

PS BUSINESS PARKS INC/CA

Form 10-K

February 27, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K**

- þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006.
or
- o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the transition period from to
Commission File Number 1-10709
PS BUSINESS PARKS, INC.
(Exact name of registrant as specified in its charter)

California **95-4300881**
(State or other jurisdiction of *(I.R.S. Employer Identification No.)*
incorporation or organization)
701 Western Avenue, Glendale, California 91201-2397
(Address of principal executive offices) (Zip Code)
818-244-8080
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.01 par value per share	American Stock Exchange
Depository Shares Each Representing 1/1,000 of a Share of 7.000% Cumulative Preferred Stock, Series H, \$0.01 par value per share	American Stock Exchange
Depository Shares Each Representing 1/1,000 of a Share of 6.875% Cumulative Preferred Stock, Series I, \$0.01 par value per share	American Stock Exchange
Depository Shares Each Representing 1/1,000 of a Share of 7.950% Cumulative Preferred Stock, Series K, \$0.01 par value per share	American Stock Exchange
Depository Shares Each Representing 1/1,000 of a Share of 7.600% Cumulative Preferred Stock, Series L, \$0.01 par value per share	American Stock Exchange
Depository Shares Each Representing 1/1,000 of a Share of 7.200% Cumulative Preferred Stock, Series M, \$0.01 par value per share	American Stock Exchange
Depository Shares Each Representing 1/1,000 of a Share of 7.375% Cumulative Preferred Stock, Series O, \$0.01 par value per share	American Stock Exchange
Depository Shares Each Representing 1/1,000 of a Share of	American Stock Exchange

6.700% Cumulative Preferred Stock, Series P, \$0.01 par value
per share

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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 the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

As of June 30, 2006, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$936,035,059 based on the closing price as reported on the American Stock Exchange.

Number of shares of the registrant's common stock, par value \$0.01 per share, outstanding as of February 23, 2007 (the latest practicable date): 21,318,663.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement to be filed in connection with the Annual Meeting of Shareholders to be held in 2007 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I.

ITEM 1. BUSINESS

The Company

PS Business Parks, Inc. (PSB) is a fully-integrated, self-advised and self-managed real estate investment trust (REIT) that acquires, develops, owns and operates commercial properties, primarily multi-tenant flex, office and industrial space. As of December 31, 2006, PSB owned approximately 75% of the common partnership units of PS Business Parks, L.P. (the Operating Partnership or OP). The remaining common partnership units were owned by Public Storage, Inc. (PSI or Public Storage). PSB, as the sole general partner of the Operating Partnership, has full, exclusive and complete responsibility and discretion in managing and controlling the Operating Partnership. Unless otherwise indicated or unless the context requires otherwise, all references to the Company, we, us, our, and similar references mean PS Business Parks, Inc. and its subsidiaries, including the Operating Partnership.

As of December 31, 2006, the Company owned and operated approximately 18.7 million rentable square feet of commercial space located in eight states: Arizona, California, Florida, Maryland, Oregon, Texas, Virginia, and Washington. The Company also manages approximately 1.4 million rentable square feet on behalf of PSI and its affiliated entities.

History of the Company: The Company was formed in 1990 as a California corporation under the name Public Storage Properties XI, Inc. In a March 17, 1998 merger with American Office Park Properties, Inc. (AOPP) (the Merger), the Company acquired the commercial property business previously operated by AOPP and was renamed PS Business Parks, Inc. Prior to the merger in January, 1997, AOPP was reorganized to succeed to the commercial property business of PSI, becoming a fully integrated, self advised and self managed REIT.

From 1998 through 2001, the Company added 9.7 million square feet in Virginia, Maryland, Texas, Oregon, California and Arizona, acquiring 9.2 million square feet of commercial space from unaffiliated third parties and developing an additional 500,000 square feet.

In 2002, the economy and real estate fundamentals softened. This resulted in an environment in which the Company was unable to identify acquisitions at prices that met its investment criteria. The Company disposed of four properties totaling 386,000 square feet that no longer met its investment criteria.

In 2003, the Company acquired 4.1 million square feet of commercial space from unaffiliated third parties, including a 3.4 million square foot property located in Miami, Florida, which represented a new market for the Company. The Miami property represented approximately 18% of the Company s aggregate rentable square footage at December 31, 2003. The cost of these acquisitions was \$282.4 million. The Company also disposed of four properties totaling 226,000 square feet as well as a one acre plot of land that no longer met its investment criteria.

In 2004, the Company made only one acquisition, a 165,000 square foot asset in Fairfax, Virginia, for \$24.1 million. During 2004, the Company sold two significant assets, comprising 400,000 square feet in Maryland resulting in a gain of \$15.2 million. Additionally in 2004, the Company sold an aggregate of 91,000 square feet in Texas, Oregon and Miami.

In 2005, the Company acquired one asset, a 233,000 square foot multi-tenant flex space in San Diego, California. The asset, which was 94.6% leased at the time of acquisition, was purchased for \$35.1 million. In connection with the acquisition, the Company assumed a \$15.0 million mortgage which bears interest at a fixed rate of 5.73%. During 2005, the Company sold Woodside Corporate Park, a 574,000 square foot flex and office park in Beaverton, Oregon, for \$64.5 million resulting in a gain of \$12.5 million. The park was 76.8% leased at the time of the sale. Additionally in 2005, the Company sold 100,000 square feet and some parcels of land in Miami and Oregon.

In 2006, the Company acquired 1.2 million square feet for an aggregate cost of \$180.3 million. The Company acquired WesTech Business Park, a 366,000 square foot office and flex park in Silver Spring, Maryland, for \$69.3 million; a 88,800 square foot multi-tenant flex park in Signal Hill, California, for \$10.7 million; a 107,300 square

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foot multi-tenant flex park in Chantilly, Virginia, for \$15.8 million, Meadows Corporate Park; a 165,000 square foot multi-tenant office park in Silver Spring, Maryland, for \$29.9 million; Rogers Avenue, a 66,500 square foot multi-tenant industrial and flex park in San Jose, California, for \$8.4 million; and Boca Commerce Park and Wellington Commerce Park, two multi-tenant industrial, flex and storage parks, aggregating 398,000 square feet, located in Palm Beach County, Florida, for \$46.2 million. In connection with the Meadows Corporate Park purchase, the Company assumed a \$16.8 million mortgage with a fixed interest rate of 7.20% through November, 2011, at which time it can be prepaid without penalty. In addition, in connection with the Palm Beach County purchases, the Company assumed three mortgages with a combined total of \$23.8 million with a weighted average fixed interest rate of 5.84%. During 2006, the Company sold a 30,500 square foot building located in Beaverton, Oregon, for \$4.4 million resulting in a gain of \$1.5 million. Additionally in 2006, the Company sold 32,400 square feet in Miami for a combined total of \$3.7 million, resulting in a gain of \$865,000.

The Company has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the Code), commencing with its taxable year ended December 31, 1990. To the extent that the Company continues to qualify as a REIT, it will not be taxed, with certain limited exceptions, on the net income that is currently distributed to its shareholders.

The Company's principal executive offices are located at 701 Western Avenue, Glendale, California 91201-2397. The Company's telephone number is (818) 244-8080. The Company maintains a website with the address www.psbusinessparks.com. The information contained on the Company's website is not a part of, or incorporated by reference into, this Annual Report on Form 10-K. The Company makes available free of charge through its website its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after the Company electronically files such material with, or furnishes such material to, the Securities and Exchange Commission.

Business of the Company: The Company is in the commercial property business, with properties consisting of multi-tenant flex, industrial, and office space. The Company owns approximately 11.5 million square feet of flex space. The Company defines flex space as buildings that are configured with a combination of warehouse and office space and can be designed to fit a wide variety of uses. The warehouse component of the flex space has a number of uses including light manufacturing and assembly, storage and warehousing, showroom, laboratory, distribution and research and development activities. The office component of flex space is complementary to the warehouse component by enabling businesses to accommodate management and production staff in the same facility. The Company owns approximately 3.9 million square feet of industrial space that have characteristics similar to the warehouse component of the flex space. In addition, the Company owns approximately 3.3 million square feet of low-rise office space, generally either in business parks that combine office and flex space or in submarkets where the economics of the market demand an office build-out.

The Company's commercial properties typically consist of low-rise buildings, ranging from one to over fifty buildings per property, located on up to 216 acres and comprising from approximately 12,000 to 3.2 million aggregate square feet of rentable space. Facilities are managed through either on-site management or area offices central to the facilities. Parking is generally open but in some instances is covered. The ratio of parking spaces to rentable square feet ranges from two to six per thousand square feet depending upon the use of the property and its location. Office space generally requires a greater parking ratio than most industrial uses. The Company may acquire properties that do not have these characteristics.

The tenant base for the Company's facilities is diverse. The portfolio can be bifurcated into those facilities that service small to medium-sized businesses and those that service larger businesses. Approximately 39.7% of in-place rents from the portfolio are from facilities that serve small to medium-sized businesses. A property in this facility type is typically divided into units ranging in size from 500 to 4,999 square feet and leases generally range from one to three years. The remaining 60.3% of the in-place rents are derived from facilities that serve larger businesses, with units greater than or equal to 5,000 square feet. The Company also has several tenants that lease space in multiple buildings and locations. The U.S. Government is the largest tenant with leases encompassing 469,000 square feet, in 12 separate locations, or approximately 5.1% of the Company's annual revenue.

The Company intends to continue acquiring commercial properties located in its target markets within the United States. The Company's policy of acquiring commercial properties may be changed by its Board of Directors without

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shareholder approval. However, the Board of Directors has no intention of changing this policy at this time. Although the Company currently owns properties in eight states, it may expand its operations to other states or reduce the number of states in which it operates. Properties are acquired for both income and potential capital appreciation; there is no limitation on the amount that can be invested in any specific property. Although there are no restrictions on our ability to expand our operations into foreign markets, we currently operate solely within the United States and have no foreign operations.

The Company has acquired land for the development of commercial properties. The Company owned approximately 6.4 acres of land in Northern Virginia, 14.9 acres in Portland, Oregon, 1.0 acre in Rockville, Maryland and 10.0 acres in Dallas, Texas as of December 31, 2006.

Operating Partnership

The properties in which the Company has an equity interest will generally be owned by the Operating Partnership. The Company has the ability to acquire interests in additional properties in transactions that could defer the contributors' tax consequences by causing the Operating Partnership to issue equity interests in return for interests in properties.

