

Paramount Group, Inc.
Form 10-Q
November 05, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended: September 30, 2018

OR

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

For the transition period from to

Commission File Number: 001-36746

PARAMOUNT GROUP, INC.

(Exact name of registrant as specified in its charter)

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Maryland 32-0439307
(State or other jurisdiction of (IRS Employer
incorporation or organization) Identification No.)

1633 Broadway, Suite 1801, New York, NY 10019
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (212) 237-3100

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth 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 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

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As of October 31, 2018, there were 237,253,335 shares of the registrant's common stock outstanding.

Table of Contents

Item	Page Number
Part I. Financial Information	
Item 1. <u>Consolidated Financial Statements</u>	
<u>Consolidated Balance Sheets (Unaudited) as of September 30, 2018 and December 31, 2017</u>	3
<u>Consolidated Statements of Income (Unaudited) for the three and nine months ended _ September 30, 2018 and 2017</u>	4
<u>Consolidated Statements of Comprehensive Income (Unaudited) for the three and nine months _ ended September 30, 2018 and 2017</u>	5
<u>Consolidated Statements of Changes in Equity (Unaudited) for the nine months ended September 30, 2018 and 2017</u>	6
<u>Consolidated Statements of Cash Flows (Unaudited) for the nine months _ ended September 30, 2018 and 2017</u>	7
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	9
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	32
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	65
Item 4. <u>Controls and Procedures</u>	67
Part II. Other Information	
Item 1. <u>Legal Proceedings</u>	68
Item 1A. <u>Risk Factors</u>	68
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	68
Item 3. <u>Defaults Upon Senior Securities</u>	69
Item 4. <u>Mine Safety Disclosures</u>	69
Item 5. <u>Other Information</u>	69

Item 6. <u>Exhibits</u>	69
<u>Signatures</u>	71

PART I – FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

PARAMOUNT GROUP, INC.

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(Amounts in thousands, except share, unit and per share amounts)	September 30, 2018	December 31, 2017
ASSETS		
Real estate, at cost		
Land	\$2,065,206	\$2,209,506
Buildings and improvements	5,998,805	6,119,969
	8,064,011	8,329,475
Accumulated depreciation and amortization	(598,756)	(487,945)
Real estate, net	7,465,255	7,841,530
Cash and cash equivalents	538,725	219,381
Restricted cash	30,902	31,044
Investments in unconsolidated joint ventures	75,255	44,762
Investments in unconsolidated real estate funds	9,007	7,253
Preferred equity investments, net of allowance of \$0 and \$19,588	35,983	35,817
Marketable securities	26,668	29,039
Accounts and other receivables, net of allowance of \$503 and \$277	16,205	17,082
Deferred rent receivable	254,002	220,826
Deferred charges, net of accumulated amortization of \$27,311 and \$19,412	111,870	98,645
Intangible assets, net of accumulated amortization of \$230,985 and \$200,857	287,222	352,206
Other assets	90,143	20,076
Total assets ⁽¹⁾	\$8,941,237	\$8,917,661
LIABILITIES AND EQUITY		
Notes and mortgages payable, net of deferred financing costs of \$35,112 and \$41,800	\$3,564,688	\$3,541,300
Revolving credit facility	-	-
Due to affiliates	27,299	27,299
Accounts payable and accrued expenses	133,995	117,630
Dividends and distributions payable	26,596	25,211
Intangible liabilities, net of accumulated amortization of \$84,271 and \$75,073	102,279	130,028
Other liabilities	56,968	54,109
Total liabilities ⁽¹⁾	3,911,825	3,895,577
Commitments and contingencies		
Paramount Group, Inc. equity:		

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Common stock \$0.01 par value per share; authorized 900,000,000 shares; issued		
and outstanding 240,461,106 and 240,427,022 shares in 2018 and 2017, respectively	2,402	2,403
Additional paid-in-capital	4,301,329	4,297,948
Earnings less than distributions	(201,868)	(133,693)
Accumulated other comprehensive income	31,530	10,083
Paramount Group, Inc. equity	4,133,393	4,176,741
Noncontrolling interests in:		
Consolidated joint ventures	399,934	404,997
Consolidated real estate fund	66,099	14,549
Operating Partnership (25,127,003 and 24,620,279 units outstanding)	429,986	425,797
Total equity	5,029,412	5,022,084
Total liabilities and equity	\$8,941,237	\$8,917,661

