

DUKE REALTY CORP  
Form 10-Q  
November 05, 2007

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended **September 30, 2007**

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 Number: 1-9044

**DUKE REALTY CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

**Indiana**  
(State or Other Jurisdiction  
of Incorporation or Organization)

**600 East 96<sup>th</sup> Street, Suite 100**  
**Indianapolis, Indiana**  
(Address of Principal Executive Offices)

**35-1740409**  
(I.R.S. Employer  
Identification Number)

**46240**  
(Zip Code)

Registrant's Telephone Number, Including Area Code: (317) 808-6000

Edgar Filing: DUKE REALTY CORP - Form 10-Q

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 whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

YES  NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Outstanding at November 1, 2007
Common Stock, \$.01 par value per share	145,598,641 shares

---

DUKE REALTY CORPORATION

INDEX

	<b>Page</b>
<b><u>Part I - Financial Information</u></b>	
<b><u>Item 1.</u></b>	
<b><u>Financial Statements</u></b>	
<u>Consolidated Balance Sheets as of September 30, 2007 (Unaudited) and December 31, 2006</u>	2
<u>Consolidated Statements of Operations (Unaudited) for the three and nine months ended September 30, 2007 and 2006</u>	3
<u>Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2007 and 2006</u>	4
<u>Consolidated Statement of Shareholders' Equity (Unaudited) for the nine months ended September 30, 2007</u>	5
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	6-13
<b><u>Item 2.</u></b>	
<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	14-29
<b><u>Item 3.</u></b>	
<b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	30
<b><u>Item 4.</u></b>	
<b><u>Controls and Procedures</u></b>	30
<b><u>Part II - Other Information</u></b>	
<u>Item 1.</u>	31
<u>Item 1A.</u>	31
<u>Item 2.</u>	31-32
<u>Item 3.</u>	32
<u>Item 4.</u>	32
<u>Item 5.</u>	32
<u>Item 6.</u>	33-34

## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

## DUKE REALTY CORPORATION AND SUBSIDIARIES

## Consolidated Balance Sheets

(in thousands)

	September 30, 2007 (Unaudited)	December 31, 2006
<b>ASSETS</b>		
Real estate investments:		
Land and improvements	\$ 822,436	\$ 844,091
Buildings and tenant improvements	4,493,009	4,211,602
Construction in progress	441,560	359,765
Investments in and advances to unconsolidated companies	551,193	628,323
Land held for development	800,737	737,752
	<b>7,108,935</b>	6,781,533
Accumulated depreciation	(928,024)	(867,079)
Net real estate investments	<b>6,180,911</b>	5,914,454
Real estate investments and other assets held for sale	<b>351,259</b>	512,925
Cash and cash equivalents	18,424	68,483
Accounts receivable, net of allowance of \$2,260 and \$1,088	22,483	24,118
Straight-line rent receivable, net of allowance of \$1,800 and \$1,915	110,544	105,319
Receivables on construction contracts, including retentions	60,190	64,768
Deferred financing costs, net of accumulated amortization of \$27,543 and \$19,492	57,579	62,277
Deferred leasing and other costs, net of accumulated amortization of \$146,472 and \$127,155	367,729	311,553
Escrow deposits and other assets	247,723	174,698
	<b>\$ 7,416,842</b>	<b>\$ 7,238,595</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Indebtedness:		
Secured debt	\$ 492,538	\$ 515,192
Unsecured notes	3,368,920	3,129,653
Unsecured lines of credit	304,224	317,000
	<b>4,165,682</b>	3,961,845
Liabilities of properties held for sale	<b>37,926</b>	155,185
Construction payables and amounts due subcontractors, including retentions	<b>140,679</b>	136,508
Accrued expenses:		
Real estate taxes	88,182	59,276
Interest	37,603	52,106
Other	46,790	63,217
Other liabilities	134,126	118,901
Tenant security deposits and prepaid rents	28,251	31,121
Total liabilities	<b>4,679,239</b>	4,578,159

Edgar Filing: DUKE REALTY CORP - Form 10-Q

Minority interest	<b>90,524</b>	156,853
Shareholders' equity:		
Preferred shares (\$.01 par value); 5,000 shares authorized; 3,241 shares issued and outstanding	<b>876,250</b>	876,250
Common shares (\$.01 par value); 250,000 shares authorized; 138,570 and 133,921 shares issued and outstanding	<b>1,386</b>	1,339
Additional paid-in capital	<b>2,378,590</b>	2,196,388
Accumulated other comprehensive income	<b>6,053</b>	5,435
Distributions in excess of net income	<b>(615,200)</b>	(575,829)
Total shareholders' equity	<b>2,647,079</b>	2,503,583
	<b>\$ 7,416,842</b>	\$ 7,238,595

See accompanying Notes to Consolidated Financial Statements.

