

PS BUSINESS PARKS INC/CA

Form 10-Q

May 04, 2011

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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 March 31, 2011**

or

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____**

**Commission File Number 1-10709
PS BUSINESS PARKS, INC.**

(Exact name of registrant as specified in its charter)

California
(State or Other Jurisdiction
of Incorporation)

95-4300881
(I.R.S. Employer
Identification Number)

701 Western Avenue, Glendale, California 91201-2397
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(818) 244-8080**

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 (§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 definition 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 Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes No

As of April 29, 2011, the number of shares of the registrant's common stock, \$0.01 par value per share, outstanding was 24,714,144.

**PS BUSINESS PARKS, INC.
INDEX**

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated balance sheets as of March 31, 2011 (unaudited) and December 31, 2010</u>	3
<u>Consolidated statements of income (unaudited) for the three months ended March 31, 2011 and 2010</u>	4
<u>Consolidated statement of equity (unaudited) for the three months ended March 31, 2011</u>	5
<u>Consolidated statements of cash flows (unaudited) for the three months ended March 31, 2011 and 2010</u>	6
<u>Notes to consolidated financial statements (unaudited)</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	33
<u>Item 4. Controls and Procedures</u>	33
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	33
<u>Item 1A. Risk Factors</u>	33
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	34
<u>Item 6. Exhibits</u>	35
<u>EX-12</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-101 INSTANCE DOCUMENT</u>	
<u>EX-101 SCHEMA DOCUMENT</u>	
<u>EX-101 CALCULATION LINKBASE DOCUMENT</u>	
<u>EX-101 LABELS LINKBASE DOCUMENT</u>	
<u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>	
<u>EX-101 DEFINITION LINKBASE DOCUMENT</u>	

Table of Contents

PS BUSINESS PARKS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	March 31, 2011 (Unaudited)	December 31, 2010
ASSETS		
Cash and cash equivalents	\$ 4,548	\$ 5,066
Real estate facilities, at cost:		
Land	564,851	564,851
Buildings and equipment	1,788,504	1,782,613
	2,353,355	2,347,464
Accumulated depreciation	(795,547)	(776,840)
	1,557,808	1,570,624
Land held for development	6,829	6,829
	1,564,637	1,577,453
Rent receivable	4,536	3,127
Deferred rent receivable	22,558	22,277
Other assets	9,947	13,134
Total assets	\$ 1,606,226	\$ 1,621,057
LIABILITIES AND EQUITY		
Accrued and other liabilities	\$ 51,773	\$ 53,421
Note payable to affiliate	121,000	
Credit facility		93,000
Mortgage notes payable	48,512	51,511
Total liabilities	221,285	197,932
Commitments and contingencies		
Equity:		
PS Business Parks, Inc.'s shareholders' equity:		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, 23,942 shares issued and outstanding at March 31, 2011 and December 31, 2010	598,546	598,546
Common stock, \$0.01 par value, 100,000,000 shares authorized, 24,714,009 and 24,671,177 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	246	246
Paid-in capital	559,821	557,882

Edgar Filing: PS BUSINESS PARKS INC/CA - Form 10-Q

Cumulative net income	811,678	784,616
Cumulative distributions	(769,079)	(747,762)
Total PS Business Parks, Inc. s shareholders equity	1,201,212	1,193,528
Noncontrolling interests:		
Preferred units	5,583	53,418
Common units	178,146	176,179
Total noncontrolling interests	183,729	229,597
Total equity	1,384,941	1,423,125
Total liabilities and equity	\$ 1,606,226	\$ 1,621,057

See accompanying notes.

Table of Contents

PS BUSINESS PARKS, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited, in thousands, except per share data)

	For the Three Months Ended March 31,	
	2011	2010
Revenues:		
Rental income	\$ 73,946	\$ 67,132
Facility management fees	178	173
Total operating revenues	74,124	67,305
Expenses:		
Cost of operations	25,901	22,966
Depreciation and amortization	20,859	18,190
General and administrative	1,570	2,749
Total operating expenses	48,330	43,905
Other income and expenses:		
Interest and other income	94	109
Interest expense	(1,215)	(855)
Total other income and expenses	(1,121)	(746)
Income from continuing operations	24,673	22,654
Discontinued operations:		
Income from discontinued operations		34
Gain on sale of real estate facility		5,153
Total discontinued operations		5,187
Net income	\$ 24,673	\$ 27,841
Net income allocation:		
Net income allocable to noncontrolling interests:		
Noncontrolling interests common units	\$ 4,901	\$ 3,513
Noncontrolling interests preferred units	(7,290)	1,382
Total net income allocable to noncontrolling interests	(2,389)	4,895
Net income allocable to PS Business Parks, Inc.:		
Common shareholders	16,562	11,740
Preferred shareholders	10,450	11,155
Restricted stock unit holders	50	51

Edgar Filing: PS BUSINESS PARKS INC/CA - Form 10-Q

Total net income allocable to PS Business Parks, Inc.	27,062	22,946
	\$ 24,673	\$ 27,841
Net income per common share basic:		
Continuing operations	\$ 0.67	\$ 0.32
Discontinued operations	\$	\$ 0.16
Net income	\$ 0.67	\$ 0.48
Net income per common share diluted:		
Continuing operations	\$ 0.67	\$ 0.32
Discontinued operations	\$	\$ 0.16
Net income	\$ 0.67	\$ 0.48
Weighted average common shares outstanding:		
Basic	24,685	24,413
Diluted	24,792	24,564

See accompanying notes.

Table of Contents

PS BUSINESS PARKS, INC.
CONSOLIDATED STATEMENT OF EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2011
(Unaudited, in thousands, except share data)

	Preferred Stock		Common Stock		Paid-in Capital	Cumulative Net Income	Cumulative Distributions	Total PS Business Parks, Inc. s Shareholders' Equity	Noncontrolling Interests	Total Equity
	Shares	Amount	Shares	Amount						
Balances at December 31, 2010	23,942	\$ 598,546	24,671,177	\$ 246	\$ 557,882	\$ 784,616	\$ (747,762)	\$ 1,193,528	\$ 229,597	\$ 1,423,125
Repurchase of preferred units, net of issuance costs					10,107			10,107	(49,194)	(39,087)
Exercise of stock options			22,600		944			944		944
Stock compensation, net			20,232		(84)			(84)		(84)
Net income						27,062		27,062	(2,389)	24,673
Distributions:										
Preferred stock							(10,450)	(10,450)		(10,450)
Common stock							(10,867)	(10,867)		(10,867)
Noncontrolling interests									(3,313)	(3,313)
Adjustment to noncontrolling interests in underlying operating partnership					(9,028)			(9,028)	9,028	
Balances at March 31, 2011	23,942	\$ 598,546	24,714,009	\$ 246	\$ 559,821	\$ 811,678	\$ (769,079)	\$ 1,201,212	\$ 183,729	\$ 1,384,941

See accompanying notes.

Table of Contents

PS BUSINESS PARKS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	For the Three Months Ended March 31,	
	2011	2010
Cash flows from operating activities:		
Net income	\$ 24,673	\$ 27,841
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	20,859	18,190
In-place lease adjustment	209	(37)
Tenant improvement reimbursements net of lease incentives	(194)	(163)
Amortization of mortgage premium	(61)	(69)
Gain on sale of real estate facility		(5,153)
Stock compensation	458	615
Decrease in receivables and other assets	1,099	942
Decrease in accrued and other liabilities	(1,807)	(699)
 Total adjustments	 20,563	 13,626
 Net cash provided by operating activities	 45,236	 41,467
Cash flows from investing activities:		
Capital improvements to real estate facilities	(8,043)	(7,055)
Acquisition of real estate facilities		(58,417)
Proceeds from sale of real estate facility		9,181
 Net cash used in investing activities	 (8,043)	 (56,291)
Cash flows from financing activities:		
Borrowings on note payable to affiliate	121,000	
Repayment of credit facility	(93,000)	
Principal payments on mortgage notes payable	(278)	(274)
Repayment of mortgage note payable	(2,660)	
Proceeds from the exercise of stock options	944	2,649
Repurchase of preferred units	(39,087)	
Distributions paid to common shareholders	(10,867)	(10,747)
Distributions paid to preferred shareholders	(10,450)	(11,155)
Distributions paid to noncontrolling interests common units	(3,214)	(3,214)
Distributions paid to noncontrolling interests preferred units	(99)	(1,382)
 Net cash used in financing activities	 (37,711)	 (24,123)
 Net decrease in cash and cash equivalents	 (518)	 (38,947)
Cash and cash equivalents at the beginning of the period	5,066	208,229
 Cash and cash equivalents at the end of the period	 \$ 4,548	 \$ 169,282

Supplemental schedule of non-cash investing and financing activities:

Adjustment to noncontrolling interests in underlying operating partnership:					
Noncontrolling interests	common units	\$	9,028	\$	89
Paid-in capital		\$	(9,028)	\$	(89)
Gain on repurchase of preferred equity:					
Preferred units		\$	(8,748)	\$	
Paid-in capital		\$	8,748	\$	
Issuance costs related to the repurchase of preferred equity:					
Noncontrolling interest	common units	\$	(1,359)	\$	
Paid-in capital		\$	1,359	\$	

See accompanying notes.

Table of Contents

PS BUSINESS PARKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2011

1. Organization and description of business

PS Business Parks, Inc. (PSB) was incorporated in the state of California in 1990. As of March 31, 2011, PSB owned 77.2% of the common partnership units of PS Business Parks, L.P. (the Operating Partnership). The remaining common partnership units are owned by Public Storage (PS). PSB, as the sole general partner of the Operating Partnership, has full, exclusive and complete responsibility and discretion in managing and controlling the Operating Partnership. PSB and the Operating Partnership are collectively referred to as the Company.

The Company is a fully-integrated, self-advised and self-managed real estate investment trust (REIT) that acquires, develops, owns and operates commercial properties, primarily multi-tenant flex, office and industrial space. As of March 31, 2011, the Company owned and operated 21.8 million rentable square feet of commercial space located in eight states. The Company also manages 1.4 million rentable square feet on behalf of PS and its affiliated entities.

References to the number of properties or square footage are unaudited and outside the scope of the Company's independent registered public accounting firm's review of the Company's financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States).

2. Summary of significant accounting policies

Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ended December 31, 2011. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

The accompanying consolidated financial statements include the accounts of PSB and the Operating Partnership. All significant inter-company balances and transactions have been eliminated in the consolidated financial statements.

Noncontrolling Interests

The Company's noncontrolling interests are reported as a component of equity separate from the parent's equity. Purchases or sales of equity interests that do not result in a change in control are accounted for as equity transactions. In addition, net income attributable to the noncontrolling interest is included in consolidated net income on the face of the income statement and, upon a gain or loss of control, the interest purchased or sold, as well as any interest retained, is recorded at fair value with any gain or loss recognized in earnings.

