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MISSION WEST PROPERTIES INC

Form 10-K

March 30, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For Fiscal Year Ended: December 31, 2000

OR

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

For the transition period from to

Commission File No. 1-8383

MISSION WEST PROPERTIES, INC.

(Exact name of registrant as specified in its charter)

Maryland

95-2635431

(State or other jurisdiction of
Incorporation or organization)

(I.R.S. Employer
Identification Number)

10050 Bandley Drive, Cupertino CA
(Address of principal executive offices)

95014
(Zip Code)

Registrant's telephone number, including area code: (408) 725-0700

Securities Registered Pursuant to Section 12(b) of the Act:

| Title of each class ----- | Name of each exchange on which registered ----- |
|---|--|
| Common Stock, par value \$.001 per share | American Stock Exchange Pacific Exchange, Inc. |

Securities Registered Pursuant to Section 12(g) of the Act:

NONE

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements

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incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

The aggregate market value of the voting stock held by non-affiliates of the registrant, based upon the closing sale price of the Common Stock on March 28, 2001, as reported on the American Stock Exchange, was approximately \$13.00. As of March 28, 2001 there were 17,049,953 shares of the Registrant's Common Stock outstanding.

FORWARD LOOKING INFORMATION

This annual report contains forward-looking statements within the meaning of the federal securities laws. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and are including this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of us, are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project" or similar expressions. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations and future prospects of the Company include, but are not limited to, changes in: economic conditions generally and the real estate market specifically, legislative or regulatory provisions affecting us (including changes to laws governing the taxation of REITs), availability of capital, interest rates, competition, supply of and demand for office and industrial properties in our current and proposed market areas, and general accounting principles, policies and guidelines applicable to REITs. These risks and uncertainties, together with the other risks described from time to time in our reports and documents filed with the Securities and Exchange Commission, should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. See Part I, Item 1, "Risk Factors."

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MISSION WEST PROPERTIES, INC.

2000 FORM 10-K ANNUAL REPORT

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PART I

ITEM 1. BUSINESS

ORGANIZATION AND GENERAL BUSINESS DESCRIPTION

Mission West Properties, Inc. (the "Company") acquires, markets, leases, and manages R&D properties, primarily located in the Silicon Valley portion of the San Francisco Bay Area. As of December 31, 2000, we owned and managed 89 properties totaling approximately 6.2 million rentable square feet of R&D properties through four limited partnerships, or operating partnerships, for which we are the sole general partner. This class of property is designed for research and development and office uses and, in some cases, includes space for light manufacturing operations with loading docks. We believe that we have one of the largest portfolios of R&D properties in the Silicon Valley. The four tenants who lease the most square footage from us are Microsoft Corporation, Amdahl Corporation (a subsidiary of Fujitsu Limited), Apple Computer, Inc. and Cisco Systems, Inc. For federal income tax purposes we have operated as a self-managed, self-administered and fully integrated real estate investment trust ("REIT") since 1999.

Prior to July 1, 1998, most of our properties were under the ownership or control of Carl E. Berg, his brother Clyde J. Berg, the members of their respective immediate families, and certain entities in which Carl E. Berg and/or Clyde J. Berg held controlling or other ownership interests (the "Berg Group"). We acquired these properties as of July 1, 1998 by becoming the general partner of each of the four operating partnerships in an UPREIT transaction. At that time, we also acquired ten properties with approximately 560,000 rentable square feet from entities controlled by third parties in which Berg Group members were significant owners.

Through various property acquisition agreements with the Berg Group, we have the right to purchase, on pre-negotiated terms, R&D and other types of office and light industrial properties that the Berg Group develops in the future. With in-house development, architectural and construction

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personnel, the Berg Group continues to focus on a full range of land acquisition, development and construction activities for R&D properties, often build-to-suit, to meet the demands of Silicon Valley information technology companies. As the developer, the Berg Group takes on the risks of purchasing the land, obtaining regulatory approvals and permits, financing construction and leasing the properties. Since September 1998, we have acquired approximately 1,841,570 additional rentable square feet of R&D properties from the Berg Group under these agreements.

OUR RELATIONSHIP WITH THE BERG GROUP

Through a series of transactions occurring between May 1997 and December 1998, we have become the vehicle for substantially all of the Silicon Valley R&D property activities of the Berg Group. We are the general partner pursuant to the partnership agreements of the operating partnerships and, along with members of the Berg Group and other individuals, are party to an exchange rights agreement, the pending projects acquisition agreement and the Berg land holdings option agreement. Each agreement defines the material rights and obligations among us, the Berg Group members, and other parties to those agreements. Among other things, these agreements give us rights to:

- control the operating partnerships;
- acquire, on pre-negotiated terms, existing, identified R&D properties under development by the Berg Group;
- acquire, on pre-negotiated terms, all future R&D properties developed by the Berg Group on land currently owned or acquired in the future; and
- acquire R&D, office and industrial properties identified by the Berg Group in California, Oregon and Washington.

Under these agreements, our charter or our bylaws, the Berg Group has the right to:

- designate two of five nominees for director to be elected by our stockholders, subject to the Berg Group's maintenance of certain ownership interests;
- participate in our securities offerings;

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- exchange their O.P. Units for our common stock;
- vote on major transactions, subject to its maintenance of certain ownership interests; and
- prevent us from selling properties when the sale will have adverse tax consequences to the Berg Group members.

To comply with REIT requirements that restrict the percentage of the total value of our stock that may be owned by five or fewer individuals to 50% or less, our charter generally prohibits the direct or indirect ownership of more than 9% of our common stock by any stockholder. This limit excludes the Berg Group, which has an aggregate ownership limit of 20%. Currently, the Berg Group members collectively own less than 1% of the outstanding shares of our common stock.

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Carl E. Berg, the Company's President and Chief Executive Officer and the controlling member of the Berg Group, has been engaged in the development and long-term ownership of Silicon Valley real estate for approximately 30 years, most recently through Berg & Berg Developers ("Berg & Berg"), a general partnership of Carl E. Berg and Clyde J. Berg. In 1969, Mr. Berg foresaw the rising demand for efficient, multi-purpose facilities for the rapidly growing information technology industry in the Silicon Valley. Since 1972, in addition to his real estate activities, Mr. Berg also has been actively involved in venture capital investments in many information technology companies in the Silicon Valley, including such companies as Amdahl Corporation, Sun Microsystems, Inc., and Integrated Device Technologies, Inc. He serves on the boards of directors of numerous information technology companies. These activities have helped Mr. Berg develop a detailed understanding of the real estate requirements of information technology companies, acquire valuable market information and increase his name recognition within the venture capital and entrepreneurial communities. These activities also manifest his commitment to the growth and success of Silicon Valley companies. We believe that Mr. Berg's substantial knowledge of and contacts in the information technology industry provide a significant benefit to the Company.

BUSINESS STRATEGY

Our acquisition and growth strategy incorporates the following elements:

- working with the Berg Group to take advantage of their abilities and resources to pursue development opportunities which we have an option to acquire, on pre-negotiated terms, upon completion and leasing;
- capitalizing on opportunistic acquisitions from third parties of high-quality R&D properties that provide attractive initial yields and significant potential for growth in cash-flow;
- focusing on general purpose, single-tenant Silicon Valley R&D properties for information technology companies in order to maintain low operating costs, reduce tenant turnover and capitalize on our relationships with these companies and our extensive knowledge of their real estate needs; and
- maintaining prudent financial management principles that emphasize current cash flow while building long-term value, the acquisition of pre-leased properties to reduce development and leasing risks and the maintenance of sufficient liquidity to acquire and finance properties on desirable terms.

ACQUIRING PROPERTIES DEVELOPED BY THE BERG GROUP

We anticipate that most of our growth in the foreseeable future will come from the acquisition of new R&D properties that are either currently under development or to be developed in the future by the Berg Group. During 2001, we expect to acquire a total of approximately 1,809,000 additional rentable square feet currently under development. These acquisitions will be completed on pre-negotiated terms under the pending projects acquisition agreement, as amended by the supplemental agreement, and the Berg land holdings option agreement. In addition to the projects currently under development, the Berg land holdings option agreement gives us the right to acquire future developments by the Berg Group on up to 257 additional acres of land currently controlled by the Berg Group, which could support approximately 4.06 million square feet of new developments. Under the Berg land holdings option agreement, we also have an option to purchase all land acquired, directly or indirectly, by Carl E. Berg or Clyde J. Berg that has

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not been approved with completed buildings and which is zoned for, intended for or appropriate for research and development, office and/or industrial development or use in the states of California,

Oregon and Washington. We expect to exercise this option in order to acquire an approximate 50% interest in a joint venture established to develop approximately 961,000 rentable square feet on 62 acres held by TBI-Mission West, LLC, in which the Berg Group holds a 50% interest. We will not manage this joint venture. In addition, Carl E. Berg has agreed not to directly or indirectly acquire or develop any real property zoned for office, industrial or R&D use in the states of California, Oregon and Washington without first disclosing and making the acquisition opportunity available to us. Our independent

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directors committee will decide whether we will pursue the opportunity presented to us by Mr. Berg. This restriction will expire when there is no Berg Group nominee on our board of directors and the Berg Group's fully diluted ownership percentage, which is calculated based on all outstanding shares of common stock and all shares of common stock that could be acquired upon the exercise of all outstanding options to acquire our voting stock, as well as all shares of common stock issuable upon exchange of all O.P. Units, falls below 25%.

PENDING PROJECTS ACQUISITION AGREEMENT. In December 1998, we entered into the pending projects acquisition agreement with members of the Berg Group, under which we held the right to acquire approximately 1.0 million additional rentable square feet upon the completion and leasing of a number of pending development projects. By December 31, 2000, we had acquired all of these projects. The last project under the pending projects acquisition agreement was acquired on December 1, 2000, and the agreement was terminated on that date. The agreement permitted the Berg Group members to obtain cash or, at their option, O.P. Units for their equity interests in the properties. We had reserved and registered for issuance up to 33,919,072 shares of our common stock upon exchange of up to the same number of O.P. Units issuable in exchange for the pending development projects, of which a total of 20,028,176 O.P. Units were issued for new properties acquired under the agreement. We acquired the pending projects upon the following terms:

- The acquisition price was payable in cash or, at the option of the Berg Group, in O.P. Units valued at \$4.50 per O.P. Unit, which was the price per share of our common stock in May 1998, when we agreed to the terms of the pending projects acquisition agreement.
- The Berg Group built and delivered each completed and fully-leased R&D property in the pending development projects to the operating partnerships at an acquisition price equal to the average monthly rental rate per square foot over the term of the lease divided by an agreed upon capitalization rate between 14% and 17%, minus the amount of debt encumbering the property.
- The closing for the acquisition of an individual R&D property occurred only when the building was fully completed and leased.
- The leases each contained reasonable terms and conditions, comparable to arm's length leasing transactions between unrelated parties.
- All actions taken by us under the pending projects acquisition agreement were approved by a majority of the members of the

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independent directors committee of our board of directors.

For a discussion of risks associated with the pending projects acquisition agreement and related transactions, please refer to this Item 1., "Risk Factors - Our contractual business relationships with the Berg Group present additional conflicts of interests which may result in the realization of economic benefits or the deferral of tax liabilities by the Berg Group without equivalent benefits to our stockholders."

BERG LAND HOLDINGS OPTION AGREEMENT. We believe that control of high quality, developable land is an important strategic factor for continued success in the Silicon Valley market. In December 1998, we entered into the Berg land holdings option agreement under which we have the option to acquire any future R&D, office and industrial property developed by the Berg Group on land currently owned, optioned, or acquired for these purposes in the future, directly or indirectly, by Carl E. Berg or Clyde J. Berg. As of December 31, 2000, we had acquired eight leased R&D properties totaling approximately 826,000 rentable square feet under this agreement at a cost of approximately \$80.6 million, for which we issued 4,325,358 O.P. Units and assumed debt of approximately \$43.1 million. The principal terms of the agreement include the following:

- So long as the Berg Group members and their affiliates own or have the right to acquire shares representing at least 65% of our common stock on a fully diluted basis, we will have the option to acquire any building developed by any member of the Berg Group on the land subject to the agreement at such time as the building has been leased. Upon our exercise of the option, the option price will equal the sum of:
 1. the full construction cost of the building; plus
 2. 10% of the full construction cost of the building; plus
 3. interest at LIBOR plus 1.65%, on the amount of the full construction cost of the building for the period from the date funds were disbursed by the developer to the close of escrow; plus
 4. the original acquisition cost of the parcel on which the improvements will be constructed, which range from \$8.50 to \$20.00 per square foot for land currently owned or under option; plus
- 5. 10% per annum of the amount of the original acquisition cost of the parcel from the later of January 1, 1998 and the seller's acquisition date, to the close of escrow; minus
- 6. the aggregate principal amount of all debt encumbering the acquired property.
- The acquisition cost, net of any debt, will be payable in cash, or O.P. Units valued at the average closing price of our common stock over the 30-trading-day period preceding the acquisition or, in cash, at the option of the Berg Group.
- We also must assume all tax assessments.
- If we elect not to exercise the option with respect to any property, the Berg Group may hold and lease the property for its own account, or may sell it to a third party.

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- All action taken by us under the Berg land holdings option agreement must be approved by a majority of the members of the independent directors committee of our board of directors.

The following table presents certain information concerning currently identified land or projects that we have the right to acquire under the Berg land holdings option agreement.

| PROPERTY | NET ACRES | APPROXIMATE RENTABLE AREA (SQUARE FEET) | ANTICIPATED ACQUISITION DA |
|--------------------------|-----------|---|-------------------------------|
| ----- | | | |
| UNDER DEVELOPMENT: | | | |
| Hellyer Vista (Phase I) | 6 | 131,500 | Q1 2001 |
| Hellyer III (Phase I) | 7 | 117,740 | Q2 2001 |
| Creekside | 5 | 65,000 | Q2 2001 |
| Morgan Hill (JV I) (1) | 13 | 211,000 | Q2 2001 |
| Silver Creek | 18 | 346,000 | Q3 2001 |
| Caspian (Phase II) | 5 | 100,000 | Q2 2001 |
| 5550 Hellyer | 6 | 79,800 | Q3 2001 |
| 5535 Hellyer | 6 | 125,000 | Q4 2001 |
| Morgan Hill (JV IV) (1) | 12 | 160,000 | Q4 2001 |
| 5750 Hellyer | 7 | 73,312 | Q3 2001 |
| Morgan Hill (JV II) (1) | 4 | 60,000 | Q4 2001 |
| Morgan Hill (JV III) (1) | 3 | 40,000 | Q4 2001 |
| Piercy & Hellyer | 8 | 130,000 | Q4 2001 |
| Piercy & Hellyer | 4 | 65,000 | Q4 2001 |
| Piercy & Hellyer | 7 | 105,000 | Q4 2001 |
| | | ----- | |
| SUBTOTAL | 111 | 1,809,352 | |
| | | ===== | |
| AVAILABLE LAND: | | | |
| Morgan Hill (1) | 30 | 490,000 | |
| King Ranch | 15 | 248,500 | |
| Piercy & Hellyer | 28 | 458,000 | |
| Fremont & Cushing | 24 | 387,000 | |
| Evergreen | 160 | 2,480,000 | |
| | | ----- | |
| SUBTOTAL | 257 | 4,063,500 | |
| | | ----- | |
| TOTAL | 368 | 5,872,852 | |
| | | ===== | |

- (1) The Company expects to own an approximate 50% interest in the partnership that will develop the property. The property will be operated and managed by the other partner.

The time required to complete the leasing of developments varies from property to property. The acquisition dates and acquisition costs set forth in the table are only estimates by management. Generally, the Company will not acquire any of the above projects until they are fully completed and leased. There can be no assurance that the acquisition date and final cost

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to the Company as indicated above will be realized. No estimate can be given at this time as to our total cost to acquire projects under the Berg land holdings option agreement, or can we be certain of the period in which we will acquire any of the projects.

Although we expect to acquire the new properties available to us under the terms of the Berg land holdings option agreement, there can be no assurance that we actually will consummate any of the intended transactions, including all of those discussed above. Furthermore, we have not yet determined the means by which we would acquire and pay for any such properties or the impact of any of the acquisitions on our business, results of operations, financial condition or available cash for distribution. See Item 1., "Risk Factors - Our contractual business relationships with the Berg Group present additional conflicts of interest which may result in the realization of economic benefits or the deferral of tax liabilities by the Berg Group without equivalent benefits to our stockholders."

OPPORTUNISTIC ACQUISITIONS

In addition to our principal opportunities under the Berg land holdings option agreement, we believe our acquisitions experience, established network of real estate, information technology professionals and overall financial condition will continue to provide opportunities for external growth. In general, we will seek opportunistic acquisitions of high quality, well located Silicon Valley R&D properties in situations where illiquidity or inadequate management permit their acquisition at favorable prices, and where our management skills and knowledge of Silicon Valley submarkets may facilitate increases in cash flow and asset value. Furthermore, our use of the operating partnership structure allows us to offer prospective sellers the opportunity to contribute properties on a tax-deferred basis in exchange for O.P. Units. Although we have not consummated any transactions like this since our July 1, 1998 acquisition of the Berg Group properties, this capacity to complete tax-deferred transactions with sellers of real property further enhances our ability to acquire additional properties.

FOCUS ON SINGLE TENANT SILICON VALLEY R&D PROPERTIES

We intend to continue to emphasize the acquisition of single-tenant rather than multi-tenant properties, a practice that has contributed to the relatively low turnover and high occupancy rates on our properties. We believe that the relatively small number of tenants (98) occupying our 89 properties, mostly under the triple-net lease structure, allows us to efficiently manage the properties and to serve our tenants' needs without extensive in-house staff or the assistance of a third-party property management organization. In addition, this emphasis allows us to incur less expense for tenant improvements and leasing commissions than multi-tenant, high turnover property owners. This strategy also reduces the time and expense associated with obtaining building permits and other governmental approvals. We believe that the relatively stable, extended relationships that we have developed with our key tenants are valuable in the expansion of our business.

OPERATIONS

We operate as a self-administered, self-advised and self-managed REIT with our own employees. Generally, as the sole general partner of the operating partnerships, we control the business and assets of the operating partnerships and have full and complete authority, discretion and responsibility with respect to the operating partnerships' operations and transactions, including, without limitation, acquiring additional

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properties, borrowing funds, raising new capital, leasing buildings and selecting and supervising all agents of the operating partnerships.

Although most of our leases are triple net and building maintenance and tenant improvements are the responsibility of the tenants, from time to time we may be required to undertake construction and repair work at our properties. We will bid all major work competitively to subcontractors. Members of the Berg Group may participate in the competitive bidding for the work.

We generally will market the properties and negotiate leases with tenants ourselves. We make the availability of our properties known to the brokerage community to garner their assistance in locating prospective tenants. As a result, we expect to retain our policy of paying fixed commissions to tenants' brokers.

We believe that our business practices provide us with competitive advantages, including-

- EXTERNAL DEVELOPMENT AFFILIATE. We have the option to purchase all future R&D, office, industrial property developments of the Berg Group under the Berg land holdings option agreement on land currently held or acquired

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directly or indirectly by Carl E. Berg or Clyde J. Berg that is zoned for those purposes and located in California, Oregon and Washington following completion and lease-up of the property. Our option will terminate when the Berg Group's ownership percentage falls below 65% of our common stock calculated on a fully diluted basis. Carl E. Berg has agreed to refer to us, and not acquire through the Berg Group, all opportunities to acquire the same kinds of real property in these states that he identifies in the future, until the Berg Group's fully diluted ownership percentage falls below 25% and there is no Berg Group nominee on our board of directors. The acquisition terms and conditions for the existing and identified projects have been pre-negotiated and are documented under the Berg land holdings option agreement. This relationship provides us with the economic benefits of development while eliminating development and initial lease-up risks. It also provides us with access to one of the most experienced development teams in the Silicon Valley without the expense of maintaining development personnel.

- LEAN, EXPERIENCED ORGANIZATION. In part because of its primary focus on Silicon Valley, its experience with the special real estate requirements of information technology tenants and the long-term triple-net structure of its leases, we are able to conduct and expand our business with a small management team comprised of highly qualified and experienced professionals working within a relatively flat organizational structure. We believe that the leanness and our experience will enable us to rapidly assess and respond to market opportunities and tenant needs, control operating expenses and develop and maintain excellent relationships with tenants. We further believe that these advantages translate into significantly lower costs for operations and give us the ability, along with the Berg Group, to compete favorably with other R&D property developers in Silicon Valley, especially for build-to-suit projects subject to competitive bidding. Furthermore, a lower cost structure should allow us to generate better returns from properties whose value can be increased through appropriate remodeling and efficient property management.

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- SOUND PROPERTY MANAGEMENT PRACTICES. For each property, the management team, along with the Berg Group staff, develops a specific marketing and property management program. We select vendors and subcontractors on a competitive bid basis from a select group of highly qualified firms with whom we maintain ongoing relationships and carefully supervise their work.

OPERATING PARTNERSHIP AGREEMENTS

MANAGEMENT

The operating partnerships consist of four separate Delaware limited partnerships engaged in the combined operation and ownership of our properties. The operating partnership agreements are identical in all material respects for all four of the limited partnerships. Generally, pursuant to the operating partnership agreement, we act as the sole general partner of the operating partnerships, in which capacity we have exclusive control of the business and assets of the operating partnerships and full and complete authority, discretion and responsibility with respect to the operating partnerships' operations and transactions, including, without limitation, acquisitions of additional properties, borrowing funds, raising new capital, leasing buildings, as well as selecting and supervising all employees and agents of the operating partnerships. Through our authority to manage our business and affairs, our board of directors will direct the business of the operating partnerships.

Notwithstanding our effective control of the operating partnerships, the consent of the limited partners holding a majority of the outstanding O.P. Units is required with respect to certain extraordinary actions involving the operating partnerships, including:

- the amendment, modification or termination of the operating partnership agreements;
- a general assignment for the benefit of creditors or the appointment of a custodian, receiver or trustee for any of the assets of the operating partnerships;
- the institution of any proceeding for bankruptcy of the operating partnerships;
- the transfer of any general partnership interests in the operating partnerships, including, with certain exceptions, transfers attendant to any merger, consolidation or liquidation of our corporation;
- the admission of any additional or substitute general partner in the operating partnerships; and
- a change of control of the operating partnerships.

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The Berg Group holds a substantial majority of the outstanding O.P. Units. In addition, until the ownership interest of the Berg Group and its affiliates is less than 15% of the common stock on a fully diluted basis, which is calculated based on all outstanding shares of common stock and all shares of common stock that could be acquired upon the exercise of all outstanding options to acquire our voting stock, as well as all shares of common stock issuable upon exchange of all O.P. Units, the consent of the

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limited partners holding a majority of the outstanding O.P. Units is also required with respect to:

- the liquidation of the operating partnerships;
- the sale or other transfer of all or substantially all of the assets of the operating partnerships and certain mergers and business combinations resulting in the complete disposition of all O.P. Units; and
- the issuance of limited partnership interests having seniority as to distributions, assets and voting over the O.P. Units.

TRANSFERABILITY OF O.P. UNITS

The operating partnership agreement provides that the limited partners may transfer their O.P. Units, subject to certain limitations. Except for certain transfers by the limited partners to or from certain of their affiliates, however, all transfers may be made only with our prior written consent as the sole general partner of the operating partnerships.

In addition, no transfer of O.P. Units by the limited partners may be made in violation of certain regulatory and other restrictions set forth in the operating partnership agreement. Except in the case of certain permitted transfers to or from certain affiliates of the limited partners, the exchange rights, the put rights, rights to participate in future equity financings and provisions requiring the approval of certain limited partners for certain matters will no longer be applicable to O.P. Units so transferred, and the transferee will not have any rights to nominate persons to our board of directors.

ADDITIONAL CAPITAL CONTRIBUTIONS AND LOANS

Each operating partnership agreement provides that, if the operating partnership requires additional funds to pursue its investment objectives, we may fund such investments by raising additional equity capital and making a capital contribution to the operating partnerships or by borrowing such funds and lending the net proceeds of such loans to the operating partnerships. If we intend to provide additional funds through a contribution to capital and purchase of units of general partnership interest, the limited partners will have the right to participate in such funding on a pro rata, pari passu basis and to acquire additional O.P. Units. If the limited partners do not participate in such financing, we will acquire additional units of general partnership interest. In either case, the number of additional units of partnership interest will be increased based upon the amount of the additional capital contributions and the value of the operating partnerships as of the date such contributions are made.

In addition, as general partner of the operating partnerships, we have the ability to cause the operating partnerships to issue additional O.P. Units. In the event that the operating partnerships issue new O.P. Units for cash but not property, the limited partners will have the right to purchase new O.P. Units at the price we offer in the transaction giving rise to such participation right in order, and to the extent necessary, to maintain their respective percentage interests in the operating partnerships.

EXCHANGE RIGHTS, PUT RIGHTS AND REGISTRATION RIGHTS

Under the exchange rights agreement between us and the limited partners, the limited partners have exchange rights that generally became exercisable on December 29, 1999. The exchange rights agreement permits every limited

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partner to tender O.P. Units to us, and at our election, to receive common stock on a one-for-one basis at then-current market value, an equivalent amount of cash, or a combination of cash and common stock in exchange for the O.P. Units tendered, subject to the 9% overall ownership limit imposed on non-Berg Group stockholders under our charter document, or the overall 20% Berg Group ownership limit, as the case may be. For more information, please refer to this Item 1., "Risk Factors - Failure to satisfy federal income tax requirements for REITs could reduce our distributions, reduce our income and cause our stock price to fall." This exchange ratio is subject to adjustment for stock splits, stock dividends, recapitalizations of our common stock and similar types of corporate actions. In addition, once in each 12-month period beginning each December 29, the limited partners, other than Mr. Berg and Clyde J. Berg, have the right to exchange their O.P. Units for shares of common stock, subject to the ownership limit in our charter, and to exercise a put right to sell their O.P. Units to the operating partnerships at a price equal to the average market price of the common stock for the 10-trading day period immediately preceding the date of tender. Upon any exercise of the put rights, we will have the opportunity for a period of 15 days to elect to fund the purchase of the O.P. Units and purchase additional general partner interests in the operating partnerships for cash, unless the purchase price exceeds \$1 million in the aggregate for all tendering limited partners, in which case, the operating partnerships or we shall be entitled to reduce proportionally the number of O.P. Units to be acquired from each tendering limited partner so that the total purchase price is not more than \$1 million.

