PS BUSINESS PARKS INC/CA
Form 10-Q
May 04, 2011

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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 March 31, 2011

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

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

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

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

See accompanying notes.

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

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

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

See accompanying notes.

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

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

See accompanying notes.

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

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

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

See accompanying notes.

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

1. Organization and description of business

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

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

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

2. Summary of significant accounting policies

Basis of presentation

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

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

Noncontrolling Interests

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

Use of estimates

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

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Allowance for doubtful accounts

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

Financial instruments

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

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

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

Real estate facilities

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

Intangible assets/liabilities

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

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Evaluation of asset impairment
The Company evaluates its assets used in operations by identifying indicators of impairment and by comparing the sum of the estimated undiscounted future cash flows for each asset to the asset s carrying value. When indicators of impairment are present and the sum of the undiscounted future cash flows is less than the carrying value of such asset, an impairment loss is recorded equal to the difference between the asset s current carrying value and its value based on discounting its estimated future cash flows. In addition, the Company evaluates its assets held for disposition for impairment. Assets held for disposition are reported at the lower of their carrying value or fair value, less cost of disposition. At March 31, 2011, the Company did not consider any assets to be impaired.
Stock compensation
All share-based payments to employees, including grants of employee stock options, are recognized as stock compensation in the Company s income statement based on their fair values. See Note 11.
Revenue and expense recognition
The Company must meet four basic criteria before revenue can be recognized: persuasive evidence of an arrangement exists; the delivery has occurred or services rendered; the fee is fixed or determinable; and collectability is reasonably assured. All leases are classified as operating leases. Rental income is recognized on a straight-line basis over the terms of the leases. Straight-line rent is recognized for all tenants with contractual fixed increases in rent that are not included on the Company s credit watch list. Deferred rent receivable represents rental revenue recognized on a straight-line basis in excess of billed rents. Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as rental income in the period the applicable costs are incurred. Property management fees are recognized in the period earned.
Costs incurred in connection with leasing (primarily tenant improvements and lease commissions) are capitalized and amortized over the lease period.
Gains from sales of real estate facilities
The Company recognizes gains from sales of real estate facilities at the time of sale using the full accrual method, provided that various criteria related to the terms of the transactions and any subsequent involvement by the Company with the properties sold are met. If the criteria are not met, the Company defers the gains and recognizes them when the criteria are met or using the installment or cost recovery methods as appropriate under the circumstances.
General and administrative expenses
General and administrative expenses include executive and other compensation, office expense, professional fees, acquisition transaction costs, state income taxes and other such administrative items.
Income taxes
The Company has qualified and intends to continue to qualify as a REIT, as defined in Section 856 of the Internal Revenue Code. As a REIT, the Company is not subject to federal income tax to the extent that it distributes its REIT taxable income to its shareholders. A REIT must distribute at least 90% of its taxable income each year. In addition, REITs are subject to a number of organizational and operating requirements. If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to federal income tax (including any applicable alternative minimum tax) based on its taxable income using corporate income tax

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

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

Accounting for preferred equity issuance costs

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

Net income allocation

Net income was allocated as follows (in thousands):

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