

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 **June 30, 2016**

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: **000-50600**

**blackbaud**<sup>®</sup>

**Blackbaud, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**11-2617163**

(I.R.S. Employer Identification No.)

**2000 Daniel Island Drive**

**Charleston, South Carolina 29492**

(Address of principal executive offices, including zip code)

**(843) 216-6200**

(Registrant's telephone number, including area code)

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 (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES  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" and "smaller reporting 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

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

YES  NO

The number of shares of the registrant's Common Stock outstanding as of July 25, 2016 was 47,518,682.



# TABLE OF CONTENTS

<b>CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS</b>	<b>2</b>
<b>PART I. FINANCIAL INFORMATION</b>	<b>3</b>
Item 1. Financial statements	
Consolidated balance sheets as of June 30, 2016 and December 31, 2015 (unaudited)	3
Consolidated statements of comprehensive income for the three and six months ended June 30, 2016 and 2015 (unaudited)	4
Consolidated statements of cash flows for the six months ended June 30, 2016 and 2015 (unaudited)	5
Consolidated statements of stockholders' equity for the six months ended June 30, 2016 and the year ended December 31, 2015 (unaudited)	6
Notes to consolidated financial statements (unaudited)	7
Item 2. Management's discussion and analysis of financial condition and results of operations	27
Item 3. Quantitative and qualitative disclosures about market risk	47
Item 4. Controls and procedures	47
<b>PART II. OTHER INFORMATION</b>	<b>48</b>
Item 1A. Risk factors	48
Item 2. Unregistered sales of equity securities and use of proceeds	48
Item 6. Exhibits	49
<b>SIGNATURES</b>	<b>50</b>

## ► CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including the documents incorporated herein by reference, contains forward-looking statements that anticipate results based on our estimates, assumptions and plans that are subject to uncertainty. These "forward-looking statements" are made subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements consist of, among other things, trend analyses, statements regarding future events, future financial performance, our anticipated growth, the effect of general economic and market conditions, our business strategy and our plan to build and grow our business, our operating results, our ability to successfully integrate acquired businesses and technologies, the effect of foreign currency exchange rate and interest rate fluctuations on our financial results, the impact of expensing stock-based compensation, the sufficiency of our capital resources, our ability to meet our ongoing debt and obligations as they become due, and potential litigation involving us, all of which are based on current expectations, estimates, and forecasts, and the beliefs and assumptions of our management. Words such as "believes," "seeks," "expects," "may," "might," "should," "intends," "could," "would," "likely," "will," "targets," "plans," "anticipates," "aims," "projects," "estimates" or any variations of such words and similar expressions are also intended to identify such forward-looking statements. These forward-looking statements are subject to risks, uncertainties and assumptions that are difficult to predict. Accordingly, they should not be viewed as assurances of future performance, and actual results may differ materially and adversely from those expressed in any forward-looking statements.

Important factors that could cause actual results to differ materially from our expectations expressed in forward-looking statements include, but are not limited to, those summarized under "Item 1A. Risk factors" and elsewhere in this report, in our Annual Report on Form 10-K for the year ended December 31, 2015 and in our other SEC filings. Forward-looking statements represent our management's beliefs and assumptions only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to update or revise any forward-looking statements, or to update the reasons actual results could differ materially from those anticipated in any forward-looking statement, whether as a result of new information, future events or otherwise.

# ▶ PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

### Blackbaud, Inc. Consolidated Balance Sheets (Unaudited)

(dollars in thousands)	June 30, 2016	December 31, 2015
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 15,263	\$ 15,362
Restricted cash due to customers	195,034	255,038
Accounts receivable, net of allowance of \$4,386 and \$4,943 at June 30, 2016 and December 31, 2015, respectively	107,749	80,046
Prepaid expenses and other current assets	53,797	48,666
<b>Total current assets</b>	<b>371,843</b>	<b>399,112</b>
Property and equipment, net	54,144	52,651
Software development costs, net	27,793	19,551
Goodwill	436,012	436,449
Intangible assets, net	273,445	294,672
Other assets	21,847	20,901
<b>Total assets</b>	<b>\$ 1,185,084</b>	<b>\$ 1,223,336</b>
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Trade accounts payable	\$ 27,817	\$ 19,208
Accrued expenses and other current liabilities	44,739	57,461
Due to customers	195,034	255,038
Debt, current portion	4,375	4,375
Deferred revenue, current portion	250,449	230,216
<b>Total current liabilities</b>	<b>522,414</b>	<b>566,298</b>
Debt, net of current portion	398,865	403,712
Deferred tax liability	27,823	27,996
Deferred revenue, net of current portion	6,212	7,119
Other liabilities	8,102	7,623
<b>Total liabilities</b>	<b>963,416</b>	<b>1,012,748</b>
Commitments and contingencies (see Note 10)		
Stockholders' equity:		
Preferred stock; 20,000,000 shares authorized, none outstanding	—	—
Common stock, \$0.001 par value; 180,000,000 shares authorized, 57,543,656 and 56,873,817 shares issued at June 30, 2016 and December 31, 2015, respectively	58	57
Additional paid-in capital	294,810	276,340
Treasury stock, at cost; 10,048,472 and 9,903,071 shares at June 30, 2016 and December 31, 2015, respectively	(207,898)	(199,861)
Accumulated other comprehensive loss	(1,640)	(825)
Retained earnings	136,338	134,877
<b>Total stockholders' equity</b>	<b>221,668</b>	<b>210,588</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,185,084</b>	<b>\$ 1,223,336</b>

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

**Blackbaud, Inc.**  
**Consolidated statements of comprehensive income**  
**(Unaudited)**

(dollars in thousands, except per share amounts)	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
<b>Revenue</b>				
Subscriptions	\$ 104,039	\$ 80,009	\$ 200,890	\$ 152,522
Maintenance	37,449	38,627	74,609	77,523
Services	35,419	33,667	67,833	64,973
License fees and other	3,284	3,956	6,115	8,234
<b>Total revenue</b>	<b>180,191</b>	<b>156,259</b>	<b>349,447</b>	<b>303,252</b>
<b>Cost of revenue</b>				
Cost of subscriptions	52,142	39,400	101,814	75,578
Cost of maintenance	5,685	6,969	11,008	14,471
Cost of services	24,696	25,915	49,015	52,886
Cost of license fees and other	1,020	1,146	1,622	2,307
<b>Total cost of revenue</b>	<b>83,543</b>	<b>73,430</b>	<b>163,459</b>	<b>145,242</b>
<b>Gross profit</b>	<b>96,648</b>	<b>82,829</b>	<b>185,988</b>	<b>158,010</b>
<b>Operating expenses</b>				
Sales, marketing and customer success	39,308	29,723	74,922	58,285
Research and development	22,578	20,166	45,357	41,442
General and administrative	19,857	17,955	39,613	34,798
Amortization	708	524	1,460	1,012
<b>Total operating expenses</b>	<b>82,451</b>	<b>68,368</b>	<b>161,352</b>	<b>135,537</b>
<b>Income from operations</b>	<b>14,197</b>	<b>14,461</b>	<b>24,636</b>	<b>22,473</b>
Interest expense	(2,721)	(1,873)	(5,396)	(3,559)
Other expense, net	(65)	(1,274)	(170)	(1,561)
<b>Income before provision for income taxes</b>	<b>11,411</b>	<b>11,314</b>	<b>19,070</b>	<b>17,353</b>
Income tax provision	3,598	4,272	6,262	6,026
<b>Net income</b>	<b>\$ 7,813</b>	<b>\$ 7,042</b>	<b>\$ 12,808</b>	<b>\$ 11,327</b>
<b>Earnings per share</b>				
Basic	\$ 0.17	\$ 0.15	\$ 0.28	\$ 0.25
Diluted	\$ 0.17	\$ 0.15	\$ 0.27	\$ 0.24
<b>Common shares and equivalents outstanding</b>				
Basic weighted average shares	46,083,055	45,579,345	46,047,788	45,554,645
Diluted weighted average shares	46,927,626	46,402,707	46,865,218	46,289,440
<b>Dividends per share</b>	<b>\$ 0.12</b>	<b>\$ 0.12</b>	<b>\$ 0.24</b>	<b>\$ 0.24</b>
<b>Other comprehensive (loss) income</b>				
Foreign currency translation adjustment	(431)	(196)	(28)	(522)
Unrealized (loss) gain on derivative instruments, net of tax	(118)	97	(787)	(372)
<b>Total other comprehensive loss</b>	<b>(549)</b>	<b>(99)</b>	<b>(815)</b>	<b>(894)</b>
<b>Comprehensive income</b>	<b>\$ 7,264</b>	<b>\$ 6,943</b>	<b>\$ 11,993</b>	<b>\$ 10,433</b>

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

**Blackbaud, Inc.**  
**Consolidated statements of cash flows**  
**(Unaudited)**

(dollars in thousands)	Six months ended June 30,	
	2016	2015
<b>Cash flows from operating activities</b>		
Net income	\$ 12,808	\$ 11,327
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	35,549	27,272
Provision for doubtful accounts and sales returns	2,264	2,934
Stock-based compensation expense	15,787	11,413
Excess tax benefits from exercise and vesting of stock-based compensation	(2,729)	(954)
Deferred taxes	(129)	(801)
Loss on sale of business	—	1,976
Amortization of deferred financing costs and discount	478	420
Other non-cash adjustments	(429)	289
Changes in operating assets and liabilities, net of acquisition and disposal of businesses:		
Accounts receivable	(30,097)	(13,355)
Prepaid expenses and other assets	(6,011)	(2,102)
Trade accounts payable	8,857	5,235
Accrued expenses and other liabilities	(18,019)	(9,882)
Restricted cash due to customers	62,038	78,718
Due to customers	(62,038)	(78,718)
Deferred revenue	19,658	13,792
<b>Net cash provided by operating activities</b>	<b>37,987</b>	<b>47,564</b>
<b>Cash flows from investing activities</b>		
Purchase of property and equipment	(12,569)	(7,014)
Capitalized software development costs	(12,168)	(6,982)
Purchase of net assets of acquired companies, net of cash	530	—
Net cash used in sale of business	—	(521)
<b>Net cash used in investing activities</b>	<b>(24,207)</b>	<b>(14,517)</b>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of debt	120,900	70,100
Payments on debt	(126,088)	(93,388)
Proceeds from exercise of stock options	5	18
Excess tax benefits from exercise and vesting of stock-based compensation	2,729	954
Dividend payments to stockholders	(11,398)	(11,255)
<b>Net cash used in financing activities</b>	<b>(13,852)</b>	<b>(33,571)</b>
Effect of exchange rate on cash and cash equivalents	(27)	(984)
<b>Net decrease in cash and cash equivalents</b>	<b>(99)</b>	<b>(1,508)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>15,362</b>	<b>14,735</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 15,263</b>	<b>\$ 13,227</b>

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

**Blackbaud, Inc.**  
**Consolidated statements of stockholders' equity**  
**(Unaudited)**

(dollars in thousands)	Common stock		Additional paid-in capital	Treasury stock	Accumulated other comprehensive loss	Retained earnings	Total stockholders' equity
	Shares	Amount					
<b>Balance at December 31, 2014</b>	56,048,135	\$ 56	\$ 245,674	\$ (190,440)	\$ (1,032)	\$ 131,658	\$ 185,916
Net income	—	—	—	—	—	25,649	25,649
Payment of dividends	—	—	—	—	—	(22,508)	(22,508)
Exercise of stock options and stock appreciation rights and vesting of restricted stock units	202,078	—	32	—	—	—	32
Surrender of 163,017 shares upon vesting of restricted stock and restricted stock units and exercise of stock appreciation rights	—	—	—	(9,421)	—	—	(9,421)
Excess tax benefits from exercise and vesting of stock-based compensation	—	—	5,466	—	—	—	5,466
Stock-based compensation	—	—	25,168	—	—	78	25,246
Restricted stock grants	736,252	1	—	—	—	—	1
Restricted stock cancellations	(112,648)	—	—	—	—	—	—
Other comprehensive income	—	—	—	—	207	—	207
<b>Balance at December 31, 2015</b>	56,873,817	\$ 57	\$ 276,340	\$ (199,861)	\$ (825)	\$ 134,877	\$ 210,588
Net income	—	—	—	—	—	12,808	12,808
Payment of dividends	—	—	—	—	—	(11,398)	(11,398)
Exercise of stock options and stock appreciation rights and vesting of restricted stock units	225,653	—	5	—	—	—	5
Surrender of 145,401 shares upon vesting of restricted stock and restricted stock units and exercise of stock appreciation rights	—	—	—	(8,037)	—	—	(8,037)
Excess tax benefits from exercise and vesting of stock-based compensation	—	—	2,729	—	—	—	2,729
Stock-based compensation	—	—	15,736	—	—	51	15,787
Restricted stock grants	510,936	1	—	—	—	—	1
Restricted stock cancellations	(66,750)	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	(815)	—	(815)
<b>Balance at June 30, 2016</b>	57,543,656	\$ 58	\$ 294,810	\$ (207,898)	\$ (1,640)	\$ 136,338	\$ 221,668

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



**Blackbaud, Inc.**  
**Notes to consolidated financial statements**  
**(Unaudited)**

## **1. Organization**

---

We are the world's leading cloud software company powering social good. Serving the entire social good community—nonprofits, foundations, corporations, education institutions, and individual change agents—we connect and empower organizations to increase their impact through software, services, expertise, and data intelligence. Our portfolio is tailored to the unique needs of vertical markets, with solutions for fundraising and relationship management, digital marketing, advocacy, accounting, payments, analytics, school management, grant management, corporate social responsibility and volunteerism. Serving the industry for more than three decades, we are headquartered in Charleston, South Carolina and have operations in the United States, Australia, Canada, Ireland and the United Kingdom. As of June 30, 2016, we had approximately 35,000 active customers.

## **2. Summary of Significant Accounting Policies**

---

### **Unaudited interim consolidated financial statements**

The accompanying interim consolidated financial statements have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC") for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to state fairly the consolidated balance sheets, consolidated statements of comprehensive income, consolidated statements of cash flows and consolidated statements of stockholders' equity, for the periods presented in accordance with accounting principles generally accepted in the United States ("GAAP"). The consolidated balance sheet at December 31, 2015, has been derived from the audited consolidated financial statements at that date. Operating results and cash flows for the six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2016, or any other future period. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted in accordance with the rules and regulations for interim reporting of the SEC. These interim 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, 2015, and other forms filed with the SEC from time to time.

### Reclassifications

In order to provide comparability between periods presented, "interest income", "loss on sale of business", "loss on debt extinguishment and termination of derivative instruments" and "other income (expense), net" have been combined within "other expense, net" in the previously reported consolidated statements of comprehensive income to conform to presentation of the current period. See Note 7 to these consolidated financial statements for additional details.

### **Basis of consolidation**

The consolidated financial statements include the accounts of Blackbaud, Inc. and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

### **Use of estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. On an ongoing basis, we reconsider and evaluate our estimates and assumptions, including those that impact revenue recognition, long-lived and intangible assets including goodwill, stock-based compensation, the provision for income taxes, deferred taxes, capitalization of software development costs and related amortization, our allowances for sales returns and doubtful accounts, deferred sales commissions and professional services costs, valuation

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

of derivative instruments, accounting for business combinations and loss contingencies. Changes in the facts or circumstances underlying these estimates could result in material changes and actual results could materially differ from these estimates.

### **Revenue recognition**

Our revenue is primarily generated from the following sources: (i) charging for the use of our software solutions in cloud-based and hosted environments; (ii) providing software maintenance and support services; (iii) providing professional services including implementation, training, consulting, analytic, hosting and other services; (iv) providing transaction and payment processing services; and (v) selling perpetual licenses of our software solutions.

We recognize revenue when all of the following conditions are met:

- Persuasive evidence of an arrangement exists;
- The solutions or services have been delivered;
- The fee is fixed or determinable; and
- Collection of the resulting receivable is probable.

Determining whether and when these criteria have been met can require significant judgment and estimates. We deem acceptance of a contract to be evidence of an arrangement. Delivery of our services occurs when the services have been performed. Delivery of our solutions occurs when the solution is shipped or transmitted, and title and risk of loss have transferred to the customers. Our typical arrangements do not include customer acceptance provisions; however, if acceptance provisions are provided, delivery is deemed to occur upon acceptance. We consider the fee to be fixed or determinable unless the fee is subject to refund or adjustment or is not payable within our standard payment terms. Payment terms greater than 90 days are considered to be beyond our customary payment terms. Collection is deemed probable if we expect that the customer will be able to pay amounts under the arrangement as they become due. If we determine that collection is not probable, we defer revenue recognition until collection. Revenue is recognized net of actual and estimated sales returns and allowances.

We follow guidance provided in ASC 605-45, *Principal Agent Considerations*, which states that determining whether a company should recognize revenue based on the gross amount billed to a customer or the net amount retained is a matter of judgment that depends on the facts and circumstances of the arrangement and that certain factors should be considered in the evaluation.

### Subscriptions

We provide software solutions to customers which are available for use in cloud-based subscription arrangements without licensing perpetual rights to the software (“cloud-based solutions”). Revenue from cloud-based solutions is recognized ratably beginning on the activation date over the term of the agreement, which generally ranges from one to three years. Any revenue related to upfront activation or set-up fees is deferred and recognized ratably over the estimated period that the customer benefits from the related cloud-based solution. Direct and incremental costs related to upfront activation or set-up activities for cloud-based solutions are capitalized until the cloud-based solution is deployed and in use, and then expensed ratably over the estimated period that the customer benefits from the related cloud-based solution.

We provide hosting services to customers who have purchased perpetual rights to certain of our software solutions (“hosting services”). Revenue from hosting services, online training programs as well as subscription-based analytic services such as data enrichment and data management services, is recognized ratably beginning on the activation date over the term of the agreement, which generally ranges from one to three years. Any related set-up fees are recognized ratably over the estimated period that the customer benefits from the related hosting service. The estimated period of benefit is evaluated on an annual basis using historical customer retention information by solution or service.

For arrangements that have multiple elements and do not include software licenses, we allocate arrangement consideration at the inception of the arrangement to those elements that qualify as separate units of accounting. The arrangement consideration is allocated to the separate units of accounting based on relative selling price method in accordance with

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

the selling price hierarchy, which includes: (i) vendor specific objective evidence (“VSOE”) of fair value if available; (ii) third-party evidence (“TPE”) if VSOE is not available; and (iii) best estimate of selling price (“BESP”) if neither VSOE nor TPE is available. In general, we use VSOE to allocate the selling price to subscription and service deliverables.

We offer certain payment processing services with the assistance of third-party vendors. In general, when we are the principal in a transaction based on the predominant weighting of factors identified in ASC 605-45, we record the revenue and related costs on a gross basis. Otherwise, we net the cost of revenue associated with the service against the gross amount billed to the customer and record the net amount as revenue.

Revenue from transaction processing services is recognized when the service is provided and the amounts are determinable. Revenue directly associated with processing donations for customers are included in subscriptions revenue.

#### Maintenance

We recognize revenue from maintenance services ratably over the term of the arrangement, generally one year at contract inception with annual renewals thereafter. Maintenance contracts are at rates that vary according to the level of the maintenance program associated with the software solution and are generally renewable annually. Maintenance contracts may also include the right to unspecified solution upgrades on an if-and-when available basis. Certain incremental support services are sold in prepaid units of time and recognized as revenue upon their usage.

#### Services

We generally bill consulting, installation and implementation services based on hourly rates plus reimbursable travel-related expenses. Revenue is recognized for these services over the period the services are delivered.

We recognize analytic services revenue from donor prospect research engagements, the sale of lists of potential donors, benchmarking studies and data modeling service engagements upon delivery. In arrangements where we provide customers the right to updated information during the contract period, revenue is recognized ratably over the contract period.

We sell fixed-rate programs, which permit customers to attend unlimited training over a specified contract period, typically one year, subject to certain restrictions, and revenue in those cases is recognized ratably over the contract period. Additionally, we sell training at a fixed rate for each specific class at a per attendee price or at a packaged price for several attendees, and recognize the related revenue upon the customer attending and completing training.

#### License fees

We sell perpetual software licenses with maintenance, varying levels of professional services and, in certain instances, with hosting services. We allocate revenue to each of the elements in these arrangements using the residual method under which we first allocate revenue to the undelivered elements, typically the non-software license components, based on VSOE of fair value of the various elements. We determine VSOE of fair value of the various elements using different methods. VSOE of fair value for maintenance services associated with software licenses is based upon renewal rates stated in the arrangements with customers, which demonstrate a consistent relationship of maintenance pricing as a percentage of the contractual license fee. VSOE of fair value of professional services and other solutions and services is based on the average selling price of these same solutions and services to other customers when sold on a stand-alone basis. Any remaining revenue is allocated to the delivered elements, which is normally the software license in the arrangement. In general, revenue is recognized for software licenses upon delivery to our customers.

When a software license is sold with software customization services, generally the services are to provide the customer assistance in creating special reports and other enhancements that will improve operational efficiency and/or help to support business process improvements. These services are generally not essential to the functionality of the software and the related revenues are recognized either as the services are delivered or upon completion. However, when software customization services are considered essential to the functionality of the software, we recognize revenue for both the software license and the services using the percentage-of-completion method.

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

### Deferred revenue

To the extent that our customers are billed for the above described solutions and services in advance of delivery, we record such amounts in deferred revenue. Generally, our subscription and maintenance customers are billed one year in advance.

### **Fair value measurements**

We measure certain financial assets and liabilities at fair value on a recurring basis, including derivative instruments. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. An active market is defined as a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. We use a three-tier fair value hierarchy to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

- Level 1 - Quoted prices for identical assets or liabilities in active markets;
- Level 2 - Quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and
- Level 3 - Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

Our financial assets and liabilities are classified in their entirety within the hierarchy based on the lowest level of input that is significant to fair value measurement. Changes to a financial asset's or liability's level within the fair value hierarchy are determined as of the end of a reporting period. All methods of assessing fair value result in a general approximation of value, and such value may never actually be realized.

### **Earnings per share**

We compute basic earnings per share by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares and dilutive potential common shares outstanding during the period. Diluted earnings per share reflect the assumed exercise, settlement and vesting of all dilutive securities using the "treasury stock method" except when the effect is anti-dilutive. Potentially dilutive securities consist of shares issuable upon the exercise of stock options, settlement of stock appreciation rights and vesting of restricted stock awards and units.

### **Recently adopted accounting pronouncements**

In September 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-16, *Simplifying the Accounting for Measurement-Period Adjustments (ASU 2015-16)*. ASU 2015-16 requires for acquirers in business combinations to recognize adjustments to provisional amounts identified during measurement periods in the reporting periods in which adjusted amounts are determined. The update requires that acquirers record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization or other income effects, if any, resulting from changes in provisional amounts, calculated as if the accounting had been completed at acquisition date. The update also requires separate income statement presentation or note disclosure of amounts recorded in current period earnings by line item that would have been recorded in previous reporting periods if the provisional amount adjustments had been recognized at the acquisition date (requirements to retrospectively account for those adjustments have been eliminated). The guidance is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. Amendments in this update should be applied prospectively to adjustments to provisional amounts that occur after its effective date, with earlier application permitted for financial statements that have not been issued. We adopted ASU 2015-16 on January 1, 2016. See Note 3 to these consolidated financial statements for details of any immaterial measurement period adjustments.

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

In April 2015, the FASB issued ASU No. 2015-05, *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40) - Customer's Accounting for Fees Paid in a Cloud Computing Arrangement (ASU 2015-05)*. The amendments in this update provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the update specifies that the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. The update further specifies that the customer should account for a cloud computing arrangement as a service contract if the arrangement does not include a software license. An entity can elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. We adopted ASU 2015-05 on January 1, 2016 on a prospective basis and it did not have a material impact on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, *Interest - Imputation of Interest - Simplifying the Presentation of Debt Issuance Costs (ASU 2015-03)*. ASU 2015-03 sets forth a requirement that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs is not affected by the amendments in this update. An entity should apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented is adjusted to reflect the period-specific effects of applying the new guidance. We adopted ASU 2015-03 on January 1, 2016 and retrospectively restated "other assets" and "debt, net of current portion", which had the effect of reducing each of those respective line items in our December 31, 2015 consolidated balance sheet by approximately \$0.5 million.

#### **Recently issued accounting pronouncements**

In March 2016, the FASB issued ASU 2016-09, *Compensation — Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting (ASU 2016-09)*. ASU 2016-09 updates the accounting for certain aspects of share-based payments to employees. Entities will be required to recognize the income tax effects of awards in the income statement when the awards vest or are settled. The guidance also updates an employers' accounting for an employee's use of shares to satisfy the employer's statutory income tax withholding obligation and accounting for forfeitures. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted but all of the guidance must be adopted in the same period. We expect ASU 2016-09 will impact our consolidated balance sheets, statements of comprehensive income and cash flows, and we are currently evaluating the extent of the impact that implementation of this standard will have on adoption. We are currently considering early adopting this new guidance during 2016.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842) (ASU 2016-02)*. ASU 2016-02 will require lessees to record most leases on their balance sheets but recognize expenses in the income statement in a manner similar to current guidance. The updated guidance also eliminates certain real estate-specific provisions and changes the guidance on sale-leaseback transactions, initial direct costs and lease executory costs for all entities. For lessors, the standard modifies the classification criteria and the accounting for sales-type and direct financing leases. All entities will classify leases to determine how to recognize lease-related revenue and expense. Classification will continue to affect amounts that lessors record on the balance sheet. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those years. Early adoption is permitted. Upon adoption, entities will be required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. We expect ASU 2016-02 will impact our consolidated financial statements and are currently evaluating the extent of the impact that implementation of this standard will have on adoption.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606) (ASU 2014-09)*. ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU 2014-09 was originally effective for fiscal years and interim periods within those years beginning after December 15, 2016. An entity should apply ASU 2014-09 either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the ASU recognized as an adjustment to the opening balance of retained earnings at the date of initial application. In July, 2015, the FASB decided to delay the effective date of the new standard for one year. The new standard now requires application no later than annual reporting periods beginning after December 15, 2017, including interim reporting periods therein; however, public entities are permitted to elect to early adopt the new standard as of the original effective date. In March 2016, the FASB finalized amendments to the guidance in the new

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

standard to clarify whether an entity is a principal or an agent in a revenue transaction. In April 2016, the FASB finalized additional amendments to the guidance in the new standard to clarify the accounting for licenses of intellectual property and identifying performance obligations. We expect the adoption of ASU 2014-09 will impact our consolidated financial statements. We are currently evaluating implementation methods and the extent of the impact that implementation of this standard and the recently issued clarifying amendments will have upon adoption.

### 3. Business Combinations

#### 2015 Acquisitions

##### Smart Tuition

On October 2, 2015, we completed our acquisition of all of the outstanding equity, including all voting equity interests, of Smart, LLC ("Smart Tuition"). Smart Tuition is a leading provider of payment software and services for private schools and parents. The acquisition of Smart Tuition further expanded our offerings in the K-12 technology sector. We acquired Smart Tuition for \$187.3 million in cash, net of closing adjustments including an adjustment of approximately \$0.5 million during the three months ended March 31, 2016. We received the proceeds from these closing adjustments during the three months ended June 30, 2016. On October 2, 2015, we drew down a \$186.0 million revolving credit loan under our 2014 Credit Facility (as defined in Note 8 below) to finance the acquisition of Smart Tuition. As a result of the acquisition, Smart Tuition has become a wholly-owned subsidiary of ours. We included the operating results of Smart Tuition as well as goodwill arising from the acquisition in our consolidated financial statements within the General Markets Business Unit ("GMBU") from the date of acquisition. For the three months ended June 30, 2016, Smart Tuition's total revenue and operating income included in our consolidated financial statements was \$8.2 million and \$0.6 million, respectively. For the six months ended June 30, 2016, Smart Tuition's total revenue and operating income included in our consolidated financial statements was \$17.4 million and \$1.8 million, respectively.

The preliminary purchase price allocation is based upon a preliminary valuation of assets and liabilities and the estimates and assumptions are subject to change as we obtain additional information during the measurement period, which may be up to one year from the acquisition date. The assets and liabilities pending finalization include the valuation of acquired intangible assets, the assumed deferred revenue and deferred taxes. Differences between the preliminary and final valuation could have a material impact on our future results of operations and financial position.

The following table summarizes the preliminary allocation of the purchase price based on the estimated fair value of the assets acquired and the liabilities assumed:

(dollars in thousands)	Purchase Price Allocation
Net working capital, excluding deferred revenue	\$ 276
Property and equipment	2,457
Deferred revenue	(6,500)
Deferred tax asset	2,637
Intangible assets	97,800
Goodwill	90,302
<b>Total purchase price<sup>(1)</sup></b>	<b>\$ 186,972</b>

(1) The purchase price differs from the net cash outlay of \$187.3 million due to certain insignificant acquisition-related expenses included therein.

The estimated fair value of accounts receivable acquired approximates the contractual value of \$2.8 million. The estimated goodwill recognized is attributable primarily to the opportunities for expected synergies from combining operations and the assembled workforce of Smart Tuition, all of which was assigned to our GMBU reporting segment. Approximately \$86.2 million of the goodwill arising in the acquisition is deductible for income tax purposes.

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

The Smart Tuition acquisition resulted in the identification of the following identifiable intangible assets:

	Intangible assets acquired  (in thousands)	Weighted average amortization period  (in years)
Customer relationships	\$ 72,300	17
Marketing assets	1,200	3
Acquired technology	22,100	7
Non-compete agreements	2,200	5
Total intangible assets	\$ 97,800	14

The estimated fair values of the finite-lived intangible assets were based on variations of the income approach, which estimates fair value based on the present value of cash flows that the assets are expected to generate which included the relief-from-royalty method, incremental cash flow method including the with and without method and excess earnings method, depending on the intangible asset being valued. The method of amortization of identifiable finite-lived intangible assets is based on the expected pattern in which the estimated economic benefits of the respective assets are consumed or otherwise used up. Customer relationships and acquired technology are being amortized on an accelerated basis while marketing assets and non-compete agreements are being amortized on a straight-line basis.

The following unaudited pro forma condensed combined consolidated results of operations assume that the acquisition of Smart Tuition occurred on January 1, 2014. This unaudited pro forma financial information does not reflect any adjustments for anticipated synergies resulting from the acquisition and should not be relied upon as being indicative of the historical results that would have been attained had the transaction been consummated as of January 1, 2014, or of the results that may occur in the future. The unaudited pro forma information reflects adjustments for amortization of intangibles related to the fair value adjustments of the assets acquired, write-down of acquired deferred revenue to fair value, additional interest expense related to the financing of the transaction and the related tax effects of the adjustments.