Use of estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates.

Table of Contents

Allowance for doubtful accounts

The Company monitors the collectability of its receivable balances including the deferred rent receivable on an ongoing basis. Based on these reviews, the Company maintains an allowance for doubtful accounts for estimated losses resulting from the possible inability of tenants to make contractual rent payments to the Company. A provision for doubtful accounts is recorded during each period. The allowance for doubtful accounts, which represents the cumulative allowances less write-offs of uncollectible rent, is netted against tenant and other receivables on the consolidated balance sheets. Tenant receivables are net of an allowance for uncollectible accounts totaling \$400,000 at March 31, 2011 and December 31, 2010.

Financial instruments

The methods and assumptions used to estimate the fair value of financial instruments are described below. The Company has estimated the fair value of financial instruments using available market information and appropriate valuation methodologies. Considerable judgment is required in interpreting market data to develop estimates of market value. Accordingly, estimated fair values are not necessarily indicative of the amounts that could be realized in current market exchanges.

The Company considers all highly liquid investments with a remaining maturity of three months or less at the date of purchase to be cash equivalents. Due to the short period to maturity of the Company's cash and cash equivalents, accounts receivable, other assets and accrued and other liabilities, the carrying values as presented on the consolidated balance sheets are reasonable estimates of fair value. Based on borrowing rates currently available to the Company, the carrying amount of debt approximates fair value.

Financial assets that are exposed to credit risk consist primarily of cash and cash equivalents and receivables. Cash and cash equivalents, which consist primarily of money market investments, are only invested in entities with an investment grade rating. Receivables are comprised of balances due from a large number of customers. Balances that the Company expects to become uncollectible are reserved for or written off.

Real estate facilities

Real estate facilities are recorded at cost. Costs related to the renovation or improvement of the properties are capitalized. Expenditures for repairs and maintenance are expensed as incurred. Expenditures that are expected to benefit a period greater than two years and exceed \$2,000 are capitalized and depreciated over the estimated useful life. Buildings and equipment are depreciated on the straight-line method over the estimated useful lives, which are generally 30 and five years, respectively. Transaction costs, which include tenant improvements and lease commissions, in excess of \$1,000 for leases with terms greater than one year are capitalized and depreciated over their estimated useful lives. Transaction costs for leases of one year or less or less than \$1,000 are expensed as incurred.

Intangible assets/liabilities

Intangible assets and liabilities include above-market and below-market in-place lease values of acquired properties based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. The capitalized above-market and below-market lease values (included in other assets and accrued liabilities in the accompanying consolidated balance sheets) are amortized to rental income over the remaining non-cancelable terms of the respective leases. The Company recorded net amortization of \$209,000 and \$37,000 of intangible assets and liabilities resulting from the above-market and below-market lease values during the three months ended March 31, 2011 and 2010, respectively. As of March 31, 2011, the value of in-place leases resulted in a net intangible asset of \$5.1 million, net of \$2.4 million of accumulated amortization with a weighted average amortization period of 6.6 years, and a net intangible liability of \$2.0 million, net of \$1.7 million of accumulated amortization with a weighted average amortization period of 4.9 years. As of December 31, 2010, the value of in-place leases resulted in a net intangible asset of \$5.4 million, net of \$2.1 million of accumulated amortization, and a net intangible liability of \$2.2 million, net of \$1.5 million of accumulated amortization.

Table of Contents

Evaluation of asset impairment

The Company evaluates its assets used in operations by identifying indicators of impairment and by comparing the sum of the estimated undiscounted future cash flows for each asset to the asset's carrying value. When indicators of impairment are present and the sum of the undiscounted future cash flows is less than the carrying value of such asset, an impairment loss is recorded equal to the difference between the asset's current carrying value and its value based on discounting its estimated future cash flows. In addition, the Company evaluates its assets held for disposition for impairment. Assets held for disposition are reported at the lower of their carrying value or fair value, less cost of disposition. At March 31, 2011, the Company did not consider any assets to be impaired.

Stock compensation

All share-based payments to employees, including grants of employee stock options, are recognized as stock compensation in the Company's income statement based on their fair values. See Note 11.

Revenue and expense recognition

The Company must meet four basic criteria before revenue can be recognized: persuasive evidence of an arrangement exists; the delivery has occurred or services rendered; the fee is fixed or determinable; and collectability is reasonably assured. All leases are classified as operating leases. Rental income is recognized on a straight-line basis over the terms of the leases. Straight-line rent is recognized for all tenants with contractual fixed increases in rent that are not included on the Company's credit watch list. Deferred rent receivable represents rental revenue recognized on a straight-line basis in excess of billed rents. Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as rental income in the period the applicable costs are incurred. Property management fees are recognized in the period earned.

Costs incurred in connection with leasing (primarily tenant improvements and lease commissions) are capitalized and amortized over the lease period.

Gains from sales of real estate facilities

The Company recognizes gains from sales of real estate facilities at the time of sale using the full accrual method, provided that various criteria related to the terms of the transactions and any subsequent involvement by the Company with the properties sold are met. If the criteria are not met, the Company defers the gains and recognizes them when the criteria are met or using the installment or cost recovery methods as appropriate under the circumstances.

General and administrative expenses

General and administrative expenses include executive and other compensation, office expense, professional fees, acquisition transaction costs, state income taxes and other such administrative items.

Income taxes

The Company has qualified and intends to continue to qualify as a REIT, as defined in Section 856 of the Internal Revenue Code. As a REIT, the Company is not subject to federal income tax to the extent that it distributes its REIT taxable income to its shareholders. A REIT must distribute at least 90% of its taxable income each year. In addition, REITs are subject to a number of organizational and operating requirements. If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to federal income tax (including any applicable alternative minimum tax) based on its taxable income using corporate income tax

Table of Contents

rates. Even if the Company qualifies for taxation as a REIT, the Company may be subject to certain state and local taxes on its income and property and to federal income and excise taxes on its undistributed taxable income. The Company believes it met all organization and operating requirements to maintain its REIT status during 2010 and intends to continue to meet such requirements for 2011. Accordingly, no provision for income taxes has been made in the accompanying consolidated financial statements.

The Company can recognize a tax benefit only if it is more likely than not that a particular tax position will be sustained upon examination or audit. To the extent that the more likely than not standard has been satisfied, the benefit associated with a position is measured as the largest amount that is greater than 50% likely of being recognized upon settlement. As of March 31, 2011, the Company did not recognize any tax benefit for uncertain tax positions.

Accounting for preferred equity issuance costs

The Company records issuance costs as a reduction to paid-in capital on its balance sheet at the time the preferred securities are issued and reflects the carrying value of the preferred equity at the stated value. The Company records issuance costs as non-cash preferred equity distributions at the time it notifies the holders of preferred stock or units of its intent to redeem such shares or units.

Net income allocation

Net income was allocated as follows (in thousands):

	For the Three Months Ended March 31, 2011		2010	
Net income allocable to noncontrolling interests:				
Noncontrolling interests common units:				
Continuing operations	\$	4,901	\$	2,322
Discontinued operations				1,191
Total net income allocable to noncontrolling interests common units		4,901		3,513
Noncontrolling interests preferred units:				
Distributions to preferred unit holders		99		1,382
Gain on repurchase of preferred units, net of issuance costs		(7,389)		
Total net income allocable to noncontrolling interests preferred units		(7,290)		1,382
Total net income allocable to noncontrolling interests		(2,389)		4,895
Net income allocable to PS Business Parks, Inc.:				
Common shareholders:				
Continuing operations		16,562		7,761
Discontinued operations				3,979
Total net income allocable to common shareholders		16,562		11,740
Preferred shareholders:				
Distributions to preferred shareholders		10,450		11,155
Restricted stock unit holders:				
Continuing operations		50		34
Discontinued operations				17
Total net income allocable to restricted stock unit holders		50		51

Total net income allocable to PS Business Parks, Inc.	27,062	22,946
	\$ 24,673	\$ 27,841

Table of Contents*Net income per common share*

Per share amounts are computed using the number of weighted average common shares outstanding. Diluted weighted average common shares outstanding includes the dilutive effect of stock options and restricted stock units under the treasury stock method. Basic weighted average common shares outstanding excludes such effect. The Company's restricted stock units are participating securities and included in the computation of basic and diluted weighted average common shares outstanding. The Company's allocation of net income to the restricted stock unit holders are paid non-forfeitable dividends in excess of the expense recorded which results in a reduction in net income allocable to common shareholders and unit holders. Earnings per share has been calculated as follows (in thousands, except per share amounts):

	For the Three Months Ended March 31,	
	2011	2010
Net income allocable to common shareholders	\$ 16,562	\$ 11,740
Weighted average common shares outstanding:		
Basic weighted average common shares outstanding	24,685	24,413
Net effect of dilutive stock compensation based on treasury stock method using average market price	107	151
Diluted weighted average common shares outstanding	24,792	24,564
Net income per common share Basic	\$ 0.67	\$ 0.48
Net income per common share Diluted	\$ 0.67	\$ 0.48

Options to purchase 66,000 and 331,000 shares for the three months ended March 31, 2011 and 2010, respectively, were not included in the computation of diluted net income per share because such options were considered anti-dilutive.

Segment reporting

The Company views its operations as one segment.

Reclassifications

Certain reclassifications have been made to the consolidated financial statements for 2010 in order to conform to the 2011 presentation.

3. Real estate facilities

The activity in real estate facilities for the three months ended March 31, 2011 is as follows (in thousands):

	Land	Buildings and Equipment	Accumulated Depreciation	Total
Balances at December 31, 2010	\$ 564,851	\$ 1,782,613	\$ (776,840)	\$ 1,570,624
Capital improvements, net		8,043		8,043
Disposals		(2,152)	2,152	
Depreciation expense			(20,859)	(20,859)
Balances at March 31, 2011	\$ 564,851	\$ 1,788,504	\$ (795,547)	\$ 1,557,808

The purchase price of acquired properties is allocated to land, buildings and equipment and intangible assets and liabilities associated with in-place leases (including tenant improvements, unamortized lease commissions, value of above-market and below-market leases, acquired in-place lease values, and tenant relationships, if any) based on their

respective estimated fair values. In addition, beginning January 1, 2009, acquisition-related costs are expensed as incurred.

Table of Contents

In determining the fair value of the tangible assets of the acquired properties, management considers the value of the properties as if vacant as of the acquisition date. Management must make significant assumptions in determining the value of assets acquired and liabilities assumed. Using different assumptions in the allocation of the purchase cost of the acquired properties would affect the timing of recognition of the related revenue and expenses. Amounts allocated to land are derived from comparable sales of land within the same region. Amounts allocated to buildings and improvements, tenant improvements and unamortized lease commissions are based on current market replacement costs and other market information. The amount allocated to acquired in-place leases is determined based on management's assessment of current market conditions and the estimated lease-up periods for the respective spaces.