⁽¹⁾Represents the consolidated assets and liabilities of Paramount Group Operating Partnership LP, a Delaware limited partnership (the “Operating Partnership”). The Operating Partnership is a consolidated variable interest entity (“VIE”), of which we are the sole general partner and own approximately 90.5% as of September 30, 2018. The assets and liabilities of the Operating Partnership, as of September 30, 2018, include \$1,999,741 and \$1,261,751 of assets and liabilities, respectively, of certain VIEs that are consolidated by the Operating Partnership. See Note 14, Variable Interest Entities (“VIEs”).

See notes to consolidated financial statements (unaudited).

PARAMOUNT GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

(Amounts in thousands, except share and per share amounts)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
REVENUES:				
Rental income	\$ 167,934	\$ 156,384	\$ 500,868	\$ 469,961
Tenant reimbursement income	15,579	14,053	42,989	38,761
Fee and other income	9,083	9,333	24,429	29,988
Total revenues	192,596	179,770	568,286	538,710
EXPENSES:				
Operating	69,811	68,264	206,435	197,696
Depreciation and amortization	64,610	66,515	194,541	198,143
General and administrative	14,452	14,470	44,278	44,624
Transaction related costs	450	274	863	1,051
Real estate impairment loss	-	-	46,000	-
Total expenses	149,323	149,523	492,117	441,514
Operating income	43,273	30,247	76,169	97,196
Income from unconsolidated joint ventures	472	671	2,931	19,143
Loss from unconsolidated real estate funds	(188)	(3,930)	(268)	(6,053)
Interest and other income (loss), net	2,778	(17,668)	6,888	(11,982)
Interest and debt expense	(37,105)	(35,733)	(109,996)	(107,568)
Loss on early extinguishment of debt	-	-	-	(7,877)
Gain on sale of real estate	36,845	-	36,845	133,989
Unrealized gain on interest rate swaps	-	-	-	1,802
Net income (loss) before income taxes	46,075	(26,413)	12,569	118,650
Income tax (expense) benefit	(1,814)	1,010	(2,171)	(4,242)
Net income (loss)	44,261	(25,403)	10,398	114,408
Less net (income) loss attributable to noncontrolling interests in:				
Consolidated joint ventures	(2,713)	14,217	(5,520)	11,029
Consolidated real estate fund	(86)	(114)	(668)	(20,195)
Operating Partnership	(3,931)	1,086	(381)	(12,068)
Net income (loss) attributable to common stockholders	\$ 37,531	\$ (10,214)	\$ 3,829	\$ 93,174
INCOME (LOSS) PER COMMON SHARE - BASIC:				
Income (loss) per common share	\$ 0.16	\$ (0.04)	\$ 0.02	\$ 0.40
Weighted average shares outstanding	240,447,921	239,445,810	240,365,882	235,151,398

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INCOME (LOSS) PER COMMON SHARE -
DILUTED:

Income (loss) per common share	\$0.16	\$(0.04) \$0.02	\$0.40
Weighted average shares outstanding	240,489,138	239,445,810	240,391,184	235,177,683

See notes to consolidated financial statements (unaudited).

PARAMOUNT GROUP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

(Amounts in thousands)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss)	\$44,261	\$(25,403)	\$10,398	\$114,408
Other comprehensive income (loss):				
Change in value of interest rate swaps	3,392	738	23,738	729
Pro rata share of other comprehensive (loss) income				
of unconsolidated joint ventures	(262)	226	(105)	39
Comprehensive income (loss)	47,391	(24,439)	34,031	115,176
Less comprehensive (income) loss attributable to noncontrolling interests in:				
Consolidated joint ventures	(2,713)	14,217	(5,520)	11,029
Consolidated real estate fund	(30)	(114)	(612)	(20,195)
Operating Partnership	(4,233)	993	(2,622)	(12,194)
Comprehensive income (loss) attributable to				
common stockholders	\$40,415	\$(9,343)	\$25,277	\$93,816

See notes to consolidated financial statements (unaudited).

