PRENTISS PROPERTIES TRUST/MD
Form 10-Q
August 08, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended June 30, 2005

OR

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

Commission File Number 1-14516
PRENTISS PROPERTIES TRUST
(Exact Name of Registrant as Specified in its Charter)

Maryland	**75-2661588**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

3890 West Northwest Highway, Suite 400, Dallas, Texas 75220
(Address of Principal Executive Offices)
(214) 654-0886
(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes þ No o

The number of Common Shares of Beneficial Interest, $0.01 par value, outstanding as of August 4, 2005, was 46,315,843 and the number of outstanding Participating Cumulative Redeemable Preferred Shares of Beneficial Interest, Series D, was 2,823,585.

PRENTISS PROPERTIES TRUST
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SIGNATURE 50

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FORWARD-LOOKING STATEMENTS

This Form 10-Q and the documents incorporated by reference into this Form 10-Q may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used in this Form 10-Q, words such as anticipate, believe, estimate, expect, intend, predict, project, and similar expressions, as they relate to us or our management, identify forward-looking statements. Such forward-looking statements are based on the beliefs of our management as well as assumptions made by us and information currently available to us. These forward-looking statements are subject to certain risks, uncertainties and assumptions, including risks, uncertainties and assumptions related to the following:

- Our failure to qualify as a REIT under the Internal Revenue Code of 1986, as amended;
- Possible adverse changes in tax and environmental laws, as well as the impact of newly adopted accounting principles on our accounting policies and on period-to-period comparison of financial results;
- Potential liability for uninsured losses and environmental contamination;
- Our properties are illiquid assets;
- Factors that could result in the poor operating performance of our properties including tenant defaults and increased costs such as taxes, insurance, utilities and casualty losses that exceed insurance limits;
- Changes in market conditions including market interest rates and employment rates;
- Our incurrence of debt and use of variable rate and derivative financial instruments;
- Our real estate acquisition, redevelopment, development and construction activities;
- The geographic concentration of our properties;
- Changes in market conditions including capitalization rates applied in real estate acquisitions;
- Competition in markets where we have properties;
- Our dependence on key personnel whose continued service is not guaranteed;
- Changes in our investment, financing and borrowing policies without shareholder approval;
- The effect of shares available for future sale on the price of common shares;
- Limited ability of shareholders to effect change of control;
- Conflicts of interest with management, our board of trustees and joint venture partners could impact business decisions;
- Our third-party property management, leasing, development and construction business and related services;
- Risks associated with an increase in the frequency and scope of changes in state and local tax laws and increases in the number of state and local tax audits; and
- Cost of compliance with the Americans with Disabilities Act and other similar laws related to our properties.

If one or more of these risks or uncertainties materialize, or if any underlying assumption proves incorrect, actual results may vary materially from those anticipated, expected or projected. Such forward-looking statements reflect our current views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. All subsequent written and oral forward-looking statements attributable to us or individuals acting on our behalf are expressly qualified in their entirety by this paragraph. A detailed discussion of risks is included, under the caption Risk Factors in our Form 10-K, filed on March 15, 2005. You are cautioned not to place undue reliance on our forward-looking statements, which speak only as of the date of this Form 10-Q or the date of any document incorporated by reference into this Form 10-Q. We do not undertake any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

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PRENTISS PROPERTIES TRUST
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(in thousands, except share and per share amounts)

	June 30, 2005	**December 31, 2004**
ASSETS		
Operating real estate:		
Land	$ 369,160	$ 341,321
Buildings and improvements	1,915,883	1,789,043
Less: accumulated depreciation	(257,923)	(234,007)
	2,027,120	1,896,357
Construction in progress	34,955	23,417
Land held for development	61,948	59,014
Deferred charges and other assets, net	287,405	260,283
Notes receivable	1,000	1,500
Accounts receivable, net	61,272	55,772
Cash and cash equivalents	10,570	8,586
Escrowed cash	8,830	9,584
Investments in securities and insurance contracts	5,014	3,279
Investments in unconsolidated joint ventures and subsidiaries	6,842	12,943
Interest rate hedges	3,286	2,804
Total assets	$2,508,242	$2,333,539
LIABILITIES AND SHAREHOLDERS EQUITY		
Mortgages and notes payable	$1,393,100	$1,191,911
Interest rate hedges	1,254	3,850
Accounts payable and other liabilities	100,395	105,304
Distributions payable	28,224	28,103
Total liabilities	1,522,973	1,329,168
Minority interest in operating partnership	23,425	24,990
Minority interest in real estate partnerships	44,905	35,792
Commitments and contingencies		
Preferred shares $.01 par value, 20,000,000 shares authorized, 3,773,585 shares issued and outstanding at June 30, 2005 and December 31, 2004	100,000	100,000
Common shares $.01 par value, 100,000,000 shares authorized, 48,444,049 and 48,268,845 (includes 3,269,444 and 3,286,957 in treasury) shares issued and outstanding at June 30, 2005 and December 31, 2004,	484	483

respectively		
Additional paid-in capital	1,026,708	1,020,917
Common shares in treasury at cost 3,269,444 and 3,286,957 shares at June 30, 2005 and December 31, 2004, respectively	(82,379)	(82,694)
Unearned compensation	(5,700)	(3,386)
Accumulated other comprehensive income	2,599	(302)
Distributions in excess of earnings	(124,773)	(91,429)
Total shareholders equity	916,939	943,589
Total liabilities and shareholders equity	$2,508,242	$2,333,539

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

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PRENTISS PROPERTIES TRUST
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(in thousands, except per share amounts)

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2005	**2004**	**2005**	**2004**
Revenues:				
Rental income	$ 96,707	$87,622	$191,746	$171,920
Service business and other income	3,506	2,928	6,556	6,416
	100,213	90,550	198,302	178,336
Operating expenses:				
Property operating and maintenance	25,230	22,015	51,275	43,392
Real estate taxes	10,856	9,780	21,715	19,116
General and administrative and personnel costs	3,689	2,785	6,572	5,370
Expenses of service business	2,892	2,466	5,547	4,115
Depreciation and amortization	26,223	22,467	50,782	43,751
	68,890	59,513	135,891	115,744
Other expenses:				
Interest expense	19,720	16,825	37,595	33,024
Amortization of deferred financing costs	572	568	1,290	1,133
Income from continuing operations before equity in (loss)/income of unconsolidated joint ventures and subsidiaries, loss on investment in securities, loss from impairment of mortgage loan and minority interests	11,031	13,644	23,526	28,435
Equity in (loss)/income of unconsolidated joint ventures and subsidiaries	(1,543)	596	(845)	1,174
Loss on investment in securities		(420)		(420)
Loss from impairment of mortgage loan	(500)		(500)	
Minority interests	(172)	(563)	(677)	(2,163)
Income from continuing operations	8,816	13,257	21,504	27,026
Discontinued operations:				
Income from discontinued operations		942		2,920
	2	10,185	17	10,185

