

PRICE ENTERPRISES INC  
Form 10-Q  
August 14, 2001

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q**

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

**For the quarter ended June 30, 2001**

**Commission File Number 0-20449**

**PRICE ENTERPRISES, INC.**

(Exact name of registrant as specified in its charter)

<b>Maryland</b> (State or other jurisdiction of incorporation or organization)	<b>33-0628740</b> (I.R.S. Employer Identification No.)
<b>17140 Bernardo Center Drive, Suite 300, San Diego, California 92128</b> (Address of principal executive offices) (Zip Code)	

**(858) 675-9400**  
(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 /x/ No //

The registrant had 13,309,006 shares of common stock, par value \$.0001 per share, outstanding at August 13, 2001.

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**PRICE ENTERPRISES, INC.**

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**PART I FINANCIAL INFORMATION**

**ITEM 1 FINANCIAL STATEMENTS (UNAUDITED)**

**PRICE ENTERPRISES, INC.**

**CONSOLIDATED BALANCE SHEETS**

(in thousands)

	June 30 2001	December 31 2000
	(unaudited)	(Note)
<b>ASSETS</b>		
Real estate assets		
Land and land improvements	\$ 294,244	\$ 247,470
Building and improvements	334,474	302,915
Fixtures and equipment	887	856
Construction in progress	9,488	4,436
	<u>639,093</u>	<u>555,677</u>
Less accumulated depreciation	(14,158)	(9,877)
	<u>624,935</u>	<u>545,800</u>
Investment in real estate joint ventures	18,129	14,515
Cash and cash equivalents	9,707	49,996
Accounts receivable	4,430	3,032
Note receivable from affiliate	39,782	25,377
Notes receivable	13,792	13,388
Deferred rents	4,555	3,352
Other assets	10,026	6,945
	<u>725,356</u>	<u>662,405</u>
Total assets	\$ 725,356	\$ 662,405

**LIABILITIES AND STOCKHOLDERS' EQUITY**

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	June 30 2001	December 31 2000
<b>Liabilities</b>		
Mortgages and notes payable	\$ 187,213	\$ 150,709
Revolving lines of credit	64,600	44,300
Accounts payable and other liabilities	4,645	4,287
<b>Total liabilities</b>	<b>256,458</b>	<b>199,296</b>
<b>Commitments</b>		
<b>Stockholders' equity</b>		
Series A preferred stock	353,404	353,404
Common stock	1	1
Additional paid-in capital	115,418	112,587
Retained earnings (deficit)	75	(2,883)
<b>Total stockholders' equity</b>	<b>468,898</b>	<b>463,109</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 725,356</b>	<b>\$ 662,405</b>

Note: The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

See accompanying notes.

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**PRICE ENTERPRISES, INC.**

**CONSOLIDATED STATEMENTS OF INCOME**

(unaudited amounts in thousands, except per share data)

	Second Quarter Three Months Ended June 30		Year-to-Date Six Months Ended June 30	
	2001	2000	2001	2000
Rental revenues	\$ 19,148	\$ 17,455	\$ 36,928	\$ 34,926
<b>Expenses</b>				
Operating and maintenance	2,542	1,401	4,845	3,189
Property taxes	2,229	2,146	4,370	4,264
Depreciation and amortization	2,310	2,498	4,536	4,787
General and administrative	823	738	1,690	1,513
<b>Total expenses</b>	<b>7,904</b>	<b>6,783</b>	<b>15,441</b>	<b>13,753</b>
Operating income	11,244	10,672	21,487	21,173
<b>Interest and other</b>				
Interest expense	(3,532)	(2,561)	(6,930)	(4,310)
Interest income	1,796	376	3,643	737

