales of real estate – land parcels	—	90	111	90
Net income (loss)	59,546	28,559	148,597	(69,591)
Net income attributable to noncontrolling interests	(5,773)	(4,084)	(18,892)	(11,614)
Net income (loss) attributable to Alexandria Real Estate Equities, Inc.'s stockholders	53,773	24,475	129,705	(81,205)
Dividends on preferred stock	(1,302)	(5,007)	(6,364)	(16,388)
Preferred stock redemption charge	—	(13,095)	(11,279)	(25,614)
Net income attributable to unvested restricted stock awards	(1,198)	(921)	(3,498)	(2,807)
Net income (loss) attributable to Alexandria Real Estate Equities, Inc.'s common stockholders	$51,273	$5,452	$108,564	$(126,014)
Net income (loss) per share attributable to Alexandria Real Estate Equities, Inc.'s common stockholders – basic and diluted	$0.55	$0.07	$1.20	$(1.69)
Dividends declared per share of common stock	$0.86	$0.80	$2.55	$2.40

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

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Alexandria Real Estate Equities, Inc.
Consolidated Statements of Comprehensive Income
(In thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income (loss)	$59,546	$28,559	$148,597	$(69,591)
Other comprehensive income (loss)				
Unrealized gains (losses) on available-for-sale equity securities:				
Unrealized holding gains (losses) arising during the period	17,018	(38,621)	23,414	(70,055)
Reclassification adjustment for (gains) losses included in net income (loss)	—	(8,540)	2,482	(18,627)
Unrealized gains (losses) on available-for-sale equity securities, net	17,018	(47,161)	25,896	(88,682)
Unrealized gains (losses) on interest rate hedge agreements:				
Unrealized interest rate hedge gains (losses) arising during the period	145	2,982	812	(7,655)
Reclassification adjustment for amortization of interest expense included in net income (loss)	198	1,702	1,810	3,725
Unrealized gains (losses) on interest rate hedge agreements, net	343	4,684	2,622	(3,930)
Unrealized gains on foreign currency translation:				
Unrealized foreign currency translation gains (losses) arising during the period	3,836	(1,322)	7,592	842
Reclassification adjustment for cumulative foreign currency translation losses included in net income (loss) upon sale or liquidation	—	3,779	2,421	10,807
Unrealized gains on foreign currency translation, net	3,836	2,457	10,013	11,649
Total other comprehensive income (loss)	21,197	(40,020)	38,531	(80,963)
Comprehensive income (loss)	80,743	(11,461)	187,128	(150,554)
Less: comprehensive income attributable to noncontrolling interests	(5,783)	(4,081)	(18,914)	(11,587)
Comprehensive income (loss) attributable to Alexandria Real Estate Equities, Inc.’s common stockholders	$74,960	$(15,542)	$168,214	$(162,141)

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

Alexandria Real Estate Equities, Inc.
Consolidated Statement of Changes in Stockholders' Equity and Noncontrolling Interests
(Dollars in thousands)
(Unaudited)

	Alexandria Real Estate Equities, Inc.'s Stockholders' Equity									
	7.00% Series D Cumulative Convertible Preferred Stock	6.45% Series E Cumulative Redeemable Preferred Stock	Number of Common Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Noncontrolling Interests	Total Equity	Redeemable Noncontrolling Interests
Balance as of December 31, 2016	$86,914	$130,000	87,665,880	$877	$4,672,650	$—	$5,355	$475,175	$5,370,971	$11,307
Net income	—	—	—	—	—	129,705	—	18,139	147,844	753
Total other comprehensive income	—	—	—	—	—	—	38,509	22	38,531	—
Distributions to noncontrolling interests	—	—	—	—	—	—	—	(16,790)	(16,790)	(642)
Contributions from noncontrolling interests	—	—	—	—	—	—	—	9,877	9,877	—
Issuances of common stock	—	—	6,249,309	62	705,329	—	—	—	705,391	—
Issuances pursuant to stock plan	—	—	409,360	4	30,638	—	—	—	30,642	—
Repurchase of 7.00% Series D preferred stock	(12,528)	—	—	—	391	(5,797)	—	—	(17,934)	—
Redemption of 6.45% Series E preferred stock	—	(130,000)	—	—	5,132	(5,482)	—	—	(130,350)	—
Dividends declared on common stock	—	—	—	—	—	(238,425)	—	—	(238,425)	—
Dividends declared on preferred stock	—	—	—	—	—	(6,364)	—	—	(6,364)	—
Distributions in excess of earnings	—	—	—	—	(126,363)	126,363	—	—	—	—
	$74,386	$—	94,324,549	$943	$5,287,777	$—	$43,864	$486,423	$5,893,393	$11,418

Balance as of
September 30,
2017

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

Alexandria Real Estate Equities, Inc.
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2017	2016
Operating Activities		
Net income (loss)	$148,597	$(69,591)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	309,069	218,168
Loss on early extinguishment of debt	670	3,230
Gain on sales of real estate – rental properties	(270)	—
Impairment of real estate	203	193,237
Gain on sales of real estate – land parcels	(111)	(90)
Equity in (earnings) losses of unconsolidated real estate joint ventures	(15,050)	270
Distributions of earnings from unconsolidated real estate joint ventures	249	286
Amortization of loan fees	8,578	8,792
Amortization of debt premiums	(1,873)	(117)
Amortization of acquired below-market leases	(14,908)	(2,905)
Deferred rent	(74,362)	(30,679)
Stock compensation expense	18,649	19,007
Investment gains	(8,425)	(28,721)
Investment losses	6,418	10,670
Changes in operating assets and liabilities:		
Restricted cash	(912)	(278)
Tenant receivables	(224)	843
Deferred leasing costs	(39,925)	(21,621)
Other assets	(10,662)	(14,813)
Accounts payable, accrued expenses, and tenant security deposits	30,619	6,163
Net cash provided by operating activities	356,330	291,851
Investing Activities		
Proceeds from sales of real estate	4,263	27,332
Additions to real estate	(660,877)	(638,568)
Purchases of real estate	(590,884)	(18,108)
Deposits for investing activities	4,700	(54,998)
Investments in unconsolidated real estate joint ventures	(248)	(6,924)
Return of capital from unconsolidated real estate joint ventures	38,576	—
Additions to investments	(128,190)	(68,384)
Sales of investments	18,896	35,295
Repayment of notes receivable	—	9,054
Net cash used in investing activities	$(1,313,764)	$(715,301)