Gain from disposition of discontinued operations				
Loss from debt defeasance related to sale of real estate		(5,316)		(5,316)
Minority interests related to discontinued operations		(182)		(246)
	2	5,629	17	7,543
Income before (loss)/gain on sale of land and an interest in a real estate partnership	8,818	18,886	21,521	34,569
(Loss)/gain on sale of land and an interest in a real estate partnership		(94)		1,222
Net income	$ 8,818	$18,792	$ 21,521	$ 35,791
Preferred dividends	(2,113)	(2,113)	(4,226)	(5,826)
Net income applicable to common shareholders	$ 6,705	$16,679	$ 17,295	$ 29,965
Basic earnings per common share:				
Income from continuing operations applicable to common shareholders	$ 0.15	$ 0.25	$ 0.39	$ 0.51
Discontinued operations		0.13		0.17
Net income applicable to common shareholders basic	$ 0.15	$ 0.38	$ 0.39	$ 0.68
Weighted average number of common shares outstanding basic	44,902	44,386	44,893	43,906
Diluted earnings per common share:				
Income from continuing operations applicable to common shareholders	$ 0.15	$ 0.25	$ 0.38	$ 0.51
Discontinued operations		0.12		0.17
Net income applicable to common shareholders diluted	$ 0.15	$ 0.37	$ 0.38	$ 0.68
Weighted average number of common shares and common share equivalents outstanding diluted	45,122	44,527	45,116	44,094

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

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PRENTISS PROPERTIES TRUST
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	**2004**	**2005**	**2004**
Net income	$ 8,818	$18,792	$21,521	$35,791
Unrealized gains and losses on securities:				
Unrealized gains/(losses) arising during the period	72	2	(18)	28
Unrealized gains and losses on interest rate hedges:				
Unrealized (losses)/gains arising during the period	(5,000)	6,911	613	2,337
Reclassification of losses on qualifying cash flow hedges into earnings	932	2,827	2,306	5,397
Other comprehensive income	(3,996)	9,740	2,901	7,762
Comprehensive income	$ 4,822	$28,532	$24,422	$43,553

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

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PRENTISS PROPERTIES TRUST
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(dollars in thousands)

	Six Months Ended June 30,	
	2005	**2004**
Cash Flows from Operating Activities:		
Net income	$ 21,521	$ 35,791
Adjustments to reconcile net income to net cash provided by operating activities:		
Minority interests	677	2,409
Gain from disposition	(17)	(11,407)
Loss on debt extinguishment/defeasance	2,207	5,316
Loss on investment in securities		420
Loss on impairment of mortgage loan	500	
Provision for doubtful accounts	(229)	(3,147)
Depreciation and amortization	50,782	47,019
Amortization of deferred financing costs	1,290	1,133
Non-cash compensation	1,888	1,221
Gain on derivative financial instruments	(159)	(171)
Changes in assets and liabilities:		
Deferred charges and other assets	1,109	(2,279)
Accounts receivable	(4,515)	(1,852)
Escrowed cash	754	1,764
Accounts payable and other liabilities	(11,943)	(9,978)
Net cash provided by operating activities	63,865	66,239
Cash Flows from Investing Activities:		
Development/redevelopment of real estate	(14,483)	(2,888)
Purchase of real estate	(154,691)	(174,943)
Capital expenditures for in-service properties	(29,564)	(21,187)
Distributions in excess of earnings of unconsolidated joint ventures	1,821	208
Proceeds from the sale of a joint venture interest in a real estate partnership		69,338
Proceeds received from repayments of notes receivable		9,962
Proceeds from the sale of investment		1,107
Proceeds from the sale of real estate		78,999
Investments in securities and insurance contracts	(841)	(666)
Investments in unconsolidated subsidiaries	(17,050)	
Net cash used in investing activities	(214,808)	(40,070)
Cash Flows from Financing Activities:		
Net proceeds from sale of common shares	847	63,790
Net proceeds from sale of treasury shares	964	

Redemption of series E preferred units		(10,000)
Redemption of series B preferred units		(95,000)
Repurchase of treasury shares	(275)	
Capital contribution from minority interest partners in consolidated joint ventures	25,146	9,334
Repurchase of operating partnership common units		(891)
Distributions paid to limited partners	(17,972)	(2,856)
Distributions paid to common shareholders	(50,539)	(48,695)
Distributions paid to preferred shareholders	(4,226)	(4,226)
Distributions paid to preferred unitholders		(3,176)
Proceeds from mortgages and notes payable	599,300	427,000
Payment of debt prepayment cost	(2,207)	
Repayments of mortgages and notes payable	(398,111)	(357,359)
Net cash provided used in financing activities	152,927	(22,079)
Net change in cash and cash equivalents	1,984	4,090
Cash and cash equivalents, beginning of period	8,586	5,945
Cash and cash equivalents, end of period	$ 10,570	$ 10,035
Supplemental Cash Flow Information:		
Cash paid for interest	$ 38,318	$ 33,878

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

**PRENTISS PROPERTIES TRUST
NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS
(Unaudited)**

1. The Organization

Organization

We are a self-administered and self-managed Maryland REIT that acquires, owns, manages, leases, develops and builds primarily office properties throughout the United States. We are self-administered in that we provide our own administrative services, such as accounting, tax and legal, through our own employees. We are self-managed in that we provide all the management and maintenance services that our properties require through our own employees, such as, property managers, leasing professionals and engineers. We operate principally through our operating partnership, Prentiss Properties Acquisition Partners, L.P., and its subsidiaries, and two management service companies, Prentiss Properties Resources, Inc. and its subsidiaries and Prentiss Properties Management, L.P. The ownership of the operating partnership was as follows at June 30, 2005:

(units in thousands)	Common Units	%	Series D Convertible Preferred Units	%
Prentiss Properties Trust	45,238(1)	97.21%	3,774	100.00%
Third parties	1,297	2.79%		0.00%
Total	46,535	100.00%	3,774	100.00%

(1) Includes 63,439 common shares held by the company pursuant to a deferred compensation plan. The shares are accounted for as common shares in treasury on the consolidated balance sheet.

As of June 30, 2005, we owned interests in a diversified portfolio of 128 primarily suburban Class A office and suburban industrial properties, the accounts of which were consolidated with and into the operations of our operating partnership.

	Number of Buildings	Net Rentable Square Feet (in thousands)
Office properties	101	16,617

Industrial properties	27	2,203
Total	128	18,820

As of June 30, 2005, our properties were 90% leased to approximately 980 tenants. In addition to managing properties that are wholly owned, we manage approximately 8.9 million net rentable square feet in office, industrial and other properties for third parties.

We have determined that our reportable segments are those that are based on our method of internal reporting, which disaggregates our business by geographic region. As of June 30, 2005, our reportable segments include our five regions (1) Mid-Atlantic; (2) Midwest; (3) Southwest; (4) Northern California; and (5) Southern California.

At June 30, 2005, our properties were located in 10 markets, which were included in our reportable segments as follows:

Reportable Segment	**Market**
Mid-Atlantic	Metropolitan Washington D.C.
Midwest	Chicago, Suburban Detroit
Southwest	Dallas/Fort Worth, Austin, Denver
Northern California	Oakland, Silicon Valley
Southern California	San Diego, Los Angeles

PRENTISS PROPERTIES TRUST
NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS
(Unaudited)

Real Estate Transactions

On May 2, 2005, using proceeds from our revolving credit facility, our operating partnership completed a transaction in which we effectively acquired for $103.2 million the remaining 75% interest in Tysons International Partners, a joint venture that prior to the transaction was owned 25% by our operating partnership and 75% by an unrelated third party. The joint venture, through its two wholly-owned subsidiaries (subsidiaries) owned two office properties totaling approximately 456,000 net rentable square feet in Tyson s Corner, Virginia. Pursuant to the purchase agreement, our operating partnership acquired from Tysons International Partners 100% of the subsidiaries thereby giving us 100% ownership of the two office properties. Tysons International Partners distributed the proceeds from the sale and immediately thereafter redeemed the 75% partner s interest in the joint venture. As a result of the redemption, Tysons International Partners terminated as a joint venture.