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	Second Quarter Three Months Ended June 30		Year-to-Date Six Months Ended June 30	
Equity in earnings of joint ventures	204	1	342	59
Total interest and other	(1,532)	(2,184)	(2,945)	(3,514)
Income before gain on sale of real estate	9,712	8,488	18,542	17,659
Net gain on sale of real estate	1,250		1,159	
Net income	10,962	8,488	19,701	17,659
Dividends paid to preferred stockholders	(8,386)	(8,327)	(16,744)	(16,651)
Net income applicable to common stockholders	\$ 2,576	\$ 161	\$ 2,957	\$ 1,008
Basic and diluted net income per common share	\$ .19	\$ .01	\$ .22	\$ .08
Weighted average common shares outstanding				
Basic and diluted	13,309	13,309	13,309	13,309
Dividends per preferred share	\$ .35	\$ .35	\$ .70	\$ .70

See accompanying notes.

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**PRICE ENTERPRISES, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(unaudited amounts in thousands)

	Year-to-Date Six Months Ended June 30	
	2001	2000
Operating activities		
Net income	\$ 19,701	\$ 17,659
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,536	4,787
Deferred rents	(1,203)	(1,611)
Equity in earnings of joint venture	(342)	(59)
Net gain on sale of real estate	(1,159)	
Changes in operating assets and liabilities:		
Accounts receivable and other assets	(4,564)	(8,571)
Accounts payable and other liabilities	358	437
Net cash provided by operating activities	17,327	12,642
Investing activities		
Additions to real estate assets	(53,230)	(19,212)
Proceeds from the sale of real estate assets	6,302	
Contributions to real estate joint ventures	(2,353)	(7,953)
Advances on notes receivable	(18,769)	(6,671)

	Year-to-Date Six Months Ended June 30	
Repayments on notes receivable	3,040	
Net cash used in investing activities	(65,010)	(33,836)
<b>Financing activities</b>		
Advances from revolving lines of credit and notes payable	24,614	161,842
Repayments of revolving lines of credit and notes payable	(3,307)	(123,215)
Dividends paid	(16,744)	(16,651)
Proceeds from exercise of stock options	2,831	371
Net cash provided by financing activities	7,394	22,347
Net (decrease) increase in cash and cash equivalents	(40,289)	1,153
Cash and cash equivalents at beginning of period	49,996	2,145
Cash and cash equivalents at end of period	\$ 9,707	\$ 3,298
Supplemental cash flow information:		
Cash paid for interest	\$ 6,360	\$ 3,863
Supplemental schedule of noncash financing activities:		
Assumption of loans to acquire real estate assets	35,497	14,686
Reduction in note receivable to acquire interest in real estate joint venture	919	
Receipt of common stock of former tenant in exchange for amounts due PEI		812

*See accompanying notes.*

**PRICE ENTERPRISES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**June 30, 2001**

**Note 1 Organization and Significant Accounting Policies**

***Organization***

Price Enterprises, Inc. (PEI) operates as a real estate investment trust (REIT) incorporated in the state of Maryland. Our principal business is to own, acquire, operate, manage and lease real property, primarily open-air shopping centers. We became a REIT in September 1997 after we spun-off our merchandising segment and certain other assets to PriceSmart, Inc. In November 1999 Excel Legacy Corporation (Legacy) completed its exchange offer for our common stock. In the exchange offer, Legacy acquired approximately 91.3% of our common stock, which represents approximately 77.5% of PEI's voting power.

In accounting for this transaction, we followed Accounting Principles Board Opinion No. 16, "Business Combinations," which requires we treat this transaction as a purchase. In following purchase accounting, we allocated the cost basis of Legacy's investment in our common stock among our assets and liabilities to adjust them to fair value at the time of the completion of the exchange offer.

***Accounting Principles***

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We prepared the financial statements following the requirements of the Securities and Exchange Commission (SEC) for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by accounting principles generally accepted in the United States (GAAP) can be omitted. Certain prior year data have been reclassified to conform to the 2001 presentation.

We are responsible for the unaudited financial statements included in this document. The financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of our financial position and operating results. You should also read the financial statements and notes in our latest annual report on Form 10-K, as amended.

Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year.

### ***Real Estate Assets and Depreciation***

Prior to Legacy's exchange offer for our common stock, we recorded real estate assets at historical costs, and adjusted them for recognition of impairment losses. In following purchase accounting, we adjusted the historical costs of our real estate assets to fair value. Our consolidated balance sheets at June 30, 2001 and December 31, 2000 reflect the new basis of our real estate assets.

We expense as incurred ordinary repairs and maintenance costs, which include building painting, parking lot repairs, etc. We capitalize major replacements and betterments, which include HVAC equipment, roofs, etc., and depreciate them over their estimated useful lives.

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Following completion of Legacy's exchange offer for our common stock, we adopted Legacy's accounting policy of depreciating real estate assets. We compute real estate asset depreciation on a straight-line basis over their estimated useful lives, as follows:

Land improvements	40 years
Building and improvements	40 years
Tenant improvements	Term of lease or 10 years
Fixtures and equipment	3-7 years

We capitalize interest incurred during the construction period of certain assets and this interest is depreciated over the lives of those assets. The following table shows interest expense and the amount capitalized (amounts in thousands):

	Three Months Ended June 30		Six Months Ended June 30	
	2001	2000	2001	2000
Interest incurred	\$ 3,885	\$ 3,035	\$ 7,723	\$ 5,228
Interest capitalized	(353)	(474)	(793)	(918)

### ***Use of Estimates***

Preparing financial statements in conformity with accounting principles generally accepted in the United States requires that we make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. We continually review our estimates and make adjustments as necessary, but actual results could differ from what we envisioned when we made these estimates.

### ***New Accounting Standards***

In 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," and in 1999 they voted to delay the effective date of this SFAS by one year. SFAS No. 133 establishes a new model for accounting for derivatives and hedging activities, where all derivatives must be recognized as assets and liabilities and measured at fair value. We adopted this standard on January 1, 2001 and it did not have a significant impact on our financial statements.

### **Note 2 Net Income Per Share**

In 1997, the Financial Accounting Standards Board issued SFAS No. 128, "Earnings Per Share." SFAS No. 128 requires presentation of two calculations of earnings per common share. Basic earnings per common share equals net income applicable to common stockholders divided by weighted average common shares outstanding during the period. Diluted earnings per common share equals net income applicable to common

stockholders divided by the sum of weighted average common shares outstanding

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during the period plus common stock equivalents. Common stock equivalents are shares assumed to be issued if outstanding stock options that are dilutive were exercised. We did not have any common stock equivalents during the periods presented.

### Note 3 Real Estate Assets

#### Acquisitions

During the first six months of 2001, we acquired the following properties:

Location	Description	Date Acquired	Purchase Price (000's)	Mortgage Assumed (000's)
Walnut Creek, CA	Land	1/4/01	\$ 2,816	\$
Anaheim, CA	Land	1/29/01	23,288	
Tempe, AZ	Shopping Center	5/18/01	23,914	14,137
Mesa, AZ	Shopping Center	5/18/01	31,367	21,360

We used the proceeds from tax-deferred exchange transactions on properties we sold in 2000 and assumed loans to fund these acquisitions.

During the first six months of 2000, we acquired the following properties:

Location	Description	Date Acquired	Purchase Price (000's)	Mortgage Assumed (000's)
Middletown, OH	Retail building	2/9/00	\$ 6,709	\$ 3,726
Terre Haute, IN	Retail building	2/9/00	5,762	3,598
San Diego/Rancho Bernardo, CA	Office building (1)	2/25/00	16,025	11,025(2)

(1)

*Property leased back to Legacy*

(2)

*Indicates maximum construction loan balance*

We purchased all three of these properties from Legacy and we funded these acquisitions through advances on our unsecured revolving credit facility.

Also during the second quarter of 2000 we purchased a 50% interest in a real estate development joint venture in Westminster, CO from Legacy for an initial payment of \$8.1 million. The purchase price was based on the property's existing operating income, with additional payments estimated to be \$4.8 million due through the completion of construction.