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The shares issued in exchange for the O.P. Units outstanding at July 1, 1998 and the O.P. Units issued pursuant to the pending projects acquisition agreement have been registered and generally may be sold without restriction if they are acquired by limited partners that are not affiliates, as defined under SEC Rule 144. For more information please refer to this Item 1., "Risk Factors - Shares eligible for future sale could affect the market price of our stock." The exchange rights agreement gives the holders of O.P. Units the right to participate in any registered public offering of the common stock initiated by us to the extent of 25% of the total shares sold in the offering upon converting O.P. Units to shares of common stock, but subject to the underwriters' unlimited right to reduce the participation of all selling stockholders. The holders of O.P. Units will be able to request resale registrations of shares of common stock acquired on exchange of O.P. Units on a Form S-3, or any equivalent form of registration statement. We are obligated to effect no more than two such registrations in any 12-month period. We are obligated to assist the O.P. Unit holders in obtaining a firm commitment underwriting agreement for such resale from a qualified investment-banking firm. If registration on Form S-3, or an equivalent form, is not available for any reason, we will be obligated to effect a registration of the shares to be acquired on exercise of the exchange rights on Form S-11, or an equivalent form, in an underwritten public offering, upon demand by the holders of no fewer than 500,000 O.P. Units. All holders of O.P. Units will be entitled to participate in such registration. We will bear all costs of such registrations other than selling expenses, including commissions and separate counsels' fees of the O.P. Unit holders. We will not be required to effect any registration for resale on Form S-3, or equivalent form of common stock shares issuable to the holder of O.P. Units if the request is for less than 250,000 shares.

OTHER MATTERS

The operating partnership agreements require that the operating

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partnerships be operated in a manner that will enable us to satisfy the requirements for being classified as a REIT and to avoid any federal income or excise tax liability.

The operating partnership agreements provide that the combined net operating cash flow from all of the operating partnerships, as well as net sales and refinancing proceeds, will be distributed from time to time as determined by our board of directors, but not less frequently than quarterly, pro rata in accordance with the partners' percentage interests in the operating partnerships, taken as a whole. This provision is intended to cause the periodic distributions per O.P. Unit and per share of our common stock to be equal. As a consequence of this provision, the capital interest of a partner in each of the operating partnerships, including our capital interests, might at times differ significantly from the partner's percentage interest in the net income and cash flow of that operating partnership. We do not believe that such differences would have a material impact on our business, financial condition or funds available for distributions ("FAD"), however.

Pursuant to the operating partnership agreements, the operating partnerships will also assume and pay when due, or reimburse us for payment of, certain costs and expenses relating to our continuity of existence and operations.

The operating partnership agreements provide that, upon the exercise of an outstanding option under the 1997 option plan, we may purchase additional general partner interests in the operating partnerships by contributing the exercise proceeds to the operating partnerships. Our increased interest shall be equal to the percentage of outstanding shares of common stock and O.P. Units on an as-converted basis represented by the shares acquired upon exercise of the option.

TERM

The operating partnerships will continue in full force and effect until December 31, 2048 or until sooner dissolved pursuant to the terms of the operating partnership agreement.

EMPLOYEES

As of March 29, 2001, we employed six people, all of whom work at our executive offices at 10050 Bandle Drive, Cupertino, California, 95014.

FACILITIES

We sublease office space from Berg & Berg Enterprises, Inc. at 10050 Bandle Drive and share clerical staff and other overhead on what we consider to be very favorable terms. The total monthly rent payable by us to the Berg & Berg Enterprises, Inc. is \$6,720.

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RISK FACTORS

You should carefully consider the following risks, together with the other information contained elsewhere in this Form 10-K. The following risks relate principally to our business and the industry in which we operate. The risks and uncertainties classified below are not the only ones we face.

WE ARE DEPENDENT ON CARL E. BERG, AND IF WE LOSE HIS SERVICES OUR BUSINESS MAY BE HARMED AND OUR STOCK PRICE COULD FALL.

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We are substantially dependent upon the leadership of Carl E. Berg, our Chairman, President and Chief Executive Officer. Losing Mr. Berg's knowledge and abilities could have a material adverse effect on our business and the value of our common stock. Mr. Berg manages our day-to-day operations and devotes a significant portion of his time to our affairs, but he has a number of other business interests as well. These other activities reduce Mr. Berg's attention to our business.

MR. BERG AND HIS AFFILIATES EFFECTIVELY CONTROL OUR CORPORATION AND THE OPERATING PARTNERSHIPS AND MAY ACT IN WAYS THAT ARE DISADVANTAGEOUS TO OTHER STOCKHOLDERS.

SPECIAL BOARD VOTING PROVISIONS. Our governing corporate documents, which are our articles of amendment and restatement, or charter, and our bylaws, provide substantial control rights for the Berg Group. The Berg Group's control of our corporation means that the value and returns from an investment in the Company's common stock are subject to the Berg Group's exercise of its rights. These rights include a requirement that Mr. Berg or his designee as director approve certain fundamental corporate actions, including amendments to our charter and bylaws and any merger, consolidation or sale of all or substantially all of our assets. In addition, our bylaws provide that a quorum necessary to hold a valid meeting of the board of directors must include Mr. Berg or his designee. The rights described in the two preceding sentences apply only as long as the Berg Group members and their affiliates, other than us and the operating partnerships, beneficially own, in the aggregate, at least 15% of our outstanding shares of common stock on a fully diluted basis, which is calculated based on all outstanding shares of common stock and all shares of common stock that could be acquired upon the exercise of all outstanding options to acquire our voting stock, as well as all shares of common stock issuable upon exchange of all O.P. Units. Also, directors representing more than 75% of the entire board of directors must approve other significant transactions, such as incurring debt above certain amounts and conducting business other than through the operating partnerships. Without the approval of Mr. Berg or his designee, board of directors approval that we may need for actions that might result in a sale of your stock at a premium or raising additional capital when needed could be difficult or impossible to obtain.

BOARD OF DIRECTORS REPRESENTATION. The Berg Group members have the right to designate two of the director nominees submitted by our board of directors to stockholders for election, as long as the Berg Group members and their affiliates, other than us and the operating partnerships, beneficially own, in the aggregate, at least 15% of our outstanding shares of common stock on a fully diluted basis, which is calculated based on all outstanding shares of common stock and all shares of common stock that could be acquired upon the exercise of all outstanding options to acquire our voting stock, as well as all shares of common stock issuable upon exchange of all O.P. Units. If the fully diluted ownership of the Berg Group members and their affiliates, other than us and the operating partnerships, is less than 15% but is at least 10% of the common stock, the Berg Group members have the right to designate one of the director nominees submitted by our board of directors to stockholders for election. Its right to designate director nominees affords the Berg Group substantial control and influence over the management and direction of our corporation. The Berg Group's interests could conflict with the interests of our stockholders, and could adversely affect the price of our common stock.

SUBSTANTIAL OWNERSHIP INTEREST. The Berg Group currently owns O.P. Units representing approximately 78.8% of the equity interests in the operating partnerships and approximately 78.4% of our equity interests on a fully

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diluted basis, which is calculated based on all outstanding shares of common stock and all shares of common stock that could be acquired upon the exercise of all outstanding options to acquire our voting stock, as well as all shares of common stock issuable upon exchange of all O.P. Units. The O.P. Units may be converted into shares of common stock, subject to limitations set forth in our charter and other agreements with the Berg Group, and upon conversion would represent voting control of our corporation. The Berg Group's ability to exchange its O.P. Units for common stock permits it to exert substantial influence over the management and direction of our corporation. This influence increases our dependence on the Berg Group.

LIMITED PARTNER APPROVAL RIGHTS. Mr. Berg and other limited partners, including other members of the Berg Group, may restrict our operations and activities through rights provided under the terms of the amended and restated agreement of limited partnership which governs each of the operating partnerships and our legal relationship to each operating partnership as its

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general partner. Matters requiring approval of the holders of a majority of the O.P. Units, which necessarily would include the Berg Group, include the following:

- the amendment, modification or termination of any of the operating partnership agreements;
- the transfer of any general partnership interest in the operating partnerships, including, with certain exceptions, transfers attendant to any merger, consolidation or liquidation of our corporation;
- the admission of any additional or substitute general partners in the operating partnerships;
- any other change of control of the operating partnerships;
- a general assignment for the benefit of creditors or the appointment of a custodian, receiver or trustee for any of the assets of the operating partnerships; and
- the institution of any bankruptcy proceeding for any operating partnership.

In addition, as long as the Berg Group members and their affiliates, other than us and the operating partnerships, beneficially own, in the aggregate, at least 15% of the outstanding shares of common stock on a fully diluted basis, which is calculated based on all outstanding shares of common stock and all shares of common stock that could be acquired upon the exercise of all outstanding options to acquire our voting stock, as well as all shares of common stock issuable upon exchange of all O.P. Units, the consent of the limited partners holding the right to vote a majority of the total number of O.P. Units outstanding is also required with respect to:

- the sale or other transfer of all or substantially all of the assets of the operating partnerships and certain mergers and business combinations resulting in the complete disposition of all O.P. Units;
- the issuance of limited partnership interests senior to the O.P. Units as to distributions, assets and voting; and

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- the liquidation of the operating partnerships.

The liquidity of an investment in the Company's common stock, including our ability to respond to acquisition offers, will be subject to the exercise of these rights.

OUR CONTRACTUAL BUSINESS RELATIONSHIPS WITH THE BERG GROUP PRESENT ADDITIONAL CONFLICTS OF INTEREST, WHICH MAY RESULT IN THE REALIZATION OF ECONOMIC BENEFITS OR THE DEFERRAL OF TAX LIABILITIES BY THE BERG GROUP WITHOUT EQUIVALENT BENEFITS TO OUR STOCKHOLDERS.

Our contracts with the Berg Group provide it with interests that could conflict with those of our other stockholders, including the following:

- our headquarters are leased from an entity owned by the Berg Group, to whom we pay rent of \$6,720 per month;
- the Berg Group is permitted to conduct real estate and business activities other than our business;
- if we decline an opportunity that has been offered to us, the Berg Group may pursue it, which would reduce the amount of time that Mr. Berg could devote to our affairs and could result in the Berg Group's development of properties that compete with our properties for tenants;
- in general, we have agreed to limit the liability of the Berg Group to our corporation and our stockholders arising from the Berg Group's pursuit of these other opportunities;
- we acquired most of our properties from the Berg Group on terms that were not negotiated at arm's length and without many customary representations and warranties that we would have sought in an acquisition from an unrelated party; and
- we have assumed liability for debt to the Berg Group and debt for which the Berg Group was liable.

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The Berg Group has agreed that the independent directors committee of our board of directors must approve all new transactions between us and any of its members, or between us and any entity in which it directly or indirectly owns 5% or more of the equity interests, including the operating partnerships for this purpose. This committee currently consists of three directors who are independent of the Berg Group.

EXCLUDED PROPERTIES. With our prior knowledge, the Berg Group retained two R&D properties in Scotts Valley, Santa Cruz County, California, in which the operating partnerships and we have no ownership interest. Efforts of the Berg Group to lease these other properties could interfere with similar efforts on our behalf.

BERG LAND HOLDINGS. The Berg Group owns several parcels of unimproved land in the Silicon Valley that the operating partnerships and we have the right to acquire under the terms of the Berg land holdings option agreement. We have agreed to pay an amount based on pre-negotiated terms for any of the properties that we do acquire. We must pay the acquisition price in cash unless the Berg Group elects, in its discretion, to receive O.P. Units valued at the average market price of a share of common stock during the

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30-day period preceding the acquisition date. At the time of acquisition, which is subject to the approval of the independent directors committee of our board of directors, these properties may be encumbered by debt that we or the operating partnerships will be required to assume or repay. The use of our cash or an increase in our indebtedness to acquire these properties could have a material adverse effect on our financial condition, results of operations and ability to make cash distributions to our stockholders.

TAX CONSEQUENCES OF SALE OF PROPERTIES. Because many of our properties have unrealized taxable gain, a sale of those properties could create adverse income tax consequences for limited partners of the operating partnerships. We have agreed with Carl E. Berg, Clyde J. Berg and John Kontrabecki, a limited partner in some of the operating partnerships, that prior to December 29, 2008, each of them may prevent us and the operating partnerships from selling or transferring any of the properties that were acquired from them in our July 1998 UPREIT acquisition if the proposed sale or other transfer will be a taxable transaction. As a result, our opportunities to sell these properties may be limited. If we need to sell any of these properties to raise cash to service our debt, acquire new properties, pay cash distributions to stockholders or for other working capital purposes, we may be unable to do so. These restrictions could harm our business and cause our stock price to fall.

TERMS OF TRANSFERS: ENFORCEMENT OF AGREEMENT OF LIMITED PARTNERSHIP. The terms of the pending projects acquisition agreement, the Berg land holdings option agreement, the partnership agreement of each operating partnership and other material agreements through which we have acquired our interests in the operating partnerships and the properties formerly controlled by the Berg Group were not determined through arm's-length negotiations and could be less favorable to us than those obtained from an unrelated party. In addition, Mr. Berg and representatives of the Berg Group sitting on our board of directors may be subject to conflicts of interests with respect to their obligations as our directors to enforce the terms of the partnership agreement of each operating partnership when such terms conflict with their personal interests. The terms of our charter and bylaws also were not determined through arm's-length negotiations. Some of these terms, including representations and warranties applicable to acquired properties, are not as favorable as those that we would have sought through arm's-length negotiations with unrelated parties. As a result, an investment in our common stock may involve risks not found in businesses in which the terms of material agreements have been negotiated at arm's length.

RELATED PARTY DEBT. As of December 31, 2000, we had borrowed approximately \$50.9 million under our \$75.0 million line of credit with the Berg Group, which is secured by seven of our properties and expires March 2002. We have the right to draw on the line of credit and are liable for repayment of all amounts owing under the line of credit. The line of credit bears interest at an annual rate of LIBOR plus 1.30 percent. We are also liable for a mortgage loan of \$11.8 million that we assumed in connection with our acquisition of a property that we acquired in May 2000 under the Berg land holdings option agreement. If we are unable to repay our debts to the Berg Group when due, the Berg Group could take action to enforce our payment obligations. Loan defaults of this type could materially and adversely affect our business, financial condition and our results of operations and cause our stock price to fall. They also could result in a substantial reduction in the amount of cash distributions to our stockholders. In turn, if we fail to meet the minimum distributions test because of a loan default or another reason, we could lose our REIT classification for federal income tax purposes. For more information please refer to "Risk Factors - Failure to satisfy federal income tax requirements for REITs could reduce our distributions, reduce our income and cause our stock price to fall."

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OUR OPTION TO ACQUIRE R&D PROPERTIES DEVELOPED ON EXISTING LAND AND LAND ACQUIRED IN THE FUTURE BY THE BERG GROUP WILL TERMINATE WHEN THE BERG GROUP'S OWNERSHIP INTEREST HAS BEEN REDUCED.

The Berg land holdings option agreement, as amended, which provides us with significant benefits and opportunities to acquire additional R&D properties from the Berg Group, will expire when the Berg Group and their affiliates (excluding us and the operating partnerships) own less than 65% of our common stock on a fully diluted basis, which is calculated based on all outstanding shares of common stock and all shares of common stock that could be acquired upon the exercise of all

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outstanding options to acquire our voting stock, as well as shares of common stock issuable upon exchange of all O.P. Units. Termination of the Berg land holdings option agreement could result in limitation of our growth, which could cause our stock price to fall.

WE MAY CHANGE OUR INVESTMENT AND FINANCING POLICIES AND INCREASE YOUR RISK WITHOUT STOCKHOLDER APPROVAL.

Our board of directors determines the investment and financing policies of the operating partnerships and our policies with respect to certain other activities, including our business growth, debt capitalization, distribution and operating policies. Our board of directors may amend these policies at any time without a vote of the stockholders. Changes in these policies could materially adversely affect our financial condition, results of operations and ability to make cash distributions to our stockholders, which could harm our business and cause our stock price to fall. For more information please refer to Item 7., "Management's Discussion and Analysis of Financial Condition and Results of Operations - Policies with Respect to Certain Activities."

ANTI-TAKEOVER PROVISIONS IN OUR CHARTER COULD PREVENT ACQUISITIONS OF OUR STOCK AT A SUBSTANTIAL PREMIUM.

Provisions of our charter and our bylaws could delay, defer or prevent a transaction or a change in control of our corporation, or a similar transaction, that might involve a premium price for our shares of common stock or otherwise be in the best interests of our stockholders. Provisions of the Maryland general corporation law, which would apply to potential business combinations with acquirers other than the Berg Group or stockholders who invested in us in December 1998, also could prevent the acquisition of our stock for a premium, as discussed in "Certain Provisions of Maryland Law and of our Charter and Bylaws."

AN INVESTMENT IN OUR STOCK INVOLVES RISKS RELATED TO REAL ESTATE INVESTMENTS THAT COULD HARM OUR BUSINESS AND CAUSE OUR STOCK PRICE TO FALL.

RENTAL INCOME VARIES. Real property investments are subject to varying degrees of risk. Investment returns available from equity investments in real estate depend in large part on the amount of income earned and capital appreciation, which our properties generate, as well as our related expenses incurred. If our properties do not generate revenues sufficient to meet operating expenses, debt service and capital expenditures, our income and ability to make distributions to our stockholders will be adversely affected. Income from our properties may also be adversely affected by general economic conditions, local economic conditions such as oversupply of commercial real estate, the attractiveness of our properties to tenants

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and prospective tenants, competition from other available rental property, our ability to provide adequate maintenance and insurance, the cost of tenant improvements, leasing commissions and tenant inducements and the potential of increased operating costs, including real estate taxes.

EXPENDITURES FOR PROPERTY OWNERSHIP ARE FIXED. Income from properties and real estate values are also affected by a variety of other factors, such as governmental regulations and applicable laws, including real estate, zoning and tax laws, interest rate levels and the availability of financing. Various significant expenditures associated with an investment in real estate, such as mortgage payments, real estate taxes and maintenance expenses, generally are not reduced when circumstances cause a reduction in revenue from the investment. Thus, our operating results and our cash flow may decline materially if our rental income is reduced.

ILLIQUIDITY. Real estate investments are relatively illiquid, which limits our ability to restructure our portfolio in response to changes in economic or other conditions.

GEOGRAPHIC CONCENTRATION. All of our properties are located in the southern portion of the San Francisco Bay Area commonly referred to as the "Silicon Valley." The Silicon Valley economy has been strong for the past several years, but future increases in values and rents for our properties depend to a significant extent on the health of this region's economy.

LOSS OF KEY TENANTS. Single tenants, many of whom are large, publicly traded information technology companies, occupy most of our properties. Losing a key tenant could adversely affect our operating results and our ability to make distributions to stockholders if we are unable to obtain replacement tenants promptly.

TENANT BANKRUPTCIES. Key tenants could seek the protection of the bankruptcy laws, which could result in the rejection and termination of their leases, thereby causing a reduction in our income.

OUR SUBSTANTIAL INDEBTEDNESS. Our properties are subject to substantial indebtedness. If we are unable to make required mortgage payments, we could sustain a loss as a result of foreclosure on our properties by the mortgagor. Failure to renew or replace the Berg Group line of credit when it expires in March 2002 would materially affect our business and affect our ability

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to pay dividends to stockholders. We cannot assure you that we will be able to obtain a replacement line of credit with terms similar to the Berg Group line of credit, or at all. Our cost of borrowing funds could increase substantially after the Berg Group line of credit expires. We have adopted a policy of maintaining a consolidated ratio of debt to total market capitalization, which includes for this purpose the market value of all shares of common stock for which outstanding O.P. Units are exchangeable, of less than 50%. This ratio may not be exceeded without the approval of more than 75% of our entire board of directors. Our board of directors may vote to change this policy, however, and we could become more highly leveraged, resulting in an increased risk of default on our obligations and an increase in debt service requirements that could adversely affect our financial condition, our operating results and our ability to make distributions to our stockholders.

ENVIRONMENTAL CLEAN-UP LIABILITIES. Our properties may expose us to liabilities under applicable environmental and health and safety laws. If

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these liabilities are material, our financial condition and ability to pay cash distributions may be affected adversely, which would cause our stock price to fall.

UNINSURED LOSSES. We may sustain uninsured losses with respect to some of our properties. If these losses are material, our financial condition, our operating results and our ability to make distributions to our stockholders may be affected adversely.

EARTHQUAKE DAMAGES ARE UNINSURED. All of our properties are located in areas that are subject to earthquake activity. Our insurance policies do not cover damage caused by seismic activity, although they do cover losses from fires after an earthquake. We generally do not consider such insurance coverage to be economical. If an earthquake occurs and results in substantial damage to our properties, we could lose our investment in those properties, which loss would have a material adverse effect on our financial condition, our operating results and our ability to make distributions to our stockholders.

FAILURE TO SATISFY FEDERAL INCOME TAX REQUIREMENTS FOR REITS COULD REDUCE OUR DISTRIBUTIONS, REDUCE OUR INCOME AND CAUSE OUR STOCK PRICE TO FALL.

FAILURE TO QUALIFY AS A REIT. Although we currently operate in a manner designed to enable us to qualify and maintain our REIT status, it is possible that economic, market, legal, tax or other considerations may cause us to fail to qualify as a REIT or may cause our board of directors either to refrain from making the REIT election or to revoke that election once made. To maintain REIT status, we must meet certain tests for income, assets, distributions to stockholders, ownership interests, and other significant conditions. If we fail to qualify as a REIT in any taxable year, we will not be allowed a deduction for distributions to our stockholders in computing our taxable income and would be subject to federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates. Moreover, unless we were entitled to relief under certain provisions of the tax laws, we would be disqualified from treatment as a REIT for the four taxable years following the year in which our qualification was lost. As a result, funds available for distribution to our stockholders would be reduced for each of the years involved and, in addition, we would no longer be required to make distributions to our stockholders.

REIT DISTRIBUTION REQUIREMENTS. To maintain REIT status, we must distribute as a dividend to our stockholders at least 95% of our otherwise taxable income, after certain adjustments, with respect to each tax year. Effective January 1, 2001, this requirement was changed to 90%, the minimum percentage that we must distribute to our stockholders. We may also be subject to a 4% non-deductible excise tax in the event our distributions to stockholders fail to meet certain other requirements. Failure to comply with these requirements could result in our income being subject to tax at regular corporate rates and could cause us to be liable for the excise tax.

OWNERSHIP LIMIT NECESSARY TO MAINTAIN REIT QUALIFICATION. As a REIT, the federal tax laws restrict the percentage of the total value of our stock that may be owned by five or fewer individuals to 50% or less. Our charter generally prohibits the direct or indirect ownership of more than 9% of our common stock by any stockholder. This limit excludes the Berg Group, which has an aggregate ownership limit of 20%. In addition, as permitted by our charter, our board of directors has authorized an exception to two other stockholders that permits them to collectively own, directly or indirectly, up to 18.5% of our common stock on an aggregate basis, subject to the terms of an ownership limit exemption agreement. In general, our charter prohibits the transfer of shares that result in a loss of our REIT

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qualification and provides that any such transfer or any other transfer that causes a stockholder to exceed the ownership limit will result in the shares being automatically transferred to a trust for the benefit of a charitable beneficiary. Accordingly, in the event that either the Berg Group or the two stockholders increase their stock ownership in our corporation, a stockholder who acquires shares of our common stock, even though his, her or its aggregate ownership may be less than 9%, may be required to transfer a portion of that stockholder's shares to such a trust in order to preserve our status as a REIT.

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STOCKHOLDERS ARE NOT ASSURED OF RECEIVING CASH DISTRIBUTIONS FROM US.

Our income will consist primarily of our share of the income of the operating partnerships, and our cash flow will consist primarily of our share of distributions from the operating partnerships. Differences in timing between the receipt of income and the payment of expenses in arriving at our taxable income or the taxable income of the operating partnerships and the effect of required debt amortization payments could require us to borrow funds, directly or through the operating partnerships, on a short-term basis to meet our intended distribution policy.

Our board of directors will determine the amount and timing of distributions by the operating partnerships and of distributions to our stockholders. Our board of directors will consider many factors prior to making any distributions, including the following:

- the amount of cash available for distribution;
- the operating partnerships' financial condition;
- whether to reinvest funds rather than to distribute such funds;
- the operating partnerships' capital expenditures;
- the effects of new property acquisitions, including acquisitions under our existing agreements with the Berg Group;
- the annual distribution requirements under the REIT provisions of the federal income tax laws; and
- such other factors as our board of directors deems relevant.

We cannot assure you that we will be able to meet or maintain our cash distribution objectives.

OUR PROPERTIES COULD BE SUBJECT TO PROPERTY TAX REASSESSMENTS.

We do not believe that any of our acquisitions of interests in the operating partnerships has resulted in a statutory change in ownership that could give rise to a reassessment of any of our properties for California property tax purposes. We cannot assure you, however, that county assessors or other tax administrative agencies in California will not attempt to assert that such a change occurred as a result of these transactions. Although we believe that such a challenge would not be successful ultimately, we cannot assure you regarding the outcome of any related dispute or proceeding. A reassessment could result in increased real estate taxes on our properties that, as a practical matter, we may be unable to pass through to our tenants in full. This could reduce our net income and our funds available for distribution and cause our stock price to fall.

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OUR OBLIGATION TO PURCHASE TENDERED O.P. UNITS COULD REDUCE OUR CASH DISTRIBUTIONS.

Each of the limited partners of the operating partnerships, other than Mr. Berg and Clyde J. Berg, has the annual right to cause the operating partnerships to purchase the limited partner's O.P. Units at a purchase price based on the average market value of the common stock for the ten-trading-day period immediately preceding the date of tender. Upon a limited partner's exercise of any such right, we will have the option to purchase the tendered O.P. Units with available cash, borrowed funds or the proceeds of an offering of newly issued shares of common stock. These put rights became exercisable on December 29, 1999, and are available once during a 12-month period. If the total purchase price of the O.P. Units tendered by all of the eligible limited partners in one year exceeds \$1 million, the operating partnerships or we will be entitled to reduce proportionately the number of O.P. Units to be acquired from each tendering limited partner so that the total purchase price does not exceed \$1 million. The exercise of these put rights may reduce the amount of cash that we have available to distribute to our stockholders and could cause our stock price to fall.

In addition, after December 1999, all O.P. Unit holders may tender their O.P. Units to us for shares of common stock on a one-for-one basis at then-current market value or an equivalent amount in cash, at our election. If we elect to pay cash for the O.P. Units, our liquidity may be reduced and we may lack sufficient funds to continue paying the amount of our anticipated or historical cash distributions. This could cause our stock price to fall.

SHARES ELIGIBLE FOR FUTURE SALE COULD AFFECT THE MARKET PRICE OF OUR STOCK.