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Alexandria Real Estate Equities, Inc.
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2017	2016
Financing Activities		
Borrowings from secured notes payable	$145,272	$215,330
Repayments of borrowings from secured notes payable	(2,882)	(234,096)
Proceeds from issuance of unsecured senior notes payable	424,384	348,604
Borrowings from unsecured senior line of credit	2,634,000	2,349,000
Repayments of borrowings from unsecured senior line of credit	(2,348,000)	(2,084,000)
Repayments of borrowings from unsecured senior bank term loans	(200,000)	(200,000)
Change in restricted cash related to financing activities	(10,467)	7,742
Payment of loan fees	(4,343)	(16,499)
Repurchase of 7.00% Series D cumulative convertible preferred stock	(17,934)	(98,633)
Redemption of 6.45% Series E cumulative redeemable preferred stock	(130,350)	—
Proceeds from the issuance of common stock	705,391	367,802
Dividends on common stock	(229,814)	(177,966)
Dividends on preferred stock	(8,317)	(17,487)
Financing costs paid for sale of noncontrolling interests	—	(8,093)
Contributions from and sale of noncontrolling interests	9,877	68,621
Distributions to and purchase of noncontrolling interests	(17,432)	(62,605)
Net cash provided by financing activities	949,385	457,720
Effect of foreign exchange rate changes on cash and cash equivalents	1,579	(1,440)
Net (decrease) increase in cash and cash equivalents	(6,470)	32,830
Cash and cash equivalents as of the beginning of period	125,032	125,098
Cash and cash equivalents as of the end of period	$118,562	$157,928
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for interest, net of interest capitalized	$86,232	$58,820
Non-Cash Investing Activities:		
Change in accrued construction	$(38,767)	$23,023
Contribution of real estate to an unconsolidated real estate joint venture	$6,998	$—
Non-Cash Financing Activities:		
Redemption of redeemable noncontrolling interests	$—	$(5,000)

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

Alexandria Real Estate Equities, Inc.
Notes to Consolidated Financial Statements
(Unaudited)

1. Organization and basis of presentation

Alexandria Real Estate Equities, Inc. (NYSE:ARE), an S&P 500® company, is an urban office REIT uniquely focused on collaborative life science and technology campuses in AAA innovation cluster locations. As used in this quarterly report on Form 10 Q, references to the "Company," "Alexandria," "ARE," "we," "us," and "our" refer to Alexandria Real Esta Equities, Inc. and its consolidated subsidiaries. The accompanying unaudited consolidated financial statements include the accounts of Alexandria Real Estate Equities, Inc. and its consolidated subsidiaries. All significant intercompany balances and transactions have been eliminated.

We have prepared the accompanying interim consolidated financial statements in accordance with GAAP and in conformity with the rules and regulations of the SEC. In our opinion, the interim consolidated financial statements presented herein reflect all adjustments, of a normal recurring nature, that are necessary to fairly present the interim consolidated financial statements. The results of operations for the interim period are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in our annual report on Form 10 K for the year ended December 31, 2016.

2. Summary of significant accounting policies

Consolidation

On an ongoing basis, as circumstances indicate the need for reconsideration, we evaluate each legal entity that is not wholly owned by us in accordance with the consolidation guidance. Our evaluation considers all of our variable interests, including equity ownership, as well as fees paid to us for our involvement in the management of each partially owned entity. To fall within the scope of the consolidation guidance, an entity must meet both of the following criteria:

- The entity has a legal structure that has been established to conduct business activities and to hold assets; such entity can be in the form of a partnership, limited liability company, or corporation, among others; and
- We have a variable interest in the legal entity – i.e., variable interests that are contractual, such as equity ownership, or other financial interests that change with changes in the fair value of the entity's net assets.

If an entity does not meet both criteria above, we apply other accounting literature, such as the cost or equity method of accounting. If an entity does meet both criteria above, we evaluate such entity for consolidation under either the variable interest model, if the legal entity meets any of the following characteristics to qualify as a VIE, or under the voting model for all other legal entities that are not VIEs.

A legal entity is determined to be a VIE if it has any of the following three characteristics:

1) The entity does not have sufficient equity to finance its activities without additional subordinated financial support;
2) The entity is established with non-substantive voting rights (i.e., where the entity deprives the majority economic interest holder(s) of voting rights); or
3) The equity holders, as a group, lack the characteristics of a controlling financial interest. Equity holders meet this criterion if they lack any of the following:

- The power, through voting rights or similar rights, to direct the activities of the entity that most significantly influence the entity's economic performance, as evidenced by:

- Substantive participating rights in day-to-day management of the entity’s activities; or
- Substantive kick-out rights over the party responsible for significant decisions;
- The obligation to absorb the entity’s expected losses; or
- The right to receive the entity’s expected residual returns.

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2. Summary of significant accounting policies (continued)

Once we consider the sufficiency of equity and voting rights of each legal entity, we then evaluate the characteristics of the equity holders' interests, as a group, to see if they qualify as controlling financial interests. Our real estate joint ventures consist of limited partnerships or limited liability companies. For an entity structured as a limited partnership or a limited liability company, our evaluation of whether the equity holders (equity partners other than us in each of our joint ventures) lack the characteristics of a controlling financial interest includes the evaluation of whether the limited partners or non-managing members (the noncontrolling equity holders) lack both substantive participating rights and substantive kick-out rights, defined as follows:

- Participating rights provide the noncontrolling equity holders the ability to direct significant financial and operating decisions made in the ordinary course of business that most significantly influence the entity's economic performance.
- Kick-out rights allow the noncontrolling equity holders to remove the general partner or managing member without cause.

If we conclude that any of the three characteristics of a VIE are met, including that the equity holders lack the characteristics of a controlling financial interest because they lack both substantive participating rights and substantive kick-out rights, we conclude that the entity is a VIE and evaluate it for consolidation under the variable interest model.

Variable interest model

If an entity is determined to be a VIE, we evaluate whether we are the primary beneficiary. The primary beneficiary analysis is a qualitative analysis based on power and benefits. We consolidate a VIE if we have both power and benefits – that is, (i) we have the power to direct the activities of a VIE that most significantly influence the VIE's economic performance (power), and (ii) we have the obligation to absorb losses of the VIE that could potentially be significant to the VIE, or the right to receive benefits from the VIE that potentially could be significant to the VIE (benefits). We consolidate VIEs whenever we determine that we are the primary beneficiary. Refer to Note 3 – "Investments in Real Estate" to these unaudited consolidated financial statements for information on specific joint ventures that qualify as VIEs. If we have a variable interest in a VIE but we are not the primary beneficiary, we account for our investment using the equity method of accounting.