	Three months ended June 30,		Six months ended June 30,	
	2015		2015	
(dollars in thousands, except per share amounts)				
Revenue	\$	164,170	\$	319,982
Net income	\$	6,084	\$	10,523
Basic earnings per share	\$	0.13	\$	0.23
Diluted earnings per share	\$	0.13	\$	0.23

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

#### 4. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

(dollars in thousands, except per share amounts)	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
<b>Numerator:</b>				
Net income	\$ 7,813	\$ 7,042	\$ 12,808	\$ 11,327
<b>Denominator:</b>				
Weighted average common shares	46,083,055	45,579,345	46,047,788	45,554,645
<b>Add effect of dilutive securities:</b>				
Stock-based compensation	844,571	823,362	817,430	734,795
Weighted average common shares assuming dilution	46,927,626	46,402,707	46,865,218	46,289,440
<b>Earnings per share:</b>				
Basic	\$ 0.17	\$ 0.15	\$ 0.28	\$ 0.25
Diluted	\$ 0.17	\$ 0.15	\$ 0.27	\$ 0.24

The following shares underlying stock-based awards were not included in diluted earnings per share because their inclusion would have been anti-dilutive:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Shares excluded from calculations of diluted earnings per share	—	12,705	44,134	10,152



**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

## 5. Fair Value Measurements

### Recurring fair value measurements

Financial assets and liabilities measured at fair value on a recurring basis consisted of the following, as of:

(dollars in thousands)	Fair value measurement using			Total
	Level 1	Level 2	Level 3	
<b>Fair value as of June 30, 2016</b>				
Financial liabilities:				
Derivative instruments <sup>(1)</sup>	\$ —	\$ 1,329	\$ —	\$ 1,329
Total financial liabilities	\$ —	\$ 1,329	\$ —	\$ 1,329
<b>Fair value as of December 31, 2015</b>				
Financial assets:				
Derivative instruments <sup>(1)</sup>	\$ —	\$ 406	\$ —	\$ 406
Total financial assets	\$ —	\$ 406	\$ —	\$ 406
<b>Fair value as of December 31, 2015</b>				
Financial liabilities:				
Derivative instruments <sup>(1)</sup>	\$ —	\$ 438	\$ —	\$ 438
Total financial liabilities	\$ —	\$ 438	\$ —	\$ 438

(1) The fair value of our interest rate swaps was based on model-driven valuations using LIBOR rates, which are observable at commonly quoted intervals. Accordingly, our interest rate swaps are classified within Level 2 of the fair value hierarchy.

We believe the carrying amounts of our cash and cash equivalents, restricted cash due to customers, accounts receivable, trade accounts payable, accrued expenses and other current liabilities and due to customers approximate their fair values at June 30, 2016 and December 31, 2015, due to the immediate or short-term maturity of these instruments.

We believe the carrying amount of our debt approximates its fair value at June 30, 2016 and December 31, 2015, as the debt bears interest rates that approximate market value. As LIBOR rates are observable at commonly quoted intervals, our debt is classified within Level 2 of the fair value hierarchy.

### Non-recurring fair value measurements

Assets and liabilities that are measured at fair value on a non-recurring basis include intangible assets and goodwill which are recognized at fair value during the period in which an acquisition is completed, from updated estimates and assumptions during the measurement period, or when they are considered to be impaired. These non-recurring fair value measurements, primarily for intangible assets acquired, were based on Level 3 unobservable inputs. In the event of an impairment, we determine the fair value of the goodwill and intangible assets using a discounted cash flow approach, which contains significant unobservable inputs and therefore is considered a Level 3 fair value measurement. The unobservable inputs in the analysis generally include future cash flow projections and a discount rate.

There were no non-recurring fair value adjustments to intangible assets and goodwill during the six months ended June 30, 2016, except for certain insignificant business combination accounting adjustments to the initial fair value estimates of the Smart Tuition assets acquired and liabilities assumed at the acquisition date from updated information obtained during the measurement period. See Note 3 to these consolidated financial statements for additional details. The measurement period may be up to one year from the acquisition date. We record any measurement period adjustments to the fair value of assets acquired and liabilities assumed, with the corresponding offset to goodwill.

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

## 6. Goodwill and Other Intangible Assets

The change in goodwill for each reportable segment (as defined in Note 14 below) during the six months ended June 30, 2016, consisted of the following:

(dollars in thousands)	ECBU	GMBU	IBU	Total
<b>Balance at December 31, 2015</b>	\$ 240,494	\$ 190,976	\$ 4,979	\$ 436,449
Adjustments related to prior year business combinations <sup>(1)</sup>	—	(256)	—	(256)
Effect of foreign currency translation	—	—	(181)	(181)
<b>Balance at June 30, 2016</b>	<b>\$ 240,494</b>	<b>\$ 190,720</b>	<b>\$ 4,798</b>	<b>\$ 436,012</b>

(1) See Note 3 to these consolidated financial statements for details of certain of the immaterial measurement period adjustments.

### Amortization expense

Amortization expense related to finite-lived intangible assets acquired in business combinations is allocated to cost of revenue on the consolidated statements of comprehensive income based on the revenue stream to which the asset contributes, except for marketing assets and non-compete agreements, for which the associated amortization expense is included in operating expenses.

The following table summarizes amortization expense:

(dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Included in cost of revenue:				
Cost of subscriptions	\$ 7,853	\$ 5,767	\$ 15,664	\$ 11,539
Cost of maintenance	1,332	1,006	2,664	2,159
Cost of services	657	702	1,310	1,309
Cost of license fees and other	85	92	170	199
Total included in cost of revenue	9,927	7,567	19,808	15,206
Included in operating expenses	708	524	1,460	1,012
Total amortization of intangibles from business combinations	\$ 10,635	\$ 8,091	\$ 21,268	\$ 16,218

The following table outlines the estimated future amortization expense for each of the next five years for our finite-lived intangible assets as of June 30, 2016:

(dollars in thousands) Years ending December 31,	Amortization expense
2016 - remaining	\$ 20,991
2017	41,426
2018	39,788
2019	36,479
2020	27,701
<b>Total</b>	<b>\$ 166,385</b>

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

## 7. Consolidated Financial Statement Details

### Prepaid expenses and other assets

(dollars in thousands)	June 30, 2016	December 31, 2015
Deferred sales commissions	\$ 34,027	\$ 30,141
Prepaid software maintenance	20,670	15,308
Deferred professional services costs	2,586	3,603
Taxes, prepaid and receivable	6,398	9,121
Deferred tax asset	3,385	2,869
Prepaid royalties	1,442	1,767
Other assets	7,136	6,758
Total prepaid expenses and other assets	75,644	69,567
Less: Long-term portion	21,847	20,901
Prepaid expenses and other current assets	\$ 53,797	\$ 48,666

### Accrued expenses and other liabilities

(dollars in thousands)	June 30, 2016	December 31, 2015
Accrued bonuses	\$ 11,979	\$ 24,591
Accrued commissions and salaries	8,371	8,391
Taxes payable	4,523	3,923
Deferred rent liabilities	4,108	4,070
Lease incentive obligations	4,306	4,734
Unrecognized tax benefit	3,299	3,147
Customer credit balances	4,305	3,515
Accrued vacation costs	2,256	2,446
Accrued health care costs	2,564	2,356
Other liabilities	7,130	7,911
Total accrued expenses and other liabilities	52,841	65,084
Less: Long-term portion	8,102	7,623
Accrued expenses and other current liabilities	\$ 44,739	\$ 57,461

### Deferred revenue

(dollars in thousands)	June 30, 2016	December 31, 2015
Subscriptions	\$ 139,177	\$ 122,524
Maintenance	86,084	85,901
Services	29,725	28,517
License fees and other	1,675	393
Total deferred revenue	256,661	237,335
Less: Long-term portion	6,212	7,119
Deferred revenue, current portion	\$ 250,449	\$ 230,216

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

**Other expense, net**

(dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Interest income	\$ 118	\$ 7	\$ 239	\$ 15
Loss on sale of business	—	(1,976)	—	(1,976)
Other (expense) income, net	(183)	695	(409)	400
Other expense, net	\$ (65)	\$ (1,274)	\$ (170)	\$ (1,561)

**8. Debt**

The following table summarizes our debt balances and the related weighted average effective interest rates, which includes the effect of interest rate swap agreements.

(dollars in thousands)	Debt balance at		Weighted average effective interest rate at	
	June 30, 2016	December 31, 2015	June 30, 2016	December 31, 2015
Credit facility:				
Revolving credit loans	\$ 239,900	\$ 242,900	2.19%	2.15%
Term loans	165,156	167,344	2.53%	2.51%
Total debt	405,056	410,244	2.33%	2.30%
Less: Unamortized debt discount	1,816	2,157		
Less: Debt, current portion	4,375	4,375	2.14%	2.11%
Debt, net of current portion	\$ 398,865	\$ 403,712	2.33%	2.30%

**Summary of the 2014 Credit Facility**

In February 2014, we entered into a five-year \$325.0 million credit facility (the "2014 Credit Facility") and drew \$175.0 million on a term loan upon closing, which was used to repay all amounts outstanding under the 2012 Credit Facility.

The 2014 Credit Facility includes the following facilities: (i) a dollar and a designated currency revolving credit facility with sublimits for letters of credit and swingline loans (the "2014 Revolving Facility") and (ii) a term loan facility (the "2014 Term Loan").

In connection with our entry into the 2014 Credit Facility, we paid \$2.5 million in financing costs, of which \$1.1 million were capitalized and, together with a portion of the unamortized deferred financing costs from prior facilities, are being amortized into interest expense over the term of the new facility using the effective interest method. As of June 30, 2016 and December 31, 2015, deferred financing costs totaling \$0.7 million and \$0.9 million, respectively, were included in other assets on the consolidated balance sheet.

The 2014 Credit Facility is secured by the stock and limited liability company interests of certain of our subsidiaries and is guaranteed by our material domestic subsidiaries.

Amounts borrowed under the dollar tranche revolving credit loans and term loan under the 2014 Credit Facility bear interest at a rate per annum equal to, at our option, (a) a base rate equal to the highest of (i) the prime rate, (ii) federal funds rate plus 0.50% and (iii) one month LIBOR plus 1.00% (the "Base Rate"), in addition to a margin of 0.00% to 0.50%, or (b) LIBOR rate plus a margin of 1.00% to 1.50%.

We also pay a quarterly commitment fee on the unused portion of the 2014 Revolving Facility from 0.15% to 0.225% per annum, depending on our net leverage ratio. At June 30, 2016, the commitment fee was 0.225%.

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

The 2014 Term Loan requires periodic principal payments. The balance of the 2014 Term Loan and any amounts drawn on the 2014 Revolving Facility are due upon maturity of the 2014 Credit Facility in February 2019. We evaluate the classification of our debt as current or non-current based on the required annual maturities of the 2014 Credit Facility.

The 2014 Credit Facility includes financial covenants related to the net leverage ratio and interest coverage ratio, as well as restrictions on our ability to declare and pay dividends and our ability to repurchase shares of our common stock. At June 30, 2016, we were in compliance with our debt covenants under the 2014 Credit Facility.

**Financing for MicroEdge acquisition**

The 2014 Credit Facility includes an option to request increases in the revolving commitments and/or request additional term loans in an aggregate principal amount of up to \$200.0 million. On October 1, 2014, we exercised this option, and certain lenders agreed, to increase the revolving credit commitments by \$100.0 million (the "October 2014 Additional Revolving Credit Commitments") such that for the period commencing October 1, 2014, the aggregate revolving credit commitments available were \$250.0 million. The October 2014 Additional Revolving Credit Commitments have the same terms as the existing revolving credit commitments.

On October 1, 2014, we drew down a \$140.0 million revolving credit loan under the 2014 Credit Facility to finance the acquisition of MicroEdge.

**Financing for Smart Tuition acquisition**

On July 17, 2015, we again exercised this option and certain lenders agreed to increase the revolving credit commitments by an additional \$100.0 million (the "July 2015 Additional Revolving Credit Commitments") such that commencing July 17, 2015, the aggregate revolving credit commitments available were \$350.0 million. The July 2015 Additional Revolving Credit Commitments have the same terms as the existing revolving credit commitments.

On October 2, 2015, we drew down a \$186.0 million revolving credit loan under the 2014 Credit Facility to finance the acquisition of Smart Tuition.

As of June 30, 2016, the required annual maturities related to the 2014 Credit Facility were as follows:

Years ending December 31, (dollars in thousands)	Annual maturities
2016 - remaining	\$ 2,187
2017	4,375
2018	4,375
2019	394,119
2020	—
Thereafter	—
Total required maturities	\$ 405,056

**9. Derivative Instruments**

We use derivative instruments to manage our variable interest rate risk. In March 2014, we entered into an interest rate swap agreement (the "March 2014 Swap Agreement"), which effectively converts portions of our variable rate debt under the 2014 Credit Facility to a fixed rate for the term of the swap agreement. The initial notional value of the March 2014 Swap Agreement was \$125.0 million with an effective date beginning in March 2014. In March 2017, the notional value of the March 2014 Swap Agreement will decrease to \$75.0 million for the remaining term through February 2018. We designated the March 2014 Swap Agreement as a cash flow hedge at the inception of the contract.

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

In October 2014, we entered into an additional interest rate swap agreement (the "October 2014 Swap Agreement"), which effectively converted portions of our variable rate debt under the 2014 Credit Facility to a fixed rate for the term of the swap agreement. The initial notional value of the October 2014 Swap Agreement was \$75.0 million with an effective date beginning in October 2014. In September 2015, the notional value of the October 2014 Swap Agreement decreased to \$50.0 million for the remaining term through June 2016. We designated the October 2014 Swap Agreement as a cash flow hedge at the inception of the contract.

In October 2015, we entered into an additional interest rate swap agreement (the "October 2015 Swap Agreement"), which effectively converts portions of our variable rate debt under the 2014 Credit Facility to a fixed rate for the term of the October 2015 Swap Agreement. The notional value of the October 2015 Swap Agreement was \$75.0 million with an effective date beginning in October 2015 and maturing in February 2018. We designated the October 2015 Swap Agreement as a cash flow hedge at the inception of the contract.

The fair values of our derivative instruments were as follows as of:

(dollars in thousands)	Balance sheet location	June 30, 2016	December 31, 2015
<b>Derivative instruments designated as hedging instruments:</b>			
Interest rate swap, long-term portion	Other assets	\$ —	\$ 406
<b>Total derivative instruments designated as hedging instruments</b>		<b>\$ —</b>	<b>\$ 406</b>
		<b>June 30, 2016</b>	<b>December 31, 2015</b>
<b>Derivative instruments designated as hedging instruments:</b>			
Interest rate swaps, current portion	Accrued expenses and other current liabilities	\$ —	\$ 2
Interest rate swaps, long-term portion	Other liabilities	(1,329)	436
<b>Total derivative instruments designated as hedging instruments</b>		<b>\$ (1,329)</b>	<b>\$ 438</b>

The effects of derivative instruments in cash flow hedging relationships were as follows:

(dollars in thousands)	Gain (loss) recognized in accumulated other comprehensive loss as of	Location of gain (loss) reclassified from accumulated other comprehensive loss into income	Gain (loss) reclassified from accumulated other comprehensive loss into income
	June 30, 2016		Three months ended June 30, 2016
Interest rate swaps	\$ (1,329)	Interest expense	\$ (302)
	June 30, 2015		Six months ended June 30, 2016
Interest rate swaps	\$ (873)	Interest expense	\$ (374)
			Three months ended June 30, 2015
Interest rate swaps	\$ (873)	Interest expense	\$ (749)
			Six months ended June 30, 2015

Our policy requires that derivatives used for hedging purposes be designated and effective as a hedge of the identified risk exposure at the inception of the contract. Accumulated other comprehensive income (loss) includes unrealized gains or losses from the change in fair value measurement of our derivative instruments each reporting period and the related income tax expense or benefit. Changes in the fair value measurements of the derivative instruments and the related income tax expense or benefit are reflected as adjustments to accumulated other comprehensive income (loss) until the actual hedged expense is incurred or until the hedge is terminated at which point the unrealized gain (loss) is reclassified from accumulated other comprehensive income (loss) to current earnings. The estimated accumulated other comprehensive loss as of June 30, 2016 that is expected to be reclassified into earnings within the next twelve months is \$1.0 million. There were no ineffective portions of our interest rate swap derivatives during the six months ended June 30, 2016 and 2015. See Note 13 to these consolidated financial statements for a summary of the changes in accumulated other comprehensive income (loss) by component.

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

## 10. Commitments and Contingencies

---

### Historical Leases

We lease our headquarters facility under a 15-year lease agreement which was entered into in October 2008, and has two five-year renewal options. The current annual base rent of the lease is \$5.1 million, payable in equal monthly installments. The base rent escalates annually at a rate equal to the change in the consumer price index, as defined in the agreement, but not to exceed 5.5% in any year.

We have a lease for office space in Austin, Texas which terminates on September 30, 2023, and has two five-year renewal options. Under the terms of the lease, we will increase our leased space by approximately 20,000 square feet on July 31, 2016. The current annual base rent of the lease is \$2.3 million. The base rent escalates annually between 2% and 4% based on the terms of the agreement. The rent expense is recorded on a straight-line basis over the length of the lease term. At June 30, 2016, we had a standby letter of credit of \$2.0 million for a security deposit for this lease.

We have provisions in our leases that entitle us to aggregate remaining leasehold improvement allowances of \$3.6 million. These amounts are being recorded as a reduction to rent expense ratably over the terms of the leases. The reductions in rent expense related to these lease provisions during the three and six months ended June 30, 2016 and 2015, were insignificant. The leasehold improvement allowances have been included in the table of operating lease commitments below as a reduction in our lease commitments ratably over the then remaining terms of the leases. The timing of the reimbursements for the actual leasehold improvements may vary from the amounts reflected in the table below.

We have also received, and expect to receive through 2016, quarterly South Carolina state incentive payments as a result of locating our headquarters facility in Berkeley County, South Carolina. These amounts are recorded as a reduction of rent expense upon receipt and were \$0.7 million and \$0.6 million for the three months ended June 30, 2016 and 2015, respectively, and \$1.6 million and \$1.2 million for the six months ended June 30, 2016 and 2015, respectively.

Total rent expense was \$3.5 million and \$2.4 million for the three months ended June 30, 2016 and 2015, respectively, and \$5.5 million and \$4.9 million for the six months ended June 30, 2016 and 2015, respectively.

### Lease for New Headquarters Facility

In May 2016, we entered into a lease agreement for a new headquarters facility to be built in Charleston, South Carolina ("the New Headquarters Facility"). The landlord is responsible for the design, development and construction of the New Headquarters Facility. Construction of the New Headquarters Facility will proceed in two phases. Phase One will include a building with approximately 172,000 rentable square feet, which is expected to be completed in the first quarter of 2018. The lease agreement also grants us a Phase Two option to request that the landlord construct and lease to us a second office building and related improvements. Total rent payments and leasehold improvement allowances for Phase One are estimated to be approximately \$102.0 million and \$12.9 million, respectively, over the life of the lease agreement, plus additional amounts for Phase Two, if applicable. The lease agreement is for a period of twenty years beginning on the date of substantial completion of construction by the landlord, which is estimated to be in the first quarter of 2018, and ending in the first quarter of 2038. The lease agreement provides for four renewal periods of five years each at a base rent equal to the then prevailing market rate for comparable buildings. We expect to receive quarterly South Carolina state incentive payments as a result of locating our headquarters facility in Berkeley County, South Carolina.

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

As of June 30, 2016, the future minimum lease commitments related to lease agreements, net of related lease incentives, were as follows:

Years ending December 31, (dollars in thousands)	Operating leases <sup>(1)</sup>
2016 – remaining	\$ 6,872
2017	12,085
2018	11,369
2019	11,792
2020	11,073
Thereafter	97,994
<b>Total minimum lease payments</b>	<b>\$ 151,185</b>

(1) Our future minimum lease commitments related to operating leases do not include payments related to Phase Two of our New Headquarters Facility, as that option had not been exercised as of June 30, 2016.

### Other commitments

As discussed in Note 8 to these consolidated financial statements, the term loans under the 2014 Credit Facility require periodic principal payments. The balance of the term loans and any amounts drawn on the revolving credit loans are due upon maturity of the 2014 Credit Facility in February 2019.

We utilize third-party technology in conjunction with our solutions and services, with contractual obligations varying in length from one to four years. In certain cases, such arrangements require a minimum annual purchase commitment. As of June 30, 2016, the remaining aggregate minimum purchase commitment under these arrangements was approximately \$41.9 million through 2020.

### Product and service indemnifications

In the ordinary course of business, we provide certain indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of our solutions or services. If we determine that it is probable that a loss has been incurred related to solution or service indemnifications, any such loss that could be reasonably estimated would be recognized. We have not identified any losses and, accordingly, we have not recorded a liability related to these indemnifications.

### Legal contingencies

We are subject to legal proceedings and claims that arise in the ordinary course of business. We record an accrual for a contingency when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. As of June 30, 2016, in our opinion, there was not at least a reasonable possibility that these actions arising in the ordinary course of business will have a material adverse effect upon our consolidated financial position, results of operations or cash flows and, therefore, no material loss contingencies were recorded.



**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

## 11. Income Taxes

Our income tax provision and effective income tax rates including the effects of period-specific events, were:

(dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Income tax provision	\$ 3,598	\$ 4,272	\$ 6,262	\$ 6,026
Effective income tax rate	31.5%	37.8%	32.8%	34.7%

The decreases in our effective income tax rates during the three and six months ended June 30, 2016, when compared to the same periods in 2015, were primarily due to a loss included in the 2015 periods from the sale of our Netherlands entity for which we did not record a tax benefit and the estimated benefit to our annual 2016 effective tax rate from federal and state research tax credits that were permanently enacted into law in December 2015. The decreases in our effective tax rates during the three and six months ended June 30, 2016 were partially offset by the estimated impact to our annual 2016 effective tax rate from Section 162(m) nondeductible compensation.

In addition to the events that impact our effective income tax rate during both the three and six months ended June 30, 2016, when compared to the same periods in 2015, the decrease in our effective tax rate during the six months ended June 30, 2016 was also partially offset by a discrete tax benefit included in the 2015 period from the settlement of an IRS audit.

Our effective income tax rate may fluctuate quarterly as a result of factors, including transactions entered into, changes in the geographic distribution of our earnings or losses, our assessment of certain tax contingencies, valuation allowances, and changes in tax law in jurisdictions where we conduct business.

We have deferred tax assets for federal, state, and international net operating loss carryforwards and state tax credits. The federal and state net operating loss carryforwards are subject to various Internal Revenue Code limitations and applicable state tax laws. A portion of the foreign and state net operating loss carryforwards and a portion of state tax credits have a valuation reserve due to the uncertainty of realizing such carryforwards and credits in the future.

The total amount of unrecognized tax benefit that, if recognized, would favorably affect the effective income tax rate, was \$2.4 million and \$2.3 million at June 30, 2016 and December 31, 2015, respectively. We recognize accrued interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense.

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

## 12. Stock-based Compensation

Stock-based compensation expense is allocated to cost of revenue and operating expenses on the consolidated statements of comprehensive income based on where the associated employee's compensation is recorded. The following table summarizes stock-based compensation expense:

(dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
<b>Included in cost of revenue:</b>				
Cost of subscriptions	\$ 290	\$ 325	\$ 571	\$ 468
Cost of maintenance	123	85	246	246
Cost of services	360	639	828	1,236
Total included in cost of revenue	773	1,049	1,645	1,950
<b>Included in operating expenses:</b>				
Sales, marketing and customer success	921	804	1,822	1,506
Research and development	1,559	1,186	3,094	2,164
General and administrative	4,618	3,272	9,226	5,793
Total included in operating expenses	7,098	5,262	14,142	9,463
Total stock-based compensation expense	\$ 7,871	\$ 6,311	\$ 15,787	\$ 11,413

## 13. Stockholders' Equity

### Dividends

Our Board of Directors has adopted a dividend policy, which provides for the distribution to stockholders of a portion of cash generated by us that is in excess of operational needs and capital expenditures. The 2014 Credit Facility limits the amount of dividends payable and certain state laws restrict the amount of dividends distributed.

In February 2016, our Board of Directors approved an annual dividend rate of \$0.48 per share to be made in quarterly payments. Dividend payments are not guaranteed and our Board of Directors may decide, in its absolute discretion, at any time and for any reason, not to declare and pay further dividends. The following table provides information with respect to quarterly dividends of \$0.12 per share paid on common stock during the six months ended June 30, 2016.

Declaration Date	Dividend per Share	Record Date	Payable Date
February 9, 2016	\$ 0.12	February 26	March 15
April 27, 2016	\$ 0.12	May 27	June 15

On August 1, 2016, our Board of Directors declared a third quarter dividend of \$0.12 per share payable on September 15, 2016 to stockholders of record on August 26, 2016.

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

**Changes in accumulated other comprehensive loss by component**

The changes in accumulated other comprehensive loss by component, consisted of the following:

(dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
<b>Accumulated other comprehensive loss, beginning of period</b>	\$ (1,091)	\$ (1,827)	\$ (825)	\$ (1,032)
<b>By component:</b>				
<b>Gains and losses on cash flow hedges:</b>				
Accumulated other comprehensive loss balance, beginning of period	\$ (688)	\$ (633)	\$ (19)	\$ (164)
Other comprehensive loss before reclassifications, net of tax effects of \$195, \$83, \$750 and \$522	(301)	(133)	(1,157)	(831)
Amounts reclassified from accumulated other comprehensive loss to interest expense	302	374	610	749
Tax benefit included in provision for income taxes	(119)	(144)	(240)	(290)
Total amounts reclassified from accumulated other comprehensive loss	183	230	370	459
Net current-period other comprehensive (loss) income	(118)	97	(787)	(372)
Accumulated other comprehensive loss balance, end of period	\$ (806)	\$ (536)	\$ (806)	\$ (536)
<b>Foreign currency translation adjustment:</b>				
Accumulated other comprehensive loss balance, beginning of period	\$ (403)	\$ (1,194)	\$ (806)	\$ (868)
Translation adjustments	(431)	(196)	(28)	(522)
Accumulated other comprehensive loss balance, end of period	(834)	(1,390)	(834)	(1,390)
<b>Accumulated other comprehensive loss, end of period</b>	<b>\$ (1,640)</b>	<b>\$ (1,926)</b>	<b>\$ (1,640)</b>	<b>\$ (1,926)</b>

**14. Segment Information**

As of June 30, 2016, our reportable segments were the General Markets Business Unit ("GMBU"), the Enterprise Customer Business Unit ("ECBU"), and the International Business Unit ("IBU"). Following is a description of each reportable segment:

- The GMBU is focused on marketing, sales, delivery and support to all emerging and mid-sized prospects and customers in North America;
- The ECBU is focused on marketing, sales, delivery and support to all large and/or strategic prospects and customers in North America; and
- The IBU is focused on marketing, sales, delivery and support to all prospects and customers outside of North America.

Our CODM is our chief executive officer ("CEO"). The CEO reviews financial information presented on an operating segment basis for the purposes of making certain operating decisions and assessing financial performance. The CEO uses internal financial reports that provide segment revenues and operating income, excluding stock-based compensation expense, amortization expense, depreciation expense, research and development expense and certain corporate sales, marketing, general and administrative expenses. Currently, the CEO believes that the exclusion of these costs allows for a better understanding of the operating performance of the operating units and management of other operating expenses and cash needs. The CEO does not review any segment balance sheet information.

**Blackbaud, Inc.**  
**Notes to consolidated financial statements (continued)**  
**(Unaudited)**

Summarized reportable segment financial results, were as follows:

(dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
<b>Revenue by segment:</b>				
GMBU	93,970	76,138	\$ 181,922	\$ 146,067
ECBU	75,037	69,385	146,536	136,299
IBU	11,138	10,687	20,896	20,814
Other(1)	46	49	93	72
Total revenue	\$ 180,191	\$ 156,259	\$ 349,447	\$ 303,252
<b>Segment operating income(2):</b>				
GMBU	45,262	39,338	\$ 87,873	\$ 74,001
ECBU	38,721	33,750	74,487	65,954
IBU	1,065	2,091	2,061	3,392
Other(1)	18	255	48	(57)
	85,066	75,434	164,469	143,290
<b>Less:</b>				
Corporate unallocated costs(3)	(52,363)	(46,571)	(102,778)	(93,186)
Stock-based compensation costs	(7,871)	(6,311)	(15,787)	(11,413)
Amortization expense	(10,635)	(8,091)	(21,268)	(16,218)
Interest expense	(2,721)	(1,873)	(5,396)	(3,559)
Other expense, net	(65)	(1,274)	(170)	(1,561)
Income before provision for income taxes	\$ 11,411	\$ 11,314	\$ 19,070	\$ 17,353

(1) Other includes revenue and the related costs from the sale of solutions and services not directly attributable to a reportable segment.

(2) Segment operating income includes direct, controllable costs related to the sale of solutions and services by the reportable segment.

(3) Corporate unallocated costs include research and development, depreciation expense, and certain corporate sales, marketing, general and administrative expenses.

## 15. Subsequent Events

On July 12, 2016, we acquired all of the outstanding equity, including all voting equity interests of Good+Geek, Inc., a Delaware corporation doing business as "Attentive.ly." Attentive.ly provides social media capabilities allowing organizations to conduct social listening, identify key influencers and drive engagement through its cloud solution. The acquisition accelerates our ability to deliver these capabilities to our customers. The results of operations of the acquired company will be included in our consolidated financial statements from the date of acquisition. Due to the timing of the transaction, the initial accounting for this acquisition, including the measurement of assets acquired, liabilities assumed and goodwill, is not complete and is pending detailed analyses of the facts and circumstances that existed as of the July 12, 2016 acquisition date. We do not expect this business combination to have a material effect on our consolidated financial position, results of operations or cash flows.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q. The following discussion and analysis presents financial information denominated in millions of dollars which can lead to differences from rounding when compared to similar information contained in the consolidated financial statements and related notes which are primarily denominated in thousands of dollars.*

### Executive Summary

---

We are the world's leading cloud software company powering social good. Serving the entire social good community—nonprofits, foundations, corporations, education institutions, and individual change agents—we connect and empower organizations to increase their impact through software, services, expertise, and data intelligence. Our portfolio is tailored to the unique needs of vertical markets, with solutions for fundraising and relationship management, digital marketing, advocacy, accounting, payments, analytics, school management, grant management, corporate social responsibility and volunteerism. Serving the industry for more than three decades, we are headquartered in Charleston, South Carolina and have operations in the United States, Australia, Canada, Ireland and the United Kingdom. As of June 30, 2016, we had approximately 35,000 active customers.