We cannot predict the effect, if any, that future sales of shares of common stock, or the availability of shares for future sale, could have on the market price of the common stock. As of December 31, 2000 all outstanding shares of our common stock,

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other than shares controlled by affiliates, were eligible for sale in the public market without resale restrictions under the federal securities laws. Sales of substantial amounts of common stock, including shares issued in connection with the exercise of the exchange rights held by the limited partners of the operating partnerships, or the perception that such sales could occur, could adversely affect prevailing market prices for the common stock. Additional shares of common stock may be issued to limited partners, subject to the applicable REIT qualification ownership limit, if they exchange their O.P. Units for shares of common stock pursuant to their exchange rights, or may be sold by us to raise funds required to purchase such O.P. Units if the limited partners elect to tender O.P. Units to us using their put rights. Shares of stock controlled by our affiliates may be sold subject to Rule 144, including the limitation under Rule 144(c) on the number of shares that may be sold within a three-month period.

MARKET INTEREST RATES MAY REDUCE THE VALUE OF THE COMMON STOCK.

One of the factors that investors consider important in deciding whether to buy or sell shares of a REIT is the distribution rate on such shares, as a percentage of the price of such shares, relative to market interest rates. If market interest rates go up, prospective purchasers of REIT shares may expect a higher distribution rate. Higher interest rates would not,

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however, increase the funds available for us to distribute, and, in fact, would likely increase our borrowing costs and decrease funds available for distribution. Thus, higher market interest rates could cause the price of our common stock to fall.

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ITEM 2. PROPERTIES

GEOGRAPHIC AND TENANT FOCUS

We focus on the facility requirements of information technology companies in the Silicon Valley, which include space for office, research and development, light manufacturing and assembly. With the Silicon Valley's highly educated and skilled work force, history of numerous successful start-up companies and large contingent of venture capital firms, we believe that this region will continue to spawn successful new high-growth industries and entrepreneurial businesses to an extent matched nowhere else in the United States. We believe that our focus and thorough understanding of the Silicon Valley real estate market enable us to:

- anticipate trends in the market;
- identify and concentrate our efforts on the most favorably located sub-markets;
- take advantage of our experience and extensive contacts and relationships with local government agencies, real estate brokers and subcontractors, as well as with tenants and prospective tenants; and
- identify strong tenants.

All of our properties are general-purpose R&D properties located in desirable sub-markets of the Silicon Valley. Many of our properties have been developed for or leased to single tenants, many of whom are large, publicly traded information technology companies. Most of our major tenants have occupied our properties for many years under triple-net leases that require the tenant to pay substantially all operating costs, including property insurance, real estate taxes and general operating costs.

LEASING

The current leases for the properties typically have terms ranging from three to ten years. Most of the leases provide for fixed periodic rental increases. Substantially all of the leases are triple-net leases pursuant to which the tenant is required to pay substantially all of the operating expenses of the property, property taxes and insurance, including all maintenance and repairs, excluding only certain structural repairs to the building shell. Most of the leases contain renewal options that allow the tenant to extend the lease based on adjustments to then prevailing market rates, or based on fixed rental adjustments, which may be below market rates.

PROPERTY PORTFOLIO

All of our properties are R&D properties. Generally, our properties are one- to four-story buildings of tilt-up concrete construction, have 3.5 or more parking spaces per thousand rentable square feet, clear ceiling heights of less than 18 feet, and range in size from 18,000 to 515,000 rentable square feet. Most of the office space is open and suitable for

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configuration to meet the tenants' requirements with the use of movable dividers.

The following table sets forth certain information relating to our properties as of December 31, 2000.

| Location | No. of Properties | Total Rentable Sq. Ft. | Percentage Leased as of Dec 31, 2000 | Average 2000 Occupancy | Major Tenants |
|---------------------------|-------------------|------------------------|--------------------------------------|------------------------|---------------------------------------|
| 5300-5350 Hellyer | 2 | 160,000 | 100% | 100% | Stellelex Microwave Sys |
| 10401-10411 Bubb Road | 1 | 20,330 | 100% | 100% | Celerity Systems |
| 2001 Logic | 1 | 72,426 | 100% | 100% | Xilinx, Inc. |
| 45365 Northport Loop West | 1 | 64,218 | 100% | 100% | JNI Corporation Mattson Technology |
| 45700 Northport Loop East | 1 | 47,570 | 100% | 100% | Phillips Electronics |
| 45738 Northport Loop West | 1 | 44,256 | 100% | 100% | EIC Corporation |
| 4050 Starboard Drive | 1 | 52,232 | 100% | 100% | Flash Electronics, In |

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| Location | No. of Properties | Total Rentable Sq. Ft. | Percentage Leased as of Dec 31, 2000 | Average 2000 Occupancy | Major Tenants |
|---|-------------------|------------------------|--------------------------------------|------------------------|--|
| 3501 W. Warren Avenue- 46600 Fremont Blvd. | 1 | 67,864 | 100% | 100% | Storage Way |
| 48800 Milmont Drive | 1 | 53,000 | 100% | 100% | Premisys Communicatio |
| 4750 Patrick Henry Drive | 1 | 65,780 | 100% | 100% | Intertrust Networking |
| 4949 Hellyer Avenue | 1 | 200,484 | 100% | 100% | Cisco Systems Inc. |
| Triangle Technology Park | 7 | 416,927 | 100% | 99% | JDS Uniphase Intevac Corporation Xicom Technology, Inc Celestica Webango |
| 5850-5870 Hellyer Avenue | 1 | 109,715 | 100% | 100% | Clear Logic, Inc. Gadzoox Networks, Inc |
| 800 Branham Lane | 1 | 239,000 | 100% | 100% | Candescent Technology |
| 5400 Hellyer Avenue | 1 | 77,184 | 100% | 100% | Jetstream Communicati |
| 5749 Fontanoso Way | 1 | 77,700 | 100% | 100% | Cisco Systems, Inc. |

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| | | | | | |
|--------------------------------------|---|---------|------|------|-----------------------|
| 1065 L'Avenida | 5 | 515,700 | 100% | 100% | Microsoft Corporation |
| 1750 Automation Parkway | 1 | 80,641 | 100% | 100% | JDS Uniphase |
| 1756 Automation Parkway | 1 | 80,640 | 100% | 100% | JDS Uniphase |
| 1762 Automation Parkway | 1 | 61,100 | 100% | 100% | JDS Uniphase |
| 1768 Automation Parkway | 1 | 110,592 | 100% | 100% | JDS Uniphase |
| 255 Caspian Drive | 1 | 98,500 | 100% | 100% | Global Centers, Inc. |
| 2251 Lawson Lane | 1 | 125,000 | 100% | 100% | Amdahl Corporation |
| 1230 East Arques | 1 | 60,000 | 100% | 100% | Amdahl Corporation |
| 1250 Arques | 4 | 200,000 | 100% | 100% | Amdahl Corporation |
| 3120 Scott Blvd. | 1 | 75,000 | 100% | 100% | Amdahl Corporation |
| 20400 Mariani Avenue | 1 | 105,000 | 100% | 100% | Behring Diagnostics |
| 10500 De Anza Blvd. | 1 | 211,000 | 100% | 100% | Apple Computer, Inc. |
| 20605-705 Valley Green Dr. | 2 | 142,000 | 100% | 100% | Apple Computer, Inc. |
| 10300 Bubb Road | 1 | 23,400 | 100% | 100% | Apple Computer, Inc. |
| 10440 Bubb Road | 1 | 19,500 | 100% | 100% | Linotext Digital Colo |
| 10460 Bubb Road | 1 | 45,460 | 100% | 100% | Luminous Networks, In |
| 1135 Kern Avenue | 1 | 18,300 | 100% | 100% | Davicom Semiconductor |
| 1190 Morse Ave/ 405 Tasman Avenue | 1 | 28,350 | 100% | 100% | Coptec West |
| 450 National Avenue | 1 | 36,100 | 100% | 92% | ePeople |
| 3301 Olcott Street | 1 | 64,500 | 100% | 100% | NEC Electronics, Inc. |
| 2800 Bayview Avenue | 1 | 59,736 | 100% | 100% | Concept System Design |
| 6850 Santa Teresa Blvd. | 1 | 30,000 | 100% | 83% | Valiant Networks, Inc |

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| Location | No. of Properties | Total Rentable Sq. Ft. | Percentage Leased as of Dec 31, 2000 | Average 2000 Occupancy | Major Tenants |
|--|-------------------|------------------------|--------------------------------------|------------------------|--|
| 6810 Santa Teresa Blvd. | 1 | 54,996 | 100% | 100% | Polaris, Inc. |
| 140-150 Great Oaks Blvd./ 6781 Via Del Oro | 2 | 105,300 | 100% | 100% | Atcor Corporation Amtech Corporation |
| 6540-6541 Via Del Oro/ 6385-6387 San Ignacio Ave. | 2 | 66,600 | 100% | 100% | Exsil Incorporated Alcatel Network System Inc. |

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| Address | Units | Sq. Ft. | Owned % | Leased % | Tenant(s) |
|---|-------|-----------|---------|----------|---|
| 6311-6351 San Ignacio Ave. | 5 | 360,254 | 100% | 100% | Modutek Corporation On Command Video Magic Manufacturing, Avnet, Inc. Photon Dynamics Teledex Corporation |
| 6320-6360 San Ignacio Ave. | 1 | 157,292 | 100% | 100% | Bell Sports, Inc. Delrina/Symantec Corp |
| 2610 N. First St. & 75 E. Trimble Road | 2 | 170,810 | 100% | 100% | County of Santa Clara Comerica Bank |
| 2033-2243 Samaritan Drive | 3 | 235,122 | 100% | 100% | Condor Systems Texas Instruments State Farm Insurance |
| 1170 Morse Avenue | 1 | 34,750 | 100% | 100% | CA Parkinsons Foundat |
| 3236 Scott Blvd. | 1 | 54,672 | 100% | 100% | Celeritek Systems, In |
| 1212 Bordeaux Lane | 1 | 71,800 | 100% | 100% | ESL Incorporated |
| McCandless Technology Park | 14 | 705,956 | 93% | 98% | Larscom, Inc. Arrow Electronics, In Sherpa Corporation Chartered Semiconduct Panasonic Industrial Kent Electronics Corp Promptu Systems Corp. |
| 1600 Memorex Drive | 1 | 107,500 | 100% | 100% | Sasco Electric |
| 1650 Richard Avenue | 1 | 52,800 | 100% | 100% | Forward Technology |
| 1700 Richard Avenue | 1 | 58,783 | 100% | 100% | IXC Communications |
| ----- | | | | | |
| TOTAL | 89 | 6,195,840 | | | |
| ===== | | | | | |

(1) Annual cash rents do not include any effect for recognition of rental income on the straight-line method of accounting required by generally accepted accounting principles under which contractual rent payment increases are recognized evenly over the lease term.

(2) The property was purchased during 2000. The 2000 Annual Base Rent reflects rent received from the date of acquisition through December 31, 2000.

We own 100% of all of the properties, except for one of the buildings in the Triangle Technology Park, which is owned by a joint venture in which we, through an operating partnership, own a 75% interest, the property at 10401-10411 Bubb Road, which is owned by a joint venture in which we, through an operating partnership, own an 83.33% interest, and the property at 5300 Hellyer Avenue, which is owned by a joint venture in which we, through an operating partnership, own a 50% interest.

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We continue to operate at consistently high occupancy levels. Occupancy levels are indicative of the strength of our local real estate markets, the continuing demand for space and our abilities to keep the properties leased.

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LEASE EXPIRATIONS

The following table sets forth a schedule of the lease expirations for the properties beginning with 2001, assuming that none of the tenants exercise existing renewal options or termination rights. The table excludes 51,602 rentable square feet that was vacant as of December 31, 2000.

| Year of Lease Expiration | Number of Leases Expiring | Rentable Square Footage Subject to Expiring Leases | 2001 Annual Base Rent Under Expiring Leases (1) | Percent Base R Exp |
|--------------------------|---------------------------|--|---|--------------------|
| 2001 | 26 | 737,507 | \$ 10,628,242 | |
| 2002 | 19 | 872,472 | 13,333,781 | |
| 2003 | 13 | 468,266 | 6,036,013 | |
| 2004 | 18 | 985,313 | 11,543,083 | |
| 2005 | 19 | 865,759 | 14,250,534 | |
| 2006 | 7 | 821,420 | 23,988,152 | |
| 2007 | 13 | 682,809 | 13,841,582 | |
| 2008 | 1 | 125,000 | 1,338,523 | |
| 2009 | 1 | 58,783 | 584,064 | |
| 2010 | 1 | 66,042 | 1,040,980 | |
| 2015 | 2 | 258,500 | 4,932,666 | |
| | ----- 120 | ----- 5,941,871 | ----- \$ 101,517,620 | |

(1) The base rent for leases expiring is based on January 2001 monthly rents multiplied by 12.

(2) Based upon 2001 annual rents as discussed in Note (1).

RECENT DEVELOPMENTS

In January 2001, we acquired a newly constructed R&D property leased to Celestica, Inc. on Hellyer Avenue in San Jose, California consisting 131,500 square feet of rentable space under the Berg land holdings option agreement. Pursuant to the Berg land holdings option agreement, the acquisition cost is based on the full construction cost of the building,

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10% of the full construction cost of the building, and other factors. The Berg Group is currently evaluating its total construction costs due to delayed billings by its vendors. Details of the acquisition cannot be determined at this time.

In January 2001, we completed the sale of the R&D property at 4949 Hellyer Avenue, San Jose, California to Cisco Systems, Inc, which exercised its purchase option in November 2000. We realized a gain of \$3.1 million on the total sale price of \$23.1 million. Cisco Systems, Inc. also exercised its purchase option in November 2000 to purchase the R&D property at 5713-49 Fontanoso Way, San Jose, California. The sale is expected to occur in the fourth quarter of 2001.

ENVIRONMENTAL MATTERS

To date, compliance with laws and regulations relating to the protection of the environment, including those regarding the discharge of materials into the environment has not had any material effects upon our capital expenditures, earnings or competitive position.

Under various federal, state and local laws, ordinances and regulations, an owner or operator of real property may be held liable for the costs of removal or remediation of certain hazardous or toxic substances located on or in the property. Such laws often impose liability on the owner and expose the owner to governmental proceedings without regard to whether the owner knew of, or was responsible for, the presence of the hazardous or toxic substances. The cost of any required remediation or removal of such substances may be substantial. In addition, the owner's liability as to any specific property is generally not limited and could exceed the value of the property and/or the aggregate assets of the owner.

The presence of such substances,

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or the failure to properly remove or remediate such substances, may also adversely affect the owner's ability to sell or rent the property or to borrow using the property as collateral. Persons who arrange for treatment or the disposal of hazardous or toxic substances may also be liable for the costs of any required remediation or removal of the hazardous or toxic substances at a disposal facility, regardless of whether the facility is owned or operated by such owner or entity. In connection with the ownership of the properties or the treatment or disposal of hazardous or toxic substances, we may be liable for such costs.

Some of our properties are leased, in part, to businesses, including manufacturers that use, store or otherwise handle hazardous or toxic substances in their business operations. These operations create a potential for the release of hazardous or toxic substances. In addition, groundwater contaminated by chemicals used in various manufacturing processes, including semiconductor fabrication, underlies a significant portion of northeastern Santa Clara County, where many of our properties are located.

Environmental laws also govern the presence, maintenance and removal of asbestos. These laws require that owners or operators of buildings containing asbestos properly manage and maintain the asbestos, that they adequately inform or train those who may come into contact with asbestos and that they undertake special precautions, including removal or other abatement in the event that asbestos is disturbed during renovation or demolition of a building. These laws may impose fines and penalties on

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building owners or operators for failure to comply with these requirements and may allow third parties to seek recovery from owners or operators for personal injury associated with exposure to asbestos fibers. We are aware that there are asbestos-containing materials, or ACMs, present at several of the properties, primarily in floor coverings. We believe that the ACMs present at these properties are generally in good condition and that no ACMs are present at the remaining properties. We believe we are in compliance in all material respects with all present federal, state and local laws relating to ACMs and that if we were given limited time to remove all ACMs present at the properties, the cost of such removal would not have a material adverse effect on our financial condition, results of operations and ability to make cash distributions to our stockholders.

Phase I assessments are intended to discover and evaluate information regarding the environmental condition of the surveyed property and surrounding properties. Phase I assessments generally include a historical review, a public records review, an investigation of the surveyed site and surrounding properties and the preparation and issuance of a written report, but do not include soil sampling or subsurface investigations and typically do not include an asbestos survey. Environmental assessments have been conducted for about half of the properties.

The environmental investigations that have been conducted on our properties have not revealed any environmental liability that we believe would have a material adverse effect on our financial condition, results of operations and assets, and we are not aware of any such liability. Nonetheless, it is possible that there are material environmental liabilities of which we are unaware. We cannot assure you that future laws, ordinances, or regulations will not impose any material environmental liability, or that the current environmental condition of the properties has not been, or will not be, affected by tenants and occupants of the properties, by the condition of properties in the vicinity of the properties, or by third parties unrelated to us.

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ITEM 3. LEGAL PROCEEDINGS

Neither the operating partnerships, the properties nor we are subject to any material litigation nor, to our knowledge, is any material litigation threatened against the operating partnerships, the properties or us. From time to time, we are engaged in legal proceedings arising in the ordinary course of our business, and we do not consider any of such proceedings to have material adverse effect on our cash flows, financial condition or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of stockholders during the fourth quarter of the year ended December 31, 2000.

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PART II

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ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Our common stock is listed on the American Stock Exchange ("AMEX") and the Pacific Exchange, Inc. and trades under the symbol "MSW." The high and low sale prices per share of common stock during each quarter of 2000 and 1999 were as follows:

| | 2000 | | 1999 | |
|-------------|----------|----------|----------|----------|
| | High | Low | High | Low |
| 1st Quarter | \$9 | \$7 1/8 | \$7 1/8 | \$6 3/8 |
| 2nd Quarter | \$10 5/8 | \$8 5/16 | \$8 3/4 | \$7 |
| 3rd Quarter | \$14 | \$10 | \$8 5/8 | \$7 3/8 |
| 4th Quarter | \$14 5/8 | \$12 7/8 | \$8 5/16 | \$7 3/16 |

As of March 28, 2001, the number of holders of record of the common stock was 270. We declared and paid dividends in each fiscal during 2000 and 1999. We expect to pay quarterly dividends during 2001. The following tables show information for quarterly dividends for years 2000 and 1999.

| | 2000 | | |
|-------------|-------------|--------------|--------------------|
| | Record Date | Payment Date | Dividend per Share |
| 1st Quarter | 03/31/00 | 04/10/00 | \$0.15 |
| 2nd Quarter | 06/28/00 | 07/07/00 | \$0.17 |
| 3rd Quarter | 09/29/00 | 10/10/00 | \$0.17 |
| 4th Quarter | 12/29/00 | 01/10/01 | \$0.19 |
| Total | | | \$0.68 |

For federal income tax purposes, we have characterized the dividends declared in 2000 as 100% ordinary income.

| | 1999 | | |
|-------------|-------------|--------------|--------------------|
| | Record Date | Payment Date | Dividend per Share |
| 1st Quarter | 04/15/99 | 04/30/99 | \$0.12 |
| 2nd Quarter | 06/21/99 | 07/02/99 | \$0.14 |
| 3rd Quarter | 09/30/99 | 10/11/99 | \$0.15 |
| 4th Quarter | 12/30/99 | 01/10/00 | \$0.15 |
| Total | | | \$0.56 |

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For federal income tax purposes, we have characterized the dividends declared in 1999 as 93% ordinary income and 7% as return of capital.

The closing price of our common stock on December 29, 2000, the last trading day, was \$13.88 per share.

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ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected historical financial information for Mission West Properties, Inc. See Part II - Item 7 "Management's Discussion and Analysis of Financial Conditions and Results of Operations" - Overview and Company History for discussion of business combinations and property dispositions that materially affect the comparability of the selected financial data. Selected consolidated financial data is derived from the audited financial statements and notes thereto (see Part II - Item 8 "Consolidated Financial Statements and Supplementary Data," below) and is as follows:

| | Year Ended December 31, | | | One Month Ended December 1997 |
|---|-------------------------|---------------|---------------|--|
| | 2000 | 1999 | 1998 | 1997 |
| (dollars in thousands) | | | | |
| OPERATING DATA: | | | | |
| Revenue: | | | | |
| Rental revenues | \$ 99,567 | \$73,726 | \$27,285 | \$ - |
| Tenant reimbursements | 14,635 | 11,047 | 4,193 | - |
| Other | 1,742 | 1,220 | 278 | 27 |
| Total revenues | 115,944 | 85,993 | 31,756 | 27 |
| Expenses: | | | | |
| Property operating and maintenance and real estate taxes | 15,025 | 11,467 | 4,821 | - |
| Interest | 8,290 | 11,623 | 4,685 | - |
| Interest (related parties) | 4,475 | 2,246 | 3,511 | - |
| General and administrative expenses | 1,065 | 1,185 | 1,501 | 139 |
| Depreciation and amortization | 15,456 | 13,156 | 5,410 | - |
| | 44,311 | 39,677 | 19,928 | 139 |
| Income before gain (loss) on sale of real estate assets, minority interest and income taxes | 71,633 | 46,316 | 11,828 | (112) |
| Gain (loss) on sale | - | - | - | - |
| Income (loss) before minority interest and income taxes | 71,633 | 46,316 | 11,828 | (112) |
| Minority interest | 59,054 | 39,785 | 12,049 | - |
| Income (loss) before income taxes | 12,579 | 6,531 | (221) | (112) |
| (Benefit) provision for income taxes | - | - | - | (38) |

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| | | | | |
|---|------------------------|------------|------------|-----------|
| Net income (loss) | \$ 12,579 | \$ 6,531 | \$ (221) | \$ (74) |
| Basic income (loss) per share (1) | \$.73 | \$.52 | \$ (.13) | \$ (.05) |
| Diluted income (loss) per share (1) | \$.72 | \$.52 | \$ (.13) | \$ (.05) |
| PROPERTY AND OTHER DATA (2): | | | | |
| Total properties, end of period | 89 | 80 | 71 | |
| Total square feet, end of period | 6,196 | 5,307 | 4,519 | |
| Average monthly rental revenue per square foot (3) | \$1.36 | \$1.16 | \$0.95 | |
| Occupancy at end of period | 99% | 99% | 99% | |
| FUNDS FROM OPERATIONS (2) (4): | | | | |
| Cash flow from operations | \$84,580 | \$60,298 | \$16,264 | \$ (46) |
| Cash flow from investing | (2,736) | (12,084) | (118) | - |
| Cash flow from financing | (83,706) | (41,920) | (21,469) | 150 |
| | December 31, | | | |
| | 2000 | 1999 | 1998 | 1997 |
| | (dollars in thousands) | | | |
| BALANCE SHEET DATA (5): | | | | |
| Real estate assets, net of accumulated depreciation | \$807,456 | \$697,616 | \$516,029 | \$ - |
| Total assets | 826,910 | 712,704 | 519,866 | 5,763 |
| Line of credit - related parties | 50,886 | - | - | - |
| Debt | 132,055 | 133,952 | 184,389 | - |
| Debt - related parties | 11,643 | 31,193 | 20,752 | - |
| Total liabilities | 255,505 | 215,212 | 213,234 | 552 |
| Minority interest | 469,332 | 396,810 | 273,379 | - |
| Stockholders' equity | 102,073 | 100,682 | 33,253 | 5,211 |
| Common stock outstanding | 17,025,365 | 16,972,374 | 8,218,594 | 1,501,104 |
| O.P. Units issued and outstanding | 83,576,027 | 76,205,789 | 60,151,697 | - |

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- (1) As adjusted for the 1 for 30 reverse stock split in November 1997.
- (2) Property and other data shown only as of December 31, 2000, 1999 and 1998.
- (3) Average monthly rental revenue per square foot has been determined by taking the total base rent for the period, divided by the number of months in the period, and then divided by the total square feet of occupied space.
- (4) As defined by the National Association of Real Estate Investment Trusts ("NAREIT"), FFO represents net income (loss) before minority interest of unit holders (computed in accordance with GAAP), excluding gains (or losses) from debt restructuring and sales of property, plus real estate related depreciation and amortization (excluding amortization of deferred financing costs and depreciation of non-real estate assets) and after adjustments for unconsolidated partnerships and joint ventures. Management considers FFO an appropriate measure of performance of an equity REIT because, along with cash flows from operating activities, financing activities and investing activities, it provides investors with an understanding of our ability to incur and service debt and make capital expenditures. FFO should not be considered as an alternative for net income as a measure of profitability or is it comparable to cash flows provided by

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operating activities determined in accordance with GAAP. FFO is not comparable to similarly entitled items reported by other REITs that do not define them exactly as we define FFO. See Part II - Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" - Certain Policies.

- (5) Balance sheet information for 1997 is shown as of December 31, 1997.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion includes forward-looking statements, including but not limited to statements with respect to the future financial performance, operating results, plans and objectives of Mission West Properties, Inc. Actual results may differ materially from those currently anticipated depending upon a variety of factors, including those described in Part I - Item 1 "Business - Risk Factors."

OVERVIEW

In May 1998, we, the Berg Group members, John Kontrabecki, and certain other persons entered into an acquisition agreement providing, among other things, for our acquisition of interests as the sole general partner in the operating partnerships. At the time, the operating partnerships held approximately 4.34 million rentable square feet of R&D property located in Silicon Valley. The agreement also provided for the parties to enter into the pending projects acquisition agreement, the Berg land holdings option agreement and the exchange rights agreement, following stockholder approval. Effective July 1, 1998, we consummated our acquisition of the general partnership interests in the operating partnerships. We effected our purchase of the general partnership interests by issuing to each of the operating partnerships a demand note bearing interest at 7.25% per annum, aggregating \$35.2 million of principal payable no later than July 1, 2000 (the "Demand Notes"). Effective July 1, 1998, all limited partnership interests in the operating partnerships were converted into 59,479,633 O.P. Units, representing ownership of approximately 87.89% of the operating partnerships, upon consummation of the acquisition. Each O.P. Unit may be exchanged for one share of common stock pursuant to certain exchange rights and is treated as a share of common stock on a fully diluted basis and also represents our minority ownership interests. At December 31, 2000, we owned a 16.92% general partnership interest in the operating partnerships, taken as a whole, on a weighted average basis.

On December 29, 1998, we sold 6,495,058 shares of common stock at a price of \$4.50 per share to a number of accredited investors to complete our May 1998 private placements. The aggregate proceeds, net of fees and offering costs, of approximately \$27.8 million were used to pay down amounts outstanding under the Demand Notes due to the operating partnerships. Also as of December 29, 1998, we and the limited partners in the operating partnerships entered into the exchange rights agreement, and we entered into the pending projects acquisition agreement and the Berg land holdings option agreement with the Berg Group and other sellers.