As the general partner of the Operating Partnership, the Company has the exclusive responsibility under the Operating Partnership Agreement to manage and conduct the business of the Operating Partnership. The Board of Directors directs the affairs of the Operating Partnership by managing the Company's affairs. The Operating Partnership will be responsible for, and pay when due, its share of all administrative and operating expenses of the properties it owns.

The Company's interest in the Operating Partnership entitles it to share in cash distributions from, and the profits and losses of, the Operating Partnership in proportion to the Company's economic interest in the Operating Partnership (apart from tax allocations of profits and losses to take into account pre-contribution property appreciation or depreciation).

Summary of the Operating Partnership Agreement

The following summary of the Operating Partnership Agreement is qualified in its entirety by reference to the Operating Partnership Agreement as amended, which is incorporated by reference as an exhibit to this report.

Issuance of Additional Partnership Interests: As the general partner of the Operating Partnership, the Company is authorized to cause the Operating Partnership from time to time to issue to partners of the Operating Partnership or to other persons additional partnership units in one or more classes, and in one or more series of any of such classes, with such designations, preferences and relative, participating, optional, or other special rights, powers and duties (which may be senior to the existing partnership units), as will be determined by the Company, in its sole and absolute discretion, without the approval of any limited partners, except to the extent specifically provided in the agreement. No such additional partnership units, however, will be issued to the Company unless (i) the agreement to issue the additional partnership interests arises in connection with the issuance of shares of the Company, which shares have designations, preferences and other rights, such that the economic interests are substantially similar to the designations, preferences and other rights of the additional partnership units that would be issued to the Company and (ii) the Company agrees to make a capital contribution to the Operating Partnership in an amount equal to the proceeds raised in connection with the issuance of such shares of the Company.

Capital Contributions: No partner is required to make additional capital contributions to the Operating Partnership, except that the Company as the general partner is required to contribute the proceeds of the sale of equity interests in the Company to the Operating Partnership in return for additional partnership units. A limited partner may be required to pay to the Operating Partnership any taxes paid by the Operating Partnership on behalf of that limited partner. No partner is required to pay to the Operating Partnership any deficit or negative balance which may exist in its capital account.

Distributions: The Company, as general partner, is required to distribute at least quarterly the available cash (as defined in the Operating Partnership Agreement) generated by the Operating Partnership for such quarter.

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Distributions are to be made (i) first, with respect to any class of partnership interests having a preference over other classes of partnership interests; and (ii) second, in accordance with the partners' respective percentage interests on the partnership record date (as defined in the Operating Partnership Agreement). Commencing in 1998, the Operating Partnership's policy has been to make distributions per unit (other than preferred units) that are equal to the per share distributions made by the Company with respect to its common stock.

Preferred Units: As of December 31, 2006, the Operating Partnership had an aggregate of 3.3 million preferred units owned by third parties with distribution rates ranging from 7.125% to 7.950% (per annum) with an aggregate stated value of \$82.8 million. The Operating Partnership has the right to redeem each series of preferred units on or after the fifth anniversary of the issuance date of the series at the original capital contribution plus the cumulative priority return, as defined, to the redemption date to the extent not previously distributed. Each series of preferred units is exchangeable for Cumulative Redeemable Preferred Stock of the respective series of PS Business Parks, Inc. on or after the tenth anniversary of the date of issuance at the option of the Operating Partnership or a majority of the holders of the applicable series of preferred units.

As of December 31, 2006, in connection with the Company's issuance of publicly traded Cumulative Preferred Stock, the Company owned 24.9 million preferred units of various series with a stated value of \$622.5 million with terms substantially identical to the terms of the publicly traded depository shares each representing 1/1,000 of a share of 6.875% to 8.750% Cumulative Preferred Stock of the Company. On December 15, 2006, the Company called 2.0 million depository shares (\$50.0 million) of its 8.750% Cumulative Preferred Stock, Series F for January 29, 2007 redemption. The holders of all series of Preferred Stock may combine to elect two additional directors if the Company fails to make dividend payments for six quarterly dividend payment periods, whether or not consecutive.

Redemption of Partnership Interests: Subject to certain limitations described below, each limited partner (other than the Company and holders of preferred units) has the right to require the redemption of such limited partner's units. This right may be exercised on at least 10 days notice at any time or from time to time, beginning on the date that is one year after the date on which such limited partner is admitted to the Operating Partnership (unless otherwise contractually agreed by the general partner).

Unless the Company, as general partner, elects to assume and perform the Operating Partnership's obligation with respect to a redemption right, as described below, a limited partner that exercises its redemption right will receive cash from the Operating Partnership in an amount equal to the redemption amount (as defined in the Operating Partnership Agreement generally to reflect the average trading price of the common stock of the Company over a specified 10 day trading period) for the units redeemed. In lieu of the Operating Partnership redeeming the units for cash, the Company, as the general partner, has the right to elect to acquire the units directly from a limited partner exercising its redemption right, in exchange for cash in the amount specified above as the redemption amount or by issuance of the shares amount (as defined in the Operating Partnership Agreement, generally to mean the issuance of one share of the Company common stock for each unit of limited partnership interest redeemed).

A limited partner cannot exercise its redemption right if delivery of shares of common stock would be prohibited under the articles of incorporation of the Company or if in the opinion of counsel to the general partner there is a significant risk that delivery of shares of common stock would cause the general partner to no longer qualify as a REIT, would cause a violation of the applicable securities or certain antitrust laws, or would result in the Operating Partnership no longer being treated as a partnership for federal income tax purposes.

Limited Partner Transfer Restrictions: Limited partners generally may not transfer partnership interests (other than to their estates, immediate family or certain affiliates) without the prior written consent of the Company as general partner, which consent may be given or withheld in its sole and absolute discretion. The Company, as general partner, has a right of first refusal to purchase partnership interests proposed to be sold by the limited partners. Transfers must comply with applicable securities laws and regulations. Transfers of partnership interests generally are not permitted if the transfer would be made through certain trading markets or adversely affect the Company's ability to qualify as a REIT or could subject the Company to any additional taxes under Section 857 or Section 4981 of the Code.

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Management: The Operating Partnership is organized as a California limited partnership. The Company, as the sole general partner of the Operating Partnership, has full, exclusive and complete responsibility and discretion in managing and controlling the Operating Partnership, except as provided in the Operating Partnership Agreement and by applicable law. The limited partners of the Operating Partnership have no authority to transact business for, or participate in the management activities or decisions of, the Operating Partnership except as provided in the Operating Partnership Agreement and as permitted by applicable law. The Operating Partnership Agreement provides that the general partner may not be removed by the limited partners. In exercising its authority under the agreement, the general partner may take into account (but is not required to do so) the tax consequences to any partner of actions or inaction and is under no obligation to consider the separate interests of the limited partners.

However, the consent of the limited partners holding a majority of the interests of the limited partners (including limited partnership interests held by the Company) generally will be required to amend the Operating Partnership Agreement. Further, the Operating Partnership Agreement cannot be amended without the consent of each partner adversely affected if, among other things, the amendment would alter the partner's rights to distributions from the Operating Partnership (except as specifically permitted in the Operating Partnership Agreement), alter the redemption right, or impose on the limited partners an obligation to make additional capital contributions.

The consent of all limited partners will be required to (i) take any action that would make it impossible to carry on the ordinary business of the Operating Partnership, except as otherwise provided in the Operating Partnership Agreement; or (ii) possess Operating Partnership property, or assign any rights in specific Operating Partnership property, for other than an Operating Partnership purpose, except as otherwise provided in the Operating Partnership Agreement. In addition, without the consent of any adversely affected limited partner, the general partner may not perform any act that would subject a limited partner to liability as a general partner in any jurisdiction or any other liability except as provided in the Operating Partnership Agreement or under California law.

Extraordinary Transactions: The Operating Partnership Agreement provides that the Company may not engage in any business combination, defined to mean any merger, consolidation or other combination with or into another person or sale of all or substantially all of its assets, any reclassification, any recapitalization (other than certain stock splits or stock dividends) or change of outstanding shares of common stock, unless (i) the limited partners of the Operating Partnership will receive, or have the opportunity to receive, the same proportionate consideration per unit in the transaction as shareholders of the Company (without regard to tax considerations); or (ii) limited partners of the Operating Partnership (other than the general partner) holding at least 60% of the interests in the Operating Partnership held by limited partners (other than the general partner) vote to approve the business combination. In addition, the Company, as general partner of the Operating Partnership, has agreed in the Operating Partnership Agreement with the limited partners of the Operating Partnership that it will not consummate a business combination in which the Company conducted a vote of shareholders unless the matter is also submitted to a vote of the partners.

The foregoing provision of the Operating Partnership Agreement would under no circumstances enable or require the Company to engage in a business combination which required the approval of shareholders if the shareholders of the Company did not in fact give the requisite approval. Rather, if the shareholders did approve a business combination, the Company would not consummate the transaction unless the Company as general partner first conducts a vote of partners of the Operating Partnership on the matter. For purposes of the Operating Partnership vote, the Company shall be deemed to vote its partnership interest in the same proportion as the shareholders of the Company voted on the matter (disregarding shareholders who do not vote). The Operating Partnership vote will be deemed approved if the votes recorded are such that if the Operating Partnership vote had been a vote of shareholders, the business combination would have been approved by the shareholders. As a result of these provisions of the Operating Partnership, a third party may be inhibited from making an acquisition proposal for the Company that it would otherwise make, or the Company, despite having the requisite authority under its articles of incorporation, may not be authorized to engage in a proposed business combination.

Indemnification: The Operating Partnership Agreement generally provides that the Company and its officers and directors and the limited partners of the Operating Partnership will be indemnified and held harmless by the Operating Partnership for matters that relate to the operations of the Operating Partnership unless it is established that (i) the act or omission of the indemnified person was material to the matter giving rise to the proceeding and either was

committed in bad faith or was the result of active and deliberate dishonesty; (ii) the indemnified person

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actually received an improper personal benefit in money, property or services; or (iii) in the case of any criminal proceeding, the indemnified person had reasonable cause to believe that the act or omission was unlawful. The termination of any proceeding by judgment, order or settlement does not create a presumption that the indemnified person did not meet the requisite standards of conduct set forth above. The termination of any proceeding by conviction or upon a plea of nolo contendere or its equivalent, or an entry of an order of probation prior to judgment, creates a rebuttable presumption that the indemnified person did not meet the requisite standard of conduct set forth above. Any indemnification so made shall be made only out of the assets of the Operating Partnership or through insurance obtained by the Operating Partnership. The general partner shall not be liable for monetary damages to the partnership, any partners or any assignees for losses sustained, liabilities incurred or benefits not derived as a result of errors in judgment or of any act or omissions if the general partner acted in good faith.