## DUKE REALTY CORPORATION AND SUBSIDIARIES

## Consolidated Statements of Operations

For the three and nine months ended September 30,

(in thousands, except per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	2007	2006	2007	2006
<b>RENTAL OPERATIONS:</b>				
Revenues:				
Rental income from continuing operations	\$ 201,376	\$ 192,568	\$ 588,564	\$ 553,006
Equity in earnings of unconsolidated companies	1,838	3,492	17,478	21,447
	<b>203,214</b>	196,060	<b>606,042</b>	574,453
Operating expenses:				
Rental expenses	44,833	41,993	133,417	124,256
Real estate taxes	24,750	21,321	73,223	64,128
Interest expense	42,390	46,825	124,924	124,757
Depreciation and amortization	71,981	59,432	202,854	173,623
	<b>183,954</b>	169,571	<b>534,418</b>	486,764
Earnings from continuing rental operations	<b>19,260</b>	26,489	<b>71,624</b>	87,689
<b>SERVICE OPERATIONS</b>				
Revenues:				
General contractor gross revenue	77,996	100,314	195,714	223,924
General contractor costs	(66,696)	(93,555)	(171,374)	(206,561)
Net general contractor revenue	11,300	6,759	24,340	17,363
Service fee revenue	7,857	7,866	21,909	16,714
Gain on sale of service operations properties	1,116	7,849	10,793	8,121
Total revenue	20,273	22,474	57,042	42,198
Operating expenses	12,972	11,923	30,789	23,721
Earnings from service operations	7,301	10,551	26,253	18,477
General and administrative expense	(3,847)	(6,760)	(27,912)	(27,642)
Operating income	<b>22,714</b>	30,280	<b>69,965</b>	78,524
<b>OTHER INCOME (EXPENSE)</b>				
Interest and other income, net	6,292	4,381	11,276	8,313
Earnings from sale of land, net of impairment adjustment	1,799	2,982	18,207	5,427
Other minority interest in earnings of subsidiaries	(38)	(126)	(89)	(301)
Minority interest in earnings of common unitholders	(1,078)	(2,126)	(3,634)	(4,754)
Income from continuing operations	<b>29,689</b>	35,391	<b>95,725</b>	87,209
Discontinued operations:				
Net income from discontinued operations, net of minority interest	1,735	1,773	4,513	9,896
Gain on sale of properties, net of minority interest	37,190	39,796	104,467	41,620
Income from discontinued operations	<b>38,925</b>	41,569	<b>108,980</b>	51,516
Net income	<b>68,614</b>	76,960	<b>204,705</b>	138,725
Dividends on preferred shares	(15,227)	(15,226)	(45,679)	(41,193)
Adjustments for redemption of preferred shares				(2,633)
Net income available for common shareholders	\$ <b>53,387</b>	\$ 61,734	\$ <b>159,026</b>	\$ 94,899
Basic net income per common share:				
Continuing operations	\$ .11	\$ .15	\$ .36	\$ .32
Discontinued operations	.28	.31	.80	.38
Total	\$ <b>.39</b>	\$ .46	\$ <b>1.16</b>	\$ .70

Edgar Filing: DUKE REALTY CORP - Form 10-Q

Diluted net income per common share:

Continuing operations	\$	.11	\$	.15	\$	.36	\$	.32
Discontinued operations		.28		.30		.79		.38
Total	\$	.39	\$	.45	\$	1.15	\$	.70
Weighted average number of common shares outstanding		137,576		135,117		137,110		134,957
Weighted average number of common shares and potential dilutive common equivalents		147,651		150,947		147,986		149,472

See accompanying Notes to Consolidated Financial Statements

## DUKE REALTY CORPORATION AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

For the nine months ended September 30,

(in thousands)

(Unaudited)

	2007	2006
Cash flows from operating activities:		
Net income	\$ 204,705	\$ 138,725
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of buildings and tenant improvements	160,987	155,156
Amortization of deferred leasing and other costs	47,235	34,956
Amortization of deferred financing costs	8,518	6,093
Minority interest in earnings	11,323	10,153
Straight-line rent adjustment	(13,643)	(15,263)
Earnings from land and depreciated property sales	(129,958)	(46,734)
Build-for-sale operations, net	(167,640)	(163,106)
Construction contracts, net	720	(208)
Other accrued revenues and expenses, net	8,901	(6,304)
Operating distributions received in excess of (less than) equity in earnings from unconsolidated companies	4,166	(4,990)
<b>Net cash provided by operating activities</b>	<b>135,314</b>	<b>108,478</b>
Cash flows from investing activities:		
Development of real estate investments	(324,317)	(274,672)
Acquisition of real estate investments and related intangible assets	(80,954)	(735,294)
Acquisition of land held for development	(155,556)	(367,517)
Recurring tenant improvements	(32,987)	(36,300)
Recurring leasing costs	(22,771)	(12,338)
Recurring building improvements	(4,894)	(5,490)
Other deferred leasing costs	(20,562)	(30,918)
Other deferred costs and other assets	(11,301)	718
Proceeds from land and depreciated property sales, net	405,094	140,273
Capital distributions from unconsolidated companies	207,545	21,238
Repayments from (advances to) unconsolidated companies	(104,461)	4,865
<b>Net cash used for investing activities</b>	<b>(145,164)</b>	<b>(1,295,435)</b>
Cash flows from financing activities:		
Proceeds from issuance of common shares	2,186	
Payments for repurchases of common shares		(11,883)
Proceeds from exercise of stock options	703	6,336
Proceeds from issuance of preferred shares, net		283,994
Payments for redemption of preferred shares		(75,010)
Proceeds from unsecured debt issuance	339,424	850,000
Payments on unsecured debt	(100,000)	(100,000)
Proceeds from issuance of secured debt		710,450
Payments on secured indebtedness including principal amortization	(22,617)	(722,777)
Borrowings (repayments) on lines of credit, net	(12,776)	521,000
Distributions to common shareholders	(195,799)	(191,256)
Distributions to preferred shareholders	(45,679)	(41,193)
Distributions to minority interest, net	(11,637)	(17,238)