In July 1999, we completed a public offering of 8,680,000 shares of our common stock at \$8.25 per share. The net proceeds of approximately \$66.9 million, after deducting underwriting discounts and other offering costs, were used primarily to repay indebtedness.

At December 31, 2000, the outstanding balance under the Demand Notes owed

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to the operating partnerships was \$1.18 million. The Company and the operating partnerships have agreed to extend the due date of the demand notes to September 30, 2001. The principal of the Demand Notes, along with the interest expense, which is interest income to the operating partnerships, is eliminated in consolidation and is not included in the corresponding line items within the consolidated financial statements. However, the interest income earned by the operating partnerships, which is interest expense to us, in connection with this debt, is included in the calculation of minority interest as reported on the consolidated statement of operations, thereby reducing our net income by this same amount. At present, our only means for repayment of this debt is through distributions received from the operating partnerships in excess of the amount of dividends to be paid to our stockholders.

COMPANY HISTORY

Our original predecessor was formed in 1969 as Palomar Mortgage Investors, a California business trust. It operated as a REIT, investing primarily in short-term and intermediate-term construction and development loans secured by first trust deeds on real property. In 1974, Palomar Mortgage Investors terminated new loan activity and, in 1975, changed its name to Mission Investment Trust. In 1979, Mission Investment Trust terminated its status as a REIT and began to develop and market the properties that it owned. In 1982, Mission West Properties was incorporated as a successor to Mission Investment Trust.

In January and May 1997, we sold all of our real estate assets to Spieker Properties, L.P. for approximately \$50.5 million in cash. In February 1997, we paid a special dividend of \$9.00 per share to our stockholders. After the sale of assets and the payment of the dividend to stockholders, we retained only nominal assets. The board of directors and management considered available strategic alternatives for the remaining corporate entity, including possible business or asset acquisitions or combinations, a sale of the corporate entity, and outright liquidation.

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Subsequently, we accepted a proposal by the Berg Group to acquire control of the corporation as a vehicle to acquire R&D properties, or interests in entities owning such properties, from the Berg Group. On May 27, 1997, we entered into a stock purchase agreement with the Berg Group, which transferred most of its share purchase rights to unaffiliated accredited investors. The transaction was completed on September 2, 1997, at which time all of our existing officers and directors resigned and the Berg Group and the other investors acquired a 79.6% controlling ownership position as a group.

On October 20, 1997, we paid a further distribution of \$3.30 per share to our stockholders from available cash, including approximately \$900,000 received in the September 1997 transaction. No portion of the distribution was paid on shares acquired by the Berg Group and its co-investors. In connection with that distribution, the AMEX halted trading of the common stock on October 20, 1997. Neither the AMEX nor we set a deadline for the resumption of trading, nor did the AMEX provide guidance beyond declaring its desire that we have a firm commitment to acquire a controlling interest in the R&D properties of the Berg Group and to raise additional capital. Our sale of common stock under two May 1998 private placements, the pending projects acquisition agreement and the Berg land holdings option agreement between us and the Berg Group, and our reincorporation in the State of Maryland. On December 8, 1998, the AMEX recommenced trading of our common

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stock.

On December 28, 1998, our stockholders approved and ratified our sale of common stock under two May 1998 private placements, the pending projects acquisition agreement and the Berg land holdings option agreement between us and the Berg Group, and our reincorporation in the State of Maryland. On December 8, 1998, the AMEX recommenced trading of our common stock. Our reincorporation under the laws of the State of Maryland through the merger of Mission West Properties into Mission West Properties, Inc. occurred on December 30, 1998, at which time all shares that had been issued by our predecessor California corporation and remained outstanding were converted into shares of our common stock on a one-for-one basis.

We have two wholly owned corporate subsidiaries, MIT Realty, Inc. and Mission West Executive Aircraft Center. Both corporations are inactive.

RESULTS OF OPERATIONS

COMPARISON OF THE YEAR ENDED DECEMBER 31, 2000 TO THE YEAR ENDED DECEMBER 31, 1999.

As of December 31, 2000, we, through our controlling interests in the operating partnerships, owned 89 properties totaling approximately 6.2 million square feet compared to 80 properties totaling approximately 5.3 million square feet as of December 31, 1999. This represented an increase of approximately 17% in total rentable square footage from the prior year. The increase resulted from the following acquisitions under the pending projects acquisition agreement and the Berg land holdings option agreement:

| Date of Acquisition | Address | Rentable Square Footage |
|------------------------|--------------------------------|----------------------------|
| 1/00 | 1756 Automation Parkway | 80,640 |
| 3/00 | 800 Branham Lane East | 239,000 |
| 4/00 | 1762 Automation Parkway | 61,100 |
| 4/00 | 255 Caspian Way | 98,500 |
| 5/00 | 5300 & 5350 Hellyer Avenue (1) | 160,000 |
| 7/00 | 5400 Hellyer Avenue | 77,184 |
| 10/00 | 45365 Northport Loop | 64,218 |
| 12/00 | 1768 Automation Parkway | 110,592 |
| | | ----- 891,234 ===== |

(1) Two buildings were acquired at this location.

The following table depicts the amounts of rental revenues represented by our historical properties and our acquired properties since July 1, 1998 for the years ended December 31, 2000 and 1999.

| | | December 31, | |
|------|------|--------------|----------|
| 2000 | 1999 | \$ Change | % Change |

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| | (Dollars in thousands) | | | |
|-------------------|------------------------|----------|----------|-------|
| Same Property (1) | \$59,304 | \$54,194 | \$ 5,110 | 9.4 |
| 1998 Acquisitions | 2,330 | 2,342 | (12) | (.5) |
| 1999 Acquisitions | 25,635 | 17,190 | 8,445 | 49.1 |
| 2000 Acquisitions | 12,298 | - | 12,298 | 100.0 |
| | ----- | ----- | ----- | |
| | \$99,567 | \$73,726 | \$25,841 | 35.0 |
| | ===== | ===== | ===== | |

(1) "Same Property" is defined as properties owned as of July 1, 1998 and still owned as of December 31, 2000.

As of December 31, 2000 and 1999, we owned a general partnership interest of 18.15%, 21.36%, 15.38% and 12.21% and 20.28%, 21.32%, 15.33% and 12.18% in Mission West Properties, L.P., Mission West Properties, L.P. I, Mission West Properties, L.P. II and Mission West Properties, L.P. III, respectively, which are the operating partnerships. We owned a 16.92% and 18.28 general partnership interest in the operating partnerships, taken as a whole, on a weighted average basis as of December 31, 2000 and 1999, respectively.

In 2000, we focused on maximizing the value of our real estate portfolio by increasing the cash flow from our properties by increasing effective rents and maintaining high occupancy levels. For the year ended December 31, 2000, our rental revenues from real estate increased by \$25.8 million, or 35%, which included an increase of approximately \$4.9 million over base rental revenues to reflect rental revenues on a straight-line basis, from \$73.7 million for the year ended December 31, 1999 to \$99.5 million for the same period of 2000. Of the \$25.8 million increase in rental revenues, \$5.1 million resulted from the Company's "Same Property" portfolio, \$8.4 million resulted from newly developed properties acquired in 1999, and \$12.3 million resulted from newly developed properties acquired in 2000. These increases were primarily attributable to increased rental rates and a high average occupancy level of 99%.

The following table reflects the increase in property operating expenses and real estate taxes for the year ended December 31, 2000 over property operating expenses and real estate taxes for the year ended December 31, 1999.

| | December 31, | | | |
|-------------------|------------------------|----------|-----------|----------|
| | 2000 | 1999 | \$ Change | % Change |
| | (Dollars in thousands) | | | |
| Same Property (1) | \$11,228 | \$ 9,882 | \$1,346 | 13.6 |
| 1998 Acquisitions | 271 | 291 | (20) | (6.9) |
| 1999 Acquisitions | 2,813 | 1,294 | 1,519 | 117.4 |
| 2000 Acquisitions | 713 | - | 713 | 100.0 |
| | ----- | ----- | ----- | |
| | \$15,025 | \$11,467 | \$3,558 | 31.0 |
| | ===== | ===== | ===== | |

(1) "Same Property" is defined as properties owned as of July 1, 1998 and

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still owned as of December 31, 2000.

Tenant reimbursements increased by \$3.6 million, or 33%, from \$11.0 million for the year ended December 31, 1999 to \$14.6 million for the year ended December 31, 2000. Operating expenses and real estate taxes, on a combined basis, increased by \$3.5 million or 31%, from \$11.5 million to \$15.0 million for the years ended December 31, 1999 and 2000, respectively. Of the \$3.5 million increase in property operating expenses and real estate taxes, \$1.3 million resulted from the Company's "Same Property" portfolio, \$1.5 million resulted from properties acquired in 1999, and \$0.7 million resulted from properties acquired in 2000. The overall increase in tenant reimbursements, property operating expenses and real estate taxes is primarily a result of the growth in the total square footage of the Company's portfolio of properties during the periods presented. The increases experienced are consistent with the increase in rental revenues. Other income, including interest, was approximately \$1.7 million and \$1.2 million for the years ended December 31, 2000 and 1999, respectively. The \$0.5 million increase was due to the sale of securities. General and administrative expenses decreased by \$120,000 from \$1.18 million to \$1.06 million for the years ended December 31, 1999 and 2000, respectively.

Interest expense decreased by \$3.3 million, or 28%, from \$11.6 million for the year ended December 31, 1999 to \$8.3 million for the year ended December 31, 2000, primarily due to the repayment of the Wells Fargo line of credit in 1999. Interest expense (related parties) increased by \$2.2 million, or 100%, from \$2.2 million for the year ended December 31, 1999 to \$4.4 million for the year ended December 31, 2000. The increase in interest expense (related parties) was attributable to our substitution of the Berg Group line of credit for the Wells Fargo line of credit, and our use of the new credit line for the nine

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acquisitions in 2000. Interest rates also increased in the second half of the year. On a combined basis, total interest expense decreased \$1.1 million from December 31, 1999 to December 31, 2000 because of the repayment of the Wells Fargo line of credit. As a result of nine R&D property acquisitions since December 31, 1999, debt outstanding, including amounts due related parties, had increased by \$29.5 million, or 17.9%, from \$165.1 million as of December 31, 1999 to \$194.6 million as of December 31, 2000. Management expects interest expense to increase as additional debt is incurred in connection with new property acquisitions.

Depreciation expense increased by \$2.3 million, or 17%, from \$13.2 million to \$15.5 million for the years ended December 31, 2000 and 1999, respectively. The increase was attributable to the acquisition of nine R&D properties comprised of approximately 891,000 rentable square feet since December 31, 1999.

Our income attributed to minority interest increased by \$19.3 million, or 48%, from \$39.8 million for the year ended December 31, 1999 to \$59.1 million for the year ended December 31, 2000. Net income to shareholders increased by \$6.1 million, or 94%, from \$6.5 million for the year ended December 31, 1999 to \$12.6 million for year ended December 31, 2000. Minority interest represents the limited partners' ownership interest of 83.08% and 81.72%, on a weighted average basis, as of December 31, 2000 and 1999, respectively, in the operating partnerships. The increase in the minority interest percentage resulted from the issuance of additional O.P. Units in connection with the acquisition of nine new properties under the pending projects acquisition agreement and the Berg land holdings option agreement.

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COMPARISON OF THE YEAR ENDED DECEMBER 31, 1999 TO THE YEAR ENDED DECEMBER 31, 1998.

Our acquisition of the general partnership interests in the operating partnerships during the third quarter of 1998 substantially altered our operations. As a consequence, operating results for the year ended December 31, 1999 are not fully comparable to our operating results for the same period of 1998.

As of December 31, 1999, we owned a general partnership interest of 20.28%, 21.32%, 15.33% and 12.18% in Mission West Properties, L.P., Mission West Properties, L.P. I, Mission West Properties, L.P. II and Mission West Properties, L.P. III, respectively, which are the operating partnerships. We owned an 18.28% general partnership interest in the operating partnerships, taken as a whole, on a weighted average basis as of December 31, 1999. As of December 31, 1998, we owned a 12.02% general partnership interest in the operating partnerships, taken as a whole, on a weighted average basis. The acquisition of the general partnership interests in the operating partnerships in July 1998 was accounted for as a purchase. Our consolidated operating results for the year ended December 31, 1998 include the results of operations, assets and other financial data for the operating partnerships from July 1, 1998 through December 31, 1998. Thus, the results of operations for the year ended December 31, 1998, include only six months of activity for our current real estate operations.

The year ended December 31, 1999 was our first full year of operation with the R&D properties acquired from the Berg Group and others in July 1998.

For the year ended December 31, 1999, our rental revenues from real estate were approximately \$73.7 million, which included an increase of approximately \$4.3 million over base rental revenues to reflect rental revenues on a straight-line basis. Tenant reimbursements were approximately \$11.0 million, and other income, including interest, was approximately \$1.2 million. Included in other income is a gain of \$393,000 from the sale of securities. Total expenses for the year ended December 31, 1999, were approximately \$39.7 million, of which approximately \$38.5 million related directly to our real estate operations. General and administrative expenses accounted for the remainder of the expenses. For the six-month period ended December 31, 1998, our rental revenues from real estate were approximately \$27.3 million, which included an adjustment for straight-lined rents of approximately \$1.6 million. Tenant reimbursements were \$4.2 million, and other income, including interest, totaled approximately \$278,000. Total expenses for 1998 reached almost \$20.0 million, of which approximately \$18.4 million related directly to newly acquired real estate operations. General and administrative expenses accounted for the remainder of our expenses.

Our income attributed to minority interest was approximately \$39.8 million, resulting in net income of approximately \$6.5 million for the year ended December 31, 1999. The minority interest's portion of our income for the six-month period ended December 31, 1998 was approximately \$12.0 million, resulting in a consolidated net loss of \$221,000. Minority interest represents the limited partners' ownership interest in the operating partnerships of 81.72%, on a weighted average basis as of December 31, 1999, and 87.98%, on a weighted average basis as of December 31, 1998.

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CHANGES IN FINANCIAL CONDITION

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YEAR ENDED DECEMBER 31, 2000.

During 2000 we acquired nine R&D properties, all located in Silicon Valley. These acquisitions added approximately 891,000 square feet of rentable space and were acquired from the Berg Group under the Berg land holdings option agreement and the pending projects acquisition agreement. The total gross acquisition price for these nine properties was approximately \$122.9 million. We financed these acquisitions by borrowing \$39.9 million under our line of credit from the Berg group, issuing an \$11.8 million note to the Berg Group, assuming other liabilities of \$2.6 million, and issuing 7,370,238 O.P. Units to various members of the Berg Group.

In May 2000, we entered into a joint venture and acquired two R&D properties of approximately 160,000 square feet located at 5300 and 5350 Hellyer Avenue in San Jose, California from the Berg Group under the Berg land holdings option agreement. These properties are operated, managed, and owned by a partnership, Hellyer Avenue Limited Partnership, in which one of the operating partnerships owns a 50% interest. The total acquisition price for these properties was \$17.2 million. We acquired these properties by issuing an \$11.8 million note secured by the property to the Berg Group, issuing 659,223 O.P. Units to various members of the Berg Group, and assuming other liabilities of \$774,000. The mortgage note bears interest at 7.65%, and is due in ten years with principal payments amortized over 20 years. Included in the acquisition price were construction fees of \$600,000, loan fees of \$380,000 and commission fees of \$275,000.

Also in May 2000, we entered into a ten-year lease with ONI Systems Corporation ("ONI") for 444,500 square feet of space to be constructed by the Berg Group on land that is subject to the Berg land holdings option agreement. As partial consideration for the lease, we were allowed to purchase 100,000 shares of ONI common stock in its initial public offering. We purchased and then sold all of the shares and realized net proceeds of \$6.3 million. Of this amount, we recognized \$501,000 during the second quarter with the balance deferred as prepaid rent that we are amortizing ratably over the ten-year lease term.

In November 2000, Cisco Systems Inc. exercised its purchase options to purchase the properties it is currently leasing from us at 4949 Hellyer Avenue, San Jose, California and 5713-49 Fontanoso Way, San Jose, California, comprising 200,484 and 77,700 rentable square feet, respectively. The sale at 4949 Hellyer Avenue was completed in January 2001 and the sale of 5713-49 Fontanoso Way will close in the fourth quarter of 2001.

During the year ended December 31, 2000, stock options were exercised to purchase a total of 52,991 shares of common stock, consisting of 39,237 shares exercised at \$4.50 per share and 13,754 shares exercised at \$8.25 per share. Total proceeds to the Company were approximately \$290,000.

YEAR ENDED DECEMBER 31, 1999.

During 1999, we acquired nine newly constructed R&D properties, all located in Silicon Valley. These acquisitions added approximately 788,000 square feet of rentable space and were acquired from the Berg Group under the Berg land holdings option agreement and the pending projects acquisition agreement. The total gross acquisition price for these five properties was approximately \$193.6 million. We financed these acquisitions by the operating partnerships' assumption of \$36.4 million of debt due Berg & Berg Enterprises, Inc., the assumption by the operating partnerships of other liabilities of \$32.8 million (including the assumption of the sellers' obligation to reimburse Microsoft Corporation for shell and tenant

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improvements of \$32.1 million) and, the issuance of 16,311,232 O.P. Units, of which 15,420,564 O.P. Units were issued to members of the Berg Group.

Michael Anderson, our former Vice President, Chief Operating Officer and a director, resigned from the Company effective April 30, 1999. We had previously issued 200,000 shares of our common stock to Mr. Anderson in exchange for a note receivable payable to us for \$900,000. Upon Mr. Anderson's resignation, we purchased 117,361 of the 200,000 shares of common stock, and canceled the related share purchase obligation representing \$528,000 of the original \$900,000 note receivable. We waived interest expense of approximately \$32,000 due on the portion of the note receivable relating to the canceled shares. The remaining \$372,000 of the note receivable was paid in full during the second quarter of 1999.

In July 1999, we completed a public offering of 8,680,000 shares of our common stock at \$8.25 per share. The net proceeds of approximately \$66.9 million, after deducting underwriting discounts and other offering costs, were used to reduce the outstanding balance on the Wells Fargo line by approximately \$41.0 million and to reimburse Microsoft Corporation for approximately \$25.0 million for shell and tenant improvements on the Microsoft project. The remaining net proceeds of approximately \$900,000 were retained for general corporate purposes.

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During the third quarter of 1999, we entered into a new lease agreement for 2001 Logic Drive with Xilinx Incorporated ("Xilinx"). The lease agreement included an option granted to Xilinx to purchase the building at a predetermined price. In September 1999, in accordance with the option provisions of the lease agreement, Xilinx paid to us a deposit of approximately \$21.6 million to secure its option right. Xilinx can exercise the option only between April 30, 2000 and July 31, 2000. In July 2000, Xilinx and the Company agreed to extend the option period for two years until July 31, 2002. Xilinx and the Company further agreed to reduce the deposit by \$167,000 per month commencing August 1, 2000 until the later of: (1) the transfer of title to the property to Xilinx or (2) July 31, 2002. Upon exercise of the option, the Company must refund the remaining deposit amount and Xilinx must deposit into escrow funds equal to the purchase price. In the event Xilinx does not exercise its option, we must refund the remaining deposit to Xilinx, without interest.

During the year ended December 31, 1999, options were exercised for a total of 191,920 shares. The exercise price for all options exercised was \$4.50 per share and total proceeds to the Company were approximately \$863,000.

YEAR ENDED DECEMBER 31, 1998.

On September 23, 1998, in our capacity as the general partner of the operating partnerships, we obtained a loan from Prudential Insurance Company of America in the amount of \$130.0 million (the "Prudential Loan"). We used the net proceeds of the loan to repay approximately \$14.2 million of mortgage notes payable, and used the remaining amount to reduce the outstanding principal balance owing under the mortgage notes payable to the Berg Group, which is a related party. The loan is cross collateralized and secured by a single deed of trust encumbering 18 properties improved with 24 buildings and consisting of approximately 1.7 million square feet of rentable space, all of which are owned by the operating partnerships. The loan bears interest at a fixed rate of 6.56% per annum, matures on October 15, 2008 and is payable in monthly installments of approximately \$827,000, which includes principal, based upon a 30-year amortization, and interest. The Prudential Loan has a substantial prepayment penalty. The loan is

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nonrecourse to the operating partnerships and us, except with respect to certain matters such as environmental liability relating to the encumbered properties, the payment of taxes and assessments with respect to the encumbered properties, the responsibility to return security deposits to the tenants of the encumbered properties, insurance or condemnation proceeds that are not properly applied under the terms of the loan, damages that result from early termination or amendment to specified major leases, waste of the subject properties, bankruptcy or insolvency of any of the operating partnerships or us, and any fraud or misrepresentations by us or the operating partnerships in connection with the loan. In addition, some limited partners have guaranteed portions of the loan.

On September 30, 1998, the operating partnerships assumed a \$100.0 million line of credit with Wells Fargo Bank, N.A. from the Berg Group. The line of credit was subsequently reduced to \$50 million in October 1999. The Wells Fargo line matured February 29, 2000 and bore interest at the lesser of (a) the Wells Fargo prime rate in effect on the first day of each calendar month; (b) LIBOR plus 1.65%; or (c) the Wells Fargo Funds Rate quoted on the first day of each calendar month plus 1.65%. Borrowings outstanding at December 31, 1998 were approximately \$27.2 million.

During the fourth quarter of 1998, we closed on the acquisition of two newly constructed R&D properties located on Richard Avenue in Santa Clara, California and Hellyer Avenue in San Jose, California. These acquisitions added approximately 163,000 square feet of rentable space and were acquired from the Berg Group under the Berg land holdings option agreement and the pending projects acquisition agreement. The total gross acquisition price for these two properties was approximately \$13.7 million. Through the operating partnerships, we assumed approximately \$9.6 million of debt due Berg & Berg Enterprises, Inc. and issued 672,064 L.P. Units of which 618,684 were issued to various members of the Berg Group.

On March 30, 1998, Michael J. Anderson, our former Vice President and Chief Operating Officer, purchased 200,000 shares of common stock at \$4.50 per share in exchange for a \$900,000 note payable to us and due March 30, 2003. The note was a full recourse promissory note bearing interest at an annual rate of 5.59% and was collateralized by a pledge of the shares. Additionally, in December 1998, Mr. Anderson acquired 25,000 shares of our common stock upon partial exercise of his option grant. The exercise price was \$4.50 per share.

On December 29, 1998, we completed the sale of 6,495,058 shares of common stock at a price of \$4.50 per share to a number of accredited investors in two May 1998 private placements. The aggregate proceeds to us, net of a fee and offering costs, were approximately \$27.8 million. We used the proceeds to pay outstanding amounts under the Demand Notes owed to the operating partnerships. Offering costs included 200,000 shares of common stock issued for services rendered with the placement of such shares.

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LIQUIDITY AND CAPITAL RESOURCES

We expect our principal source of liquidity for distributions to stockholders, debt service, leasing commissions and recurring capital expenditures to be Funds from Operations ("FFO"), and the borrowings under the line of credit with the Berg Group. We expect these sources of liquidity to be adequate to meet projected distributions to stockholders and other presently anticipated liquidity requirements in 2001. We expect to meet our long-term liquidity requirements for the funding of property development, property acquisitions and other material non-recurring capital improvements through long-term secured and unsecured indebtedness and the

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issuance of additional equity securities by us.

Our \$50 million Wells Fargo line of credit expired on February 29, 2000 and was repaid with proceeds from and replaced by a \$50 million line of credit from the Berg Group. The Wells Fargo line of credit was collateralized by 14 of our properties and was guaranteed by Mr. Berg and certain other members of the Berg Group. On April 1, 2000, the \$50 million credit line with the Berg Group was increased to \$75 million with all other terms remaining the same. The Berg Group line of credit is currently collateralized by seven properties, bears interest at LIBOR plus 1.30 percent, and matures in March 2002. The interest rate was 7.5% at December 31, 2000. We believe that the terms of the Berg Group line of credit were more favorable than those available from Wells Fargo or similar lenders. See Item 1., "Business - Risk Factors - Our contractual business relationships with the Berg Group presents additional conflicts of interest which may result in the realization of economic benefits or the deferral of tax liabilities by the Berg Group without equivalent benefits to our stockholders."

At December 31, 2000, we had total indebtedness of approximately \$194.6 million, including approximately \$143.7 million of fixed rate mortgage debt and approximately \$50.9 million under the line of credit from the Berg Group, as to which the interest rate varies with LIBOR. Of total fixed debt, the Prudential Loan represented approximately \$126.8 million.

As of December 31, 2000, our debt to total market capitalization ratio, which is computed as our total debt outstanding divided by the sum of total debt outstanding plus the market value of common stock (based upon the closing price of \$13.88 per share on December 29, 2000) on a fully diluted basis, including the conversion of all O.P. Units into common stock, was approximately 12.2%. On December 29, 2000, the last trading day for the year, total market capitalization was approximately \$1.6 billion.