Duties and Conflicts: The Operating Agreement allows the Company to operate the Operating Partnership in a manner that will enable the Company to satisfy the requirements for being classified as a REIT. The Company intends to conduct all of its business activities, including all activities pertaining to the acquisition, management and operation of properties, through the Operating Partnership. However, the Company may own, directly or through subsidiaries, interests in Operating Partnership properties that do not exceed 1% of the economic interest of any property, and if appropriate for regulatory, tax or other purposes, the Company also may own, directly or through subsidiaries, interests in assets that the Operating Partnership otherwise could acquire, if the Company grants to the Operating Partnership the option to acquire the assets within a period not to exceed three years in exchange for the number of partnership units that would be issued if the Operating Partnership had acquired the assets at the time of acquisition by the Company.

Term: The Operating Partnership will continue in full force and effect until December 31, 2096 or until sooner dissolved upon the withdrawal of the general partner (unless the limited partners elect to continue the Operating Partnership), or by the election of the general partner (with the consent of the holders of a majority of the partnerships interests if such vote is held before January 1, 2056), in connection with a merger or the sale or other disposition of all or substantially all of the assets of the Operating Partnership, or by judicial decree.

Other Provisions: The Operating Partnership Agreement contains other provisions affecting its operations and management, limited partner access to certain business records, responsibility for expenses and reimbursements, tax allocations, distribution of certain reports, winding-up and liquidation, the granting by the limited partners of powers of attorney to the general partner, the rights of holders of particular series of preferred units, and other matters.

Cost Allocation and Administrative Services

Pursuant to a cost sharing and administrative services agreement, the Company shares costs with PSI and affiliated entities for certain administrative services. These services include employee relations, administration, management information systems, legal, corporate tax and office services. Under this agreement, costs are allocated to the Company in accordance with its proportionate share of these costs. These allocated costs totaled \$320,000, \$335,000 and \$327,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

Common Officers and Directors with PSI

Ronald L. Havner, Jr., Chairman of the Company, is the Chief Executive Officer and President of PSI. Harvey Lenkin, retired president of PSI, is a Director of both the Company and PSI. The Company engages additional executive personnel who render services exclusively for the Company. However, it is expected that certain officers of PSI will continue to render services for the Company as requested.

Property Management

The Company continues to manage commercial properties owned by PSI and its affiliates, which are generally adjacent to mini-warehouses, for a fee of 5% of the gross revenues of such properties in addition to reimbursement of direct costs. The property management contract with PSI is for a seven-year term with the agreement automatically extending for successive one-year terms (unless cancelled by either party). PSI can cancel the property management contract upon 60 days notice while the Operating Partnership can cancel it upon seven years notice. Management fee revenue derived from these management contracts with PSI and its affiliates totaled \$625,000, \$579,000 and \$562,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

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Management

Joseph D. Russell, Jr. (47) leads the Company's senior management team. Mr. Russell is President and Chief Executive Officer of the Company. The Company's executive management includes: John Petersen (43), Executive Vice President and Chief Operating Officer; Edward A. Stokx (41), Executive Vice President and Chief Financial Officer; Brett Franklin (42), Senior Vice President, Acquisitions and Dispositions; Maria R. Hawthorne (47), Senior Vice President (East Coast); Coby Holley (37), Vice President (Pacific Northwest Division), Robin E. Mather (44), Vice President (Southern California Division); William A. McFaul (41), Vice President (Maryland Division); and Viola Sanchez (44) Vice President (Southeast Division).

REIT Structure

If certain detailed conditions imposed by the Code and the related Treasury Regulations are met, an entity, such as the Company, that invests principally in real estate and that otherwise would be taxed as a corporation may elect to be treated as a REIT. The most important consequence to the Company of being treated as a REIT for federal income tax purposes is that the Company can deduct dividend distributions (including distributions on preferred stock) to its shareholders, thus effectively eliminating the double taxation (at the corporate and shareholder levels) that typically results when a corporation earns income and distributes that income to shareholders in the form of dividends.

The Company believes that it has operated, and intends to continue to operate, in such a manner as to qualify as a REIT under the Code, but no assurance can be given that it will at all times so qualify. To the extent that the Company continues to qualify as a REIT, it will not be taxed, with certain limited exceptions, on the taxable income that is distributed to its shareholders.

Operating Strategy

The Company believes its operating, acquisition and finance strategies combined with its diversified portfolio produces a lower risk, higher growth business model. The Company's primary objective is to grow shareholder value. Key elements of the Company's growth strategy include:

Maximize Net Cash Flow of Existing Properties: The Company seeks to maximize the net cash flow generated by its properties by (i) maximizing average occupancy rates, (ii) achieving higher levels of realized monthly rents per occupied square foot and (iii) reducing its operating cost structure by improving operating efficiencies and economies of scale. The Company believes that its experienced property management personnel and comprehensive systems combined with increasing economies of scale will enhance the Company's ability to meet these goals. The Company seeks to increase occupancy rates and realized monthly rents per square foot by providing its field personnel with incentives to lease space to higher credit tenants and to maximize the return on investment in each lease transaction. The Company seeks to reduce its cost structure by controlling capital expenditures associated with re-leasing space by acquiring and owning properties with easily reconfigured space that appeal to a wide range of tenants.

Focus on Targeted Markets: The Company intends to continue investing in markets that have characteristics which enable them to be competitive economically. The Company believes that markets with some combination of above average population growth, education levels and personal income will produce better overall economic returns. As of December 31, 2006, substantially all of the Company's square footage was located in these targeted core markets. The Company targets individual properties in those markets that are close to important services and universities and have easy access to major transportation arteries.

Reduce Expenditures and Increase Occupancy Rates by Providing Flexible Properties and Attracting a Diversified Tenant Base: By focusing on properties with easily reconfigurable space, the Company believes it can offer facilities that appeal to a wide range of potential tenants, which aids in reducing the capital expenditures associated with re-leasing space. The Company believes this property flexibility also allows it to better serve existing tenants by accommodating their inevitable expansion and contraction needs. In addition, the Company believes that a diversified tenant base and property flexibility helps it maintain high occupancy rates during periods when market demand is weak, by enabling it to attract a greater number of potential users to its space.

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Provide Superior Property Management: The Company seeks to provide a superior level of service to its tenants in order to achieve high occupancy and rental rates, as well as minimal customer turnover. The Company's property management offices are primarily located on-site or regionally located, providing tenants with convenient access to management and helping the Company maintain its properties and convey a sense of quality, order and security. The Company has significant experience in acquiring properties managed by others and thereafter improving tenant satisfaction, occupancy levels, renewal rates and rental income by implementing established tenant service programs.

Financing Strategy

The Company's primary objective in its financing strategy is to maintain financial flexibility and a low risk capital structure using permanent capital to finance its growth. Key elements of this strategy are:

Retain Operating Cash Flow: The Company seeks to retain significant funds (after funding its distributions and capital improvements) for additional investments. During the year ended December 31, 2006, the Company distributed 31.2% of its funds from operations (FFO) to common shareholders/unit holders. During the year ended December 31, 2005, the Company distributed 33.0% of its FFO to common shareholders/unit holders. The increase in FFO is primarily due to net operating income from acquired properties partially offset by the increase in non-cash distributions associated with preferred equity redemptions. FFO is computed in accordance with the White Paper on FFO approved by the Board of Governors of the National Association of Real Estate Investment Trusts (NAREIT). The White Paper defines FFO as net income, computed in accordance with U.S. generally accepted accounting principles (GAAP), before depreciation, amortization, minority interest in income and extraordinary items. FFO is a non-GAAP financial measure and should be analyzed in conjunction with net income. However, FFO should not be viewed as a substitute for net income as a measure of operating performance as it does not reflect depreciation and amortization costs or the level of capital expenditure and leasing costs necessary to maintain the operating performance of the Company's properties, which are significant economic costs and could materially impact the Company's results of operations. Other REITs may use different methods for calculating FFO and, accordingly, the Company's FFO may not be comparable to other real estate companies' funds from operations. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Non-GAAP Supplemental Disclosure Measure: Funds from Operations, for a reconciliation of FFO and net income allocable to common shareholders and for information on why the Company presents FFO.

Perpetual Preferred Stock/Units: The primary source of leverage in the Company's capital structure is perpetual preferred stock or equivalent preferred units in the operating partnership. This method of financing eliminates interest rate and refinancing risks because the dividend rate is fixed and the stated value or capital contribution is not required to be repaid. In addition, the consequences of defaulting on required preferred distributions is less severe than with debt. The preferred shareholders may elect two additional directors if six quarterly distributions go unpaid, whether or not consecutive.

Debt Financing: The Company has used debt financing to a limited degree. The primary source of debt that the Company relies upon to provide short term capital is its \$100.0 million unsecured line of credit with Wells Fargo. In the past, the Company also had an unsecured term loan in the amount of \$50.0 million. This term loan was repaid in 2004. From time to time, the Company has also borrowed funds on a short term basis from PSI.

Access to Acquisition Capital: The Company seeks to maintain a ratio of FFO to combined fixed charges and preferred distributions paid of 3.0 to 1.0. Fixed charges include interest expense and capitalized interest. Preferred distributions include amounts paid to preferred shareholders and preferred Operating Partnership unit holders. For the year ended December 31, 2006, the FFO to combined fixed charges and preferred distributions paid ratio was 2.9 to 1.0, excluding the effects of Emerging Issues Task Force (EITF) Topic D-42. The fixed charge ratio was below the Company's objective of 3.0x as the Company issued preferred equity in 2006 in anticipation of redeeming higher rate preferred equity in 2006 and early 2007, which resulted in a higher level of preferred distributions. The Company believes that its financial position will enable it to access capital to finance its future growth. Subject to market conditions, the Company may add leverage to its capital structure. Throughout this Form 10-K, we use the term preferred equity to mean both the preferred stock issued by the Company and the preferred partnership units issued by the Operating Partnership and the term preferred distributions to mean dividends and distributions on the preferred stock and preferred partnership units.

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Competition

Competition in the market areas in which many of the Company's properties are located is significant and has reduced the occupancy levels and rental rates of, and increased the operating expenses of, certain of these properties. Competition may be accelerated by any increase in availability of funds for investment in real estate. Barriers to entry are relatively low for those with the necessary capital and the Company competes for property acquisitions and tenants with entities that have greater financial resources than the Company. Recent increases in sublease space and unleased developments are expected to further intensify competition among operators in certain market areas in which the Company operates.