#### Dispositions

During the first six months of 2001, we sold a property in Aurora, CO for \$1.6 million and another property in Sacramento, CA for \$5.1 million. We recorded a \$1.2 million net gain on the sale of these

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properties. We are using the proceeds from the sales to purchase additional properties in tax-deferred exchange transactions.

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In May 2001, we executed a master lease of our existing four self-storage properties to certain of our officers. Effective as of the date of the agreement, the officers ceased being employees of PEI and Legacy. The initial rent paid under this agreement is \$5.1 million per year, and during the second quarter of 2001 we recorded \$0.9 million in rental revenue related to this lease. As part of the agreement, we have the right to require the lessee to purchase the properties from us at a price based upon the properties' net operating income as defined by the agreement. In addition, we intend to develop four additional self-storage properties that the lessees will have the right to acquire from us upon completion and stabilization of the properties. In connection with this agreement, we recorded a loss of \$0.2 million, which is reflected in operating expenses.

There were no dispositions during the first and second quarters of 2000.

### Note 4 Notes Receivable

In March 2000, we executed a \$15 million note receivable with Legacy due December 2002. The note was amended to allow Legacy to borrow up to \$40.0 million on the note. The note bears an interest rate of LIBOR plus 375 basis points (7.7% at June 30, 2001) on the first \$15.0 million. Amounts borrowed in excess of \$15 million bear interest at a fixed rate of 12.5% per year. As of June 30, 2001, Legacy owed \$39.8 million on this note at a weighted average interest rate of 10.7%.

We also have \$13.8 million in notes receivable outstanding at June 30, 2001 related to various development projects. The notes bear interest at 8% to 25% per year and are secured by the related projects. The notes mature on various dates through December 2001.

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### Note 5 Debt

We had the following notes and mortgages payable outstanding at June 30, 2001 and December 31, 2000 (amounts in thousands):

	<u>June 30 2001</u>	<u>December 31 2000</u>
Mortgage payable with GMAC Commercial Mortgage Corporation, bearing interest at LIBOR plus 98 basis points (5.13% at June 30, 2001). The mortgage is secured by five of our properties and matures June 2004	\$ 121,375	\$ 121,375
Revolving \$75.0 million credit facility bearing interest at LIBOR plus 140 to 185 basis points (weighted average rate at June 30, 2001 was 5.55%) due December 2001	64,600	44,300
Mortgages and notes payable on six properties bearing interest ranging from 6.59% to 9.00%. The loans are secured by the properties and mature on various dates ranging from August 2001 to March 2014	53,063	17,873
Capital lease arrangement with an individual in conjunction with the San Diego/Rancho Bernardo, CA office building. The capital lease has an effective interest rate of 4.43% and matures in December 2004	11,516	11,461
Construction loans payable with a bank bearing interest at LIBOR plus 275 basis points (6.74% at June 30, 2001). The loans are due April 2003 and are secured by the projects	1,259	
	<u>          </u>	<u>          </u>
Total	\$ 251,813	\$ 195,009
	<u>          </u>	<u>          </u>

### Note 6 Related Party Transactions

Following Legacy's completion of its exchange offer, Legacy took over daily management of PEI, including property management, finance and administration. We reimburse Legacy for these services. We expensed \$0.8 million for these services during the second quarter of 2001 and \$1.7 million for the six months year-to-date period of 2001, which was based on our historical costs for similar expenses.



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During the second quarter of 2001 we recorded \$1.1 million in interest income from Legacy related to the note receivable discussed in Note 4, and \$2.0 million for the six month year-to-date period of 2001.

In conjunction with the San Diego/Rancho Bernardo, CA office building purchased from Legacy, we leased the building back to Legacy under a 10-year lease agreement. During the second quarter of 2001, we recorded \$0.3 million of rental revenue from Legacy in connection with this lease, and \$0.5 million for the six month year-to-date period of 2001.