Edgar Filing: DUKE REALTY CORP - Form 10-Q

Cash settlement of interest rate swaps		<b>10,746</b>		732
Deferred financing costs		<b>(4,760)</b>		(27,930)
<b>Net cash provided by (used for) financing activities</b>		<b>(40,209)</b>		1,185,225
<b>Net decrease in cash and cash equivalents</b>		<b>(50,059)</b>		(1,732)
Cash and cash equivalents at beginning of period		<b>68,483</b>		26,732
Cash and cash equivalents at end of period	\$	<b>18,424</b>	\$	25,000
Other non-cash items:				
Assumption of secured debt for real estate acquisitions	\$		\$	217,520
Conversion of Limited Partner Units to common shares	\$	<b>168,671</b>	\$	6,616
Contribution of real estate investments to, net of debt assumed by, unconsolidated companies	\$	<b>125,353</b>	\$	77,412
Issuance of Limited Partner Units for acquisition	\$	<b>11,020</b>	\$	

See accompanying Notes to Consolidated Financial Statements

## DUKE REALTY CORPORATION AND SUBSIDIARIES

## Consolidated Statement of Shareholders Equity

For the nine months ended September 30, 2007

(in thousands, except per share data)

(Unaudited)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Distributions in Excess of Net Income	Total
<b>Balance at December 31, 2006</b>	\$ 876,250	\$ 1,339	\$ 2,196,388	\$ 5,435	\$ (575,829)	\$ 2,503,583
Effect of implementing new accounting principle					(1,717)	(1,717)
<b>Balance at January 1, 2007</b>	\$ 876,250	\$ 1,339	\$ 2,196,388	\$ 5,435	\$ (577,546)	\$ 2,501,866
Comprehensive Income:						
Net income					204,705	204,705
Gains on derivative instruments				618		618
Comprehensive income						\$ 205,323
Issuance of common shares		1	2,185			2,186
Stock based compensation plan activity		2	11,390		(881)	10,511
Acquisition of minority interest		44	168,627			168,671
Distributions to preferred shareholders					(45,679)	(45,679)
Distributions to common shareholders (\$1.43 per share)					(195,799)	(195,799)
<b>Balance at September 30, 2007</b>	\$ 876,250	\$ 1,386	\$ 2,378,590	\$ 6,053	\$ (615,200)	\$ 2,647,079

See accompanying Notes to Consolidated Financial Statements

**DUKE REALTY CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. General Basis of Presentation**

The interim consolidated financial statements included herein have been prepared by Duke Realty Corporation (the Company) without audit (except for the Balance Sheet as of December 31, 2006). The financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and in accordance with Rule 10-01 of Regulation S-X of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenue and expenses during the reporting period. Our actual results could differ from those estimates and assumptions. These financial statements should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included herein and the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006.

Our Rental Operations (see Note 7) are conducted through Duke Realty Limited Partnership (DRLP). Approximately 94.4% of the common partnership interests of DRLP (Units) were owned by us at September 30, 2007. The remaining Units are redeemable for shares of our common stock on a one-to-one basis. We conduct our Service Operations (see Note 7) through Duke Realty Services LLC and Duke Realty Services Limited Partnership, and we are the sole general partner of both of those entities. We also conduct Service Operations through Duke Construction Limited Partnership, which is effectively 100% owned by DRLP. The consolidated financial statements include our accounts and our majority-owned or controlled subsidiaries. In this Quarterly Report on Form 10-Q (this Report), unless the context indicates otherwise, the terms we, us and our refer to the Company and those entities owned or controlled by the Company.

**2. Reclassifications**

Certain 2006 balances have been reclassified to conform to the 2007 presentation.

**3. Acquisitions**

In February 2007, we completed the acquisition of Bremner Healthcare Real Estate (Bremner), a national health care development and management firm. The primary reason for the acquisition was to expand our development capabilities within the health care real estate market.

The initial consideration paid to the sellers totaled \$47.1 million, and the sellers may be eligible for further contingent payments over the next three years.