Our revenue is primarily generated from the following sources: (i) charging for the use of our software solutions in cloud-based and hosted environments; (ii) providing software maintenance and support services; (iii) providing professional services including implementation, training, consulting, analytic, hosting and other services; (iv) providing transaction and payment processing services; and (v) selling perpetual licenses of our software solutions. We have experienced growth in our payment processing services from the continued shift to online giving, further integration of these services to our existing solution portfolio and the sale of these services to new and existing customers.

Our long-term goals include accelerating organic revenue growth, expanding our operating margins and increasing our operating cash flow. During the second quarter of 2016, we continued to execute on the following five growth strategies targeted to achieve those goals and to drive an extended period of quality enhancement, solution and service innovation, and increasing operating efficiency and financial performance:

#### 1. *Integrated and Open Solutions in the Cloud*

We continue to transition our business to predominantly serve customers through a subscription-based cloud delivery model, enabling lower cost of entry, greater scalability and lower total cost of ownership to our customers. There is a concerted effort underway to optimize our portfolio of solutions and integrate powerful capabilities — such as built in data, analytics, payment processing and tailored user-specific experiences — to bring even greater value and performance to our customers.

During the second quarter of 2016, we further expanded certain of our pre-integrated services through the general release of SKY Reporting™, beginning with Raiser's Edge NXT. SKY Reporting provides new business intelligence and reporting tools aimed at seamlessly delivering valuable insights and productivity enhancing capabilities to customers. We also launched a Partner Beta Program for SKY API, a key component of Blackbaud SKY™, which is our new, innovative cloud technology architecture for the global philanthropic community that now powers six of our next generation solutions. SKY API will allow customers, partners, and application developers to extend functionality and integrate with our solutions. On July 12, 2016, we acquired Attentive.ly, a cloud software provider that provides social media capabilities allowing organizations to conduct social listening, identify key influencers and drive engagement through its cloud solution. The acquisition accelerates our ability to deliver these capabilities to our customers by integrating Attentive.ly technology into Blackbaud SKY.

**Blackbaud, Inc.****2. Drive Sales Effectiveness**

We are making investments to increase the effectiveness of our sales organization, with a focus on enabling our expanding sales teams with the talent, processes, and tools to accelerate our revenue growth and improve effectiveness. Our customer success program separates account management from the sales organization, and is intended to drive customer loyalty and retention. In the first quarter of 2016, we launched a value added reseller ("VAR") program. During the second quarter of 2016, we continued to make investments in our sales, marketing and customer success organizations and improved our market coverage by deploying these resources into key markets like Toronto, where we recently opened a new office.

**3. Expand TAM into Near Adjacencies with Acquisitions;**

We will continue to evaluate compelling opportunities to expand our product portfolio and acquire companies, technologies and/or services. We will be guided by our acquisition criteria for considering attractive assets, which expand our total addressable market ("TAM"), provide entry into new and near adjacencies, accelerate our shift to the cloud, accelerate revenue growth, are accretive to margins and present synergistic opportunities.

**4. Streamline Operations**

We have largely completed the installations of best-in-breed back-office solutions to standardize operations utilizing scalable tools and systems. Our focus is now shifting towards optimizing those systems, as well as operational excellence and quality initiatives focused on streamlining processes to gain efficiency and scalability.

**5. Execute our 3-Year Margin Improvement Plan**

In 2014, we implemented a 3-year operating margin improvement plan designed to increase our operating effectiveness and efficiency and improve non-GAAP operating margins 300 to 600 basis points on a constant currency basis as measured against our 2014 baseline of 17.5%, by the time we exit 2017.

We plan to continue making investments in our solution portfolio, sales, and customer success organization to ensure we are well positioned to benefit from shifts in the market, including demand for our cloud-based subscription offerings, which we expect will drive higher long-term revenue growth. We also plan to continue making investments in our sales and marketing organization and the infrastructure that supports our cloud-based subscription offerings and certain solution development initiatives, including further expansion of our payment processing and analytics services. As we execute on our five key growth initiatives to accelerate organic revenue growth and strengthen our market leadership position, we also plan to focus on achieving scalability of our operations, and attaining our targeted level of profitability.

We completed our acquisition of Smart Tuition in October 2015. We have included the results of operations of Smart Tuition in our consolidated results of operations from the date of acquisition, which impacts the comparability of our results of operations when comparing the three and six months ended June 30, 2016 to the same periods in 2015. We have noted in the discussion below, to the extent meaningful, the impact on the comparability of our consolidated results of operations to prior year results due to the inclusion of Smart Tuition.

**Total revenue**

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016 <sup>(1)</sup>	2015	Change	2016 <sup>(1)</sup>	2015	Change
Total revenue	\$ 180.2	\$ 156.3	15.3%	\$ 349.4	\$ 303.3	15.2%

(1) Included in total revenue for the three and six months ended June 30, 2016 was \$8.2 million and \$17.4 million attributable to the inclusion of Smart Tuition.

Excluding the impact of Smart Tuition as discussed above, total revenue increased by \$15.7 million and \$28.7 million, respectively, during the three and six months ended June 30, 2016 when compared to the same periods in 2015. The increases in revenue were primarily driven by growth in subscriptions revenue as our business model continues to shift towards providing predominantly cloud-based subscription solutions. Subscriptions revenue also grew as a result of increases in the number of customers and the volume of transactions for which we process payments. Services revenue contributed modestly to the increases in total revenue during the three and six months ended June 30, 2016, when compared to the same periods in 2015, primarily due to increases in consulting and training revenue. Maintenance revenue as well as license fees and other revenue declined for the three and six months ended June 30, 2016 from the continued migration of our business model toward subscription-based solutions, including our NXT solutions. In the near-term, the transition to subscription-based solutions negatively impacts total revenue growth, as time-based revenue from subscription arrangements is deferred and recognized ratably over the subscription period, whereas on-premises license revenue from

**Blackbaud, Inc.**

arrangements that include perpetual licenses is recognized up-front. In addition, the fluctuation in foreign currency exchange rates, primarily those between the U.S. dollar and Canadian dollar, negatively impacted our total revenue during the three and six months ended June 30, 2016 by \$0.9 million and \$2.4 million, respectively. Further explanation of this impact is included below under the caption "Foreign Currency Exchange Rates".

**Income from operations**

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016 <sup>(1)</sup>	2015	Change	2016 <sup>(1)</sup>	2015	Change
Income from operations	\$ 14.2	\$ 14.5	(2.1)%	\$ 24.6	\$ 22.5	9.3%

(1) Included in income from operations for the three and six months ended June 30, 2016 was \$0.6 million and \$1.8 million attributable to the inclusion of Smart Tuition.

Excluding the impact of Smart Tuition as discussed above, income from operations decreased \$0.9 million during the three months ended June 30, 2016 and remained relatively unchanged during the six months ended June 30, 2016 when compared to the same periods in 2015. Increases from growth in subscriptions and services revenue as discussed above, improvements in the utilization of consulting services personnel and a reduction in non-billable implementation service hours were offset by increases in stock-based compensation expense of \$1.6 million and \$4.4 million, respectively, amortization of intangible assets from business combinations of \$2.5 million and \$5.1 million, respectively, and investments we are making in our sales organization and customer success program. In addition, the fluctuation in foreign currency exchange rates, primarily those between the U.S. dollar and Canadian dollar, negatively impacted our income from operations during the three and six months ended June 30, 2016 by \$0.3 million and \$1.1 million, respectively. Further explanation of this impact is included below under the caption "Foreign Currency Exchange Rates".

**Customer retention**

Our subscription contracts are typically for a term of three years at contract inception with one year renewals thereafter. Over time, we anticipate a decrease in maintenance contract renewals as we transition our solution portfolio and maintenance customers from a perpetual license-based model to a cloud-based subscription delivery model. We also anticipate an increase in subscription contract renewals as we continue focusing on innovation, quality and the integration of our subscription solutions which we believe will provide value-adding capabilities to better address our customers' needs. Due primarily to these factors, we believe a recurring revenue customer retention measure that combines subscription and maintenance customer contracts provides an accurate representation of our customers' overall behavior. For the three months ended June 30, 2016, approximately 93% of our customers with recurring subscription or maintenance contracts were retained when compared to the same period in 2015.

**Balance sheet and cash flow**

At June 30, 2016, our cash and cash equivalents were \$15.3 million and outstanding borrowings under the 2014 Credit Facility were \$405.1 million. During the six months ended June 30, 2016, we generated \$38.0 million in cash flow from operations, decreased our net borrowings by \$5.2 million, returned \$11.4 million to stockholders by way of dividends and had cash outlays of \$24.7 million for purchases of property and equipment and capitalized software development costs.

**Lease for New Headquarters Facility**

In May 2016, we entered into a lease agreement for a New Headquarters Facility to be built in Charleston, South Carolina. For a detailed discussion of the New Headquarters Facility, see Note 10 of our consolidated financial statements in this report.

## Results of Operations

### Comparison of the three and six months ended June 30, 2016 and 2015

We acquired Smart Tuition on October 2, 2015. We have included the results of operations of Smart Tuition in our consolidated results of operations from the date of acquisition, which impacts the comparability of our results of operations when comparing the three and six months ended June 30, 2016 and 2015. We have noted in the discussion below, to the extent meaningful and quantifiable, the impact on the comparability of our consolidated results of operations to prior year results due to the inclusion of Smart Tuition.

For the three and six months ended June 30, 2016, Smart Tuition's total revenue was \$8.2 million and \$17.4 million, respectively, and its income from operations was \$0.6 million and \$1.8 million, respectively. See Note 3 to our consolidated financial statements in this report for a summary of this acquisition.

### Revenue by segment

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016 <sup>(1)</sup>	2015	Change	2016 <sup>(1)</sup>	2015	Change
GMBU	\$ 94.0	\$ 76.1	23.5%	\$ 181.9	\$ 146.1	24.5%
ECBU	75.0	69.4	8.1%	146.5	136.3	7.5%
IBU	11.1	10.7	3.7%	20.9	20.8	0.5%
Total revenue <sup>(2)</sup>	\$ 180.2	\$ 156.3	15.3%	\$ 349.4	\$ 303.3	15.2%

(1) Included in GMBU revenue and total revenue for the three and six months ended June 30, 2016 was \$8.2 million and \$17.4 million, respectively, attributable to the inclusion of Smart Tuition.

(2) The individual amounts for each year may not sum to total revenue due to rounding.

### GMBU

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016 <sup>(1)</sup>	2015	Change	2016 <sup>(1)</sup>	2015	Change
GMBU revenue	\$ 94.0	\$ 76.1	23.5%	\$ 181.9	\$ 146.1	24.5%
% of total revenue	52.2%	48.7%		52.1%	48.2%	

(1) Included in GMBU revenue for the three and six months ended June 30, 2016 was \$8.2 million and \$17.4 million, respectively, attributable to the inclusion of Smart Tuition.

Excluding the impact of Smart Tuition as discussed above, GMBU revenue increased by \$9.7 million and \$18.4 million during the three and six months ended June 30, 2016, respectively, when compared to the same periods in 2015. The increases in GMBU revenue were primarily attributable to growth in subscriptions revenue and, to a lesser extent, services revenue. The growth in subscriptions revenue was primarily due to increases in demand across our portfolio of cloud-based solutions. GMBU subscriptions revenue also benefited from increases in the number of customers and the volume of transactions for which we process payments. GMBU services revenue increased during the three and six months ended June 30, 2016 when compared to the same periods in 2015 due to increases in consulting and training services related to our cloud-based solutions. The growth in subscriptions and services revenue was partially offset by declines in maintenance revenue and license fee and other revenue from the continued migration of our business to subscription-based solutions.



**Blackbaud, Inc.**
**ECBU**

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016	2015	Change	2016	2015	Change
ECBU revenue	\$ 75.0	\$ 69.4	8.1%	\$ 146.5	\$ 136.3	7.5%
% of total revenue	41.6%	44.4%		41.9%	44.9%	

The increases in ECBU revenue during the three and six months ended June 30, 2016, when compared to the same periods in 2015, was primarily attributable to growth in subscriptions revenue, partially offset by decreases in consulting services revenue, maintenance revenue and revenue from license fees. The growth in subscriptions resulted primarily from increases in demand for our cloud-based solutions including Gifts Online, Luminate Online and our NXT solutions, as well as an increase in the number of customers and the volume of transactions for which we process payments. As discussed above, consulting services, maintenance revenue and license fees revenue decreased as a result of the continuing shift in our go-to-market strategy towards cloud-based solutions, which in general, require less implementation services.

**IBU**

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016	2015	Change	2016	2015	Change
IBU revenue	\$ 11.1	\$ 10.7	3.7%	\$ 20.9	\$ 20.8	0.5%
% of total revenue	6.2%	6.8%		6.0%	6.9%	

The increase in IBU revenue during the three months ended June 30, 2016, when compared to the same period in 2015, was primarily related to an increase in subscriptions revenue and, to a lesser extent, license fees revenue. The increase in IBU subscriptions revenue during the three months ended June 30, 2016 was primarily due to an increase in demand for our Raiser's Edge NXT solution as well as an increase in the volume of transactions for which we process payments. The increase in license fees revenue was related to sales of our Blackbaud Enterprise CRM solution, which can vary from period to period. The growth in IBU subscriptions and license fees revenue was partially offset by reductions in consulting services revenue and maintenance revenue. In the near term, we expect a continued reduction in IBU revenue related to on-premises Raiser's Edge license fees, consulting services and maintenance as our customers transition to our Raiser's Edge NXT solution.

IBU revenue remained relatively unchanged during the six months ended June 30, 2016, when compared to the same period in 2015, as growth in subscription revenue and, to a lesser extent, license fees revenue was offset by reductions in consulting services and maintenance revenue.

## Blackbaud, Inc.

### Operating results

#### Subscriptions

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016 <sup>(1)</sup>	2015	Change	2016 <sup>(2)</sup>	2015	Change
Subscriptions revenue	\$ 104.0	\$ 80.0	30.0%	\$ 200.9	\$ 152.5	31.7%
Cost of subscriptions	52.1	39.4	32.2%	101.8	75.6	34.7%
Subscriptions gross profit	\$ 51.9	\$ 40.6	27.8%	\$ 99.1	\$ 76.9	28.9%
Subscriptions gross margin	49.9%	50.8%		49.3%	50.4%	

(1) Included in subscriptions revenue and cost of subscriptions for the three months ended June 30, 2016 was \$8.1 million and \$5.0 million, respectively, attributable to the inclusion of Smart Tuition.

(2) Included in subscriptions revenue and cost of subscriptions for the six months ended June 30, 2016 was \$17.1 million and \$9.9 million, respectively, attributable to the inclusion of Smart Tuition.

Subscriptions revenue is comprised of revenue from charging for the use of our subscription-based software solutions, which includes providing access to cloud-based solutions and hosting services, access to certain data services and our online subscription training offerings, revenue from payment processing services as well as variable transaction revenue associated with the use of our solutions.

We continue to experience growth in sales of our cloud-based solutions and hosting services as we meet the demand of our customers that increasingly prefer cloud-based subscription offerings, including existing customers that are migrating from on-premises solutions to our cloud-based solutions. In addition, we have experienced growth in our payment processing services from the continued shift to online giving, further integration of these services to our existing solution portfolio and the sale of these services to new and existing customers. Recurring subscriptions contracts are typically for a term of three years at contract inception with one year annual renewals thereafter. We intend to continue focusing on innovation, quality and integration of our subscription solutions which we believe will drive subscriptions revenue growth. We are also investing in our customer success organization to drive customer loyalty, retention, and referrals.

Cost of subscriptions is primarily comprised of compensation costs, third-party contractor expenses, third-party royalty and data expenses, hosting expenses, allocated depreciation, facilities and IT support costs, amortization of intangible assets from business combinations, amortization of software development costs, transaction-based costs related to payments services including remittances of amounts due to third-parties and other costs incurred in providing support and services to our customers.

Excluding the incremental subscriptions revenue from Smart Tuition as discussed above, subscriptions revenue increased by \$15.9 million and \$31.3 million during the three and six months ended June 30, 2016, respectively, when compared to the same periods in 2015. The increases were primarily due to strong demand across our cloud-based solution portfolio, including our NXT solution line, our suite of K-12 solutions, Luminate Online and Gifts Online. Subscriptions revenue also grew as a result of increases in the number of customers and the volume of transactions for which we process payments.

The increases in cost of subscriptions during the three and six months ended June 30, 2016, when compared to the same periods in 2015, were relatively consistent with the increases in revenue. The increases in cost of subscriptions were primarily due increases in transaction-based costs related to our payments services and those of Smart Tuition of \$4.9 million and \$9.5 million, respectively, increases in amortization of intangible assets from business combinations of \$2.1 million and \$4.1 million, respectively, increases in third-party contractor expenses of \$1.8 million and \$3.3 million, respectively, increases in the cost of third-party technology embedded in certain of our subscription solutions of \$1.1 million and \$2.3 million, respectively, and increases in amortization of software development costs of \$1.1 million and \$2.2 million, respectively. The increases in amortization of intangible assets from business combinations were primarily due the incremental amortization of intangible assets arising from the acquisition of Smart Tuition. The increases in third-party contract costs and amortization of software development costs were from investments made on innovation, quality and the integration of our cloud-based solutions.

The decreases in subscriptions gross margin for the three and six months ended June 30, 2016, when compared to the same periods in 2015, were primarily the result of a shift in the mix of subscriptions revenue generated from our payment processing services and those of Smart Tuition, both of which have historically yielded lower gross margins than our cloud-

**Blackbaud, Inc.**

based solutions. Also contributing to the decrease in subscriptions gross margin was incremental amortization of intangible assets arising from the Smart Tuition acquisition and incremental amortization of software development costs from the investments discussed above.

**Maintenance**

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016	2015	Change	2016	2015	Change
Maintenance revenue	\$ 37.4	\$ 38.6	(3.1)%	\$ 74.6	\$ 77.5	(3.7)%
Cost of maintenance	5.7	7.0	(18.6)%	11.0	14.5	(24.1)%
Maintenance gross profit	\$ 31.7	\$ 31.6	0.3 %	\$ 63.6	\$ 63.0	1.0 %
Maintenance gross margin	84.8%	82.0%		85.2%	81.3%	

Maintenance revenue is comprised of annual fees derived from maintenance contracts associated with new software licenses and annual renewals of existing maintenance contracts. These contracts provide customers with updates, enhancements and certain upgrades to our software solutions and online, telephone and email support. Maintenance contracts are typically renewed on an annual basis.

Cost of maintenance is primarily comprised of compensation costs, third-party contractor expenses, third-party royalty costs, allocated depreciation, facilities and IT support costs, amortization of intangible assets from business combinations, amortization of software development costs and other costs incurred in providing support and services to our customers.

The decreases in maintenance revenue during the three and six months ended June 30, 2016 when compared to the same periods in 2015, were primarily related to a reduction in maintenance contracts associated with on-premises Raiser's Edge and Financial Edge solutions as customers migrated to our cloud-based NXT solutions, partially offset by increases in maintenance contracts associated with Blackbaud Enterprise CRM.

The decrease during the three months ended June 30, 2016 was primarily comprised of (i) \$4.9 million of reductions in maintenance from contracts that were migrated to a cloud-based subscription or not renewed and reductions in contracts with existing customers; partially offset by (ii) \$3.3 million of incremental maintenance from new customers associated with new license contracts and increases in contracts with existing customers; and (iii) \$0.4 million of incremental maintenance from contractual inflationary rate adjustments.

The decrease during the six months ended June 30, 2016 was primarily comprised of (i) \$9.6 million of reductions in maintenance from contracts that were migrated to a cloud-based subscription or not renewed and reductions in contracts with existing customers; partially offset by (ii) \$5.9 million of incremental maintenance from new customers associated with new license contracts and increases in contracts with existing customers; and (iii) \$0.8 million of incremental maintenance from contractual inflationary rate adjustments.

Cost of maintenance decreased during the three and six months ended June 30, 2016, when compared to the same periods in 2015, primarily as a result of decreases in compensation costs of \$1.3 million and \$3.6 million, respectively, from a shift in support headcount from maintenance towards sales, marketing and customer success expense and a shift in the volume of customer support requests from maintenance towards subscriptions. Also contributing to the decreases in compensation costs were improvements in the efficiency of our customer support center.

Maintenance gross margins increased during the three and six months ended June 30, 2016 when compared to the same periods in 2015, primarily due to the shifts in compensation costs from maintenance as discussed above, as well as the improvements in the efficiency of our customer support center.

## Blackbaud, Inc.

### Services

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016(1)	2015	Change	2016(1)	2015	Change
Services revenue	\$ 35.4	\$ 33.7	5.0 %	\$ 67.8	\$ 65.0	4.3 %
Cost of services	24.7	25.9	(4.6)%	49.0	52.9	(7.4)%
Services gross profit	\$ 10.7	\$ 7.8	37.2 %	\$ 18.8	\$ 12.1	55.4 %
Services gross margin	30.3%	23.0%		27.7%	18.6%	

(1) Included in services revenue and cost of services for the three and six months ended June 30, 2016 were insignificant amounts attributable to the inclusion of Smart Tuition.

We derive services revenue from consulting, implementation, education, analytic and installation services. Consulting, implementation and installation services involve converting data from a customer's existing system, system configuration, process re-engineering and assistance in file set up. Education services involve customer training activities. Analytic services are comprised of donor prospect research, sales of lists of potential donors, benchmarking studies and data modeling services. These analytic services involve the assessment of current and prospective donor information of the customer and are performed using our proprietary analytical tools. The end product is intended to enable organizations to more effectively target their fundraising activities.

Cost of services is primarily comprised of compensation costs, third-party contractor expenses, classroom rentals, costs incurred in providing customer training, data expense incurred to perform analytic services, allocated depreciation, facilities and IT support costs and amortization of intangible assets from business combinations.

Services revenue increased during the three and six months ended June 30, 2016, when compared to the same periods in 2015, primarily due to improvements in the utilization of consulting services personnel, a reduction in non-billable implementation service hours as well as an increase in training revenue related to our cloud-based solutions.

We expect that the continuing shift in our go-to-market strategy towards cloud-based subscription offerings, which, in general, require less implementation services and little to no customization services when compared our traditional on-premises perpetual license arrangements, will negatively impact consulting services revenue growth over time. The maturation of our Blackbaud Enterprise CRM solution, our only remaining perpetual licensed-based offering, is lessening the extent of implementation services required.

The decreases in cost of services during the three and six months ended June 30, 2016, when compared to the same periods in 2015, were primarily due to decreases in compensation costs of \$1.1 million and \$3.1 million, respectively, related to a reduction in consulting services headcount from utilization improvements and a reduction in non-billable implementation service hours for our Blackbaud Enterprise CRM solution.

Services gross margin increased during the three and six months ended June 30, 2016, when compared to the same periods in 2015, primarily due to increased consulting and training revenue coupled with improvements in the utilization of consulting services personnel and a reduction in non-billable implementation hours.

**Blackbaud, Inc.****License fees and other**

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016	2015	Change	2016	2015	Change
License fees and other revenue	\$ 3.3	\$ 4.0	(17.5)%	\$ 6.1	\$ 8.2	(25.6)%
Cost of license fees and other	1.0	1.1	(9.1)%	1.6	2.3	(30.4)%
License fees and other gross profit	\$ 2.3	\$ 2.9	(20.7)%	\$ 4.5	\$ 5.9	(23.7)%
License fees and other gross margin	68.9%	71.0%		73.5%	72.0%	

License fees and other revenue includes revenue from the sale of our software solutions under perpetual license arrangements, reimbursement of travel-related expenses primarily incurred during the performance of services at customer locations, fees from user conferences and third-party software referral fees.

Cost of license fees and other is primarily comprised of third-party software royalties, variable reseller commissions, amortization of software development costs, compensation costs, costs of business forms, costs of user conferences, reimbursable expenses relating to the performance of services at customer locations, allocated depreciation, facilities and IT support costs and amortization of intangible assets from business combinations.

Revenue from license fees and other decreased during the three and six months ended June 30, 2016, when compared to the same periods in 2015, primarily as a result of the ongoing transition of our solution portfolio away from a perpetual license-based model toward a cloud-based subscription delivery model. In addition, our perpetual license transactions for Blackbaud Enterprise CRM can be of substantial value, which can result in period-to-period variations in revenue since the license fee revenue associated with these arrangements is generally recognized up front when the arrangements are entered into.

The decrease in cost of license fees and other during the three and six months ended June 30, 2016, when compared to the same periods in 2015, was primarily due to less reimbursable expenses relating to the performance of services at customer locations.

License fees and other gross margin decreased during the three months ended June 30, 2016, when compared to the same period in 2015, primarily due to less license fees revenue from the continuing shift in our business model toward cloud-based subscriptions relative to the modest reduction in reimbursable expenses which carry no margin.

License fees and other gross margin increased during the six months ended June 30, 2016, when compared to the same period in 2015, primarily due to the less reimbursable expenses which carry no margin relative to the reduction in license fees revenue.

## Blackbaud, Inc.

### Operating expenses

#### Sales, marketing, and customer success

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016	2015	Change	2016	2015	Change
Sales, marketing and customer success expense	\$ 39.3	\$ 29.7	32.3%	\$ 74.9	\$ 58.3	28.5%
% of total revenue	21.8%	19.0%		21.4%	19.2%	

Sales, marketing, and customer success expense includes compensation costs, travel-related expenses, sales commissions, advertising and marketing materials, public relations costs and allocated depreciation, facilities and IT support costs.

We continue to make investments to drive sale effectiveness, which is a component of our five-point growth strategy to accelerate revenue growth. The increases in sales, marketing, and customer success expense in dollars and as a percentage of total revenue during the three and six months ended June 30, 2016, when compared to the same periods in 2015, was primarily due to increases in compensation costs of \$5.9 million and \$10.0 million, respectively, and commissions expense of \$1.7 million and \$3.5 million, respectively. Compensation costs increased primarily due to incremental headcount to support the increase in direct sales, marketing, and customer success efforts of our growing operations. The expansion of our customer success program is targeted to ensure our customers are fully realizing the value of our solutions, which we believe will drive customer loyalty and retention and will also result in increased customer referrals. The increases in commission expense were primarily driven by increases in commissionable revenue during the three and six months ended June 30, 2016, when compared to the same periods in 2015. The inclusion of Smart Tuition also contributed to the increases in compensation costs and commissions expense.

#### Research and development

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016	2015	Change	2016	2015	Change
Research and development expense	\$ 22.6	\$ 20.2	11.9%	\$ 45.4	\$ 41.4	9.7%
% of total revenue	12.5%	12.9%		13.0%	13.7%	

Research and development expense includes compensation costs, third-party contractor expenses, software development tools and other expenses related to developing new solutions, upgrading and enhancing existing solutions, and allocated depreciation, facilities and IT support costs.

We continue to make investments to deliver integrated and open solutions in the cloud, which is a component of our five-point growth strategy to accelerate revenue growth. The increases in research and development expense during the three and six months ended June 30, 2016, when compared to the same periods in 2015, were primarily due to increases in compensation costs of \$3.4 million and \$6.2 million, respectively. We have added engineering headcount to drive our solution development efforts, and the inclusion of Smart Tuition added to the increases in compensation costs. Also contributing to the increases in research and development expense during the three and six months ended June 30, 2016 were an increases in third-party contractor expenses of \$0.9 million and \$1.8 million, respectively, to assist in our solution development efforts. Partially offsetting these increases during the three and six months ended June 30, 2016 were increases of \$2.5 million and \$5.0 million in the amount of software development costs that were capitalized. The increases in amounts capitalized were a result of incurring more qualifying costs associated with development activities that are required to be capitalized under the internal-use software guidance such as those related to development of our next generation NXT and Luminare cloud-based solutions, as well as development costs associated with the solutions of acquired companies. We expect that the increases in the amount of software development costs capitalized will continue in the near-term as we make investments on innovation, quality and the integration of our solutions which we believe will drive revenue growth. Capitalized software development costs associated with our cloud-based solutions are subsequently amortized to cost of subscriptions revenue over the related asset's estimated useful life.

**Blackbaud, Inc.**

Research and development expense decreased as a percentage of total revenue during the three and six months ended June 30, 2016, when compared to the same periods in 2015, primarily due to the increase in the amount of software development costs capitalized as discussed above.

**General and administrative**

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016	2015	Change	2016	2015	Change
General and administrative expense	\$ 19.9	\$ 18.0	10.6%	\$ 39.6	\$ 34.8	13.8%
% of total revenue	11.0%	11.5%		11.3%	11.5%	

General and administrative expense consists primarily of compensation costs for general corporate functions, including senior management, finance, accounting, legal, human resources and corporate development, third-party professional fees, insurance, allocated depreciation, facilities and IT support costs, acquisition-related expenses and other administrative expenses.

The increase in general and administrative expense during the three and six months ended June 30, 2016, when compared to the same periods in 2015, was primarily due to an increase in compensation costs of \$1.4 million and \$4.1 million, respectively. Compensation costs increased primarily due to increases in stock-based compensation expense, employee benefit costs and salaries for the resources needed to support the growth of our business. The increase in stock-based compensation expense was primarily driven by an increase in the grant date fair value of our annual equity awards granted during the three and six months ended June 30, 2016 when compared to the grant date fair value of our annual equity awards granted during the same periods in 2015. The inclusion of Smart Tuition also contributed to the growth in general and administrative expense during the three and six months ended June 30, 2016.

General and administrative expense as a percentage of total revenue remained relatively unchanged during the three and six months ended June 30, 2016, when compared to the same period in 2015.

**Interest expense**

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016	2015	Change	2016	2015	Change
Interest expense	\$ 2.7	\$ 1.9	42.1%	\$ 5.4	\$ 3.6	50.0%
% of total revenue	1.5%	1.2%		1.5%	1.2%	

Interest expense increased during the three and six months ended June 30, 2016, when compared to the same periods in 2015, primarily due to an increase in our average daily borrowings related to our acquisition of Smart Tuition in October 2015.