The Company's properties compete for tenants with similar properties located in its markets primarily on the basis of location, rent charged, services provided and the design and condition of improvements. The Company believes it possesses several distinguishing characteristics that enable it to compete effectively in the flex, office and industrial space markets. The Company believes its personnel are among the most experienced in these real estate markets. The Company's facilities are part of a comprehensive system encompassing standardized procedures and integrated reporting and information networks. The Company believes that the significant operating and financial experience of its executive officers and directors combined with the Company's capital structure, national investment scope, geographic diversity and economies of scale should enable the Company to compete effectively.

Investments in Real Estate Facilities

As of December 31, 2006, the Company owned and operated approximately 18.7 million rentable square feet compared to approximately 17.6 million rentable square feet at December 31, 2005. The net increase in rentable square feet was due to the acquisition of approximately 1.2 million square feet to its portfolio, partially offset by the disposition of facilities that were identified by management as not meeting the Company's ongoing investment strategy.

Summary of Business Model

The Company has a diversified portfolio. It is diversified geographically in eight states and has a diversified customer mix by size and industry concentration. The Company believes that this diversification combined with a conservative financing strategy, focus on markets with strong demographics for growth and our operating strategy gives the Company a business model that mitigates risk and provides strong long-term growth opportunities.

Restrictions on Transactions with Affiliates

The Company's Bylaws provide that the Company may engage in transactions with affiliates provided that a purchase or sale transaction with an affiliate is (i) approved by a majority of the Company's independent directors and (ii) fair to the Company based on an independent appraisal or fairness opinion.

Borrowings

As of December 31, 2006, the Company had outstanding mortgage notes payable of \$67.0 million. See Notes 5 and 6 to the consolidated financial statements for a summary of the Company's outstanding borrowings as of December 31, 2006.

In August of 2005, the Company modified the term of its line of credit (the Credit Facility) with Wells Fargo Bank. The Credit Facility has a borrowing limit of \$100.0 million and matures on August 1, 2008. Interest on outstanding borrowings is payable monthly. At the option of the Company, the rate of interest charged is equal to (i) the prime rate or (ii) a rate ranging from the London Interbank Offered Rate (LIBOR) plus 0.50% to LIBOR plus 1.20% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 0.65%). In addition, the Company is required to pay an annual commitment fee ranging from 0.15% to 0.30% of the borrowing limit (currently 0.20%). In connection with the modification of the Credit Facility, the Company paid a fee of \$450,000, which will be amortized over the life of the Credit Facility. The Company had no balance outstanding on its Credit Facility at December 31, 2006 and 2005.

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The Credit Facility requires the Company to meet certain covenants including (i) maintain a balance sheet leverage ratio (as defined) of less than 0.45 to 1.00, (ii) maintain interest and fixed charge coverage ratios (as defined) of not less than 2.25 to 1.00 and 1.75 to 1.00, respectively, (iii) maintain a minimum tangible net worth (as defined) and (iv) limit distributions to 95% of funds from operations (as defined) for any four consecutive quarters. In addition, the Company is limited in its ability to incur additional borrowings (the Company is required to maintain unencumbered assets with an aggregate book value equal to or greater than two times the Company's unsecured recourse debt; the Company did not have any unsecured recourse debt at December 31, 2006) or sell assets. The Company was in compliance with the covenants of the Credit Facility at December 31, 2006.

In February, 2004, the Company repaid, in full, the \$50.0 million unsecured term note agreement with Fleet National Bank. The Company incurred interest at LIBOR plus 1.45% per annum. During July, 2002, the Company entered into an interest rate swap transaction which resulted in a fixed LIBOR rate of 3.01% for the term loan resulting in an all in rate of 4.46% per annum on the term loan. The unsecured note required the Company to meet covenants that were substantially the same as the covenants in the Credit Facility.

The Company has broad powers to borrow in furtherance of the Company's objectives. The Company has incurred in the past, and may incur in the future, both short-term and long-term indebtedness to increase its funds available for investment in real estate, capital expenditures and distributions.

Employees

As of December 31, 2006, the Company employed 144 individuals, primarily personnel engaged in property operations. The Company believes that its relationship with its employees is good and none of the employees are represented by a labor union.

Insurance

The Company believes that its properties are adequately insured. Facilities operated by the Company have historically been covered by comprehensive insurance, including fire, earthquake, liability and extended coverage from nationally recognized carriers.

Environmental Matters

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

Substantially all of the Company's properties have been subjected to Phase I environmental reviews. Such reviews have not revealed, nor is management aware of, any probable or reasonably possible environmental costs that management believes would have a material adverse effect on the Company's business, assets or results of operations, nor is the Company aware of any potentially material environmental liability.

ITEM 1A. RISK FACTORS

In addition to the other information in this Form 10-K, the following factors should be considered in evaluating our company and our business.

Public Storage has significant influence over us.

At December 31, 2006, Public Storage and its affiliates owned 25.4% of the outstanding shares of our common stock and 25.5% of the outstanding common units of our operating partnership (100.0% of the common units not owned by us). Assuming conversion of its partnership units PSI would own 44.5% of the outstanding shares of our common stock. Also, Ronald L. Havner, Jr., our Chairman of the Board, is also Chief Executive Officer, President and a Director of Public Storage and Harvey Lenkin, one of our Directors, is also a Director of Public Storage. Consequently, Public Storage has the ability to significantly influence all matters submitted to a vote of our

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shareholders, including electing directors, changing our articles of incorporation, dissolving and approving other extraordinary transactions such as mergers, and all matters requiring the consent of the limited partners of the operating partnership. In addition, Public Storage's ownership may make it more difficult for another party to acquire us without Public Storage's approval.

Provisions in our organizational documents may prevent changes in control.

Our articles generally prohibit owning more than 7% of our shares: Our articles of incorporation restrict the number of shares that may be owned by any other person, and the partnership agreement of our operating partnership contains an anti-takeover provision. No shareholder (other than Public Storage and certain other specified shareholders) may own more than 7% of the outstanding shares of our common stock, unless our board of directors waives this limitation. We imposed this limitation to avoid, to the extent possible, a concentration of ownership that might jeopardize our ability to qualify as a REIT. This limitation, however, also makes a change of control much more difficult (if not impossible) even if it may be favorable to our public shareholders. These provisions will prevent future takeover attempts not approved by Public Storage even if a majority of our public shareholders consider it to be in their best interests because they would receive a premium for their shares over the shares' then market value or for other reasons.

Our board can set the terms of certain securities without shareholder approval: Our board of directors is authorized, without shareholder approval, to issue up to 50.0 million shares of preferred stock and up to 100.0 million shares of Equity Stock, in each case in one or more series. Our board has the right to set the terms of each of these series of stock. Consequently, the board could set the terms of a series of stock that could make it difficult (if not impossible) for another party to take over our company even if it might be favorable to our public shareholders. Our articles of incorporation also contain other provisions that could have the same effect. We can also cause our operating partnership to issue additional interests for cash or in exchange for property.

The partnership agreement of our operating partnership restricts mergers: The partnership agreement of our operating partnership generally provides that we may not merge or engage in a similar transaction unless the limited partners of our operating partnership are entitled to receive the same proportionate payments as our shareholders. In addition, we have agreed not to merge unless the merger would have been approved had the limited partners been able to vote together with our shareholders, which has the effect of increasing Public Storage's influence over us due to Public Storage's ownership of operating partnership units. These provisions may make it more difficult for us to merge with another entity.

Our operating partnership poses additional risks to us.

Limited partners of our operating partnership, including Public Storage, have the right to vote on certain changes to the partnership agreement. They may vote in a way that is against the interests of our shareholders. Also, as general partner of our operating partnership, we are required to protect the interests of the limited partners of the operating partnership. The interests of the limited partners and of our shareholders may differ.

We would incur adverse tax consequences if we fail to qualify as a REIT.

Our cash flow would be reduced if we fail to qualify as a REIT: While we believe that we have qualified since 1990 to be taxed as a REIT, and will continue to be so qualified, we cannot be certain. To continue to qualify as a REIT, we need to satisfy certain requirements under the federal income tax laws relating to our income, assets, distributions to shareholders and shareholder base. In this regard, the share ownership limits in our articles of incorporation do not necessarily ensure that our shareholder base is sufficiently diverse for us to qualify as a REIT. For any year we fail to qualify as a REIT, we would be taxed at regular corporate tax rates on our taxable income unless certain relief provisions apply. Taxes would reduce our cash available for distributions to shareholders or for reinvestment, which could adversely affect us and our shareholders. Also we would not be allowed to elect REIT status for five years after we fail to qualify unless certain relief provisions apply.

We may need to borrow funds to meet our REIT distribution requirements: To qualify as a REIT, we must generally distribute to our shareholders 90% of our taxable income. Our income consists primarily of our share of our Operating Partnership's income. We intend to make sufficient distributions to qualify as a REIT and otherwise

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avoid corporate tax. However, differences in timing between income and expenses and the need to make nondeductible expenditures such as capital improvements and principal payments on debt could force us to borrow funds to make necessary shareholder distributions.

Since we buy and operate real estate, we are subject to general real estate investment and operating risks.

Summary of real estate risks: We own and operate commercial properties and are subject to the risks of owning real estate generally and commercial properties in particular. These risks include:

the national, state and local economic climate and real estate conditions, such as oversupply of or reduced demand for space and changes in market rental rates;

how prospective tenants perceive the attractiveness, convenience and safety of our properties;

difficulties in consummating and financing acquisitions and developments on advantageous terms and the failure of acquisitions and developments to perform as expected;

our ability to provide adequate management, maintenance and insurance;

our ability to collect rent from tenants on a timely basis;

the expense of periodically renovating, repairing and reletting spaces;

environmental issues;

compliance with the Americans with Disabilities Act and other federal, state, and local laws and regulations;

increasing operating costs, including real estate taxes, insurance and utilities, if these increased costs cannot be passed through to tenants;

changes in tax, real estate and zoning laws;

increase in new commercial properties in our market;

tenant defaults and bankruptcies;

tenant's right to sublease space; and

concentration of properties leased to non-rated private companies.

Certain significant costs, such as mortgage payments, real estate taxes, insurance and maintenance, generally are not reduced even when a property's rental income is reduced. In addition, environmental and tax laws, interest rate levels, the availability of financing and other factors may affect real estate values and property income. Furthermore, the supply of commercial space fluctuates with market conditions.

If our properties do not generate sufficient income to meet operating expenses, including any debt service, tenant improvements, leasing commissions and other capital expenditures, we may have to borrow additional amounts to cover fixed costs, and we may have to reduce our distributions to shareholders.