In January, 2010, the Company completed the sale of a 131,000 square foot office building located in Houston, Texas, for a gross sales price of \$10.0 million, resulting in a net gain of \$5.2 million.

Included in the consolidated statements of income are rental income and cost of operations of \$91,000 and \$57,000, respectively, reported as discontinued operations for the property sold during the three months ended March 31, 2010. In addition to minimum rental payments, tenants of this property reimburse the Company for their pro rata share of specified operating expenses, which amounted to \$16,000 and reported as rental income for the three months ended March 31, 2010.

4. Leasing activity

The Company leases space in its real estate facilities to tenants primarily under non-cancelable leases generally ranging from one to 10 years. Future minimum rental revenues excluding recovery of operating expenses as of March 31, 2011 under these leases are as follows (in thousands):

2011	\$ 163,702
2012	176,985
2013	122,808
2014	78,888
2015	51,152
Thereafter	81,150
Total	\$ 674,685

In addition to minimum rental payments, certain tenants reimburse the Company for their pro rata share of specified operating expenses. Such reimbursements amounted to \$15.6 million and \$14.4 million for the three months ended March 31, 2011 and 2010, respectively. These amounts are included as rental income in the accompanying consolidated statements of income.

Leases accounting for 6.1% of total leased square footage are subject to termination options which include leases accounting for 2.9% of total leased square footage having termination options exercisable through December 31, 2011. In general, these leases provide for termination payments should the termination options be exercised. The above table is prepared assuming such options are not exercised.

5. Bank loans

The Company has a line of credit (the Credit Facility) with Wells Fargo Bank which expires on August 1, 2012. The Credit Facility has a borrowing limit of \$100.0 million. Interest on outstanding borrowings is payable monthly. The rate of interest charged on borrowings is equal to a rate ranging from the London Interbank Offered Rate (LIBOR) plus 1.60% to LIBOR plus 2.60% depending on the Company's credit ratings and coverage ratios, as defined. Currently, the Company's rate under the Credit Facility is LIBOR plus 1.80%. In addition, the Company is required to pay an annual commitment fee ranging from 0.15% to 0.40% of the borrowing limit (currently 0.20%). In February, 2011, the Company used the funds borrowed from PS, as discussed in Note 8, to pay down the Credit Facility in full and as such, the available balance was \$100.0 million as of March 31, 2011. The Company had \$93.0 million outstanding on the Credit Facility at an interest rate of 2.11% at December 31, 2010. The Credit Facility requires the Company to meet certain covenants, with which the Company was in compliance at March 31, 2011.

Table of Contents**6. Mortgage notes payable**

Mortgage notes payable consist of the following (in thousands):

	March 31, 2011	December 31, 2010
5.73% mortgage note, secured by one commercial property with a net book value of \$28.3 million, principal and interest payable monthly, due March, 2013	\$ 13,655	\$ 13,729
6.15% mortgage note, secured by one commercial property with a net book value of \$26.2 million, principal and interest payable monthly, due November, 2031 ⁽¹⁾	15,819	15,950
5.52% mortgage note, secured by one commercial property with a net book value of \$15.4 million, principal and interest payable monthly, due May, 2013	9,508	9,572
5.68% mortgage note, secured by one commercial property with a net book value of \$17.0 million, principal and interest payable monthly, due May, 2013	9,530	9,594
5.61% mortgage note, repaid January, 2011 ⁽²⁾		2,666
Total	\$ 48,512	\$ 51,511

(1) The mortgage note has a stated principal balance of \$15.7 million and a stated interest rate of 7.20%. Based on the fair market value at the time of assumption, a mortgage premium was computed based on an effective interest rate of 6.15%. The unamortized premiums were \$154,000 and \$209,000 as of March 31, 2011 and December 31, 2010, respectively. This mortgage is repayable without penalty beginning November, 2011.

(2) The unamortized premium was \$6,000 as of December 31, 2010.

At March 31, 2011, mortgage notes payable had a weighted average interest rate of 5.8% and a weighted average maturity of 8.2 years with principal payments as follows (in thousands):

2011	\$ 985
2012	1,174
2013	31,573
2014	371
2015	399
Thereafter	14,010
Total	\$ 48,512

7. Noncontrolling interests

As described in Note 2, the Company reports noncontrolling interests within equity in the consolidated financial statements, but separate from the Company's shareholders' equity. In addition, net income allocable to noncontrolling interests is shown as a reduction from net income in calculating net income allocable to common shareholders.

Common partnership units

The Company presents the accounts of PSB and the Operating Partnership on a consolidated basis. Ownership interests in the Operating Partnership that can be redeemed for common stock, other than PSB's interest, are classified as noncontrolling interests' common units in the consolidated financial statements. Net income allocable to noncontrolling interests' common units consists of the common units' share of the consolidated operating results after allocation to preferred units and shares. Beginning one year from the date of admission as a limited partner (common units) and subject to certain limitations described below, each limited partner other than PSB has the right to require the redemption of its partnership interest.

Table of Contents

A limited partner (common units) that exercises its redemption right will receive cash from the Operating Partnership in an amount equal to the market value (as defined in the Operating Partnership Agreement) of the partnership interests redeemed. In lieu of the Operating Partnership redeeming the partner for cash, PSB, as general partner, has the right to elect to acquire the partnership interest directly from a limited partner exercising its redemption right, in exchange for cash in the amount specified above or by issuance of one share of PSB common stock for each unit of limited partnership interest redeemed.

A limited partner (common units) cannot exercise its redemption right if delivery of shares of PSB common stock would be prohibited under the applicable articles of incorporation, or if the general partner believes that there is a risk that delivery of shares of common stock would cause the general partner to no longer qualify as a REIT, would cause a violation of the applicable securities laws, or would result in the Operating Partnership no longer being treated as a partnership for federal income tax purposes.

At March 31, 2011, there were 7,305,355 common units owned by PS, which are accounted for as noncontrolling interests. On a fully converted basis, assuming all 7,305,355 noncontrolling interests common units were converted into shares of common stock of PSB at March 31, 2011, the noncontrolling interests common units would convert into 22.8% of the common shares outstanding. Combined with PS's common stock ownership, on a fully converted basis, PS has a combined ownership of 40.9% of the Company's common equity. At the end of each reporting period, the Company determines the amount of equity (book value of net assets) which is allocable to the noncontrolling interest based upon the ownership interest, and an adjustment is made to the noncontrolling interest, with a corresponding adjustment to paid-in capital, to reflect the noncontrolling interests' equity interest in the Company.

Preferred partnership units

Through the Operating Partnership, the Company had the following preferred units outstanding as of March 31, 2011 and December 31, 2010:

Series	Issuance Date	Earliest Potential Dividend Redemption Date	Rate	March 31, 2011		December 31, 2010	
				Units	Amount (in thousands)	Units	Amount (in thousands)
Series N	December, 2005	December, 2010	7.125%	223,300	\$ 5,583	223,300	\$ 5,583
Series J	May & June, 2004	N/A	7.500%			1,710,000	42,750
Series Q	March, 2007	N/A	6.550%			203,400	5,085
Total				223,300	\$ 5,583	2,136,700	\$ 53,418

In February, 2011, the Company paid an aggregate of \$39.1 million to repurchase 1,710,000 units of its 7.50% Series J Cumulative Redeemable Preferred Units and 203,400 units of its 6.55% Series Q Cumulative Redeemable Preferred Units for a weighted average purchase price of \$20.43 per unit. The aggregate par value of the repurchased preferred units was \$47.8 million, which generated a gain of \$7.4 million, net of original issuance costs of \$1.4 million, which was added to net income allocable to common shareholders.

The Operating Partnership has the right to redeem preferred units on or after the fifth anniversary of the applicable issuance date at the original capital contribution plus the cumulative priority return, as defined, to the redemption date to the extent not previously distributed. The preferred units are exchangeable for Cumulative Redeemable Preferred Stock of the respective series of PSB on or after the tenth anniversary of the date of issuance at the option of the Operating Partnership or a majority of the holders of the respective preferred units. The Cumulative Redeemable Preferred Stock will have the same distribution rate and par value as the corresponding preferred units and will otherwise have equivalent terms to the other series of preferred stock described in Note 9. As of March 31, 2011, the Company had \$149,000 of deferred costs in connection with the issuance of preferred units, which the Company will report as additional distributions upon notice of redemption.

Table of Contents

8. Related party transactions

On February 9, 2011, the Company entered into an agreement with PS to borrow \$121.0 million with a maturity date of August 9, 2011 at an interest rate of LIBOR plus 0.85%. Funds from this loan were used for the repurchase of the Company's 7.50% Series J Cumulative Redeemable Preferred Units for \$35.4 million and to repay, in full, the outstanding balance on the Company's Credit Facility. The Company had \$121.0 million outstanding on the note payable to PS at a weighted average interest rate of 1.2% at March 31, 2011. Subsequent to March 31, 2011, the Company repaid \$5.0 million on the note payable to PS.

Pursuant to a cost sharing and administrative services agreement, the Company shares costs with PS and its affiliated entities for certain administrative services, which are allocated among PS and its affiliates in accordance with a methodology intended to fairly allocate those costs. These costs totaled \$110,000 and \$206,000 for the three months ended March 31, 2011 and 2010, respectively.

The Operating Partnership manages industrial, office and retail facilities for PS and its affiliated entities. These facilities, all located in the United States, operate under the Public Storage or PS Business Parks names. The PS Business Parks name and logo is owned by PS and licensed to the Company under a non-exclusive, royalty-free license agreement. The license can be terminated by either party for any reason with six months written notice.

Under the property management contracts, the Operating Partnership is compensated based on a percentage of the gross revenues of the facilities managed. Under the supervision of the property owners, the Operating Partnership coordinates rental policies, rent collections, marketing activities, the purchase of equipment and supplies, maintenance activities, and the selection and engagement of vendors, suppliers and independent contractors. In addition, the Operating Partnership assists and advises the property owners in establishing policies for the hire, discharge and supervision of employees for the operation of these facilities, including property managers and leasing, billing and maintenance personnel.

The property management contract with PS is for a seven-year term with the agreement automatically extending for an additional one-year period upon each one-year anniversary of its commencement (unless cancelled by either party). Either party can give notice of its intent to cancel the agreement upon expiration of its current term. Management fee revenues under these contracts were \$178,000 and \$173,000 for the three months ended March 31, 2011 and 2010, respectively.