In accordance with Statement of Financial Accounting Standards No. 141, Business Combinations, we allocated the purchase price of the properties acquired as follows:

(in thousands)		Three Months Ended June 30, 2005
Land	$	14,544
Buildings and improvements	$	70,784
Tenant improvements and leasing commissions	$	12,385
Above/(below) market lease value	$	(3,614)
Other intangible assets	$	9,123

On May 2, 2005, Tysons International Partners caused both Prentiss Properties Greensboro Drive, L.P. and Prentiss Properties International Drive, L.P. to pay off the outstanding mortgage loan on each property prior to the closing of our operating partnership s acquisition of the remaining 75% interest in Tysons International Partners. The prepayment amount totaled $67.6 million of which $8.8 million represented a prepayment penalty. We recognized $2.2 million, or 25% of the prepayment penalty in the line item equity in (loss)/income of unconsolidated joint ventures and subsidiaries in our consolidated statements of income for the three and six months ended June 30, 2005.

On June 6, 2005, using proceeds from our revolving credit facility, we acquired from an unrelated third party, a .65 acre tract of land in Oakland, California for gross consideration of $1.9 million. The land, which can accommodate approximately 200,000 net rentable square feet of future development, is located adjacent to one of our existing office properties.

Other Transactions

On May 4, 2005, Prentiss Office Investors, L.P. completed a five-year $30.9 million loan, collateralized by two office buildings located in Herndon, Virginia. We may borrow an additional $1.9 million over the next 24 months if certain conditions are met. The interest rate on the loan is 115 basis points over 30-day LIBOR and the monthly payments are interest only, with the principal balance due at its maturity on May 4, 2010. Proceeds from the loan were used to fund a pro rata capital distribution to the joint venture partners based on their ownership interest in Prentiss Office Investors, L.P. Our operating partnership used proceeds from the capital distribution to repay a portion of the outstanding borrowings under our revolving credit facility.

During the second quarter 2005, we formed Prentiss Properties Capital Trust II, a Delaware statutory trust, established to issue $25.0 million of trust preferred equity securities to Merrill Lynch International, in a private placement pursuant to an applicable exemption from registration. Prentiss Properties Limited, Inc., a wholly-owned affiliate of our operating partnership acquired for $774,000 a residual interest (common securities), of Prentiss Properties Capital Trust II, representing 3% of the overall equity of the trust. The preferred equity securities will

mature on June 30, 2035, but may be redeemed by Prentiss Properties Capital Trust II beginning on June 30, 2010. The holders of both the preferred equity and common securities will receive quarterly distributions from Prentiss Properties Capital Trust II, at a variable rate equal to 90-day LIBOR plus 125 basis points. Distributions will be cumulative and will accrue from the date of original issuance but may be deferred for up to 20 consecutive quarterly periods.

Prentiss Properties Capital Trust II used the proceeds from the issuance of the preferred and common securities to acquire $25.8 million of junior subordinated notes from our operating partnership pursuant to an indenture agreement.

PRENTISS PROPERTIES TRUST
NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS
(Unaudited)

The notes will mature on June 30, 2035, but may be redeemed at our option, in whole or in part, beginning on June 30, 2010 in accordance with the provisions of the indenture agreement. The notes bear interest at a variable rate equal to 90-day LIBOR plus 125 basis points. Interest is cumulative and will accrue from the date of original issuance but may be deferred by us for up to 20 consecutive quarterly periods.

The trust is a variable interest entity under paragraph 5(b)(1) of FIN 46, because the equity investors at risk hold no substantial decision-making rights. Prentiss Properties Limited, Inc. s investment is financed directly by our operating partnership; and therefore, it is not considered at risk. Because Prentiss Properties Limited, Inc. lacks a significant variable interest in the trust and thus is not the primary beneficiary, the accounts of the trust are not consolidated with and into Prentiss Properties Limited, Inc. and therefore, are not consolidated with and into our operating partnership. Prentiss Properties Limited, Inc. s investment in the trust is presented on our consolidated balance sheet as an investment in joint ventures and unconsolidated subsidiaries and is accounted for using the cost method of accounting, whereby distributions are recognized into income upon receipt.

The proceeds received by the operating partnership in exchange for the notes were used to repay a portion of the outstanding borrowings under our revolving credit facility. The notes are presented on our consolidated balance sheet in the line item mortgages and notes payable.

2. Basis of Presentation

The accompanying financial statements are unaudited; however, our financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In our opinion, all adjustments (consisting solely of normal recurring matters) necessary for a fair presentation of the financial statements for these interim periods have been included. The December 31, 2004 comparative balance sheet information was derived from audited financial statements. The results for the three and six month periods ended June 30, 2005 are not necessarily indicative of the results to be obtained for the full fiscal year. These financial statements should be read in conjunction with our audited financial statements, and notes thereto, included in our annual report on Form 10-K for the fiscal year ended December 31, 2004.

3. Share-Based Compensation

In December 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. The statement amends Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, expanding disclosure requirements and providing alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock or share-based employee compensation.

On January 1, 2003, we adopted the fair value based method of accounting as prescribed by Statement of Financial Accounting Standards No. 123 as amended for our share-based compensation plans, and we elected to apply this method on a prospective basis as prescribed in Statement of Financial Accounting Standards No. 148. The prospective basis requires that we apply the fair value based method of accounting to all awards granted, modified or settled after the beginning of the fiscal year in which we adopt the accounting method.

Historically, we applied the intrinsic value based method of accounting as prescribed by APB Opinion 25 and related Interpretations in accounting for our share-based awards. Had we fully adopted Statement of Financial Accounting Standards No. 123 for awards issued prior to January 1, 2003 it would have changed our method for recognizing the cost of our plans. Had the compensation cost for our share-based compensation plans been determined consistent with Statement of Financial Accounting Standards No. 123, our net income applicable to common shareholders and net income per common share for the three and six months ended June 30, 2005 and 2004 would approximate the pro forma amounts below:

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PRENTISS PROPERTIES TRUST
NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(amounts in thousands, except per share data)	**2005**	**2004**	**2005**	**2004**
Net income applicable to common shareholders as reported	$ 6,705	$16,679	$17,295	$29,965
Add: Share-based employee compensation expense included therein	1,089	612	2,056	1,112
Deduct: Total share-based employee compensation expense determined under fair value method for all awards	(1,090)	(633)	(2,059)	(1,154)
Pro Forma net income applicable to common shareholders	$ 6,704	$16,658	$17,292	$29,923
Earnings per share:				
Basic as reported	$ 0.15	$ 0.38	$ 0.39	$ 0.68
Basic pro forma	$ 0.15	$ 0.38	$ 0.39	$ 0.68
Diluted as reported	$ 0.15	$ 0.37	$ 0.38	$ 0.68
Diluted pro forma	$ 0.15	$ 0.37	$ 0.38	$ 0.68

The effects of applying Statement of Financial Accounting Standards No. 123 in this pro forma disclosure are not necessarily indicative of future amounts.