We may be unable to consummate acquisitions and developments on advantageous terms or acquisitions and developments may fail to perform as expected: We continue to seek to acquire and develop flex, industrial and office properties where they meet our criteria and we believe that they will enhance our future financial performance and the value of our portfolio. Our belief, however, is based on and is subject to risks, uncertainties and other factors, many of which are forward-looking and are uncertain in nature or are beyond our control, including the risks that our acquisitions and developments may not perform as expected, that we may be unable to quickly integrate new

acquisitions and developments into our existing operations and that any costs to develop projects or redevelop acquired properties may exceed estimates. Further, we face significant competition for suitable acquisition properties from other real estate investors, including other publicly traded real estate investment trusts and private institutional investors. As a result, we may be unable to acquire additional properties we desire or the purchase price for desirable properties may be significantly increased. Moreover, some of these properties may have unknown characteristics or deficiencies or may not complement our portfolio of existing properties. In addition, we may finance future acquisitions and developments through a combination of borrowings, proceeds from equity or debt offerings by us or the operating partnership, and proceeds from property divestitures. These financing options may not be available when desired or required or may be more costly than anticipated, which could adversely affect our cash flow. Real property development is subject to a number of risks, including construction delays, complications in obtaining necessary zoning, occupancy and other governmental permits, cost overruns, financing risks, and the possible inability to meet expected occupancy and rent levels. If any of these problems occur, development costs for a project may increase, and there may be costs incurred for projects that are not completed. As a result of the foregoing, some properties may be worth less or may generate less revenue

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than, or simply not perform as well as, we believed at the time of acquisition or development, negatively affecting our operating results. Any of the foregoing risks could adversely affect our financial condition, operating results and cash flow, and our ability to pay dividends on, and the market price of our stock.

We may encounter significant delays and expense in reletting vacant space, or we may not be able to relet space at existing rates, in each case resulting in losses of income: When leases expire, we will incur expenses in retrofitting space and we may not be able to release the space on the same terms. Certain leases provide tenants with the right to terminate early. Our properties as of December 31, 2006 generally have lower vacancy rates than the average for the markets in which they are located, and leases accounting for 18.9% of our annual rental income expire in 2007. While we have estimated our cost of renewing leases that expire in 2007, our estimates could be wrong. If we are unable to release space promptly, if the terms are significantly less favorable than anticipated or if the costs are higher, we may have to reduce our distributions to shareholders.

Tenant defaults and bankruptcies may reduce our cash flow and distributions: We may have difficulty in collecting from tenants in default, particularly if they declare bankruptcy. This could affect our cash flow and distributions to shareholders. Since many of our tenants are non-rated private companies, this risk may be enhanced. Subsequent to December 31, 2006, a tenant occupying approximately 134,000 square feet defaulted on its lease. The Company is currently pursuing legal action against the tenant and is uncertain of the outcome. While the Company historically has experienced a low level of write-offs due to bankruptcy, there is inherent uncertainty in a tenant's ability to continue paying rent if they are in bankruptcy. As of December 31, 2006, the Company had approximately 18,000 square feet occupied by a tenant protected by Chapter 11 of the U.S. Bankruptcy Code. Given the historical uncertainty of a tenant's ability to meet its lease obligations, we will continue to reserve any income that would have been realized on a straight line basis. From time to time, tenants have contacted us, requesting early termination of their lease, reduction in space under lease, rent deferment or abatement. At this time, the Company cannot anticipate what impact, if any, the ultimate outcome of these discussions will have on our operating results.

We may be adversely affected by significant competition among commercial properties: Many other commercial properties compete with our properties for tenants. Some of the competing properties may be newer and better located than our properties. We also expect that new properties will be built in our markets. Also, we compete with other buyers, many of which are larger than us, for attractive commercial properties. Therefore, we may not be able to grow as rapidly as we would like.

We may be adversely affected if casualties to our properties are not covered by insurance: We carry insurance on our properties that we believe is comparable to the insurance carried by other operators for similar properties. However, we could suffer uninsured losses or losses in excess of policy limits for such occurrences such as earthquakes that adversely affect us or even result in loss of the property. We might still remain liable on any mortgage debt or other unsatisfied obligations related to that property.

The illiquidity of our real estate investments may prevent us from adjusting our portfolio to respond to market changes: There may be delays and difficulties in selling real estate. Therefore, we cannot easily change our portfolio when economic conditions change. Also, tax laws limit a REIT's ability to sell properties held for less than four years.

We may be adversely affected by changes in laws: Increases in income and service taxes may reduce our cash flow and ability to make expected distributions to our shareholders. Our properties are also subject to various federal, state and local regulatory requirements, such as state and local fire and safety codes. If we fail to comply with these requirements, governmental authorities could fine us or courts could award damages against us. We believe our properties comply with all significant legal requirements. However, these requirements could change in a way that would reduce our cash flow and ability to make distributions to shareholders.

We may incur significant environmental remediation costs: Under various federal, state and local environmental laws, an owner or operator of real estate may have to clean spills or other releases of hazardous or toxic substances on or from a property. Certain environmental laws impose liability whether or not the owner knew of, or was responsible for, the presence of the hazardous or toxic substances. In some cases, liability may exceed the value of the property. The presence of toxic substances, or the failure to properly remedy any resulting contamination, may

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make it more difficult for the owner or operator to sell, lease or operate its property or to borrow money using its property as collateral. Future environmental laws may impose additional material liabilities on us.

We are affected by the Americans with Disabilities Act.

The Americans with Disabilities Act of 1990 requires that access and use by disabled persons of all public accommodations and commercial properties be facilitated. Existing commercial properties must be made accessible to disabled persons. While we have not estimated the cost of complying with this act, we do not believe the cost will be material. We have an ongoing program to bring our properties into what we believe is compliance with the Americans with Disabilities Act.

We depend on external sources of capital to grow our company.

We are generally required under the Internal Revenue Code to distribute at least 90% of our taxable income. Because of this distribution requirement, we may not be able to fund future capital needs, including any necessary building and tenant improvements, from operating cash flow. Consequently, we may need to rely on third-party sources of capital to fund our capital needs. We may not be able to obtain the financing on favorable terms or at all. Access to third-party sources of capital depends, in part, on general market conditions, the market's perception of our growth potential, our current and expected future earnings, our cash flow, and the market price per share of our common stock. If we cannot obtain capital from third-party sources, we may not be able to acquire properties when strategic opportunities exist, satisfy any debt service obligations, or make cash distributions to shareholders.

Our ability to control our properties may be adversely affected by ownership through partnerships and joint ventures.

We own most of our properties through our operating partnership. Our organizational documents do not prevent us from acquiring properties with others through partnerships or joint ventures. This type of investment may present additional risks. For example, our partners may have interests that differ from ours or that conflict with ours, or our partners may become bankrupt. During 2001, we entered into a joint venture arrangement that held property subject to debt. This joint venture has been liquidated and all debts paid; however, we may enter into similar arrangements with the same partner or other partners.

We can change our business policies and increase our level of debt without shareholder approval.

Our board of directors establishes our investment, financing, distribution and our other business policies and may change these policies without shareholder approval. Our organizational documents do not limit our level of debt. A change in our policies or an increase in our level of debt could adversely affect our operations or the price of our common stock.

We can issue additional securities without shareholder approval.

We can issue preferred equity, common stock and equity stock without shareholder approval. Holders of preferred stock have priority over holders of common stock, and the issuance of additional shares of stock reduces the interest of existing holders in our company.

Increases in interest rates may adversely affect the market price of our common stock.

One of the factors that influences the market price of our common stock is the annual rate of distributions that we pay on our common stock, as compared with interest rates. An increase in interest rates may lead purchasers of REIT shares to demand higher annual distribution rates, which could adversely affect the market price of our common stock.

Shares that become available for future sale may adversely affect the market price of our common stock.

Substantial sales of our common stock, or the perception that substantial sales may occur, could adversely affect the market price of our common stock. As of December 31, 2006, Public Storage owned 25.4% of the outstanding

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shares of our common stock (44.5% upon conversion of its interest in our operating partnership). These shares, as well as shares of common stock held by certain other significant shareholders, are eligible to be sold in the public market, subject to compliance with applicable securities laws.

We depend on key personnel.

We depend on our key personnel, including Ronald L. Havner, Jr., our Chairman of the Board, and Joseph D. Russell, Jr., our President and Chief Executive Officer. The loss of Mr. Havner, Mr. Russell, or other key personnel could adversely affect our operations. We maintain no key person insurance on our key personnel.

Terrorist attacks and the possibility of wider armed conflict may have an adverse impact on our business and operating results and could decrease the value of our assets.

Terrorist attacks and other acts of violence or war, such as those that took place on September 11, 2001, could have a material adverse impact on our business and operating results. There can be no assurance that there will not be further terrorist attacks against the United States or its businesses or interests. Attacks or armed conflicts that directly impact one or more of our properties could significantly affect our ability to operate those properties and thereby impair our operating results. Further, we may not have insurance coverage for all losses caused by a terrorist attack. Such insurance may not be available, or if it is available and we decide to obtain such terrorist coverage, the cost for the insurance may be significant in relationship to the risk overall. In addition, the adverse effects that such violent acts and threats of future attacks could have on the U.S. economy could similarly have a material adverse effect on our business and results of operations. Finally, further terrorist acts could cause the United States to enter into a wider armed conflict which could further impact our business and operating results.

Change in taxation of corporate dividends may adversely affect the value of our shares.

The Jobs and Growth Tax Relief Reconciliation Act of 2003, enacted on May 28, 2003, generally reduces to 15% the maximum marginal rate of federal tax payable by individuals on dividends received from a regular C corporation. This reduced tax rate, however, does not apply to dividends paid to individuals by a REIT on its shares except for certain limited amounts. The earnings of a REIT that are distributed to its shareholders are still generally subject to less federal income taxation on an aggregate basis than earnings of a non-REIT C corporation that are distributed to its shareholders net of corporate-level income tax. The Jobs and Growth Tax Act, however, could cause individual investors to view stocks of regular C corporations as more attractive relative to shares of REITs than was the case prior to the enactment of the legislation because the dividends from regular C corporations, which previously were taxed at the same rate as REIT dividends, are now taxed at a maximum marginal rate of 15% while REIT dividends are taxed at a maximum marginal rate of 35%. We cannot estimate what effect, if any, the enactment of this legislation has had on the value of our common stock, either in terms of price or relative to other investments.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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As of December 31, 2006, the Company owned approximately 11.5 million square feet of flex space, 3.9 million square feet of industrial space and 3.3 million square feet of office space concentrated primarily in nine markets consisting of Southern and Northern California, Southern and Northern Texas, South Florida, Virginia, Maryland, Oregon and Arizona. The weighted average occupancy rate throughout 2006 was 93.4% and the average realized rental revenue per square foot was \$14.37.