## Edgar Filing: DUKE REALTY CORP - Form 10-Q

Approximately \$39.1 million of the total purchase price was allocated to goodwill, which is attributable to the value of Bremner's overall development capabilities and its in-place workforce. The results of operations for Bremner since the date of acquisition have been included in continuing operations in our consolidated financial statements.

#### 4. Indebtedness

We had one unsecured line of credit available as of September 30, 2007. Additionally, in July 2007, one of our consolidated majority owned subsidiaries entered into a lending agreement that included an additional unsecured line of credit. Our unsecured lines of credit as of September 30, 2007 are described as follows (dollars in thousands):

Description	Borrowing Capacity	Maturity Date	Outstanding Balance at September 30, 2007
Unsecured Line of Credit	\$ 1,000,000	January 2010	\$ 302,000
Unsecured Line of Credit Consolidated Subsidiary	\$ 30,000	July 2011	\$ 2,224

We use our line of credit to fund development activities, acquire additional rental properties and provide working capital. This line of credit provides us with an option to obtain borrowings from financial institutions that participate in the line, at rates lower than the stated interest rate, subject to certain restrictions. Interest rates on the amounts outstanding on the unsecured line of credit as of September 30, 2007 range from LIBOR +.16% to LIBOR +.525% (equal to 5.29% and 5.655% as of September 30, 2007). Our line of credit also contains financial covenants that require us to meet financial ratios and defined levels of performance, including those related to variable rate indebtedness, consolidated net worth and debt-to-market capitalization. As of September 30, 2007, we were in compliance with all covenants under our line of credit.

The consolidated subsidiary's unsecured line of credit allows for borrowings up to \$30.0 million at a rate of LIBOR + .85%. (equal to 6.04% as of September 30, 2007). The unsecured line of credit is used to fund development activities within the consolidated subsidiary. The consolidated subsidiary's unsecured line of credit matures on July 27, 2011 with a 12-month extension option.

In August 2007, we repaid \$100.0 million of 7.375% senior unsecured notes on their scheduled maturity date.

In September 2007, we issued \$300.0 million of 6.50% senior unsecured notes due in January 2018. This issuance was hedged with an interest rate swap (Note 9) that reduced the effective interest rate to 6.16%. The net proceeds from that issuance were used to partially pay down the outstanding balance on our \$1.0 billion unsecured line of credit.

#### 5. Related Party Transactions

We provide property management, leasing, construction and other tenant related services to unconsolidated companies in which we have equity interests. For the nine months ended September 30, 2007 and 2006, we received management fees of \$5.1 million and \$3.3 million, leasing fees of \$2.7 million and \$2.2 million and construction and development fees of \$9.0 million and \$16.8 million, respectively, from these companies. These fees approximate market rates for these types of services, and we have eliminated our ownership percentage of these fees in the consolidated financial statements.

#### 6. Net Income Per Common Share

## Edgar Filing: DUKE REALTY CORP - Form 10-Q

Basic net income per common share is computed by dividing net income available for common shareholders by the weighted average number of common shares outstanding for the period. Diluted net income per common share is computed by dividing the sum of net income available for common shareholders and the minority interest in earnings allocable to Units not owned by us, by the sum of the weighted average number of common shares outstanding and minority Units outstanding, including any potential dilutive common equivalents for the period.

## Edgar Filing: DUKE REALTY CORP - Form 10-Q

The following table reconciles the components of basic and diluted net income per common share for the three and nine months ended September 30, 2007 and 2006, respectively (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Basic net income available for common shareholders	\$ 53,387	\$ 61,734	\$ 159,026	\$ 94,899
Joint venture partner convertible ownership net income (2)		378		
Minority interest in earnings of common unitholders	3,573	6,083	11,101	9,396
Diluted net income available for common shareholders	\$ 56,960	\$ 68,195	\$ 170,127	\$ 104,295
Weighted average number of common shares outstanding	137,576	135,117	137,110	134,957
Weighted average partnership Units outstanding	9,176	13,211	9,560	13,302
Joint venture partner convertible ownership common share equivalents (2)		1,357		
Dilutive shares for stock-based compensation plans (1)	899	1,262	1,316	1,213
Weighted average number of common shares and potential dilutive common equivalents	147,651	150,947	147,986	149,472

(1) Excludes the effect of outstanding stock options, as well as Exchangeable Senior Notes ( Exchangeable Notes ) issued in 2006, that have an anti-dilutive effect on earnings per share for the three and nine-month periods ended September 30, 2007 and 2006.

(2) One of our joint venture partners in one of our unconsolidated companies has the option to convert a portion of its ownership in the joint venture to common shares. The effect of this option on earnings per share is dilutive for the third quarter 2006; therefore, conversion to common shares is included in weighted average potential dilutive common equivalents for the quarter.

### 7. Segment Reporting

We are engaged in three reportable operating segments, the first two of which consist of the ownership and rental of office and industrial real estate investments (collectively, Rental Operations ). The third reportable segment consists of our build-to-suit for sale operations and providing of various real estate services such as property management, maintenance, leasing, development and construction management to third-party property owners and joint ventures ( Service Operations ). Our reportable segments offer different products or services and are managed separately because each segment requires different operating strategies and management expertise.