In conjunction with the purchase of the Anaheim land in the first quarter of 2001, we executed a ground lease agreement with Legacy. The lease has a term of 50 years and requires payments of \$2.8 million per year in rent. During the second quarter of 2001 we recorded \$0.7 million in rental

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revenue from Legacy related to this lease, and \$1.2 million for the six month year-to date period of 2001.

We discuss other related party transactions with Legacy in Note 3, Note 4, and Note 7.

### Note 7 Significant Events

On March 21, 2001, PEI, PEI Merger Sub, Inc., a Maryland corporation (Merger Sub), and Legacy entered into an Agreement and Plan of Merger (the Merger Agreement). Pursuant to the Merger Agreement and subject to the terms and conditions set forth therein, Merger Sub will be merged with and into Legacy (the Merger), with Legacy continuing as a wholly-owned subsidiary of PEI. At the effective time of the Merger, each outstanding share of Legacy common stock, will be exchanged for 0.6667 of a share of PEI common stock, and each option to purchase shares of Legacy common stock will be exchanged for an option to purchase shares of PEI common stock (with the exercise price and number of shares appropriately adjusted to reflect the exchange ratio). Following the Merger, PEI will continue to operate as a real estate investment trust under the name Price Legacy Corporation (Price Legacy). The Merger, which is structured to qualify as a tax-free reorganization, is subject to the approval of the stockholders of both PEI and Legacy and other customary closing conditions.

Also on March 21, 2001, PEI entered into a Securities Purchase Agreement (the Securities Purchase Agreement) with Warburg, Pincus Equity Partners, L.P. and certain of its affiliates (Warburg Pincus), pursuant to which PEI agreed to sell to Warburg Pincus (a) 17,985,612 shares of a new class of preferred stock, 9% Series B Junior Convertible Redeemable Preferred Stock, par value \$0.0001 per share (the Series B Preferred Stock), and (b) a warrant (the Warrant) to purchase an aggregate of 2.5 million shares of Price Legacy common stock at an exercise price of \$8.25 per share, for an aggregate purchase price of \$100,000,000. The Series B Preferred Stock is junior to the Series A Preferred Stock with respect to dividend, liquidation and other rights, and is convertible under certain conditions into Price Legacy common stock at \$5.56 per share after 24 months from the date of issuance. The 9% coupon will be paid in kind with additional shares of Series B Preferred Stock for the first 45 months from issuance. Since the Warburg Pincus investment and the Merger are subject to substantially the same conditions, it is expected that the two transactions will close concurrently (assuming they are both completed).

On April 12, 2001, PEI and Sol Price, a significant stockholder of PEI and Legacy through various trusts, agreed to convert an existing Legacy loan payable to a trust controlled by Sol Price of approximately \$9.3 million into 1,681,142 shares of the Series B Preferred Stock and a warrant to purchase 233,679 shares of our common stock at an exercise price of \$8.25 per share concurrently with the closing of the merger with Legacy and the sale of the Series B Preferred Stock to Warburg Pincus. These transactions are subject to stockholder approval and other customary conditions.

In addition, the Merger Agreement obligates PEI to commence a tender offer for all outstanding shares of our common stock (other than those shares currently held by Legacy and those shares issued in the Merger) at a cash price of \$7.00 per share. Legacy currently owns approximately 91.3% of our common stock, with approximately 1,154,717 shares held by the public. The Merger Agreement further obligates us to commence an exchange offer in which holders of Legacy's outstanding debentures and

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notes will be offered shares of our Series A Preferred Stock in exchange for their debt securities valued at par. The tender offer and exchange offer are conditioned on, and expected to close concurrently with, the Merger.