In December, 2006, PS began providing property management services for the mini storage component of two assets owned by the Company. These mini storage facilities, located in Palm Beach County, Florida, operate under the Public Storage name.

Under the property management contracts, PS is compensated based on a percentage of the gross revenues of the facilities managed. Under the supervision of the Company, PS coordinates rental policies, rent collections, marketing activities, the purchase of equipment and supplies, maintenance activities, and the selection and engagement of vendors, suppliers and independent contractors. In addition, PS assists and advises the Company in establishing policies for the hire, discharge and supervision of employees for the operation of these facilities, including on-site managers, assistant managers and associate managers.

Either the Company or PS can cancel the property management contract upon 60 days notice. Management fee expenses under the contract were \$13,000 and \$12,000 for the three months ended March 31, 2011 and 2010, respectively.

At March 31, 2011, the Company had amounts due to PS of \$88,000 for these contracts, as well as for certain operating expenses, compared to amounts due from PS of \$530,000 at December 31, 2010.

Table of Contents**9. Shareholders equity***Preferred stock*

As of March 31, 2011 and December 31, 2010, the Company had the following series of preferred stock outstanding:

Series	Issuance Date	Earliest Potential Dividend Redemption Date	Rate	March 31, 2011		December 31, 2010	
				Shares Outstanding (in thousands)	Amount (in thousands)	Shares Outstanding (in thousands)	Amount (in thousands)
Series H	January & October, 2004	January, 2009	7.000%	6,340,776	\$ 158,520	6,340,776	\$ 158,520
Series I	April, 2004	April, 2009	6.875%	2,745,050	68,626	2,745,050	68,626
Series M	May, 2005	May, 2010	7.200%	3,182,000	79,550	3,182,000	79,550
Series O	June & August, 2006	June, 2011	7.375%	3,384,000	84,600	3,384,000	84,600
Series P	January, 2007	January, 2012	6.700%	5,290,000	132,250	5,290,000	132,250
Series R	October, 2010	October, 2015	6.875%	3,000,000	75,000	3,000,000	75,000
Total				23,941,826	\$ 598,546	23,941,826	\$ 598,546

The Company paid \$10.5 million and \$11.2 million in distributions to its preferred shareholders for the three months ended March 31, 2011 and 2010, respectively.

Holders of the Company's preferred stock will not be entitled to vote on most matters, except under certain conditions. In the event of a cumulative arrearage equal to six quarterly dividends, the holders of the preferred stock will have the right to elect two additional members to serve on the Company's Board of Directors until all events of default have been cured. At March 31, 2011, there were no dividends in arrears.

Except under certain conditions relating to the Company's qualification as a REIT, the preferred stock is not redeemable prior to the previously noted redemption dates. On or after the respective redemption dates, the respective series of preferred stock will be redeemable, at the option of the Company, in whole or in part, at \$25.00 per depositary share, plus any accrued and unpaid dividends. As of March 31, 2011, the Company had \$19.7 million of deferred costs in connection with the issuance of preferred stock, which the Company will report as additional non-cash distributions upon notice of its intent to redeem such shares.

Common stock

The Company's Board of Directors previously authorized the repurchase, from time to time, of up to 6.5 million shares of the Company's common stock on the open market or in privately negotiated transactions. Since inception of the program, the Company has repurchased an aggregate of 4.3 million shares of common stock at an aggregate cost of \$152.8 million or an average cost per share of \$35.84. Under existing board authorizations, the Company can repurchase an additional 2.2 million shares. No shares of common stock were repurchased under this program during the three months ended March 31, 2011 and 2010.

The Company paid \$10.9 million (\$0.44 per common share) and \$10.7 million (\$0.44 per common share) in distributions to its common shareholders for the three months ended March 31, 2011 and 2010, respectively.

Equity stock

In addition to common and preferred stock, the Company is authorized to issue 100.0 million shares of equity stock. The Articles of Incorporation provide that the equity stock may be issued from time to time in one or more series and give the Board of Directors broad authority to fix the dividend and distribution rights, conversion and voting rights, redemption provisions and liquidation rights of each series of equity stock.

Table of Contents**10. Commitments and contingencies**

The Company currently is neither subject to any material litigation nor, to management's knowledge, is any material litigation currently threatened against the Company other than routine litigation and administrative proceedings arising in the ordinary course of business.

11. Stock compensation

PSB has a 1997 Stock Option and Incentive Plan (the "1997 Plan") and a 2003 Stock Option and Incentive Plan (the "2003 Plan"), each covering 1.5 million shares of PSB's common stock. Under the 1997 Plan and 2003 Plan, PSB has granted non-qualified options to certain directors, officers and key employees to purchase shares of PSB's common stock at a price not less than the fair market value of the common stock at the date of grant. Additionally, under the 1997 Plan and 2003 Plan, PSB has granted restricted stock units to officers and key employees.

The weighted average grant date fair value of options granted during the three months ended March 31, 2010 was \$5.99 per share. The Company has calculated the fair value of each option grant on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants during the three months ended March 31, 2010: a dividend yield of 3.4%; expected volatility of 17.5%; expected life of five years; and risk-free interest rates of 2.4%. No options were granted during the three months ended March 31, 2011.

The weighted average grant date fair value of restricted stock units granted during the three months ended March 31, 2010 was \$52.35. The Company calculated the fair value of each restricted stock unit grant using the market value on the date of grant. No restricted stock units were granted during the three months ended March 31, 2011.

At March 31, 2011, there were a combined total of 886,000 options and restricted stock units authorized to grant. Information with respect to outstanding options and nonvested restricted stock units granted under the 1997 Plan and 2003 Plan is as follows:

	Number of	Weighted	Weighted	Aggregate
	Options	Average	Average	Intrinsic
Options:		Exercise	Remaining	Value
		Price	Contract Life	(in
				thousands)
Outstanding at December 31, 2010	577,816	\$ 48.95		
Granted		\$		
Exercised	(22,600)	\$ 41.81		
Forfeited		\$		
Outstanding at March 31, 2011	555,216	\$ 49.24	6.38 Years	\$ 5,246
Exercisable at March 31, 2011	291,216	\$ 46.10	4.42 Years	\$ 3,700
			Number of	Weighted
			Units	Average Grant
Restricted Stock Units:				Date Fair
				Value
Nonvested at December 31, 2010			85,674	\$ 53.60
Granted				\$
Vested			(24,030)	\$ 56.08
Forfeited			(3,500)	\$ 51.53
Nonvested at March 31, 2011			58,144	\$ 52.70

Included in the Company's consolidated statements of income for the three months ended March 31, 2011 and 2010, was \$136,000 and \$94,000, respectively, in net compensation expense related to stock options. Net compensation expense of \$287,000 and \$479,000 related to restricted stock units was recognized during the three months ended March 31, 2011 and 2010, respectively.

As of March 31, 2011, there was \$1.5 million of unamortized compensation expense related to stock options expected to be recognized over a weighted average period of 3.7 years. As of March 31, 2010, there was \$3.1 million of unamortized compensation expense related to restricted stock units expected to be recognized over a weighted average period of 3.3 years.

Table of Contents

Cash received from 22,600 stock options exercised during the three months ended March 31, 2011 was \$944,000. Cash received from 73,000 stock options exercised during the three months ended March 31, 2010 was \$2.6 million. The aggregate intrinsic value of the stock options exercised during the three months ended March 31, 2011 and 2010 was \$445,000 and \$1.2 million, respectively.

During the three months ended March 30, 2011, 24,030 restricted stock units vested; in settlement of these units, 15,232 shares were issued, net of shares applied to payroll taxes. The aggregate fair value of the shares vested for the three months ended March 31, 2011 was \$1.4 million. During the three months ended March 31, 2010, 31,597 restricted stock units vested; in settlement of these units, 19,892 shares were issued, net of shares applied to payroll taxes. The aggregate fair value of the shares vested for the three months ended March 31, 2010 was \$1.7 million.

In May of 2004, the shareholders of the Company approved the issuance of up to 70,000 shares of common stock under the Retirement Plan for Non-Employee Directors (the Director Plan). Under the Director Plan, the Company grants 1,000 shares of common stock for each year served as a director up to a maximum of 5,000 shares issued upon retirement. The Company recognizes compensation expense with regards to grants to be issued in the future under the Director Plan. As a result, included in the Company's consolidated statements of income was \$36,000 and \$42,000 in compensation expense for the three months ended March 31, 2011 and 2010, respectively. As of March 31, 2011 and 2010, there was \$304,000 and \$450,000, respectively, of unamortized compensation expense related to these shares. In January, 2011 the Company issued 5,000 shares to a director upon retirement with an aggregate fair value of \$290,000. No shares were issued for the three months ended March 31, 2010.

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

Forward-Looking Statements: Forward-looking statements are made throughout this Quarterly Report on Form 10-Q. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words may, believes, anticipates, plans, expects, seeks, estimates, intends, and similar expressions are intended to identify forward-looking statements. There are a number of important factors that could cause the results of the Company to differ materially from those indicated by such forward-looking statements: (a) changes in general economic and business conditions; (b) decreases in rental rates or increases in vacancy rates/failure to renew or replace expiring leases; (c) tenant defaults; (d) the effect of the recent credit and financial market conditions; (e) our failure to maintain our status as a real estate investment trust (REIT); (f) the economic health of our tenants; (g) increases in operating costs; (h) casualties to our properties not covered by insurance; (i) the availability and cost of capital; (j) increases in interest rates and its effect on our stock price; (k) other factors discussed under the heading Item 1A. Risk Factors in our annual report on Form 10-K for the year ended December 31, 2010. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. Moreover, we assume no obligation to update these forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements, except as required by law.

Overview

As of March 31, 2011, the Company owned and operated 21.8 million rentable square feet of multi-tenant flex, industrial and office properties located in eight states.

The Company focuses on increasing profitability and cash flow aimed at maximizing shareholder value. The Company strives to maintain high occupancy levels while increasing rental rates when market conditions allow, although the Company may decrease rental rates in markets where conditions require. The Company also acquires properties it believes will create long-term value, and from time to time disposes of properties which no longer fit within the Company's strategic objectives or in situations where the Company believes it can optimize cash proceeds. Operating results are driven by income from rental operations and are therefore substantially influenced by rental demand for space within our properties and rental rates.

Table of Contents

During the first three months of 2011, the Company leased or re-leased 1.5 million square feet of space while experiencing a decrease in rental rates of 7.2%. Total net operating income for the three months ended March 31, 2011 increased \$3.9 million, or 8.8%, compared to the three months ended March 31, 2010 (see reconciliation of net operating income to income from continuing operations on page 27). See further discussion of operating results below.