The assets of the Service Operations business segment generally include properties under development. During the period between the completion of development, rehabilitation or repositioning of a Service Operations property and the date the property is contributed to a property fund or sold to a third party, the property and its associated rental income and rental expenses are included in the applicable Rental Operations segment because the primary activity associated with the Service Operations property during that period is rental activities. Upon contribution or sale, the resulting gain or loss is part of the income of the Service Operations business segment.

## Edgar Filing: DUKE REALTY CORP - Form 10-Q

Non-segment revenue consists mainly of equity in earnings of unconsolidated companies and other insignificant rental operations such as retail and medical office properties. Segment FFO information (FFO is defined below) is calculated by subtracting operating expenses attributable to the applicable segment from segment revenues. Non-segment assets consist of corporate assets, including cash, deferred financing costs and investments in unconsolidated companies. Interest expense and other non-property specific revenues and expenses are not allocated to individual segments in determining our performance measure.



We assess and measure segment operating results based upon an industry performance measure referred to as Funds From Operations ( FFO ), which management believes is a useful indicator of our operating performance. FFO is used by industry analysts and investors as a supplemental operating performance measure of an equity real estate investment trust ( REIT ) like Duke. FFO is calculated in accordance with the definition that was adopted by the Board of Governors of the National Association of Real Estate Investment Trusts ( NAREIT ). NAREIT created FFO as a supplemental measure of REIT operating performance that excludes historical cost depreciation, among other items, from net income determined in accordance with GAAP. FFO is a non-GAAP financial measure developed by NAREIT to compare the operating performance of REITs. The most comparable GAAP measure is net income (loss). FFO should not be considered as a substitute for net income or any other measures derived in accordance with GAAP and may not be comparable to other similarly titled measures of other companies.

Historical cost accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values instead have historically risen or fallen with market conditions, many industry analysts and investors have considered presentation of operating results for real estate companies that use historical cost accounting to be insufficient by themselves. FFO, as defined by NAREIT, represents GAAP net income (loss), excluding extraordinary items as defined under GAAP and gains or losses from sales of previously depreciated operating real estate assets, plus certain non-cash items such as real estate asset depreciation and amortization, and after similar adjustments for unconsolidated partnerships and joint ventures.

Management believes that the use of FFO, combined with the required primary GAAP presentations, improves the understanding of operating results of REITs among the investing public and makes comparisons of REIT operating results more meaningful. Management believes FFO is a useful measure for reviewing comparative operating and financial performance (although FFO should be reviewed in conjunction with net income which remains the primary measure of performance) because by excluding gains or losses related to sales of previously depreciated operating real estate assets and excluding real estate asset depreciation and amortization, FFO provides a useful comparison of the operating performance of our real estate between periods or as compared to different companies.

Edgar Filing: DUKE REALTY CORP - Form 10-Q

The following table shows (i) the revenues and FFO for each of the reportable segments and (ii) a reconciliation of net income available for common shareholders to the calculation of FFO for the three and nine months ended September 30, 2007 and 2006, respectively (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
<b>Revenues</b>				
Rental Operations:				
Office	\$ 140,858	\$ 139,260	\$ 409,886	\$ 399,938
Industrial	52,741	50,755	160,761	144,113
Service Operations	20,273	22,474	57,042	42,198
Total Segment Revenues	213,872	212,489	627,689	586,249
Non-Segment Revenue	9,615	6,045	35,395	30,402
Consolidated Revenue from continuing operations	\$ 223,487	\$ 218,534	\$ 663,084	\$ 616,651
Discontinued Operations	7,088	17,482	32,949	59,964
Consolidated Revenue	\$ 230,575	\$ 236,016	\$ 696,033	\$ 676,615
<b>Funds From Operations</b>				
Rental Operations:				
Office	\$ 87,742	\$ 88,494	\$ 251,862	\$ 249,786
Industrial	40,645	40,357	123,528	111,079
Services Operations	7,301	10,551	26,253	18,477
Total Segment FFO	135,688	139,402	401,643	379,342
Non-Segment FFO:				
Interest expense	(42,390)	(46,825)	(124,924)	(124,757)
Interest and other income, net	6,292	4,381	11,276	8,313
General and administrative expense	(3,847)	(6,760)	(27,912)	(27,642)
Gain on land sales, net of impairment	1,799	2,982	18,207	5,427
Other non-segment income	3,407	169	6,535	3,492
Minority interest	(1,116)	(2,252)	(3,723)	(5,055)
Minority interest share of FFO adjustments	(2,697)	(2,621)	(7,539)	(13,831)
Joint venture FFO	12,414	8,341	36,801	27,060
Dividends on preferred shares	(15,227)	(15,226)	(45,679)	(41,193)
Adjustment for redemption of preferred shares				(2,633)
Discontinued operations, net of minority interest	(650)	7,196	2,597	26,697
Consolidated basic FFO	\$ 93,673	\$ 88,787	\$ 267,282	\$ 235,220
Depreciation and amortization on continuing operations	(71,981)	(59,432)	(202,854)	(173,623)
Depreciation and amortization on discontinued operations	(95)	(4,931)	(5,368)	(16,489)
Company's share of joint venture adjustments	(10,574)	(4,568)	(21,152)	(13,695)
Earnings from depreciated property sales on discontinued operations	39,670	39,537	111,751	41,573
Earnings from depreciated property sales-share of joint venture	(3)	(280)	1,828	8,082
Minority interest share of FFO adjustments	2,697	2,621	7,539	13,831
Net income available for common shareholders	\$ 53,387	\$ 61,734	\$ 159,026	\$ 94,899