**Blackbaud, Inc.**
**Deferred revenue**

The table below compares the components of deferred revenue from our consolidated balance sheets:

(dollars in millions)	Timing of recognition	June 30, 2016	Change	December 31, 2015
Subscriptions	Over the period billed in advance, generally one year	\$ 139.2	13.6 %	\$ 122.5
Maintenance	Over the period billed in advance, generally one year	86.1	0.2 %	85.9
Services	As services are delivered	29.7	4.2 %	28.5
License fees and other	Upon delivery of the solution or service	1.7	325.0 %	0.4
<b>Total deferred revenue<sup>(1)</sup></b>		<b>256.7</b>	<b>8.2 %</b>	<b>237.3</b>
Less: Long-term portion		6.2	(12.7)%	7.1
<b>Current portion<sup>(1)</sup></b>		<b>\$ 250.4</b>	<b>8.8 %</b>	<b>\$ 230.2</b>

(1) The individual amounts for each year may not sum to total deferred revenue or current portion of deferred revenue due to rounding.

To the extent that our customers are billed for our solutions and services in advance of delivery, we record such amounts in deferred revenue. We generally invoice our maintenance and subscription customers in annual cycles 30 days prior to the end of the contract term. Deferred revenue from subscriptions increased during the six months ended June 30, 2016 primarily due to an increase in subscription sales as well as a seasonal increase subscription contract renewals. Historically, due to the timing of client budget cycles, we have an increase in customer contract renewals in our second quarter as compared to our fourth quarter. The increase in deferred revenue from services during the six months ended June 30, 2016 was the result of an increase in training services billings. The increase in deferred revenue from license fees and other during the six months ended June 30, 2016 was primarily due to a seasonal increase in advance registration billings associated with our K-12 and bbcon user conferences, which occur each year in July and October, respectively. Deferred revenue from maintenance remained relatively unchanged during the six months ended June 30, 2016.

We have acquired businesses whose net tangible assets include deferred revenue. In accordance with GAAP reporting requirements, we recorded write-downs of deferred revenue from customer arrangements predating the acquisition to fair value, which resulted in lower recorded deferred revenue as of the acquisition date than the actual amounts paid in advance for solutions and services under those customer arrangements. Therefore, our deferred revenue after an acquisition will not reflect the full amount of deferred revenue that would have been reported if the acquired deferred revenue was not written down to fair value. The impact of acquisition-related deferred revenue write-downs largely impacted deferred revenue from subscriptions as of June 30, 2016 and December 31, 2015. Further explanation of this impact is included below under the caption "Non-GAAP financial measures".

**Income tax provision**

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016	2015	Change	2016	2015	Change
Income tax provision	\$ 3.6	\$ 4.3	(16.3)%	\$ 6.3	\$ 6.0	5.0%
Effective income tax rate	31.5%	37.8%		32.8%	34.7%	

The decreases in our effective income tax rate during the three and six months ended June 30, 2016, when compared to the same periods in 2015, was primarily due to a loss included in the 2015 periods from the sale of our Netherlands entity for which we did not record a tax benefit and the estimated benefit to our annual 2016 effective tax rate from federal and state research tax credits that were permanently enacted into law in December 2015. The decreases in our effective tax rates during the three and six months ended June 30, 2016 were partially offset by the estimated impact to our annual 2016 effective tax rate from Section 162(m) nondeductible compensation.

In addition to the events that impact our effective income tax rate during both the three and six months ended June 30, 2016, when compared to the same periods in 2015, the decrease in our effective tax rate during the six months ended June 30, 2016 was also partially offset by a discrete tax benefit included in the 2015 period from the settlement of an IRS audit.



## Blackbaud, Inc.

Our effective income tax rate may fluctuate quarterly as a result of factors, including transactions entered into, changes in the geographic distribution of our earnings or losses, our assessment of certain tax contingencies, valuation allowances, and changes in tax law in jurisdictions where we conduct business.

We have deferred tax assets for federal, state, and international net operating loss carryforwards and state tax credits. The federal and state net operating loss carryforwards are subject to various Internal Revenue Code limitations and applicable state tax laws. A portion of the foreign and state net operating loss carryforwards and a portion of state tax credits have a valuation reserve due to the uncertainty of realizing such carryforwards and credits in the future.

The total amount of unrecognized tax benefit that, if recognized, would favorably affect the effective income tax rate, was \$2.4 million and \$2.3 million at June 30, 2016 and December 31, 2015, respectively. We recognize accrued interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense.

### ***Non-GAAP financial measures***

The operating results analyzed below are presented on a non-GAAP basis. We use non-GAAP revenue, non-GAAP gross profit, non-GAAP gross margin, non-GAAP income from operations, non-GAAP operating margin, non-GAAP net income and non-GAAP diluted earnings per share internally in analyzing our operational performance. Accordingly, we believe these non-GAAP measures are useful to investors, as a supplement to GAAP measures, in evaluating our ongoing operational performance. While we believe these non-GAAP measures provide useful supplemental information, non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information prepared in accordance with GAAP. In addition, these non-GAAP financial measures may not be completely comparable to similarly titled measures of other companies due to potential differences in the exact method of calculation between companies.

We have acquired businesses whose net tangible assets include deferred revenue. In accordance with GAAP reporting requirements, we recorded write-downs of deferred revenue under arrangements predating the acquisition to fair value, which resulted in lower recognized revenue than the contributed purchase price until the related obligations to provide services under such arrangements are fulfilled. Therefore, our GAAP revenues after the acquisitions will not reflect the full amount of revenue that would have been reported if the acquired deferred revenue was not written down to fair value. The non-GAAP measures described below reverse the acquisition-related deferred revenue write-downs so that the full amount of revenue booked by the acquired companies is included, which we believe provides a more accurate representation of a revenue run-rate in a given period and, therefore, will provide more meaningful comparative results in future periods.

The non-GAAP financial measures discussed below exclude the impact of certain transactions because we believe they are not directly related to our operating performance in any particular period, but are for our long-term benefit over multiple periods. We believe that these non-GAAP financial measures reflect our ongoing business in a manner that allows for meaningful period-to-period comparisons and analysis of trends in our business.

**Blackbaud, Inc.**

(dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2016	2015	Change	2016	2015	Change
<b>GAAP Revenue</b>	\$ 180.2	\$ 156.3	15.3 %	\$ 349.4	\$ 303.3	15.2 %
<b>Non-GAAP adjustments:</b>						
Add: Acquisition-related deferred revenue write-down	1.9	2.5	(24.0)%	3.6	6.0	(40.0)%
<b>Non-GAAP revenue(1)</b>	\$ 182.0	\$ 158.7	14.7 %	\$ 353.1	\$ 309.3	14.2 %
<b>GAAP gross profit</b>	\$ 96.6	\$ 82.8	16.7 %	\$ 186.0	\$ 158.0	17.7 %
<b>GAAP gross margin</b>	53.6%	53.0%		53.2%	52.1%	
<b>Non-GAAP adjustments:</b>						
Add: Acquisition-related deferred revenue write-down	1.9	2.5	(24.0)%	3.6	6.0	(40.0)%
Add: Stock-based compensation expense	0.8	1.0	(20.0)%	1.6	2.0	(20.0)%
Add: Amortization of intangibles from business combinations	9.9	7.6	30.3 %	19.8	15.2	30.3 %
Add: Employee severance	0.1	0.3	(66.7)%	0.1	0.9	(88.9)%
Subtotal(1)	12.6	11.4	10.5 %	25.2	24.1	4.6 %
<b>Non-GAAP gross profit(1)</b>	\$ 109.3	\$ 94.3	15.9 %	\$ 211.2	\$ 182.1	16.0 %
<b>Non-GAAP gross margin</b>	60.0%	59.4%		59.8%	58.9%	

(1) The individual amounts for each year may not sum to non-GAAP revenue, subtotal or non-GAAP gross profit due to rounding.

(dollars in millions, except per share amounts)	Three months ended June 30,			Six months ended June 30,		
	2016	2015	Change	2016	2015	Change
<b>GAAP income from operations</b>	\$ 14.2	\$ 14.5	(2.1)%	\$ 24.6	\$ 22.5	9.3 %
<b>GAAP operating margin</b>	7.9%	9.3%		7.0%	7.4%	
<b>Non-GAAP adjustments:</b>						
Add: Acquisition-related deferred revenue write-down	1.9	2.5	(24.0)%	3.6	6.0	(40.0)%
Add: Stock-based compensation expense	7.9	6.3	25.4 %	15.8	11.4	38.6 %
Add: Amortization of intangibles from business combinations	10.6	8.1	30.9 %	21.3	16.2	31.5 %
Add: Employee severance	0.1	0.4	(75.0)%	0.4	1.6	(75.0)%
Add: Acquisition-related integration costs	0.1	0.2	(50.0)%	0.5	0.7	(28.6)%
Add: Acquisition-related expenses	—	0.7	(100.0)%	0.1	0.8	(87.5)%
Subtotal(1)	20.6	18.2	13.2 %	41.7	36.7	13.6 %
<b>Non-GAAP income from operations(1)</b>	\$ 34.8	\$ 32.7	6.4 %	\$ 66.3	\$ 59.2	12.0 %
<b>Non-GAAP operating margin</b>	19.1%	20.6%		18.8%	19.1%	
<b>GAAP net income</b>	\$ 7.8	\$ 7.0	11.4 %	\$ 12.8	\$ 11.3	13.3 %
<b>Shares used in computing GAAP diluted earnings per share</b>	46,927,626	46,402,707	1.1 %	46,865,218	46,289,440	1.2 %
<b>GAAP diluted earnings per share</b>	\$ 0.17	\$ 0.15	13.3 %	\$ 0.27	\$ 0.24	12.5 %
<b>Non-GAAP adjustments:</b>						
Add: Total Non-GAAP adjustments affecting loss from operations	20.6	18.2	13.2 %	41.7	36.7	13.6 %
Add: Loss on sale of business	—	2.0	(100.0)%	—	2.0	(100.0)%
Less: Tax impact related to Non-GAAP adjustments	(6.6)	(8.0)	(17.5)%	(13.2)	(15.8)	(16.5)%
<b>Non-GAAP net income(1)</b>	\$ 21.8	\$ 19.2	13.5 %	\$ 41.3	\$ 34.2	20.8 %
<b>Shares used in computing Non-GAAP diluted earnings per share</b>	46,927,626	46,402,707	1.1 %	46,865,218	46,289,440	1.2 %
<b>Non-GAAP diluted earnings per share</b>	\$ 0.46	\$ 0.41	12.2 %	\$ 0.88	\$ 0.74	18.9 %

(1) The individual amounts for each year may not sum to subtotal, non-GAAP income from operations or non-GAAP net income due to rounding.

## Blackbaud, Inc.

The increases in non-GAAP income from operations during the three and six months ended June 30, 2016, when compared to the same periods in 2015, were primarily due to growth in subscriptions revenue, improvements in the utilization of consulting services personnel and a reduction in non-billable implementation service hours, partially offset by increases in transaction-based costs related to our payments services and compensation costs. The inclusion of Smart Tuition contributed to the increase in subscriptions revenue as well as the increases in costs related to our payment services and compensation costs. The decreases in non-GAAP operating margins during the three and six months ended June 30, 2016, when compared to the same periods in 2015, were primarily due to investments we are making in our sales organization and customer success program, as discussed above.

Historically, for the purposes of determining non-GAAP net income, we have utilized a non-GAAP tax rate of 39.0% in our calculation of the tax impact related to non-GAAP adjustments. Beginning in 2016, we now apply a non-GAAP effective tax rate of 32.0% in our calculation of the tax impact on non-GAAP adjustments, which affects the tax impact related to non-GAAP adjustments, non-GAAP net income and non-GAAP diluted earnings per share measures. As announced at our 2015 Investor Day, we previously communicated that we would be adjusting this rate to 36.0% to better reflect our periodic effective tax rate calculated in accordance with GAAP and our then current expectations related to tax rate impacting legislation such as the domestic production activities deduction and certain credits which are recurring in nature. Subsequent to that Investor Day communication, the business research and development tax credit was permanently extended. The non-GAAP effective tax rate utilized will be reviewed annually to determine whether it remains appropriate in consideration of our financial results including our periodic effective tax rate calculated in accordance with GAAP, our operating environment and related tax legislation in effect and other factors deemed necessary. For the three and six months ended June 30, 2015, the tax impact related to non-GAAP adjustments, non-GAAP net income and non-GAAP diluted earnings per share are calculated under our historical non-GAAP effective tax rate of 39.0%.

### ***Non-GAAP organic revenue growth***

In addition, we discuss non-GAAP organic revenue growth, non-GAAP organic revenue growth on a constant currency basis and non-GAAP organic recurring revenue growth, which we believe provides useful information for evaluating the periodic growth of our business on a consistent basis. Each of these measures of non-GAAP organic revenue growth excludes incremental acquisition-related revenue attributable to companies acquired in the current fiscal year. For companies acquired in the immediately preceding fiscal year, each of these non-GAAP organic revenue growth measures reflects presentation of full year incremental non-GAAP revenue derived from such companies as if they were combined throughout the prior period, and it includes the non-GAAP revenue attributable to those companies, as if there were no acquisition-related write-downs of acquired deferred revenue to fair value as required by GAAP. In addition, each of these non-GAAP organic revenue growth measures excludes prior period revenue associated with divested businesses. The exclusion of the prior period revenue is to present the results of the divested businesses within the results of the combined company for the same period of time in both the prior and current periods. We believe this presentation provides a more comparable representation of our current business' organic revenue growth and revenue run-rate. Unaudited calculations of non-GAAP organic revenue growth, non-GAAP organic revenue growth on a constant currency basis and non-GAAP recurring revenue growth for the three and six months ended June 30, 2016, as well as unaudited reconciliations of those non-GAAP measures to their most directly comparable GAAP measures, are as follows:

**Blackbaud, Inc.**

(dollars in millions)	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
GAAP revenue	\$ 180.2	\$ 156.3	\$ 349.4	\$ 303.3
<b>GAAP revenue growth</b>	<b>15.3%</b>		<b>15.2%</b>	
Add: Non-GAAP acquisition-related revenue (1)	1.9	10.4	3.6	22.7
Less: Revenue from divested businesses (2)	—	(0.2)	—	(0.6)
Total Non-GAAP adjustments	1.9	10.2	3.6	22.2
Non-GAAP revenue	\$ 182.0	\$ 166.5	\$ 353.1	\$ 325.4
<b>Non-GAAP organic revenue growth</b>	<b>9.4%</b>		<b>8.5%</b>	
Non-GAAP revenue (3)	\$ 182.0	\$ 166.5	\$ 353.1	\$ 325.4
Foreign currency impact on Non-GAAP organic revenue (4)	0.9	—	2.4	—
Non-GAAP revenue on constant currency basis (4)	\$ 182.9	\$ 166.5	\$ 355.5	\$ 325.4
<b>Non-GAAP organic revenue growth on constant currency basis</b>	<b>9.9%</b>		<b>9.2%</b>	
GAAP subscriptions revenue	\$ 104.0	\$ 80.0	\$ 200.9	\$ 152.5
GAAP maintenance revenue	\$ 37.4	\$ 38.6	74.6	77.5
GAAP recurring revenue	\$ 141.5	\$ 118.6	275.5	230.0
<b>GAAP recurring revenue growth</b>	<b>19.3%</b>		<b>19.8%</b>	
Add: Non-GAAP acquisition-related revenue (1)	1.8	10.0	3.6	21.9
Less: Revenue from divested businesses (2)	—	(0.1)	—	(0.4)
Total Non-GAAP adjustments	1.8	9.9	3.6	21.6
Non-GAAP recurring revenue	\$ 143.3	\$ 128.5	\$ 279.1	\$ 251.6
<b>Non-GAAP organic recurring revenue growth</b>	<b>11.5%</b>		<b>10.9%</b>	

(1) Non-GAAP acquisition-related revenue excludes incremental acquisition-related revenue calculated in accordance with GAAP that is attributable to companies acquired in the current fiscal year. For companies acquired in the immediately preceding fiscal year, non-GAAP acquisition-related revenue reflects presentation of full-year incremental non-GAAP revenue derived from such companies, as if they were combined throughout the prior period, and it includes the non-GAAP revenue from the acquisition-related deferred revenue write-down attributable to those companies.

(2) For businesses divested in the prior fiscal year, non-GAAP organic revenue growth excludes revenue associated with divested businesses. The exclusion of the prior period revenue is to present the results of the divested business with the results of the combined company for the same period of time in both the prior and current periods.

(3) Non-GAAP revenue for the prior year periods presented herein may not agree to non-GAAP revenue presented in the respective prior period quarterly financial information solely due to the manner in which non-GAAP organic revenue growth is calculated.

(4) To determine non-GAAP organic revenue growth on a constant currency basis, revenues from entities reporting in foreign currencies were translated to U.S. Dollars using the comparable prior period's quarterly weighted average foreign currency exchange rates. The primary foreign currencies creating the impact are the Canadian Dollar, EURO, British Pound and Australian Dollar.

**Seasonality**

Our revenues normally fluctuate as a result of certain seasonal variations in our business. Our revenue from professional services has historically been lower in the first quarter when many of those services commence and in the fourth quarter due to the holiday season. In addition, our transaction revenue has historically been at its lowest in the first quarter due to the timing of customer fundraising initiatives and events. Our revenue from payment processing services has also historically increased during the fourth quarter due to year-end giving. As a result of these and other factors, our total revenue has historically been lower in the first quarter than in the remainder of our fiscal year, with the third and fourth quarters historically achieving the highest total revenues. Our expenses, however, do not vary significantly as a result of these factors, but do fluctuate on a quarterly basis due to varying timing of expenditures. Our cash flow from operations normally fluctuates quarterly due to the combination of the timing of customer contract renewals including renewals associated with customers of acquired companies, delivery of professional services and occurrence of customer events, the payment of bonuses, as well as merit-based salary increases, among other factors. Historically, due to lower revenues in our first quarter, combined with the payment of bonuses from the prior year in our first quarter, our cash flow from operations has been lowest in our first quarter, and due to the timing of customer contract renewals, many of which take place at or near the beginning of our third quarter, our cash flow from operations has been lower in our second quarter as compared to our third and fourth quarters. Partially offsetting these favorable drivers of cash flow from operations in

**Blackbaud, Inc.**

our third and fourth quarters are merit-based salary increases, which are generally effective in April each year. In addition, deferred revenues can vary on a seasonal basis for the same reasons. These patterns may change as a result of the continued shift to online giving, growth in volume of transactions for which we process payments, or as a result of acquisitions, new market opportunities, new solution introductions or other factors.

**Liquidity and Capital Resources**

The following table presents selected financial information about our financial position:

(dollars in millions)		June 30, 2016	Change	December 31, 2015
Cash and cash equivalents	\$	15.3	(0.6)%	\$ 15.4
Property and equipment, net		54.1	2.7 %	52.7
Software development costs, net		27.8	41.8 %	19.6
Total carrying value of debt		403.2	(1.2)%	408.1
Working capital		(150.6)	9.9 %	(167.2)
Working capital excluding deferred revenue		99.9	58.6 %	63.0

The following table presents selected financial information about our cash flows:

(dollars in millions)		Six months ended June 30,		
		2016	Change	2015
Net cash provided by operating activities	\$	38.0	(20.2)%	\$ 47.6
Net cash used in investing activities		(24.2)	66.9 %	(14.5)
Net cash used in financing activities		(13.9)	(58.6)%	(33.6)

Our principal sources of liquidity are operating cash flow, funds available under the 2014 Credit Facility and cash on hand. Our operating cash flow depends on continued customer renewal of our subscription, maintenance and support arrangements and market acceptance of our solutions and services. Based on current estimates of revenue and expenses, we believe that the currently available sources of funds and anticipated cash flows from operations will be adequate for at least the next twelve months to finance our operations, fund anticipated capital expenditures, meet our debt obligations and pay dividends. Dividend payments are not guaranteed and our Board of Directors may decide, in its absolute discretion, at any time and for any reason, not to declare and pay further dividends and/or repurchase our common stock. To the extent we undertake future material acquisitions, investments or unanticipated capital expenditures, we may require additional capital. In that context, we regularly evaluate opportunities to enhance our capital structure including through potential debt issuances.

At June 30, 2016, our total cash and cash equivalents balance included approximately \$7.5 million of cash that was held by operations outside the U.S. While these funds may not be needed to fund our U.S. operations for at least the next twelve months, if we need these funds, we may be required to accrue and pay taxes to repatriate the funds. We currently do not intend nor anticipate a need to repatriate our cash held outside the U.S.

**Operating cash flow**

Net cash provided by operating activities of \$38.0 million decreased by \$9.6 million during the six months ended June 30, 2016, when compared to the same period in 2015, primarily due to a decrease in cash flow from operations associated with working capital. Throughout both periods, our cash flows from operations were derived principally from: (i) our earnings from on-going operations prior to non-cash expenses such as depreciation, amortization, stock-based compensation, amortization of deferred financing costs and debt discount and adjustments to our provision for sales returns and allowances; and (ii) changes in our working capital.

Working capital changes are composed of changes in accounts receivable, prepaid expenses and other assets, trade accounts payable, accrued expenses and other liabilities, and deferred revenue. Cash flow from operations associated with working

**Blackbaud, Inc.**

capital decreased \$19.3 million during the six months ended June 30, 2016, when compared to the same period in 2015, primarily due to:

- an increase in tax payments made on behalf of employees for surrendered shares upon vesting or exercise of equity awards;
- an increase in current period bonus payments as a result of an increase in amounts accrued as of December 31, 2015 for over-performance against 2015 targets as well as a change in the timing of certain bonus payment in 2016 from an semi-annual to a quarterly frequency; and
- an increase in accounts receivable related to a seasonal increase in customer contract renewals including renewals associated with customers of acquired companies, many of which take place at or near the beginning of our third quarter; partially offset by
- fluctuations in the timing of vendor payments.

**Investing cash flow**

Net cash used in investing activities of \$24.2 million increased by \$9.7 million during the six months ended June 30, 2016, when compared to the same period in 2015. During the six months ended June 30, 2016, we had cash outlays of \$12.6 million and \$12.2 million for purchases of property and equipment and software development costs, respectively, which were up \$5.6 million and \$5.2 million, respectively, from cash spent during the same period in 2015. The increase in cash outlays for property and equipment were primarily driven by investments in our information technology infrastructure, technology platforms and infrastructure used in the delivery of our solutions to customers, fluctuations in the timing of vendor payments, various facilities upgrades at a number of our U.S. and international locations, as well as incremental property and equipment costs from prior year business acquisitions. The increase in cash outlays for software development costs was primarily driven by development activities related to our next generation NXT and Luminate cloud-based solutions, development activities for other solutions and the inclusion of software development costs related to solutions historically provided by Smart Tuition. These increases were partially offset by an insignificant cash inflow from a post-closing working capital adjustment associated with the prior year acquisition of Smart Tuition.

**Financing cash flow**

During the six months ended June 30, 2016, we had a net decrease in borrowings of \$5.2 million compared to a net decrease in borrowings of \$23.3 million during the same period in 2015. Also during the six months ended June 30, 2016, we paid dividends of \$11.4 million, which was relatively consistent with the amount paid in the comparable period of 2015.

**2014 Credit Facility**

We have drawn on our credit facility from time to time to help us meet financial needs, such as financing for business acquisitions. At June 30, 2016, our available borrowing capacity under the 2014 Credit Facility was \$106.7 million. We believe the 2014 Credit Facility will provide us with sufficient flexibility to meet our future financial needs. The 2014 Credit Facility matures in February 2019.

At June 30, 2016, the carrying amount of our debt under the 2014 Credit Facility was \$403.2 million. Our average daily borrowings during the three and six months ended June 30, 2016 were \$416.7 million and \$412.4 million, respectively.

Following is a summary of the financial covenants under our credit facility:

Financial Covenant	Requirement	Ratio as of June 30, 2016
Net Leverage Ratio	≤ 3.50 to 1.00	2.61 to 1.00
Interest Coverage Ratio	≥ 2.50 to 1.00	15.50 to 1.00

Under the 2014 Credit Facility, we also have restrictions on our ability to declare and pay dividends and our ability to repurchase shares of our common stock. In order to pay any cash dividends and/or repurchase shares of stock: (i) no default or event of default shall have occurred and be continuing under the 2014 Credit Facility, and (ii) our pro forma net leverage

## Blackbaud, Inc.

ratio, as set forth in the 2014 Credit Facility, must be 0.25 less than the net leverage ratio requirement at the time of dividend declaration or share repurchase. At June 30, 2016, we were in compliance with all debt covenants under the 2014 Credit Facility.

### Commitments and contingencies

As of June 30, 2016, we had contractual obligations with future minimum commitments as follows:

(in millions)	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
<b>Recorded contractual obligations:</b>					
Debt(1)	\$ 405.1	\$ 4.4	\$ 400.7	\$ —	\$ —
Interest payments on debt(2)	1.3	1.0	0.3	—	—
<b>Unrecorded contractual obligations:</b>					
Operating leases(3)	169.5	14.7	26.3	24.2	104.3
Interest payments on debt(4)	22.7	8.5	14.2	—	—
Purchase obligations(5)	41.9	17.1	22.7	2.1	—
<b>Total contractual obligations</b>	<b>\$ 640.5</b>	<b>\$ 45.7</b>	<b>\$ 464.2</b>	<b>\$ 26.3</b>	<b>\$ 104.3</b>

(1) Represents principal payments only, under the following assumptions: (i) that the amounts outstanding under the 2014 Credit Facility at June 30, 2016 will remain outstanding until maturity, with minimum payments occurring as currently scheduled, and (ii) that there are no assumed future borrowings on the 2014 Revolving Facility for the purposes of determining minimum commitment amounts.

(2) Represents interest payment obligations related to our interest rate swap agreements.

(3) Our commitments related to operating leases have not been reduced by incentive payments and reimbursement of leasehold improvements.

(4) The actual interest expense recognized in our consolidated statements of comprehensive income will depend on the amount of debt, the length of time the debt is outstanding and the interest rate, which could be different from our assumptions described in (1) above.

(5) We utilize third-party technology in conjunction with our solutions and services, with contractual obligations varying in length from one to four years. In certain cases, these arrangements require a minimum annual purchase commitment by us.

The term loan under the 2014 Credit Facility requires periodic principal payments. The balance of the term loans and any amounts drawn on the revolving credit loans are due upon maturity of the 2014 Credit Facility in February 2019.

The total liability for uncertain tax positions as of June 30, 2016 and December 31, 2015, was \$3.1 million and \$3.0 million, respectively. Our accrued interest and penalties related to tax positions taken on our tax returns was insignificant as of June 30, 2016 and December 31, 2015.

In February 2016, our Board of Directors approved our annual dividend rate of \$0.48 per share to be made in quarterly payments. Dividends at this annual rate would aggregate to \$22.6 million assuming 47.0 million shares of common stock are outstanding, although dividends are not guaranteed and our Board of Directors may decide, in its absolute discretion, to change or suspend dividend payments at any time for any reason. Our ability to continue to declare and pay dividends quarterly this year and beyond might be restricted by, among other things, the terms of the 2014 Credit Facility, general economic conditions and our ability to generate adequate operating cash flow.

On August 1, 2016, our Board of Directors declared a third quarter dividend of \$0.12 per share payable on September 15, 2016 to stockholders of record on August 26, 2016.

### Lease for New Headquarters Facility

In May 2016, we entered into a lease agreement for a New Headquarters Facility to be built in Charleston, South Carolina. For a detailed discussion of the New Headquarters Facility, see Note 10 of our consolidated financial statements in this report.

## Off-Balance Sheet Arrangements

---

As of June 30, 2016, we did not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K promulgated by the SEC, that have or are reasonably likely to have, a current or future effect on our financial condition, changes in our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

## Foreign Currency Exchange Rates

---

Approximately 10% of our total revenue for the six months ended June 30, 2016 was generated from operations outside the United States. We do not have significant operations in countries in which the economy is considered to be highly inflationary. Our consolidated financial statements are denominated in U.S. dollars and, accordingly, changes in the exchange rate between foreign currencies and the U.S. dollar will affect the translation of our subsidiaries' financial results into U.S. dollars for purposes of reporting our consolidated financial results. The accumulated currency translation adjustment, recorded within other comprehensive loss as a component of stockholders' equity, was a loss of \$0.8 million and \$0.8 million as of June 30, 2016 and December 31, 2015, respectively.

The vast majority of our contracts are entered into by our U.S. or U.K. entities. The contracts entered into by the U.S. entity are almost always denominated in U.S. dollars or Canadian dollars, and contracts entered into by our U.K., Australian and Irish subsidiaries are generally denominated in Pounds Sterling, Australian dollars and Euros, respectively. Historically, as the U.S. dollar weakened, foreign currency translation resulted in an increase in our revenues and expenses denominated in non-U.S. currencies. Conversely, as the U.S. dollar strengthened, foreign currency translation resulted in a decrease in our revenue and expenses denominated in non-U.S. currencies. During the six months ended June 30, 2016, foreign translation resulted in a decrease in our revenues and expenses denominated in non-U.S. currencies. Though we have exposure to fluctuations in currency exchange rates, primarily those between the U.S. dollar and Canadian dollar, the impact has generally not been material to our consolidated results of operations or financial position. For the six months ended June 30, 2016, the fluctuation in foreign currency exchange rates reduced our total revenue and income from operations by \$2.4 million and \$1.1 million, respectively. We will continue monitoring such exposure and take action as appropriate. To determine the impacts on total revenue (or income from operations) from fluctuations in currency exchange rates, current period revenues (or income from operations) from entities reporting in foreign currencies were translated into U.S. dollars using the comparable prior year period's weighted average foreign currency exchange rates. These impacts are non-GAAP financial information and are not in accordance with, or an alternative to, information prepared in accordance with GAAP.

## Inflation

---

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations. In addition, if inflationary pressures impact the rate of giving to our customers, there could be adverse impacts to our business, financial condition and results of operations.

## Critical Accounting Policies and Estimates

---

There have been no significant changes in our critical accounting policies and estimates during the six months ended June 30, 2016 as compared to those disclosed in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.



## Recently Issued Accounting Pronouncements

---

For a discussion of the impact that recently issued accounting pronouncements are expected to have on our financial position and results of operations when adopted in the future, see Note 2 of our consolidated financial statements in this report.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have market rate sensitivity for interest rates and foreign currency exchange rates.

### Interest Rate Risk

---

Our variable rate debt is our primary financial instrument with market risk exposure for changing interest rates. We manage our variable rate interest rate risk through a combination of short-term and long-term borrowings and the use of derivative instruments entered into for hedging purposes. Due to the nature of our debt, the materiality of the fair values of the derivative instruments and the highly liquid, short-term nature and level of our cash and cash equivalents as of June 30, 2016, we believe there is no material risk of exposure to changing interest rates for those positions. There were no significant changes in how we manage interest rate risk between December 31, 2015 and June 30, 2016.