Critical Accounting Policies and Estimates:

Our accounting policies are described in Note 2 to the consolidated financial statements included in this Form 10-Q. We believe our most critical accounting policies relate to revenue recognition, property acquisitions, allowance for doubtful accounts, impairment of long-lived assets, depreciation, accruals of operating expenses and accruals for contingencies, each of which we discuss below.

Revenue Recognition: The Company must meet four basic criteria before revenue can be recognized: persuasive evidence of an arrangement exists; the delivery has occurred or services rendered; the fee is fixed or determinable; and collectability is reasonably assured. All leases are classified as operating leases. Rental income is recognized on a straight-line basis over the terms of the leases. Straight-line rent is recognized for all tenants with contractual fixed increases in rent that are not included on the Company's credit watch list. Deferred rent receivable represents rental revenue recognized on a straight-line basis in excess of billed rents. Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as rental income in the period the applicable costs are incurred. Property management fees are recognized in the period earned.

Property Acquisitions: The Company allocates the purchase price of acquired properties to land, buildings and equipment and intangible assets and liabilities associated with in-place leases (including tenant improvements, unamortized lease commissions, value of above-market and below-market leases, acquired in-place lease values, and tenant relationships, if any) based on their respective estimated fair values. In addition, beginning January 1, 2009, acquisition-related costs are expensed as incurred.

In determining the fair value of the tangible assets of the acquired properties, management considers the value of the properties as if vacant as of the acquisition date. Management must make significant assumptions in determining the value of assets acquired and liabilities assumed. Using different assumptions in the allocation of the purchase cost of the acquired properties would affect the timing of recognition of the related revenue and expenses. Amounts allocated to land are derived from comparable sales of land within the same region. Amounts allocated to buildings and improvements, tenant improvements and unamortized lease commissions are based on current market replacement costs and other market rate information.

The value allocable to the above-market or below-market in-place lease values of acquired properties is determined based upon the present value (using a discount rate which reflects the risks associated with the acquired leases) of the difference between (i) the contractual rents to be paid pursuant to the in-place leases, and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. The amounts allocated to above-market or below-market leases are included in other assets or other liabilities in the accompanying consolidated balance sheets and are amortized on a straight-line basis as an increase or reduction of rental income over the remaining non-cancelable term of the respective leases.

Allowance for Doubtful Accounts: Rental revenue from our tenants is our principal source of revenue. We monitor the collectability of our receivable balances including the deferred rent receivable on an ongoing basis. Based on these reviews, we maintain an allowance for doubtful accounts for estimated losses resulting from the possible inability of our tenants to make required rent payments to us. Tenant receivables and deferred rent receivables are carried net of the allowances for uncollectible tenant receivables and deferred rent. As discussed below, determination of the adequacy of these allowances requires significant judgments and estimates. Our estimate of the required allowance is subject to revision as the factors discussed below change and is sensitive to the effect of economic and market conditions on our tenants.

Table of Contents

Tenant receivables consist primarily of amounts due for contractual lease payments, reimbursements of common area maintenance expenses, property taxes and other expenses recoverable from tenants. Determination of the adequacy of the allowance for uncollectible current tenant receivables is performed using a methodology that incorporates specific identification, aging analysis, an overall evaluation of the historical loss trends and the current economic and business environment. The specific identification methodology relies on factors such as the age and nature of the receivables, the payment history and financial condition of the tenant, the assessment of the tenant's ability to meet its lease obligations, and the status of negotiations of any disputes with the tenant. The allowance also includes a reserve based on historical loss trends not associated with any specific tenant. This reserve as well as the specific identification reserve is reevaluated quarterly based on economic conditions and the current business environment.

Deferred rent receivable represents the amount that the cumulative straight-line rental income recorded to date exceeds cash rents billed to date under the lease agreement. Given the long-term nature of these types of receivables, determination of the adequacy of the allowance for unbilled deferred rent receivable is based primarily on historical loss experience. Management evaluates the allowance for unbilled deferred rent receivable using a specific identification methodology for significant tenants designed to assess their financial condition and ability to meet their lease obligations.

Impairment of Long-Lived Assets: The Company evaluates a property for potential impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. On a quarterly basis, we evaluate our entire portfolio for impairment based on current operating information. In the event that these periodic assessments reflect that the carrying amount of a property exceeds the sum of the undiscounted cash flows (excluding interest) that are expected to result from the use and eventual disposition of the property, the Company would recognize an impairment loss to the extent the carrying amount exceeded the estimated fair value of the property. The estimation of expected future net cash flows is inherently uncertain and relies on subjective assumptions dependent upon future and current market conditions and events that affect the ultimate value of the property. Management must make assumptions related to the property such as future rental rates, tenant allowances, operating expenditures, property taxes, capital improvements, occupancy levels and the estimated proceeds generated from the future sale of the property. These assumptions could differ materially from actual results in future periods. Our intent to hold properties over the long-term directly decreases the likelihood of recording an impairment loss. If our strategy changes or if market conditions otherwise dictate an earlier sale date, an impairment loss could be recognized, and such loss could be material.

Depreciation: We compute depreciation on our buildings and equipment using the straight-line method based on estimated useful lives of generally 30 and five years, respectively. A significant portion of the acquisition cost of each property is allocated to building and building components. The allocation of the acquisition cost to building and building components, as well as the determination of their useful lives, are based on estimates. If we do not appropriately allocate to these components or we incorrectly estimate the useful lives of these components, our computation of depreciation expense may not appropriately reflect the actual impact of these costs over future periods, which will affect net income. In addition, the net book value of real estate assets could be overstated or understated. The statement of cash flows, however, would not be affected.

Accruals of Operating Expenses: The Company accrues for property tax expenses, performance bonuses and other operating expenses each quarter based on historical trends and anticipated disbursements. If these estimates are incorrect, the timing and amount of expense recognized will be affected.

Accruals for Contingencies: The Company is exposed to business and legal liability risks with respect to events that may have occurred, but in accordance with U.S. generally accepted accounting principles (GAAP) has not accrued for such potential liabilities because the loss is either not probable or not estimable. Future events could result in such potential losses becoming probable and estimable, which could have a material adverse impact on our financial condition or results of operations.

Table of Contents***Effect of Economic Conditions on the Company's Operations:***

During the first three months of 2011, the impact of the recent recession and weak economic conditions continued to affect commercial real estate negatively as the Company experienced a decrease in new rental rates over expiring rental rates on executed leases. Although it is uncertain what impact economic conditions will have on the Company's future ability to maintain existing occupancy levels and rental rates, management expects that the decrease in rental rates on lease transactions will result in a decrease in rental income for 2011 when compared to 2010. The current economic conditions may have a significant impact on the Company, potentially resulting in further reductions in occupancy and rental rates.

While the Company historically has experienced a low level of write-offs of uncollectable rents, there is inherent uncertainty in a tenant's ability to continue paying rent and meet their full lease obligation. The table below summarizes the impact to the Company from tenants' inability to pay rent or continue to meet their lease obligation (in thousands):

	For The Three Months Ended March 31,	
	2011	2010
Write offs of uncollectible rent	\$ 248	\$ 419
Write offs as a percentage of rental income	0.3%	0.6%
Square footage of leases terminated prior to scheduled expiration due to business failures	81	125
Accelerated depreciation expense related to unamortized tenant improvements and lease commissions associated with early terminations	\$ 248	\$ 495

As of April 29, 2011, the Company had 33,000 square feet of leased space occupied by tenants that are protected by Chapter 11 of the U.S. Bankruptcy Code. From time to time, tenants contact us, requesting early termination of their lease, a reduction in space under lease, or rent deferment or abatement. At this time, the Company cannot anticipate what impact, if any, the ultimate outcome of these discussions will have on our future operating results.

Company Performance and Effect of Economic Conditions on Primary Markets:

The Company's operations are substantially concentrated in 10 regions. The Company's assessment of these regions as of March 31, 2011 is summarized below. During the three months ended March 31, 2011, initial rental rates on new and renewed leases within the Company's overall portfolio decreased 7.2% over expiring rents, an improvement from a decline of 13.0% for the year ended December 31, 2010. The Company's Same Park (defined below) vacancy rate at March 31, 2011 was 8.9%, up from 8.5% at March 31, 2010. The Company's overall vacancy rate at March 31, 2011 was 10.7%, up from 8.8% at March 31, 2010. Each of the 10 regions in which the Company owns assets is subject to its own unique market influences. Below is a summary of the general market conditions as well as the Company's operating statistics for each of the 10 regions in which the Company operates. The Company has compiled market information set forth below using third party reports for each respective market. The Company considers these sources to be reliable, but there can be no assurance that the information in these reports is accurate.

The Company owns 4.0 million square feet in Southern California located in Los Angeles, Orange and San Diego Counties. For the first three months of 2011, fundamentals for Southern California continued to reflect signs of modest stability despite slight decreases in rental rates. Two of the three markets experienced a decline in vacancy rate and had positive net absorption year over year. Market vacancy rates in Southern California range from 3.9% to 16.7%. The Company's vacancy rate in its Southern California portfolio was 10.7% at March 31, 2011. For the three months ended March 31, 2011, the overall region experienced a weighted positive net absorption of 0.6%. Despite the positive net absorption in the overall region, the Company's weighted average occupancy in this region decreased from 92.4% for the first three months of 2010 to 89.6% for the first three months of 2011. The decrease in the Company's weighted average occupancy was primarily due to several large tenants vacating 91,000 square feet in 2010 and 2011. Annualized realized rent per square foot decreased 1.8% from \$15.74 per square foot for the first three months of 2010 to \$15.46 per square foot for the first three months of 2011.

Table of Contents

The Company owns 1.8 million square feet in Northern California with concentrations in Sacramento, the East Bay (Hayward and San Ramon) and Silicon Valley (San Jose and Santa Clara). Market vacancy rates in these submarkets are 23.5%, 21.3% and 18.2%, respectively. The Company's vacancy rate in its Northern California portfolio was 10.1% at March 31, 2011. During the first three months of 2011, demand in these submarkets remained low, which negatively impacted both rental and occupancy rates. Leasing activity was primarily related to companies contracting and reorganizing business operations. For the three months ended March 31, 2011, the combined submarkets experienced negative net absorption of 0.2%. Despite the negative net absorption in these submarkets, the Company's weighted average occupancy in this region increased from 88.9% for the first three months of 2010 to 90.5% for the first three months of 2011. The increase in the weighted average occupancy was due to 32,000 square feet of vacant space leased during the fourth quarter of 2010. However, annualized realized rent per square foot decreased 2.3% from \$12.35 per square foot for the first three months of 2010 to \$12.07 per square foot for the first three months of 2011.