The following table contains information about all properties owned by the Company as of December 31, 2006 and the weighted average occupancy rates throughout 2006 (except as set forth below, all of the properties are held in fee simple interest) (*in thousands*):

Location	Rentable Square Footage			Total	Weighted Average Occupancy Rate
	Flex	Industrial	Office		
Arizona					
Mesa	78			78	85.8%
Phoenix	310			310	95.1%
Tempe	291			291	94.9%
	679			679	94.0%
Northern California					
Hayward		407		407	91.4%
Monterey			12	12	100.0%
Sacramento			367	367	95.4%
San Jose	457			457	94.0%
San Ramon			52	52	99.2%
Santa Clara	178			178	100.0%
So. San Francisco	94			94	94.5%
	729	407	431	1,567	94.6%
Southern California					
Buena Park		317		317	99.1%
Carson	77			77	95.2%
Cerritos		395	31	426	97.6%
Culver City	146			146	98.0%
Irvine			160	160	97.2%
Laguna Hills	614			614	97.1%
Lake Forest	297			297	95.8%
Monterey Park	199			199	95.0%
Orange			108	108	90.7%
San Diego (2)	768			768	95.7%
Santa Ana			437	437	92.3%
Signal Hill	267			267	95.0%
Studio City	22			22	100.0%
Torrance	147			147	97.2%

	2,537	712	736	3,985	96.0%
Maryland					
Beltsville	309			309	98.5%
Gaithersburg			29	29	90.6%
Rockville	212		688	900	97.2%
Silver Spring (2)	366		166	532	95.1%
	887		883	1,770	96.8%
Oregon					
Beaverton	1,024		188	1,212	90.9%
Milwaukee	102			102	82.3%
	1,126		188	1,314	90.2%

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Location	Rentable Square Footage			Total	Weighted Average Occupancy Rate
	Flex	Industrial	Office		
Northern Texas					
Dallas	237			237	82.9%
Farmers Branch	112			112	85.2%
Garland	36			36	58.6%
Irving (1)	715	231		946	83.0%
Mesquite	57			57	84.1%
Plano	184			184	61.9%
Richardson	117			117	81.8%
	1,458	231		1,689	80.3%
Southern Texas					
Austin	787			787	89.6%
Houston	177		131	308	88.2%
Missouri City	66			66	95.0%
	1,030		131	1,161	89.5%
South Florida					
Boca Raton (2)	135			135	94.8%
Miami	631	2,556	12	3,199	96.4%
Wellington (2)	262			262	97.9%
	1,028	2,556	12	3,596	96.4%
Virginia					
Alexandria	155		54	209	97.6%
Chantilly (2)	563		38	601	91.5%
Fairfax			166	166	91.2%
Herndon			244	244	97.2%
Lorton	246			246	98.9%
Merrifield	303		355	658	91.5%
Springfield	270		90	360	99.7%
Sterling	296			296	93.5%
Woodbridge	114			114	98.5%
	1,947		947	2,894	94.6%
Washington					
Renton	28			28	76.5%

	28			28	76.5%
Totals	11,449	3,906	3,328	18,683	93.4%

(1) The Company owns one property that is subject to a ground lease in Las Colinas, Texas.

(2) Five commercial properties, one in San Diego, California, two in Chantilly, Virginia, one in Silver Spring, Maryland, one in Boca Raton, Florida, and two in Wellington, Florida, serve as collateral to mortgage notes payable. For more information, see Note 6 of the Consolidated Financial Statements.

We currently anticipate that each of these properties will continue to be used for its current purpose. Competition exists in each of the market areas in which these properties are located. Significant amounts of capital appear to be available to fund potential buyers of commercial real estate and the Company may be competing for properties and tenants with entities that have greater financial resources than the Company. For information regarding general competitive conditions to which the Company's properties are or may be subject, see Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Effect of Economic Conditions on the Company's Primary Markets.

The Company has no present plans for any material renovation, improvement or development of its properties. The Company typically renovates its properties in connection with the re-leasing of space to tenants and expects that it will pay the costs of such renovations from rental income. The Company has risks that tenants will default on leases and declare bankruptcy. Management believes these risks are mitigated through the Company's geographic diversity and diverse tenant base.

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The Company evaluates the performance of its properties primarily based on net operating income (NOI). NOI is defined by the Company as rental income as defined by GAAP less cost of operations as defined by GAAP. See Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Concentration of Portfolio by Region below for more information on NOI, including why the Company presents NOI and how the Company uses NOI. The following information illustrates rental income, cost of operations and NOI generated by the Company's total portfolio in 2006, 2005 and 2004 by geographic region and by property classifications. As a result of acquisitions and dispositions, certain properties were not held for the full year.

The Company's calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance in accordance with generally accepted accounting principles. The tables below also include a reconciliation of NOI to the most comparable amounts based on GAAP (*in thousands*):

	For the Year Ended December 31, 2006				For the Year Ended December 31, 2005				For the Year Ended December 31, 2004			
	Flex	Office	Industrial	Total	Flex	Office	Industrial	Total	Flex	Office	Industrial	Total
Total												
By Region:												
California	\$ 41,077	\$ 15,020	\$ 5,130	\$ 61,227	\$ 36,093	\$ 13,748	\$ 4,878	\$ 54,719	\$ 33,605	\$ 13,062	\$ 5,129	\$ 51,796
California	9,743	6,805	2,475	19,023	9,427	6,505	3,039	18,971	10,576	6,131	2,786	19,493
California	8,271	2,201		10,472	7,906	1,709		9,615	7,971	1,682		9,653
California	13,643		1,093	14,736	14,585		1,127	15,712	13,209		953	14,162
California	6,256	198	18,219	24,673	5,786	185	16,109	22,080	5,293	159	14,834	20,296
California	30,361	20,442		50,803	28,804	19,895		48,699	35,312	10,813		46,125
California	15,763	19,656		35,419	7,576	16,613		24,189	6,823	17,598		24,421
California	15,795	3,065		18,860	15,878	2,805		18,683	15,093	3,320		18,413
California	7,001			7,001	6,936			6,936	6,588			6,588
	147,910	67,387	26,917	242,214	132,991	61,460	25,153	219,604	134,470	52,765	23,702	210,937
By Property Classification:												
California	10,416	6,163	1,012	17,591	8,142	5,881	974	14,997	7,807	5,422	922	14,151
California	2,236	2,150	657	5,043	1,969	2,005	609	4,583	2,025	1,983	568	4,576
California	3,649	1,019		4,668	3,182	933		4,115	3,314	875		4,189
California	5,550		261	5,811	5,076		261	5,337	5,197		269	5,466
California	2,070	94	6,008	8,172	1,996	82	5,689	7,767	1,708	74	5,408	7,190
California	7,310	6,976		14,286	7,176	6,705		13,881	9,172	3,733		12,905
California	4,129	5,824		9,953	1,703	4,787		6,490	1,546	4,716		6,262
California	5,101	1,300		6,401	4,667	1,216		5,883	4,265	1,232		5,497
California	2,746			2,746	2,659			2,659	2,758			2,758

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	43,207	23,526	7,938	74,671	36,570	21,609	7,533	65,712	37,792	18,035	7,167	62,
ern												
Fornia	30,661	8,857	4,118	43,636	27,951	7,867	3,904	39,722	25,798	7,640	4,207	37,
ern												
Fornia	7,507	4,655	1,818	13,980	7,458	4,500	2,430	14,388	8,551	4,148	2,218	14,
ern												
s	4,622	1,182		5,804	4,724	776		5,500	4,657	807		5,
ern												
s	8,093		832	8,925	9,509		866	10,375	8,012		684	8,
h												
da	4,186	104	12,211	16,501	3,790	103	10,420	14,313	3,585	85	9,426	13,
inia	23,051	13,466		36,517	21,628	13,190		34,818	26,140	7,080		33,
yland	11,634	13,832		25,466	5,873	11,826		17,699	5,277	12,882		18,
ron	10,694	1,765		12,459	11,211	1,589		12,800	10,828	2,088		12,
r	4,255			4,255	4,277			4,277	3,830			3,
	\$ 104,703	\$ 43,861	\$ 18,979	\$ 167,543	\$ 96,421	\$ 39,851	\$ 17,620	\$ 153,892	\$ 96,678	\$ 34,730	\$ 16,535	\$ 147,

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The following table is provided to reconcile NOI to consolidated income from continuing operations before minority interests as determined by GAAP (*in thousands*):

	For the Years Ended December 31,		
	2006	2005	2004
Property net operating income	\$ 167,543	\$ 153,892	\$ 147,943
Facility management fees	625	579	624
Interest and other income	6,874	4,888	406
Depreciation and amortization	(86,216)	(76,178)	(69,942)
General and administrative	(7,046)	(5,843)	(4,628)
Interest expense	(2,575)	(1,330)	(3,054)
Asset impairment due to casualty loss		(72)	
Income from continuing operations before minority interests	\$ 79,205	\$ 75,936	\$ 71,349

Significant Properties

As of and for the year ended December 31, 2006, one of the Company's properties had a book value of more than 10% of the Company's total assets. The property, known as Miami International Commerce Center (MICC), is a business park in Miami, Florida, consisting of 46 buildings (3.2 million square feet) consisting of flex (631,000 square feet), industrial (2.6 million square feet), and office (12,000 square feet) space. The property was purchased on December 30, 2003 and has a net book value of \$178.2 million, representing approximately 12.2% of the Company's total assets at December 31, 2006.

During 2006, the Company sold 32,400 square feet located at MICC for a combined sales price of \$3.7 million.

MICC property taxes for the year ended December 31, 2006 were \$3.3 million at a rate of 2.1% of the respective parcel value.

The following table sets forth information with respect to occupancy and rental rates at Miami International Commerce Center for each of the last five years, including a 56,000 square foot retail center and 94,000 square feet of flex space disposed of:

	2002	2003	2004	2005	2006
Weighted average occupancy rate	86.3%	81.7%	83.8%	91.8%	96.4%
Realized rent per square foot	\$ 6.96	\$ 7.12	\$ 7.75	\$ 7.47	\$ 7.88

There is no one tenant that occupies ten percent or more of the rentable square footage at Miami International Commerce Center.