### Foreign Currency Risk

---

For a discussion of our exposure to foreign currency exchange rate fluctuations, see “Management’s discussion and analysis of financial condition and results of operations — Foreign Currency Exchange Rates” in this report.

## ITEM 4. CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

---

Disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)) are designed only to provide reasonable assurance that they will meet their objectives. As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial and accounting officer), of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e)) pursuant to Exchange Act Rule 13a-15(b). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective to provide the reasonable assurance discussed above.

### Changes in Internal Control Over Financial Reporting

---

No change in internal control over financial reporting occurred during the most recent fiscal quarter ended June 30, 2016 with respect to our operations, which has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## ► PART II. OTHER INFORMATION

### ITEM 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described in Part I, Item IA, "Risk factors" in our Annual Report on Form 10-K for the year ended December 31, 2015, which could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our stock. There have been no material changes to our risk factors since our Annual Report on Form 10-K for the year ended December 31, 2015.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

#### Issuer Purchases of Equity Securities

The following table provides information about shares of common stock acquired or repurchased during the three months ended June 30, 2016. All of these acquisitions were of common stock withheld by us to satisfy minimum tax obligations of employees due upon exercise of stock appreciation rights and vesting of restricted stock awards and units. The level of acquisition activity varies from period to period based upon the timing of grants and vesting as well as employee exercise decisions.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs <sup>(1)</sup>	Approximate dollar value of shares that may yet be purchased under the plans or programs (in thousands)
Beginning balance, April 1, 2016				\$ 50,000
April 1, 2016 through April 30, 2016	1,202	\$ 60.21	—	50,000
May 1, 2016 through May 31, 2016	33,718	61.53	—	50,000
June 1, 2016 through June 30, 2016	5,837	64.12	—	50,000
<b>Total</b>	<b>40,757</b>	<b>\$ 61.86</b>	<b>—</b>	<b>\$ 50,000</b>

(1) In August 2010, our Board of Directors approved a stock repurchase program that authorized us to purchase up to \$50.0 million of our outstanding shares of common stock. We have not made any repurchases under the program to date, and the program does not have an expiration date.

## ITEM 6. EXHIBITS

The exhibits listed below are filed or incorporated by reference as part of this Quarterly Report on Form 10-Q:

Exhibit Number	Description of Document	Filed In			
		Filed Herewith	Form	Exhibit Number	Filing Date
10.84	Lease Agreement dated May 16, 2016 between Blackbaud, Inc. and HPBB1, LLC	X			
10.85	Blackbaud, Inc. 2016 Equity and Incentive Compensation Plan		DEF 14A	Appendix C	4/26/2016
10.86	Form of Retention Agreement dated April 19, 2016 between Blackbaud, Inc. and Brian E. Boruff		10-Q	10.37	11/10/2008
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X			
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X			
32.1	Certification by the Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X			
32.2	Certification by the Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X			
101.INS*	XBRL Instance Document.	X			
101.SCH*	XBRL Taxonomy Extension Schema Document.	X			
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.	X			
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.	X			
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.	X			
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.	X			

\* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended or otherwise subject to liability of that Section, and shall not be part of any registration statement or other document filed under the Securities Act of 1933, as amended or the Securities Exchange Act of 1934, as amended, except as shall be expressly set forth by specific reference in such filing.

► **SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

**BLACKBAUD, INC.**

Date: August 4, 2016

By: /s/ Michael P. Gianoni

Michael P. Gianoni  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: August 4, 2016

By: /s/ Anthony W. Boor

Anthony W. Boor  
Executive Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

**PORTIONS OF THIS AGREEMENT ARE SUBJECT TO ARBITRATION PURSUANT TO THE UNIFORM  
ARBITRATION ACT, S.C. CODE SECTION 15-48-10, AS AMENDED AS PROVIDED HEREIN.**

**LEASE AGREEMENT**

**BY AND BETWEEN**

**HPBB1, LLC  
AS LANDLORD**

**AND**

**BLACKBAUD, INC.  
AS TENANT**

**May 16, 2016**

# TABLE OF CONTENTS

	<b>Page</b>
ARTICLE 1 BASIC LEASE TERMS	1
1.1    PREMISES	1
1.2    TERM	1
1.3    DEFINITIONS.	4
 ARTICLE 2 RENT	 7
2.1    BASE RENT	7
2.2    OPERATING EXPENSES	7
2.3    DEFINITION OF OPERATING EXPENSES	8
2.4    LATE PAYMENT CHARGE; DEFAULT INTEREST	11
2.5    HOLDING OVER	11
2.6    NET LEASE	12
2.7    TRUE LEASE	13
 ARTICLE 3 OCCUPANCY AND USE	 13
3.1    USE	13
3.2    SIGNS	14
3.3    COMPLIANCE WITH LAWS, RULES AND REGULATIONS	14
3.4    WARRANTY OF POSSESSION	14
3.5    INSPECTION	14
3.6    USE OF ROOF	14
 ARTICLE 4 BUILDING SERVICES	 15
 ARTICLE 5 REPAIRS AND MAINTENANCE; UTILITIES	 16
5.1    LANDLORD REPAIRS	16
5.2    TENANT REPAIRS AND OTHER SERVICES; PROPERTY MANAGEMENT	16
5.3    TENANT DAMAGES	17
5.4    PAYMENT FOR UTILITIES	17
5.5    UTILITIES	17
 ARTICLE 6 ALTERATIONS AND IMPROVEMENTS	 18
6.1    LANDLORD IMPROVEMENTS	18
6.2    TENANT IMPROVEMENTS	18

ARTICLE 7 CASUALTY AND INSURANCE	20
7.1    FIRE AND CASUALTY DAMAGE	20
7.2    WAIVER OF SUBROGATION	21
7.3    HOLD HARMLESS.	21
7.4    TENANT’S INSURANCE	22
7.5    LANDLORD’S INSURANCE	22
 ARTICLE 8 CONDEMNATION	 23
8.1    SUBSTANTIAL TAKING	23
8.2    PARTIAL TAKING	23
 ARTICLE 9 ASSIGNMENT OR SUBLEASE; RIGHTS OF MORTGAGEES	 24
9.1    LANDLORD ASSIGNMENT	24
9.2    TENANT ASSIGNMENT OR SUBLEASE	24
9.3    CONDITIONS OF ASSIGNMENT OR SUBLEASE	25
9.4    RIGHTS OF MORTGAGEE AND OTHERS	26
9.5    ESTOPPEL CERTIFICATES	26
 ARTICLE 10 DEFAULT AND REMEDIES	 27
10.1   DEFAULT BY TENANT	27
10.2   REMEDIES FOR TENANT’S DEFAULT	27
10.3   DEFAULT BY LANDLORD	29
10.4   REMEDIES FOR LANDLORD’S DEFAULT	29
10.5   MITIGATION	30
 ARTICLE 11 HAZARDOUS MATERIALS	 30
 ARTICLE 12 MISCELLANEOUS	 31
12.1   WAIVER	31
12.2   FORCE MAJEURE	31
12.3   ATTORNEY’S FEES	31
12.4   SUCCESSORS	32
12.5   RENT TAX	32
12.6   CAPTIONS	32
12.7   NOTICE	32
12.8   SUBMISSION OF LEASE	32
12.9   AUTHORITY	32
12.1   SEVERABILITY	33

12.11	LIMITATIONS OF LIABILITY	33
12.12	NO BROKER CLAIMS	33
12.13	NO ESTATE IN LAND	33
12.14	NO JOINT VENTURE	33
12.15	TIME OF ESSENCE	33
12.16	JOINT AND SEVERAL LIABILITY	33
12.17	NO LIGHT OR AIR EASEMENT	34
12.18	ENTIRE LEASE	34
12.19	SPECIAL STIPULATIONS, EXHIBITS AND SUMMARY OF LEASE PROVISION	34
12.2	CONDITIONS PRECEDENT.	34
12.21	NO MERGER OF TITLE	36
12.22	FINANCIAL STATEMENTS	36
ARTICLE 13 PHASE 2		36
13.1	PHASE 2 NOTICE	36
13.2	PHASE 2 FINANCING NOTICE	37
13.3	PHASE 2 DEVELOPED BY LANDLORD.	37
13.4	PHASE 2 DEVELOPED BY TENANT.	37
13.5	MEMORANDUM OF LEASE	38
ARTICLE 14 SIGNATURES		39



## SUMMARY OF LEASE PROVISIONS

1. **Landlord:** HPBB1, LLC, a Georgia limited liability company
2. **Tenant:** BLACKBAUD, INC., a Delaware corporation
3. **Premises:** Approximately 12.98 acres of real property located in Berkeley County, South Carolina and being more particularly described on *Exhibit A* hereto, together with an approximately 172,000 square foot, 4-story building, and associated parking lots, access drives and other improvements to be designed and constructed by Landlord pursuant to the Work Agreement attached hereto as *Exhibit B*; provided, however, as of and after the Phase 2 Trigger Date (defined below), the Premises shall exclude the Phase 2 Property.
4. **Term:** Twenty (20) Lease Years; subject to four (4) renewal periods for five (5) years each. The parties estimate that the Commencement Date shall be January 1, 2018, and the Expiration Date shall be December 31, 2038, but such dates shall be established pursuant to Section 1.2.
5. **Base Rent:** The Base Rent shall be as follows:
  - (a) during the first Lease Year, an amount equal to the product of the Project Costs (defined below) and the Rent Factor (defined below); and
  - (b) beginning on the first day of the second Lease Year, and on the first day of each Lease Year thereafter, an amount equal to the product of the Base Rent in effect for the prior Lease Year and 1.0192. Base Rent shall be payable in equal monthly installments.

Notwithstanding the foregoing to the contrary, from and after the Phase 2 Trigger Date, the monthly Base Rent for the period after the Phase 2 Trigger Date shall be reduced by the Phase 2 Amortization Amount. The “**Phase 2 Amortization Amount**” is equal to the monthly installment of principal and interest that would be paid for the repayment of a hypothetical loan in the original principal amount of the Phase 2 Gross Purchase Price that is amortized in equal monthly installments using an amortization period of 360 months beginning on the Commencement Date and an interest rate equal to the Rent Factor and assuming that principal and interest payments under the hypothetical loan are made on the first day of each month during the amortization period.
6. **Landlord’s Notice Address:**

Holder Properties, Inc. 3300 Cumberland Blvd. Suite 200 Atlanta, Georgia 30339 Attn: Mr. John R. Holder Mr. Jeff Mixson	<i>with a copy to:</i> Sutherland Asbill & Brennan LLP 999 Peachtree Street, N.E Suite 2300 Atlanta, Georgia 30309-3996 Attn: R. Robinson Plowden, Esq.
--	--
7. **Tenant’s Notice Address:**

2000 Daniel Island Drive Charleston, SC 29492 Attn: Mr. Otto Orr	<i>with a copy to:</i> 2000 Daniel Island Drive Charleston, SC 29492 Attn: Mr. Jon Olson
--	---

8. **Address For Rent Billing:** *(If different from Tenant's notice address above)*  
2000 Daniel Island Drive  
Charleston, SC 29492  
Attn: Mr. Otto Orr
9. **Broker:** Landlord's Broker - Holder Properties, Inc.  
Tenant's Broker - JLL
10. **Effective Date:** May 16, 2016

# LEASE

## ARTICLE 1

### BASIC LEASE TERMS

**1.1 PREMISES.** In consideration of the rents, terms, provisions and covenants of this Lease, Landlord hereby leases, lets and demises to Tenant and Tenant hereby leases from Landlord the premises described in Paragraph 3 of the Summary of Lease Provisions (the "Summary") above (the "Premises"). The Premises consists of a tract of real property located in Daniel Island, South Carolina, being more particularly described on *Exhibit A* attached hereto, together with a building (the "Building") to be constructed by Landlord on such real property pursuant to the Work Agreement attached hereto as *Exhibit B*.

#### **1.2 TERM.**

(a) **Initial Term.** Subject to and upon the conditions set forth herein, the term of this Lease shall commence on the date (the "Commencement Date") which is the earlier of (a) the day of Substantial Completion of the Premises as provided in *Exhibit B* attached hereto, or (b) the day Tenant first occupies any portion of the Building (but not including any occupancy for the purpose of performing Tenant's Extra Work in accordance with *Exhibit B* attached hereto), and shall terminate at 11:59 p.m. (Charleston, SC time) on the last day (the "Expiration Date") of the later to occur of (i) the twentieth (20<sup>th</sup>) Lease Year, or (ii) if the Phase 2 Lease is in effect, the expiration date of the initial term of the Phase 2 Lease, unless sooner terminated or renewed or extended as may be hereinafter provided (such term, taking into account any such sooner termination or renewal or extension, is hereinafter referred to as the "Term"). Contemporaneously with the execution of the Phase 2 Lease, if applicable, Tenant shall deliver an amendment to this Lease, in form reasonably satisfactory to Landlord, which memorializes the extension of the initial Term of this Lease in accordance with the immediately preceding sentence. Promptly following the Commencement Date, Landlord and Tenant shall enter into a letter agreement in the form attached hereto as *Exhibit C* confirming the Commencement Date and the Expiration Date and acknowledging Tenant's acceptance of delivery of the Premises; however the failure to do so will not affect the occurrence of the Commencement Date or Expiration Date. In the event that Landlord fails to achieve Substantial Completion, as advanced by Tenant Delay as defined in Section 3.03 *Exhibit B* on or before the Delivery Deadline, subject to extension on account of Force Majeure, Base Rent shall be abated one (1) day for each one (1) day of delay in achieving Substantial Completion after the Delivery Deadline. Such abatement shall increase to one and a half days of Base Rent abatement for each day of such delay that exceeds thirty (30) days after the Delivery Deadline. Such abatement shall increase to two days of Base Rent abatement for each day of such delay that exceeds sixty (60) days after the Delivery Deadline. Notwithstanding the foregoing, if Landlord fails to or is unable to achieve Substantial Completion within ninety (90) days after the Delivery Deadline, Tenant may elect, as its sole and exclusive remedy, Tenant hereby waiving any other rights and remedies for such delay, either (i) to continue to receive an abatement equal to two days of Base Rent for each day of such delay that exceeds ninety (90) days after the Delivery Deadline, (ii) to terminate this Lease by providing written notice thereof to Landlord within five (5) business days after the expiration of such ninety (90) days, or (iii) to exercise its self-help rights under Section

10.4 by providing written notice thereof to Landlord within five (5) business days after the expiration of such ninety (90) days and to receive an abatement of Base Rent from the first day of delay in achieving Substantial Completion after the Delivery Deadline until the date Tenant delivers such written notice to Landlord in accordance with the above. Upon exercise of Tenant's rights under (ii) or (iii) of the prior sentence, Landlord shall deliver the Approved Plans and any construction documents relating thereto, any surveys, any third (3<sup>rd</sup>) party engineering reports, and any other site due diligence materials relating to this Lease or the Property in Landlord's possession or control to Tenant within three (3) business days. The "Delivery Deadline" is four hundred fifty-one (451) days after the Land Closing, but shall be extended one (1) day for each day that Substantial Completion is delayed due to Force Majeure. The abated Base Rent provided for under this Section 1.2(a) shall constitute liquidated damages for any such delay. The parties acknowledge and agree that Tenant's harm caused by a Landlord's failure to achieve Substantial Completion by said date would be impossible or very difficult to accurately estimate as of the Effective Date, and that the liquidated damages are a reasonable estimate of the anticipated or actual harm that might arise.

(b) **Renewal Term.** Tenant shall have the right to renew the Term of the Lease for four (4) additional periods of five (5) years each (each, a "**Renewal Term**") by giving Landlord prior written notice not more than fifteen (15) months and not less than nine (9) months prior to the expiration of the initial Term or Renewal Term, as the case may be, that Tenant has exercised such renewal right, subject to the following conditions:

(i) There shall not be an Event of Default under any of the terms or provisions of the Lease at the time such notice is given or at the time of the commencement of the Renewal Term.

(ii) At the time such notice is given and at the time of the commencement of the Renewal Term, Tenant and/or its Affiliates shall be occupying the entire Premises.

(iii) At the time such notice is given and at the time of the commencement of the Renewal Term, Tenant shall not have assigned the Lease or sublet any portion of the Premises, except to an Affiliate as permitted under Article 9 of this Lease.

(iv) Tenant shall occupy the Premises during the Renewal Term under the same terms and conditions as specified in the Lease except Tenant shall lease the Premises in their then "as-is" condition, with Tenant being entitled to no additional tenant improvement allowance or other right to require the improvements be made to the Premises, and the Base Rent for any Renewal Term shall be the then Market Rate, but not less than the Base Rent for the Premises in effect immediately prior to the commencement of such Renewal Term.

(c) As used herein, the term "Market Rate" shall be initially determined by Landlord as the amount of base annual rent per gross square foot, including escalations of such base annual rent, then being charged in Comparable Buildings (as defined below) for renewal of leases for space comparable to the Premises and taking into consideration all other relevant factors establishing similarity or dissimilarity between the comparable lease renewal and the leasing of the Premises to Tenant for the Renewal Term, including without limitation, escalations (including type, base year and stop), concessions, length of renewal term, size and location of the Premises, building

standard work letter and/or tenant improvement allowances, quality and quantity of existing tenant improvements, quality and creditworthiness of Tenant, amenities offered, location of building, the cost and provision of parking spaces, and other generally applicable concessions, allowances, escalation rate, terms and conditions of tenancy. The term “**Comparable Buildings**” shall mean any comparable Class A office building in Charleston, South Carolina. The reference to the foregoing factors is illustrative only and the presence or absence of such factors shall be taken into account in determining Market Rate. The Market Rate shall include any escalations to the initial Market Rate for the Renewal Term in question (as opposed to the escalations applicable during the initial Term).

(d) On or before the later to occur of (i) thirty (30) days after Landlord receives the notice of Tenant’s exercise of the renewal option, or (ii) twelve (12) months prior to the expiration of the initial Term or Renewal Term, as the case may be, Landlord shall notify Tenant of the proposed Market Rate. In the event that Landlord and Tenant are not able to agree as to the Market Rate within thirty (30) days of good faith negotiation, the Market Rate shall be determined in accordance with the procedure hereinafter set forth. Within ten (10) business days following the expiration of such thirty (30) day period, Tenant shall notify Landlord that the Market Rate has not yet been determined, whereupon Landlord and Tenant shall mutually agree upon an independent commercial real estate appraiser licensed in the State of South Carolina who has had at least ten (10) years’ experience, immediately prior to the date in question evaluating rental rates for similar office properties in Charleston, South Carolina, and who has not previously been employed by either Landlord or Tenant. If the parties are unable to agree on such appraiser, the parties shall apply to the American Arbitration Association for designation of an appropriate appraiser. The appraiser agreed to by Landlord and Tenant or designated by the American Arbitration Association is hereinafter referred to as the “Appraiser.” Within ten (10) days following the selection of the Appraiser, Landlord and Tenant shall each submit to the Appraiser their respective final determinations of the Market Rate. Within twenty (20) business days thereafter, the Appraiser shall select, as the Market Rate, the determination submitted by Landlord or the determination submitted by Tenant which the Appraiser considers most correct. The Appraiser shall notify both Landlord and Tenant, in writing, which of the rates the Appraiser has selected as the Market Rate. The selection of the Appraiser shall be final and binding on both Landlord and Tenant and the Market Rate, as selected by the Appraiser, if applicable, shall be the Base Rent rate for the applicable Renewal Term. The fees of the Appraiser shall be paid by the party whose determination was not selected by the Appraiser.

(e) Tenant shall not be entitled to more than four (4) renewal options. In the event Tenant fails to timely notify Landlord in the manner herein specified as to any Renewal Term, Tenant shall be conclusively deemed to have waived its right to enter into such Renewal Term and any successive Renewal Terms.

(f) This renewal right shall be subject to Tenant’s financial condition at the time of exercise being comparable, as determined by Landlord, in all material respects to or better than that as exists on the Commencement Date. In determining whether the requirements of this provision are satisfied, all aspects of Tenant’s financial condition (including, without limitation, net worth, liquidity, and credit ratings by recognized rating agencies) may be examined by Landlord.

### 1.3 DEFINITIONS.

- (a) **Additional Rent.** “Additional Rent” as used in this Lease shall mean all sums due Landlord from Tenant under this Lease, other than Base Rent.
- (b) **Affiliate.** “Affiliate” as used in this Lease is defined in Section 9.2.
- (c) **All Risk.** “All Risk” as used in this Lease is defined in Section 7.4.
- (d) **Appraiser.** “Appraiser” as used in this Lease is defined in Section 1.2.
- (e) **Approved Plans.** “Approved Plans” as used in this Lease is defined in the Work Agreement.
- (f) **Base Rent.** “Base Rent” as used in this Lease means the amount specified in Paragraph 5 of the Summary as Base Rent.
- (g) **Brokers.** “Brokers” as used in this Lease is defined in Section 12.12.
- (h) **Building.** “Building” as used in this Lease is defined in Section 1.1.
- (i) **Business Day.** “Business Day” or “business day” as used in this Lease shall mean Mondays through Fridays, exclusive of any Holidays. If any date on which payment, performance, consent, approval or other action is due by either party hereunder falls on a day other than a Business Day, such payment, performance, consent, approval or other action shall be deemed timely if made, given or taken on the next succeeding Business Day.
- (j) **Commencement Date.** “Commencement Date” shall be the date set forth in Section 1.2. The Commencement Date shall constitute the commencement of the Term of this Lease for all purposes, whether or not Tenant has actually taken possession.
- (k) **Comparable Buildings.** “Comparable Buildings” as used in this Lease is defined in Section 1.2.
- (l) **Declaration.** “Declaration” as used in this Lease means that certain reciprocal easement agreement to be agreed to by Landlord and Tenant in accordance with Section 12.20 and entered into as of the Land Closing.
- (m) **Delivery Deadline.** “Delivery Deadline” as used in this Lease is defined in Section 1.2.
- (n) **Events of Default.** “Events of Default” as used in this Lease means those events specified in Section 10.1 as Events of Default.
- (o) **Expiration Date.** “Expiration Date” as used in this Lease is defined in Section 1.2.

(p) **Fee Agreement.** “Fee Agreement” as used in this Lease means any fee in lieu of tax agreement relating to the Premises between Tenant, Landlord, any affiliates of Landlord and/or Berkeley County, South Carolina or other governmental entities.

(q) **Force Majeure.** A “Force Majeure” is defined for purposes of this Lease as causes beyond the commercially reasonable control of the nonperforming party, including, without limitation, strikes, lockouts, sitdowns, inability to obtain material or labor on a timely basis, restrictions by any governmental authority, unusual transportation delays, riots, floods, washouts, explosions, earthquakes, fire, storms, weather (including wet grounds or inclement weather which prevents or hinders construction), unavailability of or delays in obtaining permits or other governmental approvals, power outages, acts of the public enemy, wars and insurrections, but excluding financial inability to perform.

(r) **Hazardous Materials.** “Hazardous Materials” as used in this Lease is defined in Article 11.

(s) **Holiday.** “Holiday” as used in this Lease shall mean New Year’s Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day, Christmas Day, and any other day that office buildings in Charleston, South Carolina, are commonly closed.

(t) **Land.** “Land” as used in this Lease means the real property described on *Exhibit A* hereto.

(u) **Land Closing.** “Land Closing” as used in this Lease means the closing of Landlord’s acquisition of the Land pursuant to the Purchase Agreement.

(v) **Landlord.** “Landlord” as used in this Lease means the entity or person identified as Landlord in Paragraph 1 of the Summary.

(w) **Laws.** “Laws” as used in this Lease means any applicable laws, codes, regulations, ordinances or rules of any governmental or quasi-governmental entity having jurisdiction and any requirements of any applicable insurance underwriters.

(x) **Lease Year.** “Lease Year” as used in this Lease means the period beginning on the Commencement Date and ending on the expiration of twelve (12) full calendar months from the Commencement Date and each successive period of twelve (12) calendar months thereafter during the Term.

(y) **Liability Policy.** “Liability Policy” as used in this Lease is defined in Section 7.4.

(z) **Market Rate.** “Market Rate” as used in this Lease is defined in Section 1.2.

(aa) **Occurrence Basis.** “Occurrence Basis” as used in this Lease is defined in Section 7.4.

(bb) **Operating Expenses.** “Operating Expenses” as used in this Lease is defined in Section 2.3.

(cc) **Phase 1 Per Acre Value.** “Phase 1 Per Acre Value” as used in this Lease is defined as (i) \$625,000 per gross acre of the portion of the Phase 2 Property located south of Fairchild Street, and (ii) \$850,000 per gross acre of the portion of the Phase 2 Property located north of Fairchild Street.

(dd) **Phase 2.** “Phase 2” as used in this Lease means the development of one or more first-class office buildings on the Phase 2 Property with specifications substantially similar to the Building or otherwise acceptable to Tenant for use by Tenant for general office purposes or such other use as may be permitted by applicable laws, zoning regulations, the Declaration, and any other documents burdening the Phase 2 Property.

(ee) **Phase 2 Acreage.** “Phase 2 Acreage” as used in this Lease is defined as the gross acreage of the Phase 2 Property, rounded to the nearest 1/1000th.

(ff) **Phase 2 Property.** “Phase 2 Property” as used in this Lease is defined as that certain portion of the Land sold or transferred for Phase 2 to Tenant, Landlord, or an Affiliate of Landlord, as the case may be, as set forth on the Site Plan (defined below).

(gg) **Phase 2 Rent Commencement Date.** “Phase 2 Rent Commencement Date” as used in this Lease is defined as the date Tenant commences the payment of regularly scheduled rent under the Phase 2 Lease.

(hh) **Phase 2 Trigger Date.** “Phase 2 Trigger Date” as used in this Lease is defined as either, if applicable, (i) the day Landlord closes on the sale of the Phase 2 Property to Tenant in accordance with Section 13.4, or (ii) the Phase 2 Rent Commencement Date.

(ii) **Premises.** “Premises” as used in this Lease is defined in Section 1.1.

(jj) **Prime Rate.** “Prime Rate” as used in this Lease is defined in Section 2.4.

(kk) **Project Costs.** “Project Costs” as used in this Lease means “Project Costs” as defined in the Work Agreement less any credits, rebates, incentives, benefits, offsets and allowances of any kind, howsoever entitled, attributable to the Property and actually received by or paid to Landlord.

(ll) **Property.** “Property” as used in this Lease means the Land, including that portion of the Land on which the Building is situated; provided, however, as of and after the Phase 2 Trigger Date (defined below), the Property shall exclude the Phase 2 Property.

(mm) **Purchase Agreement.** “Purchase Agreement” as used in this Lease means that certain Purchase and Sale Agreement between Daniel Island Company and Tenant, which provides for Purchaser’s acquisition of the Land at a purchase price of (i) \$625,000 per gross acre of the portion of the Land located south of Fairchild Street, and (ii) \$850,000 per gross acre of the portion of the Land located north of Fairchild Street. Tenant represents that the Purchase Agreement



has not been further modified or amended except as set forth in any amendments delivered to Landlord on or before the date hereof, and Tenant agrees not to further modify or amend the Purchase Agreement without Landlord's prior written approval, which approval Landlord may not unreasonably withhold, condition or delay.

(nn) **Renewal Term.** "Renewal Term" as used in this Lease is defined in Section 1.2.

(oo) **Rent.** "Rent", "rent", or "rental" means, collectively, Base Rent and Additional Rent.

(pp) **Rent Factor.** "Rent Factor" as used in this Lease is defined as 7.56%.

(qq) **Substantial Completion.** "Substantial Completion" or "Substantially Complete" as used in this Lease is defined in Section 3.04 of *Exhibit B*.

(rr) **Summary.** "Summary" as used in this Lease is defined in Section 1.1.

(ss) **Taxes.** "Taxes" as used in this Lease is defined in Section 2.3.

(tt) **Tenant.** "Tenant" as used in this Lease means the entity or person identified as Tenant in Paragraph 2 of the Summary.

(uu) **Term.** "Term" as used in this Lease means the period of time specified in Section 1.2(a) commencing on the Commencement Date and terminating at the time specified in Section 1.2.

## ARTICLE 2

### RENT

**2.1 BASE RENT.** Tenant agrees to pay monthly as Base Rent during the Term, without notice or demand, set-off or deduction except as otherwise expressly provided in the Lease, the sums of money set forth in Paragraph 5 of the Summary, which amount shall be payable to Landlord at the address set forth in Paragraph 6 of the Summary, or at such other address notice of which is given to Tenant by Landlord. Upon thirty (30) days' notice from Landlord to Tenant, Tenant shall commence making all Base Rent and other payments due hereunder by wire transfer in accordance with wire transfer instructions specified in Landlord's notice to Tenant. One full monthly installment of Base Rent shall be due and payable for the first month of the Term on or before the Commencement Date and a like monthly installment of Base Rent shall be due and payable on or before the first day of each calendar month following the Commencement Date during the Term. Tenant shall pay without set-off or deduction except as otherwise expressly provided in this Lease, as Additional Rent, all other sums due under this Lease. Payments of Base Rent for any fractional month (including the first month, if applicable) shall be prorated based on the number of calendar days in such fractional month.

**2.2 OPERATING EXPENSES(a)** . Tenant agrees to pay as Additional Rent all Operating Expenses, as set forth herein. Landlord may require Tenant to pay estimated Operating Expenses in monthly installments. If Landlord requires such monthly payments, Landlord will give Tenant at least thirty (30) days' notice of the amount of such payments and may revise such amount upon thirty (30) days' notice to Tenant. Such monthly installments are due and payable on the first day of each month without notice, abatement, offset or deduction, except as expressly provided herein. Landlord shall use reasonable efforts to provide to Tenant an accounting showing in reasonable detail all computations of Additional Rent due under this section within one hundred twenty (120) days of the close of each calendar year. In the event the accounting shows the total of the monthly estimated payments made by Tenant exceeds the amount of Additional Rent due by Tenant under this section, Landlord shall credit any such amount against the Additional Rent payment next coming due. In the event the accounting shows that the total of the monthly payments made by Tenant is less than the amount of Additional Rent due by Tenant under this section, the accounting shall be accompanied by an invoice for the Additional Rent.