## Edgar Filing: DUKE REALTY CORP - Form 10-Q

The assets for each of the reportable segments as of September 30, 2007 and December 31, 2006, respectively, are as follows (in thousands):

	September 30, 2007	December 31, 2006
<b>Assets</b>		
<b>Rental Operations:</b>		
Office	\$ 3,890,873	\$ 4,061,806
Industrial	2,099,009	1,942,992
Service Operations	349,163	301,886
Total Segment Assets	6,339,045	6,306,684
Non-Segment Assets	1,077,797	931,911
Consolidated Assets	\$ 7,416,842	\$ 7,238,595

In addition to revenues and FFO, we also review our recurring capital expenditures in measuring the performance of our individual Rental Operations segments. These recurring capital expenditures consist of tenant improvements, leasing commissions and building improvements. We review these expenditures to determine the costs associated with re-leasing vacant space and maintaining the condition of our properties. Our recurring capital expenditures by segment are summarized as follows for the nine months ended September 30, 2007 and 2006, respectively (in thousands):

	Nine Months Ended September 30,	
	2007	2006
<b>Recurring Capital Expenditures</b>		
Office	\$ 50,079	\$ 42,035
Industrial	10,383	9,672
Non-segment	190	347
Total	\$ 60,652	\$ 52,054

### 8. Discontinued Operations

We classified the operations of 67 buildings as discontinued operations as of September 30, 2007. These 67 buildings consist of 32 industrial and 35 office properties. Of these properties, 30 were sold during the first nine months of 2007, 21 were sold during 2006 and 16 operating properties are classified as held-for-sale at September 30, 2007.

The following table illustrates the operations of the buildings reflected in discontinued operations for the three and nine months ended September 30, 2007 and 2006, respectively (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
<b>Statement of Operations:</b>				
Revenues	\$ 7,088	\$ 17,482	\$ 32,949	\$ 59,964
Expenses:				
Operating	3,080	6,780	14,022	21,645

Edgar Filing: DUKE REALTY CORP - Form 10-Q

Interest	<b>2,045</b>	3,776	<b>8,690</b>	10,858
Depreciation and Amortization	<b>95</b>	4,931	<b>5,368</b>	16,489
General and Administrative	<b>17</b>	46	<b>41</b>	97
Operating Income	<b>1,851</b>	1,949	<b>4,828</b>	10,875
Minority interest expense	<b>(116)</b>	(176)	<b>(315)</b>	(979)
Income from discontinued operations, before gain on sales	<b>1,735</b>	1,773	<b>4,513</b>	9,896
Gain on sale of property	<b>39,670</b>	43,735	<b>111,751</b>	45,739
Minority interest expense gain on sales	<b>(2,480)</b>	(3,939)	<b>(7,284)</b>	(4,119)
Gain on sale of property, net of minority interest	<b>37,190</b>	39,796	<b>104,467</b>	41,620
Income from discontinued operations	<b>\$ 38,925</b>	\$ 41,569	<b>\$ 108,980</b>	\$ 51,516

## Edgar Filing: DUKE REALTY CORP - Form 10-Q

At September 30, 2007, we classified 16 properties as held-for-sale and included in discontinued operations. Additionally, we have classified 13 in-service properties as held-for-sale, but have included the results of operations of these properties in continuing operations, either based on our present intention to sell the majority of our ownership interest in the properties to entities in which we will retain a minority equity ownership interest or because the results of operations for the properties are immaterial. The following table illustrates the aggregate balance sheet of the aforementioned properties included in discontinued operations, as well as the 13 held-for-sale properties whose results are included in continuing operations, at September 30, 2007 (in thousands):

	<b>Properties Included in Discontinued Operations</b>	<b>Properties Included in Continuing Operations</b>	<b>Total Held-for-Sale Properties</b>
<b>Balance Sheet:</b>			
Real estate investments, net	\$ 133,895	\$ 193,064	\$ 326,959
Other assets	9,810	14,490	24,300
<b>Total assets</b>	<b>\$ 143,705</b>	<b>\$ 207,554</b>	<b>\$ 351,259</b>
Accrued expenses	\$ 2,762	\$ 633	\$ 3,395
Other liabilities	1,021	7,759	8,780
Secured debt		25,751	25,751
<b>Total liabilities held-for-sale</b>	<b>\$ 3,783</b>	<b>\$ 34,143</b>	<b>\$ 37,926</b>

We allocate interest expense to discontinued operations and have included such interest expense in computing net income from discontinued operations. Interest expense allocable to discontinued operations includes interest on any debt on secured properties included in discontinued operations and an allocable share of our consolidated unsecured interest expense for unencumbered properties. The allocation of unsecured interest expense to discontinued operations was based upon the gross book value of the discontinued operations unencumbered population as it related to our entire unencumbered population.