The following table sets forth information with respect to lease expirations at Miami International Commerce Center (*in thousands, except number of leases expiring*):

Year of Lease Expiration	Number of Leases Expiring	Rentable Square Footage Subject to Expiring Leases	Annual Base Rents Under Expiring Leases	Percentage of Total Annual Base Rents Represented by Expiring Leases
2007	74	552	\$ 4,836	17.7%
2008	92	832	6,754	24.8%
2009	97	710	6,259	23.0%
2010	49	587	4,694	17.2%

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2011	29	327	3,172	11.6%
Thereafter	17	156	1,558	5.7%
Total	358	3,164	\$ 27,273	100.0%

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The following table sets forth information with respect to tax depreciation at Miami International Commerce Center (*in thousands, except year data*):

	Tax Basis	Rate of Depreciation	Method	Life In Years	Accumulated Depreciation
Land Improvements	\$ 45,588	8.0%	MACRS, 150%	15	\$ 12,936
Improvements	24,541	14.0%	VARIOUS MACRS,	5	19,670
Tenant Buildings	87,365	2.6%	SL	VAR	7,292
Total	\$157,494				\$ 39,898

Accumulated depreciation for personal property shown in the preceding table was derived using the mid-quarter convention.

Portfolio Information

Approximately 60.3% of the Company's annual rents are derived from large tenants, which consist of tenants with leases averaging greater than or equal to 5,000 square feet. These tenants generally sign longer leases, may require more generous tenant improvements, are typically represented by a broker and are more creditworthy tenants. The remaining 39.7% of the Company's annual rents are derived from small tenants with average space requirements of less than 5,000 square feet and a shorter lease term duration. Tenant improvements are relatively less for these tenants and most of these tenants are not represented by brokers and therefore the Company does not pay lease commissions. The following tables set forth the lease expirations for the entire portfolio of properties owned as of December 31, 2006 in addition to bifurcating the lease expirations for properties serving primarily small businesses and those properties serving primarily larger businesses (*in thousands*):

Lease Expirations (Entire Portfolio) as of December 31, 2006

Year of Lease Expiration	Rentable Square Footage Subject to Expiring Leases	Annual Base Rents Under Expiring Leases	Percentage of Total Annual Base Rents Represented by Expiring Leases
2007	3,604	\$ 50,872	18.9%
2008	4,182	62,817	23.4%
2009	3,297	45,670	17.0%
2010	2,216	32,964	12.2%
2011	1,694	30,022	11.2%
Thereafter	2,527	46,605	17.3%
Total	17,520	\$ 268,950	100.0%

Lease Expirations (Small Tenant Portfolio) as of December 31, 2006

The Company's small tenant portfolio consists of properties with average leases less than 5,000 square feet.

Percentage of Small

Year of Lease Expiration	Rentable Square Footage Subject to Expiring Leases	Annual Base Rents Under Expiring Leases	Tenant Annual Base Rents Represented by Expiring Leases
2007	2,050	\$ 30,136	11.2%
2008	1,785	29,044	10.8%
2009	1,200	20,242	7.5%
2010	567	10,527	3.9%
2011	377	7,247	2.7%
Thereafter	442	9,864	3.6%
Total	6,421	\$ 107,060	39.7%

Table of Contents**Lease Expirations (Large Tenant Portfolio) as of December 31, 2006**

The Company's large tenant portfolio consists of properties with leases averaging greater than or equal to 5,000 square feet.

Year of Lease Expiration	Rentable Square Footage Subject to Expiring Leases	Annual Base Rents Under Expiring Leases	Percentage of Large Tenant Annual Base Rents Represented by Expiring Leases
2007	1,554	\$ 20,736	7.7%
2008	2,397	33,773	12.6%
2009	2,097	25,428	9.5%
2010	1,649	22,437	8.3%
2011	1,317	22,775	8.5%
Thereafter	2,085	36,741	13.7%
Total	11,099	\$ 161,890	60.3%

ITEM 3. LEGAL PROCEEDINGS

We are not presently subject to material litigation nor, to our knowledge, is any material litigation threatened against us, other than routine actions for negligence and other claims and administrative proceedings arising in the ordinary course of business, some of which are expected to be covered by liability insurance or third party indemnifications and all of which collectively we do not expect to have a material adverse effect on our financial condition, results of operations, or liquidity.

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

The Company did not submit any matter to a vote of security holders in the fourth quarter of the fiscal year ended December 31, 2006.

ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT

The following is a biographical summary of the executive officers of the Company:

Joseph D. Russell, Jr., age 47, has been President since September, 2002 and was named Chief Executive Officer and elected as a Director in August, 2003. Mr. Russell joined Spieker Partners in 1990 and became an officer of Spieker Properties when it went public as a REIT in 1993. Prior to its merger with Equity Office Properties (EOP) in 2001, Mr. Russell was President of Spieker Properties Silicon Valley Region from 1999 to 2001. Mr. Russell earned a Bachelor of Science degree from the University of Southern California and a Masters of Business Administration from the Harvard Business School. Prior to entering the commercial real estate business, Mr. Russell spent approximately six years with IBM in various marketing positions. Mr. Russell has been a member and past President of the National Association of Industrial and Office Parks, Silicon Valley Chapter.

John Petersen, age 43, has been Executive Vice President and Chief Operating Officer since he joined the Company in December, 2004. Prior to joining the Company, Mr. Petersen was Senior Vice President, San Jose Region, for Equity Office Properties from July, 2001 to December, 2004, responsible for 11.3 million square feet of multi-tenant office, industrial and R&D space in Silicon Valley. Prior to EOP, Mr. Petersen was Senior Vice President with Spieker Properties, from 1995 to 2001 overseeing the growth of that company's portfolio in San Jose, through acquisition and development of nearly three million square feet. Mr. Petersen is a graduate of The Colorado College in Colorado Springs, Colorado, and was recently the President of National Association of Industrial and Office Parks, Silicon Valley Chapter.

Edward A. Stokx, age 41, a certified public accountant, has been Chief Financial Officer and Secretary of the Company since December, 2003 and Executive Vice President since March, 2004. Mr. Stokx has overall responsibility for the Company's finance and accounting functions. In addition, he has responsibility for executing the Company's financial initiatives. Mr. Stokx joined Center Trust, a developer, owner, and operator of retail shopping centers in 1997. Prior to his promotion to Chief Financial Officer and Secretary in 2001 he served as

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Senior Vice President, Finance and Controller. After Center Trust's merger in January, 2003 with another public REIT, Mr. Stokx provided consulting services to various entities. Prior to joining Center Trust, Mr. Stokx was with Deloitte and Touche from 1989 to 1997, with a focus on real estate clients. Mr. Stokx earned a Bachelor of Science degree in Accounting from Loyola Marymount University.

Brett Franklin, age 43, is Senior Vice President, Acquisitions & Dispositions. Mr. Franklin joined the Company as Vice President of Acquisitions in December, 1997. Since joining the Company, Mr. Franklin has been involved in acquiring over 13.3 million square feet of commercial real estate in Northern and Southern California, Arizona, Texas, Maryland, Virginia, Oregon and Miami. Prior to joining, Mr. Franklin worked for Public Storage Pickup & Delivery as Vice President of Acquisitions from 1996 to 1997. His duties included acquiring and leasing over 1.5 million square feet of industrial properties in 16 cities across the country. From 1995 to October, 1996, Mr. Franklin was a business consultant to San Diego and Los Angeles based real estate firms. From 1992 until 1995, Mr. Franklin held various positions for FORCE, Inc., an environmental remediation and technology company located in Camarillo, California. His positions included Director of Marketing and Chief Operating Officer. From 1987 until 1992, he managed and operated a real estate brokerage company in western Los Angeles. Mr. Franklin received his Bachelor of Science degree from the University of California at Los Angeles. He is a member of the Urban Land Institute.

Maria R. Hawthorne, age 47, was promoted to Senior Vice President of the Company in March, 2004, with responsibility for property operations on the East Coast, which include Northern Virginia, Maryland and Florida. Ms. Hawthorne has been with the Company and its predecessors for eighteen years. From June, 2001 through March, 2004, Ms. Hawthorne was Vice President of the Company, responsible for property operations in Northern Virginia. From July, 1994 to June, 2001, Ms. Hawthorne was a Regional Manager of the Company in Northern Virginia. From August, 1988 to July, 1994, Ms. Hawthorne was the Director of Leasing and Property Manager for American Office Park Properties. Ms. Hawthorne earned a Bachelor of Arts Degree in International Relations from Pomona College.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****a. Market Price of the Registrant's Common Equity:**

The common stock of the Company trades on the American Stock Exchange under the symbol PSB. The following table sets forth the high and low sales prices of the common stock on the American Stock Exchange for the applicable periods:

Three Months Ended	Range	
	High	Low
March 31, 2005	\$ 45.28	\$ 38.18
June 30, 2005	\$ 45.61	\$ 38.56
September 30, 2005	\$ 47.30	\$ 42.51
December 31, 2005	\$ 49.48	\$ 42.60
March 31, 2006	\$ 56.68	\$ 49.10
June 30, 2006	\$ 59.48	\$ 50.00
September 30, 2006	\$ 62.80	\$ 57.18
December 31, 2006	\$ 74.75	\$ 59.55

As of February 23, 2007, there were 545 holders of record of the common stock.

b. Dividends

Holders of common stock are entitled to receive distributions when, as and if declared by the Company's Board of Directors out of any funds legally available for that purpose. The Company is required to distribute at least 90% of its taxable income prior to the filing of the Company's tax return to maintain its REIT status for federal income tax purposes. It is management's intention to pay distributions of not less than these required amounts.

Distributions paid per share of common stock for 2006 and 2005 amounted to \$1.16 per year. In 2006, the Company continued to pay quarterly dividends of \$0.29 per common share. The Board of Directors has established a distribution policy to maximize the retention of operating cash flow and distribute the minimum amount required for the Company to maintain its tax status as a REIT. Pursuant to restrictions contained in the Company's Credit Facility with Wells Fargo Bank, distributions may not exceed 95% of funds from operations, as defined, for any four consecutive quarters. For more information on the Credit Facility, see Note 5 to the consolidated financial statements.

c. Issuer Repurchases of Equity Securities:

The Company's Board of Directors has authorized the repurchase, from time to time, of up to 4.5 million shares of the Company's common stock on the open market or in privately negotiated transactions. The program does not expire.

During the last three months of 2006, there were no shares of the Company's common stock repurchased. As of December 31, 2006, the Company has 1,207,789 shares available for purchase under the program. See Note 9 to the consolidated financial statements for additional information on repurchases and redemptions of equity securities.

d. Securities Authorized for Issuance Under Equity Compensation Plans:

The equity compensation plan information is provided in Item 12.