Voting model

If a legal entity fails to meet any of the three characteristics of a VIE (due to insufficiency of equity, existence of non-substantive voting rights, or lack of a controlling financial interest), we then evaluate such entity under the voting model. Under the voting model, we consolidate the entity if we determine that we, directly or indirectly, have greater than 50% of the voting shares and that other equity holders do not have substantive participating rights. Refer to Note 4 – "Investments in Unconsolidated Real Estate Joint Ventures" to these unaudited consolidated financial statements for further information on one of our unconsolidated real estate joint ventures that qualifies for evaluation under the voting model.

Use of estimates

The preparation of consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, and equity; the disclosure of contingent assets and liabilities as of the date of the consolidated financial statements; and the amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

Investments in real estate and properties classified as held for sale

In January 2017, the FASB issued an ASU that clarifies the framework for determining whether an integrated set of assets and activities meets the definition of a business. The revised framework establishes a screen for determining whether an integrated set of assets and activities is a business and narrows the definition of a business, which is expected to result in fewer real estate transactions being accounted for as business combinations. Acquisitions of integrated sets of assets and activities that do not meet the definition of a business are accounted for as asset acquisitions. We early adopted this accounting standard effective October 1, 2016, and since then have evaluated all of our acquisitions under the new framework.

2. Summary of significant accounting policies (continued)

Evaluation of business combination or asset acquisition

We evaluate each acquisition of real estate or in-substance real estate (including equity interests in entities that predominantly hold real estate assets) to determine whether the integrated set of assets and activities acquired meet the definition of a business and need to be accounted as a business combination. If either of the following criteria is met, the integrated set of assets and activities acquired would not qualify as a business:

- Substantially all of the fair value of the gross assets acquired is concentrated in either a single identifiable asset or a group of similar identifiable assets; or
- The integrated set of assets and activities is lacking, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs (i.e., revenue generated before and after the transaction).

An acquired process is considered substantive if:

- The process includes an organized workforce (or includes an acquired contract that provides access to an organized workforce) that is skilled, knowledgeable, and experienced in performing the process;
- The process cannot be replaced without significant cost, effort, or delay; or
- The process is considered unique or scarce.

Generally, we expect that acquisitions of real estate or in-substance real estate will not meet the revised definition of a business because substantially all of the fair value is concentrated in a single identifiable asset or group of similar identifiable assets (i.e., land, buildings, and related intangible assets) or because the acquisition does not include a substantive process in the form of an acquired workforce or an acquired contract that cannot be replaced without significant cost, effort, or delay. When evaluating acquired service or management contracts, we consider the nature of the services performed, the terms of the contract relative to similar arm's length contracts, and the availability of comparable vendors in evaluating whether the acquired contract constitutes a substantive process.

Recognition of real estate acquired

For acquisitions of real estate or in-substance real estate that are accounted for as business combinations, we recognize the assets acquired (including the intangible value of acquired above- or below-market leases, acquired in-place leases, tenant relationships, and other intangible assets or liabilities), liabilities assumed, noncontrolling interests, and previously existing ownership interests at fair value as of the acquisition date. Any excess (deficit) of the consideration transferred relative to the fair value of the net assets acquired is accounted for as goodwill (bargain purchase gain). Acquisition costs related to business combinations are expensed as incurred.

Acquisitions of real estate and in-substance real estate that do not meet the definition of a business are accounted for as asset acquisitions. The accounting model for asset acquisitions is similar to the accounting model for business combinations except that the acquisition consideration (including acquisition costs) is allocated to the individual assets acquired and liabilities assumed on a relative fair value basis. As a result, asset acquisitions do not result in the recognition of goodwill or a bargain purchase gain. Additionally, because the accounting model for asset acquisitions is a cost accumulation model, preexisting interests in the acquired assets, if any, are not remeasured to fair value but continue to be accounted for at their historical cost.

The relative fair values used to allocate the cost of an asset acquisition are determined by the same methodologies and assumptions we utilize to determine fair value in a business combination.

If a real estate property is acquired with an in-place lease that contains a bargain fixed-rate renewal option for the period beyond the non-cancelable lease term, we evaluate factors, such as the business conditions in the industry in which the lessee operates, the economic conditions in the area in which the property is located, and the ability of the lessee to sublease its space during the renewal term, in order to determine the likelihood that the lessee will renew. When we determine there is reasonable assurance that such bargain renewal option will be exercised, we consider the option in determining the intangible value of such lease and its related amortization period. The value of tangible assets acquired is based upon our estimation of value on an “as if vacant” basis. The value of acquired in-place leases includes the estimated costs during the hypothetical lease-up period and other costs that would have been incurred in the execution of similar leases under the market conditions at the acquisition date of the acquired in-place lease. We assess the fair value of tangible and intangible assets based on numerous factors, including estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information. Estimates of future cash flows are based on a number of factors, including the historical operating results, known trends, and market/economic conditions, that may affect the property.

2. Summary of significant accounting policies (continued)

The values allocated to buildings and building improvements, land improvements, tenant improvements, and equipment are depreciated on a straight-line basis using the shorter of the term of the respective ground lease and up to 40 years for buildings and building improvements, an estimated life of up to 20 years for land improvements, the respective lease term for tenant improvements, and the estimated useful life for equipment. The values of acquired above- and below-market leases are amortized over the terms of the related leases and recognized as either increases (for below-market leases) or decreases (for above-market leases) to rental revenue. The values of acquired above- and below-market ground leases are amortized over the terms of the related ground leases and recognized as either increases (for below-market ground leases) or decreases (for above-market ground leases) to rental operating expense. The values of acquired in-place leases are classified in other assets in the accompanying consolidated balance sheets and amortized over the remaining terms of the related leases.

Capitalized project costs

We capitalize project costs, including pre-construction costs, interest, property taxes, insurance, and other costs directly related and essential to the development, redevelopment, pre-construction, or construction of a project. Capitalization of development, redevelopment, pre-construction, and construction costs is required while activities are ongoing to prepare an asset for its intended use. Fluctuations in our development, redevelopment, pre-construction, and construction activities could result in significant changes to total expenses and net income. Costs incurred after a project is substantially complete and ready for its intended use are expensed as incurred. Should development, redevelopment, pre-construction, or construction activity cease, interest, property taxes, insurance, and certain other costs would no longer be eligible for capitalization and would be expensed as incurred. Expenditures for repairs and maintenance are expensed as incurred.

Real estate sales

A property is classified as held for sale when all of the following criteria for a plan of sale have been met: (i) management, having the authority to approve the action, commits to a plan to sell the property; (ii) the property is available for immediate sale in its present condition, subject only to terms that are usual and customary; (iii) an active program to locate a buyer and other actions required to complete the plan to sell have been initiated; (iv) the sale of the property is probable and is expected to be completed within one year; (v) the property is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and (vi) actions necessary to complete the plan of sale indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. Depreciation of assets ceases upon designation of a property as held for sale.