(b) Notwithstanding any provision to the contrary, in computing the amount of Operating Expenses for any calendar year after the first full year of occupancy, the amount of Controllable Operating Expenses shall not exceed the amount of Controllable Operating Expenses for the first full year of occupancy, as to the initial Term, or the first year of the Renewal Term, as to any Renewal Term, increased at the rate of 5% per annum computed on a compounding and cumulative basis. As used herein, the term "Controllable Operating Expenses" shall mean all Operating Expenses except (1) electricity, fuel, water, sewer, gas, heating, and air conditioning and other utility charges; (2) the cost of any capital repair, replacement or improvement that is permitted to be included in Operating Expenses pursuant to the terms hereof; (3) the cost of compliance with any Laws (or any revisions thereto) that are not in effect as of the date of Substantial Completion or are not applicable to the Building as of the date of Substantial Completion; (4) insurance costs and premiums; (4) Taxes; and (5) and cost increases due to increases in the governmentally mandated minimum wage laws.

### **2.3 DEFINITION OF OPERATING EXPENSES.**

(a) The term "Operating Expenses" includes all expenses incurred by Landlord with respect to the ownership, management, maintenance, repair, replacement and/or operation of the Building or the Property, and all Landlord's personal property used in connection therewith, including, but not limited to, the following: (i) maintenance, repair and replacement costs, including without limitation, all inspection fees, services, supplies and other expenses for maintaining and operating the Building and the Property, including elevators, lighting, parking and common areas; (ii) electricity, fuel, water, sewer, gas, heating and air conditioning and other utility charges; (iii) security, window washing, janitorial services, trash and snow removal; (iv) landscaping and pest control; (v) if Tenant and Landlord agree in writing for Landlord to provide management services for the Property, management fees, compensation, labor costs (including wages, salaries, social security and employment taxes, insurance, uniforms, training and retirement and pension plans) payable to employees of Landlord, or of any management agent of Landlord providing services in connection with the operation and maintenance of the Property and other direct or indirect costs

related thereto and rent and other costs of operating the Building's management office; (vi) the cost, including interest at then market rates, amortized over its useful life, of any capital repairs, replacements or improvements made to the Property by Landlord after the date of this Lease which is required under any governmental law or regulation that was not applicable to the Property at the time it was constructed or is required by Tenant; (vii) the cost, including interest at then market rates, amortized over its useful life, of any capital repairs, replacements or improvements made to the Property by Landlord in order for Landlord to perform its obligations hereunder; (viii) insurance premiums including, without limitation, commercial general liability insurance, property insurance and other insurance carried by Landlord with respect to the Property; (ix) all professional and consulting fees incurred in connection with the operation of the Property, including, without limitation, accounting fees for preparing the statements of Operating Expenses required hereunder; (x) Landlord's share of any costs or assessments payable under any reciprocal easement agreement or declaration of conditions, covenants and restrictions affecting the Property, including without limitation, the Declaration; (xi) costs or assessments required to be paid by Landlord in connection with any community improvement district or similar arrangement; (xii) costs of procuring and maintaining contractors' and manufacturers' warranties and guaranties; and (xiii) Taxes. For purposes hereof, the term "Taxes" includes all real property and personal property taxes, charges, impositions, fines, levies, burdens and assessments of every kind and nature (including dues and assessments by means of deed restrictions and/or owners' associations) which accrue against the Property during the Term and federal, state and local taxes or charges assessed against the Property by any governmental or quasi-governmental body or authority, and any sums payable in connection with any traffic improvement district or program or community development district or other infrastructure improvement program, whether general or extraordinary, foreseen or unforeseen, together with all expenses incurred in contesting, protesting or monitoring the payment of such taxes and assessments. In no event shall Taxes include taxes on the income of Landlord; provided, however, if the method of taxation then prevailing shall be altered so that any method of taxation shall be levied or imposed upon Landlord in place or partly in place of any such real property taxes and assessments and shall be measured by or based in whole or in part upon the income of the Property or other rents or other income therefrom, then all such new taxes, assessments, levies, impositions or charges shall be included in Taxes. Except to the extent specifically excluded from Operating Expenses, all expenses of operating and maintaining the Property without regard to whether such expenses are foreseen or unforeseen and ordinary or extraordinary, shall be included in Operating Expenses.

(b) For the first ten (10) years after Substantial Completion, the term Operating Expenses does not include any repairing or replacing (but will include routine inspection and maintenance of): (a) the structural components of the Building, including, but not limited to, foundation, floor slab (excluding regular floor cleaning and maintenance), exterior walls, and roof structure, (b) roof membrane systems, (c) windows, (d) utility systems to the termination point in the Building utility closets, and (e) exterior pavement areas (the "*Structural Maintenance Obligations*"). If requested by Tenant following Tenant's approval of the associated cost, Landlord, at Tenant's sole cost and expense, shall obtain and maintain (if commercially available) during the Term a performance bond in an amount not less than Five Million and 00/100 Dollars (\$5,000,000.00) securing the Structural Maintenance Obligations in form reasonably acceptable to Tenant.

(c) The term Operating Expenses does not include the following: (i) repairs, restoration or other work occasioned by fire, wind, the elements or other casualty, to the extent covered by insurance proceeds received by Landlord; (ii) interest or principal payments on any mortgage or other indebtedness of Landlord; (iii) any depreciation allowance or expenses; (iv) cost of correcting any defects in original construction; (v) costs paid to any affiliates or other parties related to Landlord for services or materials to the extent such costs are in excess of the amount which would be paid to an unrelated third party at market prices for such materials or services; (vi) any amounts payable by Landlord as a result of Landlord's failure to perform its obligations on a timely basis including fines, penalties, late fees and overtime expenses, to the extent such amounts exceed the costs that Landlord would have incurred in the absence of such failure to perform; (vii) rent or any other payments due pursuant to a ground lease; (viii) repairs, construction or any other costs necessary to remedy violations of laws in effect as of the date of this Lease and requiring compliance at any time during the term of the Lease; (ix) costs necessary to bring the Building or any other portion of the Property into compliance with the requirements of ADA, as such requirements exist on the date of Substantial Completion and as such requirements should be reasonably interpreted by Landlord based upon currently existing case law and regulations; (x) any costs related to the wages and fringe benefits payable to any employees above the level of property manager; (xi) management fees in excess of three percent of Rent; (xii) costs incurred in connection with the sale, financing or refinancing of the Premises; (xiii) all capital costs, except as permitted in Section 2.3(a); (xiv) costs associated with the operation of the business of the partnership or entity which constitutes Landlord as the same are distinguished from the costs of operation of the Building or the Property, including partnership accounting and legal matters to the extent such accounting and legal matters do not relate to the operation of the Building or the Property, costs of selling, syndicating, or hypothecating any of Landlord's interest in the Property, costs of any disputes between Landlord and its employees (if any) whether engaged in Property operation or not; (xv) reserves, unless they are applied to the Operating Expenses or returned to Tenant at Lease termination; and (xvi) the cost of any performance bond Landlord acquires for the Structural Maintenance Obligations during the first ten (10) years after Substantial Completion.

(d) Tenant shall pay as and when due all taxes levied against personal property and trade fixtures in the Premises.

(e) Tenant, at Tenant's cost, shall have the right to contest Taxes, so long as such contest does not expose Landlord or the Property to any risk of any delinquent liens for Taxes or any civil or criminal penalties. Landlord will cooperate with any such contest at Tenant's expense.

(f) Within one hundred twenty (120) days after Tenant receives Landlord's Operating Expenses statement, Tenant may contest such statement by providing written notice to Landlord. If no such contest is made by written notice to Landlord within such 120-day period, such Operating Expenses statement shall be binding upon Tenant in all respects. If Tenant timely contests such Operating Expenses statement, Tenant shall have the right to inspect and examine, at reasonable times during normal business hours, Landlord's books of account and records pertaining to the Operating Expenses, all at Tenant's sole cost and expense. Such audit shall be conducted at the offices of the Building manager where such records are kept within thirty (30) days after the date of Tenant's notice. Such audit shall be conducted by Tenant or by a certified public accountant

retained by Tenant, at its expense (except as otherwise expressly provided herein), whose compensation is not contingent upon the results of such accountant's audit or the amount of any refund received by Tenant. Tenant shall notify Landlord of the results of such audit in writing. Landlord may have an agent or employee present during such inspection and audit. Landlord shall have the right to dispute the results of Tenant's audit. Any such dispute shall be resolved by a certified public accountant mutually satisfactory to Landlord and Tenant, or selected by the American Arbitration Association if Landlord and Tenant cannot agree on the identity of such accountant. If the audit by Tenant shall ultimately result in Landlord and Tenant agreeing that Tenant has overpaid Landlord for Operating Expenses, such overpayment shall be applied to the next accruing installment(s) of Additional Rent due from Tenant, until such credit is depleted or refunded by Tenant if this Lease has expired or been terminated. If the audit by Tenant shall ultimately result in Landlord and Tenant agreeing that Tenant has overpaid Landlord for Operating Expenses in excess of five percent (5%) of the amount Tenant should have paid, Landlord will reimburse Tenant for the reasonable, actual out-of-pocket costs incurred by Tenant in performing the audit, up to a maximum amount of \$10,000. Tenant hereby agrees to keep the results of any such audit confidential, and to require Tenant's auditor and its employees and each of their respective attorneys and advisors to likewise keep the results of such audit in strictest confidence. In particular, but without limitation, Tenant agrees that: (i) Tenant shall not disclose the results of any such audit to any prospective tenant of the Building; and (ii) Tenant shall require, that its auditors, attorneys and anyone associated with such parties shall not disclose the results of such audit to any past, current or prospective tenant of Landlord in the Building; provided, however, that Landlord hereby agrees that nothing in items (i) or (ii) above shall preclude Tenant from disclosing the results of such audit in any judicial or quasi-judicial proceeding, or pursuant to court order or discovery request, pursuant to any required public disclosure, in response to any public disclosure first made by Landlord or to any current or prospective assignee or sublessee of Tenant, or to any agent, representative, or employee of Landlord who or which requests the same.

**2.4 LATE PAYMENT CHARGE; DEFAULT INTEREST.** Other remedies for nonpayment of rent notwithstanding, if the monthly rental payment or any other payment due Landlord by Tenant is not received by Landlord on or before the fifth (5th) business day after written notice of nonpayment, a late payment charge of five percent (5%) of such past due amount, shall become due and payable, in addition to any other amounts owed under this Lease. Notwithstanding the foregoing, with respect to the first late payment in any twelve (12) month period, no late charges shall be due if Tenant pays the past due amount within five (5) business days after Landlord's notice that such payment is past due. Any further late payments during such twelve (12) month period shall incur the late charges described above without any notice or cure right. Such late payment charge is not intended as a penalty, but instead is intended to compensate Landlord for the additional administrative expenses resulting from any such late payment and which shall be paid on demand. In addition, any sum not paid within thirty (30) days of its due date shall accrue interest thereafter until paid at the rate per annum equal to the lesser of (a) the "prime rate," as published from time to time in The Wall Street Journal plus four percent (4%), or (b) the maximum rate permitted by applicable law.

**2.5 HOLDING OVER.** In the event of holding over by Tenant after the end of the Term, the hold over shall be as a month-to-month tenant and Tenant shall otherwise be subject to

all the covenants and provisions of this Lease insofar as the same are applicable to a tenant at sufferance, including, without limitation, the payment of Additional Rent. Tenant shall pay Landlord, on demand, as monthly rent for the first six (6) months of such holdover period an amount equal to 110% of the Base Rent payable during the last month of the Term prior to the holdover plus 100% of Additional Rent. From and after such six (6) month period, Tenant shall pay Landlord, on demand, as monthly rent for any additional holdover period an amount equal to 150% of the Base Rent payable during the last month of the Term prior to the holdover plus 100% of Additional Rent. Tenant shall not be liable to Landlord for any consequential damages incurred by Landlord resulting from delay by Tenant in so surrendering the Premises, including any claims made by any succeeding tenant or prospective tenant founded upon such delay.

## **2.6 NET LEASE.**

(a) This is a net lease and, except as otherwise expressly set forth in Sections 1.2, 7.1(b), 8.1 and 10.4, the Base Rent, Additional Rent and all other sums payable hereunder by Tenant, shall be paid without notice or demand, and without any setoff, counterclaim, abatement, suspension, deduction or defense. Except as otherwise expressly provided in this Lease, this Lease shall not terminate, nor shall Tenant have any right to terminate this Lease, nor shall Tenant be entitled to any abatement or reduction of rent hereunder, nor shall the obligations of Tenant under this Lease be affected, by reason of (i) any damage to or destruction or removal of all or any part of the Premises, for any reason whatsoever (including, without limitation, fire, casualty, condemnation or acts of God or enemy), (ii) the prohibition, limitation or restriction of Tenant's use of all or any part of the Premises, or any interference with such use, (iii) any eviction of Tenant from or loss of possession by Tenant of all or any part of the Premises by paramount title or otherwise, (iv) Tenant's acquisition or ownership of all or any part of the Premises, (v) any default by Landlord under this Lease or under any other agreement, (vi) the invalidity or unenforceability of any provision hereof, or (vii) any other cause whether similar or dissimilar to the foregoing, any present or future Laws to the contrary notwithstanding. The obligations of Tenant hereunder are separate and independent covenants and agreements and shall continue unaffected, unless the requirement to pay or perform the same shall have been modified or terminated pursuant to an express provision of this Lease. Except for construction of the Phase 1 Improvements (as defined in *Exhibit B*) and repairs which are Landlord's responsibility pursuant to the terms of Sections 5.1, 7.1(a), Article 8 and *Exhibit B*, Tenant at its sole cost and expense, shall be responsible for the payment of any and all costs and expenses, whether general or special, foreseen or unforeseen, ordinary or extraordinary, related to the repair, maintenance, replacement and operation of the Premises and as may be necessary to maintain the Premises in good order and repair.

(b) Tenant covenants to remain obligated under this Lease and to take no action to terminate, rescind or avoid this Lease, notwithstanding (i) the bankruptcy, insolvency, reorganization, composition, readjustment, liquidation, dissolution, winding-up or other proceeding affecting Landlord or any assignee of Landlord, and (ii) any action with respect to this Lease which may be taken by any trustee or receiver of Landlord or any assignee of Landlord or by any court, provided Tenant's use of and access to the Premises is not materially adversely affected.

(c) Except as otherwise expressly provided in this Lease, including without limitation in Sections 7.1(b), 8.1, and 12.20, Tenant waives all rights now or hereafter by Law (i) to quit, terminate or surrender this Lease or the Premises or any part thereof, or (ii) to any setoff, abatement, suspension, deferment or reduction of the Base Rent, Additional Rent or any other sums payable under this Lease.

(d) Base Rent, Additional Rent and each and every other charge, fee, cost, or expense which Tenant is obligated to pay, refund or reimburse Landlord hereunder shall, for the purposes of the default provisions of this Lease, be deemed rent due from Tenant, and Tenant's failure to so pay, refund or reimburse when due (beyond all applicable cure periods) shall entitle Landlord to all the remedies provided for herein and at law or in equity on account of failure to pay rent.

(e) Landlord acknowledges that, in connection with Tenant's operation of the Property, Tenant has obtained, and may from time to time in the future pursue, certain tax and other incentives, credits, rebates, benefits, offsets and allowances available to Tenant or Landlord in relation to the Property from the State of South Carolina or any political subdivision thereof, including, without limitation, the incentives provided pursuant to the Fee Agreement (collectively, the "Incentives"). Landlord hereby agrees to reasonably cooperate with Tenant, at Tenant's sole cost and expense, to further Tenant's pursuit and realization of the Incentives, and to execute, acknowledge (where necessary), and deliver such further documents, and perform such further acts, as may be reasonably necessary to obtain such Incentives; however, Landlord shall not be required to incur any liability or any cost (other than costs paid by Tenant). Landlord shall take no action which, to the knowledge of Landlord, will result in any material delay or reduction in the Incentives available to Tenant. Any Incentives actually received or paid to Landlord shall be applied against the Project Costs or Operating Expenses, as applicable.

(f) Tenant shall file or cause to be filed, on a timely basis, all property tax returns required in connection with the Property, including, but not limited to, Form SCDOR PT-300 or such comparable form as the South Carolina Department of Revenue may provide. Landlord hereby agrees to reasonably cooperate with Tenant, at Tenant's sole cost and expense, with respect to any such filings, and hereby agrees to execute, acknowledge (if necessary) and deliver such further documents or information, and to perform such further acts, as may be reasonably necessary for any such filings. Landlord shall take no action which would unduly delay Tenant's filing of any state or local property tax returns pursuant to this Section. However, Landlord shall not be required to incur any liability or any cost (other than costs paid by Tenant). For avoidance of doubt, Landlord will not have any liability to Tenant under these subsections (e) and (f) for any delay in construction of the Project or any delay in Substantial Completion.

**2.7 TRUE LEASE.** Landlord and Tenant agree that this Lease is a true lease and does not represent a financing arrangement. Each party shall reflect the transaction represented hereby in all applicable books, records and reports (including income tax filings) in a manner consistent with "true lease" treatment rather than "financing" treatment.

## ARTICLE 3

### OCCUPANCY AND USE

**3.1 USE.** Tenant warrants and represents to Landlord that the Premises shall be used and occupied for general office purposes, a call center and for lawful purposes ancillary thereto, all in a manner consistent with the zoning for the Property and any recorded land use restrictions (the "Principal Intended Use"), and for no other purpose. Tenant shall occupy the Premises, conduct its business and use reasonable efforts to control its agents, employees, invitees and visitors in such a manner as is lawful, reputable and will not create any nuisance. Tenant shall not commit or permit any waste on the Premises or permit the Premises to be used in any way which would be extra hazardous on account of fire or which would in any way increase or render void the insurance on the Building. Subject to any Laws, Tenant shall have the right to access the Premises twenty-four (24) hours a day, seven (7) days a week.

**3.2 SIGNS.** Tenant may erect, place or paint signs on the exterior of the Building and elsewhere on the Premises (other than the roof of the Building, except as provided in the Approved Plans (as defined in the Work Agreement) or permitted under Section 6.2), provided (i) that such signs comply in all respects with Laws and any applicable recorded restrictions, and (ii) Tenant's installation, use, operation, maintenance and / or replacement of such signage shall not, and shall only be permitted by Landlord to the extent it does not, (A) interfere with any of the Building systems, (B) violate any of Landlord's warranties, (C) increase any costs to Landlord under Section 5.1, or (D) reduce the useful life of any improvement, fixture, equipment or property that Landlord is responsible for maintaining under any warranty, including the warranties set forth in *Exhibit B* or Section 5.1. Tenant shall cause any such signs to be removed at the end of the Term, at Tenant's sole cost, and Tenant will repair any damage to the Building caused by such removal. As to any signs that are installed as part of the Phase 1 Improvements (as defined in *Exhibit B*), Tenant shall cause any identification panels to be removed at the end of the Term, at Tenant's sole cost, and shall repair any damage to the Building caused by such removal, but Tenant shall not be required to remove the sign structures (exclusive of any identification panels).

**3.3 COMPLIANCE WITH LAWS, RULES AND REGULATIONS.** Subject to Landlord's obligations set forth in this Lease, at Tenant's sole cost and expense, Tenant shall comply with all Laws and the requirements of the Declaration relating to the use, condition and occupancy of the Premises.

**3.4 WARRANTY OF POSSESSION.** Landlord warrants that it has the right and authority to execute this Lease, and Tenant, upon payment of the required rents and subject to the terms, conditions, covenants contained in this Lease and any SNDA (as defined below) to which Tenant is a party, shall have quiet enjoyment of the Premises during the Term. Landlord will warrant and defend Tenant against the claims of all persons claiming by, through or under Landlord, but not otherwise.

**3.5 INSPECTION.** Landlord or its authorized agents shall at any and all reasonable times, upon at least 24 hours prior notice to Tenant (which notice shall not be required in any emergency, may be written or telephonic, and if telephonic, shall be to such contact and telephone



number as Tenant may specify by at least five (5) days' written notice to Landlord), have the right to enter the Premises to inspect the same, to show the Premises to prospective purchasers, lenders or tenants (but as to prospective tenants, only during the last twelve (12) months of the Term), and to perform any repairs required of Landlord hereunder. Tenant hereby waives any claim for damages for injury or inconvenience to or interference with Tenant's business, any loss of occupancy or use of the Premises, and any other loss occasioned thereby, unless caused by the gross negligence or willful misconduct of Landlord, its employees, agents or contractors; provided, however, Landlord shall use reasonable efforts not to interfere with Tenant's use of or access to the Premises or Tenant's business operations.

**3.6 USE OF ROOF.** Tenant shall be entitled to install, operate and maintain (i) microwave antennas or satellite dishes as well as cabling, conduits, piping and fiber options related to such equipment (collectively, the "**Antenna**"), and (ii) solar panels and related equipment (collectively, the "**Solar Panels**"; and together with the Antenna, the "**Roof Equipment**"), at its sole cost and expense (and not to be included in the Project Costs), on the rooftop of the Building. Tenant shall be entitled to retain any financial benefits from the installation of any third party Roof Equipment in accordance with the terms of this Section. Landlord shall have the right to approve the location, method of installation, size, aesthetics and shielding requirements of the Roof Equipment. Tenant, at all reasonable times and subject to such reasonable rules and regulations as Landlord may promulgate, shall have the right to enter or leave the rooftop for the purpose of accessing the Roof Equipment. Tenant shall obtain all necessary municipal, state and federal permits and authorizations to install, maintain and operate the Roof Equipment and pay any charges levied by governmental agencies in connection therewith. At the expiration of the Term, if requested by Landlord in writing prior to the expiration of the Term, Tenant shall remove the Roof Equipment and surrender and restore the space occupied thereby to Landlord in substantially as good as condition as when received, reasonable wear and tear and damage by casualty and condemnation excepted. Tenant agrees to indemnify and hold Landlord harmless from and against any and all losses, liabilities, costs and damages suffered by Landlord on account of Tenant's use of the Roof Equipment, including without limitation to any damage to the roof caused by the installation or use of the Roof Equipment. Tenant's use of the rooftop for the Roof Equipment shall be free of charge, and Landlord shall not charge Tenant any additional rent for such use. Notwithstanding anything herein to the contrary, Tenant's installation, use, operation, maintenance and or replacement of the Roof Equipment shall not, and shall only be permitted by Landlord to the extent it does not, (i) interfere with any of the Building systems, (ii) violate any of Landlord's warranties (including the roof warranty), (iii) increase any costs to Landlord under Section 5.1, or (iii) reduce the useful life of the roof or any other improvement, fixture, equipment or property that Landlord is responsible for maintaining under any warranty, including the warranties set forth in *Exhibit B*, or Section 5.1. The provisions of this Section 3.6 shall survive for a period of one (1) year from the expiration or earlier termination of this Lease.

## ARTICLE 4

### BUILDING SERVICES

(a) Notwithstanding anything to the contrary herein, except as set forth in Sections 5.1, 6.1, 7.1 and Article 8, Landlord has no obligation to perform or provide any management, repair, maintenance, replacement, operation or other services for the Project.

(b) Failure by Landlord to any extent to furnish or cause to be furnished any services, or any cessation thereof, shall not render Landlord liable in any respect to Tenant, or Tenant's agents, licensees, invitees or other visitors to the Premises or the Property, for damages to either person or property or for consequential damages of any nature, be construed as a constructive or actual eviction of Tenant, work an abatement of rent or relieve Tenant from fulfillment of any covenant in this Lease. If any component of the Project breaks down, or for any cause ceases to function properly, and Landlord is responsible for maintaining that components pursuant to the terms of Section 5.1 hereof, Landlord shall use reasonable diligence to repair the same promptly, but Tenant shall have no claim for abatement or rebate of rent on account of any interruption in service occasioned from the repairs.

## ARTICLE 5

### REPAIRS AND MAINTENANCE; UTILITIES

**5.1 LANDLORD REPAIRS.** Landlord shall not be required to make any improvements, replacements or repairs of any kind or character to the Premises, Building or Property during the Term, except such initial improvements (and subsequent warranty claim repairs that Landlord is required to make under Section 3.02 of *Exhibit B*) as are described in *Exhibit B* and the repairs and replacements as are set forth in this section. Landlord shall keep and maintain in accordance with all Laws and in good order and condition, repair and replace (if necessary) (a) the structural components of the Building, including, but not limited to, the foundation, floor slab (excluding regular floor cleaning and maintenance), the structural components of the exterior walls, and roof structure, (b) roof membrane systems, (c) windows, (d) utility lines, conduits and pipes to the termination point at the Building, including the main disconnect switch for electricity and the demarcation room for communications lines, and (e) exterior pavement areas. In the event that any repair or replacement which is the responsibility of Landlord under this Section 5.1 is necessitated by the negligence or misconduct of Tenant or Tenant's agents, employees, licensee or invitees, other than HPI (if HPI is Tenant's contractor under the Tenant Maintenance Obligations Agreement), Tenant shall reimburse Landlord for the actual cost of such repair or replacement within thirty (30) days of receipt of an invoice therefor, and such reimbursement shall constitute Additional Rent under this Lease. Landlord shall not be liable to Tenant, or Tenant's agents, licensees, invitees or other visitors to the Premises, Building or Property, except as expressly provided in this Lease, for any damage to person or property or inconvenience, or for consequential damages of any nature, and Tenant shall not be entitled to any abatement or reduction of rent by reason of any repairs, replacements, alterations or additions made or to be made by Landlord in accordance with Landlord's maintenance, repair and replacement obligations hereunder.

**5.2 TENANT REPAIRS AND OTHER SERVICES; PROPERTY MANAGEMENT.** Except for those repairs to be made by Landlord pursuant to Article 4 and Section 5.1 above, Tenant shall, at its sole cost and expense, maintain the Premises in good order and repair, reasonable wear and tear and damage by casualty and condemnation excepted, including,

but not limited to, all repairs and replacements reasonably necessary to keep the Premises in good condition, general or special, ordinary or extraordinary or foreseen or unforeseen and regardless of how the need for such repairs, replacements and maintenance arose, including but not limited to those instances of repair or replacement where the expenses thereof would be deemed capital in nature. Tenant shall also be solely responsible for the payment of all costs and expenses related to the operation of the Premises in good order and repair, and related to the provision of all services to the Building, including but not limited to, the following expenses (subject to Landlord's obligations under Section 5.1): (a) costs of performing all services necessary for the operation, maintenance, replacement and repair of the Building, including but not limited to costs of trash removal, security service and other services for the Building and Property, whether or not the services are billed directly to Tenant; (b) costs of maintaining, replacing and repairing Building mechanical, electrical, plumbing, sewer, storm water, life safety and other systems (other than those utility lines, conduits and pipes that Landlord is responsible for repairing and replacing pursuant to Section 5.1(d) above); and (c) costs of performing all services necessary for the operation and maintenance of the Property, including without limitation the parking lot, driveways, medians and landscaped areas (the "*Tenant Maintenance Obligations*"). Tenant shall be entitled to select the service providers of its choice.

Tenant may engage HPI to perform the Tenant Maintenance Obligations pursuant to a certain Tenant Maintenance Obligations Agreement between Tenant and HPI (the "*Tenant Maintenance Obligations Agreement*"). Landlord acknowledges and agrees that during the period in which HPI is performing the Tenant Maintenance Obligations (i) Landlord shall simultaneously provide notice to HPI of any alleged defaults of Tenant under this Section, (ii) the notice and cure period for such defaults under this Lease shall be extended by any notice and cure period under the Tenant Maintenance Obligations Agreement, and (iii) any failures by HPI to perform its responsibilities under the Tenant Maintenance Obligations Management Agreement, including routine maintenance, shall not relieve Landlord of any obligations under this Lease.

**5.3 TENANT DAMAGES.** Tenant shall not permit or cause any waste to any portion of the Premises, Building or Property. At the termination of this Lease, by lapse of time or otherwise, Tenant shall deliver the Premises to Landlord, broom-clean, in good order and repair, ordinary wear and tear and damage by casualty and condemnation and repairs which are the responsibility of Landlord hereunder excepted. The cost and expense of any repairs necessary to restore the condition of the Premises as required by the preceding sentence shall be borne by Tenant. Within ten (10) days of the expiration or termination of this Lease, Landlord shall tour the Premises with a Tenant representative to estimate any reasonable restoration costs. Landlord shall submit the line-item estimation within ten (10) business days of completion of such joint tour.

**5.4 PAYMENT FOR UTILITIES.** During the Term, Tenant shall pay, when due, all charges of every nature, kind or description for utilities furnished to the Premises or chargeable against the Premises, including all charges for water, sewage, heat, gas, light, garbage, electricity, telephone, steam, power, or other public or private utility services; provided, however, Landlord shall be obligated to provide the infrastructure for the Premises to receive all such utilities (including, without limitation, water, sewer, electrical and telephone lines) to the extent set forth in *Exhibit B-1* attached hereto.

**5.5 UTILITIES.** From and after the Commencement Date, Tenant shall be responsible for contracting directly with all suppliers of utility services. In the event that any charge or fee is required by the State of South Carolina, or by any agency, subdivision or instrumentality thereof, or by any utility company or other entity furnishing services or utilities to the Premises, as a condition precedent to furnishing or continuing to furnish utilities or services to the Premises, such charge or fee shall be deemed to be a utility charge payable by Tenant. The inability of Tenant to obtain, or any stoppage of, the utility services referred to in this Section resulting from any cause shall not make Landlord liable in any respect for damages to any person, property or business, or entitle Tenant to any abatement of Rent or other relief from any of Tenant's obligations under this Lease; provided, however, in the event that any of the essential services to the Premises (consisting of electricity, HVAC, water and sewer service) are interrupted and such interruption results in any material portion of the Premises being unusable for the Principal Intended Use and is caused by a matter within Landlord's control and continues for five (5) or more consecutive business days after Tenant notifies Landlord, Tenant shall be entitled to an abatement of Base Rent accruing from and after the expiration of such 5-day period, based on the proportion of the Premises which is not reasonably usable, and is in fact not used, as a result of such interruption.

As part of Tenant's Extra Work, and at Tenant's sole cost and expense, Tenant shall have the right to install one (1) emergency generator on any portion of the Premises outside the Building together with associated fuel tanks, pumping systems and required vertical or other risers to connect the generator to the Premises, provided (i) the location of such generator is approved by Landlord, which approval Landlord may not unreasonably withhold, condition or delay, (ii) Tenant obtains and maintains all applicable governmental permits and approvals, (iii) the generator shall be powered by a diesel or natural gas engine with a self-contained, above-ground fuel tank, with Tenant being responsible for the clean-up and remediation of any spills of diesel fuel, lubricating oils and other hazardous materials, and (iv) the generator shall utilize a hospital grade muffler system, and shall be enclosed with an enclosure of a design and color approved by Landlord, which enclosure shall achieve sound attenuation which limits noise to not more than 50 decibels at seven (7) meters. If installed, Tenant will maintain and repair the generator and all related equipment in good working condition, which maintenance shall include periodic testing.