4. Earnings per Share

We calculate earnings per share in accordance with Statement of Financial Accounting Standards No. 128, Earnings per Share, which requires a dual presentation of basic and diluted earnings per share on the face of the income statement. Additionally, the statement requires a reconciliation of the numerator and denominator used in computing basic and diluted earnings per share. The table below presents a reconciliation of the numerator and denominator used to calculate basic and diluted earnings per share for the three and six month periods ended June 30, 2005 and 2004:

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PRENTISS PROPERTIES TRUST
NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS
(Unaudited)

(in thousands, except per share data)	Three Months Ended June 30, 2005	Three Months Ended June 30, 2004	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
Reconciliation of the numerator used for basic earnings per share				
Income from continuing operations	$ 8,816	$13,257	$21,504	$27,026
Preferred dividends	(2,113)	(2,113)	(4,226)	(5,826)
(Loss)/gain on sale of land and an interest in a real estate partnership		(94)		1,222
Income from continuing operations applicable to common shareholders	$ 6,703	$11,050	$17,278	$22,422
Discontinued operations	2	5,629	17	7,543
Net income applicable to common shareholders	$ 6,705	$16,679	$17,295	$29,965
Reconciliation of the denominator used for basic earnings per share				
Weighted average common shares outstanding	44,902	44,386	44,893	43,906
Basic earnings per share	$ 0.15	$ 0.38	$ 0.39	$ 0.68
Reconciliation of the numerator used for dilutive earnings per share				
Income from continuing operations	$ 8,816	$13,257	$21,504	$27,026
Preferred dividends	(2,113)	(2,113)	(4,226)	(5,826)
(Loss)/gain on sale of land and an interest in a real estate partnership		(94)		1,222
Income from continuing operations applicable to common shareholders	$ 6,703	$11,050	$17,278	$22,422
Discontinued operations	2	5,629	17	7,543
Net income applicable to common shareholders	$ 6,705	$16,679	$17,295	$29,965
Reconciliation of the denominator used for dilutive earnings per share [(1)]				
Weighted average common shares outstanding	44,902	44,386	44,893	43,906

Dilutive options	86	82	98	133
Dilutive share grants	134	59	125	55
Weighted average common shares and common share equivalents outstanding [1]	45,122	44,527	45,116	44,094
Diluted earnings per share	$ 0.15	$ 0.37	$ 0.38	$ 0.68

[1] The following securities were not included in the diluted earnings per share computation because they would have had an antidilutive effect.

	Three Months Ended June 30,		Six Months Ended June 30,	
Antidilutive Securities (in thousands)	**2005**	**2004**	**2005**	**2004**
Series D Convertible Preferred Shares	3,774	3,774	3,774	3,774

5. Deferred Charges and Other Assets, Net

Deferred charges consisted of the following at June 30, 2005 and December 31, 2004:

	(in thousands)	
	June 30, 2005	**December 31, 2004**
Deferred leasing costs and tenant improvements	$ 350,344	$ 311,320
In-place lease values	39,852	27,910
Above market lease values	5,624	5,666
Deferred financing costs	15,535	14,568
Prepaids and other assets	8,787	11,610
	420,142	371,074
Less: accumulated amortization	(132,737)	(110,791)
	$ 287,405	$ 260,283

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We record the amortization related to deferred leasing costs and tenant improvements and in-place lease values in the line item depreciation and amortization. We record above market lease value amortization in the line item rental income. Amortization for deferred financing cost is recorded in the line item amortization of deferred financing costs, and the amortization for prepaid items is recorded in the line items property operating and maintenance and real estate taxes.

6. Notes Receivable

Our notes receivable balance of $1.0 million at June 30, 2005 is the result of a real estate transaction that included a non-recourse promissory note totaling $4.4 million, collateralized by a real estate property sold, maturing March 1, 2005, bearing interest at 7.95% per annum and requiring interest only payments until maturity. On December 22, 2004, we received correspondence from the borrower indicating an inability to fulfill its total obligation under the note. Due to the fact that our note receivable is subordinate to a first mortgage totaling approximately $12.0 million, we initiated an evaluation of the underlying real estate. Our evaluation was to determine whether the fair value of the property, less cost to sell, would be sufficient to satisfy both the first mortgage and our note receivable. In our opinion, the fair value of the underlying real estate would not be sufficient to satisfy both the first mortgage and our note receivable and thus, in the preparation of our financial statements for the year ended December 31, 2004, we recognized a $2.9 million write-down of the note. On April 4, 2005, the borrower sent notice notifying us that they were attempting to restructure the first mortgage. Subsequent to quarter end, we were made aware by the borrower of his intent to abandon the property. On August 2, 2005, we completed the sale of our note receivable to an unrelated party for total proceeds of $1.0 million. In an effort to reflect the realizable value of the note in our June 30, 2005 consolidated balance sheet, effective June 30, 2005, we recognized a $500,000 write-down to the note.

7. Accounts Receivable, Net

Accounts receivable consisted of the following at June 30, 2005 and December 31, 2004:

	(in thousands)	
	June 30, 2005	**December 31, 2004**
Rents and services	$ 9,272	$ 10,449
Accruable rental income	56,074	50,721
Other	575	809
	65,921	61,979
Less: allowance for doubtful accounts	(4,649)	(6,207)
	$61,272	$ 55,772

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8. Investments in Unconsolidated Joint Ventures and Subsidiaries

The following information summarizes the financial position at June 30, 2005 and December 31, 2004 and the results of operations for the three and six month periods ended June 30, 2005 and 2004 for the investments in which we held a non-controlling interest during the period presented:

Summary of Financial Position:	Total Assets		Total Debt [4]		Total Equity		Company s Investment	
(in thousands)	June 30, 2005	Dec. 31, 2004	June 30, 2005	Dec. 31, 2004	June 30, 2005	Dec. 31, 2004	June 30, 2005	Dec. 31, 2004
Broadmoor Austin Associates[1]	$96,570	$97,962	$128,487	$131,979	$(34,030)	$(34,814)	$4,482	$ 4,217
Tysons International Partners[2]		89,268		59,113		28,914		8,726
Other Investments[3]							2,360	
							$6,842	$12,943

Summary of Operations for the Three Months Ended June 30, 2005 and 2004:	Total Revenue		Net Income		Company s Share of Net Income/(Loss)	
(in thousands)	2005	2004	2005	2004	2005	2004
Broadmoor Austin Associates	$ 5,645	$ 5,018	$ 1,369	$1,254	$ 685	$ 627
Tysons International Partners[2]	1,070	2,876	(8,912)	(124)	(2,228)	(31)
Total					$(1,543)	$ 596

Summary of Operations for the Six Months Ended June 30, 2005 and 2004:	Total Revenue		Net Income		Company s Share of Net Income/(Loss)	
(in thousands)	2005	2004	2005	2004	2005	2004
Broadmoor Austin Associates	$11,292	$10,035	$ 2,742	$2,474	$ 1,371	$1,237
Tysons International Partners[2]	4,228	5,819	(8,864)	(250)	(2,216)	(63)
Total					$ (845)	$1,174

(1) We own a 50% non-controlling interest in Broadmoor Austin Associates, an entity, which owns a seven-building, 1.1 million net

rentable square foot office complex in Austin, Texas.

(2) At December 31, 2004, we owned a 25% non-controlling interest in Tysons International Partners, an entity, which owns two office properties containing 456,000 net rentable square feet in the Northern Virginia area. On May 2, 2005, we acquired the remaining 75% interest in the properties owned by the joint venture. Prior to our acquisition of the remaining 75% for $103.2 million, we contributed to the joint venture $14.7 million representing our pro rata share of the outstanding indebtedness on the properties. As a condition of closing, out of proceeds from the sale and our capital contribution, the

joint venture prepaid the outstanding indebtedness collateralized by the properties. The prepayment amount totaled $67.6 million of which $8.8 million represented a prepayment penalty. Net income for Tysons International Partners includes the $8.8 million loss from debt prepayment but excludes the gain on sale resulting from our acquisition of the remaining 75% interest in the joint venture.