If the disposal of a property represents a strategic shift that has (or will have) a major effect on our operations or financial results, such as (i) a major line of business, (ii) a major geographic area, (iii) a major equity method investment, or (iv) other major parts of an entity, then the operations of the property, including any interest expense directly attributable to it, are classified as discontinued operations in our consolidated statements of income, and amounts for all prior periods presented are reclassified from continuing operations to discontinued operations. The disposal of an individual property generally will not represent a strategic shift and, therefore, will typically not meet the criteria for classification as a discontinued operation.

Impairment of long-lived assets

On a quarterly basis, we review current activities and changes in the business conditions of all of our properties prior to and subsequent to the end of each quarter to determine the existence of any triggering events requiring an impairment analysis. If triggering events are identified, we review an estimate of the future undiscounted cash flows for the properties, including, if necessary, a probability-weighted approach if multiple outcomes are under consideration.

2. Summary of significant accounting policies (continued)

Long-lived assets to be held and used, including our rental properties, CIP, land held for development, and intangibles, are individually evaluated for impairment when conditions exist that may indicate that the carrying amount of a long-lived asset may not be recoverable. The carrying amount of a long-lived asset to be held and used is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. Impairment indicators or triggering events for long-lived assets to be held and used, including our rental properties, CIP, land held for development, and intangibles, are assessed by project and include significant fluctuations in estimated net operating income, occupancy changes, significant near-term lease expirations, current and historical operating and/or cash flow losses, construction costs, estimated completion dates, rental rates, and other market factors. We assess the expected undiscounted cash flows based upon numerous factors, including, but not limited to, construction costs, available market information, current and historical operating results, known trends, current market/economic conditions that may affect the property, and our assumptions about the use of the asset, including, if necessary, a probability-weighted approach if multiple outcomes are under consideration. Upon determination that an impairment has occurred, a write-down is recognized to reduce the carrying amount to its estimated fair value. If an impairment loss is not required to be recognized, the recognition of depreciation is adjusted prospectively, as necessary, to reduce the carrying amount of the real estate to its estimated disposition value over the remaining period that the real estate is expected to be held and used. We may adjust depreciation of properties that are expected to be disposed of or redeveloped prior to the end of their useful lives.

We use the held for sale impairment model for our properties classified as held for sale. The held for sale impairment model is different from the held and used impairment model. Under the held for sale impairment model, an impairment loss is recognized if the carrying amount of the long-lived asset classified as held for sale exceeds its fair value less cost to sell. Because of these two different models, it is possible for a long-lived asset previously classified as held and used to require the recognition of an impairment charge upon classification as held for sale.

International operations

In addition to operating properties in the U.S., we have operating properties in Canada and China. The functional currency for our subsidiaries operating in the U.S. is the U.S. dollar. The functional currencies for our foreign subsidiaries are the local currencies in each respective country. The assets and liabilities of our foreign subsidiaries are translated into U.S. dollars at the exchange rate in effect as of the financial statement date. Income statement accounts of our foreign subsidiaries are translated using the weighted-average exchange rate for the periods presented. Gains or losses resulting from the translation are classified in accumulated other comprehensive income as a separate component of total equity.

Whenever a foreign investment meets the criteria for classification as held for sale, we evaluate the recoverability of the investment under the held for sale impairment model. We may recognize an impairment charge if the carrying amount of the investment exceeds its fair value less cost to sell. In determining an investment's carrying amount, we consider its net book value and any unrealized cumulative foreign currency translation adjustment related to the investment.

The appropriate amounts of foreign exchange rate gains or losses classified in accumulated other comprehensive income will be reclassified to net income only when realized upon the sale of our investment or upon the complete or substantially complete liquidation of our investment.

Investments

We hold equity investments in certain publicly traded companies and investments in certain privately held entities and limited partnerships primarily involved in the life science and technology industries. All of our equity investments in actively traded public companies are considered available-for-sale and are reflected in the accompanying consolidated balance sheets at fair value. Fair value has been determined based upon the closing price as of each balance sheet date, with unrealized gains and losses shown as a separate component of other comprehensive income. The classification of each investment is determined at the time each investment is made, and such determination is reevaluated at each balance sheet date. The cost of each investment sold is determined by the specific identification method, with realized gains or losses classified in other income in the accompanying consolidated statements of income. Investments in privately held entities are generally accounted for under the cost method when our interest in the entity is so minor that we have virtually no influence over the entity's operating and financial policies. Certain investments in privately held entities require accounting under the equity method unless our interest in the entity is deemed to be so minor that we have virtually no influence over the entity's operating and financial policies. Under the equity method of accounting, we recognize our investment initially at cost and adjust the carrying amount of the investment to recognize our share of the earnings or losses of the investee subsequent to the date of our investment. Additionally, we generally limit our ownership percentage in the voting stock of each individual entity to less than 10%.

2. Summary of significant accounting policies (continued)

We periodically assess our investments in available-for-sale equity securities and privately held companies accounted for under the cost method for other-than-temporary impairment. We monitor each of our investments throughout the year for new developments, including operating results, results of clinical trials, capital-raising events, and merger and acquisition activities. Individual investments are evaluated for impairment when changes in conditions may indicate an impairment exists. The factors that we consider in making these assessments include, but are not limited to, market prices, market conditions, available financing, prospects for favorable or unfavorable clinical trial results, new product initiatives, and new collaborative agreements. If an unrealized loss related to an available-for-sale equity security is determined to be other-than-temporary, such unrealized loss is reclassified from other comprehensive income into current earnings. For a cost method investment, if a decline in the fair value of an investment below its carrying value is determined to be other-than-temporary, such investment is written down to its estimated fair value with a charge to current earnings. If there are no identified events or changes in circumstances that might have an adverse effect on our cost method investments, we do not estimate the investment's fair value. Refer to Note 5 – "Investments" to these unaudited consolidated financial statements for further information.

Recognition of rental income and tenant recoveries

Rental revenue from operating leases is recognized on a straight-line basis over the respective lease terms. We classify amounts currently recognized as rental revenue in our consolidated statements of income, and amounts expected to be received in later years as deferred rent in the accompanying consolidated balance sheets. Amounts received currently but recognized as revenue in future years are classified in accounts payable, accrued expenses, and tenant security deposits in the accompanying consolidated balance sheets. We commence recognition of rental revenue at the date the property is ready for its intended use and the tenant takes possession of or controls the physical use of the property.