## ARTICLE 6

### ALTERATIONS AND IMPROVEMENTS

**6.1 LANDLORD IMPROVEMENTS.** Landlord shall construct the Building and improve the Property in accordance with the provisions of *Exhibit B*. All improvements made by Landlord pursuant to *Exhibit B* shall at once become the property of Landlord and shall be surrendered to Landlord upon the expiration or earlier termination of this Lease.

**6.2 TENANT IMPROVEMENTS.** Tenant shall not make or allow to be made any alterations, physical additions or improvements in or to the Premises, or those which are visible from the exterior of the Building, without first obtaining the written consent of Landlord, which consent shall not be unreasonably withheld, conditioned or delayed, except that, upon prior written notice to Landlord, but without first obtaining the written consent of Landlord, Tenant shall be permitted to perform any alterations which (a) are non-structural; (b) do not cause any violation of

and do not require any change in any certificate of occupancy applicable to the Building; (c) do not require a governmental permit, (d) do not affect any item for which Landlord is responsible for the maintenance and repair; and (e) do not affect any Building electrical, mechanical, plumbing, life safety, HVAC or other systems; provided further that if such alteration, physical addition or improvement complies with clauses (a) – (e) above, and the costs of any such alteration, physical addition or improvement is also less than Five Thousand and 00/100 Dollars (\$5,000.00), Tenant shall not be required to provide notice to Landlord. If Landlord's consent is required under this Section 6.2 as to any proposed alterations, additions or improvements, Landlord shall be deemed to have approved such alterations, additions or improvements unless Landlord notifies Tenant of Landlord's disapproval within twenty (20) Business Days after receipt of a notice from Tenant containing Tenant's detailed plans and specifications for the proposed alterations, additions or improvements and a request for consent that includes the following in bold, all caps: **"PURSUANT TO SECTION 6.2 OF THE LEASE, LANDLORD'S CONSENT WILL BE DEEMED GIVEN UNLESS LANDLORD DISAPPROVES THIS REQUEST FOR CONSENT WITHIN TWENTY (20) BUSINESS DAYS."** If Tenant resubmits revised plans and specifications within thirty (30) days after any such disapproval, Landlord will be deemed to have approved such alterations, additions or improvements unless Landlord notifies Tenant of Landlord's disapproval within ten (10) days after receipt of a notice from Tenant containing Tenant's revised detailed plans and specifications for the proposed alterations, additions or improvements, along with a detailed list of all changes made to such revised plans and specifications since the previous submittal and a request for consent that includes the following in bold, all caps: **"PURSUANT TO SECTION 6.2 OF THE LEASE, LANDLORD'S CONSENT WILL BE DEEMED GIVEN UNLESS LANDLORD DISAPPROVES THIS REQUEST FOR CONSENT WITHIN TEN (10) DAYS."** Prior to performing or allowing to be performed any alterations, physical additions or improvements to the Premises, Tenant shall cause each contractor performing any aspect of the work to procure, or Tenant itself shall procure, insurance in form and amount reasonably satisfactory to Landlord and to deliver a certificate of insurance to Landlord that identifies as additional insureds thereunder Landlord and the holder of any mortgage, security deed or deed to secure debt affecting the Premises. For purposes hereof, the insurance for any such contract shall be reasonably satisfactory to Landlord if such insurance consists of (1) a Liability Policy (as hereinafter defined) with minimum limits of at least \$1,000,000.00 per occurrence and \$2,000,000.00 in the aggregate and that otherwise satisfies the requirements pertaining to the Liability Policy set forth in Section 7.4 below, and (2) an umbrella policy with minimum limits of at least \$10,000,000.00 that otherwise satisfies the requirements set forth in Section 7.4 with respect to the Liability Policy; provided, however, if the cost of the work being performed is less than \$150,000.00, the amount of such umbrella policy shall be at least \$2,000,000.00. Landlord shall have the right to alter the amount and types of insurance that such contractors are required to carry (or that Tenant shall be required to carry in lieu thereof) so that such insurance requirements are consistent with the insurance requirements imposed on contractors performing similar work in Comparable Buildings. Tenant shall also cause all such contractors to maintain such insurance throughout the duration of any work in the Premises. Any alterations, physical additions or improvements to the Premises made by Tenant (excluding moveable equipment or furniture of Tenant) shall at once become the property of Landlord and shall be surrendered to Landlord upon the expiration or earlier termination of this Lease; provided, however, if Landlord reasonably considers such alteration, physical addition or improvement incompatible with typical office use or reasonably believes such alteration, physical addition or improvement will negatively

affect the future marketability of the Premises and notifies Tenant within thirty (30) days of receipt of Tenant's plans and specifications as to any intended alterations, additions or improvements, Landlord, at its option, may require Tenant to remove such physical additions and/or alterations and repair any damage caused thereby in order to restore the Premises to the condition as existed on the Commencement Date, all costs of removal and repair to be borne by Tenant. In addition, at the expiration or earlier termination of this Lease, Landlord may require Tenant, at Tenant's expense, to remove any additions and/or alterations made without Landlord's consent and repair any damage caused thereby in order to restore the Premises to the condition as existed on the Commencement Date. Tenant shall be responsible for obtaining, at its cost, all permits required as to any alterations or improvements made by or on behalf of Tenant. Tenant shall provide a copy of such permits to Landlord prior to starting work. Upon completion of any permitted alterations, physical additions or improvements (except for those that are only decorative in nature), Tenant shall provide Landlord with copies of as-built plans or drawings with respect to such alterations, physical additions or improvements, as well as operation and maintenance manuals for any non-moveable equipment installed in the Premises. Tenant shall not do or permit to be done any act which results in a lien being filed against the Premises or Property. Tenant shall have no authority, express or implied, to create any lien, charge or encumbrance upon the interest of Landlord in the Premises or Property. Following completion of any alterations, additions or improvements costing more than \$50,000, Tenant shall deliver Landlord evidence reasonably satisfactory to Landlord that no liens or other encumbrances have resulted from such alterations, additions or improvements.

## ARTICLE 7

### CASUALTY AND INSURANCE

#### 7.1 FIRE AND CASUALTY DAMAGE.

(a) **Restoration by Landlord.** If the Premises or any portion thereof is damaged or destroyed by any casualty, Landlord shall, within a reasonable time after the date of such destruction or damage, subject Section 7.1(b) and subject to force majeure or to any delay caused by Tenant, restore the Premises to as near the same condition as existed prior to such damage or destruction. Except as set forth in Section 7.1(b) below, in no event shall Rent abate nor shall Tenant be entitled to terminate this Lease on account of any such damage or destruction of the Premises.

(b) **Termination.** In the event the Premises are damaged or destroyed and such damage or destruction cannot be restored within twelve (12) months from the date of such damage or destruction, as determined by Landlord in Landlord's reasonable judgment, or if any mortgagee of the Building or Property requires that the insurance proceeds be applied to the payment of the mortgage debt, or if a material uninsured loss to the Building occurs, Landlord shall have the right, at Landlord's option, to terminate this Lease by giving Tenant notice of such termination within ninety (90) days after the date of such damage or destruction. Landlord will notify Tenant as promptly as is reasonably practicable after such damage or destruction (but in any event within ninety (90) days after the date of such damage or destruction) as to Landlord's good faith estimate of the time period to restore such damage. If the Premises or any portion thereof is damaged or destroyed by any casualty, and if, in Tenant's reasonable opinion, the Premises cannot be restored within twelve (12) months after the date of such damage or destruction, then Tenant shall have the

right to terminate this Lease by giving written notice to Landlord within ninety (90) days after such damage or destruction. If this Lease is not terminated pursuant to the terms hereof, Landlord will commence such repairs after the expiration or waiver of all termination rights under this Section and, thereafter, diligently pursue such repairs to completion. Notwithstanding the foregoing, Tenant shall not have the right to terminate this Lease if damage to or destruction of the Premises is the result of a willful act of Tenant, or Tenant's agents, employees, representatives, contractors, successors or assigns, licensees or invitees. If this Lease is not terminated in accordance with this Section, Rent shall be abated in proportion to the degree to which Tenant's use of the Premises is impaired, as of the date of damage or destruction, except as set forth in the immediately preceding sentence.

**7.2 WAIVER OF SUBROGATION.** Anything in this Lease to the contrary notwithstanding, each party (the "Waiving Party") hereby waives and releases the other party (the "Benefiting Party") of and from any and all rights of recovery, claim, action or cause of action, against the Benefiting Party, its partners, agents, officers and employees, for any loss or damage that may occur to the Premises or Property, or personal property within the Building, which is insured or is required to be insured by Waiving Party pursuant to the terms hereof regardless of cause or origin, including negligence of Landlord or Tenant and their partners, agents, officers and employees. The Waiving Party agrees to give immediately to its insurance companies which have issued policies of insurance covering any risk of direct physical loss, written notice of the terms of the mutual waivers contained in this Section 7.2, and to have the insurance policies properly endorsed, if necessary. The Waiving Party acknowledges that the waivers and releases set forth in this Section 7.2 are intended to result in any loss or damage which is covered by insurance or required to be insured by the Waiving Party being borne by the insurance carrier of the Waiving Party, as by the party having the insurable interest if such loss is not covered by insurance and this Lease required such party to maintain insurance to cover such loss.

**7.3 HOLD HARMLESS.**

(a) Neither Landlord, its agents, servants, employees, any other holder of any deed to secure debt or mortgage nor the lessor under any superior lease shall be liable to Tenant, or to Tenant's employees, agents, invitees, licensees, contractors or visitors, or to any other person, for any injury to person or damage to property or for consequential, incidental, indirect, special or punitive damages of any nature on or about the Premises or Property, caused by any act or omission of Tenant, its agents, servants or employees, or of any other persons entering upon the Premises or Property under express or implied invitation by Tenant, or caused by the Premises or Property or the improvements located thereon becoming out of repair, the failure or cessation of any service provided by Landlord, or caused by leakage of gas, oil, water or steam or by electricity emanating from the Premises or Property; provided, however, Landlord shall be liable for actual damages resulting from the gross negligence or willful misconduct of Landlord or Landlord's agents, servants, representatives, employees, contractors, invitees or licensees.

(b) Except if resulting from the gross negligence or willful misconduct of Landlord, or its employees, contractors, agents, representatives, servants, invitees or licensees, subject to Section 7.2 above, Tenant agrees to indemnify, defend and hold harmless Landlord, its

agents, servants, employees, any holder of any deed to secure debt, deed of trust or mortgage of and from any losses, reasonable attorney's fees, expenses or claims (i) arising out of any damage or injury of any kind caused by the negligence or willful misconduct of Tenant, or any of its agents, servants, employees, contractors, subtenants, assignees or invitees, and/or (ii) resulting from the use or occupancy of the Premises by Tenant or any of its agents, servants, employees, contractors, subtenants, assignees or invitees.

(c) Subject to Sections 7.2 and 7.3(a) above, Landlord agrees to indemnify, defend and hold harmless Tenant, its agents, servants or employees of and from any losses, reasonable attorney's fees, expenses or claims resulting from any damage or injury caused by the gross negligence or willful misconduct of Landlord, or any of its agents, servants, employees, contractors, subtenants, assignees or invitees.

(d) The provisions of this Section 7.3 shall survive the expiration or earlier termination of this Lease.

**7.4 TENANT'S INSURANCE.** Tenant covenants and agrees to provide at its expense before the earlier to occur of the Commencement Date or the commencement of any work by Tenant under *Exhibit B*, and to keep in force at all times (i) a commercial general liability insurance policy (hereinafter referred to as a "Liability Policy") written on an "occurrence basis" including contractual liability coverage, property damage, independent contractor's coverage and personal injury coverage, naming Landlord, its managing agent and the holders of any deeds of trust or mortgages, as additional insured, and Tenant against any liability, occasioned by any occurrence on or about the Premises; (ii) a Causes of Loss – Special Form or "All Risk" Property policy insuring the improvements installed by Tenant before or after the Commencement Date and all of the furniture, trade fixtures and other personal property of Tenant located in the Premises, with a waiver of subrogation in favor of Landlord; (iii) Worker's Compensation policy covering all costs, benefits and liabilities under state worker's compensation and similar Laws with statutory limits for employees of Tenant, with a waiver of subrogation in favor of Landlord; (iv) Employer's Liability Insurance with limits of \$1,000,000.00 per accident or disease and \$1,000,000.00 aggregate by disease; and (v) Motor Vehicle Liability with coverage for all owned and non-owned and hired vehicles with combined single limits of \$1,000,000.00. Such policies shall be written by insurance companies licensed to do business in the State of South Carolina with an A.M. Best Company financial and performance rating of A-: VIII or better. As of the date of this Lease, Landlord reasonably requires limits of liability under the Liability Policy of \$1,000,000 per occurrence and in the aggregate and umbrella coverage totaling \$10,000,000.00 in the aggregate, subject to increase from time to time upon request by Landlord consistent with commercially reasonable standards. Prior to the time such insurance is first required to be carried by Tenant and thereafter prior to the expiration date of any such policy, Tenant agrees to deliver to Landlord certificates evidencing such insurance coverage. Said certificate shall be on ACORD Form and shall contain an endorsement that such insurance may not be canceled except upon thirty (30) days' prior written notice to Landlord and any designated mortgagee. All policies must contain a waiver of subrogation of claims against Landlord and/or Landlord's insurer, a severability of interest clause, a cross-liability clause and shall be primary and shall not provide for contribution of any other insurance available to Landlord, its managing agent or the holders of any such deeds of trust or mortgages. Notwithstanding anything



to the contrary contained in this Lease, the carrying of insurance by Tenant in compliance with this Section 7.4 shall not modify, reduce, limit or impair Tenant's obligations and liabilities under Section 7.3 hereof.

**7.5 LANDLORD'S INSURANCE.** Landlord covenants and agrees to provide, at its expense, but subject to inclusion in the Operating Expenses, on or before the Commencement Date and to keep in force during the Term (i) a commercial general liability insurance policy or successor comparable form of coverage written on an occurrence basis, including contractual liability coverage, property damage, independent contractor's coverage and personal injury coverage, with limits equal to those customarily carried by landlords of Comparable Buildings (subject to commercially reasonable deductibles), and naming Tenant as an additional insured; and (ii) a Causes of Loss – Special Form or "All Risk" property policy insuring the Building against loss or damage by fire, theft and such other risks or hazards, in an amount not less than the full replacement cost of the Building, exclusive of the foundation, with a waiver of subrogation in favor of Tenant and subject to commercially reasonable deductibles (the "Property Policy"). Such policies shall be written by insurance companies licensed to do business in the State of South Carolina with an A.M. Best Company financial and performance rating of A-: VIII or better. Prior to the time such insurance is first required to be carried by Landlord and thereafter prior to the expiration date of any such policy, Landlord agrees to deliver to Tenant a certificate evidencing such insurance coverage. Said certificate shall be on ACORD form. All policies must contain a waiver of subrogation against Tenant and/or Tenant's insurer, a severability of interest clause, and a cross-liability clause and shall be primary and shall not provide for contribution of any other insurance available to Landlord, its managing agent or the holders of any such deeds of trust or mortgages. The carrying of insurance by Landlord in compliance with this Section 7.5 shall not modify, reduce, limit or impair Landlord's obligations and liabilities under this Lease. Either the insurance provider or Landlord will notify Tenant at least thirty (30) days' prior to cancelation of any insurance required to be maintained by Landlord hereunder.

## ARTICLE 8

### CONDEMNATION

**8.1 SUBSTANTIAL TAKING.** If the entire Premises or all or a material portion of the Building or more than twenty percent (20%) of the parking areas serving the Building is taken (and reasonably comparable substitute parking within reasonable proximity to the Premises is not provided by Landlord in the form of surface parking or a parking deck) for any public or quasi-public use under any Laws, or by right of eminent domain or by purchase in lieu thereof, and the taking would prevent or materially interfere with the use of the Premises as set forth in Section 3.1, then either party may terminate this Lease upon notice to the other within ninety (90) days of the taking, and the rent shall be abated during the unexpired portion of the Term effective on the date physical possession is taken by the condemning authority. If this Lease is terminated as provided herein, Landlord shall be entitled to the entire award paid by the condemning authority. Tenant shall have the right to make a separate claim for its moving expenses, leasehold improvements and leasehold estate, so long as Tenant's award does not reduce Landlord's award.

**8.2 PARTIAL TAKING.** In the event a portion of the Premises shall be taken for any public or quasi-public use under any governmental law, ordinance or regulation, or by right of eminent domain or by purchase in lieu thereof, and this Lease is not terminated as provided in Section 8.1 above, Landlord shall restore and reconstruct the Buildings and other improvements on the Premises; provided, however, that Landlord shall not be required to expend more than the condemnation award received by Landlord. Such restoration shall be performed in accordance with plans and specifications prepared by Landlord and approved by Tenant, and shall be performed by a contractor reasonably approved by Landlord, in a good and workmanlike manner, using new, first-class materials. All compensation for any such taking (or the proceeds of private sale in lieu thereof) of the Premises shall be the property of Landlord. If applicable, Tenant shall have the right to make a separate claim for its leasehold improvements, so long as Tenant's award does not reduce Landlord's award.

## **ARTICLE 9**

### **ASSIGNMENT OR SUBLEASE; RIGHTS OF MORTGAGEES**

**9.1 LANDLORD ASSIGNMENT.** Landlord shall have the right to sell, transfer or assign, in whole or in part, its rights and obligations in this Lease and in the Premises. Any such sale, transfer or assignment shall operate to release Landlord from any and all liabilities under this Lease arising after the date of such sale, transfer or assignment, provided that the transferee agrees in writing to assume all of Landlord's obligations hereunder. Notwithstanding anything herein to the contrary, Landlord shall have no right to (i) sell any portion of the Property for a period of one (1) year after the Commencement Date, except in connection with a condemnation or taking in accordance with ARTICLE 8, or (ii) place a mortgage loan on the Property, which loan is in excess of eighty-five percent (85%) of the "as-stabilized" value of the Property, provided clause (ii) shall not apply to any loan that satisfies clause (ii) as of the closing of such loan.

### **9.2 TENANT ASSIGNMENT OR SUBLEASE.**

(a) Without first obtaining Landlord's consent, Tenant shall not assign, in whole or in part, this Lease, or allow it to be assigned, in whole or in part, by operation of law or otherwise (including without limitation by transfer of a controlling interest of stock, partnership interests or other ownership interests, merger, or dissolution, which transfer of majority interest of stock, partnership interests or other ownership interests, merger or dissolution shall be deemed an assignment) or mortgage, encumber or pledge the same, or sublet the Premises, in whole or in part, or allow all or a portion of the Premises to be used by a third party (except as may be permitted by Section 9.2(b) or Section 9.3 below). In no event shall any such assignment or sublease ever release Tenant or any guarantor from any obligation or liability hereunder. No assignee or subtenant of the Premises or any portion thereof may assign or sublet the Premises or any portion thereof except pursuant to the terms of Section 9.3 below. Landlord will not unreasonably withhold, condition or delay its consent to a proposed assignment. In determining the reasonableness of Landlord's decision to withhold or grant its consent to any proposed assignment, Landlord may take into consideration all relevant factors surrounding the proposed assignment or sublease, including, without limitation, the following: (i) the business reputation of the proposed assignee and its officers and directors; (ii) the nature of the business and the proposed use of the Premises by the proposed assignee; and

(iii) the financial condition and creditworthiness of the proposed assignee is equal to or better than the financial condition and creditworthiness of Tenant as of the date of this Lease.

(b) Notwithstanding anything to the contrary contained in this Lease, Tenant shall be entitled to assign this Lease without Landlord's consent but only after written notice to Landlord, to a corporation or entity (an "Affiliate") in control of, controlled by or under common control with Tenant, and only if (a) such corporation or entity at all times thereafter remains an Affiliate of Tenant, and (b) at the time of such assignment, the assignee has a tangible net worth and creditworthiness (including, but not limited to, credit rating) equal to or better than that of Tenant as of the date hereof. As used herein, control shall require the ownership of fifty-one percent (51%) or more of the ownership interests in the entity in question. No such assignment without the consent of Landlord shall be effective unless each such assignee by written instrument or operation of law assumes and becomes bound to perform and observe all of the covenants and agreements of Tenant under this Lease arising from and after the date of such assignment, provided that the assignor/Tenant shall not be released of liability for the payment of rent and for the performance and observe of the other covenants and agreements of Tenant under the Lease after the effective time of such assignment. Notwithstanding anything to the contrary herein, so long as Tenant is no in default (beyond all applicable notice and cure periods hereunder), upon notice to Landlord, Tenant will have the right to sublease all or a portion of the Premises. Such notice of sublease shall specify the name and address of the applicable sublease and the space sublet and shall include updated insurance certificates that confirm that Tenant's insurance covers all activities of such subtenant and its employees, agents, contractors and invitees. No such sublease shall operate to release Tenant from any liability hereunder.

**9.3 CONDITIONS OF ASSIGNMENT OR SUBLEASE.** If Tenant desires to assign this Lease or sublet all or any part of the Premises (other than in accordance with Section 9.2(b)), it shall so notify Landlord at least thirty (30) days in advance of the date on which Tenant desires to make such assignment or sublease. Tenant agrees to pay to Landlord within fifteen (15) business days Landlord's then standard processing fee and shall reimburse Landlord for all reasonable legal fees incurred in connection with Tenant's request, not to exceed \$1,000.00 (for the standard processing fee and legal fees combined), computed in Constant Dollars. As used herein, "Constant Dollars" shall mean the value of the U.S. dollar to which such phrase refers, as adjusted from time to time. An adjustment shall occur on January 1 of the first calendar year following the Commencement Date, and on each January 1 thereafter (each January 1 being an "Adjustment Date"). Constant Dollars shall be determined by multiplying the dollar amount to be adjusted by a fraction, the numerator of which is the Current Index Number and the denominator of which is the Base Index Number. The "Base Index Number" shall be the level of the Index published closest, but prior to, the Commencement Date; the "Current Index Number" shall be the level of the Index published closest, but prior to, the then applicable Adjustment Date; the "Index" shall be the Consumer Price Index for All Urban Consumers as of the Adjustment Date, published by the Bureau of Labor Statistics of the United States Department of Labor for U.S. City Average, All Items (1982-84=100), or any successor index thereto as hereinafter provided. If publication of the Index is discontinued, or if the basis of calculating the Index is materially changed, then Landlord shall substitute for the Index comparable statistics as computed by an agency of the United States Government or, if none, by a substantial and responsible periodical or publication of recognized

authority most closely approximating the result which would have been achieved by the Index. Tenant shall provide Landlord with a copy of the proposed assignment or sublease and such information as Landlord reasonably requests concerning the proposed subtenant or assignee to allow Landlord to make an informed judgment as to the financial condition, reputation, operations and general desirability of the proposed subtenant or assignee. Within fifteen (15) business days after Landlord's receipt of Tenant's proposed assignment or sublease and all required information concerning the proposed subtenant or assignee, Landlord shall have the following options: (a) consent to the proposed assignment or sublease; or (b) acting reasonably, refuse to consent to the proposed assignment or sublease. For purposes hereof, Tenant acknowledges that, in evaluating the reasonableness of Tenant's requested assignment, Landlord may consider all relevant factors surrounding the proposed assignment or sublease, including, without limitation, the following: (a) the business reputation of the proposed subtenant or assignee and its officer or directors; (b) the nature of the business and the proposed use of the Premises by the proposed subtenant or assignee in relation to restrictions, if any, contained in other leases or agreements with third parties affecting the Property; (c) the proposed assignee or subtenant shall not be a party who would or whose use would detract from the character of the Building; and (d) the financial condition and creditworthiness of the proposed assignee is equal to or better than the financial condition and creditworthiness of Tenant as of the date of this Lease. In the event the Lease is assigned or all or any part of the Premises are sublet, Landlord may, at its option, collect directly from the assignee or subtenant all rents becoming due to Tenant by reason of the assignment or sublease. Any collection directly by Landlord from the assignee or subtenant shall not be construed to constitute a novation or a release of Tenant or any guarantor from the further performance of its obligations under this Lease.

**9.4 RIGHTS OF MORTGAGEE AND OTHERS.** Tenant accepts this Lease subject and subordinate to the lien of any mortgage, deed to secure debt or deed of trust presently existing or hereafter created upon the Premises and to all existing, recorded restrictions, covenants, easements and agreements with respect to the Premises or any part thereof, including all amendments, modifications and restatements thereof and all replacements and substitutions therefor. The subordination of this Lease to any such mortgage, deed to secure debt, deed of trust, restrictions, covenants, easements or agreements shall be self-operative and shall occur automatically; Tenant, however, agrees within fifteen (15) business days of receipt of written request from Landlord to execute additional reasonable instruments subordinating this Lease as Landlord may require (including, without limitation, subordination, non-disturbance and attornment agreements in form attached hereto as *Exhibit D* or another commercially reasonable form (an "SNDA")). From and after the Effective Date, Landlord shall not consent to the recordation of any instruments against the Property other than customary utility easements necessary for the development of the Property and/or a mortgage, deed of trust or other security interest in accordance with this Section without the prior written consent of Tenant and Landlord shall promptly provide Tenant a copy of any such matters filed or recorded on or after the Effective Date.

Notwithstanding anything to the contrary contained in this Lease, Tenant's obligation to subordinate its interest under this Lease and attorn to any party shall be subject to and conditioned upon the lender or any party holding any mortgage, deed to secure debt or deed of trust, as applicable, entering into an SNDA with Tenant (on such lender's or lessor's standard form which shall be reasonably satisfactory to Tenant), which document shall provide (among other standard provisions) that, so

long as there is no Event of Default under this Lease, Tenant's right to possession of the Premises under this Lease shall not be disturbed. Simultaneously with the execution of this Lease, Landlord shall provide to Tenant, and Tenant shall execute, the SNDA in the form attached hereto as *Exhibit D* or on Landlord's lender's standard form which shall be reasonably satisfactory to Tenant.

Notwithstanding anything to the contrary contained in this Lease, any mortgage, deed of trust or other security instrument granted by Landlord shall provide for the release of the Phase 2 Property upon the development by Landlord or transfer to an Affiliate of Landlord or Tenant in accordance with Article 13.

**9.5 ESTOPPEL CERTIFICATES.** Either party agrees to furnish, from time to time, within ten (10) business days after receipt of a request from the other, a statement certifying, if applicable, the following: (a) that Tenant is in possession of the Premises; (b) the Premises are acceptable; (c) the Lease is in full force and effect; (d) the Lease is unmodified; (e) Tenant claims no present charge, lien, or claim of offset against rent; (f) the rent is paid for the current month, but is not prepaid for more than one month and will not be prepaid for more than one month in advance; (g) there is no existing default by reason of some act or omission by the other party; and (h) such other matters as may be reasonably required by the requesting party. If Tenant's failure to deliver such requested statement shall continue for an additional five (5) business day period following notice from Landlord that such statement was not delivered within the required ten (10) business day period, Tenant's failure to deliver such requested statement shall be an Event of Default under this Lease. If Landlord's failure to deliver such statement shall continue for an additional five (5) business day period following notice from Tenant that such statement was not delivered within the required ten (10) business days, in addition to being a default by Landlord hereunder, shall be deemed conclusively that this Lease is in full force and effect except as declared by Tenant, that Tenant is not in default of any of its obligations under this Lease, and that Tenant has not paid more than one month's rent in advance. The statement meeting the requirements of this section shall include, without limitation, the estoppel certificate attached hereto as *Exhibit E*.

## ARTICLE 10

### DEFAULT AND REMEDIES

**10.1 DEFAULT BY TENANT.** The following shall be deemed to be Events of Default by Tenant under this Lease: (a) Tenant shall fail to pay when due any installment of Rent or any other payment required pursuant to this Lease and the continuation of such failure for five (5) days following Landlord's written notice thereof to Tenant (but Landlord shall not be obligated to provide such written default notice on more than two (2) occasions in any one calendar year; thereafter an Event of Default shall occur if such payment is not made when due); (b) Tenant shall fail to comply with any term, provision or covenant of this Lease, other than the payment of Rent, and the failure is not cured within thirty (30) days after written notice to Tenant; provided, however, that no Event of Default shall occur if the failure is not susceptible to cure within thirty (30) days so long as Tenant promptly commences the cure within such thirty (30) day period and diligently and continuously pursues it to completion as soon as reasonably possible and in any event within one hundred eighty (180) days thereafter; (c) Tenant or any guarantor of Tenant's obligations shall file a petition or be adjudged bankrupt or insolvent under any applicable federal or state bankruptcy or insolvency law

or admit that it cannot meet its financial obligations as they become due; or a receiver or trustee shall be appointed for all or substantially all of the assets of Tenant or any guarantor of Tenant's obligations; or Tenant shall make a transfer to defraud creditors or shall make an assignment for the benefit of creditors; or (d) Tenant shall do or permit to be done any act which results in a lien being filed against the Premises, Building or Property, which lien is not removed or bonded over in accordance with South Carolina law within twenty (20) days after written notice thereof by Landlord to Tenant or such shorter period as required by the holder of any mortgage or deed of trust encumbering the Premises.

**10.2 REMEDIES FOR TENANT'S DEFAULT.** Upon the occurrence of any Event of Default, Landlord may at its option pursue any one or more of the following remedies, and any and all other rights or remedies accruing to Landlord by law or otherwise, without any notice or demand to the extent permitted by applicable Laws:

(a) Commence dispossessory proceedings with or without the termination of this Lease. Tenant shall remain liable for the payment of all Rents accruing after any writ of possession as to the Premises is issued to Landlord.