### 9. Financial Instruments

We are exposed to capital market risk, such as changes in interest rates. In order to reduce the volatility relating to interest rate risk, we may enter into interest rate hedging arrangements from time to time. We do not utilize derivative financial instruments for trading or speculative purposes.

In August 2005, we entered into \$300.0 million of cash flow hedges through forward-starting interest rate swaps to hedge interest rates on \$300.0 million of estimated debt offerings in 2007. The swaps qualified for hedge accounting, with any change in fair value recorded in Accumulated Other Comprehensive Income ( OCI ). In conjunction with the September 2007 issuance of \$300.0 million of senior unsecured notes (Note 4), we terminated these cash flow hedges as designated. The settlement amount received of \$10.7 million will be recognized to earnings through interest expense over the term of the hedged cash flows. The ineffective portion of the hedge was insignificant.

In July 2007, we entered into a \$21.0 million cash flow hedge through an interest rate swap to fix the rate on \$21.0 million of floating rate term debt, issued by one of our consolidated majority owned subsidiaries, which matures in July 2011. The swap qualifies for hedge accounting, with any changes in fair value recorded in OCI. At September 30, 2007 the fair value of this swap was approximately \$585,000 in a liability position.

## Edgar Filing: DUKE REALTY CORP - Form 10-Q

The effectiveness of our hedges will be evaluated throughout their lives using the hypothetical derivative method under which the change in fair value of the actual swap designated as the hedging instrument is compared to the change in fair value of a hypothetical swap.

## 10. Recent Accounting Pronouncements

We adopted Financial Accounting Standards Board ( FASB ) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* ( FIN 48 ), on January 1, 2007. The adoption of FIN 48 resulted in an additional tax exposure of approximately \$1.7 million recorded as an adjustment to the opening balance of Distributions in Excess of Net Income. Our uncertain tax positions are immaterial both individually and in the aggregate primarily due to our tax status as a REIT.

In September 2006, the FASB issued Statement of Financial Accounting Standard ( SFAS ) No. 157, *Fair Value Measurements* ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosure about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. Management is currently evaluating the impact of adopting this statement.

In January 2007, the FASB issued SFAS No. 159, *The Fair Value Options for Financial Assets and Financial Liabilities* ( SFAS 159 ). SFAS 159 provides a Fair Value Option under which a company may irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities. This Fair Value Option will be available on a contract-by-contract basis with changes in fair value recognized in earnings as those changes occur. The effective date for SFAS 159 is the beginning of each reporting entity's first fiscal year end that begins after November 15, 2007. We do not expect to elect the Fair Value Option for any of our financial assets or liabilities.

## 11. Subsequent Events

### *Declaration of Dividends*

The Company's board of directors declared the following dividends at its October 31, 2007, regularly scheduled board meeting:

Class	Quarterly Amount/Share	Record Date	Payment Date
Common	\$ 0.48	November 14, 2007	November 30, 2007
Preferred (per depositary share):			
Series J	\$ 0.414063	November 16, 2007	November 30, 2007
Series K	\$ 0.406250	November 16, 2007	November 30, 2007
Series L	\$ 0.412500	November 16, 2007	November 30, 2007
Series M	\$ 0.434375	December 17, 2007	December 31, 2007
Series N	\$ 0.453125	December 17, 2007	December 31, 2007

### *Issuance of Common Stock*

In October 2007, we issued 7.0 million shares of our common stock for net proceeds of \$232.7 million. The net proceeds of the offering were used to partially pay down our \$1.0 billion unsecured line of credit.



*Redemption of Series B Cumulative Redeemable Preferred Shares*

In October 2007, we redeemed all of the outstanding shares of our 7.990% Series B Cumulative Redeemable Preferred Stock at a liquidation amount of \$132.3 million.

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

**Cautionary Statement Regarding Forward Looking Statements**

Certain statements contained in this Report, including, without limitation, those related to our future operations, constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words believe, estimate, expect, anticipate, intend, plan, seek, may, and similar expressions or statements re future periods are intended to identify forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance or achievements, or industry results, to differ materially from any predictions of future results, performance or achievements that we express or imply in this Report. Some of the risks, uncertainties and other important factors that may affect future results include, among others:

Changes in general economic and business conditions, including the performance of financial markets;

Our continued qualification as a real estate investment trust, or REIT, for U.S. federal income tax purposes;

Heightened competition for tenants and potential decreases in property occupancy;

Potential increases in real estate construction costs;

Potential changes in the financial markets and interest rates;

Our continuing ability to raise funds on favorable terms through the issuance of debt and equity in the capital markets;

Our ability to successfully identify, acquire, develop and/or manage properties on terms that are favorable to us;

Our ability to successfully dispose of properties on terms that are favorable to us;

Inherent risks in the real estate business, including, but not limited to, tenant defaults, potential liability relating to environmental matters and liquidity of real estate investments; and

Other risks and uncertainties described herein, as well as those risks and uncertainties discussed from time to time in our other reports and filings with the Securities and Exchange Commission (SEC).