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The following table sets forth certain information regarding debt outstanding as of December 31, 2000.

| DEBT DESCRIPTION | COLLATERAL PROPERTIES | AT DECEMBER 2000 |
|---|--|---------------------|
| | | (\$ in tho |
| Line of Credit: | | |
| Berg Group (related parties) | 2033-2043 Samaritan Drive, San Jose, CA | \$ 5 |
| | 2133 Samaritan Drive, San Jose, CA | |
| | 2233-2243 Samaritan Drive, San Jose, CA | |
| | 1310-1450 McCandless Drive, Milpitas, CA | |
| | 1315-1375 McCandless Drive, Milpitas, CA | |
| | 1650-1690 McCandless Drive, Milpitas, CA | |
| | 1795-1845 McCandless Drive, Milpitas, CA | |
| Mortgage Notes Payable (related parties): | 5300-5350 Hellyer Avenue, San Jose, CA | 1 |
| Mortgage Notes Payable: (2) | | |
| Prudential Capital Group | 20400 Mariani Avenue, Cupertino, CA | |
| New York Life Insurance Company | 10440 Bubb Road, Cupertino, CA | |
| Home Savings & Loan Association | 10460 Bubb Road, Cupertino, CA | |

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| | |
|---|---|
| Mellon Mortgage Company | 3530 Bassett Street, Santa Clara, CA |
| Prudential Insurance Co. of America (3) | 10300 Bubb Road, Cupertino, CA |
| | 10500 N. DeAnza Blvd, Cupertino, CA |
| | 4050 Starboard Drive, Fremont, CA |
| | 45700 Northport Loop, Fremont, CA |
| | 45738 Northport Loop, Fremont, CA |
| | 450-460 National Ave, Mountain View, CA |
| | 4949 Hellyer Avenue, San Jose, CA |
| | 6311 San Ignacio Avenue, San Jose, CA |
| | 6321 San Ignacio Avenue, San Jose, CA |
| | 6325 San Ignacio Avenue, San Jose, CA |
| | 6331 San Ignacio Avenue, San Jose, CA |
| | 6341 San Ignacio Avenue, San Jose, CA |
| | 6351 San Ignacio Avenue, San Jose, CA |
| | 3236 Scott Blvd, Santa Clara, CA |
| | 3560 Bassett Street, Santa Clara, CA |
| | 3570 Bassett Street, Santa Clara, CA |
| | 3580 Bassett Street, Santa Clara, CA |
| | 1135 Kern Avenue, Sunnyvale, CA |
| | 1212 Bordeaux Lane, Sunnyvale, CA |
| | 1230 E. Arques, Sunnyvale, CA |
| | 1250 E. Arques, Sunnyvale, CA |
| | 1170 Morse Avenue, Sunnyvale, CA |
| | 3540 Bassett Street, Santa Clara, CA |
| | 3542 Bassett Street, Santa Clara, CA |
| | 3544 Bassett Street, Santa Clara, CA |
| | 3550 Bassett Street, Santa Clara, CA |

12

Mortgage Notes Payable

13

TOTAL

\$19
=====

- (1) The debt owed to the Berg Group under the line of credit carries a variable interest rate equal to LIBOR plus 1.30 percent and is payable in full in March 2002. The interest rate was 7.5% at December 31, 2000.
- (2) Mortgage notes payable generally require monthly installments of interest and principal over various terms extending through the year 2009. The weighted average interest rate of mortgage notes payable was 6.64% at December 31, 2000 and 1999.
- (3) The Prudential Loan is payable in monthly installments of \$827, which includes principal (based upon a 30-year amortization) and interest. John Kontrabecki, one of the limited partners, has guaranteed approximately \$12.0 million of this debt. Costs and fees incurred with obtaining this loan aggregated approximately \$900.

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The following table presents certain information concerning projects for which development has commenced that we might acquire under the Berg land holdings option agreement during 2001. The total acquisition cost of all of these projects is estimated currently at approximately \$217 million. For more information, please review Item 1., "Acquiring Properties Developed by the Berg Group."

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| PROPERTY | NET ACRES | APPROXIMATE RENTABLE AREA (SQUARE FEET) |
|--------------------------|-----------|---|
| ----- | | |
| UNDER DEVELOPMENT: | | |
| Hellyer Vista (Phase I) | 6 | 131,500 |
| Hellyer III (Phase I) | 7 | 117,740 |
| Creekside | 5 | 65,000 |
| Morgan Hill (JV I) (1) | 13 | 211,000 |
| Silver Creek | 18 | 346,000 |
| Caspian (Phase II) | 5 | 100,000 |
| 5550 Hellyer | 6 | 79,800 |
| 5535 Hellyer | 6 | 125,000 |
| Morgan Hill (JV IV) (1) | 12 | 160,000 |
| 5750 Hellyer | 7 | 73,312 |
| Morgan Hill (JV II) (1) | 4 | 60,000 |
| Morgan Hill (JV III) (1) | 3 | 40,000 |
| Piercy & Hellyer | 8 | 130,000 |
| Piercy & Hellyer | 4 | 65,000 |
| Piercy & Hellyer | 7 | 105,000 |
| ----- | | |
| TOTAL | 111 | 1,809,352 |
| ===== | | |

- (1) The Company expects to own an approximate 50% interest in the partnership that will develop the property. The property will be operated and managed by the other partner.

HISTORICAL CASH FLOWS

Net cash provided by operating activities for the year ended December 31, 2000 was approximately \$84.6 million, compared to net cash provided in operating activities of approximately \$60.3 million for the year ended December 31, 1999. The change was a direct result of the nine acquisitions and rent increases during the year.

In May 2000, we entered into a ten-year lease with ONI Systems Corporation ("ONI") for 444,500 square feet of space to be constructed by the Berg Group on land that is subject to the Berg land holdings option agreement. As partial consideration for the lease, we were allowed to purchase 100,000 shares of ONI common stock in its initial public offering. We purchased and then sold all of the shares and realized net proceeds of approximately \$6.3 million, which we used for debt payments.

Net cash used in investing activities was approximately \$2.7 million for the year ended December 31, 2000, compared to net cash used in investing activities of approximately \$12.1 million. Cash used in investing activities during 2000 related to improvements and additions made to existing real estate assets.

Net cash used in financing activities was approximately \$83.7 million for the year ended December 31, 2000, compared to \$41.9 million for the year ended December 31, 1999. During 2000, we paid our debt outstanding and made distributions to holders of our common stock and O.P Units by utilizing cash generated from operating activities. For the year ended December 31, 2000, we paid dividends to our stockholders and made distributions to the O.P Unit holders totaling \$12.9 million.

Net cash provided by operating activities for the year ended December 31, 1999 was approximately \$60.3 million, compared to net cash used in

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operating activities of approximately \$16.3 million for the year ended December 31, 1998. The change was a direct result of our acquisition of our general partnership interests in the operating partnerships during the third quarter of 1998.

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Net cash used in investing activities was approximately \$12.1 million for the year ended December 31, 1999, compared to net cash used in investing activities of approximately \$118,000 ended December 31, 1998. Cash used in investing activities during 1999 related to improvements made to existing real estate assets, as well as to payments made to Microsoft Corporation for shell and tenant improvements, which were partially offset by the receipt of \$21.6 million for a refundable option payment. Cash used in investing activities during 1998 related solely to improvements made to existing real estate assets acquired as part of our investment in the operating partnerships.

Net cash used in financing activities was approximately \$41.9 million for the year ended December 31, 1999 compared to \$21.5 million for the year ended December 31, 1998. During 1999, we reduced debt outstanding by utilizing net proceeds from the underwritten public offering of 8,680,000 shares of common stock for net proceeds of \$66.9 million and by utilizing cash provided by operating activities. For the year ended December 31, 1999, we paid dividends to our stockholders and made distributions to our O.P Unit holders totaling \$6.5 million. During 1998, we reduced debt outstanding by utilizing proceeds from new borrowings, issuing 6,495,058 shares of common stock for net proceeds of approximately \$28.1 million and utilizing cash provided by operating activities.

CAPITAL EXPENDITURES

The properties require periodic investments of capital for tenant-related capital expenditures and for general capital improvements. For the years ended December 31, 1995 through December 31, 2000, the recurring tenant improvement costs and leasing commissions incurred with respect to new leases and lease renewals of the properties previously owned or controlled by members of the Berg Group averaged approximately \$1.75 million annually. We will have approximately 737,507 rentable square feet under expiring leases from January 1, 2001 through December 31, 2001. We expect that the average annual cost of recurring tenant improvements and leasing commissions, related to these properties, will be approximately \$3.0 million during 2001. We believe we will recover substantially all of these sums from the tenants under the new or renewed leases through increases in rental rates. Until we actually sign the leases, however, we cannot assure you that this will occur. Capital expenditures may fluctuate in any given period subject to the nature, extent, and timing of improvements required to be made to the properties. Tenant improvements and leasing costs may also fluctuate in any given period year depending upon factors such as the property, the term of the lease, the type of lease and the overall market conditions. We expect to meet our long-term liquidity requirements for the funding of property acquisitions and other material non-recurring capital improvements through long-term secured and unsecured indebtedness and the issuance of additional equity securities by the Company, but cannot be assured that we will be able to meet our requirements on favorable terms. See "Policy with Respect to Certain Activities - Financing Policies."

FUNDS FROM OPERATIONS

As defined by the National Association of Real Estate Investment Trusts ("NAREIT"), FFO represents net income (loss) before minority interest of

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O.P unit holders, computed in accordance with generally accepted accounting principles, excluding gains (or losses) from debt restructuring and sales of property, plus real estate related depreciation and amortization, excluding amortization of deferred financing costs and depreciation of non-real estate assets, and after adjustments for unconsolidated partnerships and joint ventures. Management considers FFO an appropriate measure of performance of an equity REIT because, along with cash flows from operating activities, financing activities and investing activities, it provides investors with an understanding of our ability to incur and service debt and make capital expenditures. FFO should not be considered as an alternative for net income as a measure of profitability nor is it comparable to cash flows provided by operating activities determined in accordance with generally accepted accounting principles, nor is FFO necessarily indicative of funds available to meet our cash needs, including our need to make cash distributions to satisfy REIT requirements.

Our definition of FFO also assumes conversion at the beginning of the period of all convertible securities, including minority interests that might be exchanged for common stock. Our FFO does not represent the amount available for management's discretionary use; as such funds may be needed for capital replacement or expansion, debt service obligations or other commitments and uncertainties.

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Furthermore, FFO is not comparable to similarly entitled items reported by other REITs that do not define FFO exactly as we do. FFO for the years ended December 31, 2000 and 1999 is as follows:

| | For the Year Ended December 31, | |
|---------------------------------|---------------------------------|----------|
| | 2000 | 1999 |
| | (dollars in thousands) | |
| Net income | \$12,579 | \$ 6,531 |
| Add: | | |
| Minority Interest (1) | 58,769 | 39,785 |
| Depreciation | 15,456 | 13,156 |
| Less: | | |
| Gain/(Loss) on sale of security | 501 | (393) |
| FFO | \$86,303 | \$59,079 |

- (1) The minority interest for unrelated parties was deducted from total minority interest in calculating FFO.

OVERVIEW OF DISTRIBUTION POLICY

We intend to make regular quarterly distributions to holders of common stock based on our funds available for distribution ("FAD"), which is calculated as FFO less straight-lined rents, leasing commissions paid and capital expenditures made during the respective period. Our ability to make

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such distributions will be affected by numerous factors including, most importantly, the receipt of distributions from the operating partnerships.

FAD does not represent cash generated from operating activities in accordance with generally accepted accounting principles and is not necessarily indicative of cash available to fund cash needs. The actual return that we will realize and the amount available for distributions to stockholders will be affected by a number of factors, including the revenues received from our properties, our operating expenses, the interest expense incurred on borrowings and planned and unanticipated capital expenditures.

We anticipate that cash available for distribution will exceed earnings and profits for federal income tax purposes, as the latter figure takes into account non-cash expenses, such as depreciation and amortization, that we will incur. Distributions, other than capital gain distributions, by us to the extent of our current and accumulated earnings and profits for federal income tax purposes most likely will be taxable to U.S. stockholders as ordinary dividend income unless a stockholder is a tax-exempt entity. Distributions in excess of earnings and profits generally will be treated as a non-taxable reduction of the U.S. stockholder's basis in the common stock to the extent of such basis, and thereafter as taxable gain. The percentage of such distributions in excess of earnings and profits, if any, may vary from period to period.

Distributions will be determined by our board of directors and will depend on actual FAD, our financial condition, capital requirements, the annual distribution requirements under the REIT provisions of the Code and such other factors as the board of directors deems relevant. For a discussion of the risk that we will not meet our distribution objectives, see Part I - Item 1 "Business - Risk Factors--Stockholders are not assured of receiving cash distributions from us." The calculation of FAD for the years ended December 31, 2000 and 1999 is as follows:

| | For the Year Ended December 31, | |
|----------------------|---------------------------------|----------|
| | 2000 | 1999 |
| | (dollars in thousands) | |
| FFO | \$86,303 | \$59,079 |
| Less: | | |
| Straight-lined rents | 4,905 | 4,340 |
| Leasing commissions | 1,401 | 434 |
| Capital expenditures | 1,400 | 708 |
| FAD | \$78,597 | \$53,597 |

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For year 2000, the total distributions of \$0.68 per share of common stock are to be classified for income tax purposes as 100% ordinary income. Distributions that are declared and recorded during the calendar year and paid within 30 days of the end of the year are included in that year's distributions.

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POLICIES WITH RESPECT TO CERTAIN ACTIVITIES

We have adopted policies with respect to investment, financing, conflicts of interest and other activities. These policies have been formulated by our board of directors, are set forth in our charter, bylaws, operating partnership agreements or agreements with the Berg Group, and generally may be amended or revised from time to time, subject to applicable agreement terms, at the discretion of the board of directors without a vote of the stockholders. Among other things, these policies provide that:

- so long as the Berg Group members and their affiliates, other than us and the operating partnerships, beneficially own, in the aggregate, at least 15% of the outstanding shares of common stock on a fully diluted basis, which is calculated based on all outstanding shares of common stock and all shares of common stock that could be acquired upon the exercise of all outstanding options to acquire our voting stock, as well as all shares of common stock issuable upon exchange of all O.P. Units, the approval of a majority of our directors, including Carl E. Berg or his designee as a director, and of the holders of a majority of the O.P. Units is required for us to take title to assets, other than temporarily in connection with an acquisition prior to contributing such assets to the operating partnerships, or to conduct business other than through the operating partnerships, or for us or the operating partnerships to engage in any business other than the ownership, construction, development and operation of real estate properties, or for certain fundamental corporate actions, including amendments to our charter, bylaws or any operating partnership agreement and any merger, consolidation or sale of all or substantially all of our assets or the assets of the operating partnerships;
- changes in certain policies with respect to conflicts of interest must be consistent with legal requirements;
- certain policies with respect to competition by the Berg Group are imposed pursuant to provisions of the acquisition agreement that cannot be amended or waived without the approval of the independent directors committee of our board of directors;
- we cannot take any action intended to terminate our qualification as a REIT without the approval of more than 75% of the entire board of directors; and
- we cannot undertake certain other specified transactions, including the issuance of debt securities, and borrowings in excess of specified limits, or the amendment of our charter and bylaws, without the approval of more than 75% of the entire board of directors.

INVESTMENT POLICIES

We expect to pursue our business and investment objectives principally through the direct ownership by the operating partnerships of our properties and future acquired properties. Development or investment activities are not limited to any specified percentage of our assets. We may also participate with other entities in property ownership, through joint ventures or other types of co-ownership. Equity investments may be subject to existing mortgage financing and other indebtedness that have priority over our equity interests.

While we will emphasize equity real estate investments, we may, in our discretion and subject to the percentage ownership limitations and gross

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income tests necessary for REIT qualification, invest in mortgage and other real estate interests, including securities of other real estate investment trusts. We have not previously invested in mortgages or securities of other real estate investment trusts, and we do not have any present intention to make such investments.

FINANCING POLICIES

To the extent that our board of directors determines to seek additional capital, we may raise such capital through additional equity offerings, debt financing or retention of cash flow, or through a combination of these sources, after consideration of provisions of the Code requiring the distribution by a REIT of a certain percentage of its taxable income and taking into account taxes that would be imposed on undistributed taxable income. It is our present intention that any additional borrowings will be made through the operating partnerships, although we may incur borrowings that would be related to the operating partnerships. Borrowings may be unsecured or may be secured by any or all of our assets, the operating partnerships or any existing or new property, and may have full or limited recourse to all or any portion of our assets, the operating partnerships or any existing or new property.

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We have not established any limit on the number or amount of mortgages that may be placed on any single property or on our portfolio as a whole. We may also determine to finance acquisitions through the exchange of properties or the issuance of additional O.P. Units in the operating partnerships, shares of common stock or other securities.

In the event that the board of directors determines to raise additional equity capital, it has the authority, without stockholder approval, to issue additional shares of common stock, preferred stock or other capital stock, including securities senior to the common stock, in any manner and on such terms and for such consideration it deems appropriate, including in exchange for property. In the event that we issue any shares of common stock or securities convertible into or exchangeable or exercisable for, shares of common stock, subject to limited exceptions, such as the issuance of common stock pursuant to any stock incentive plan adopted by us or pursuant to limited partners' exercise of the exchange rights or the put rights, the limited partners will have the right to purchase common stock or such securities in order to maintain their respective percentage interests in us on a fully diluted basis. If the board of directors determines that we will raise additional equity capital to fund investments by the operating partnerships, we will contribute such funds to the operating partnerships as a contribution to capital and purchase of additional general partnership interest; however, holders of O.P. Units will have the right to participate in such funding on a pro rata basis. In the event that holders of O.P. Units sell their O.P. Units to us upon exercise of their put rights, we are authorized to raise the funds for such purchase by issuing additional shares of common stock. Alternatively, we may issue additional shares of common stock in exchange for the tendered O.P. Units.

Our board of directors also has the authority to cause the operating partnerships to issue additional O.P. Units in any manner and on such terms and for such consideration, as it deems appropriate, including in exchange for property. In the event that the operating partnerships issue new O.P. Units for cash, but not property, the limited partners holding O.P. Units in an operating partnership will have the right to purchase O.P. Units in order, and to the extent necessary, to maintain their respective percentage

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interests in that operating partnership. The new O.P. Units will be exchangeable for common stock pursuant to the exchange rights or may be tendered to us pursuant to the put rights.

DISPOSITION POLICIES

We have no current intention of disposing of any of our properties, although we reserve the right to do so. The tax basis of the limited partners in the properties in the operating partnerships is substantially less than current fair market value. Accordingly, prior to the disposition of their O.P. Units, upon a disposition of any of the properties, a disproportionately large share of the gain for federal income tax purposes would be allocated to the limited partners. For a more detailed discussion of these tax effects, see "Federal Income Tax Considerations- Tax Aspects of the Operating Partnerships." Consequently, it may be in the interests of the limited partners that we continue to hold the properties in order to defer such taxable gain. In light of this tax effect, the operating partnership agreements provide that, until January 2009, or until the Berg Group members and their affiliates, other than us and the operating partnerships, beneficially own, in the aggregate, less than 15% of the outstanding shares of common stock on a fully diluted basis, which is calculated based on all outstanding shares of common stock and all shares of common stock that could be acquired upon the exercise of all outstanding options to acquire our voting stock, as well as all shares of common stock issuable upon exchange of all O.P. Units, if earlier, Mr. Berg and Clyde J. Berg may prohibit the operating partnerships from disposing of properties which they designate in a taxable transaction. Mr. Kontrabecki has a similar right with respect to seven of the properties, which right will lapse before the end of the ten-year period if his beneficial ownership interest falls below 750,000 O.P. Units. The limited partners may seek to cause us to retain the properties even when such action may not be in the interests of some, or a majority, of our stockholders. The operating partnerships will be able to effect "tax-free," like-kind exchanges under Section 1031 of the Code, or in connection with other non-taxable transactions, such as a contribution of property to a new partnership, without obtaining the prior written consent of these individuals. The approval of a majority of our directors, including Mr. Berg or his designee, will be required to sell all or substantially all of our assets. The consent of the holders of a majority of the O.P. Units will be required to effect a sale or sales of all, or substantially all, of the assets of any of the operating partnerships.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

We do not believe that recently issued accounting standards will materially impact our financial position or results of operations.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We use fixed and variable rate debt to finance our operations. Our exposure to market risk for changes in interest rates relates primarily to our current and future debt obligations. We are vulnerable to significant fluctuations of interest rates on our floating rate debt, and pricing on our future debt. The following table provides information about the principal cash flows, weighted average interest rates, and expected maturity dates for debt outstanding as of December 31, 2000. The current terms of this debt are described in Item 7., "Management's Discussion and

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Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources." Average interest rates are based on implied LIBOR for the respective time period. Fair value approximates book value for fixed rate debt. Of the projected fair value of secured notes payable, approximately \$126.8 million represents the Prudential secured loan.

For variable rate debt, the table presents the assumption that the outstanding principal balance at December 31, 2000 will be paid upon maturity in March 2002.

For fixed rate debt, the table presents the assumption that the outstanding principal balance at December 31, 2000 will be paid according to scheduled principal payments and that we will not prepay any of the outstanding principal balance.

| | 2001 ---- | 2002 ---- | 2003 ---- | 2004 ---- | 2005 ---- |
|---|--------------|--------------|--------------|--------------|--------------|
| VARIABLE RATE DEBT: (dollars in thousands) | | | | | |
| Secured notes payable (related parties) | | \$50,886 | | | |
| Average interest rate | | 7.72% | | | |
| FIXED RATE DEBT: | | | | | |
| Secured notes payable | \$4,911 | \$2,334 | \$2,502 | \$2,683 | \$2,877 |
| Average interest rate | 6.72% | 6.72% | 6.72% | 6.72% | 6.72% |

The variable rate debt represented 26.2% and 18.9% and the fixed rate debt represented 73.8% and 81.1% of all debt outstanding for the years ended December 31, 2000 and 1999, respectively. All of the debt is denominated in United States dollars. The weighted average interest rate for variable rate debt was approximately 7.72% and 7.06% for the years ended December 31, 2000 and 1999, respectively. The weighted average interest rate for fixed rate debt was approximately 6.72% and 6.64% for the years ended December 31, 2000 and 1999, respectively.

The primary market risk we face is the risk of interest rate fluctuations. During 2000, the primary market risk we faced was the market risk resulting from increasing LIBOR based interest rates. The Berg Group line of credit is tied to a LIBOR based interest rate that was approximately \$50.1 million, or 26.2%, of the total \$194.6 million of debt as of December 31, 2000. As a result, we pay lower rates of interest in periods of decreasing interest rates and higher rates of interest in periods of increasing interest rates. At December 31, 2000, we had no interest caps or swaps.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MISSION WEST PROPERTIES, INC.

INDEX TO FINANCIAL STATEMENTS

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Report of Independent Accountants

Consolidated Balance Sheets of Mission West Properties, Inc. at December 31, 2000 and 1999
Consolidated Statements of Operations of Mission West Properties, Inc. for the years ended
December 31, 2000, 1999 and 1998

Consolidated Statements of Changes in Stockholders' Equity of Mission West Properties, Inc.
for the years ended December 31, 2000, 1999 and 1998

Consolidated Statements of Cash Flows of Mission West Properties, Inc. for the years ended
December 31, 2000, 1999 and 1998

Notes to the Consolidated Financial Statements

Supplemental Financial Information

Report of Independent Accountants

Schedule III: Real Estate and Accumulated Depreciation of Mission West Properties, Inc. as of
December 31, 2000

Schedule III: Real Estate and Accumulated Depreciation of Mission West Properties, Inc. as of
December 31, 1999

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders
of Mission West Properties, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Mission West Properties, Inc. and its subsidiaries (the "Company") at December 31, 2000 and 1999, and the results of their operations and their cash flows for the years ended December 31, 2000, 1999 and 1998, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

San Francisco, California
January 21, 2001

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MISSION WEST PROPERTIES, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share and per share data)

| ASSETS | December |
|--|------------|
| | 2000 |
| Real estate assets: | |
| Land | \$ 187,219 |
| Buildings and improvements | 654,259 |
| | 841,478 |
| Less accumulated depreciation | (34,022) |
| Net real estate assets | 807,456 |
| Cash and cash equivalents | 4,691 |
| Deferred rent | 10,869 |
| Other assets (net of accumulated amortization of \$706 and \$275 at December 31, 2000 and 1999, respectively) | 3,894 |
| Total assets | \$ 826,910 |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | |
|--|-----------|
| Liabilities: | |
| Line of Credit (related parties) | \$ 50,886 |
| Mortgage notes payable | 132,055 |
| Mortgage notes payable (related parties) | 11,643 |
| Interest payable | 347 |
| Security deposits | 4,801 |
| Prepaid rental income | 11,298 |
| Dividends/distributions payable | 19,115 |
| Refundable option payment | 20,835 |
| Accounts payable and accrued expenses | 4,525 |
| Total liabilities | 255,505 |
| Commitments and contingencies (Notes 4, 6, 13 and 15) | |
| Minority interest | 469,332 |
| Stockholders' equity: | |
| Preferred stock, no par value, 200,000 shares authorized, none issued and outstanding | - |
| Common stock, \$.001 par value at December 31, 2000 and 1999, 200,000,000 shares authorized, 17,025,365 shares and 16,972,374 shares issued and outstanding at December 31, 2000 and 1999, respectively | 17 |
| Paid-in capital | 123,136 |

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| | |
|--|------------|
| Accumulated deficit | (21,080) |
| Total stockholders' equity | 102,073 |
| Total liabilities and stockholders' equity | \$ 826,910 |

See notes to consolidated financial statements

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MISSION WEST PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share data)

| | Year Ended December 31, | | |
|---|-------------------------|-----------|-------------|
| | 2000 | 1999 | 1998 |
| Revenue: | | | |
| Rental revenues from real estate | \$ 99,567 | \$ 73,726 | \$ 27,440 |
| Tenant reimbursements | 14,635 | 11,047 | 4,220 |
| Other income, including interest | 1,742 | 1,220 | 1,220 |
| | 115,944 | 85,993 | 31,880 |
| Expenses: | | | |
| Property operating, maintenance and real estate taxes | 15,025 | 11,467 | 4,220 |
| Interest | 8,290 | 11,623 | 4,220 |
| Interest (related parties) | 4,475 | 2,246 | 3,220 |
| General and administrative expenses | 1,065 | 1,185 | 1,220 |
| Depreciation | 15,456 | 13,156 | 5,220 |
| | 44,311 | 39,677 | 19,100 |
| Income before minority interest | 71,633 | 46,316 | 11,780 |
| Minority interest | 59,054 | 39,785 | 12,220 |
| Net income (loss) | \$ 12,579 | \$ 6,531 | \$ (10,440) |
| Per share amounts: | | | |
| Basic net income (loss) per share | \$ 0.73 | \$ 0.52 | \$ (0.68) |
| Diluted net income (loss) per share | \$ 0.72 | \$ 0.52 | \$ (0.68) |

See notes to consolidated financial statements

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MISSION WEST PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Dollars in thousands, except share data)

| | Shares of Common Stock Outstanding | Common Stock | Paid-in Capital | Amounts Receivable on Private Placement |
|---|---------------------------------------|-----------------|--------------------|---|
| Balance, December 31, 1997 | 1,501,104 | | \$ 26,707 | \$ (334) |
| Issuance of common stock upon option exercise | 225,000 | | 1,013 | (900) |
| Issuance of common stock upon private placement | 6,495,058 | | 27,827 | |
| Amounts received from 1997 private placements | | | | 334 |
| Odd lot tender offer | (2,568) | | (11) | |
| Net (loss) | | | | |
| Reincorporation (Note 1) | | \$ 8 | (8) | |
| Balance, December 31, 1998 | 8,218,594 | 8 | 55,528 | (900) |
| Issuance of common stock upon option exercise | 191,920 | | 863 | |
| Issuance of common stock from public offering | 8,680,000 | 9 | 66,891 | |
| Odd lot tender offer | (779) | | (8) | |
| Repurchase of common stock | (117,361) | | (528) | 528 |
| Amounts received from 1998 private placements | | | | 372 |
| Dividends declared | | | | |
| Net income | | | | |
| Balance, December 31, 1999 | 16,972,374 | 17 | 122,746 | - |
| Issuance of common stock upon option exercise | 52,991 | | 390 | |
| Dividends declared | | | | |
| Net income | | | | |
| Balance, December 31, 2000 | 17,025,365 | \$ 17 | \$123,136 | - |

See notes to consolidated financial statements

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MISSION WEST PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

| | Year Ended December 31, | | |
|--|-------------------------|----------|------|
| | 2000 | 1999 | 1998 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income (loss) | \$ 12,579 | \$ 6,531 | \$ |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | |
| Minority interest | 59,054 | 39,785 | 1 |
| Depreciation | 15,456 | 13,156 | |
| Other | (364) | - | |
| Change in operating assets and liabilities: | | | |
| Deferred rent | (4,905) | (4,340) | (|
| Other assets | (942) | (604) | (|
| Interest payable | (658) | 373 | |
| Security deposits | 1,854 | 127 | |
| Prepaid rental income | 3,064 | 4,555 | |
| Accounts payable and accrued expenses | (558) | 714 | |
| Net cash provided by operating activities | 84,580 | 60,298 | 1 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Improvements to real estate | (2,007) | (33,648) | |
| Refundable option payment | (729) | 21,564 | |
| Net cash used in investing activities | (2,736) | (12,084) | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Net repayments on line of credit | - | (27,201) | (1 |
| Proceeds from mortgage notes payable | - | - | 13 |
| Principal payments on mortgage notes payable | (1,897) | (23,236) | (1 |
| Principal payments on mortgage notes payable (related parties) | (149) | (53,068) | (14 |
| Net payments under line of credit (related parties) | (69,015) | - | |
| Payments on receivable from private placements | - | 372 | |
| Net proceeds from issuance of common stock | - | 66,900 | 2 |
| Net proceeds from exercise of stock options | 290 | 863 | |
| Repurchase of common stock | - | (8) | |
| Minority interest distributions | (2,048) | (1,844) | |
| Dividends | (10,887) | (4,685) | |
| Net cash used in financing activities | (83,706) | (41,907) | (2 |
| Net (decrease) increase in cash and cash equivalents | (1,862) | 6,307 | (|
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 6,553 | 246 | |
| CASH AND CASH EQUIVALENTS, END OF YEAR | \$ 4,691 | \$ 6,553 | \$ |

Please refer to Note 14 for supplemental cash flow information.