Rental revenue from direct financing leases is recognized over the lease term using the effective interest rate method. At lease inception, we record an asset within other assets in our consolidated balance sheets, which represents our net investment in the direct financing lease. This initial net investment is determined by aggregating the total future minimum lease payments attributable to the direct financing lease and the estimated residual value of the property less unearned income. Over the lease term, the investment in the direct financing lease is reduced and rental income is recognized as rental revenue in our consolidated statements of income and produces a constant periodic rate of return on the net investment in the direct financing lease.

Tenant recoveries related to reimbursement of real estate taxes, insurance, utilities, repairs and maintenance, common area expenses, and other operating expenses are recognized as revenue in the period during which the applicable expenses are incurred and the tenant's obligation to reimburse us arises.

Tenant receivables consist primarily of amounts due for contractual lease payments, reimbursements of common area maintenance expenses, property taxes, and other expenses recoverable from tenants. Tenant receivables are expected to be collected within one year. We may maintain an allowance for estimated losses that may result from the inability of our tenants to make payments required under the terms of the lease and for tenant recoveries due. If a tenant fails to make contractual payments beyond any allowance, we may recognize additional bad debt expense in future periods equal to the amount of uncollectible tenant receivables and deferred rent arising from the straight-lining of rent. As of September 30, 2017, and December 31, 2016, no allowance for uncollectible tenant receivables and deferred rent was deemed necessary.

Monitoring tenant credit quality

During the term of each lease, we monitor the credit quality of our tenants by (i) monitoring the credit rating of tenants that are rated by a nationally recognized credit rating agency, (ii) reviewing financial statements of the tenants that are publicly available or that are required to be delivered to us pursuant to the applicable lease, (iii) monitoring news reports regarding our tenants and their respective businesses, and (iv) monitoring the timeliness of lease payments. We have a research team consisting of employees who, among them, have doctorate, graduate, and undergraduate degrees in biology, chemistry, industrial biotechnology, and engineering, and experience in the life science and technology industries, as well as in finance. Our research team is responsible for assessing and monitoring the credit quality of our tenants and any material changes in their credit quality.

2. Summary of significant accounting policies (continued)

Income taxes

We are organized and operate as a REIT pursuant to the Internal Revenue Code (the “Code”). Under the Code, a REIT that distributes at least 90% of its REIT taxable income to its shareholders annually (excluding net capital gains) and meets certain other conditions is not subject to federal income tax on its distributed taxable income, but could be subject to certain federal, foreign, state, and local taxes. We distribute 100% of our taxable income annually; therefore, a provision for federal income taxes is not required. In addition to our REIT returns, we file federal, foreign, state, and local tax returns for our subsidiaries. We file with jurisdictions located in the U.S., Canada, India, China, and other international locations. Our tax returns are subject to routine examination in various jurisdictions for the 2011–2016 calendar years.

Recent accounting pronouncements

Definition of a business

On October 1, 2016, we adopted an ASU issued by the FASB in January 2017, which clarified the definition of a business. Refer to “Investments in Real Estate and Properties Classified as Held for Sale” above for additional information.

Employee share-based payments

On January 1, 2017, we adopted an ASU issued by the FASB in March 2016, which simplifies several aspects of employee share-based payment accounting, including the accounting for forfeitures. The ASU allows an entity to make an accounting policy election either to continue to estimate the total number of awards that are expected to vest (the method used prior to January 1, 2017) or to account for forfeitures when they occur. This entity-wide accounting policy election only applies to service conditions; for performance conditions, the entity continues to assess the probability that such conditions will be achieved. If an entity elects to account for forfeitures when they occur, all nonforfeitable dividends paid on share-based payment awards are initially charged to retained earnings and reclassified to compensation cost only when forfeitures of the underlying awards occur. We elected to account for forfeitures when they occur and applied this ASU on a modified retrospective basis resulting in a cumulative-effect adjustment aggregating approximately $368 thousand, which was recorded as a decrease to retained earnings and an increase to additional paid-in capital upon adoption of the ASU on January 1, 2017.

2. Summary of significant accounting policies (continued)

Recent accounting pronouncements (continued)

Lease accounting, revenue recognition, and financial instruments

In February 2016, the FASB issued an ASU that sets out new lease accounting standards for both lessees and lessors. In May 2014, the FASB issued an ASU that will require a new model for recognition of revenue arising from contracts with customers, as well as recognizing gains and losses from the transfer of nonfinancial assets in contracts with noncustomers. In January 2016, the FASB issued an ASU that amended the accounting for equity investments. These three ASUs will update the current accounting standards for all of our revenues with the exception of revenues subject to other accounting standards as noted in the table below. Our revenues and gains on sales of real estate for the nine months ended September 30, 2017, and the related effective date for adoption of new ASUs, consisted of the following (in thousands):

	Date of ASU Adoption	Nine Months Ended September 30, 2017	
Revenues subject to the new lease ASU:			
Rental revenues	1/1/19	$604,570	
Tenant recoveries [1]	1/1/19	188,874	
			$793,444
Revenues subject to the new revenue recognition ASU:			
Parking and other revenues	1/1/18		32,323
Revenues not subject to the new lease or revenue recognition ASUs:			
Investment income subject to the new financial instruments ASU	1/1/18	$2,007	
Interest and other income within the scope of other existing accounting standards	N/A	1,532	
			3,539
Total revenues			$829,306
Gains on sales of real estate subject to the new revenue recognition ASU	1/1/18		$381

(1) Includes a portion of tenant recoveries that is subject to the new revenue recognition ASU upon adoption of the new lease ASU on January 1, 2019. See further discussion below.

2. Summary of significant accounting policies (continued)

Recent accounting pronouncements (continued)

Lease accounting

In February 2016, the FASB issued an ASU that sets out the principles for the recognition, measurement, presentation, and disclosure of leases for both parties to a lease agreement (i.e., lessees and lessors). The ASU is effective for us no later than January 1, 2019, with early adoption permitted. The ASU requires us to identify lease and nonlease components of a lease agreement. This ASU will govern the recognition of revenue for lease components. Revenue related to nonlease components under our lease agreements will be subject to the new revenue recognition standard effective upon adoption of the new lease accounting standard. We expect to adopt the new lease accounting standard on January 1, 2019.

The lease ASU requires the use of the modified retrospective transition method and does not allow for a full retrospective approach. Under the modified retrospective method, an entity will apply the standard to all leases that exist at, or commence after, the beginning of the earliest comparative period presented in the financial statements, with a cumulative adjustment to the opening balance of retained earnings for the effect of applying the standard at the date of initial application. In addition, an entity may elect a practical expedient package, which allows the following:

- An entity need not reassess whether any expired or existing contracts are or contain leases;
- An entity need not reassess the lease classification for any expired or existing leases; and
- An entity need not reassess initial direct costs for any existing leases.