The Company owns 1.7 million square feet in Southern Texas, specifically in the Austin and Houston markets. During the second quarter of 2010, the Company acquired a portfolio of assets in Austin aggregating 704,000 square feet of multi-tenant flex parks. Market vacancy rates are 20.8% in the Austin market and 16.0% in the Houston market. The Company's vacancy rate for these combined markets at March 31, 2011 was 10.8%. For the first three months of 2011, fundamentals continue to reflect signs of stability for the combined markets as they experienced a weighted positive net absorption of 0.1% and flat rental rate growth. Weighted average occupancy for the Company's Same Park portfolio for this market increased from 85.3% for the first three months of 2010 to 88.3% for the first three months of 2011. The increase in the weighted average occupancy was primarily due to 28,000 square feet of vacant space leased during the second quarter of 2010. The Company's overall weighted average occupancy for this market increased from 85.3% for the first three months of 2010 to 87.7% for the first three months of 2011. Annualized realized rent per square foot increased 6.9% from \$10.90 per square foot for the first three months of 2010 to \$11.65 per square foot for the first three months of 2011. Excluding the acquisition, annualized realized rent per square foot for this market increased 0.5% from \$10.90 per square foot for the first three months of 2010 to \$10.95 per square foot for the first three months of 2011.

The Company owns 1.7 million square feet in Northern Texas, throughout the Dallas Metroplex market. The market vacancy rate in Las Colinas, where significant concentration of the Company's Northern Texas portfolio is located, is 12.8%. The Company's vacancy rate at March 31, 2011 in this market was 9.1%. For the three months ended March 31, 2011, the market experienced negative net absorption of 0.3%. The Company's weighted average occupancy for the region decreased from 91.3% for the first three months of 2010 to 90.7% for the first three months of 2011. Annualized realized rent per square foot decreased 3.0% from \$10.95 per square foot for the first three months of 2010 to \$10.62 per square foot for the first three months of 2011.

The Company owns 3.7 million square feet in South Florida, which consists of the Miami International Commerce Center (MICC) business park located in the Airport West submarket of Miami-Dade County and two multi-tenant flex parks located in Palm Beach County. MICC is located less than one mile from the cargo entrance of the Miami International Airport, which is one of the most active cargo airports in the United States. For the first three months of 2011, the Miami and Palm Beach markets experienced a decline in vacancy rates and had positive net absorption year over year. Market fundamentals may be stabilizing in Miami as market vacancy is at its lowest since 2009 and positive net absorption was recorded for four consecutive quarters. Market vacancy rates for Miami-Dade County and Palm Beach County are 7.8% and 11.7%, respectively, compared to the Company's vacancy rate for Miami-Dade County and Palm Beach County of 1.2% and 10.3%, respectively, at March 31, 2011. For the three months ended March 31, 2011, the combined markets experienced a weighted positive net absorption of 1.1%. The Company's weighted average occupancy in this region increased from 95.2% for the first three months of 2010 to 96.9% for the first three months of 2011. Annualized realized rent per square foot decreased 6.1% from \$9.23 per square foot for the first three months of 2010 to \$8.67 per square foot for the first three months of 2011. During the third quarter of 2010, the Company completed construction on a parcel of land within MICC, which added 75,000 square feet of rentable small tenant industrial space. As of March 31, 2011, the newly constructed building was 100.0% occupied.

Table of Contents

The Company owns 4.0 million square feet in the Northern Virginia submarket of Washington D.C. During the second half of 2010, the Company acquired Tysons Corporate Center, a 270,000 square foot two-building multi-tenant office park, and Westpark Business Campus, a 735,000 square foot seven-building multi-tenant office park, each located in Tysons Corner, Virginia. The Company's overall vacancy rate at March 31, 2011 was 17.2% compared to the average market vacancy rate of 13.7%. For the three months ended March 31, 2011, the market experienced negative net absorption of 0.3%. Weighted average occupancy for the Company's Same Park portfolio for this market decreased from 94.4% for the first three months of 2010 to 90.7% for the first three months of 2011. The decrease in the Same Park weighted average occupancy was primarily due to four large tenants with scheduled expirations in 2010 and 2011. The Company's overall weighted average occupancy for this market decreased from 94.4% for the first three months of 2010 to 82.8% for the first three months of 2011 as a result of the acquisitions which had a combined weighted average occupancy of 58.9% for the three months ended March 31, 2011. Annualized realized rent per square foot increased 4.2% from \$21.13 per square foot for the first three months of 2010 to \$22.01 per square foot for the first three months of 2011. Excluding the acquisitions, annualized realized rent per square foot for this market decreased 4.0% from \$21.13 per square foot for the first three months of 2010 to \$20.28 per square foot for the first three months of 2011.

The Company owns 2.4 million square feet in the Maryland submarket of Washington D.C. During the first half of 2010, the Company acquired Shady Grove Executive Center, a 350,000 square foot multi-tenant office park, and Parklawn Business Park, a 232,000 square foot multi-tenant office and flex park, each located in Rockville, Maryland. The Company's overall vacancy rate in the region at March 31, 2011 was 13.5% compared to 14.3% for the market as a whole. For the three months ended March 31, 2011, the net absorption remained flat for the market. Weighted average occupancy for the Company's Same Park portfolio for this market decreased from 93.6% for the first three months of 2010 to 88.9% for the first three months of 2011. The decrease in the Same Park weighted average occupancy was primarily due to several tenants aggregating 74,000 square feet vacating in 2010, of which 39,000 square feet were scheduled expirations. The Company's overall weighted average occupancy decreased from 92.9% for the first three months of 2010 to 86.3% for the first three months of 2011 as a result of the acquisitions which had a combined weighted average occupancy of 78.4% for the three months ended March 31, 2011. Annualized realized rent per square foot increased 3.5% from \$23.74 per square foot for the first three months of 2010 to \$24.57 per square foot for the first three months of 2011. Excluding the acquisitions, annualized realized rent per square foot for this market increased 3.8% from \$23.56 per square foot for the first three months of 2010 to \$24.46 per square foot for the first three months of 2011.

The Company owns 1.3 million square feet in the Beaverton submarket of Portland, Oregon. Market vacancy for this submarket is 24.7% compared to the Company's vacancy rate of 14.3% at March 31, 2011. Despite the improvement in leasing activity and occupancy for the first three months of 2011, rental rates continued to soften. For the three months ended March 31, 2011, the net absorption remained flat for the market. The Company's weighted average occupancy increased from 82.0% for the first three months of 2010 to 85.7% for the first three months of 2011 primarily as a result of 40,000 square feet leased to tenants in 2010. However, annualized realized rent per square foot decreased 2.1% from \$16.29 per square foot for the first three months of 2010 to \$15.94 per square foot for the first three months of 2011.

The Company owns 679,000 square feet in the Phoenix and Tempe submarkets of Arizona. During 2011, national and local economies continued to impact the submarkets negatively. Market vacancies increased significantly in 2009 due in part to companies contracting and reorganizing business operations in the market, which had a negative impact on rental rates in 2010. For the first three months of 2011, market vacancy decreased for the fourth consecutive quarter, while market rental rates remained flat. The combined submarket vacancy rate is 13.5% compared to the Company's vacancy rate of 11.7% at March 31, 2011. For the three months ended March 31, 2011, the market experienced positive net absorption of 0.7%. The Company's weighted average occupancy in the region increased from 82.9% for the first three months of 2010 to 87.9% for the first three months of 2011. Annualized realized rent per square foot decreased 10.0% from \$10.69 per square foot for the first three months of 2010 to \$9.62 per square foot for the first three months of 2011 as rental rates decreased on new and renewed leases.

Table of Contents

The Company owns 521,000 square feet in the state of Washington which mostly consists of Overlake Business Center, a 493,000 square foot multi-tenant office and flex park located in Redmond. Leasing activity showed signs of stabilization as evidenced by the positive net absorption and a drop in vacancy rates from the prior quarter. The market vacancy rate is 13.5% compared to the Company's vacancy rate of 5.3% at March 31, 2011. For the three months ended March 31, 2011, the market experienced positive net absorption of 0.2%. The Company's weighted average occupancy increased from 87.5% for the first three months of 2010 to 94.4% for the first three months of 2011. Annualized realized rent per square foot decreased 0.7% from \$18.42 per square foot for the first three months of 2010 to \$18.29 per square foot for the first three months of 2011 as rental rates decreased on new and renewed leases.

Growth of the Company's Operations and Acquisitions and Dispositions of Properties:

The Company is focused on maximizing cash flow from its existing portfolio of properties by looking for opportunities to expand its presence in existing and new markets through strategic acquisitions. The Company may from time to time dispose of non-strategic assets that do not meet this criterion. The Company has historically maintained a low-leverage-level approach intended to provide the Company with the greatest level of flexibility for future growth.

In 2010, the Company acquired five business parks comprising 2.3 million square feet for an aggregate purchase price of \$301.7 million. As of March 31, 2011, the blended occupancy of the assets acquired was 73.5%. As of March 31, 2011, the Company had approximately 607,000 square feet of vacancy spread over the five parks which provides the Company with considerable opportunity to generate additional rental income given that the Company's other assets in these same submarkets have a blended occupancy of 88.7% at March 31, 2011. The table below reflects the assets acquired in 2010 (in thousands):

Property	Date Acquired	Location	Purchase Price	Square Feet	Occupancy at March 31, 2011
Westpark Business Campus	December, 2010	Tysons Corner, Virginia	\$ 140,000	735	61.9%
Tysons Corporate Center	July, 2010	Tysons Corner, Virginia	\$ 35,400	270	53.1%
Parklawn Business Park	June, 2010	Rockville, Maryland	\$ 23,430	232	79.0%
Austin Flex Portfolio	April, 2010	Austin, Texas	\$ 42,900	704	89.7%
Shady Grove Executive Center	March, 2010	Rockville, Maryland	\$ 60,000	350	77.4%

In addition to the 2010 property acquisitions, during 2010, the Company also completed construction on a parcel of land within MICC in Miami, Florida, which added 75,000 square feet of rentable small tenant industrial space. As of March 31, 2011, the newly constructed building was 100.0% occupied.

The Company made no acquisitions during the three months ended March 31, 2011.

During January, 2010, the Company completed the sale of a 131,000 square foot office building located in Houston, Texas, for a gross sales price of \$10.0 million, resulting in a net gain of \$5.2 million. The Company made no dispositions during the three months ended March 31, 2011.

Scheduled Lease Expirations:

In addition to the 2.3 million square feet, or 10.7%, of space available in our total portfolio as of March 31, 2011, leases representing 16.0% of the leased square footage of our total portfolio are scheduled to expire during the remainder of 2011. Our ability to re-lease available space depends upon the market conditions in the specific submarkets in which our properties are located. As a result, we cannot predict with certainty the rate at which expiring leases will be re-leased.