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See notes to consolidated financial statements

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MISSION WEST PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

1. ORGANIZATIONS AND FORMATION OF THE COMPANY

Mission West Properties, Inc. ("the Company") is a fully integrated, self-managed real estate company that acquires and manages office/research and development/manufacturing ("R&D") properties in the portion of the San Francisco Bay Area commonly referred to as Silicon Valley. In July 1998, the Company acquired control of four existing limited partnerships (referred to collectively as the "operating partnerships"), by becoming the sole general partner in each one effective July 1, 1998 for financial accounting and reporting purposes ("the Acquisition"). The Company purchased an approximate 12.11% interest in each of the operating partnerships. The Company effected the purchase of its general partnership interests by issuing to the operating partnerships separate demand notes bearing interest at 7.25% per annum (the "Demand Notes"). The total principal amount of the Demand Notes issued was \$35,200. All limited partnership interests in the operating partnerships were converted into 59,479,633 units of limited partnership interest ("O.P. Units"), which represented an ownership interest of approximately 87.89% of the operating partnerships. The operating partnerships are the vehicles through which the Company will own its assets, will make its future acquisitions, and generally conduct its business.

On December 30, 1998, the Company was reincorporated under the laws of the State of Maryland through a merger with and into Mission West Properties, Inc. Accordingly, shares of the former company, Mission West Properties, a California corporation (no par), which were outstanding at December 30, 1998, were converted into shares of common stock (\$.001 par value per share) on a one-for-one basis.

As of December 31, 2000, the Company owns a general partnership interest of 18.15%, 21.36%, 15.38% and 12.21% in Mission West Properties, L.P., Mission West Properties, L.P. I, Mission West Properties, L.P. II and Mission West Properties, L.P. III, respectively, for a 16.92% general partnership interest in the operating partnerships, taken as a whole, on a weighted average basis.

The Company, through the operating partnerships, owns interests in 89 R&D properties, all of which are located in the Silicon Valley.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION AND FINANCIAL STATEMENT PRESENTATION:

The accompanying consolidated financial statements include the accounts of the Company and its controlled subsidiaries, the operating partnerships, which include a 50% joint venture (the "Company"). All significant intercompany transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") in the United States of America

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requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

REAL ESTATE ASSETS:

Real estate assets are stated at the lower of cost or fair value. Cost includes expenditures for improvements or replacements. Maintenance and repairs are charged to expense as incurred. Gains and losses from sales are included in income in accordance with Statement of Financial Accounting Standard ("SFAS") No. 66, Accounting for Sales of Real Estate.

The Company reviews real estate assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the carrying amount of the asset exceeds its estimated undiscounted net cash flow, before interest, the Company will recognize an impairment loss equal to the difference between its carrying amount and its fair value. If impairment is recognized, the reduced carrying amount of the asset will be accounted for as its new cost. For a depreciable asset, the new cost will be depreciated over the asset's remaining useful life. Generally, fair values are estimated using discounted cash flow, replacement cost or market comparison analyses. The process of evaluating for impairment requires estimates as to future events and conditions, which are subject to varying market and economic factors. Therefore, it is reasonably possible that a change in estimate resulting from judgments as to future events could occur which would affect

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MISSION WEST PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

the recorded amounts of the property. As of December 31, 2000 and 1999, the properties' carrying values did not exceed the estimated fair values.

DEPRECIATION:

Depreciation is computed using the straight-line method over estimated useful lives of 40 years for buildings and improvements.

CASH AND CASH EQUIVALENTS:

The Company considers highly liquid short-term investments with initial maturities of three months or less to be cash equivalents.

Cash and cash equivalents are primarily held in a single financial institution, and at times, such balances may be in excess of the Federal Deposit Insurance Corporation insurance limit.

OTHER ASSETS:

Included in other assets are costs associated with obtaining debt financing. Such costs are being amortized over the term of the associated debt, by a method that approximates the effective interest method.

REVENUE RECOGNITION:

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Rental income is recognized on the straight-line method of accounting required by GAAP under which contractual rent payment increases are recognized evenly over the lease term. The difference between recognized rental income and rental cash receipts is recorded as deferred rent on the balance sheet. Certain lease agreements contain terms that provide for additional rents based on reimbursement of certain costs. These additional rents are reflected on the accrual basis.

INCOME TAXES:

The Company has been taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended, (the "Code") commencing with the taxable year ended December 31, 1999. In order for the Company to qualify as a REIT, it must distribute annually at least 95% of its REIT taxable income, as defined in the Code, to its stockholders and comply with certain other requirements. Effective January 1, 2001, this requirement was changed to 90%, the minimum percentage that the Company must distribute to its stockholders. Accordingly, for the years ended December 31, 2000 and 1999, no provision for federal income taxes has been included in the accompanying consolidated financial statements.

For the year ended December 31, 2000, the Company's total dividends paid or payable to the stockholders represent 100% ordinary income for income tax purposes.

For the year ended December 31, 1998, income taxes were accounted for in accordance with SFAS No. 109, ACCOUNTING FOR INCOME TAXES. Deferred income taxes were provided for all temporary differences and operating loss and tax credit carry forwards. Deferred tax assets were reduced by a valuation allowance when, in the opinion of management, it was more likely than not that some portion or all of the deferred tax assets would not be realized. Deferred tax assets and liabilities were adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Company had no tax liability for the year ended December 31, 1998.

NET INCOME PER SHARE:

The computation of net income per share is based on the weighted average number of common shares outstanding during the period. Diluted earnings per share amounts are based upon the weighted average of common and common equivalent shares outstanding during the year.

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

ACCOUNTING FOR STOCK-BASED COMPENSATION:

SFAS 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, encourages, but does not require companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant

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over the amount an employee must pay to acquire the stock.

FAIR VALUE OF FINANCIAL INSTRUMENTS:

The Company's financial instruments include cash, receivables, payables and debt. Considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

Based on borrowing rates currently available to the Company, the carrying amount of mortgage debt and the line of credit, approximate fair value. Cash, receivables and payables are also carried at amounts that approximate fair value due to their short-term maturities.

CONCENTRATION OF CREDIT RISK

The Company's properties are not geographically diverse, and our tenants operate primarily in the information technology industry. Additionally, because the properties are leased to 98 tenants, default by any major tenant could significantly impact the results of the consolidated total. One tenant, Microsoft Corporation, accounted for approximately 19.9% and 18.0% of the Company's rental revenues for the years ended December 31, 2000 and 1999, respectively, with the next largest tenant accounting for 6.7% and 9.1%, respectively, of total rental revenues. Rental income from Microsoft Corporation was \$18,803 and \$13,249 for the years ended December 31, 2000 and 1999, respectively. Future minimum rents from this tenant are \$111,694. For the year ended December 31, 1998, Apple Computers, Inc. accounted for approximately 12.2% of the Company's rental revenues, with the next largest tenant accounting for 6.6% of total rental revenues. However, management believes the risk of default is reduced because of the nature of these properties for ongoing tenant operations.

3. ACQUISITION

The Acquisition was accounted for as a purchase with the results of the operating partnerships included from July 1, 1998. The fair value of the assets acquired was \$507,807 and liabilities assumed totaled \$239,903.

The pro forma results listed below are unaudited and assume the Acquisition occurred at the beginning of the period.

| | Pro Forma Year Ended December 31, 1998 ----- |
|---|---|
| Total Revenues | \$ 62,253 ----- |
| Expenses: | |
| Operating, maintenance and real estate taxes | 9,251 |
| Interest expenses (including related parties) | 17,631 |
| General and administrative expenses | 1,501 |
| Depreciation and amortization | 10,781 |

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| | |
|---|--------|
| | ----- |
| | 39,164 |
| | ----- |
| Income before minority interest, gain on sale of real estate and income taxes | 23,089 |
| Minority interest | 22,541 |
| | ----- |
| Income before gain on real estate and income taxes | 548 |
| Gain on sale of real estate | - |
| | ----- |
| Income before income taxes | 548 |
| Provision for income taxes | 142 |
| | ----- |
| Net income | \$ 408 |
| | ===== |
| Basic and diluted net income per share | \$.24 |
| | ===== |

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

4. STOCK TRANSACTIONS

On December 29, 1998, the Company completed the sale of 6,495,058 shares of common stock, at a price of \$4.50 per share to a number of accredited investors in two separate private placements. The aggregate proceeds to the Company, net of fees and offering costs, were \$27,827. The proceeds were used to pay a portion of the outstanding amounts under the Demand Notes due the operating partnerships. As of December 31, 2000 and 1999, \$1,186 and \$1,103, respectively, remained outstanding under the Demand Notes. The Demand Notes, along with the interest expense (interest income to the operating partnerships), are eliminated in consolidation and are not included in the corresponding line items within the consolidated financial statements.

The limited partners of the operating partnerships have the right to tender their O.P. Units to the Company for shares of common stock or, at the Company's election, for cash. Each of the limited partners of the operating partnerships (other than Carl E. Berg and Clyde J. Berg) has the annual right to exercise put rights and cause the operating partnerships to purchase a portion of the limited partner's O.P. Units at a purchase price based on the average market value of the common stock for the 10-trading day period immediately preceding the date of tender, generally limited to one-third of the aggregate number of O.P. Units owned by each limited partner. Upon the exercise of any such right by a limited partner, the Company will have the option to purchase the tendered O.P. Units with available cash, borrowed funds or the proceeds of an offering of newly issued shares of common stock. These put rights are available once a year. If the total purchase price of the O.P. Units tendered by all of the eligible limited partners in one year exceeds \$1 million, the Company or the operating partnerships will be entitled to reduce proportionately the number of O.P. Units to be acquired from each tendering limited partner so that the total purchase price does not exceed \$1 million. There were no O.P. Units tendered in 2000 or 1999.

On March 30, 1998, the Company issued 200,000 shares of common stock at \$4.50 per share to Michael Anderson, Chief Operating Officer and a director

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of the Company, in exchange for a \$900 note receivable payable to the Company. The note was a full recourse promissory note bearing interest at 5.59% and was collateralized by a pledge of the shares. Effective April 30, 1999, Mr. Anderson resigned from the Company. Upon Mr. Anderson's resignation, the Company, in accordance with the terms of its agreements with Mr. Anderson, repurchased and subsequently canceled 117,361 of the 200,000 shares of common stock, representing \$528 of the original \$900 note receivable. The remaining portion of the note receivable in the amount of \$372 was paid in full.

During the second and fourth quarters of 1998, the Company received total payments of \$334 relating to amounts receivable from the private placements of shares of common stock in November 1997.

In July 1999, the Company completed a public offering at 8,680,000 shares of its common stock at \$8.25 per share. The net proceeds of approximately \$66,900, after deducting underwriting discounts and other offering costs, were used to reduce the outstanding balance on the line of credit with Wells Fargo Bank, N.A. ("Wells Fargo line") by approximately \$41,000 and to reimburse Microsoft Corporation for approximately \$25,000 for shell and tenant improvements on the Microsoft project. The remaining net proceeds of approximately \$900 were retained for general corporate purposes.

During the year ended December 31, 2000, options were exercised for a total of 52,991 shares. Options to purchase 39,237 shares were exercised at \$4.50 per share and options to purchase 13,754 shares were exercised at \$8.25 per share. Total proceeds to the Company were \$290.

5. MINORITY INTEREST

Minority interest represents the separate private ownership of the operating partnerships, by the Berg Group and other non-affiliate interests. In total, these interests account for 83.08% and 81.72%, on a weighted average basis, of the ownership interests in the real estate operations of the Company as of December 31, 2000 and 1999, respectively. Minority interest in earnings has been calculated by taking the net income of the operating partnerships (on a stand-alone basis) multiplied by the respective minority interest ownership percentage.

There are three properties (owned through three separate joint ventures) for which 100% of the ownership is not held within the operating partnerships. The operating partnerships own an 83.33% interest in the first joint venture, a 75% interest in the second joint venture, and a 50% interest in the third joint venture. For the years ended December 31, 2000, 1999, and the period of July 1, 1998 through December 31, 1998, income associated with the interests held by the non-affiliated third parties of these properties is \$481, \$113, and \$42, respectively.

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

6. REAL ESTATE

PENDING PROJECTS ACQUISITION AGREEMENT

The Company had entered into the pending projects acquisition agreement under which the Company would acquire, through the operating partnerships, approximately one million additional rentable square feet upon the

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completion and leasing of a number of pending development projects owned by certain members of the Berg Group. As of December 31, 2000, the Company had completed all twelve acquisitions under the pending projects acquisition agreement representing 1,015,252 rentable square feet (see Property Acquisitions below). The pending projects acquisition agreement was terminated in December 2000 when the last property contemplated for development was completed, leased and purchased by the Company.

The pending projects acquisition agreement provided for the Company to purchase the proposed properties once each building was fully completed and leased. The Company entered into the purchase agreement and became obligated to purchase such properties only when the above criteria were met. If such development properties were not approved, constructed, completed and/or leased, the Company had no obligation to purchase them. During the development, construction and lease-up of the properties, the Berg Group retained all risks and rewards of ownership. The risk of construction cost overruns, financial carrying costs and other potential delay costs of development, construction and leasing were the sole responsibility of the Berg Group. The Company provided no capital in the form of equity or debt to the Berg Group in connection with the development of the properties and had no input as to the design, construction or leasing of the projects. Each individual property acquisition agreement was not entered into and the acquisitions were not consummated until the property was fully completed and leased. Once those conditions were met the Company purchased the building. Upon the consummation of the purchase transaction, the property was recorded on the Company's balance sheet at the fair market value of the consideration exchanged at the date the transaction was consummated.

The sellers of the pending development projects may have elected to receive cash or O.P. Units at a value of \$4.50 per unit, which was set in May 1998 based on the \$4.50 per share price of the Company's common stock agreed to in private placement transactions at that time. The acquisition value to be received by the sellers was fixed based upon the capitalized rental value of the property when fully completed and leased or approved by the independent directors committee if the sellers elected to receive cash. If the sellers elected to receive O.P. Units, which were issued at \$4.50 per unit, the acquisition value would be based upon the capitalized rental value of the property when fully completed and leased and the value of the Company's common stock on the date of acquisition, or approved by the independent directors committee. The underlying value of the O.P. Units was the variable impacting the acquisition value. Since the value of the O.P. Units was fixed at \$4.50 per unit, for the purposes of calculating the number of units to be distributed to the sellers, any increase in the value of the O.P. Units increased the acquisition price paid by the Company for the individual properties based on the value of the O.P. Units at the time the acquisitions were closed. As the market value price of a share of common stock exceeded the \$4.50 price for much of the period subsequent to May 1998, this valuation represented a substantial discount from the current market value of the common stock that may be issued in exchange for these O.P. Units. Because the value of the properties increased as rental rates increased, more O.P. Units were distributed than contemplated during the negotiation of the original pending projects acquisition agreement in May 1998. Under GAAP, the acquisition cost in the form of O.P. Units issued were valued based upon the current market value of the Company's common stock on the date the acquisition closed. Consequently, the Company's actual accounting cost of these acquisitions depended in large part on the percentage of the fixed acquisition value paid for by the issuance of O.P. Units and the price of the Company's common stock on the closing of the acquisition. For properties acquired during 2000 and 1999 under the pending projects acquisition agreement, the difference resulted in an increase of approximately \$68.0 million in the acquisition cost for accounting purposes

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compared to the fixed acquisition value contemplated at the time the agreement was entered into.

BERG LAND HOLDINGS OPTION AGREEMENT

Under the terms of the Berg land holdings option agreement, the Company, through the operating partnerships, has the option to acquire any future R&D property developed by the Berg Group on land currently owned or optioned, or acquired for these purposes in the future, directly or indirectly, by Carl E. Berg or Clyde J. Berg. At present, there are approximately 368 acres of Silicon Valley land, including land under development, owned directly or under 50% joint venture by certain members of the Berg Group that are subject to the terms of the Berg land holdings option agreement. The owners of the future R&D property developments may obtain cash or, at their option, O.P. Units valued at the average closing price of the shares of common stock over the 30-trading-day period preceding the acquisition date. To date, the Company has completed eight acquisitions under the Berg land holdings option agreement representing approximately 826,317 rentable square feet (see Property Acquisitions below). Upon the Company's exercise of an option to purchase any of the future R&D property developments, the acquisition price will equal the sum of (a) the full construction cost of the building; plus (b) 10% of the full construction cost of

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

the building; plus (c) interest at LIBOR (London Interbank Offer Rate) plus 1.65% on the amount of the full construction cost of the building for the period from the date funds were disbursed by the developer to the close of escrow; plus (d) the original acquisition cost of the parcel on which the improvements will be constructed, which range from \$8.50 to \$20.00 per square foot for land currently owned; plus (e) 10% per annum of the amount of the original acquisition cost of the parcel from the later of January 1, 1998 and the seller's acquisition date to the close of escrow; minus (f); the aggregate principal amount of all debt encumbering the acquired property, or a lesser amount as approved by the independent directors committee.

No estimate can be given at this time as to the total cost to the Company to acquire projects under the Berg land holdings option agreement, or the timing as to when the Company will acquire such projects. However, the Berg Group is currently constructing 21 properties with a total of 1,809,352 rentable square feet that the Company has the right to acquire under this agreement. Of the 21 properties, six are approximately 50% joint ventures consisting of approximately 471,000 rentable square feet. As of December 31, 2000, the estimated acquisition value to the operating partnerships for these 21 projects is approximately \$217.0 million. The final acquisition price of these 21 properties could differ significantly from this estimate. In addition to projects currently under development, the Company has the right to acquire future developments by the Berg Group on up to 257 additional acres of land currently controlled by the Berg Group, which could support approximately 4.06 million square feet of new developments. Under the Berg land holdings option agreement, as long as the Berg Group ownership in the Company and the operating partnerships taken as a whole is at least 65%, the Company also has an option to purchase all land acquired, directly or indirectly, by Carl E. Berg or Clyde J. Berg in the future which has not been improved with completed buildings and which is zoned for, intended for or appropriate for research and development, office

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and/or industrial development or use in the states of California, Oregon, and Washington.

PROPERTY ACQUISITIONS (UNAUDITED)

As of December 31, 2000, the Company had acquired twenty R&D properties under its agreements with the Berg Group. All twenty of these acquisitions are currently 100% occupied by one or more tenants.

The following table provides unaudited information as to the estimated fair market value, calculated using an estimated capitalization rate based upon the first year's cash rent, and the actual acquisition price paid by the operating partnerships:

| Property | First Year's Rent Per Square Foot | Rentable Square Footage | Estimated Fair Value |
|------------------------|--|-------------------------------|-------------------------|
| 2000 ACQUISITIONS | | | |
| 1756 Automation Pkwy | \$1.81 | 80,640 | \$ 16,367 |
| 800 Branham Lane | \$1.14 | 239,000 | 32,054 |
| 255 Caspian Way | \$1.70 | 98,500 | 20,094 |
| 1762 Automation Pkwy | \$2.75 | 61,100 | 20,196 |
| 5300-50 Hellyer Ave | \$1.60 | 160,000 | 30,720 |
| 5400 Hellyer Ave | \$1.52 | 77,184 | 14,078 |
| 45365 Northport Loop | \$1.58 | 64,218 | 12,140 |
| 1768 Automation Pkwy | \$2.31 | 110,592 | 30,432 |
| Subtotal | | 891,234 | 176,081 |
| 1999 ACQUISITIONS | | | |
| 6810 Santa Teresa Blvd | \$1.38 | 54,996 | 9,107 |
| 1065 L'Avenida | \$2.95 | 515,700 | 182,558 |
| 1750 Automation Pkwy | \$1.69 | 80,640 | 16,354 |
| 1700 Richard Ave | \$0.80 | 58,783 | 5,940 |
| 5749 Fontanoso Way | \$1.30 | 77,700 | 12,121 |
| Subtotal | | 787,819 | 226,080 |
| 1998 ACQUISITIONS | | | |
| 1650 Richard Ave | \$1.06 | 52,800 | 6,716 |
| 5850 Hellyer Ave | \$0.99 | 109,715 | 13,034 |
| Subtotal | | 162,515 | 19,750 |
| Total | | 1,841,568 | \$421,911 |

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MISSION WEST PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

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During the third quarter of 1999, the Company entered into a new lease agreement for 2001 Logic Drive with Xilinx Incorporated ("Xilinx"). The lease agreement includes an option granted to Xilinx to purchase the building at a predetermined price. In September 1999, in accordance with the option provisions of the lease agreement, Xilinx paid to us a deposit of approximately \$21.6 million to secure its option right. Originally, the option was exercisable only between April 30, 2000 and July 31, 2000. In July 2000, Xilinx and the Company agreed to extend the option period for two years until July 31, 2002. Xilinx and the Company further agreed to reduce the deposit by \$167 per month commencing August 1, 2000 until the later of: (1) the transfer of title to the property to Xilinx or (2) July 31, 2002. Upon exercise of the option, the Company must refund the remaining deposit amount and Xilinx must deposit into escrow funds equal to the purchase price. In the event Xilinx does not exercise its option, the Company must refund the remaining deposit in full to Xilinx, without interest.

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

7. DEBT

The following table sets forth certain information regarding debt outstanding as of December 31, 2000 and 1999.

| Debt Description | Collateral Properties | Balance At December 31, | |
|---|--|----------------------------|------|
| | | 2000 | 1999 |
| Line of Credit: | | | |
| Berg Group (related parties) | 2033-2043 Samaritan Drive, San Jose, CA | \$ 50,886 | |
| | 2133 Samaritan Drive, San Jose, CA | | |
| | 2233-2243 Samaritan Drive, San Jose, CA | | |
| | 1310-1450 McCandless Drive, Milpitas, CA | | |
| | 1315-1375 McCandless Drive, Milpitas, CA | | |
| | 1650-1690 McCandless Drive, Milpitas, CA | | |
| | 1795-1845 McCandless Drive, Milpitas, CA | | |
| Mortgage Notes Payable (related parties): | 5300-5350 Hellyer Avenue, San Jose, CA | 11,643 | 31, |
| Mortgage Notes Payable: (3) | | | |
| Prudential Capital Group | 20400 Mariani Avenue, Cupertino, CA | 1,756 | 1, |
| New York Life Insurance Company | 10440 Bubb Road, Cupertino, CA | 377 | |
| Home Savings & Loan Association | 10460 Bubb Road, Cupertino, CA | 423 | |
| Mellon Mortgage Company | 3530 Bassett Street, Santa Clara, CA | 2,735 | 2, |
| Prudential Insurance Company of America (4) | 10300 Bubb Road, Cupertino, CA | 126,764 | 128, |
| | 10500 N. DeAnza Blvd, Cupertino, CA | | |
| | 4050 Starboard Drive, Fremont, CA | | |
| | 45700 Northport Loop, Fremont, CA | | |
| | 45738 Northport Loop, Fremont, CA | | |
| | 450-460 National Ave, Mountain View, CA | | |

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4949 Hellyer Avenue, San Jose, CA
 6311 San Ignacio Avenue, San Jose, CA
 6321 San Ignacio Avenue, San Jose, CA
 6325 San Ignacio Avenue, San Jose, CA
 6331 San Ignacio Avenue, San Jose, CA
 6341 San Ignacio Avenue, San Jose, CA
 6351 San Ignacio Avenue, San Jose, CA
 3236 Scott Blvd, Santa Clara, CA
 3560 Bassett Street, Santa Clara, CA
 3570 Bassett Street, Santa Clara, CA
 3580 Bassett Street, Santa Clara, CA
 1135 Kern Avenue, Sunnyvale, CA
 1212 Bordeaux Lane, Sunnyvale, CA
 1230 E. Arques, Sunnyvale, CA
 1250 E. Arques, Sunnyvale, CA
 1170 Morse Avenue, Sunnyvale, CA
 3540 Bassett Street, Santa Clara, CA
 3542 Bassett Street, Santa Clara, CA
 3544 Bassett Street, Santa Clara, CA
 3550 Bassett Street, Santa Clara, CA

Mortgage Notes Payable

 132,055 133,

Total

 \$194,584 \$165,
 =====

- (1) The debt owed to the Berg Group under the line of credit carries a variable interest rate equal to LIBOR plus 1.30 percent and is payable in full in March 2002. The interest rate was 7.5% at December 31, 2000..
- (2) There was no set repayment plan associated with this debt; payments were made to Berg & Berg Enterprises, Inc. on demand.
- (3) Mortgage notes payable generally require monthly installments of interest and principal over various terms extending through the year 2009. The weighted average interest rate of mortgage notes payable was 6.64% at December 31, 2000 and 1999.
- (4) The Prudential Loan is payable in monthly installments of \$827, which includes principal (based upon a 30-year amortization) and interest. John Kontrabecki, one of the limited partners, has guaranteed approximately \$12,000 of this debt. Costs and fees incurred with obtaining this loan aggregated approximately \$900.