(b) Terminate the Lease, in which event Tenant shall immediately surrender the Premises to Landlord. Tenant agrees to pay on demand an amount which, at the date of such termination, is calculated as follows: (i) the value of the excess, if any, of (x) a sum equal to the discounted then present value of the Base Rent and any amounts treated as Additional Rent hereunder (calculated for this purpose only in an amount equal to the Additional Rent payable during the calendar year most recently ended prior to the occurrence of such Event of Default), and other sums provided herein to be paid by Tenant for the remainder of the stated Term hereof, over (y) the aggregate reasonable rental value of the Premises for the remainder of the stated Term hereof, which excess, if any, shall be discounted to present value at a rate of six percent (6%) per annum for the remainder of the stated Term hereof; plus (ii) the costs of recovering possession of the Premises and all other expenses incurred by Landlord due to Tenant's default, including, without limitation, reasonable attorney's fees; plus (iii) the unpaid Base Rent and Additional Rent owing as of the date of termination plus any interest and late fees due hereunder. The amount as calculated above shall be deemed immediately due and payable. The payment of the amount calculated in subparagraph (b)(i) shall not constitute payment of Rent in advance for the remainder of the Term. Instead, such sum shall be paid as agreed liquidated damages and not as a penalty; the parties agree that it is difficult or impossible to calculate the damages which Landlord will suffer as a result of Tenant's default, and this provision is intended to provide a reasonable estimate of such damages. Tenant waives any right to assert that Landlord's actual damages are less than the amount calculated hereunder; Landlord waives any right to assert that its damages are greater than the amount calculated hereunder. In determining the aggregate reasonable rental value pursuant to subparagraph (b)(i)(y) above, the parties hereby agree that, at the time Landlord seeks to enforce this remedy, all relevant factors should be considered, including, but not limited to, (1) the length of time remaining in the Term, (2) the then current market conditions in the general area in which the Building is located, (3) the likelihood of reletting the Premises for a period of time equal to the remainder of the Term, (4) the net effective rental rates then being obtained by landlords for similar type space of similar size in similar type buildings in the general area in which the Building is located, (5) the vacancy

levels in the general area in which the Building is located, (6) current levels of new construction that will be completed during the remainder of the Term and how this construction will likely affect vacancy rates and rental rates, and (7) inflation.

(c) Commence proceedings against Tenant for all amounts owed by Tenant to Landlord, whether as Base Rent, Additional Rent or damages.

(d) Terminate the Lease, in which event Tenant shall immediately surrender the Premises to Landlord. Without limiting Tenant's obligations under any other portion of this Lease, Tenant agrees to pay on demand the amount of all loss and damage which Landlord suffers by reason of the termination of the Term under this Section 10.2.

(e) Terminate Tenant's right to possession without terminating this Lease. Upon any termination of Tenant's right to possession only, without termination of the Lease, Landlord may, at Landlord's option, enter into the Premises, remove Tenant's signs and other evidences of tenancy, and take and hold possession thereof as provided below, without such entry and possession terminating the Lease or releasing Tenant, in whole or in part, from any obligation, including Tenant's obligation to pay Rent, including any amounts treated as Additional Rent, hereunder for the full Term. In any such case, Landlord may relet the Premises on behalf of Tenant for such term or terms (which may be greater or less than the period which would otherwise have constituted the balance of the Term) and on such terms and conditions (which may include concessions of free rent and alteration, repair and improvement of the Premises) as Landlord, in its sole discretion, may determine and receive directly the Rent by reason of the reletting. Tenant agrees to pay Landlord on demand any deficiency that may arise by reason of any reletting of the Premises. Tenant further agrees to reimburse Landlord upon demand for any expenditures made by it for remodeling or repairing in order to relet the Premises and for all other expenses incurred in connection with such reletting (including without limitation reasonable attorney's fees and brokerage commissions). Except as provided in Section 10.5, Landlord shall have no obligation to relet the Premises or any part thereof and shall in no event be liable for failure to relet the Premises or any part thereof, or, in the event of any such reletting, for refusal or failure to collect any rent due upon such reletting. No such refusal or failure shall operate to relieve Tenant of any liability under this Lease. Tenant shall instead remain liable for all Rent and for all such expenses.

(f) Enter upon and take possession of the Premises to perform any unperformed obligation of Tenant, to perform any obligation of Landlord, or to enforce Landlord's remedies under this Lease, without being liable for prosecution of any claim for damages or for trespass or other tort.

(g) Do or cause to be done whatever Tenant is obligated to do under the terms of this Lease, in which case Tenant agrees to reimburse Landlord on demand for any and all reasonable costs or expenses which Landlord may thereby incur. Tenant agrees that Landlord shall not be liable for any damages resulting to Tenant from effecting compliance with Tenant's obligations under this Section 10.2, whether caused by the negligence of Landlord or otherwise.

(h) Enforce the performance of Tenant's obligations hereunder by injunction or other equitable relief.

**10.3 DEFAULT BY LANDLORD.** Landlord shall not be in default hereunder unless (a) Landlord shall fail to pay when due any amount required pursuant to this Lease and the continuation of such failure for five (5) days following Tenant's written notice thereof to Landlord; or (b) Landlord shall fail to comply with any term, provision or covenant of this Lease, and the failure is not cured within thirty (30) days after written notice to Landlord; provided, however, that no default shall occur if the failure is not susceptible to cure within thirty (30) days so long as Landlord promptly commences the cure within such thirty (30) day period and diligently and continuously pursues it to completion as soon as reasonably possible.

**10.4 REMEDIES FOR LANDLORD'S DEFAULT.** During the continuation of any uncured default (beyond all applicable notice and cure periods) of Landlord, in addition to any rights and remedies available to Tenant at law or in equity, Tenant shall have the right, but not the obligation, to remedy Landlord's default and charge Landlord for the reasonable, actual cost incurred by Tenant in curing such default, which charges shall be payable by Landlord within thirty (30) days of Tenant's demand therefor. If Landlord shall fail to pay same within such 30-day period, Tenant shall have the right to deduct such costs from Base Rent next accruing hereunder; provided, however, that such deduction shall be spread over more than one (1) month, if necessary, in order that Tenant shall not deduct in any one month more than twenty percent (20%) of the total monthly Base Rent. Except as expressly set forth in Sections 1.2, 7.1(b), 8.1 and 12.20, Tenant will not have the right to terminate this Lease.

**10.5 MITIGATION.** Following any termination of Tenant's right to possession only, without termination of the Lease, Landlord agrees to use reasonable efforts to relet the Premises at fair market rental rates and to otherwise mitigate any damages arising out of an Event of Default on the part of Tenant; provided, however, that (i) Landlord shall have no obligation to treat preferentially the Premises compared to other premises Landlord or Landlord's affiliates has available for leasing in other properties owned or managed by Landlord or Landlord's affiliates; (ii) Landlord shall not be obligated to expend any efforts or any monies beyond those Landlord would expend in the ordinary course of leasing space within a building comparable to the Building; and (iii) in evaluating a prospective reletting of the Premises, the term, rental, use and the reputation, experience and financial standing of prospective tenants are factors which Landlord may properly consider. In no event shall Landlord be required to enter into a lease for less than all of the Premises or for a rental rate that is less than the fair market rental rate, as reasonably determined by Landlord.

## ARTICLE 11

### HAZARDOUS MATERIALS

Tenant covenants and agrees not to permit, introduce or maintain in, on or about any portion of the Premises, any asbestos, polychlorinated biphenyls, petroleum products or any other hazardous or toxic materials (other than de minimis amounts of pre-packaged cleaning and related consumer products used lawfully for office use), wastes and substances which are defined, determined or identified as such in any Laws (whether now existing or hereafter enacted or promulgated) or any judicial or administrative interpretation of any thereof, including any judicial or administrative orders or judgments. Any such asbestos, polychlorinated biphenyls, petroleum products and any such other hazardous or toxic materials, wastes and substances are herein collectively called



“Hazardous Materials”. Tenant further covenants and agrees to indemnify, protect and save Landlord harmless against and from any and all damages, losses, liabilities, obligations, penalties, claims, litigation, demands, defenses, judgments, suits, proceedings, costs, disbursements or expenses of any kind or of any nature whatsoever (including, without limitation, reasonable attorneys’ and experts’ fees and disbursements) which may at any time be imposed upon, incurred by or asserted or awarded against Landlord and arising from or out of any Hazardous Materials on, in, under or affecting all or any portion of the Premises, introduced by, or on behalf of, Tenant including, without limitation, (a) the costs of remediating (in a manner satisfactory to Landlord) of any and all such Hazardous Materials, (b) additional costs required to take precautions required under applicable Laws, orders, judgments or regulations, to protect against the release of Hazardous Materials on, in, under or affecting the Premises, into the air, any body of water, any other public domain or any surrounding areas, and (c) any costs incurred to comply, in connection with all or any portion of the Premises, with all applicable Laws, orders, judgments and regulations with respect to Hazardous Materials. Landlord covenants and agrees to indemnify, protect and save Tenant harmless against and from any and all damages, losses, liabilities, obligations, penalties, claims, litigation, demands, defenses, judgments, suits, proceedings, costs, disbursements or expenses of any kind or of any nature whatsoever (including, without limitation, reasonable attorneys’ and experts’ fees and disbursements) which may at any time be imposed upon, incurred by or asserted or awarded against Tenant and arising from or out of any Hazardous Materials on, in, under or affecting all or any portion of the Premises, introduced by, or on behalf of, Landlord. The provisions of this ARTICLE 11 shall survive the expiration or earlier termination of this Lease. Landlord represents and warrants to Tenant that, to Landlord’s actual knowledge, as of the Commencement Date, there are no Hazardous Materials at or under the Premises in violation of applicable Laws, orders, judgments or regulations.

## ARTICLE 12

### MISCELLANEOUS

**12.1 WAIVER.** Failure of either party to declare a default immediately upon its occurrence, or delay in taking any action in connection with a default, shall not constitute a waiver of the default, but such party shall have the right to declare the default at any time and take such action as is lawful or authorized under this Lease. Pursuit of any one or more of the remedies set forth in Article 10 above shall not preclude pursuit of any one or more of the other remedies provided elsewhere in this Lease or provided by law, nor shall pursuit of any remedy constitute forfeiture or waiver of any rent or damages accruing to a party by reason of the violation of any of the terms, provisions or covenants of this Lease. Failure by either party to enforce one or more of the remedies provided upon a default shall not be deemed or construed to constitute a waiver of the default or of any other violation or breach of any of the terms, provisions and covenants contained in this Lease. No agreement to accept a surrender of the Premises and no act or omission by Landlord or Landlord’s agents during the Term shall constitute an acceptance or surrender of the Premises or a termination of this Lease unless made in writing and signed by Landlord. No re-entry or taking possession of the Premises by Landlord shall constitute an election by Landlord to terminate this Lease unless a written notice of such intention is given to Tenant. No custom or practice which may develop between the parties in connection with the terms of this Lease shall be construed to waive or lessen

either party's right to insist upon strict performance of the terms of this Lease, without written notice thereof to the other party.

**12.2 FORCE MAJEURE.** Landlord and Tenant (except with respect to the payment of Rent or any other monetary obligations under this Lease and except with regard to Tenant's obligations under Section 2.5 above) shall be excused for the period of any delay and shall not be deemed in default with respect to the performance of any of the terms, covenants and conditions of this Lease when prevented from so doing by Force Majeure

**12.3 ATTORNEY'S FEES.** If either party commences an action against the other arising out of or in connection with the Lease, the prevailing party shall be entitled to recover from the losing party reasonable attorneys' fees and costs of suit, whether in a mediation or arbitration proceeding, at trial, on appeal, or in a bankruptcy proceeding. All references herein to attorneys' fees and expenses shall be deemed to refer to reasonable attorneys' fees and expenses actually incurred.

**12.4 SUCCESSORS.** This Lease shall be binding upon and inure to the benefit of Landlord and Tenant and their respective heirs, personal representatives, successors and assigns, subject, however, to Article 9 of this Lease. It is hereby covenanted and agreed that should Landlord's interest in the Premises cease to exist for any reason during the Term of this Lease, then notwithstanding the happening of such event, this Lease nevertheless shall remain unimpaired and in full force and effect and Tenant hereunder agrees to attorn to the then owner of the Premises, subject to Article 9 of this Lease.

**12.5 RENT TAX.** If applicable in the jurisdiction where the Premises are situated, Tenant shall pay and be liable for all rental, sales and use taxes or other similar taxes resulting from Tenant's Rent payments or use of the Premises, if any, levied or imposed by any city, state or county or other governmental body having authority, such payments to be in addition to all other payments required to be paid to Landlord by Tenant under the terms of this Lease. Any such payment shall be paid concurrently with the payment of Rent.

**12.6 CAPTIONS.** The captions appearing in this Lease are inserted only as a matter of convenience and in no way define, limit, construe or describe the scope or intent of any section.

**12.7 NOTICE.** All rent and other payments required to be made by Tenant shall be payable to Landlord pursuant to Section 2.1. All payments required to be made by Landlord to Tenant shall be payable to Tenant at the address set forth in Paragraph 7 of the Summary. Any notice, demand or document required or permitted to be delivered by the terms of this Lease shall be written in the English language and shall be deemed to be delivered (whether or not actually received) when personally delivered, on the first (1st) business day after being deposited with a recognized overnight delivery service or the third (3rd) day after being deposited in the United States mail, postage prepaid, certified mail, return receipt requested, addressed to Landlord at the address set forth in Paragraph 6 of the Summary and addressed to Tenant at the address set forth in Paragraph 7 of the Summary. Either party may by notice to the other specify a different address for payments or for delivery of notices.

**12.8 SUBMISSION OF LEASE.** The negotiation and submission of this Lease to Tenant for signature does not constitute an offer to lease to Tenant or a reservation of space or an option to lease. Landlord shall not be bound until it has executed and delivered such Lease to Tenant.

**12.9 AUTHORITY.** Each party executing this Lease on behalf of Landlord and Tenant represents that he or she is duly authorized to execute this Lease on behalf of Landlord or Tenant, as the case may be, and that the execution and delivery of this Lease has been authorized by all necessary corporate or partnership action. Landlord and Tenant agree to provide the other upon request reasonable evidence confirming the existence of such authority.

**12.10 SEVERABILITY.** If any provision of this Lease or the application thereof to any person or circumstances shall be invalid or unenforceable to any extent, the remainder of this Lease and the application of such provisions to other persons or circumstances shall not be affected thereby and shall be enforced to the greatest extent permitted by Laws.

**12.11 LIMITATIONS OF LIABILITY.** If Landlord shall be in default under this Lease and, if as a consequence of such default, Tenant shall recover a money judgment against Landlord, such judgment shall be satisfied only out of the right, title and interest of Landlord in the Premises as the same may then be encumbered and neither Landlord nor any person or entity comprising Landlord shall be liable for any deficiency. In no event shall Tenant have the right to levy execution against any property of Landlord nor any person or entity comprising Landlord other than its interest in the Premises as herein expressly provided. In no event shall any partner of Landlord or Tenant nor any joint venturer in Landlord or Tenant, nor any officer, director or shareholder of Landlord or Tenant or any such partner or joint venturer of Landlord or Tenant be personally liable hereunder.

**12.12 NO BROKER CLAIMS.** Landlord and Tenant acknowledge that the brokers set forth in Paragraph 9 of the Summary (referred to collectively for purposes of this section as “Brokers”) have acted as brokers with respect to the Premises and will be paid by Landlord pursuant to the terms of separate agreements. Landlord and Tenant hereby warrant and represent to the other that the party making said warranty and representation has not dealt with any broker, agent or finder, other than Brokers. In connection with this Lease, and, subject to the default and remedies provisions of Article 10 of this Lease, Landlord and Tenant covenant and agree to indemnify and hold the other harmless from and against any and all loss, liability, damage, claim, judgment, cost or expense (including but not limited to attorney’s fees and expenses and court costs) that may be incurred or suffered by the other because of any claim for any fee, commission or similar compensation with respect to this Lease, made by any broker, agent or finder, other than Brokers, claiming by, through or under the indemnifying party, whether or not such claim is meritorious. Such obligations shall survive the expiration or earlier termination of this Lease.

**12.13 NO ESTATE IN LAND.** Tenant’s interest hereunder is not subject to levy, execution and sale and is not assignable except with Landlord’s prior written consent or as otherwise expressly provided in this Lease.

**12.14 NO JOINT VENTURE.** Nothing contained in this Lease or any exhibits hereto shall be deemed or construed to create a partnership or joint venture between Landlord and Tenant or to create any relationship between them except the relationship of landlord and tenant.

**12.15 TIME OF ESSENCE.** Time is of the essence of this Lease. However, if a certain day stated for payment or performance of any obligation of Landlord or Tenant is a Saturday or Sunday, or a state or federal holiday, the certain day shall be extended until the end of the next day which is not a Saturday, Sunday or state or federal holiday.

**12.16 JOINT AND SEVERAL LIABILITY.** If Tenant comprises more than one person, corporation, partnership or other entity, the liability hereunder of all such persons, corporations, partnerships or other entities shall be joint and several.

**12.17 NO LIGHT OR AIR EASEMENT.** Any diminution or shutting off of light or air by any structure which is now or hereafter erected on the Property or upon property adjacent to the Property shall not affect this Lease or impose any liability on Landlord.

**12.18 ENTIRE LEASE.** It is expressly agreed by Tenant, as a material consideration for the execution of this Lease, that this Lease, with the specific references to written extrinsic documents, is the entire agreement of the parties; that there are, and were, no representations, warranties, understandings, stipulations, agreements or promises pertaining to this Lease or the expressly mentioned written extrinsic documents not incorporated in writing in this Lease. This Lease may not be altered, waived, amended or extended except by an instrument in writing executed and delivered by Landlord and Tenant in the same manner as the execution and delivery of this Lease. Landlord and Tenant expressly agree that there are and shall be no implied warranties of merchantability, habitability, fitness for a particular purpose or of any other kind arising out of this Lease and there are no warranties which extend beyond those expressly set forth in this Lease.

**12.19 SPECIAL STIPULATIONS, EXHIBITS AND SUMMARY OF LEASE PROVISION.** The content of each and every provision of the special stipulations (if any) attached hereto is incorporated into this Lease as fully as if set forth in the body of this Lease. To the extent that such special stipulations conflict or are inconsistent with any of the foregoing provisions of this Lease, the special stipulations shall control. The content of each and every exhibit which is referenced in this Lease is incorporated into this Lease as fully as if set forth in the body of this Lease. The content of each and every provision of the Summary which is referenced in this Lease is incorporated into this Lease as fully as if set forth in the body of this Lease.

**12.20 CONDITIONS PRECEDENT.**

(a) The parties' obligations under this Lease are expressly contingent upon satisfaction of the following conditions (the "**Conditions Precedent**"):

(i) Landlord obtaining equity and debt financing to acquire the Land and construct the Phase 1 Improvements on terms satisfactory to Landlord, which terms shall provide for a construction loan of not less than seventy percent (70%) of the Project Costs, as set forth in the Final Budget;

(ii) Tenant's delivery to Landlord or an Affiliate of Landlord selected by Landlord of (A) an assignment of the Purchase Agreement, (B) a certification from Tenant that represents that there are no defaults under the Purchase Agreement and the Purchase Agreement

has not been assigned to any other party, and (C) documentation satisfactory to Landlord that all diligence materials related to the Land, this Lease, and the Phase 1 Improvements has been certified to and assigned to Landlord or such Affiliate of Landlord;

(iii) Receipt of the Approvals (as defined under the Purchase Agreement) and Landlord's and Tenant's written approval prior to expiration of the Inspection Period (as defined under the Purchase Agreement) of the due diligence materials to be provided by Seller under the Purchase Agreement;

(iv) Landlord's acquisition of the Land in accordance with, and subject to, the express terms of the Purchase Agreement;

(v) Tenant's written approval of the Final Budget; and

(vi) approval by Landlord and Tenant, which approval neither Landlord nor Tenant may unreasonably withhold, condition or delay, of the form of the Declaration to be recorded contemporaneously with Landlord's acquisition of the Land. The Declaration shall provide for, among other things, the following:

(A) as of the Phase 2 Trigger Date, cross easements for parking and access over the Property and Phase 2 Property;

(B) maintenance, repair and replacement of certain common areas to the Property, including the Phase 2 Property;

(C) the sharing of costs related to such maintenance, repair and replacement between the owners of the Property and Phase 2 Property, as applicable, which costs shall be split pro rata between such owners based on the proportion such party's gross acreage bears to the aggregate acreage of the Property and Phase 2 Property;

(D) reasonable rules and regulations to ensure the Property continues to be in compliance with all applicable Laws, including any parking and zoning requirements; and

(E) the requirement that each improved parcel provide parking of not less than 4 parking spaces per 1,000 square feet of leasable space in improvements constructed or to be constructed on such parcel.

(b) Contemporaneously with the execution of this Lease, Tenant has signed and delivered in escrow to Chicago Title Insurance Company (the "**Title Company**"), an assignment of the Purchase Agreement in form satisfactory to Landlord (the "**PSA Assignment**"), which PSA Assignment shall be signed by Tenant on the date hereof but shall not be effective unless and until the PSA Assignment is released from escrow. The Title Company shall be authorized to release the PSA Assignment from escrow on express written notice from Landlord stating that the Conditions Precedent (other than those set forth in Sections 12.20(a)(ii) and 12.20(a)(iii)) have been satisfied,

and both parties have waived (or are deemed to have waived) their right to terminate the Lease in accordance with Section 12.20(c).

(c) Each party agrees to use commercially reasonable efforts to satisfy the Conditions Precedent as soon as reasonably practicable. If the Conditions Precedent have not been satisfied or otherwise waived in writing by Landlord or Tenant, as applicable, as of or prior to the Closing Date (as defined under the Purchase Agreement) (the “**Conditions Precedent Outside Date**”), then Landlord shall be entitled to terminate the Lease by written notice to Tenant by 11:59 p.m. eastern time on the date that is five (5) days after the Conditions Precedent Outside Date, whereupon neither Landlord nor Tenant nor any third party shall have any further rights, duties or liabilities under the Lease, except Tenant shall promptly reimburse Landlord for all reasonable expenses actually incurred in accordance with the Preliminary Budget or, if complete, the Final Budget under the Work Agreement by Landlord in connection with this Lease if the conditions set forth in Sections 12.20(a)(ii), 12.20(a)(v) or Tenant’s approvals under Section 12.20(a)(iii) or Section 12.20(a)(vi) were not satisfied or waived in writing by Tenant as of the Conditions Precedent Outside Date. If Sections 12.20(a)(i), 12.20(a)(iv), or Landlord’s approvals under Section 12.20(a)(iii) or Section 12.20(a)(vi) have not been satisfied or otherwise waived in writing by Landlord on or before the Conditions Precedent Outside Date, then Tenant shall be entitled to terminate the Lease by written notice to Landlord by 11:59 p.m. eastern time on the date that is five (5) days after the Conditions Precedent Outside Date, whereupon neither Landlord nor Tenant nor any third party shall have any further rights, duties or liabilities under the Lease. If this Lease is terminated pursuant to this Section, Landlord shall instruct the Title Company to return the PSA Assignment to Tenant or, if the PSA Assignment has been released from Escrow, Landlord shall assign the Purchase Agreement to Tenant or its designee, unless Tenant consents in writing to the termination of the Purchase Agreement.

**12.21 NO MERGER OF TITLE.** There shall be no merger of this Lease nor of the leasehold estate created hereby with the fee estate in or ownership of the Premises by reason of the fact that the same entity may acquire or hold or own (i) this Lease or such leasehold estate or any interest therein and (ii) the fee estate or ownership of any of the Premises or any interest therein. No such merger shall occur unless and until all entities having any interest in (x) this Lease or such leasehold estate and (y) the fee estate in the Premises including, without limitation, any lender’s interest therein, shall join in a written, recorded instrument effecting such merger.

**12.22 FINANCIAL STATEMENTS.** If Tenant’s financial statements are not publicly available online at no cost to Landlord, then within 10 days after written request by Landlord (but not more than twice during any 12-month period), Tenant shall furnish to Landlord, Landlord’s mortgagee, prospective mortgagee or purchaser, reasonably requested financial information, including without limitation, annual, audited financial statements for the most recently concluded fiscal year, and financial statements for the most recently ended fiscal quarter. All such financial statements shall be certified to Landlord as being true and correct in all material respects. Such certification may be made by an independent certified public accounting firm or by an authorized officer of Tenant. In connection therewith and upon Tenant’s request, Landlord and Tenant shall execute a commercially reasonable confidentiality agreement on Landlord’s form therefor.

## ARTICLE 13

### PHASE 2

**13.1 PHASE 2 NOTICE.** Tenant shall have the right to proceed with Phase 2 in accordance with the terms of this ARTICLE 13, provided (i) Tenant provides written notice thereof to Landlord prior to the date three (3) years prior to the end of the then current Term, including any Renewal Terms exercised by Tenant (the “**Phase 2 Notice**”), which Phase 2 Notice shall set forth the size and major details of the office-building(s) Tenant desires to be built on the Phase 2 Property; and (ii) Tenant shall not be in default (beyond any applicable notice and cure period) under the Lease as of the date such written notice is delivered.

**13.2 PHASE 2 FINANCING NOTICE.** Within sixty (60) days after Landlord’s receipt of the Phase 2 Notice (the “**Phase 2 Exercise Deadline**”), Landlord shall deliver written notice to Tenant stating whether it has obtained sufficient commitments for equity and debt financing to construct Phase 2 for Tenant (the “**Holder Phase 2 Financing Notice**”).

#### **13.3 PHASE 2 DEVELOPED BY LANDLORD.**

(a) Provided Landlord timely delivers the Holder Phase 2 Financing Notice, then within twenty-five (25) Business Days after Landlord’s delivery of the Holder Phase 2 Financing Notice, Landlord or, at Landlord’s election, an Affiliate of Landlord, and Tenant, shall enter into the lease for the Phase 2 Property (the “**Phase 2 Lease**”). The Phase 2 Lease shall be in the same form as this Lease, provided (A) the rent factor for the Phase 2 Lease shall be equal to the interest rate in effect for the 10-year Treasury Note as of the date of the closing of the construction loan for Phase 2 plus 600 basis points, and (B) the parties’ obligations under the Phase 2 Lease shall be conditioned only upon the following:

(i) Tenant’s approval, which approval Tenant may not unreasonably withhold, condition or delay, of a final budget for Phase 2, as established in accordance with Section 13.3(b);

(ii) Landlord obtaining equity and debt financing to construct Phase 2 on terms reasonably satisfactory to Landlord, which terms shall provide for a construction loan of not less than seventy (70%) of the Project Costs (as defined in the Phase 2 Lease); and

(iii) approval by Landlord’s lender holding a mortgage over the Phase 2 Property.

(b) If Landlord timely delivers the Holder Phase 2 Financing Notice, Landlord shall use reasonable efforts to deliver a preliminary budget (the “**Phase 2 Preliminary Budget**”) for Phase 2 within ninety (90) days after delivery of the Holder Phase 2 Financing Notice. If Landlord fails to deliver such Phase 2 Preliminary Budget within the stated time frame, Tenant’s sole remedy (notwithstanding any provision herein to the contrary) shall be to terminate Landlord’s right to develop Phase 2 by delivering written notice thereof to Landlord at any time prior to Landlord’s delivery of the Phase 2 Preliminary Budget. Landlord and Tenant shall use commercially

reasonable efforts to agree on the final budget for Phase 2 within sixty (60) days after Landlord's delivery to Tenant of the Phase 2 Preliminary Budget (the "**Outside Phase 2 Final Budget Date**"). If the parties cannot agree on a final budget for Phase 2 by the Outside Phase 2 Final Budget Date, or if Landlord has not satisfied or waived the conditions set forth in Section 13.3(a)(ii) or Section 13.3(a)(ii) by the Outside Phase 2 Final Budget Date, then either party may terminate the Phase 2 Lease by written notice to the other party.

#### **13.4 PHASE 2 DEVELOPED BY TENANT.**

(a) If Landlord fails to timely deliver the Holder Phase 2 Financing Notice, the Phase 2 Lease is terminated in accordance with Section 13.3 or Landlord does not develop Phase 2 for any other reason, then Tenant may purchase the Phase 2 Property from Landlord on the following terms and conditions:

(i) Tenant delivers Landlord written notice of its intent to purchase the Phase 2 Property in accordance with this Section 13.4 within six (6) months after the Phase 2 Exercise Deadline;

(ii) the purchase price for the Phase 2 Property shall be the difference of (A) the product of the Phase 2 Acreage and the Phase 1 Per Acre Value (the "**Phase 2 Gross Purchase Price**"), and (B) the product of (x) the number of months between the Commencement Date and the closing of the sale of the Phase 2 Property (rounded up to the nearest whole number), and (y) the Phase 2 Amortization Amount; and

(iii) Tenant shall be responsible for all deed transfer taxes and closing costs payable upon the sale of the Phase 2 Property by Landlord, other than Landlord's attorneys' fees.

**13.5 MEMORANDUM OF LEASE.** Upon execution of this Lease, Tenant and Landlord shall execute a memorandum of this Lease substantially in the form attached as *Exhibit F*, which shall be recorded by Landlord in the real property records for Berkeley County, South Carolina at the Land Closing.

[Rest of Page Intentionally Left Blank; Signatures Continue on Following Page]



**ARTICLE 14**

**SIGNATURES**

**IN WITNESS WHEREOF**, the parties hereto have caused this Lease to be executed under seal, effective as of the date set forth below.

LANDLORD

**HPBB1, LLC**, a Georgia limited liability company

By: /s/ John R. Holder

Printed Name: John R. Holder

Its: Managing Member

[SEAL]

Witness: /s/ Emily Nixon

Date: May 16, 2016

TENANT

**BLACKBAUD, INC.**, a Delaware corporation

By: /s/ Michael Gianoni

Printed Name: Michael Gianoni

Its: President and Chief Executive Officer

[CORPORATE SEAL]

Witness: /s/ Jon W. Olson

Date: May 16, 2016

## Blackbaud, Inc.

## CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Michael P. Gianoni, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Blackbaud, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2016

By: /s/ Michael P. Gianoni  
Michael P. Gianoni  
President and Chief Executive Officer  
(Principal Executive Officer)

## Blackbaud, Inc.

## CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Anthony W. Boor, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Blackbaud, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2016

By: /s/ Anthony W. Boor

Anthony W. Boor

Executive Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)

## Blackbaud, Inc.

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED  
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Blackbaud, Inc. (the "Company") for the period ended June 30, 2016 as filed with the Securities and Exchange Commission on or about the date hereof (the "Report"), I, Michael P. Gianoni, President and Chief Executive Officer, hereby certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 4, 2016

By: /s/ Michael P. Gianoni  
Michael P. Gianoni  
President and Chief Executive Officer  
(Principal Executive Officer)

## Blackbaud, Inc.

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED  
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Blackbaud, Inc. (the "Company") for the period ended June 30, 2016 as filed with the Securities and Exchange Commission on or about the date hereof (the "Report"), I, Anthony W. Boor, Executive Vice President and Chief Financial Officer, hereby certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 4, 2016

By: /s/ Anthony W. Boor

Anthony W. Boor

Executive Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)