(3) Represents an interest in Prentiss Properties Capital Trust I and Prentiss Properties Capital Trust II that we account for using the cost method of accounting.

(4) The mortgage debt, all of which is non-recourse, is collateralized by the individual real estate

property or
properties
within each
venture.

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9. Mortgages and Notes Payable

At June 30, 2005, we had mortgages and notes payable of $1.4 billion, excluding our proportionate share of debt from our unconsolidated joint ventures.

The following table sets forth our consolidated mortgages and notes payable as of June 30, 2005 and December 31, 2004:

	(in thousands)				
Description	**June 30, 2005**	**December 31, 2004**	**Amortization**	**Interest Rate[1]**	**Maturity**
Revolving credit facility	$ 255,000	$217,500	None	LIBOR+1.350%	February 19, 2007
PPREFI portfolio loan [2]	180,100	180,100	None	7.58%	February 26, 2007
High Bluffs construction loan	19,019	8,929	None	LIBOR+1.400%	September 1, 2007
Collateralized term loan Union Bank of Calif.[3]	30,000	30,000	None	LIBOR+1.150%	September 30, 2007
Unsecured term loan Eurohypo I	100,000	100,000	None	LIBOR+1.375%	May 22, 2008
Unsecured term loan Commerzbank	75,000	75,000	None	LIBOR+1.350%	March 15, 2009
Unsecured term loan Eurohypo II	13,620	13,760	30 yr	7.46%	July 15, 2009
Collateralized term loan Mass Mutual [4]	85,000	85,000	None	LIBOR+0.850%	August 1, 2009
Prentiss Properties Capital Trust I Debenture	52,836		None	LIBOR+1.250%	March 30, 2035
Prentiss Properties Capital Trust II Debenture	25,774		None	LIBOR+1.250%	June 30, 2035
Variable rate mortgage notes payable [5]	61,600	96,700	None	[6]	[6]
Fixed rate mortgage notes payable [7]	495,151	384,922	[8]	[8]	[8]
	$1,393,100	$1,191,911			

(1) All of our variable rate loans are based on 30-day LIBOR with the exception of our Prentiss Properties Capital Trust I

& II Debentures which are based on 90-day LIBOR. 30-day and 90-day LIBOR were 3.34% and 3.52% at June 30, 2005, respectively.

(2) The PPREFI portfolio loan is collateralized by 36 properties with an aggregate net book value of real estate of $233.9 million.

(3) The term loan is collateralized by two properties with an aggregate net book value of real estate of $18.1 million.

(4) The term loan is collateralized by 9 properties with an aggregate net book value of real estate of $106.7 million.

(5) The variable rate mortgage loans are collateralized by 5 buildings with an aggregate net book value of $84.6 million.

(6) Interest rates on our variable rate mortgages range from 30-day

LIBOR plus 110 basis points to 30-day LIBOR plus 130 basis points. Maturity dates range from July 2009 through May 2010.

(7) The fixed rate mortgage loans are collateralized by 23 buildings with an aggregate net book value of $553.7 million.

(8) The payments on our fixed rate mortgages are based on amortization periods ranging between 18 and 30 years. The effective interest rates for our fixed rate mortgages range from 3.70% to 8.05% with a weighted average effective interest rate of 6.77% at June 30, 2005. Maturity dates range from November 2005 through April 2015 with a weighted average maturity of 6.0 years from June 30, 2005.

Our mortgages and notes payable at June 30, 2005 consisted of $675.3 million of fixed rate, non-recourse, long-term mortgages, $13.6 million of fixed rate, recourse debt and $704.2 million of floating rate debt,

$415.0 million of which was hedged at June 30, 2005 with variable to fixed rate hedges.

Future scheduled principal repayments of our outstanding mortgages and notes payable are as follows:

	(in thousands)
2005	$ 48,197
2006	9,704
2007	496,201
2008	107,094
2009	251,764
Thereafter	480,140
	$1,393,100

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10. Interest Rate Hedges

In the normal course of business, we are exposed to the effect of interest rate changes. We limit our interest rate risk by following established risk management policies and procedures including the use of derivatives. For interest rate exposures, derivatives are used to hedge against rate movements on our related debt.

To manage interest rate risk, we may employ options, forwards, interest rate swaps, caps and floors or a combination thereof depending on the underlying exposure. We undertake a variety of borrowings from credit facilities, to medium- and long-term financings. To hedge against increases in interest cost, we use interest rate instruments, typically interest rate swaps, to convert a portion of our variable-rate debt to fixed-rate debt.

On the date we enter into a derivative contract, we designate the derivative as a hedge of (a) a forecasted transaction or (b) the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (cash flow hedge). These agreements involve the exchange of amounts based on a variable interest rate for amounts based on fixed interest rates over the life of the agreement based upon a notional amount. The difference to be paid or received as the interest rates change is recognized as an adjustment to interest expense. The related amount payable to or receivable from counterparties is included in accounts payable and other liabilities. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash flow hedge, to the extent that the hedge is effective, are recorded in other comprehensive income, until earnings are affected by the variability of cash flows of the hedged transaction (e.g. until periodic settlements of a variable-rate asset or liability are recorded in earnings). Any hedge ineffectiveness (which represents the amount by which the changes in the fair value of the derivative exceed the variability in the cash flows of the forecasted transaction) is recorded in current-period earnings. Changes in the fair value of non-hedging instruments are reported in current-period earnings.

We formally document all relationships between hedging instruments and hedged items, as well as our risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as cash flow hedges to (1) specific assets and liabilities on the balance sheet or (2) specific firm commitments or forecasted transactions. We also formally assess (both at the hedge s inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. When it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, we discontinue hedge accounting prospectively, as discussed below.

We discontinue hedge accounting prospectively when (1) we determine that the derivative is no longer effective in offsetting changes in the cash flows of a hedged item (including hedged items such as firm commitments or forecasted transactions); (2) the derivative expires or is sold, terminated, or exercised; (3) it is no longer probable that the forecasted transaction will occur; (4) a hedged firm commitment no longer meets the definition of a firm commitment; or (5) management determines that designating the derivative as a hedging instrument is no longer appropriate.

When we discontinue hedge accounting because it is no longer probable that the forecasted transaction will occur in the originally expected period, the gain or loss on the derivative remains in accumulated other comprehensive income and is reclassified into earnings when the forecasted transaction affects earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were accumulated in other comprehensive income will be recognized immediately in earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, we will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value in current-period earnings.

To determine the fair value of derivative instruments, we use a variety of methods and assumptions that are based on market conditions and risks existing at each balance sheet date. For our derivatives, standard market conventions and techniques such as discounted cash flow analysis, option pricing models, replacement cost, and termination cost are used to determine fair value. All methods of assessing fair value result in a general approximation of value, and

such value may never actually be realized.

Over time, the unrealized gains and losses held in accumulated other comprehensive income will be reclassified to earnings. This reclassification is consistent with when the hedged items are recognized in earnings. Within the next twelve months, we expect to reclassify to earnings approximately $1.4 million and $709,000 of unrealized gains and unrealized losses, respectively.