These three practical expedients are available as a single election that must be elected as a package and must be consistently applied to all existing leases at the date of adoption. The FASB has also tentatively noted in Board meeting minutes of May 2017 that lessors that adopt this package of practical expedients are not expected to reassess expired or existing leases at the date of adoption in order to bifurcate lease and nonlease components under the new lease ASU.

Lessor accounting

We recognized revenue from our lease agreements aggregating $793.4 million for the nine months ended September 30, 2017. This revenue consisted primarily of rental revenue and tenant recoveries aggregating $604.6 million and $188.9 million, respectively.

Under current accounting standards, we recognize rental revenue from our operating leases on a straight-line basis over the respective lease terms. We commence recognition of rental revenue at the date the property is ready for its intended use and the tenant takes possession of or controls the physical use of the property. We recognize rental revenue from direct financing leases over the lease term using the effective interest rate method.

Under the new lease ASU, each lease agreement will be evaluated to identify the lease components and nonlease components within each lease agreement. The total consideration in the lease agreement will be allocated to the lease and nonlease components based on their relative standalone selling prices. Lessors will continue to recognize the lease revenue component using an approach that is substantially equivalent to existing guidance for operating leases (straight-line basis) and direct financing leases (effective interest rate method).

Under current accounting standards, tenant recoveries related to payments of real estate taxes, insurance, utilities, repairs and maintenance, common area expenses, and other operating expenses, are considered lease components. We recognize these tenant recoveries as revenue when services are rendered in an amount equal to the related operating expenses incurred that are recoverable under the terms of the applicable lease.

We have not completed our analysis of this ASU but expect that our tenant recoveries will be separated into lease and nonlease components. Tenant recoveries that qualify as lease components, which relate to the right to use the leased asset (e.g., property taxes, insurance), will be accounted for under the new lease ASU. Tenant recoveries that qualify as nonlease components, which relate to payments for goods or services that are transferred separately from the right to use the underlying asset, including tenant recoveries related to payments for maintenance activities and common area expenses, will be accounted for under the new revenue recognition ASU upon adoption of the new lease ASU on January 1, 2019.

2. Summary of significant accounting policies (continued)

Recent accounting pronouncements (continued)

Lease accounting (continued)

Tenant recoveries that are categorized as lease components will generally be variable consideration. Tenant recoveries that are categorized as nonlease components will be recognized at a point in time or over time based on the pattern of transfer of the underlying goods or services to our tenants.

Costs to execute leases

The new ASU will require that lessors capitalize, as initial direct costs, only those costs that are incurred due to the execution of a lease. Under this ASU, allocated payroll costs and other costs such as legal costs incurred as part of the leasing process prior to the execution of a lease will no longer qualify for classification as initial direct costs but will instead be expensed as incurred. During the nine months ended September 30, 2017, we capitalized $18.4 million of such costs. Under the new ASU, these costs will be expensed as incurred.

Lessee accounting

Under the new lease ASU, lessees are required to apply a dual approach by classifying leases as either finance or operating leases based on the principle of whether the lease is effectively a financed purchase of the leased asset by the lessee. This classification will determine whether the lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to recognize a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases.

The ASU requires the recognition of a right-of-use asset and a related liability to account for our future obligations under our ground lease arrangements for which we are the lessee. For the nine months ended September 30, 2017, we recognized rent expense, included in rental operations expense, aggregating $9.4 million under these ground leases. As of September 30, 2017, the remaining contractual payments under our ground lease agreements for which we are the lessee aggregated $584.0 million. All of our existing ground leases for which we are the lessee are currently classified as operating leases, and therefore, we will have the option, under the practical expedients provided by the lease ASU, to continue to classify these leases as operating leases upon adoption of the ASU. We are still evaluating the impact to our consolidated financial statements from the initial recognition of each lease liability upon adoption and the pattern of recognition of ground lease expense subsequent to adoption.

2. Summary of significant accounting policies (continued)

Recent accounting pronouncements (continued)

Revenue recognition

In May 2014, the FASB issued an ASU on recognition of revenue arising from contracts with customers, as well as recognizing gains and losses from the transfer of nonfinancial assets in contracts with noncustomers, and subsequently, it issued additional guidance that further clarified the ASU. The revenue recognition ASU has implications for all revenues, excluding those that are under the specific scope of other accounting standards, such as revenue associated with leases (described above) and financial instruments (described below). Our revenues and gains for the nine months ended September 30, 2017, which will become subject to the revenue recognition ASU upon adoption on January 1, 2018, were as follows (in thousands):

	Nine Months Ended September 30, 2017
Parking and other revenue	$ 32,323
Gain on sales of real estate	$ 381

The core principle underlying the revenue recognition ASU is that an entity will recognize revenue to represent the transfer of goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in such exchange. This will require entities to identify contractual performance obligations and determine whether revenue should be recognized at a point in time or over time, based on when control of goods and services transfers to a customer.

A customer is distinguished from a noncustomer by the nature of the goods or services that are transferred. Customers are provided with goods or services that are generated by a company's ordinary output activities, whereas noncustomers are provided with nonfinancial assets that are outside of a company's ordinary output activities. This distinction may not significantly change the pattern of income recognition, but will determine whether that income is classified as revenue (contracts with customers) or other gains/losses (contracts with noncustomers) in our consolidated income statement.

The ASU will require the use of a new five-step model to recognize revenue from customer contracts. The five-step model requires that we (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, including variable consideration to the extent that it is probable that a significant future reversal will not occur, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) we satisfy the performance obligation.

An entity will also be required to determine if it controls the goods or services prior to the transfer to the customer in order to determine if it should account for the arrangement as a principal or agent. Principal arrangements, where the entity controls the goods or services provided, will result in the recognition of the gross amount of consideration expected in the exchange. Agent arrangements, where the entity simply arranges but doesn't control the goods or services being transferred to the customer, will result in the recognition of the net amount the entity is entitled to retain in the exchange.

The ASU is effective for us on January 1, 2018. Entities can use either a full retrospective or modified retrospective method to adopt the ASU. Under the full retrospective method, all periods presented will be restated upon adoption to conform to the new standard and a cumulative adjustment for effects on periods prior to 2016 will be recorded to retained earnings as of January 1, 2016. Under the modified retrospective approach, prior periods are not restated to conform to the new standard. Instead, a cumulative adjustment for effects of applying the new standard to periods prior to 2018 is recorded to retained earnings as of January 1, 2018. Additionally, incremental disclosures are required to present the 2018 revenues under the prior standard. Under the modified retrospective method, an entity may also elect to apply the standard to either (i) all contracts as of January 1, 2018, or (ii) only to contracts that are not completed as of January 1, 2018.