PARAMOUNT GROUP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(UNAUDITED)

(Amounts in thousands, except per share and unit amounts)	Common Shares				Noncontrolling Interests in				
	Shares	Amount	Additional Paid-in-Capital	Earnings Less than Distributions	Accumulated Other Comprehensive Income (Loss)	Consolidated Joint Ventures	Consolidated Real Estate Fund	Consolidated Operating Partnership	Total Equity
Balance as of December 31, 2016	230,015	\$2,300	\$4,116,987	\$(129,654)	\$372	\$253,788	\$64,793	\$577,361	\$4,885,947
Net income (loss)	-	-	-	93,174	-	(11,029)	20,195	12,068	114,408
Common shares issued upon redemption of common units	10,001	100	166,424	-	-	-	-	(166,524)	-
Common shares issued under Omnibus share plan, net of shares withheld for taxes	58	-	-	(154)	-	-	-	-	(154)
Dividends and distributions (\$0.285 per share and unit)	-	-	-	(67,425)	-	-	-	(8,204)	(75,629)
Contributions from noncontrolling interests	-	-	-	-	-	96,472	4,305	-	100,777
	-	-	-	-	-	(41,203)	(74,346)	-	(115,549)

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Distributions to noncontrolling interests									
Consolidation of 50 Beale Street	-	-	-	-	-	110,007	-	-	110,007
Change in value of interest rate swaps	-	-	-	-	600	-	-	129	729
Pro rata share of other comprehensive income									
(loss) of unconsolidated joint ventures	-	-	-	-	42	-	-	(3)	39
Amortization of equity awards	-	-	2,244	-	-	-	-	10,882	13,126
Other	-	-	610	-	-	-	-	7,845	8,455
Balance as of September 30, 2017	240,074	\$2,400	\$4,286,265	\$(104,059)	\$1,014	\$408,035	\$14,947	\$433,554	\$5,042,156
Balance as of December 31, 2017	240,427	\$2,403	\$4,297,948	\$(133,693)	\$10,083	\$404,997	\$14,549	\$425,797	\$5,022,084
Basis adjustment upon adoption of ASU 2017-05	-	-	-	529	-	-	6,557	-	7,086
Balance as of January 1, 2018	240,427	2,403	4,297,948	(133,164)	10,083	404,997	21,106	425,797	5,029,170
Net income	-	-	-	3,829	-	5,520	668	381	10,398
Common shares issued upon redemption of common units	203	2	3,459	-	-	-	-	(3,461)	-
Common shares issued under Omnibus share plan, net of shares withheld for	68	-	-	(213)	-	-	-	-	(213)

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taxes									
Repurchases of common shares	(237)	(3)	(3,566)	-	-	-	-	-	(3,569)
Dividends and distributions (\$0.30 per share and unit)	-	-	-	(72,149)	-	-	-	(7,694)	(79,843)
Contributions from noncontrolling interests	-	-	-	-	-	-	44,381	-	44,381
Distributions to noncontrolling interests	-	-	-	-	-	(10,583)	-	-	(10,583)
Change in value of interest rate swaps	-	-	-	-	21,492	-	-	2,246	23,738
Pro rata share of other comprehensive loss of unconsolidated joint ventures	-	-	-	-	(44)	-	(56)	(5)	(105)
Amortization of equity awards	-	-	2,206	-	-	-	-	14,003	16,209
Other	-	-	1,282	(171)	(1)	-	-	(1,281)	(171)
Balance as of September 30, 2018	240,461	\$2,402	\$4,301,329	\$(201,868)	\$31,530	\$399,934	\$66,099	\$429,986	\$5,029,412

See notes to consolidated financial statements (unaudited).