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The following table summarizes the notional values and fair values of our derivative financial instruments at June 30, 2005. The notional value provides an indication of the extent of our involvement in these instruments as of the balance sheet date, but does not represent exposure to credit, interest rate or market risks.

Notional Amount	Swap Rate Paid (Fixed)	Swap Rate Received (Variable) at June 30, 2005	Swap Maturity	Fair Value
				(in thousands)
$25 million	4.345%	3.34%	July 2005	$ (7)
$15 million	4.345%	3.34%	July 2005	(4)
$20 million	5.985%	3.34%	March 2006	(304)
$30 million	5.990%	3.34%	March 2006	(456)
$50 million	2.270%	3.34%	August 2007	1,619
$25 million	2.277%	3.34%	August 2007	806
$70 million[1]	4.139%	3.34%	August 2008	(470)
$30 million	3.857%	3.34%	September 2008	58
$30 million	3.819%	3.34%	October 2008	93
$20 million	3.819%	3.34%	October 2008	62
$50 million	3.935%	3.34%	May 2009	23
$30 million	3.443%	3.34%	October 2009	625
$20 million [1]	4.000%	3.34%	February 2010	(13)
Total				$2,032

(1) The interest rate swap agreement was executed by Prentiss Office Investors, L.P., a partnership

which is 51% owned by our operating partnership.

Cash payments made under our interest rate swap agreements exceeded cash receipts from our interest rate swap agreements by $1.1 million and $2.7 million for the three months ended June 30, 2005 and 2004, respectively and $2.6 million and $5.3 million for the six months ended June 30, 2005 and 2004, respectively.

11. Accounts Payable and Other Liabilities

Accounts payable and other liabilities consisted of the following at June 30, 2005 and December 31, 2004:

	(in thousands)	
	June 30, 2005	**December 31, 2004**
Accrued interest expense	$ 6,454	$ 5,685
Accrued real estate taxes	25,132	28,178
Advance rents and deposits	20,424	20,010
Deferred compensation liability	7,435	6,516
Below market lease values, net of amortization[1]	11,156	8,319
Other liabilities	29,794	36,596
	$100,395	$105,304

[1] Accumulated amortization for below market lease values as of June 30, 2005 and December 31, 2004 was $3.0 million and $2.0 million, respectively. We record below market lease value amortization in the line item rental income.

12. Distributions

On June 8, 2005, we declared a cash distribution for the second quarter of 2005 in the amount of $0.56 per share, payable on July 8, 2005 to common shareholders of record on June 30, 2005. Additionally, we determined that a distribution of $0.56 per common unit would be made to the partners of the operating partnership and the holders of our Series D Convertible Preferred Shares. The distributions totaling $28.2 million were paid July 8, 2005.

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13. Supplemental Disclosure of Non-Cash Activities

During the three months ended June 30, 2005, we declared cash distributions totaling $28.2 million payable to holders of common shares, operating partnership units and Series D Convertible Preferred Shares. The distributions were paid July 8, 2005.

Pursuant to our long-term incentive plan, during the six months ended June 30, 2005, we issued 110,250 restricted common shares to various key employees. The shares, which had a market value of approximately $3.8 million based upon the per share price on the date of grant, were classified as unearned compensation and recorded in the shareholders equity section of the consolidated balance sheet. The unearned compensation is amortized quarterly as compensation expense over the three-year vesting period.

During the six months ended June 30, 2005, 37,733 common shares were issued pursuant to the conversion of 37,733 common units of our operating partnership. The common shares had a market value of approximately $1.4 million on the conversion date.

We marked-to-market our investments in securities and our interest rate hedges. During the six months ended June 30, 2005, we recorded unrealized gains of $613,000 and unrealized losses of $18,000 on our interest rate hedges and investments in securities, respectively.

In connection with the acquisitions and the consolidation of the Tysons International joint venture during the six months ended June 30, 2005, we recorded and assumed liabilities of approximately $2.3 million and receivables of approximately $756,000.

14. Segment Information

The tables below present information about segment assets, our investments in equity method investees, expenditures for additions to long-lived assets and revenues and income from continuing operations used by our chief operating decision maker as of and for the three and six month periods ended June 30, 2005 and 2004:

For the Three Months Ended June 30, 2005
(in thousands)

	Mid-Atlantic	Midwest	Southwest	Northern California	Southern California	Total Segments	Corporate Not Allocable To Segments	Consolidated Total
Revenues	$ 28,064	$ 16,681	$ 32,053	$ 12,287	$ 10,338	$ 99,423	$ 790	$ 100,213
Income from continuing operations	$ 9,433	$ 4,241	$ 10,982	$ 3,799	$ 4,043	$ 32,498	$(23,682)	$ 8,816
Additions to long-lived assets:								
Development/redevelopment	$ 55	$ 589	$ 725	$ 991	$ 6,058	$ 8,418	$	$ 8,418
Purchase of real estate	103,222			1,885		105,107		105,107
Capital expenditures for in-service properties	4,630	763	6,863	514	1,749	14,519		14,519
Total additions	$107,907	$ 1,352	$ 7,588	$ 3,390	$ 7,807	$ 128,044	$	$ 128,044
	$	$	$ 4,482	$	$	$ 4,482	$	$ 4,482

Investment balance in equity method investees								
Assets	$780,343	$432,473	$700,319	$280,518	$285,347	$2,479,000	$ 29,242	$2,508,242

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For the Three Months Ended June 30, 2004
(in thousands)

	Mid-Atlantic	Midwest	Southwest	Northern California	Southern California	Total Segments	Corporate Not Allocable To Segments	Consolidated Total
Revenues	$ 24,241	$ 14,419	$ 32,729	$ 8,338	$ 10,291	$ 90,018	$ 532	$ 90,550
Income from continuing operations	$ 11,291	$ 4,695	$ 11,147	$ 3,351	$ 3,694	$ 34,178	$(20,921)	$ 13,257
Additions to long-lived assets:								
Development/redevelopment	$ 15	$ 459	$ 17	$ 1	$ 881	$ 1,373	$	$ 1,373
Purchase of Real Estate			123,323	34,780	17,724	175,827	$	175,827
Capital expenditures for in-service properties	2,286	1,301	3,681	1,667	1,498	10,433		10,433
Total additions	$ 2,301	$ 1,760	$127,021	$ 36,448	$ 20,103	$ 187,633	$	$ 187,633
Investment balance in equity method investees	$ 8,764	$	$ 4,010	$	$	$ 12,774	$	$ 12,774
Assets	$611,022	$414,105	$753,585	$215,255	$259,191	$2,253,158	$ 28,516	$2,281,674

For the Six Months Ended June 30, 2005
(in thousands)

	Mid-Atlantic	Midwest	Southwest	Northern California	Southern California	Total Segments	Corporate Not Allocable To Segments	Consolidated Total
Revenues	$ 54,634	$33,421	$64,138	$24,527	$20,265	$196,985	$ 1,317	$198,302
Income from continuing operations	$ 21,185	$ 8,500	$20,582	$ 8,194	$ 7,616	$ 66,077	$(44,573)	$ 21,504
Additions to long-lived assets:								
Development/redevelopment	$ 58	$ 797	$ 738	$ 1,237	$11,653	$ 14,483	$	$ 14,483
Purchase of real estate	155,040			1,885		156,925		156,925
	13,154	1,332	11,209	722	3,147	29,564		29,564

Capital expenditures for in-service properties								
Total additions	$168,252	$ 2,129	$11,947	$ 3,844	$14,800	$200,972	$	$200,972