We continue to review the impact that the new standard will have on our consolidated financial statements and our disclosures. We continue to implement changes to our accounting policies, business processes, and internal controls to support the new accounting and disclosure requirements. We expect to complete our assessment and implementation by December 31, 2017.

2. Summary of significant accounting policies (continued)

Recent accounting pronouncements (continued)

Revenue recognition (continued)

Revenue within the scope of the new revenue recognition ASU

Parking

Parking and other revenue aggregated $32.3 million for the nine months ended September 30, 2017. These revenues consist primarily of short term rental revenues that are not considered lease revenue. These revenues will be accounted under the new revenue recognition ASU effective January 1, 2018. Under current accounting standards, we recognize parking when the amounts are fixed or determinable, collectability is reasonably assured, and services have been rendered. Under the new revenue recognition ASU, the recognition of such revenue will occur when the services are provided and the performance obligations are satisfied. These services are normally provided at a point in time, therefore revenue recognition under the new revenue recognition ASU is expected to be similar to the recognition pattern under existing accounting standards.

Sales of real estate

During the nine months ended September 30, 2017, we sold real estate for contractual sales prices aggregating $10.9 million, which resulted in an aggregate gain of $381 thousand. Our ordinary output activities consist of leasing space to our tenants in our operating properties, not the sale of real estate. Therefore, sales of real estate qualify as contracts with non-customers.

The amount and timing of recognition of gain or loss on those sales may differ significantly under the new standards. The current standards focus on whether the seller retains substantial risks or rewards of ownership as a result of its continuing involvement with the sold property.

Under the new standard, which includes guidance on recognition of gains and losses arising from the derecognition of nonfinancial assets in a transaction with noncustomers, the derecognition model is based on the transfer of control. If a real estate sale contract includes ongoing involvement by the seller with the property, the seller must evaluate each promised good or service under the contract to determine whether it represents a separate performance obligation, constitutes a guarantee, or prevents the transfer of control. If a good or service is considered a separate performance obligation, an allocated portion of the transaction price should be recognized as revenue as the entity transfers the related good or service to the buyer.

Under the current standards, a partial sale of real estate in which the seller retains a noncontrolling interest results in the recognition of a gain or loss related to the interest sold.

Under the new standards, a partial sale of real estate in which the seller retains a noncontrolling interest will result in recognition by the seller of a gain or loss as if 100% of the real estate was sold. Conversely, under the new standards, a partial sale of real estate in which the seller retains a controlling interest will result in the seller's continuing to reflect the asset at its current book value, recording a noncontrolling interest for the book value of the partial interest sold, and recognizing additional paid-in capital for the difference between the consideration received and the partial interest at book value, consistent with the current accounting standards.

Tenant recoveries

As previously noted above in the lease accounting section, certain tenant recoveries may be subject to the new revenue recognition ASU upon our adoption of the lease ASU, no later than January 1, 2019.

Revenue within the scope of guidance other than revenue recognition or lease accounting

Interest and investment income fall outside the scope of the new revenue recognition and lease accounting standards. Investment income is subject to a recently issued accounting pronouncement on financial instruments related to the accounting for equity investments.

2. Summary of significant accounting policies (continued)

Recent accounting pronouncements (continued)

Financial instruments

In January 2016, the FASB issued an ASU that amended the accounting for equity investments (except for debt securities and equity investments accounted for under the equity method of accounting or that result in consolidation) and the presentation and disclosure requirements for financial instruments. The core principle of the amendment involves the measurement of equity investments at fair value and the recognition of changes in fair value of those investments during each period in net income.

As of September 30, 2017, our consolidated balance sheet contained the following amounts related to our investments (in thousands):

	Cost	Net Unrealized Gains	Total
Available-for-sale equity securities	$55,433	$ 45,189	$100,622
Investments accounted for under cost method:			
Investments in limited partnerships	136,044	N/A	136,044
Investments in other privately held entities	248,596	N/A	248,596
Total investments	$440,073	$ 45,189	$485,262

For the nine months ended September 30, 2017, our consolidated statement of income and statement of comprehensive income contained the following amounts related to our investments (in thousands):

	Nine Months Ended September 30, 2017
Investment income recognized in net income	$ 2,007
Unrealized gain recognized in other comprehensive income (component of stockholder’s equity)	$ 23,414

The ASU is effective for us on January 1, 2018. The ASU requires the use of the modified retrospective transition method, under which cumulative unrealized gains and losses related to equity investments with readily determinable fair values will be reclassified from accumulated other comprehensive income to retained earnings on January 1, 2018, upon adoption of this ASU. The guidance related to equity investments without readily determinable fair values, including our investments in limited partnerships and other privately held entities, will be applied prospectively to all investments that exist as of the date of adoption. We expect the adoption of this new ASU to increase the volatility of our earnings due to the recognition of changes in fair value of our equity investments in net income for reporting periods subsequent to December 31, 2017.

The ASU introduces significant changes to current accounting for equity investments, including elimination of (i) the classification of equity investments as trading or available-for-sale, and the related recognition of unrealized holding gains and losses on available-for-sale equity securities in other comprehensive income, (ii) the cost method of accounting for equity securities that do not have readily determinable fair values, and (iii) the consideration of impairments as other-than-temporary, and instead requires recognition of impairments under a single-step model. A readily determinable fair value exists on investments for which sales prices/quotes are available on securities exchanges, or are published and are the basis for current transactions.

Under the new ASU, equity investments in publicly traded securities are required to be measured and reported at fair value, with the changes in fair value recognized through earnings. The year-to-date change in unrealized holding gains on available-for-sale equity securities, aggregating $23.4 million for the nine months ended September 30, 2017, would have been recognized in net income under this new ASU.

2. Summary of significant accounting policies (continued)

Recent accounting pronouncements (continued)

Financial instruments (continued)

Equity investments without readily determinable fair values, which are currently subject to the cost method of accounting, will be accounted for under two categories, as follows:

- Equity investments that qualify for the practical expedient to be measured at net asset value (NAV) in accordance with ASC 820, Fair Value Measurement, such as our other privately held investments in limited partnerships, are required to be measured using the reported NAV per share or otherwise valued at fair value using other accepted valuation techniques. The aggregate NAV per share of our investments in limited partnerships exceeds our cost basis by approximately $71.8 million as of September 30, 2017. Under a proposed ASU issued recently by the FASB, the cumulative difference between NAV and cost basis for these investments is expected to be recognized as a cumulative adjustment to our retained earnings on January 1, 2018. Subsequent changes in NAV per share will be recognized in earnings each reporting period. The year-to-date change in unrealized holding gains on other privately held investments in limited partnerships, aggregating approximately $16.2 million for the nine months ended September 30, 2017, would have been recognized in net income under this new ASU.
- Equity investments that do not qualify for the NAV practical expedient, such as our private investments, will be measured at cost less impairments, adjusted for observable price changes that are known or can be reasonably known. An “observable price” is a price observed in an orderly transaction for an identical or similar investment of the same issuer. Investments will be evaluated on the basis of a qualitative assessment for indicators of impairment. If such indicators are present, we are required to estimate the investment’s fair value and recognize an impairment loss equal to the amount by which the investment’s carrying value exceeds its fair value.