Scheduled principal payments on debt for the years ending are as follows:

| | Mortgage Notes Payable (Including Related Parties) | Berg Group Lin (Related |
|-------------------|--|-------------------------------|
| | ----- | ----- |
| December 31, 2001 | \$ 4,911 | |
| December 31, 2002 | 2,334 | \$5 |
| December 31, 2003 | 2,502 | |
| December 31, 2004 | 2,683 | |
| December 31, 2005 | 2,877 | |

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| | | |
|------------|-----------|-------|
| Thereafter | 128,391 | |
| | ----- | ----- |
| | \$143,698 | \$5 |
| | ===== | ===== |

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MISSION WEST PROPERTIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
 (Dollars in thousands, except share and per share data)

8. OPERATING PARTNERSHIP DISTRIBUTIONS

During 2000, the Company, as general partner of the operating partnerships, declared quarterly distributions aggregating \$0.68 per O.P. Unit for total distributions of \$66,993, including \$19,115 payable in January 2001. Total distributions attributable to O.P. Units owned by various members of the Berg Group were \$52,478. The entire amount was treated as a draw on the Berg Group line of credit.

During 1999, the Company, as general partner of the operating partnerships, declared quarterly distributions aggregating \$0.56 per O.P. Unit for total distributions of \$47,705, including \$13,975 payable in January 2000. Total distributions attributable to O.P. Units owned by various members of the Berg Group were \$38,090. Of this amount, \$27,307 was converted to related party debt during the year ended December 31, 1999, and the remaining distributions of \$10,783 were borrowed from the Berg Group line of credit in January 2000.

On December 28, 1998, the Company, as general partner of the operating partnerships, declared a \$0.17 per O.P. Unit distribution for total distributions of \$11,633. Of this amount, \$9,599 was owed to various members of the Berg Group and was converted to related party debt on December 31, 1998. The Company received \$1,408 that was used to repay amounts outstanding under the Demand Notes owed to the operating partnerships. A distribution in the amount of \$298 was attributable to units held by John Kontrabecki and was applied against amounts owed by him to the operating partnerships as of December 31, 1998. The remaining amount of \$328, which was owed to other O.P. Unit holders was included in accounts payable and accrued expenses in the consolidated balance sheet as of December 31, 1998. The \$328 was paid in January 1999.

9. STOCK-BASED COMPENSATION PLANS

The Company's 1997 Stock Option Plan was approved by the Company's shareholders on November 10, 1997. The 1997 Stock Option Plan was adopted so that the Company may attract and retain the high quality employees, consultants and directors necessary to build the Company's infrastructure and to provide ongoing incentives to the Company's employees in the form of options to purchase the Company's common stock by enabling them to participate in the Company's success.

The 1997 Stock Option Plan provides for the granting to employees, including officers (whether or not they are directors) of "incentive stock options" within the meaning of Section 422 of the Code, and for the granting of non-statutory options to employees, consultants and directors of the Company. Options to purchase a maximum of 5,500,000 shares of common stock may be granted under the 1997 Stock Option Plan, subject to equitable adjustments to reflect certain corporate events. During 2000, options were

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granted to five employees and three directors totaling 256,000 and 96,000, respectively, which become exercisable in quarterly installments equal to 1/16th of the underlying shares beginning on the first month anniversary of the grant date. Additionally, during 2000, one employee was granted an option for 80,000 shares that become exercisable as follows: a) 8,000 shares on March 14, 2001; b) each month thereafter for 36 months, an additional 2,000 shares. All options granted to employees in 1998 become exercisable as follows: a) six months from date of grant, 6.25%; b) one year from date of grant, an additional 12.50%; c) each month thereafter for 36 months, an additional 2.26%. Each option has a term of six years from the date of grant subject to earlier termination in certain events related to termination of employment. Options granted to directors will become exercisable cumulatively with respect to 1/48th of the underlying shares on the first day of each month following the date of grant. Generally, the options must be exercised while the optionee is a director of the Company. The option price is equal to the fair market value of the common stock on the date of grant.

The remaining contractual lives of unexercised options granted range from January 2004 to October 2006. All options granted during 2000 have a \$13.00 and \$8.25 option price per share.

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MISSION WEST PROPERTIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
 (Dollars in thousands, except share and per share data)

The following table shows the activity and detail for the 1997 Stock Option Plan.

| | 1997 Stock Option Plan | Option Price Per Share |
|----------------------------|---------------------------|---------------------------|
| | ----- | ----- |
| Balance, December 31, 1998 | 680,000 | |
| Options granted | 337,000 | \$8.25 |
| Options exercised | (191,920) | |
| Options cancelled | (299,722) | |
| | ----- | |
| Balance, December 31, 1999 | 525,358 | |
| Options granted | 80,000 | \$8.25 |
| Options granted | 352,000 | \$13.00 |
| Options exercised | (52,991) | |
| Options cancelled | (113,867) | |
| | ----- | |
| Balance, December 31, 2000 | 790,500 | |
| | ===== | |

As of December 31, 2000, 4,239,589 additional options were available for grant. None of the options granted are contingent upon the attainment of performance goals or subject to other restrictions. As of December 31, 2000, outstanding options to purchase 158,527 shares of common stock were exercisable.

The Company applies APB 25 and related interpretations in accounting for its stock-based compensation plans. Accordingly, no compensation expense

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has been recognized for its stock-based compensation plans. Had compensation cost for the Company's stock option plans been determined based upon the fair value at the grant date for awards under these plans consistent with the methodology prescribed under SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's net income and net income per share would have been decreased by approximately \$634 or \$.04 per share, resulting in a total consolidated net income of \$11,945 or \$0.68 per share on a diluted basis, for the year ended December 31, 2000. The estimated fair value of the options granted during 2000 ranged from \$9.32 to \$14.56 per share on the date of grant using the Black-Scholes option pricing model with the following assumptions: dividend yield of 8%, volatility of 25.37%, risk free rates of 5.70% to 6.61% and an expected life of 4 years. For the year ended December 31, 1999, the Company's net income and net income per share would have been decreased by approximately \$132 or \$.02 per share, resulting in a total consolidated net income of \$6,399 or \$0.51 per share. The estimated fair value of the options granted during 1999 was \$9.20 per share on the date of grant using the Black-Scholes option pricing model with the following assumptions: dividend yield of 8%, volatility of 24.56%, risk free rate of 5.65% and an expected life of 5 years. For the year ended December 31, 1998, the Company's net loss and net loss per share would have been increased by approximately \$146 or \$.09 per share, resulting in a total consolidated net loss of \$367 or \$.21 per share. The estimated fair value of the options granted during 1998 ranged from \$4.95 to \$5.01 per share on the date of grant using the Black-Scholes option pricing model with the following assumptions: dividend yield of 8%, volatility of 24.07%, risk free rates of 4.53% to 5.72% and an expected life of 5 years.

The Company has adopted an employee investment plan (the "Plan"), under Section 401(k) of the Internal Revenue Code. Employees who are at least 21 years old and who have completed six months of eligibility service may become participants in the Plan. Each participant may make contributions to the Plan through salary deferrals in amounts of at least 1% to a maximum of 15% of the participant's compensation, subject to certain limitations imposed by the Internal Revenue Code. The Company contributes an amount up to 15% of the participant's compensation contributed, based upon management's discretion. A participant's contribution to the Plan is 100% vested and nonforfeitable. A participant will become vested in 100% of the Company's contributions after two years of eligible service. For the years ended December 31, 2000 and 1999, the Company recognized \$40 and \$46 of expense for employer contributions made in connection with this plan, respectively.

10. NET INCOME PER SHARE

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted net income per share is computed by dividing net income by the sum of weighted-average number of common shares outstanding for the period plus the assumed exercise of all dilutive securities.

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MISSION WEST PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

The computation for weighted average shares is detailed below:

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| | Year Ended December 31, 2000 | Year Ended December 31, 1999 |
|---|------------------------------------|------------------------------------|
| | ----- | ----- |
| Weighted average shares outstanding (basic) | 17,016,660 | 12,553,854 |
| Incremental shares from assumed option exercise | 493,990 | 104,586 |
| | ----- | ----- |
| Weighted average shares outstanding (diluted) | 17,510,650 | 12,658,440 |
| | ===== | ===== |

The outstanding O.P. Units have been excluded from the diluted net income per share calculation as there would be no effect on the amounts since the minority interests' share of income would also be added back to net income. O.P. Units outstanding at December 31, 2000 and 1999 were 83,576,027 and 76,205,789, respectively.

11. OTHER INCOME

IN May 2000, we entered into a ten-year lease with ONI Systems Corporation ("ONI") for 444,500 square feet of space to be constructed by the Berg Group on land that is subject to the Berg land holdings option agreement. As partial consideration for the lease, we were allowed to purchase 100,000 shares of ONI common stock in its initial public offering. We purchased and then sold all of the shares and realized net proceeds of \$6.3 million. Of this amount, we recognized \$501,000 during the second quarter with the balance deferred as prepaid rent that we are amortizing ratably over the ten-year lease term. We may on occasion receive equity instruments from tenants that may lease our properties, in the course of our business.

12. RELATED PARTY TRANSACTIONS

As of December 31, 2000 and 1999, the Berg Group owned 79,255,425 and 71,885,187 O.P. Units, respectively, of the total 83,576,027 and 76,205,789 O.P. Units issued and outstanding, respectively. Along with the Company's common shares owned by the Berg Group, the Berg Group's interest in the Company represents 78.8% and 77.2% of the Company as of December 31, 2000 and 1999, respectively, assuming conversion of the O.P. Units into common shares of the Company.

During 2000 the Company acquired nine R&D properties, all located in Silicon Valley. These acquisitions added approximately 891,000 square feet of rentable space and were acquired from the Berg Group under the Berg land holdings option agreement and the pending projects acquisition agreement. The total gross acquisition price for these nine properties was approximately \$122.9 million. The Company financed these acquisitions by borrowing \$39.9 million under our line of credit from the Berg group, issuing an \$11.8 million note to the Berg Group, assuming other liabilities of \$2.6 million, and issuing 7,370,238 O.P. Units to various members of the Berg Group.

In connection with the Acquisition, through the operating partnerships, the Company assumed certain liabilities that included amounts due to the Berg Group in the amount of \$1,989 for management fees and interest expense. Such amounts were paid as of December 31, 1998.

As of December 31, 2000 and 1999, debt in the amount of \$50,886 and \$31,193, respectively, was due the Berg Group under the line of credit.

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This amount includes \$51,732 and \$36,380 of debt assumed in connection with the acquisitions of properties from the Berg Group in 2000 and 1999, respectively (see Note 6). Additionally, during 2000 and 1999, the operating partnerships declared distributions of \$0.68 and \$0.56 per O.P. Unit, respectively. The amount of these distributions payable to various members of the Berg Group was \$48,202 and \$27,307 during 2000 and 1999, respectively. Interest expense incurred in connection with debt due the Berg Group was \$3,914, \$2,246 and \$3,511 for the years ended December 31, 2000, 1999 and 1998, respectively.

As of December 31, 2000, debt in the amount of \$11,643 was due the Berg Group under a mortgage note established May 15, 2000 in connection with the acquisition of a 50% interest in Hellyer Avenue Limited Partnership, the obligor under the mortgage note. The mortgage note bears interest at 7.65%, and is due in ten years with principal payments amortized over 20 years.

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Dollars in thousands, except share and per share data)

Carl E. Berg has a significant financial interest in one company that leases space from the operating partnerships. This company occupies, in the aggregate, 5,862 square feet at a rate of \$0.93 per square foot per month. This lease was in effect prior to the Company's acquisition of its general partnership interests. The lease expires in 2001.

The Company currently leases space owned by Berg & Berg Enterprises, Inc. an affiliate of Carl E. Berg and Clyde J. Berg. Rental amounts and overhead reimbursements paid to Berg & Berg Enterprises, Inc. were \$80 for the years ended December 31, 2000 and 1999.

13. FUTURE MINIMUM RENTS

The Company, through the operating partnerships, owns interests in 89 R&D properties that are leased to tenants under net operating leases with initial terms extending to the year 2015, and are typically subject to fixed increases. Generally, the leases grant tenants renewal options. Future minimum rentals under non-cancelable operating leases, excluding tenant reimbursements of expenses, as of December 31, 2000, are as follows:

| | |
|------------|------------|
| 2001 | \$ 101,353 |
| 2002 | 94,353 |
| 2003 | 87,847 |
| 2004 | 82,217 |
| 2005 | 68,040 |
| Thereafter | 118,608 |
| | ----- |
| Total | \$ 552,418 |
| | ===== |

14. SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest was \$12,676, \$13,406 and \$7,540 for the years ended December 31, 2000, 1999, and 1998, respectively.

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In connection with the Acquisition, the Company, through the operating partnerships, acquired assets with a fair value of \$507,807 and assumed liabilities of \$239,903 effective July 1, 1998.

The Company assumed the Wells Fargo line of credit on September 30, 1998 from the Berg Group. As of that date, the outstanding balance on the Wells Fargo line of credit was \$39,044. In connection with this assumption, the Company retired \$39,044 of related party debt due Berg & Berg Enterprises, Inc.

In connection with the property acquisitions, the Company assumed \$51,732 and \$36,380 of related party debt due the Berg Group, assumed other liabilities of \$2,636 and \$126, and issued 7,370,238 and 16,311,232 O.P. Units for a total acquisition value of \$122,875 and \$193,553 for the years ended December 31, 2000 and 1999, respectively.

Amounts of \$48,202, \$27,307 and \$9,599 were due the Berg Group for distributions declared to O.P. Unit holders during the years ended December 31, 2000, 1999, and 1998, respectively.

15. COMMITMENTS AND CONTINGENCIES

The Company and the operating partnerships, from time to time, are parties to litigation arising out of the normal course of business. Management does not expect that such matters would have a material adverse effect on the cash flows, consolidated financial position or results of operations of the Company.

Insurance policies currently maintained by the Company do not cover seismic activity, although they do cover losses from fires after an earthquake.

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

16. SUBSEQUENT EVENTS (UNAUDITED)

In January 2001, we acquired a newly constructed R&D property leased to Celestica, Inc. on Hellyer Avenue in San Jose, California consisting 131,500 square feet of rentable space under the Berg land holdings option agreement. Pursuant to the Berg land holdings option agreement, the acquisition cost is based on the full construction cost of the building, 10% of the full construction cost of the building, and other factors. The Berg Group is currently evaluating its total construction costs due to delayed billings by its vendors. Details of the acquisition cannot be determined at this time.

In January 2001, we completed the sale of the R&D property at 4949 Hellyer Avenue, San Jose, California to Cisco Systems, Inc, which exercised its option in November 2000. We realized a gain of \$3.1 million on the total sale price of \$23.1 million. Cisco Systems, Inc. also exercised its option in November 2000 to purchase the R&D property at 5713-49 Fontanoso Way, San Jose, California. The sale is expected to occur in the fourth quarter of 2001.

In January 2001, the Company paid dividends aggregating \$3,236 to its common stockholders which were payable to stockholders of record as of

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December 31, 2000.

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MISSION WEST PROPERTIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
 (Dollars in thousands, except share and per share data)

SUPPLEMENTAL FINANCIAL INFORMATION (UNAUDITED)

Quarterly financial information for the year ended December 31, 2000 is as follows:

| | First ----- | Second ----- | Third ----- |
|--|----------------|-----------------|----------------|
| Revenue | \$ 21,235 | \$ 23,899 | \$ 26,8 |
| Income before minority interest | \$ 14,463 | \$ 16,555 | \$ 19,3 |
| Net Income | \$ 2,631 | \$ 2,930 | \$ 3,3 |
| Per share data: | | | |
| Basic net income per share | \$ 0.15 | \$ 0.17 | \$ 0. |
| Diluted net income per share | \$ 0.15 | \$ 0.17 | \$ 0. |
| Weighted average number of common shares outstanding (basic) | 16,990,353 | 17,025,365 | 17,025,3 |
| Weighted average number of common shares outstanding (diluted) | 17,389,409 | 17,113,346 | 17,191,3 |

Quarterly financial information for the year ended December 31, 1999 is as follows:

| | First ----- | Second ----- | Third ----- |
|--|----------------|-----------------|----------------|
| Revenue | \$ 14,027 | \$ 18,376 | \$ 20,5 |
| Income before minority interest | \$ 7,605 | \$ 10,552 | \$ 13,4 |
| Net Income | \$ 881 | \$ 1,065 | \$ 2,1 |
| Per share data: | | | |
| Basic net income per share | \$ 0.11 | \$ 0.13 | \$ 0. |
| Diluted net income per share | \$ 0.10 | \$ 0.13 | \$ 0. |
| Weighted average number of common shares outstanding (basic) | 8,227,261 | 8,166,977 | 16,715,3 |
| Weighted average number of common shares outstanding (diluted) | 8,415,412 | 8,305,603 | 16,808,1 |

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Report of Independent Accountants on
Financial Statement Schedules

To the Board of Directors and Stockholders
of Mission West Properties, Inc.

Our audits of the consolidated financial statements referred to in our report dated January 21, 2001 included in this Form 10-K of Mission West Properties, Inc. also included audits of the financial statement schedules listed in Item 14(a)(2) of this Form 10-K. In our opinion, the financial statement schedules presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

PricewaterhouseCoopers LLP

San Francisco, California
January 21, 2001

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MISSION WEST PROPERTIES, INC.
Schedule III
Real Estate and Accumulated Depreciation
December 31, 2000

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(Dollars in thousands)

| Property Name | City | | December 31, 2000 Encumbrances | Initial Cost | | Subse Const Acqu |
|------------------------------------|-----------------|---|--------------------------------------|--------------|----------------------------------|------------------------|
| | | | | Land | Buildings and Improvements | |
| 5300 Hellyer Avenue | San Jose | E | \$ 11,643 | \$ 5,742 | \$ 11,442 | |
| 10401-10411 Bubb Road | Cupertino | A | | 632 | 3,078 | |
| 2001 Logic Drive | Cupertino | | | 2,288 | 11,134 | |
| 45365 Northport Loop | Fremont | | | 2,447 | 5,711 | |
| 47000 Northport Loop | Fremont | | | 1,184 | 5,760 | |
| 45738 Northport Loop | Fremont | | | 891 | 4,338 | |
| 4050 Starboard Drive | Fremont | | | 1,329 | 6,467 | |
| 3501 W. Warren Ave/Fremont Blvd. | Fremont | | | 1,866 | 9,082 | |
| 48800 Milmont Blvd | Fremont | | | 1,013 | 4,932 | |
| 4750 Patrick Henry Drive | Santa Clara | | | 1,604 | 7,805 | |
| 4949 Hellyer Avenue | San Jose | | | 3,593 | 17,484 | |
| 3520 Bassett Street | Santa Clara C | | | 1,104 | 5,371 | |
| 3530 Bassett Street | Santa Clara C,D | | 2,735 | 849 | 4,133 | |
| 5850-5870 Hellyer Avenue | San Jose | | | 2,787 | 6,502 | |
| 800 Branham Lane East | San Jose | | | 5,508 | 12,851 | |
| 5400 Hellyer Avenue | San Jose | | | 3,238 | 5,358 | |
| 5749 Fontanoso Way | San Jose | | | 2,572 | 4,597 | |
| 1065-1105 L'Avenida | Mountain View | | | 46,832 | 109,275 | |
| 1750 Automation Parkway | San Jose | | | 4,789 | 11,174 | |
| 1756 Automation Parkway | San Jose | | | 4,378 | 10,216 | |
| 1762 Automation Parkway | San Jose | | | 4,804 | 12,224 | |
| 1768 Automation Parkway | San Jose | | | 8,195 | 19,121 | |
| 255 Caspian Drive | Sunnyvale | | | 3,491 | 8,146 | |
| 2251 Lawson Lane | Santa Clara | | | 1,952 | 9,498 | |
| 1230 E. Arques | Sunnyvale | | | 540 | 2,628 | |
| 1250 E. Arques | Sunnyvale | | | 1,335 | 6,499 | |
| 3120 Scott Blvd | Santa Clara | | | 2,044 | 9,948 | |
| 20400 Mariani Avenue | Cupertino | | 1,756 | 1,670 | 8,125 | |
| 10500 De Anza Blvd | Cupertino | | | 7,666 | 37,304 | |
| 20605-705 Valley Green Dr. | Cupertino | | | 3,490 | 16,984 | |
| 10300 Bubb Road | Cupertino | | | 635 | 3,090 | |
| 10440 Bubb Road | Cupertino | | 377 | 434 | 2,112 | |
| 10460 Bubb Road | Cupertino | | 423 | 994 | 4,838 | |
| 1135 Kern Avenue | Sunnyvale | | | 407 | 1,982 | |
| 405 Tasman Drive | Sunnyvale | | | 550 | 2,676 | |
| 450 National Avenue | Mountain View | | | 611 | 2,973 | |
| 3301 Olcott Street | Santa Clara | | | 1,846 | 8,984 | |
| 2800 Bayview Avenue | Fremont | | | 1,070 | 5,205 | |
| 6850 Santa Teresa Blvd | San Jose | | | 377 | 1,836 | |
| 6810 Santa Teresa Blvd | San Jose | | | 2,567 | 5,991 | |
| 140-160 Great Oaks Blvd | San Jose | | | 1,402 | 6,822 | |
| 6541 Via del Oro/6385 San Ignacio | San Jose | | | 1,039 | 5,057 | |
| 6311-6351 San Ignacio Avenue | San Jose | | | 6,246 | 30,396 | |
| 6320-6360 San Ignacio Avenue | San Jose | | | 2,616 | 12,732 | |
| 75 E. Trimble Rd./2610 N. First St | San Jose | | | 3,477 | 16,919 | |
| 2033-2243 Samaritan Drive | San Jose | | 50,886 | 5,046 | 24,556 | |
| 1170 Morse Avenue | Sunnyvale | | | 658 | 3,201 | |
| 3236 Scott Blvd | Santa Clara | | | 1,234 | 6,005 | |
| 1212 Bordeaux Lane | Sunnyvale | | | 2,250 | 10,948 | |
| 1325-1810 McCandless Drive | Milpitas | | | 13,994 | 66,213 | |
| 1600 Memorex Drive | Santa Clara | | | 1,221 | 5,940 | |

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| | | | | |
|-------------------------------|---------------|---|------------|-----------|
| 1688 Richard Avenue | Santa Clara | | 1,248 | 2,913 |
| 1700 Richard Avenue | Santa Clara | | 1,727 | 4,030 |
| 3506-3510 Bassett Street | Santa Clara C | | 943 | 4,591 |
| 3540-3544 Bassett Street | Santa Clara C | B | 1,565 | 7,615 |
| 3550 Bassett Street | Santa Clara C | B | 1,079 | 5,251 |
| 3560 Bassett Street | Santa Clara C | B | 1,075 | 5,233 |
| 3570-3580 Bassett Street | Santa Clara C | B | 1,075 | 5,233 |
| Prudential Capital Group Loan | | | 126,764 B | |
| | | | ----- | ----- |
| | | | \$ 194,584 | \$187,219 |
| | | | ===== | ===== |
| | | | | \$650,529 |
| | | | | ===== |
| | | | | \$ |
| | | | | ===== |

MISSION WEST PROPERTIES, INC.
Schedule III
Real Estate and Accumulated Depreciation
December 31, 2000
(Dollars in thousands)

| Property Name | City | | Total Cost | | Total | Accu Depr |
|----------------------------------|-----------------|---|------------|----------------------------------|----------|--------------|
| | | | Land | Buildings And Improvements | | |
| 5300 Hellyer Avenue | San Jose | E | \$ 5,742 | \$ 11,442 | \$17,184 | |
| 10401-10411 Bubb Road | Cupertino | A | 632 | 3,078 | 3,710 | |
| 2001 Logic Drive | Cupertino | | 2,288 | 11,134 | 13,422 | |
| 45365 Northport Loop | Fremont | | 2,447 | 5,722 | 8,169 | |
| 47000 Northport Loop | Fremont | | 1,184 | 5,767 | 6,951 | |
| 45738 Northport Loop | Fremont | | 891 | 4,343 | 5,234 | |
| 4050 Starboard Drive | Fremont | | 1,329 | 6,475 | 7,804 | |
| 3501 W. Warren Ave/Fremont Blvd. | Fremont | | 1,866 | 9,082 | 10,948 | |
| 48800 Milmont Blvd | Fremont | | 1,013 | 4,932 | 5,945 | |
| 4750 Patrick Henry Drive | Santa Clara | | 1,604 | 7,958 | 9,562 | |
| 4949 Hellyer Avenue | San Jose | | 3,593 | 17,545 | 21,138 | |
| 3520 Bassett Street | Santa Clara C | | 1,104 | 5,371 | 6,475 | |
| 3530 Bassett Street | Santa Clara C,D | | 849 | 4,133 | 4,982 | |
| 5850-5870 Hellyer Avenue | San Jose | | 2,787 | 6,502 | 9,289 | |
| 800 Branham Lane East | San Jose | | 5,508 | 12,851 | 18,359 | |
| 5400 Hellyer Avenue | San Jose | | 3,238 | 5,358 | 8,596 | |
| 5749 Fontanoso Way | San Jose | | 2,572 | 4,646 | 7,218 | |
| 1065-1105 L'Avenida | Mountain View | | 46,832 | 109,340 | 156,172 | |
| 1750 Automation Parkway | San Jose | | 4,789 | 11,489 | 16,278 | |
| 1756 Automation Parkway | San Jose | | 4,378 | 10,231 | 14,609 | |
| 1762 Automation Parkway | San Jose | | 4,804 | 12,224 | 17,028 | |
| 1768 Automation Parkway | San Jose | | 8,195 | 19,121 | 27,316 | |
| 255 Caspian Drive | Sunnyvale | | 3,491 | 8,146 | 11,637 | |
| 2251 Lawson Lane | Santa Clara | | 1,952 | 9,498 | 11,450 | |
| 1230 E. Arques | Sunnyvale | | 540 | 2,628 | 3,168 | |
| 1250 E. Arques | Sunnyvale | | 1,335 | 6,499 | 7,834 | |
| 3120 Scott Blvd | Santa Clara | | 2,044 | 9,948 | 11,992 | |
| 20400 Mariani Avenue | Cupertino | | 1,670 | 8,125 | 9,795 | |
| 10500 De Anza Blvd | Cupertino | | 7,666 | 37,304 | 44,970 | |
| 20605-705 Valley Green Dr. | Cupertino | | 3,490 | 16,984 | 20,474 | |