For the Six Months Ended June 30, 2004
(in thousands)

	Mid-Atlantic	Midwest	Southwest	Northern California	Southern California	Total Segments	Corporate Not Allocable To Segments	Consolidated Total
Revenues	$48,435	$28,575	$ 63,156	$16,786	$20,094	$177,046	$ 1,290	$178,336
Income from continuing operations	$21,572	$ 8,170	$ 23,096	$ 7,255	$ 6,752	$ 66,845	$(39,819)	$ 27,026
Additions to long-lived assets:								
Development/redevelopment	$ 15	$ 1,714	$ 179	$ 1	$ 979	$ 2,888	$	$ 2,888
Purchase of real estate			123,323	34,780	17,724	175,827		175,827
Capital expenditures for in-service properties	3,890	4,529	7,306	2,962	2,500	21,187		21,187
Total additions	$ 3,905	$ 6,243	$130,808	$37,743	$21,203	$199,902	$	$199,902

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15. Recently Issued Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board Issued Statement of Financial Accounting Standards No. 123(R), Share-Based Payment, a revision to Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation. The Statement supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance.

The Statement which focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions, establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity s equity instruments or that may be settled by the issuance of those equity instruments.

The Statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award the requisite service period (usually the vesting period). No compensation cost is recognized for equity instruments for which employees do not render the requisite service.

The Statement, which originally was to take effect the beginning of the first interim or annual reporting period that begins after June 15, 2005 for public entities that do not file as small business issuers, was amended on April 14, 2005. The Securities and Exchange Commission adopted a new rule to amend the compliance dates, which now allows companies to implement the statement at the beginning of their next fiscal year. The Statement will not have a material impact on our financial statements.

In May 2005, the Financial Accounting Standards Board issued FASB Statement No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3. The Statement provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. This Statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

At the June 2005 EITF meeting, the Task Force reached a consensus on EITF 04-5, Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights. The consensus provides a framework for addressing when a general partner, or general partners as a group, controls a limited partnership or similar entity. The Task Force reached a consensus that for general partners of all new limited partnerships formed and for existing limited partnerships for which the partnership agreements are modified, the guidance in this issue is effective after June 29, 2005. For general partners in other limited partnerships, the guidance is effective no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005. The Task Force also amended EITF 96-16 to be consistent with the consensus reached in Issue No. 04-05. Additionally, the Financial Accounting Standards Board issued FSP SOP 78-9-1 which amends the guidance in SOP 78-9 to be consistent with the consensus in 04-5. We are currently evaluating the impact on our financial statements of this framework, the amendments to EITF 96-16 and FSP SOP 78-9-1.

Also at the June 2005 meeting, the Task Force reached a consensus on EITF 05-6, Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination. The consensus reached is that the leasehold improvements whether acquired in a business combination or that are placed in service significantly after and not contemplated at or near the beginning of the lease term should be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured. The consensus in this issue which is to be applied to leasehold improvements that are purchased or acquired in reporting periods beginning after June 29, 2005 will not have a material impact on our financial

statements.

16. Pro Forma

The following unaudited pro forma consolidated statements of income are presented as if all of the properties acquired between January 1, 2005 and June 30, 2005 had occurred January 1, 2005 and 2004.

These pro forma consolidated statements of income should be read in conjunction with our historical consolidated financial statements and notes thereto for the three and six months ended June 30, 2005, included in this Form 10-Q. The pro forma

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consolidated statements of income are not necessarily indicative of what actual results would have been had the acquisitions actually occurred on January 1, 2005 and 2004 nor purport to represent our operations for future periods.

Pro Forma	**Six Months Ended June 30,**	
(in thousands)	**2005[1]**	**2004**
Total revenue	$203,113	$186,694
Income applicable to common shareholders before discontinued operations	19,071	22,332
Net income applicable to common shareholders	19,088	29,875
Basic earnings per share:		
Income applicable to common shareholders before discontinued operations	$ 0.43	$ 0.51
Net income applicable to common shareholders	$ 0.43	$ 0.68
Weighted average number of common shares outstanding	44,893	43,906
Diluted earnings per share:		
Income applicable to common shareholders before discontinued operations	$ 0.42	$ 0.51
Net income applicable to common shareholders	$ 0.42	$ 0.68
Weighted average number of common shares and common share equivalents outstanding	45,116	44,094

(1) The pro forma results of operations for the six months ended June 30, 2005 excludes a $2.2 million prepayment penalty due to its non-recurring nature. The $2.2 million loss is included in the line item equity in (loss)/income of unconsolidated joint ventures and subsidiaries on our consolidated statement of income during

the three and six
months ended
June 30, 2005.

17. Subsequent Events

On July 14, 2005, Prentiss Office Investors, L.P., which is owned 51% by our operating partnership and its affiliates and 49% by Stichting Pensioenfond ABP, acquired, from an unrelated third party, an office building with approximately 238,000 net rentable square feet. The property is located in the City Center submarket of the Oakland, California CBD and was acquired for gross proceeds of $39.4 million. Each partner contributed their pro rata share of the cash purchase price to Prentiss Office Investors, L.P. for the acquisition. Amounts contributed from the operating partnership were funded with proceeds from our revolving credit facility. As a part of the transaction, the venture assumed a $25 million non-recourse mortgage with a 5.175% interest rate that amortizes on a 30-year amortization schedule and has a maturity date of June 1, 2010.

On July 14, 2005, we completed a $100 million loan collateralized by two office buildings in Tyson s Corner, Virginia. The interest rate is fixed at 4.84% and the monthly payments are interest only until September 11, 2008 at which time it converts to amortizing, on a 30-year amortization schedule, until the maturity date of August 1, 2015. The proceeds were used to repay a portion of the outstanding borrowings under our revolving credit facility.

On July 26, 2005, we renewed our revolving credit facility, increased it from $375 to $400 million and obtained an expansion right to $500 million. The facility also includes an extension right of the maturity date from July 26, 2008 to July 26, 2009. The interest rate on the facility will fluctuate based on our overall leverage with a range between LIBOR plus 85 basis points and LIBOR plus 135 basis points. The pricing on the renewed facility generally represents a 25 basis point to 30 basis point pricing reduction across the leverage grid and several covenant requirements were also modified to the company s benefit. Except as set forth above, the remaining terms of the revolving credit facility remain substantially unchanged. Banking participants in the revolving credit facility include JP Morgan Chase Bank as Administrative Agent; Bank of America as Syndication Agent; Commerzbank, EuroHypo, Societe General, PNC Bank, Sun Trust, Union Bank of California, Comerica Bank, Mellon Bank, Deutsche Bank, ING Real Estate Finance, US Bank and Wachovia Bank as Lenders.

On July 26, 2005, and August 3, 2005, we modified our $75 million unsecured term loan with Commerzbank and our $100 million unsecured term loan with EuroHypo, respectively. The modifications were basically the same pricing and covenant changes that were incorporated into our revolving credit facility renewal as discussed above, with the expiration dates remaining unchanged at March 15, 2009 and May 22, 2008, respectively.

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On August 1, 2005, using proceeds from our revolving credit facility, we paid off a $45.5 million loan collateralized by a property in Oakland, California scheduled to mature on November 1, 2005. In accordance with the terms of the loan, there was no prepayment penalty.

On August 2, 2005, we completed the sale of our mortgage note receivable to an unrelated party for total proceeds of $1.0 million. The proceeds were used to repay a portion of the outstanding borrowings under our revolving credit facility.