The new ASU requires additional disclosures. Equity investments that have readily determinable fair values require disclosure of the unrealized gains and losses recognized through earnings during the period that relate to equity securities still held at the reporting date. Equity investments without readily determinable fair values require disclosure of (i) the carrying amount, (ii) the amount of impairments and downward adjustments, if any, both cumulative and annual, (iii) the amount of upward adjustments, if any, both cumulative and annual, and (iv) qualitative information to facilitate an understanding of the quantitative disclosures.

We continue to review the impact that the new standard will have on our consolidated financial statements and our disclosures. We also continue to implement changes to our accounting policies, business processes, and internal controls to support the new accounting and disclosure requirements. We expect to complete our assessment and implementation by December 31, 2017.

Joint venture distributions

In August 2016, the FASB issued an ASU that provides guidance on the classification of cash distributions received from equity method investments, including unconsolidated joint ventures, in the statement of cash flows. The ASU provides two approaches to determine the classification of cash distributions received from equity method investees: (i) the “cumulative earnings” approach, under which distributions up to the amount of cumulative equity in earnings recognized will be classified as cash flows from operating activities, and those in excess of that amount will be classified as cash inflows from investing activities, and (ii) the “nature of the distribution” approach, under which distributions will be classified based on the nature of the underlying activity that generated cash distributions. An entity may elect either the “cumulative earnings” or the “nature of the distribution” approach. An entity that elects the "nature of the distribution" approach but lacks the information to apply it will apply the "cumulative earnings" approach as an accounting change on a retrospective basis. The ASU is effective for reporting periods beginning after December 15, 2017, with early adoption permitted, and will be applied retrospectively (exceptions apply). We will adopt this ASU on January 1, 2018, and expect to use the "nature of the distribution" approach. We currently present distributions from our equity method investees utilizing the "nature of the distribution" approach; therefore, the adoption of this ASU will have no impact on our consolidated financial statements. During the nine months ended September 30, 2017, distributions received from our equity method investees totaled $38.8 million, consisting of approximately $249 thousand classified as a return on investment (cash flows from operating activities) and approximately $38.6 million classified as a return of investment (cash flows from investing activities).

2. Summary of significant accounting policies (continued)

Recent accounting pronouncements (continued)

Restricted cash

In November 2016, the FASB issued an ASU that will require companies to include restricted cash with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown in the statement of cash flows. The ASU will require disclosure of a reconciliation between the statement of financial position and the statement of cash flows when the statement of financial position includes more than one line item for cash, cash equivalents, restricted cash, and restricted cash equivalents. An entity with material restricted cash and restricted cash equivalents balances will be required to disclose the nature of the restrictions. The ASU is effective for reporting periods beginning after December 15, 2017, with early adoption permitted, and will be applied retrospectively to all periods presented. As of September 30, 2017, and December 31, 2016, we had $27.7 million and $16.3 million of restricted cash, respectively, on our consolidated balance sheets. Upon adoption of this ASU, restricted cash balances will be included with cash and cash equivalents balances as of the beginning and ending of each period presented in our consolidated statements of cash flows; separate line items reconciling changes in restricted cash balances to the changes in cash and cash equivalents will no longer be presented within the operating, investing, and financing sections of our consolidated statements of cash flows.

Allowance for credit losses

In June 2016, the FASB issued an ASU that changes the impairment model for most financial instruments by requiring companies to recognize an allowance for expected losses, rather than incurred losses as required currently by the other-than-temporary impairment model. The ASU will apply to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans, held-to-maturity debt securities, net investments in leases, and off-balance-sheet credit exposures (e.g., loan commitments). The ASU is effective for reporting periods beginning after December 15, 2019, with early adoption permitted, and will be applied as a cumulative adjustment to retained earnings as of the effective date. We are currently assessing the potential effect the adoption of this ASU will have on our consolidated financial statements.

Hedge accounting

In August 2017, the FASB issued an ASU that simplifies hedge accounting. The purpose of this updated ASU is to better align a company’s financial reporting for hedging activities with the economic objectives of those activities. For cash flow hedges that are highly effective, the new standard requires all changes (effective and ineffective components) in the fair value of the hedging instrument to be recorded in other comprehensive income and to be reclassified into earnings only when the hedged item impacts earnings.

Under existing standards, a quantitative assessment is made on an ongoing basis to determine whether a hedge is highly effective in offsetting changes in cash flows associated with the hedged item. Currently, hedge accounting requires hedge ineffectiveness to be recognized in earnings. Under the new standard, an entity will still be required to perform an initial quantitative test. However, the new standard allows an entity to elect to subsequently perform only a qualitative assessment unless facts and circumstances change.

The ASU is effective for reporting periods beginning after December 15, 2018, with early adoption permitted. For cash flow hedges in existence at the date of adoption, an entity is required to apply a cumulative-effect adjustment for previously recognized ineffectiveness from retained earnings to accumulated other comprehensive income, as of the beginning of the fiscal year when an entity adopts the amendments in this ASU.

We utilize interest rate hedge agreements to hedge a portion of our exposure to variable interest rates primarily associated with borrowings based on LIBOR. As a result, all of our interest rate hedge agreements are designated as cash flow hedges. During the three and nine months ended September 30, 2017, and September 30, 2016, we did not have any hedge ineffectiveness related to our interest rate hedge agreements. Therefore, we do not believe this ASU would have impacted our operating results for the nine months ended September 30, 2017.

3. Investments in real estate

Our consolidated investments in real estate consisted of the following as of September 30, 2017, and December 31, 2016 (in thousands):

	September 30, 2017	December 31, 2016
Land (related to rental properties)	$1,206,152	$1,131,416
Buildings and building improvements	8,466,889	7,810,269
Other improvements	714,834	584,565
Rental properties	10,387,875	9,526,250
Development and redevelopment of new Class A properties:		
Undergoing construction		
Development projects – target delivery in 2017	466,047	809,254
Development projects – target delivery in 2018 and 2019	143,038	—
Redevelopment projects – target delivery in 2018 and 2019	59,224	—
Near-term projects undergoing marketing and pre-construction	114,954	—