PARAMOUNT GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(Amounts in thousands)	For the Nine Months Ended September 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 10,398	\$ 114,408
Adjustments to reconcile net income to net cash provided by		
operating activities:		
Depreciation and amortization	194,541	198,143
Real estate impairment loss	46,000	-
Straight-lining of rental income	(45,671)	(43,529)
Gain on sale of real estate	(36,845)	(133,989)
Amortization of stock-based compensation expense	15,245	11,692
Amortization of above and below-market leases, net	(12,611)	(14,164)
Amortization of deferred financing costs	8,267	8,367
Income from unconsolidated joint ventures	(2,931)	(19,143)
Distributions of earnings from unconsolidated joint ventures	4,910	3,380
Realized and unrealized gains on marketable securities	(802)	(3,198)
Loss from unconsolidated real estate funds	268	6,053
Distributions of earnings from unconsolidated real estate funds	232	275
Valuation allowance on preferred equity investment	-	19,588
Loss on early extinguishment of debt	-	7,877
Unrealized gain on interest rate swaps	-	(1,802)
Other non-cash adjustments	308	(1,104)
Changes in operating assets and liabilities:		
Accounts and other receivables	877	2,260
Deferred charges	(20,637)	(25,429)
Other assets	(31,148)	(18,094)
Accounts payable and accrued expenses	700	(10,710)
Other liabilities	3,067	1,190
Net cash provided by operating activities	134,168	102,071
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of real estate	349,013	540,333
Additions to real estate	(85,621)	(59,255)
Investments in unconsolidated joint ventures	(25,491)	(28,886)
Sales of marketable securities	16,352	25,855
Purchases of marketable securities	(13,192)	(28,133)
Escrow deposits and loans receivable for Residential Development Fund	(15,680)	-

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Contributions of capital to unconsolidated real estate funds	(2,254)	(790)
Distributions of capital from unconsolidated joint ventures	-	20,000
Acquisitions of real estate	-	(161,184)
Distributions of capital from unconsolidated real estate funds	-	13,849
Net cash provided by investing activities	223,127	321,789

See notes to consolidated financial statements (unaudited).

7

PARAMOUNT GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED

(UNAUDITED)

(Amounts in thousands)	For the Nine Months Ended September 30,	
	2018	2017
CASH FLOWS FROM FINANCING ACTIVITIES:		
Dividends paid to common stockholders	\$(70,944)	\$(66,469)
Contributions from noncontrolling interests	44,381	100,777
Proceeds from notes and mortgages payable	16,700	991,556
Distributions to noncontrolling interests	(10,583)	(115,549)
Distributions paid to common unitholders	(7,514)	(9,100)
Debt issuance costs	(6,351)	(7,344)
Repurchases of common shares	(3,569)	-
Repurchase of shares related to stock compensation agreements		
and related tax withholdings	(213)	(154)
Repayments of notes and mortgages payable	-	(1,044,821)
Repayment of borrowings under revolving credit facility	-	(290,000)
Borrowings under revolving credit facility	-	60,000
Transfer tax refund in connection with the acquisition of noncontrolling interests	-	9,555
Settlement of interest rate swap liabilities	-	(19,425)
Loss on early extinguishment of debt	-	(7,877)
Net cash used in financing activities	(38,093)	(398,851)
Net increase in cash and cash equivalents and restricted cash	319,202	25,009
Cash and cash equivalents and restricted cash at beginning of period	250,425	192,339
Cash and cash equivalents and restricted cash at end of period	\$569,627	\$217,348
RECONCILIATION OF CASH AND CASH EQUIVALENTS AND RESTRICTED CASH		
Cash and cash equivalents at beginning of period	\$219,381	\$162,965
Restricted cash at beginning of period	31,044	29,374
Cash and cash equivalents and restricted cash at beginning of period	\$250,425	\$192,339
Cash and cash equivalents at end of period	\$538,725	\$185,028
Restricted cash at end of period	30,902	32,320
Cash and cash equivalents and restricted cash at end of period	\$569,627	\$217,348
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash payments for interest	\$101,989	\$106,731
Cash payments for income taxes, net of refunds	1,541	5,042

NON-CASH TRANSACTIONS:

Dividends and distributions declared but not yet paid	\$26,596	\$25,211
Additions to real estate included in accounts payable and accrued expenses	32,790	10,986
Basis adjustment to investment in unconsolidated joint ventures upon		
adoption of ASU 2017-05	7,086	-
Write-off of fully amortized and/or depreciated assets	3,141	5,958
Common shares issued upon redemption of common units	3,461	166,524
Change in value of interest rate swaps	(23,738)	(729)
Consolidation of real estate	-	102,512
Assumption of notes and mortgages payable	-	228,000

See notes to consolidated financial statements (unaudited).

