PS BUSINESS PARKS INC/CA
Form 10-Q
November 04, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2009

or

o **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	**95-4300881**
(State or Other Jurisdiction of Incorporation)	(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 þ No o

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 o No o

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 þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Yes o No þ

As of October 31, 2009, the number of shares of the registrant s common stock, $0.01 par value per share, outstanding was 24,386,083.

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

	September 30, 2009 (Unaudited)	December 31, 2008
ASSETS		
Cash and cash equivalents	$ 203,204	$ 55,015
Real estate facilities, at cost:		
Land	494,849	494,849
Buildings and equipment	1,533,208	1,517,484
	2,028,057	2,012,333
Accumulated depreciation	(697,879)	(637,948)
	1,330,178	1,374,385
Land held for development	6,829	7,869
	1,337,007	1,382,254
Rent receivable	1,978	2,055
Deferred rent receivable	21,952	21,633
Other assets	7,180	8,366
Total assets	$ 1,571,321	$ 1,469,323
LIABILITIES AND EQUITY		
Accrued and other liabilities	$ 50,727	$ 46,428
Mortgage notes payable	53,196	59,308
Total liabilities	103,923	105,736
Commitments and contingencies		
Equity:		
PS Business Parks, Inc. s shareholders equity:		
Preferred stock, $0.01 par value, 50,000,000 shares authorized, 25,042 and 28,250 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively	626,046	706,250
Common stock, $0.01 par value, 100,000,000 shares authorized, 24,385,891 and 20,459,916 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively	243	204
Paid-in capital	547,860	363,587
Cumulative net income	679,212	622,113

Cumulative distributions		(636,403)		(571,340)
Total PS Business Parks, Inc. s shareholders equity		1,216,958		1,120,814
Noncontrolling interests:				
Preferred units		73,418		94,750
Common units		177,022		148,023
Total noncontrolling interests		250,440		242,773
Total equity		1,467,398		1,363,587
Total liabilities and equity	$	1,571,321	$	1,469,323

See accompanying notes.

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

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008	For the Nine Months Ended September 30, 2009	For the Nine Months Ended September 30, 2008
Revenues:				
Rental income	$ 67,546	$ 71,464	$ 205,269	$ 212,021
Facility management fees	172	178	522	550
Total operating revenues	67,718	71,642	205,791	212,571
Expenses:				
Cost of operations	21,550	22,591	65,854	67,020
Depreciation and amortization	19,828	24,703	63,631	75,270
General and administrative	1,413	1,950	4,927	6,081
Total operating expenses	42,791	49,244	134,412	148,371
Other income and expenses:				
Interest and other income	134	404	381	1,014
Interest expense	(875)	(988)	(2,686)	(2,971)
Gain on sale of land			1,488	
Total other income and expenses	(741)	(584)	(817)	(1,957)
Net income	$ 24,186	$ 21,814	$ 70,562	$ 62,243
Net income allocation:				
Net income allocable to noncontrolling interests:				
Noncontrolling interests common units	$ 2,838	$ 1,910	$ 17,414	$ 4,897
Noncontrolling interests preferred units	1,382	1,752	(3,951)	5,256
Total net income allocable to noncontrolling interests	4,220	3,662	13,463	10,153
Net income allocable to PS Business Parks, Inc.:				
Common shareholders	8,762	5,336	50,517	13,646
Preferred shareholders	11,156	12,756	6,285	38,269
Restricted stock unit holders	48	60	297	175
Total net income allocable to PS Business Parks, Inc.	19,966	18,152	57,099	52,090
	$ 24,186	$ 21,814	$ 70,562	$ 62,243

Net income per common share:								
Basic	$	0.39	$	0.26	$	2.38	$	0.67
Diluted	$	0.39	$	0.26	$	2.37	$	0.66
Weighted average common shares outstanding:								
Basic		22,549		20,448		21,191		20,438
Diluted		22,709		20,642		21,311		20,627

See accompanying notes.

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PS BUSINESS PARKS, INC.
CONSOLIDATED STATEMENT OF EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009
(Unaudited, in thousands, except share data)

	Preferred Stock		Common Stock		Paid-in	Cumulative Net	Cumulative	Total PS Business Parks, Inc. s Shareholders	Noncontrolling	Total
	Shares	Amount	Shares	Amount	Capital	Income	Distributions	Equity	Interests	Equity
Balances at December 31, 2008	28,250	$ 706,250	20,459,916	$ 204	$ 363,587	$ 622,113	$ (571,340)	$ 1,120,814	$ 242,773	$ 1,363,587
Issuance of common stock, net of issuance costs			3,833,333	38	171,194			171,232		171,232
Repurchase of preferred stock, net of issuance costs	(3,208)	(80,204)			32,788		(2,783)	(50,199)		(50,199)
Repurchase of preferred units, net of issuance costs					9,578			9,578	(21,913)	(12,335)
Repurchase of common stock					(230)			(230)		(230)
Exercise of stock options			22,100		678			678		678
Stock compensation, net			70,542	1	565			566		566
Shelf registration					(75)			(75)		(75)
Net income						57,099		57,099	13,463	70,562
Distributions:										
Preferred stock							(33,507)	(33,507)		(33,507)
Common stock							(28,773)	(28,773)		(28,773)
Noncontrolling interests									(14,108)	(14,108)
Adjustment to noncontrolling interests in underlying operating partnership					(30,225)			(30,225)	30,225	

Balances at September 30, 2009	25,042	$ 626,046	24,385,891	$ 243	$ 547,860	$ 679,212	$ (636,403)	$ 1,216,958	$ 250,440	$ 1,467,398

See accompanying notes.