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| | | | | |
|------------------------------------|---------------|-----------|-----------|-----------|
| 10300 Bubb Road | Cupertino | 635 | 3,090 | 3,725 |
| 10440 Bubb Road | Cupertino | 434 | 2,112 | 2,546 |
| 10460 Bubb Road | Cupertino | 994 | 5,996 | 6,991 |
| 1135 Kern Avenue | Sunnyvale | 407 | 1,982 | 2,389 |
| 405 Tasman Drive | Sunnyvale | 550 | 2,676 | 3,226 |
| 450 National Avenue | Mountain View | 611 | 2,973 | 3,584 |
| 3301 Olcott Street | Santa Clara | 1,846 | 8,984 | 10,830 |
| 2800 Bayview Avenue | Fremont | 1,070 | 5,205 | 6,275 |
| 6850 Santa Teresa Blvd | San Jose | 377 | 2,616 | 2,993 |
| 6810 Santa Teresa Blvd | San Jose | 2,567 | 6,003 | 8,570 |
| 140-160 Great Oaks Blvd | San Jose | 1,402 | 6,980 | 8,382 |
| 6541 Via del Oro/6385 San Ignacio | San Jose | 1,039 | 5,057 | 6,096 |
| 6311-6351 San Ignacio Avenue | San Jose | 6,246 | 30,490 | 36,736 |
| 6320-6360 San Ignacio Avenue | San Jose | 2,616 | 12,929 | 15,545 |
| 75 E. Trimble Rd./2610 N. First St | San Jose | 3,477 | 17,001 | 20,478 |
| 2033-2243 Samaritan Drive | San Jose | 5,046 | 24,556 | 29,602 |
| 1170 Morse Avenue | Sunnyvale | 658 | 3,201 | 3,859 |
| 3236 Scott Blvd | Santa Clara | 1,234 | 6,005 | 7,239 |
| 1212 Bordeaux Lane | Sunnyvale | 2,250 | 10,948 | 13,198 |
| 1325-1810 McCandless Drive | Milpitas | 13,994 | 66,438 | 80,432 |
| 1600 Memorex Drive | Santa Clara | 1,221 | 5,940 | 7,161 |
| 1688 Richard Avenue | Santa Clara | 1,248 | 2,919 | 4,167 |
| 1700 Richard Avenue | Santa Clara | 1,727 | 4,030 | 5,757 |
| 3506-3510 Bassett Street | Santa Clara C | 943 | 4,690 | 5,633 |
| 3540-3544 Bassett Street | Santa Clara C | 1,565 | 7,804 | 9,368 |
| 3550 Bassett Street | Santa Clara C | 1,079 | 5,284 | 6,363 |
| 3560 Bassett Street | Santa Clara C | 1,075 | 5,241 | 6,316 |
| 3570-3580 Bassett Street | Santa Clara C | 1,075 | 5,233 | 6,308 |
| Prudential Capital Group Loan | | | | |
| | | ----- | ----- | ----- |
| | | \$187,219 | \$654,259 | \$841,478 |
| | | ===== | ===== | ===== |

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- (A) 16.67% of this property's ownership is held by unaffiliated parties outside the operating partnerships or the Company.
- (B) Encumbered by the \$126,764 Prudential Capital Group loan - full amount of loan shown at the bottom of the schedule.
- (C) Part of the property group referred to as Triangle Technology Park.
- (D) 25% of this property's ownership is held by unaffiliated parties outside the operating partnerships or the Company.
- (E) 50% of this property's ownership is held by unaffiliated parties outside the operating partnerships or the Company.
- (F) Four properties at McCandless Drive, in addition to the three properties at Samaritan Drive, are encumbered by the \$50,886 debt due the Berg Group under the line of credit.

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MISSION WEST PROPERTIES, INC.
 Schedule III
 Real Estate and Accumulated Depreciation
 December 31, 1999
 (Dollars in thousands)

| Property Name | City | December 31, 1999 Encumbrances | Initial Cost | |
|-------------------------------------|---------------|--------------------------------------|--------------|----------------------------------|
| | | | Land | Buildings and Improvements |
| 10401-10411 Bubb Road | Cupertino | A | \$ 632 | \$ 3,078 |
| 2001 Logic Drive | Cupertino | | 2,288 | 11,134 |
| 47000 Northport Loop | Fremont | B | 1,184 | 5,760 |
| 45738 Northport Loop | Fremont | B | 891 | 4,338 |
| 4050 Starboard Drive | Fremont | B | 1,329 | 6,467 |
| 3501 W. Warren Ave/Fremont Blvd | Fremont | | 1,866 | 9,082 |
| 48800 Milmont Blvd | Fremont | | 1,013 | 4,932 |
| 4750 Patrick Henry Drive | Santa Clara | | 1,604 | 7,805 |
| 4949 Hellyer Avenue | San Jose | B | 3,593 | 17,484 |
| 3520 Bassett Street | Santa Clara C | | 1,104 | 5,371 |
| 3530 Bassett Street | Santa Clara C | \$ 2,853 | 849 | 4,133 |
| 5850-5870 Hellyer Avenue | San Jose | | 2,787 | 6,502 |
| 5749 Fontanoso Way | San Jose | | 2,572 | 4,597 |
| 1065-1105 L'Avenida | Mountain View | | 46,832 | 109,275 |
| 1750 Automation Parkway | San Jose | | 4,789 | 11,174 |
| 2251 Lawson Lane | Santa Clara | | 1,952 | 9,498 |
| 1230 E. Arques | Sunnyvale | | 540 | 2,628 |
| 1250 E. Arques | Sunnyvale | | 1,335 | 6,499 |
| 3120 Scott Blvd | Santa Clara | | 2,044 | 9,948 |
| 20400 Mariani Avenue | Cupertino | 1,902 | 1,670 | 8,125 |
| 10500 De Anza Blvd | Cupertino | B | 7,666 | 37,304 |
| 20605-705 Valley Green Dr. | Cupertino | | 3,490 | 16,984 |
| 10300 Bubb Road | Cupertino | B | 635 | 3,090 |
| 10440 Bubb Road | Cupertino | 405 | 434 | 2,112 |
| 10460 Bubb Road | Cupertino | 477 | 994 | 4,838 |
| 1135 Kern Avenue | Sunnyvale | | 407 | 1,982 |
| 405 Tasman Drive | Sunnyvale | | 550 | 2,676 |
| 450 National Avenue | Mountain View | B | 611 | 2,973 |
| 3301 Olcott Street | Santa Clara | | 1,846 | 8,984 |
| 2800 Bayview Avenue | Fremont | | 1,070 | 5,205 |
| 6850 Santa Teresa Blvd | San Jose | | 377 | 1,836 |
| 6810 Santa Teresa Blvd | San Jose | | 2,567 | 5,991 |
| 140-160 Great Oaks Blvd | San Jose | | 1,402 | 6,822 |
| 6541 Via del Oro/6385 San Ignacio | San Jose | | 1,039 | 5,057 |
| 6311-6351 San Ignacio | San Jose | B | 6,246 | 30,396 |
| 6320-6360 San Ignacio | San Jose | | 2,616 | 12,732 |
| 75 E. Trimble Road/2610 N. First St | San Jose | | 3,477 | 16,919 |
| 2033-2243 Samaritan Drive | San Jose | 31,193 | 5,046 | 24,556 |
| 1170 Morse Avenue | Sunnyvale | B | 658 | 3,201 |
| 3236 Scott Blvd | Santa Clara | B | 1,234 | 6,005 |
| 1212 Bordeaux Lane | Sunnyvale | | 2,250 | 10,948 |
| 1325-1810 McCandless Dr. | Milpitas | | 13,994 | 66,213 |
| 1600 Memorex Drive | Santa Clara | | 1,221 | 5,940 |
| 1688 Richard Avenue | Santa Clara | | 1,248 | 2,912 |
| 1700 Richard Avenue | Santa Clara | | 1,727 | 4,029 |
| 3506-3510 Bassett Street | Santa Clara C | | 943 | 4,591 |

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| | | | | |
|-------------------------------|---------------|---|-----------|-----------|
| 3540-3544 Bassett Street | Santa Clara C | B | 1,565 | 7,615 |
| 3550 Bassett Street | Santa Clara C | B | 1,079 | 5,251 |
| 3560 Bassett Street | Santa Clara C | B | 1,075 | 5,233 |
| 3570-3580 Bassett Street | Santa Clara C | B | 1,075 | 5,233 |
| Prudential Capital Group Loan | | | 128,315B | |
| | | | ----- | ----- |
| | | | \$165,145 | \$149,416 |
| | | | ===== | ===== |
| | | | | \$565,458 |
| | | | | ===== |

MISSION WEST PROPERTIES, INC.
Schedule III
Real Estate and Accumulated Depreciation
December 31, 1999
(Dollars in thousands)

| Property Name | City | Total Cost | | | Accumu Deprec | |
|-----------------------------------|---------------|------------|----------------------------------|----------|------------------|----|
| | | Land | Buildings and Improvements | Total | | |
| 10401-10411 Bubb Road | Cupertino | A | \$ 632 | \$ 3,078 | \$ 3,710 | \$ |
| 2001 Logic Drive | Cupertino | | 2,288 | 11,134 | 13,422 | |
| 47000 Northport Loop | Fremont | | 1,184 | 5,767 | 6,951 | |
| 45738 Northport Loop | Fremont | | 891 | 4,343 | 5,234 | |
| 4050 Starboard Drive | Fremont | | 1,329 | 6,475 | 7,804 | |
| 3501 W. Warren Ave/Fremont Blvd | Fremont | | 1,866 | 9,082 | 10,948 | |
| 48800 Milmont Blvd | Fremont | | 1,013 | 4,932 | 5,945 | |
| 4750 Patrick Henry Drive | Santa Clara | | 1,604 | 7,958 | 9,562 | |
| 4949 Hellyer Avenue | San Jose | | 3,593 | 17,545 | 21,138 | |
| 3520 Bassett Street | Santa Clara C | | 1,104 | 5,371 | 6,475 | |
| 3530 Bassett Street | Santa Clara C | | 849 | 4,133 | 4,982 | |
| 5850-5870 Hellyer Avenue | San Jose | | 2,787 | 6,502 | 9,289 | |
| 5749 Fontanosos Way | San Jose | | 2,572 | 4,597 | 7,169 | |
| 1065-1105 L'Avenida | Mountain View | | 46,832 | 109,275 | 156,107 | |
| 1750 Automation Parkway | San Jose | | 4,789 | 11,489 | 16,278 | |
| 2251 Lawson Lane | Santa Clara | | 1,952 | 9,498 | 11,450 | |
| 1230 E. Arques | Sunnyvale | | 540 | 2,628 | 3,168 | |
| 1250 E. Arques | Sunnyvale | | 1,335 | 6,499 | 7,834 | |
| 3120 Scott Blvd | Santa Clara | | 2,044 | 9,948 | 11,992 | |
| 20400 Mariani Avenue | Cupertino | | 1,670 | 8,125 | 9,795 | |
| 10500 De Anza Blvd | Cupertino | | 7,666 | 37,304 | 44,970 | |
| 20605-705 Valley Green Dr. | Cupertino | | 3,490 | 16,984 | 20,474 | |
| 10300 Bubb Road | Cupertino | | 635 | 3,090 | 3,725 | |
| 10440 Bubb Road | Cupertino | | 434 | 2,112 | 2,546 | |
| 10460 Bubb Road | Cupertino | | 994 | 4,868 | 5,862 | |
| 1135 Kern Avenue | Sunnyvale | | 407 | 1,982 | 2,389 | |
| 405 Tasman Drive | Sunnyvale | | 550 | 2,676 | 3,226 | |
| 450 National Avenue | Mountain View | | 611 | 2,973 | 3,584 | |
| 3301 Olcott Street | Santa Clara | | 1,846 | 8,984 | 10,830 | |
| 2800 Bayview Avenue | Fremont | | 1,070 | 5,205 | 6,275 | |
| 6850 Santa Teresa Blvd | San Jose | | 377 | 1,863 | 2,240 | |
| 6810 Santa Teresa Blvd | San Jose | | 2,567 | 6,038 | 8,605 | |
| 140-160 Great Oaks Blvd | San Jose | | 1,402 | 6,913 | 8,315 | |
| 6541 Via del Oro/6385 San Ignacio | San Jose | | 1,039 | 5,057 | 6,096 | |
| 6311-6351 San Ignacio | San Jose | | 6,246 | 30,417 | 36,663 | |

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| | | | | |
|-------------------------------------|---------------|-----------|-----------|-----------|
| 6320-6360 San Ignacio | San Jose | 2,616 | 12,929 | 15,545 |
| 75 E. Trimble Road/2610 N. First St | San Jose | 3,477 | 16,919 | 20,396 |
| 2033-2243 Samaritan Drive | San Jose | 5,046 | 24,556 | 29,602 |
| 1170 Morse Avenue | Sunnyvale | 658 | 3,201 | 3,859 |
| 3236 Scott Blvd | Santa Clara | 1,234 | 6,005 | 7,239 |
| 1212 Bordeaux Lane | Sunnyvale | 2,250 | 10,948 | 13,198 |
| 1325-1810 McCandless Dr. | Milpitas | 13,994 | 66,443 | 80,437 |
| 1600 Memorex Drive | Santa Clara | 1,221 | 5,940 | 7,161 |
| 1688 Richard Avenue | Santa Clara | 1,248 | 2,919 | 4,167 |
| 1700 Richard Avenue | Santa Clara | 1,727 | 4,029 | 5,756 |
| 3506-3510 Bassett Street | Santa Clara C | 943 | 4,643 | 5,586 |
| 3540-3544 Bassett Street | Santa Clara C | 1,565 | 7,672 | 9,237 |
| 3550 Bassett Street | Santa Clara C | 1,079 | 5,251 | 6,330 |
| 3560 Bassett Street | Santa Clara C | 1,075 | 5,233 | 6,308 |
| 3570-3580 Bassett Street | Santa Clara C | 1,075 | 5,233 | 6,308 |
| Prudential Capital Group Loan | | | | |
| | | ----- | ----- | ----- |
| | | \$149,416 | \$566,766 | \$716,182 |
| | | ===== | ===== | ===== |

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- (A) 16.67% of this property's ownership is held by unaffiliated parties outside the operating partnerships or the Company
- (B) Encumbered by the \$128,315 Prudential Capital Group loan - full amount of loan shown at the bottom of the schedule.
- (C) Part of the property group referred to as Triangle Technology Park
- (D) 25% of this property's ownership is held by unaffiliated parties outside the operating partnerships or the Company.

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MISSION WEST PROPERTIES, INC.
 NOTE TO SCHEDULE III
 December 31, 2000 and 1999
 (Dollars in thousands)

1. Reconciliation of real estate and accumulated depreciation:

| | 2000 | 1999 |
|------------------------------|------------|------------|
| | ----- | ----- |
| Real estate investments: | | |
| Balance at beginning of year | \$ 716,182 | \$ 521,439 |
| Additions | 125,296 | 194,743 |
| Dispositions | - | - |
| | ----- | ----- |
| Balance at end of year | \$ 841,478 | \$ 716,182 |
| | ===== | ===== |

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Accumulated depreciation:

| | | |
|------------------------------|-----------|-----------|
| Balance at beginning of year | \$ 18,566 | \$ 5,410 |
| Additions | 15,456 | 13,156 |
| Dispositions | - | - |
| | ----- | ----- |
| Balance at end of year | \$ 34,022 | \$ 18,566 |
| | ===== | ===== |

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by Item 10 is incorporated by reference from the sections titled "Directors and Executive Officers" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's definitive proxy statement for its annual stockholders' meeting.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated by reference from the section titled "Executive Compensation" in the Company's definitive proxy statement for its annual stockholders' meeting, excluding, however, the sections titled "Executive Compensation - Performance Graph" and "Executive Compensation - Report on Executive Compensation by the Compensation Committee of the Board of Directors," none of which are incorporated by reference in response to this item.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by Item 12 is incorporated by reference from the sections titled "Share Ownership" in the Company's definitive proxy statement for its annual stockholders' meeting.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by Item 13 is incorporated by reference from the sections titled "Certain Relationships and Related Transactions" in the Company's definitive proxy statement for its annual stockholders' meeting.

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PART IV

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ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

Exhibits required by Item 601 of Regulation S-K.

EXHIBIT INDEX

| | |
|----------|---|
| 3.2.1+ | Articles of Amendment and Restatement of Mission West Properties, Inc. |
| 3.2.2+ | Restated Bylaws of Mission West Properties, Inc. |
| 10.1.1** | Amended and Restated Agreement of Limited Partnership of Mission West Properties |
| 10.1.2** | Amended and Restated Agreement of Limited Partnership of Mission West Properties |
| 10.1.3** | Amended and Restated Agreement of Limited Partnership of Mission West Properties |
| 10.1.4** | Amended and Restated Agreement of Limited Partnership of Mission West Properties |
| 10.2** | Exchange Rights Agreement between Mission West Properties and the Limited Partnership |
| 10.3.1* | 1997 Stock Option Plan |
| 10.3.2* | Form of Incentive Stock Option Agreement |
| 10.3.3* | Form of Non-statutory Stock Option Agreement |
| 10.3.4* | Form of Directors Stock Option Agreement |
| 10.4.1* | Acquisition Agreement, dated as of May 14, 1998, among Mission West Properties and the Berg Group (as defined therein) |
| 10.4.2* | Amendment of Acquisition Agreement, dated as of July 1, 1998 |
| 10.4.3* | Form of Partnership Interest Purchase Demand Note |
| 10.5.1* | Stock Purchase Agreement dated as of May 4, 1998, between Mission West Properties and the Berg Group |
| 10.5.2* | Stock Purchase Agreement dated as of May 4, 1998 between Mission West Properties and the Berg Group |
| 10.5.3** | Stock in a private placement of 5,800,000 shares and Subscription Agreement relating to the same |
| | Stock in a private placement of 695,058 shares and Subscription Agreement relating to the same |
| | Form of Registration Rights Agreement for purchasers, who acquired shares of Common Stock pursuant to the above described |
| | Stock Purchase Agreements (filed as Exhibits 10.8 to Post-effective Amendment to the above described Acquisition Agreement) |
| 10.6** | filed on Form S-3 on February 11, 1999. Commission File No. 333-52835-99) |
| | Pending Projects Acquisition Agreement among Mission West Properties, the Open Market Group and the Berg Group |
| 10.7** | Berg Land Holdings Option Agreement between Mission West Properties and certain members of the Berg Group |
| 10.8* | Berg & Berg Enterprises, Inc. Sublease Agreement |
| 10.9++ | Amended and Restated Stock Option Agreement for Michael J. Anderson (200,000 shares) |
| 10.10* | Restricted Stock Purchase Agreement for Michael J. Anderson (200,000 shares of Common Stock) |
| 10.11* | Promissory Note from Michael J. Anderson |
| 10.12* | Lease Agreement with Apple Computer, Inc. |
| 10.13* | Lease Agreement with Cisco Systems, Inc. |
| 10.14* | Lease Agreement with Amdahl Corporation |
| 10.15* | Prudential Promissory Note |
| 10.16* | Prudential Deed of Trust |
| 10.17* | Prudential Certificate Regarding Distribution |
| 10.18* | Prudential Guaranty |
| 10.19+ | Waiver Agreement |
| 10.20** | Ownership Limit Exemption Agreement dated December 29, 1999 between Mission West Properties and Paul McCarthy |
| 10.21x | Lease Agreement with Microsoft Corporation |
| 10.22x | Contribution Agreement |
| 10.23xx | Assumption Agreement for Wells Fargo Line of Credit |
| 10.24xx | Form of secured note payable to the Berg Group |
| 10.25xx | Form of deed of trust granted to the Berg Group |
| 10.26xx | Supplemental Agreement among Mission West Properties, Inc., Carl E. Berg and the Berg Group |
| 10.27 | Revolving Credit - \$75,000,000 Secured Promissory Note |

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10.28 Deed of Trust Securing Revolving Promissory Note
21.1++ Subsidiaries of the Registrant
24.1xx Powers of Attorney (included in the signature page on page ___ of this report)
27.1 Financial Data Schedule

- * Incorporated herein by reference to the same-numbered exhibit to the Company's Registration Statement on Form S-4 filed on May 15, 1998 and declared effective on November 23, 1998
- ** Incorporated herein by reference to the same-numbered exhibit to the Company's Post-effective Amendment No. 1 to Registration Statement on Form S-4 filed on Form S-3 on February 11, 1999. (Commission File No. 333-52835-99).
- + Incorporated herein by reference to the same-numbered exhibit to Amendment No. 4 to the Registration Statement on Form S-4 filed on November 16, 1998 and declared effective on November 23, 1998.
- ++ Incorporated herein by reference to the same-numbered exhibit to the annual report on Form 10-K for 1998 filed on March 31, 1999.
- x Incorporated herein by reference to the same-numbered exhibit to current report on Form 8-K filed on May 14, 1999 (Commission File No. 000-25235).
- xx Incorporated herein by reference to the same-numbered exhibit to the Registration Statement on Form S-11 filed on June 8, 1999 (Commission File No. 333-80203).

(b) Reports on Form 8-K.

The registrant has not filed any reports on Form 8-K during the last quarter of the period covered by this report.

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SIGNATURES

Pursuant to the requirements of the Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

MISSION WEST PROPERTIES, INC.

Date: March 30, 2001

By: /s/ CARL E. BERG

Carl E. Berg
Chairman of the Board, Chief
Executive Officer, President and
Director

Date: March 30, 2001

By: /s/ WAYNE N. PHAM

Wayne N. Pham
Vice President of Finance and
Controller (Principal Accounting
Officer)

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Carl E. Berg his true and lawful attorney-in-fact with the power of substitution, to sign any amendments to this Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorney-in-fact, or his or her

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substitute, may do or choose to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|--|----------------|
| /s/ CARL E. BERG ----- Carl E. Berg | Chairman of the Board, Chief Executive Officer, President and Director | March 30, 2001 |
| /s/ JOHN C. BOLGER ----- John C. Bolger | Director | March 30, 2001 |
| /s/ WILLIAM A. HASLER ----- William A. Hasler | Director | March 30, 2001 |
| /s/ LAWRENCE B. HELZEL ----- Lawrence B. Helzel | Director | March 30, 2001 |

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EXHIBIT 10.27

REVOLVING CREDIT SECURED PROMISSORY NOTE ("Note")

\$75,000,000.00

March 1, 2000

FOR VALUE RECEIVED, Mission West Properties, L.P., a Delaware limited partnership, Mission West Properties, L.P. I, a Delaware limited partnership, Mission West Properties L.P. II, a Delaware limited partnership, and Mission West Properties, L.P. III, a Delaware limited partnership (collectively "Borrower"), promises to pay to the order of Berg & Berg Enterprises, LLC, a California limited liability company ("Lender") or its assigns, at 10050 Bandle Drive, Cupertino, California 95014, or at such other place as the holder of this Note may from time to time designate, the principal sum of Seventy-Five Million Dollars (\$75,000,000.00) (the "Credit Amount") or so much of that sum as may be advanced under this Note from time to time by any holder, plus interest as computed herein.

Interest on the principal sum of this Note from time to time outstanding will be computed from the date of each advance of principal at LIBOR plus 1.30% (the "Applicable Interest Rate"). Interest will be computed on the basis of a three hundred sixty (360) day year and the actual number of days elapsed, which will result in the payment of more interest than if a 365-day year were used.

All accrued and unpaid principal and interest shall be due and payable no later than March 1, 2002.

Advances under this Note may be drawn by Borrower, up to the Credit Amount, upon

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not less than 5 days notice to Lender.

Each payment shall be credited first on the interest then due and the remainder on the principal sum.

The undersigned agrees that the holder of this Note may, without notice to the undersigned and without affecting the liability of the undersigned, accept additional or substitute security for this Note, or release any security or any party liable for this Note, or extend or renew this Note.

If the undersigned consists of more than one person or entity, their liability and obligations under this Note will be joint and several. Borrower jointly and severally waives diligence, presentment, protest and demand, notice of protest, dishonor and non-payment of this Note, expressly agrees that this Note or any payment hereunder, may be extended from time to time, and consents to the acceptance of further security for this Note, including other types of security, all without in any way affecting the liability of the Borrower. The right to plead any and all statutes of limitations as a defense to any demand on this Note, or on any guaranty hereof, or to any agreement to pay the same, or to any demand secured by the Deed of Trust, or other security, securing this Note, against Borrower, the holder of any property encumbered by the Deed of Trust or other instrument securing this Note, and any guarantors or sureties, is expressly waived by each and all said parties.

All amounts payable under this Note are payable in lawful money of the United States, free from any offset, deduction or counterclaim. Checks will constitute payment only when collected.

Upon any default in the payment of any amounts due under this Note or upon any default under the Deed of Trust, the holder may, at its option and upon ten (10) days' written notice to the undersigned, declare the entire unpaid principal sum of this Note together with all accrued interest to be due and payable provided, however, that if the undersigned should cure such default under this Note or the Deed of Trust within the time period described above, the right of the holder to declare the entire unpaid principal sum of this Note together with all accrued interest immediately due and payable shall terminate as to such default as if no such default occurred.

The undersigned agrees to pay all costs of collection when incurred, including but not limited to reasonable attorneys' fees. If any suit or action is instituted to enforce this Note, the undersigned promises to pay, in addition to the costs and disbursements otherwise allowed by law, such sum as the court may adjudge as reasonable attorneys' fees in such suit or action.

This Note may be prepaid in whole or in part at any time without penalty. Until the maturity date, including all extensions thereof, amounts repaid may be subsequently advanced under this Note, up to the Credit Amount.

This Note will be governed by the laws of the State of California.

This Note is a non-recourse loan secured by a Deed of Trust and Assignment of Rents (the "Deed of Trust") executed by the undersigned in favor of Lender and covering real property located in San Jose, California. The Deed of Trust contains provisions for the acceleration of the maturity of this Note.

Mission West Properties, L.P.,
Mission West Properties, L.P. I,
Mission West Properties, L.P. II, and
Mission West Properties, L.P. III

By: Mission West Properties, Inc., their general partner

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/s/ Carl E. Berg

By: Carl E. Berg, President