On May 14, 2001, PEI, Swerdlow Real Estate Group, Inc. (Swerdlow) and entities affiliated with Swerdlow entered into a Purchase and Sale Agreement effective as of May 7, 2001 (the Purchase Agreement). Subject to the terms and conditions set forth in the Purchase Agreement, as

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subsequently amended, PEI has the right to acquire from Swerdlow and its affiliates up to five properties located in Florida for aggregate consideration of \$247.3 million, subject to adjustment, including the assumption of mortgage indebtedness. The properties are primarily retail centers that contain an aggregate of approximately 2.4 million square feet of gross leasable area. As of May 14, 2001, four properties were operating and approximately 97% leased to approximately 215 tenants and one property was under development. The top five tenants of the Swerdlow properties as of May 14, 2001, representing approximately 31% of gross leasable area, were Home Depot, Kmart, Ross, BJ's Wholesale Club and Regal Cinemas. The transaction is subject to satisfactory completion of PEI's due diligence investigation of the properties, and other customary closing conditions. If the necessary conditions are satisfied, the transaction is expected to be completed in the third quarter of 2001. However, no assurance can be given that the transaction will be completed on the terms described in the Purchase Agreement, in this Form 10-Q or at all.

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

### *Introduction*

Our disclosure and analysis in this report contain "forward-looking statements." Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historic or current facts. They use words such as "anticipate," "estimate," "expect," "project," "intend," "plan," "believe," and other words and terms of similar meaning in connection with any discussion of future operating or financial performance. From time to time, we also may provide oral or written forward-looking statements in other materials we release to the public. Any or all of our forward-looking statements in this report and in any other public statements we make may turn out to be incorrect. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Consequently, no forward-looking statement can be guaranteed. Actual results may vary materially.

We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our reports on Forms 10-K, 10-Q and 8-K filed with the SEC. Our Form 10-K filing for the 2000 fiscal year listed various important factors that could cause actual results to differ materially from expected and historic results.

We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. Readers can find them in Part I of our 2000 Form 10-K under the heading "Factors That May Affect Future Performance." You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider any such list to be a complete set of all potential risks or uncertainties.

In Management's Discussion and Analysis we explain our general financial condition and results of operations including:

why revenues, costs and earnings changed from the prior period

funds from operations (FFO)

how we used cash for capital projects and dividends and how we expect to use cash in 2001

where we plan on obtaining cash for future dividend payments and future capital expenditures

As you read Management's Discussion and Analysis, it may be helpful to refer to our financial statements and accompanying notes beginning on page 3. In Management's Discussion and Analysis we explain the changes in specific line items in the statements of income. Where changes are due to more than one reason, we list the reasons in order of importance.

### *Rental Revenues*

	<u>Amount</u>	<u>Change</u>	<u>Percent Change</u>
2nd Quarter 2001	\$ 19,148	\$ 1,693	10%

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	<u>Amount</u>	<u>Change</u>	<u>Percent Change</u>
2nd Quarter 2000	17,455		
Year-to-Date 2001	36,928	2,002	6%
Year-to-Date 2000	34,926		

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Revenues increased \$1.7 million to \$19.1 million in the second quarter of 2001 compared to the same period in 2000 primarily because:

properties we acquired during 2001 generated \$1.6 million of additional revenues

properties we acquired during 2000 generated \$0.5 million of additional revenues

revenue from properties we owned in 2000 and 2001 increased \$1.1 million, primarily due to increased operating and maintenance expenses reimbursed by tenants

revenues associated with the self storage facilities increased \$0.1 million

partially offsetting these increases were revenues from properties we sold, which contributed \$1.6 million of additional revenues in 2000

Revenues increased \$2.0 million to \$36.9 million in the six month year-to-date period of 2001 compared to the same period in 2000 primarily because:

properties we acquired during 2001 generated \$2.1 million of additional revenues

properties we acquired during 2000 generated \$1.1 million of additional revenues

revenue from properties we owned in 2000 and 2001 increased \$1.4 million

revenues associated with the self storage facilities increased \$0.3 million

partially offsetting these increases were revenues from properties we sold in 2000, which contributed \$2.9 million of additional revenues