Impact of Inflation:

Although inflation has not been significant in recent years, it remains a potential factor in our economy, and the Company continues to seek ways to mitigate its potential impact. A substantial portion of the Company's leases require

tenants to pay operating expenses, including real estate taxes, utilities, and insurance, as well as increases in common area expenses, partially reducing the Company's exposure to inflation.

Table of Contents**Concentration of Portfolio by Region:**

Rental income, cost of operations and rental income less cost of operations, excluding depreciation and amortization, or net operating income (defined as NOI for purposes of the following table), are summarized for the three months ended March 31, 2011 by major geographic region. The Company uses NOI and its components as a measurement of the performance of its commercial real estate. Management believes that these financial measures provide them, as well as the investor, the most consistent measurement on a comparative basis of the performance of the commercial real estate and its contribution to the value of the Company. Depreciation and amortization have been excluded from NOI as they are generally not used in determining the value of commercial real estate by management or the investment community. Depreciation and amortization are generally not used in determining value as they consider the historical costs of an asset compared to its current value; therefore, to understand the effect of the assets' historical cost on the Company's results, investors should look at GAAP financial measures, such as total operating costs including depreciation and amortization. The Company's calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance calculated in accordance with GAAP. The table below reflects rental income, operating expenses and NOI from continuing operations for the three months ended March 31, 2011 based on geographical concentration. The total of all regions is equal to the amount of rental income and cost of operations recorded by the Company in accordance with GAAP. As part of the table below, we have reconciled total NOI to income from continuing operations, which we consider the most directly comparable financial measure calculated in accordance with GAAP. The percent of total by region reflects the actual contribution to rental income, cost of operations and NOI during the period (in thousands):

Three Months Ended March 31, 2011:

Region	Weighted Square Footage	Percent of Total	Rental Income	Percent of Total	Cost of Operations	Percent of Total	NOI	Percent of Total
Southern								
California	3,988	18.3%	\$ 13,802	18.7%	\$ 4,437	17.1%	\$ 9,365	19.5%
Northern								
California	1,818	8.3%	4,967	6.7%	1,686	6.5%	3,281	6.8%
Southern Texas	1,734	8.0%	4,428	6.0%	1,615	6.2%	2,813	5.9%
Northern Texas	1,689	7.7%	4,069	5.5%	1,430	5.5%	2,639	5.5%
South Florida	3,672	16.9%	7,714	10.4%	2,746	10.6%	4,968	10.3%
Virginia	4,024	18.5%	18,336	24.8%	6,399	24.7%	11,937	24.9%
Maryland	2,351	10.8%	12,459	16.9%	4,583	17.7%	7,876	16.4%
Oregon	1,314	6.0%	4,487	6.1%	1,650	6.4%	2,837	5.9%
Arizona	679	3.1%	1,435	1.9%	663	2.6%	772	1.6%
Washington	521	2.4%	2,249	3.0%	692	2.7%	1,557	3.2%
Total NOI	21,790	100.0%	\$ 73,946	100.0%	\$ 25,901	100.0%	\$ 48,045	100.0%

Reconciliation of NOI to income from continuing operations

Total NOI	\$ 48,045
Other income and expenses:	
Facility management fees	178
Interest and other income	94
Interest expense	(1,215)

Depreciation and amortization	(20,859)
General and administrative	(1,570)
Income from continuing operations	\$ 24,673

Table of Contents**Concentration of Credit Risk by Industry:**

The information below depicts the industry concentration of our tenant base as of March 31, 2011. The Company analyzes this concentration to minimize significant industry exposure risk.

Industry	Percent of Annualized Rental Income
Business Services	15.7%
Health Services	11.6%
Government	11.1%
Computer Hardware, Software and Related Services	10.7%
Warehouse, Distribution, Transportation and Logistics	7.5%
Insurance and Financial Services	6.8%
Retail, Food, and Automotive	5.9%
Engineering and Construction	5.8%
Communications	4.8%
Home Furnishings	3.6%
Aerospace/Defense Products and Services	3.2%
Electronics	2.8%
Educational Services	2.7%
Other	7.8%
Total	100.0%

The information below depicts the Company's top 10 customers by annualized rental income as of March 31, 2011 (in thousands):

Tenants	Square Footage	Annualized Rental Income⁽¹⁾	Percent of Annualized Rental Income
U.S. Government	769	\$ 19,542	6.4%
Lockheed Martin Corporation	176	4,779	1.6%
Kaiser Permanente	205	4,778	1.6%
Wells Fargo Bank	126	2,325	0.8%
Luminex Corporation	149	2,047	0.7%
ATS Corporation	58	1,783	0.6%
AARP	102	1,742	0.5%
Welch Allyn Protocol, Inc.	103	1,657	0.5%
Verizon	80	1,583	0.5%
Investorplace Media, LLC	46	1,504	0.5%
Total	1,814	\$ 41,740	13.7%

⁽¹⁾ For leases expiring prior to December 31, 2011, annualized rental income represents income to be received under existing leases from March 31, 2011 through the date of expiration.

Comparative Analysis of the Three Months Ended March 31, 2011 to the Three Months Ended March 31, 2010

Results of Operations: In order to evaluate the performance of the Company's overall portfolio over comparable periods, management analyzes the operating performance of a consistent group of properties owned and operated throughout both periods (herein referred to as Same Park). Operating properties that the Company acquired subsequent to January 1, 2010 are referred to as Non-Same Park. For the three months ended March 31, 2011 and 2010, the Same Park facilities constitute 19.4 million rentable square feet, which includes all assets in continuing operations that the Company owned from January 1, 2010 through March 31, 2011, representing 89.1% of the total square footage of the Company's portfolio as of March 31, 2011.

Table of Contents

The following table presents the operating results of the Company's properties for the three months ended March 31, 2011 and 2010 in addition to other income and expense items affecting income from continuing operations. The Company reports Same Park operations to provide information regarding trends for properties the Company has held for the periods being compared (in thousands, except per square foot data):

	For the Three Months Ended March 31,		
	2011	2010	Change
Rental income:			
Same Park (19.4 million rentable square feet) ⁽¹⁾	\$ 64,578	\$ 66,788	(3.3%)
Non-Same Park (2.4 million rentable square feet) ⁽²⁾	9,368	344	2,623.3%
Total rental income	73,946	67,132	10.2%
Cost of operations:			
Same Park	22,125	22,859	(3.2%)
Non-Same Park	3,776	107	3,429.0%
Total cost of operations	25,901	22,966	12.8%
Net operating income ⁽³⁾ :			
Same Park	42,453	43,929	(3.4%)
Non-Same Park	5,592	237	2,259.5%
Total net operating income	48,045	44,166	8.8%
Other income and expenses:			
Facility management fees	178	173	2.9%
Interest and other income	94	109	(13.8%)
Interest expense	(1,215)	(855)	42.1%
Depreciation and amortization	(20,859)	(18,190)	14.7%
General and administrative	(1,570)	(2,749)	(42.9%)
Income from continuing operations	\$ 24,673	\$ 22,654	8.9%
Same Park gross margin ⁽⁴⁾	65.7%	65.8%	(0.2%)
Same Park weighted average occupancy	91.0%	91.4%	(0.4%)
Same Park annualized realized rent per square foot ⁽⁵⁾	\$ 14.61	\$ 15.05	(2.9%)

(1) See above for a definition of Same Park.

(2) See above for a definition of Non-Same Park.

(3) Net operating income (NOI) is an important measurement in the commercial real estate industry for determining the value of the real estate generating the NOI. See Concentration of Portfolio by Region above for more information on NOI. The Company's calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance in accordance with GAAP.

- (4) Same Park gross margin is computed by dividing Same Park NOI by Same Park rental income.
- (5) Same Park realized rent per square foot represents the annualized Same Park rental income earned per occupied square foot.

Supplemental Property Data and Trends: Rental income, cost of operations and rental income less cost of operations, excluding depreciation and amortization, or net operating income prior to depreciation and amortization (defined as NOI for purposes of the following table) from continuing operations is summarized for the three months ended March 31, 2011 and 2010 by major geographic region below. See Concentration of Portfolio by Region above for more information on NOI, including why the Company presents NOI and how the Company uses NOI. The Company's calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance calculated in accordance with GAAP.

Table of Contents

The following table summarizes the Same Park operating results by major geographic region for the three months ended March 31, 2011 and 2010. In addition, the table reflects the comparative impact on the overall rental income, cost of operations and NOI from properties that have been acquired since January 1, 2010, and the impact of such is included in Non-Same Park facilities in the table below. As part of the table below, we have reconciled total NOI to income from continuing operations (in thousands):

Three Months Ended March 31, 2011 and 2010:

Region	Rental	Rental	Increase (Decrease)	Cost of	Cost of	Increase (Decrease)	NOI	NOI	Increase (Decrease)
	Income March 31, 2011	Income March 31, 2010		Operation	Operations		March 31, 2011	March 31, 2010	
Southern California	\$ 13,802	\$ 14,489	(4.7%)	\$ 4,437	\$ 4,363	1.7%	\$ 9,365	\$ 10,126	(7.5%)
Northern California	4,967	4,990	(0.5%)	1,686	1,720	(2.0%)	3,281	3,270	0.3%
Southern Texas	2,491	2,395	4.0%	912	1,012	(9.9%)	1,579	1,383	14.2%
Northern Texas	4,069	4,225	(3.7%)	1,430	1,459	(2.0%)	2,639	2,766	(4.6%)
South Florida	7,583	7,898	(4.0%)	2,675	2,653	0.8%	4,908	5,245	(6.4%)
Virginia	13,881	15,051	(7.8%)	4,594	5,016	(8.4%)	9,287	10,035	(7.5%)
Maryland	9,614	9,749	(1.4%)	3,386	3,622	(6.5%)	6,228	6,127	1.6%
Oregon	4,487	4,387	2.3%	1,650	1,752	(5.8%)	2,837	2,635	7.7%
Arizona	1,435	1,504	(4.6%)	663	631	5.1%	772	873	(11.6%)
Washington	2,249	2,100	7.1%	692	631	9.7%	1,557	1,469	6.0%
Total Same Park	64,578	66,788	(3.3%)	22,125	22,859	(3.2%)	42,453	43,929	(3.4%)
Non-Same Park	9,368	344	2,623.3%	3,776	107	3,429.0%	5,592	237	2,259.5%
Total NOI	\$ 73,946	\$ 67,132	10.2%	\$ 25,901	\$ 22,966	12.8%	\$ 48,045	\$ 44,166	8.8%

Reconciliation of NOI to income from continuing operations

Total NOI	\$ 48,045	\$ 44,166	8.8%
Other income and expenses:			
Facilities management fees	178	173	2.9%
Interest and other income	94	109	(13.8%)
Interest expense	(1,215)	(855)	42.1%
Depreciation and amortization	(20,859)	(18,190)	14.7%
General and administrative	(1,570)	(2,749)	(42.9%)
	\$ 24,673	\$ 22,654	8.9%

Income from continuing
operations

Rental Income: Rental income increased \$6.8 million from \$67.1 million to \$73.9 million for the three months ended March 31, 2011 over the same period in 2010 as a result of an increase in rental income from the Non-Same Park facilities of \$9.0 million partially offset by a decrease in rental income from the Company's Same Park portfolio of \$2.2 million primarily due to decreases in rental and occupancy rates.