PARAMOUNT GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Organization and Business

As used in these consolidated financial statements, unless otherwise indicated, all references to “we,” “us,” “our,” the “Company,” and “Paramount” refer to Paramount Group, Inc., a Maryland corporation, and its consolidated subsidiaries, including Paramount Group Operating Partnership LP (the “Operating Partnership”), a Delaware limited partnership. We are a fully-integrated real estate investment trust (“REIT”) focused on owning, operating, managing, acquiring and redeveloping high-quality, Class A office properties in select central business district submarkets of New York City, Washington, D.C. and San Francisco. As of September 30, 2018, our portfolio consisted of 12 Class A office properties aggregating approximately 11.9 million square feet. We conduct our business through, and substantially all of our interests in properties and investments are held by, the Operating Partnership. We are the sole general partner of, and owned approximately 90.5% of, the Operating Partnership as of September 30, 2018.

2. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements are unaudited and have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and in conjunction with the instructions to Form 10-Q of the Securities and Exchange Commission (“SEC”). Accordingly, certain information and footnote disclosures required by GAAP for complete financial statements have been condensed or omitted. These consolidated financial statements include the accounts of Paramount and its consolidated subsidiaries, including the Operating Partnership. In the opinion of management, all significant adjustments (which include only normal recurring adjustments) and eliminations (which include intercompany balances and transactions) necessary to present fairly the financial position, results of operations and changes in cash flows have been made. The consolidated balance sheet as of December 31, 2017 was derived from audited financial statements as of that date, but does not include all information and disclosures required by GAAP. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC.

Significant Accounting Policies

There are no material changes to our significant accounting policies as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017.

Use of Estimates

We have made estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates. The results of operations for the three and nine months ended September 30, 2018, are not necessarily indicative of the operating results for the full year.

Reclassification

Certain prior year balances have been reclassified to conform to current year presentation.

PARAMOUNT GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Recently Issued Accounting Pronouncements Not Materially Impacting Our Financial Statements

In May 2014, the Financial Accounting Standard's Board ("FASB") issued ASU 2014-09, an update to ASC Topic 606, Revenue from Contracts with Customers. ASU 2014-09, as amended, supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of this guidance is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. This guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments made in applying the guidance. This guidance is effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years, and can be applied using a full retrospective or modified retrospective approach. We adopted the provisions of ASU 2014-09 on January 1, 2018, using the modified retrospective approach. The adoption of ASU 2014-09 did not impact our consolidated financial results but resulted in additional disclosures on our consolidated financial statements. See Note 16, Revenues.

In June 2016, the FASB issued ASU 2016-13, an update to ASC Topic 326, Financial Instruments – Credit Losses. ASU 2016-13 requires measurement and recognition of expected credit losses on financial instruments measured at amortized cost at the end of each reporting period rather than recognizing the credit losses when it is probable that the loss has been incurred in accordance with current guidance. ASU 2016-13 is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2019, with early adoption permitted for fiscal years beginning after December 15, 2018. We are evaluating the impact of ASU 2016-13 but do not believe the adoption will have a material impact on our consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, an update to ASC Topic 718, Compensation – Stock Compensation. ASU 2017-09 clarifies the types of changes to the terms and conditions of a share-based payment award that requires modification accounting. ASU 2017-09 does not change the accounting for modification of share-based awards, but clarifies that modification accounting should only be applied if there is a change to the value, vesting condition or award classification and would not be required if the changes are considered non-substantive. ASU 2017-09 is effective for interim and annual reporting periods in fiscal years that begin after December 31, 2017, with early adoption permitted. We adopted the provisions of ASU 2017-09 on January 1, 2018 and the adoption of ASU 2017-09

did not have an impact on our consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, an update to ASC Topic 815, Derivatives and Hedging. ASU 2017-12 improves transparency and understandability of information by better aligning the financial reporting for hedging relationships with the risk management activities. ASU 2017-12 also simplifies the application of hedge accounting through changes in both the designation and measurement of qualifying hedging relationships. ASU 2017-12 is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2018, with early adoption permitted. We are evaluating the impact of ASU 2017-12 but do not believe the adoption will have an impact on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, an update to ASC Topic 820, Fair Value Measurements. ASU 2018-13 modifies the disclosure requirements in ASC Topic 820, by (i) removing certain disclosure requirements related to transfers between Level 1 and Level 2 of the fair value hierarchy and the valuation processes for Level 3 fair value measurements, (ii) modifying existing disclosure requirements related to measurement uncertainty and (iii) adding new disclosure requirements related to changes in unrealized gains or losses for the period included in other comprehensive income for recurring Level 3 fair value measurements and disclosures related to the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. ASU 2018-13 is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2019, with early adoption permitted. We are evaluating the impact of ASU 2018-13 but do not believe the adoption will have an impact on our consolidated financial statements.