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

	For the Nine Months Ended September 30, 2009	2008
Cash flows from operating activities:		
Net income	$ 70,562	$ 62,243
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	63,631	75,270
In-place lease adjustment	(214)	(145)
Lease incentives net of tenant improvement reimbursements	(294)	(147)
Amortization of mortgage premium	(203)	(194)
Gain on disposition of real estate	(1,488)	
Stock compensation	2,324	3,057
Decrease in receivables and other assets	422	1,111
Increase in accrued and other liabilities	3,542	6,717
Total adjustments	67,720	85,669
Net cash provided by operating activities	138,282	147,912
Cash flows from investing activities:		
Capital improvements to real estate facilities	(19,424)	(28,985)
Proceeds from disposition of land	2,557	
Net cash used in investing activities	(16,867)	(28,985)
Cash flows from financing activities:		
Principal payments on mortgage notes payable	(781)	(865)
Repayment of mortgage note payable	(5,128)	
Net proceeds from the issuance of common stock	171,232	
Proceeds from the exercise of stock options	678	733
Shelf registration costs	(75)	
Repurchase of common stock	(230)	(21,626)
Repurchase of preferred stock	(50,199)	
Repurchase of preferred units	(12,335)	
Distributions paid to common shareholders	(28,773)	(26,975)
Distributions paid to preferred shareholders	(33,507)	(38,269)
Distributions paid to noncontrolling interests common units	(9,642)	(9,642)
Distributions paid to noncontrolling interests preferred units	(4,466)	(5,256)
Net cash provided by (used in) financing activities	26,774	(101,900)
Net increase in cash and cash equivalents	148,189	17,027
Cash and cash equivalents at the beginning of the period	55,015	35,041
Cash and cash equivalents at the end of the period	$ 203,204	$ 52,068

Supplemental schedule of non-cash investing and financing activities:				
Adjustment to noncontrolling interests in underlying operating partnership:				
Noncontrolling interests common units	$	30,225	$	(2,228)
Paid-in capital	$	(30,225)	$	2,228

See accompanying notes.

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PS BUSINESS PARKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009

1. Organization and description of business

PS Business Parks, Inc. (PSB) was incorporated in the state of California in 1990. As of September 30, 2009, PSB owned 76.9% of the common partnership units of PS Business Parks, L.P. (the Operating Partnership). The remaining common partnership units were 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 September 30, 2009, the Company owned and operated approximately 19.6 million rentable square feet of commercial space located in eight states. The Company also manages approximately 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 and nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ended December 31, 2009. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K as amended for the year ended December 31, 2008.

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.

The Company has evaluated subsequent events through November 4, 2009, the date of issuance of the consolidated financial statements.

Effective July 1, 2009, the Financial Accounting Standards Board Accounting Standards Codification (the FASB Codification) became the single source of authoritative GAAP in the United States of America. The FASB Codification reorganized the previous GAAP pronouncements into accounting topics, which are displayed using a single numerical structure. Certain Securities and Exchange Commission (SEC) guidance is also included in the FASB Codification and follows a similar topical structure in separate SEC sections. Any technical references contained in the accompanying interim financial statements have been updated to correspond to the new FASB Codification references.

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. The Company adopted this guidance beginning January 1, 2009 and it was applied prospectively, except for presentation and disclosure requirements, which was applied retrospectively. The adoption of this guidance did not have a material impact on the Company s consolidated financial position or earnings per share.

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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.

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 and $300,000 at September 30, 2009 and December 31, 2008, respectively.

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 short-term investments, including commercial paper, 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 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.

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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, net, to rental income over the remaining non-cancelable terms of the respective leases. The Company recorded net amortization of $53,000 and $49,000 of intangible assets and liabilities resulting from the above-market and below-market lease values during the three months ended September 30, 2009 and 2008, respectively. Amortization was $214,000 and $145,000 for each of the nine months ended September 30, 2009 and 2008, respectively. As of September 30, 2009, the value of in-place leases resulted in a net intangible asset of $116,000, net of $1.1 million of accumulated amortization, and a net intangible liability of $306,000, net of $1.1 million of accumulated amortization. As of December 31, 2008, the value of in-place leases resulted in a net intangible asset of $181,000, net of $1.0 million of accumulated amortization, and a net intangible liability of $585,000, net of $772,000 of accumulated amortization.

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 September 30, 2009, 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 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 revenues 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

The Company recognizes gains from sales of real estate 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.

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General and administrative expense

General and administrative expense includes executive and other compensation, office expense, professional fees, state income taxes and other such administrative items.

Income taxes

The Company 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 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 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 2008 and intends to continue to meet such requirements for 2009. Accordingly, no provision for income taxes has been made in the accompanying consolidated financial statements.

In July 2006, the Financial Accounting Standards Board (FASB) issued authoritative guidance that seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes, which provides guidance on derecognition, classification, interest and penalties, and accounting in interim periods and requires expanded disclosure with respect to the uncertainty in income taxes. The Company adopted this guidance as of January 1, 2007 and did not record any adjustment as a result of such adoption.

Accounting for preferred equity issuance costs

The Company records its issuance costs as a reduction to paid-in capital on its balance sheet at the tim