At June 30, 2005, we had 3,773,585 shares outstanding of Participating Cumulative Redeemable Preferred Shares of Beneficial Interest, Series D (the Series D Preferred Shares) held by Security Capital Preferred Growth, Incorporated. Subsequent to quarter end, pursuant to their rights under the agreement which allows Security Capital Preferred Growth, Incorporated to convert any or all of the Series D Preferred Shares into common shares on a one for one basis, Security Capital Preferred Growth, Incorporated converted 950,000 Series D Preferred Shares into 950,000 common shares. As a result, we have 2,823,585 Series D Preferred Shares outstanding at August 4, 2005.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes thereto presented in this Form 10-Q. Historical results set forth in our consolidated financial statements should not be taken as an indication of our future operations.

Overview

We are a self-administered and self-managed Maryland REIT. We acquire, own, manage, lease, develop and build primarily office properties throughout the United States. We are self-administered in that we provide our own administrative services, such as accounting, tax and legal, internally through our own employees. We are self-managed in that we internally provide all the management and maintenance services that our properties require through employees, such as property managers, leasing professionals and engineers. We operate principally through our operating partnership, Prentiss Properties Acquisition Partners, L.P. and its subsidiaries, and two management service companies, Prentiss Properties Resources, Inc. and its subsidiaries and Prentiss Properties Management, L.P.

As of June 30, 2005, we owned interests in a diversified portfolio of 135 primarily suburban Class A office and suburban industrial properties as follows:

	Number of Buildings[1]	Net Rentable Square Feet [2] (in thousands)
Office properties	108	17,729
Industrial properties	27	2,203
Total	135	19,932

(1) Includes 7 buildings owned through a joint venture, the operations of which are accounted for using the equity method of accounting and 14 buildings which are owned through a joint venture, the operations of which are consolidated.

(2) Includes 1.1 million square feet in the 7 buildings owned by our unconsolidated

joint venture of which we own a 50% non-controlling interest and 1.2 million square feet in the 14 buildings owned by our consolidated joint venture of which we own a 51% controlling interest.

As an owner of real estate, the majority of our income and cash flow is derived from rental income received pursuant to tenant leases for space at our properties; and thus, our earnings would be negatively impacted by a deterioration of our rental income. One or more factors could result in a deterioration of rental income including (1) our failure to renew or execute new leases as current leases expire, (2) our failure to renew or execute new leases with rental terms at or above the terms of in-place leases, and (3) tenant defaults.

Our failure to renew or execute new leases as current leases expire or to execute new leases with rental terms at or above the terms of in-place leases is dependent on factors such as (1) the local economic climate, which may be adversely impacted by business layoffs or downsizing, industry slowdowns, changing demographics and other factors and (2) local real estate conditions, such as oversupply of office and industrial space or competition within the market.

On April 22, 2004, we acquired from 7-Eleven, Inc., an unrelated third party, the Cityplace Center property, a 42-story, 1.3 million net rentable square foot class AA office building in Dallas, Texas. Under the terms of the purchase, 7-Eleven, Inc. executed a 504,351 square-foot lease at the property for a term of three years from the date of closing. 7-Eleven, Inc. has the option to extend the term of its lease an additional seven years by notifying us no later than October 21, 2005. The acquisition price of the building totaled approximately $124 million. In determining the amount we were willing to pay for property, we projected 7-Eleven s departure from the building at the end of the initial 3-year term. The operating partnership is obligated to fund an additional $14.5 million if 7-Eleven, Inc. exercises its extension option.

Although 7-Eleven, Inc. announced to the public on April 20, 2005, their intention to enter into a lease at a property to be constructed, they have not provided us formal notification and as a result retain their rights under the purchase agreement to extend the lease in accordance with the conditions included therein. We anticipate that 7-Eleven, Inc. will vacate our property upon completion of the new property.

Our industry s performance is generally predicated on a sustained pattern of job growth. In 2004, while the overall United States economy began to demonstrate economic growth, there were few indications that the economy was creating jobs at a pace sufficient to generate significant increases in demand for our office space.

As a result of the recent weak economic climate, the office real estate markets have been materially impacted by higher vacancy rates. In 2003, vacancy rates appeared to peak in many of our markets and some positive net absorption of space started to occur. During 2004, all of our markets, with the exception of Downtown Chicago, experienced positive net absorption of space. In addition, the overall vacancy rates were down as compared to 2003. With the exception of Denver and Downtown Chicago, our markets have continued to experience positive net absorption in 2005. Although there are signs of improvement in the economic climate, we anticipate that leasing efforts will remain tough for the remainder of 2005. In the face of challenging market conditions, we have followed a disciplined approach to managing our operations. We are constantly reviewing our portfolio and the markets in which we operate to identify potential asset acquisitions, opportunities for development and where we believe significant value can be found, asset dispositions.

At the direction of our board of trustees, during the first quarter of 2005, we initiated an analysis of our business strategy in our Midwest region. Our Midwest Region includes properties located within the Chicago and Detroit markets. Our Chicago portfolio consists of 16 office properties containing 2.2 million square feet and 4 industrial properties containing 700,000 square feet. We have one office property in Detroit, Michigan containing 242,000 square feet. As part of our analysis, Holliday Fenoglio Fowler, L.P. has been retained as broker and is marketing our Chicago and Detroit properties for sale. Subsequent to quarter end, we received purchase offers for the properties. During the next 30 to 60 days, we will be evaluating the offers to determine which properties will be retained, the properties to be sold and the extent of any future involvement with the properties. We anticipate that on or before September 30, 2005, we will commit to a plan to sell some or all of the properties within our Midwest region and pursuant to this plan, the properties selected for sale will qualify as held for sale in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

The occupancy in our portfolio of operating properties slightly increased in the second quarter of 2005 to 90% at June 30, 2005 compared to 88% at December 31, 2004. Market rental rates have declined in each of our markets from peak levels and there may be additional declines throughout the remainder of 2005. Rental rates on our office space that were re-leased during the first and second quarters of 2005 decreased an average of 3%, and 9%, respectively, in comparison to rates that were in effect under expiring leases.

Our organization consists of a corporate office located in Dallas, Texas and five regional offices each of which operates under the guidance of a member of our senior management team. The following table presents second quarter 2005 regional revenues and the 10 markets in which our properties are located, with the first market being the location of each regional office:

Region	**Revenues** (in thousands)	**Market**
Mid-Atlantic	$ 28,064	Metropolitan Washington D.C.
Midwest	16,681	Chicago, Suburban Detroit
Southwest	32,053	Dallas/Fort Worth, Austin, Denver
Northern California	12,287	Oakland, Silicon Valley
Southern California	10,338	San Diego, Los Angeles
Total	$ 99,423	

In addition to the $99.4 million of regional revenues, during the three months ended June 30, 2005, we recognized $790,000 of revenue consisting of reimbursements from employees for their share of health care related costs of $146,000, interest income of $37,000 representing the portion not allocated to our regions and the balance of $607,000 relates primarily to income derived from services performed for third parties not allocated to our regions.

At June 30, 2005, we had 17.9 million square feet of in-place leases representing 90% of the 19.9 million net rentable square feet of both our consolidated and unconsolidated properties. Our leases generally range in term from 1 month to 15 years with an average term of 5 to 7 years. The following table presents, by region, the expiration of our 17.9 million square feet of in-place leases.

Square Feet