*Expenses*

	<u>Amount</u>	<u>Change</u>	<u>Percent Change</u>
2nd Quarter 2001	\$ 7,904	\$ 1,121	17%

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	<u>Amount</u>	<u>Change</u>	<u>Percent Change</u>
2nd Quarter 2000	6,783		
Year-to-Date 2001	15,441	1,688	12%
Year-to-Date 2000	13,753		

Expenses increased \$1.1 million to \$7.9 million in the second quarter of 2001 compared to 2000 primarily because:

expenses from properties we owned in both 2000 and 2001 increased by \$0.7 million

expenses on properties we acquired in 2000 and 2001 increased \$0.5 million

bad debt expense increased \$0.6 million due to a recovery in the prior year of amounts previously written-off related to the bankruptcy of a former tenant

these increases in expenses were partially offset by a decrease in expenses of \$0.7 million from properties sold during 2000

Expenses increased \$1.7 million to \$15.4 million in the six month year-to-date period of 2001 compared to the same period in 2000 primarily because:

bad debt expense increased \$1.1 million primarily due to a recovery in the prior year of amounts previously written off from a former tenant

expenses on properties we acquired in 2000 and 2001 increased \$0.8 million

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expenses on properties we owned in 2000 and 2001 increased \$0.7 million

expenses of our self storage business increased \$0.2 million

these increases in expenses were partially offset by a decrease in expenses of \$1.1 million from properties sold during 2000

***Operating Income***

	<u>Amount</u>	<u>Change</u>	<u>Percent Change</u>
2nd Quarter 2001	\$ 11,244	\$ 572	5%
2nd Quarter 2000	10,672		
Year-to-Date 2001	21,487	314	1%
Year-to-Date 2000	21,173		

Operating income increased for the second quarter and year-to-date periods of 2001 compared to the same periods in the prior year primarily because of the changes in Rental Revenues and Expenses discussed above.

**Interest Expense**

	<u>Amount</u>	<u>Change</u>	<u>Percent Change</u>
2nd Quarter 2001	\$ 3,532	\$ 971	38%
2nd Quarter 2000	2,561		
Year-to-Date 2001	6,930	2,620	61%
Year-to-Date 2000	4,310		

Interest expense increased \$1.0 million in the second quarter of 2001 compared to 2000 because during the second quarter of 2001 we had an average of \$233.4 million debt outstanding compared to \$138.4 million in the second quarter of 2000. Interest expense increased \$2.6 million in the six month year-to-date period of 2001 compared to 2000 because during the six month year-to-date period of 2001 we had an average of \$218.9 million debt outstanding compared to \$124.8 million for the same period in 2000. The increase in interest expense due to the amount of debt outstanding was partially offset by a decrease in interest rates on our variable rate debt. The weighted average interest rate on our variable rate debt decreased from 7.64% in June 2000 to 5.49% in June 2001. We discuss our outstanding debt further in "Liquidity and Capital Resources" located elsewhere in this Form 10-Q.

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**Interest Income**

	<u>Amount</u>	<u>Change</u>	<u>Percent Change</u>
2nd Quarter 2001	\$ 1,796	\$ 1,420	378%
2nd Quarter 2000	376		
Year-to-Date 2001	3,643	2,906	394%
Year-to-Date 2000	737		

Interest income increased \$1.4 million in the second quarter of 2001 compared to 2000 primarily because

interest income on our notes receivable from Legacy increased \$0.9 million due to our higher notes receivable balance

our notes receivable due from other real estate developers increased from \$2.8 million in June 2000 to \$13.8 million and earned additional interest income of \$0.5 million

Interest income increased \$2.9 million in the six month year-to-date period of 2001 compared to the same period in 2000 primarily because

interest income on our notes receivable from Legacy increased \$1.8 million

our notes receivable with other real estate developers earned additional interest income of \$0.9 million