PARAMOUNT GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Recently Issued Accounting Pronouncements Impacting or Potentially Impacting Our Financial Statements

In February 2016, the FASB issued ASU 2016-02, an update to ASC Topic 842, Leases. ASU 2016-02 amends the existing guidance for lease accounting by requiring lessees to, among other things, (i) recognize most leases on their balance sheets, (ii) classify leases as either financing or operating, and (iii) record a right-of-use asset and a lease liability for all leases with a term greater than 12 months. ASU 2016-02 is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2018, with early adoption permitted. We plan to adopt the provisions of ASU 2016-02 on January 1, 2019, using the modified retrospective method and we will record a right-of-use asset and a lease liability upon such adoption for a select few leases in which we are a lessee. However, we do not believe that any asset and liability recorded in connection with such adoption will have a material impact to our financial statements.

While accounting for lessors under ASU 2016-02 is substantially similar to existing lease accounting guidance, lessors are required to separate payments received pursuant to a lease between lease components (rental income) and non-lease components (revenue related to various services we provide). In July 2018, the FASB issued ASU 2018-11, which provided lessors with a practical expedient to not separate lease and non-lease components, if certain criteria are met. We believe we meet such criteria and upon the adoption of ASU 2016-02, we plan to elect this practical expedient.

Furthermore, ASU 2016-02 also updates the definition of initial direct costs for both lessees and lessors to include only incremental costs of a lease that would not have been incurred if the lease had not been obtained. As a result, upon adoption of ASU 2016-02 on January 1, 2019, we will no longer be able to capitalize internal leasing costs and will have to expense them instead. We had capitalized internal leasing costs of \$1,169,000 and \$1,491,000 for the three months ended September 30, 2018 and 2017, respectively, and \$4,276,000 and \$4,488,000, for the nine months ended September 30, 2018 and 2017, respectively.

In November 2016, the FASB issued ASU 2016-18, an update to ASC Topic 230, Statement of Cash Flows, to provide guidance on classification and presentation of changes in restricted cash on the statement of cash flows. ASU 2016-18 requires that an entity's reconciliation of the beginning-of-period and end-of-period total amounts shown on

the statement of cash flows to include restricted cash with cash and cash equivalents. ASU 2016-18 is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2017, with early adoption permitted. We elected to early adopt ASU 2016-18 retrospectively, on December 31, 2017. This adoption resulted in (i) additional disclosures to reconcile cash and cash equivalents and restricted cash on our consolidated balance sheets to our consolidated statements of cash flows and (ii) a decrease to cash provided by operating activities of \$3,000,000 and an increase in cash provided by investing activities of \$5,946,000 for the nine months ended September 30, 2017.

In February 2017, the FASB issued ASU 2017-05, an update to ASC Topic 610, Other Income. ASU 2017-05 clarifies the scope and accounting for derecognition of a nonfinancial asset and eliminates the guidance in ASC 360-20 specific to real estate sales and partial sales. ASU 2017-05 requires an entity that transfers control of a nonfinancial asset to measure any noncontrolling interest it retains (or receives) at fair value. ASU 2017-05 is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2017, with early adoption permitted for entities concurrently early adopting ASU 2014-09. We adopted the provisions of ASU 2017-05 on January 1, 2018, using the modified retrospective approach. Upon adoption, we recorded a \$7,086,000 adjustment to “investments in unconsolidated joint ventures” relating to the measurement of our consolidated Residential Development Fund’s (“RDF”) retained interest in One Stuart Lane (formerly 75 Howard Street) at fair value with an offset to equity. See Note 5, Investments in Unconsolidated Joint Ventures.