Facility Management Fees: Facility management fees account for a small portion of the Company's net income. During the three months ended March 31, 2011, \$178,000 of revenue was recognized from facility management fees compared to \$173,000 for the same period in 2010.

Cost of Operations: Cost of operations increased \$2.9 million from \$23.0 million to \$25.9 million for the three months ended March 31, 2011 over the same period in 2010 as a result of an increase in cost of operations from Non-Same Park facilities of \$3.7 million partially offset by a \$734,000 decrease in Same Park costs of operations. The decrease in Same Park cost of operations for the three months ended March 31, 2011 compared to the same period in 2010 was primarily due to decreases in repairs and maintenance costs of \$372,000 and property taxes of \$363,000.

Depreciation and Amortization Expense: Depreciation and amortization expense for the three months ended March 31, 2011 was \$20.9 million compared to \$18.2 million for the same period in 2010. The increase for the comparative three months was primarily due to depreciation from 2010 property acquisitions.

General and Administrative Expenses: General and administrative expenses was \$1.6 million for the three months ended March 31, 2011 compared to \$2.7 million for the three months ended March 31, 2010. The decrease of \$1.2 million, or 42.9%, was primarily due to \$1.1 million of acquisition transaction costs related to 2010 property acquisitions.

Table of Contents

Interest and Other Income: Interest and other income reflect earnings on cash balances in addition to miscellaneous income items. Interest income was \$5,000 for the three months ended March 31, 2011 compared to \$83,000 for the same period in 2010. The decrease for the three months ended March 31, 2011 compared to the same period in 2010 was primarily attributable to a lower average cash balances in 2011. Average cash balances and effective interest rates for the three months ended March 31, 2011 were \$16.0 million and 0.1%, respectively, compared to \$218.4 million and 0.2%, respectively, for the same period in 2010.

Interest Expense: Interest expense was \$1.2 million for the three months ended March 31, 2011 compared to \$855,000 for the same period in 2010. The increase was primarily attributable to an increase in interest expense related to borrowings on the Credit Facility and note payable to affiliate.

Gain on Sale of Real Estate Facility: Included in total discontinued operations is the gain on the sale of a 131,000 square foot office building located in Houston, Texas, for a gross sales price of \$10.0 million, resulting in a net gain of \$5.2 million during January, 2010.

Net Income Allocable to Noncontrolling Interests: Net income allocable to noncontrolling interests reflects the net income allocable to equity interests in the Operating Partnership that are not owned by the Company. Net income allocable to noncontrolling interests was \$2.4 million (\$7.3 million of loss allocated to preferred unit holders and \$4.9 million allocated to common unit holders) for the three months ended March 30, 2011 compared to \$4.9 million of allocated income (\$1.4 million allocated to preferred unit holders and \$3.5 million of income allocated to common unit holders) for the same period in 2010. Included in net income allocable to noncontrolling interests in 2011 was \$1.7 million of income allocated to common unit holders due to the net gain on the repurchases of preferred units partially offset with a \$7.4 million loss allocated to preferred unit holders due to the net gain on the repurchases of preferred units.

Liquidity and Capital Resources

Cash and cash equivalents decreased \$518,000 from \$5.1 million at December 31, 2010 to \$4.5 million at March 31, 2011. The decrease was the result of repurchasing \$39.1 million of preferred equity below par partially offset by short term borrowings and cash from operations.

Net cash provided by operating activities for the three months ended March 31, 2011 and 2010 was \$45.2 million and \$41.5 million, respectively. Management believes that the Company's internally generated net cash provided by operating activities will be sufficient to enable it to meet its operating expenses, capital improvements, debt service requirements and distributions to shareholders.

Net cash used in investing activities was \$8.0 million and \$56.3 million for the three months ended March 31, 2011 and 2010, respectively. The change was primarily due to cash paid for an acquisition in Maryland of \$58.4 million and proceeds received from the sale of real estate of \$9.2 million during the first three months of 2010. No properties were acquired or disposed of during the first three months of 2011.

Net cash used in financing activities was \$37.7 million and \$24.1 million for the three months ended March 31, 2011 and 2010, respectively. The \$13.6 million increase in cash used was primarily due to net short term borrowings of \$28.0 million and the repurchases of preferred units below par of \$39.1 million.

The Company's preferred equity outstanding decreased to 23.0% of its market capitalization as of March 31, 2011 due to the repurchases of preferred units combined with outstanding short term borrowings. The Company's capital structure is characterized by a low level of leverage. As of March 31, 2011, the Company had four fixed-rate mortgages totaling \$48.5 million and a note payable to affiliate of \$121.0 million, which represented 1.8% and 4.6%, respectively, of its total market capitalization. The Company calculates market capitalization by adding (1) the liquidation preference of the Company's outstanding preferred equity, (2) principal value of the Company's outstanding mortgages and (3) the total number of common shares and common units outstanding at March 31, 2011 multiplied by the closing price of the stock on that date. The weighted average interest rate for the mortgages is 5.8% per annum and the interest rate on the note payable to affiliate was 1.2%. The Company had 5.6% of its properties, in terms of net book value, encumbered at March 31, 2011.

Table of Contents

On February 9, 2011, the Company entered into an agreement with PS to borrow \$121.0 million with a maturity date of August 9, 2011 at an interest rate of LIBOR plus 0.85%. Funds from this loan were used for the repurchase of the Company's 7.50% Series J Cumulative Redeemable Preferred Units for \$35.4 million and to repay, in full, the outstanding balance on the Company's Credit Facility. Subsequent to March 31, 2011, the Company repaid \$5.0 million on the note payable to PS.

The Company has a line of credit (the Credit Facility) with Wells Fargo Bank which expires on August 1, 2012. The Credit Facility has a borrowing limit of \$100.0 million. Interest on outstanding borrowings is payable monthly. The rate of interest charged on borrowings is equal to a rate ranging from the London Interbank Offered Rate (LIBOR) plus 1.60% to LIBOR plus 2.60% depending on the Company's credit ratings and coverage ratios, as defined. Currently, the Company's rate under the Credit Facility is LIBOR plus 1.80%. In addition, the Company is required to pay an annual commitment fee ranging from 0.15% to 0.40% of the borrowing limit (currently 0.20%). In February, 2011, the Company used the funds borrowed from PS to pay down the Credit Facility in full and as such, the available balance was \$100.0 million as of March 31, 2011. The Company had \$93.0 million outstanding on the Credit Facility at an interest rate of 2.11% at December 31, 2010.

The Company focuses on retaining cash for reinvestment as we believe that this provides the greatest level of financial flexibility. While operating performance has been down recently due to the economic recession, it is possible that when the economy recovers and operating fundamentals improve, additional increases in distributions to the Company's common shareholders may be required. Going forward, the Company will continue to monitor its taxable income and the corresponding dividend requirements.

Non-GAAP Supplemental Disclosure Measure: Funds from Operations: Management believes that Funds from Operations (FFO) is a useful supplemental measure of the Company's operating performance. The Company computes FFO in accordance with the White Paper on FFO approved by the Board of Governors of the National Association of Real Estate Investment Trusts (NAREIT). The White Paper defines FFO as net income, computed in accordance with GAAP, before depreciation, amortization, gains or losses on asset dispositions, net income allocable to noncontrolling interests' common units, net income allocable to restricted stock unit holders and nonrecurring items. Management believes that FFO provides a useful measure of the Company's operating performance and when compared year over year, reflects the impact to operations from trends in occupancy rates, rental rates, operating costs, development activities, general and administrative expenses and interest costs, providing a perspective not immediately apparent from net income.

FFO should be analyzed in conjunction with net income. However, FFO should not be viewed as a substitute for net income as a measure of operating performance or liquidity as it does not reflect depreciation and amortization costs or the level of capital expenditure and leasing costs necessary to maintain the operating performance of the Company's properties, which are significant economic costs and could materially affect the Company's results of operations.

Management believes FFO provides useful information to the investment community about the Company's operating performance when compared to the performance of other real estate companies as FFO is generally recognized as the industry standard for reporting operations of REITs. Other REITs may use different methods for calculating FFO and, accordingly, our FFO may not be comparable to other real estate companies.

Table of Contents

FFO for the Company is computed as follows (in thousands):

	For the Three Months Ended March 31,	
	2011	2010
Net income allocable to common shareholders	\$ 16,562	\$ 11,740
Gain on sale of real estate facility		(5,153)
Depreciation and amortization	20,859	18,190
Net income allocable to noncontrolling interests – common units	4,901	3,513
Net income allocable to restricted stock unit holders	50	51
Consolidated FFO allocable to common and dilutive shares	42,372	28,341
FFO allocated to noncontrolling interests – common units	(9,654)	(6,505)
FFO allocated to restricted stock unit holders	(95)	(95)
FFO allocated to common shares	\$ 32,623	\$ 21,741

FFO allocable to common and dilutive shares for the three months ended March 31, 2011 increased \$14.0 million compared to the same period in 2010. The increase was primarily due to the net gain of \$7.4 million on the repurchase of preferred units below par during the first quarter of 2011 combined with an increase in net operating income and a decrease in preferred equity distributions as a result of the repurchases of preferred units during 2011 combined with preferred equity redemptions during 2010.

Capital Expenditures: During the three months ended March 31, 2011, the Company expended \$7.1 million in recurring capital expenditures, or \$0.33 per weighted average square foot owned. The Company defines recurring capital expenditures as those necessary to maintain and operate its commercial real estate at its current economic value. During the three months ended March 31, 2010, the Company expended \$5.0 million in recurring capital expenditures, or \$0.26 per weighted average square foot owned. The following table depicts actual capital expenditures (in thousands):

	For the Three Months Ended March 31,	
	2011	2010
Recurring capital expenditures	\$ 7,088	\$ 4,977
Property renovations and other capital expenditures	955	2,078
Total capital expenditures	\$ 8,043	\$ 7,055

Property renovations and other capital expenditures decreased \$1.1 million from \$2.1 million to \$955,000 for the three months ended March 31, 2011 compared to the same period in 2010 as a result of the 2010 development at Miami International Commerce Center in Miami, Florida, combined with