This list of risks and uncertainties, however, is only a summary of some of the most important factors and is not intended to be exhaustive. Additional information regarding risk factors that may affect us is included under the caption Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, which we filed with the SEC on March 1, 2007, and is updated by us from time to time in Quarterly Reports on Form 10-Q and other public filings.

## Edgar Filing: DUKE REALTY CORP - Form 10-Q

Although we presently believe that the plans, expectations and results expressed in or suggested by the forward-looking statements are reasonable, all forward-looking statements are inherently subjective, uncertain and subject to change, as they involve substantial risks and uncertainties beyond our control. New factors emerge from time to time, and it is not possible for us to predict the nature, or assess the potential impact, of each new factor on our business. Given these uncertainties, we caution you not to place undue reliance on these forward-looking statements. We undertake no obligation to update or revise any of our forward-looking statements for events or circumstances that arise after the statement is made, except as otherwise may be required by law.

**Business Overview**

We are a self-administered and self-managed REIT that began operations through a related entity in 1972. As of September 30, 2007, we:

Owned or jointly controlled 723 industrial, office and retail properties (including properties under development), consisting of approximately 119.8 million square feet; and

Owned or jointly controlled more than 7,600 acres of land with an estimated future development potential of more than 112 million square feet of industrial, office and retail properties.

We provide the following services for our properties and for certain properties owned by third parties and joint ventures:

Property leasing;

Property management;

Construction;

Development; and

Other tenant-related services.

**Acquisitions**

In February 2007, we completed the acquisition of Bremner Healthcare Real Estate ( Bremner ), a national health care development and management firm. The primary reason for the acquisition was to expand our development capabilities within the health care real estate market.

The initial consideration paid to the sellers totaled \$47.1 million, and the sellers may be eligible for further contingent payments over the next three years.

Approximately \$39.1 million of the total purchase price is allocated to goodwill, which is attributable to the value of Bremner s overall development capabilities and its in-place workforce.

**Key Performance Indicators**

## Edgar Filing: DUKE REALTY CORP - Form 10-Q

Our operating results depend primarily upon rental income from our office and industrial properties ( Rental Operations ). The following highlights the areas of Rental Operations that we consider critical for future revenue growth. All square footage totals and occupancy percentages reflect both wholly owned properties and properties in joint ventures.

**Occupancy Analysis:** Our ability to maintain favorable occupancy rates is a principal driver of our results of operations. The following table sets forth occupancy information regarding our in-service portfolio of rental properties (excluding in-service properties developed or acquired with the intent to sell Service Operations Buildings ) as of September 30, 2007 and 2006, respectively (in thousands, except percentage data):

Type	Total Square Feet		Percent of Total Square Feet		Percent Occupied	
	2007	2006	2007	2006	2007	2006
<b>Industrial</b>	<b>75,225</b>	73,248	<b>69.5%</b>	69.0%	<b>94.6%</b>	93.2%
<b>Office</b>	<b>31,688</b>	32,170	<b>29.2%</b>	30.3%	<b>91.0%</b>	91.0%
<b>Other</b>	<b>1,378</b>	745	<b>1.3%</b>	0.7%	<b>90.7%</b>	96.9%
<b>Total</b>	<b>108,291</b>	106,163	<b>100.0%</b>	100.0%	<b>93.5%</b>	92.5%

**Lease Expiration and Renewal:** Our ability to maintain and grow occupancy rates primarily depends upon our continuing ability to re-lease expiring space. The following table reflects our in-service lease expiration schedule by property type as of September 30, 2007. The table indicates square footage and annualized net effective rents (based on September 2007 rental revenue) under expiring leases (in thousands, except percentage data):

Year of Expiration	Square Feet	Total Portfolio		Industrial		Office		Other	
		Ann. Rent Revenue	% of Revenue	Square Feet	Ann. Rent Revenue	Square Feet	Ann. Rent Revenue	Square Feet	Ann. Rent Revenue
2007	2,580	\$ 13,597	2%	2,130	\$ 8,075	405	\$ 4,953	45	\$ 569
2008	12,358	69,195	9%	9,606	35,501	2,724	33,295	28	399
2009	11,524	74,835	11%	8,287	33,313	3,177	40,931	60	591
2010	12,938	98,818	14%	8,660	38,755	4,263	59,876	15	187
2011	13,538	85,246	12%	10,107	38,743	3,364	45,442	67	1,061
2012	10,589	74,873	11%	7,159	28,149	3,386	45,868	44	856
2013	8,589	74,965	11%	4,752	20,335	3,785	53,812	52	818
2014									