PARAMOUNT GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

3. Dispositions

2099 Pennsylvania Avenue

On August 9, 2018, we completed the sale of 2099 Pennsylvania Avenue, a 208,776 square foot, Class A office building in Washington, D.C. for \$219,900,000 and recognized a gain of \$35,836,000, which is included as a component of “gain on sale of real estate” on our consolidated statements of income for the three and nine months ended September 30, 2018.

425 Eye Street

On September 27, 2018, we completed the sale of 425 Eye Street, a 372,552 square foot, Class A office building in Washington, D.C. for \$157,000,000 and recognized a gain of \$1,009,000, which is included as a component of “gain on sale of real estate” on our consolidated statements of income for the three and nine months ended September 30, 2018.

Waterview

On May 3, 2017, we completed the sale of Waterview, a 636,768 square foot, Class A office building in Rosslyn, Virginia for \$460,000,000 and recognized a gain of \$110,583,000, which is included as a component of “gain on sale of real estate” on our consolidated statement of income for the nine months ended September 30, 2017.

4. Acquisitions

50 Beale Street

On July 17, 2017, we and a new joint venture in which we have a 36.6% interest, acquired, through a series of transactions, a 62.2% interest in 50 Beale Street, a 660,625 square foot, Class A office building in San Francisco. Subsequent to the acquisition, we own a direct 13.2% interest in the property and the new joint venture owns the remaining 49.0% interest. Accordingly, our economic interest in the property is 31.1%. The acquisition valued the property at \$517,500,000 and included the assumption of \$228,000,000 of existing debt.

PARAMOUNT GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

5. Investments in Unconsolidated Joint Ventures

Prior to March 14, 2018, RDF, in which we have a 7.4% interest, owned 20.0% of One Steuart Lane (the "Property"). On March 14, 2018, RDF transferred its 20.0% interest to a new joint venture in which it owns a 75.0% interest. Separately on March 14, 2018, RDF acquired an additional 10.0% interest in the Property from its existing partner. Subsequent to these transactions RDF owns a 25.0% economic interest in the Property, comprised of the newly acquired 10.0% interest and an indirect 15.0% interest it owns through the joint venture. As a result of these transactions, RDF was required to consolidate its 75.0% interest in the joint venture that owns 20.0% of the Property, and reflect the 25.0% interest in this venture (5.0% economic interest in the Property) it does not own as noncontrolling interests. We continue to consolidate our 7.4% interest in RDF and reflect the 92.6% interest we do not own as noncontrolling interests. As of September 30, 2018, our economic interest in the Property was 1.85%.

The following tables summarize our investments in unconsolidated joint ventures as of the dates thereof and the income or loss from these investments for the periods set forth below.

(Amounts in thousands)	Paramount	As of	
Our Share of Investments:	Ownership	September	December
		30,	31, 2017
		2018	
712 Fifth Avenue ⁽¹⁾	50.0%	\$-	\$-
60 Wall Street ⁽²⁾	5.0%	23,121	25,083
One Steuart Lane ⁽²⁾	25.0% ⁽³⁾	48,530 ⁽⁴⁾	16,031
Oder-Center, Germany ⁽²⁾	9.5%	3,604	3,648
Investments in unconsolidated joint ventures		\$75,255	\$44,762

(Amounts in thousands)	Paramount Ownership	For the Three Months Ended September		For the Nine Months Ended September 30,	
		2018	2017	2018	2017
Our Share of Net Income (Loss):					
712 Fifth Avenue ⁽¹⁾	50.0%	\$558	\$596	\$3,166	\$19,030
60 Wall Street ⁽²⁾	5.0%	(116)	(45)	(291)	(81)
One Steuart Lane ⁽²⁾	25.0% ⁽³⁾	-	100	(18)	133
Oder-Center, Germany ⁽²⁾	9.5%	30	20	74	61
Income from unconsolidated joint ventures		\$472	\$671	\$2,931	\$19,143

⁽¹⁾ As of September 30, 2018, our basis in the partnership was negative \$20,256 resulting from distributions made to us in excess of our share of earnings recognized. Accordingly, we no longer recognize our proportionate share of earnings from the venture because we have no further obligation to fund additional capital to the venture. Instead, we only recognize earnings to the extent we receive cash distributions from the venture.

⁽²⁾ As of September 30, 2018, the carrying amount of our investments in 60 Wall Street, One Steuart Lane and Oder-Center is greater than our share of equity in these investments by \$2,866, \$692 and \$5,036, respectively.

⁽³⁾ Represents RDF's economic interest in the Property.

⁽⁴⁾ Includes a \$7,086 basis adjustment which was recorded upon the adoption of ASU 2017-05 on January 1, 2018.

PARAMOUNT GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

712 Fifth Avenue

The following tables provide summarized financial information of 712 Fifth Avenue as of the dates and for the periods set forth below.

(Amounts in thousands)	As of	
Balance Sheets:	September 30, 2018	December 31, 2017
Real estate, net	\$199,862	\$202,040
Other assets	61,283	58,034
Total assets	\$261,145	\$260,074
Notes and mortgages payable, net	\$296,440	\$296,132
Other liabilities	5,217	4,615
Total liabilities	301,657	300,747
Partners' deficit	(40,512)	(40,673)
Total liabilities and partners' deficit	\$261,145	\$260,074

(Amounts in thousands)	For the Three Months Ended		For the Nine Months Ended	
Income Statements:	September 30,		September 30,	
	2018	2017	2018	2017
Rental income	\$12,229	\$12,626	\$36,887	\$38,284
Tenant reimbursement income	1,227	1,338	3,817	3,855
Fee and other income	125	507	742	1,101
Total revenues	13,581	14,471	41,446	43,240
Operating expenses	6,250	6,197	18,560	18,265

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Depreciation and amortization	2,864	3,067	8,788	9,062
Total expenses	9,114	9,264	27,348	27,327
Operating income	4,467	5,207	14,098	15,913
Interest and other income, net	146	68	416	140
Interest and debt expense	(2,701)	(2,700)	(8,020)	(8,651)
Unrealized gain on interest rate swaps	-	-	-	1,896
Net income	\$1,912	\$2,575	\$6,494	\$9,298

PARAMOUNT GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

6. Investments in Unconsolidated Real Estate Funds

We are the general partner and investment manager of Paramount Group Real Estate Fund VII, LP (“Fund VII”) and its parallel fund, Paramount Group Real Estate Fund VII-H, LP (“Fund VII-H”). As of September 30, 2018, Fund VII and Fund VII-H own 100% of Zero Bond Street. We also manage Paramount Group Real Estate Fund VIII, LP (“Fund VIII”), our Alternative Investment Fund, which invests in mortgage and mezzanine loans and preferred equity investments.

The following tables summarize our investments in these unconsolidated real estate funds as of the dates thereof and the income or loss recognized for the periods set forth below.

(Amounts in thousands)	As of	
	September 30, 2018	December 31, 2017
Our Share of Investments:		
Property funds	\$2,059	\$ 2,429
Alternative investment fund	6,948	4,824
Investments in unconsolidated real estate funds	\$9,007	\$ 7,253

(Amounts in thousands)	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Our Share of Net Income (Loss):				
Net investment income	\$82	\$104	\$207	\$228
Net realized loss	-	(839)	-	(665)
Net unrealized (loss) gain	(270)	202	(475)	(26)

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Carried interest	-	(3,397)	-	(5,590)
Loss from unconsolidated real estate funds	\$(188)	\$(3,930)	\$(268)	\$(6,053)

PARAMOUNT GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The following tables provide summarized financial information for Fund VII as of the dates and for the periods set forth below.

(Amounts in thousands)	As of	
	September 30, 2018	December 31, 2017
Balance Sheets:		
Real estate investments	\$28,109	\$ 32,943
Cash and cash equivalents	144	138
Total assets	\$28,253	\$ 33,081
Other liabilities	\$1,171	\$ 1,058
Total liabilities	1,171	1,058
Equity	27,082	32,023
Total liabilities and equity	\$28,253	\$ 33,081

(Amounts in thousands)	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2018	2017	September 30, 2018	2017
Income Statements:				
Investment income	\$4	\$479	\$9	\$1,441
Investment expenses	43	120	163	1,156
Net investment (loss) income	(39)	359	(154)	285
Net realized losses	-	(3,809)	-	(3,875)
Net unrealized losses	(3,880)			