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The following sets forth selected consolidated and combined financial and operating information on a historical basis of the Company. The following information should be read in conjunction with the consolidated financial statements and notes thereto of the Company included elsewhere in this Form 10-K. Note that historical results from 2002 through 2005 were reclassified to conform with 2006 presentation for discontinued operations. See Note 3 of the Notes to Consolidated Financial Statements included elsewhere in this Form 10-K for a discussion of income from discontinued operations.

	For the Years Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands, except per share data)				
Revenues:					
Rental income	\$ 242,214	\$ 219,604	\$ 210,937	\$ 186,171	\$ 181,836
Facility management fees primarily from affiliates	625	579	624	742	763
Total operating revenues	242,839	220,183	211,561	186,913	182,599
Expenses:					
Cost of operations	74,671	65,712	62,994	51,536	48,967
Depreciation and amortization	86,216	76,178	69,942	56,179	51,974
General and administrative	7,046	5,843	4,628	4,683	5,125
Total operating expenses	167,933	147,733	137,564	112,398	106,066
Other income and expenses:					
Gain on sale of marketable securities				2,043	41
Interest and other income	6,874	4,888	406	1,125	959
Interest expense	(2,575)	(1,330)	(3,054)	(4,015)	(5,324)
Total other income and expenses	4,299	3,558	(2,648)	(847)	(4,324)
Asset impairment due to casualty loss		72			
Income from continuing operations before minority interests and equity in income of liquidated joint venture	79,205	75,936	71,349	73,668	72,209
Equity in income of liquidated joint venture				2,296	1,978
Minority interests in continuing operations:					
Minority interest in income preferred units:					
Distributions to preferred unit holders	(9,789)	(10,350)	(17,106)	(19,240)	(17,927)
Redemption of preferred operating partnership units	(1,366)	(301)	(3,139)		
Minority interest in income common units					
	(5,113)	(5,611)	(4,540)	(10,398)	(10,344)
Total minority interests in continuing operations	(16,268)	(16,262)	(24,785)	(29,638)	(28,271)
Income from continuing operations	62,937	59,674	46,564	46,326	45,916
Discontinued operations:					
Income (loss) from discontinued operations	(125)	2,769	5,337	6,727	7,290
Impairment charge				(5,907)	(900)
Gain on disposition of real estate	2,328	18,109	15,462	2,897	9,023
Minority interest in income attributable to discontinued operations common units	(560)	(5,258)	(5,220)	(947)	(3,899)

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Income from discontinued operations	1,643	15,620	15,579	2,770	11,514
Net Income	64,580	75,294	62,143	49,096	57,430
Net income allocable to preferred shareholders:					
Preferred stock distributions					
Preferred stock distributions	44,553	43,011	31,154	15,784	15,412
Redemptions of preferred stock	3,380		1,866		
Total preferred stock distributions	47,933	43,011	33,020	15,784	15,412
Net income allocable to common shareholders	\$ 16,647	\$ 32,283	\$ 29,123	\$ 33,312	\$ 42,018

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	For the Years Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands, except per share data)				
Per Common Share:					
Cash Distribution	\$ 1.16	\$ 1.16	\$ 1.16	\$ 1.16	\$ 1.16
Net income Basic	\$ 0.78	\$ 1.48	\$ 1.34	\$ 1.56	\$ 1.95
Net income Diluted	\$ 0.77	\$ 1.47	\$ 1.33	\$ 1.54	\$ 1.93
Weighted average common shares Basic	21,335	21,826	21,767	21,412	21,552
Weighted average common shares Diluted	21,646	22,018	21,960	21,565	21,743
Balance Sheet Data:					
Total assets	\$ 1,462,864	\$ 1,463,678	\$ 1,366,052	\$ 1,358,861	\$ 1,156,802
Total debt	\$ 67,048	\$ 25,893	\$ 11,367	\$ 264,694	\$ 70,279
Preferred stock called for redemption	\$ 50,000	\$	\$	\$	\$
Minority interest preferred units	\$ 82,750	\$ 135,750	\$ 127,750	\$ 217,750	\$ 217,750
Minority interest common units	\$ 165,469	\$ 169,451	\$ 169,295	\$ 169,888	\$ 167,469
Redeemable preferred stock	\$ 572,500	\$ 593,350	\$ 510,850	\$ 168,673	\$ 170,813
Common shareholders equity	\$ 482,703	\$ 500,108	\$ 506,114	\$ 502,155	\$ 493,589
Other Data:					
Net cash provided by operating activities	\$ 165,515	\$ 149,428	\$ 151,958	\$ 132,410	\$ 134,926
Net cash (used in) provided by investing activities	\$ (169,986)	\$ 24,389	\$ (26,108)	\$ (294,885)	\$ 5,776
Net cash (used in) provided by financing activities	\$ (129,694)	\$ (13,058)	\$ (91,971)	\$ 123,472	\$ (98,966)
Funds from operations (1)	\$ 106,235	\$ 102,463	\$ 97,214	\$ 97,448	\$ 104,543
Square footage owned at end of period	18,683	17,555	17,988	18,322	14,426

(1) Funds from operations (FFO) is computed in accordance with the White Paper on FFO approved by the Board of Governors of the National Association of Real Estate Investment Trusts (NAREIT). The White Paper defines FFO as net income, computed in accordance with U.S. generally

accepted accounting principles (GAAP), before depreciation, amortization, minority interest in income and extraordinary items. FFO should be analyzed in conjunction with net income. However, FFO should not be viewed as a substitute for net income as a measure of operating performance or liquidity as it does not reflect depreciation and amortization costs or the level of capital expenditure and leasing costs necessary to maintain the operating performance of the Company s properties, which are significant economic costs and could materially impact the Company s results of operations. Other REITs may use different methods for calculating FFO and,

accordingly, the Company's FFO may not be comparable to other real estate companies. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, Liquidity and Capital Resources, Funds from Operations, for a reconciliation of FFO and net income allocable to common shareholders and for information on why the Company presents FFO.

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

The following discussion and analysis of the results of operations and financial condition should be read in conjunction with the selected financial data and the Company's consolidated financial statements and notes thereto included elsewhere in the Form 10-K.

Forward-Looking Statements: Forward-looking statements are made throughout this Annual Report on Form 10-K. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words may, believes, anticipates, plans, expects, seeks, intends, and similar expressions are intended to identify forward-looking statements. There are a number of important factors that could cause the results of the Company to differ materially from those indicated by such forward-looking statements, including those detailed under the heading Item 1A. Risk Factors. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of the information contained in such forward-looking statements should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. Moreover, we assume no obligation to update these forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

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Overview

As of December 31, 2006, the Company owned and operated 18.7 million rentable square feet of multi-tenant flex, industrial and office properties located in eight states.

The Company focuses on increasing profitability and cash flow aimed at maximizing shareholder value. The Company strives to maintain high occupancy levels while increasing rental rates when market conditions allow. The Company also acquires properties it believes will create long-term value, and disposes of properties which no longer fit within the Company's strategic objectives or in situations where the Company believes it can optimize cash proceeds. Operating results are driven by income from rental operations and are therefore substantially influenced by rental demand for space within our properties.

In 2006, the Company generally experienced solid and improving commercial real estate conditions throughout its portfolio. Markets experienced steady to improving demand with the Company having a greater ability throughout its portfolio to maintain or improve occupancy while in certain markets the Company raised rents aggressively. During 2006, the Company still faced rental rate roll downs primarily on leases originally signed at a high market point prior to 2002. As of December 31, 2006, less than 5% of the Company's leases were executed prior to December 31, 2002.

The Company successfully leased or re-leased 4.8 million square feet of space in 2006 and achieved an overall occupancy of 93.4% as of December 31, 2006. The Company also continued to experience a trend of decreasing transaction costs from the high levels incurred in 2003 and 2004. Total net operating income increased from the year ended December 31, 2005 to 2006 by \$13.7 million or 8.9%. See further discussion of operating results below.

Critical Accounting Policies and Estimates:

Our accounting policies are described in Note 2 to the consolidated financial statements included in this Form 10-K. We believe our most critical accounting policies relate to revenue recognition, allowance for doubtful accounts, impairment of long-lived assets, depreciation, accrual of operating expenses and accruals for contingencies, each of which we discuss below.

Revenue Recognition: We recognize revenue in accordance with Staff Accounting Bulletin No. 104 of the Securities and Exchange Commission, Revenue Recognition in Financial Statements (SAB 104). SAB 104 requires that the following four basic criteria must be met before revenue can be recognized: persuasive evidence of an arrangement exists; the delivery has occurred or services rendered; the fee is fixed and determinable; and collectibility is reasonably assured. All leases are classified as operating leases. Rental income is recognized on a straight-line basis over the terms of the leases. Straight-line rent is recognized for all tenants with contractual increases in rent that are not included on the Company's credit watch list. Deferred rent receivables represent rental revenue recognized on a straight-line basis in excess of billed rents. Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as rental income in the period the applicable costs are incurred.

Property Acquisitions: In accordance with Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, we allocate the purchase price of acquired properties to land, buildings and equipment and identified tangible and intangible assets and liabilities associated with in-place leases (including tenant improvements, unamortized leasing commissions, value of above-market and below-market leases, acquired in-place lease values, and tenant relationships, if any) based on their respective estimated fair values.

The fair value of the tangible assets of the acquired properties considers the value of the properties as if vacant as of the acquisition date. Management must make significant assumptions in determining the value of assets and liabilities acquired. Using different assumptions in the allocation of the purchase cost of the acquired properties would affect the timing of recognition of the related revenue and expenses. Amounts allocated to land are derived from comparable sales of land within the same region. Amounts allocated to buildings and improvements, tenant improvements and unamortized leasing commissions are based on current market replacement costs and other market rate information.

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The amount allocated to acquired in-place leases is determined based on management's assessment of current market conditions and the estimated lease-up periods for the respective spaces. The amount allocated to acquired in-place leases is included in deferred leasing costs and other related intangible assets in the balance sheet and amortized as an increase to amortization expense over the remaining non-cancelable term of the respective leases.

The value allocable to the above or below market component of an acquired in-place lease is determined based upon the present value (using a discount rate which reflects the risks associated with the acquired leases) of the difference between (i) the contractual rents to be paid pursuant to the lease over its remaining term, and (ii) management's estimate of the rents that would be paid using fair market rental rates over the remaining term of the lease. The amounts allocated to above or below market leases are included in other assets or other liabilities in the balance sheet and are amortized on a straight-line basis as an increase or reduction of rental income over the remaining non-cancelable term of the respective leases.

Allowance for Doubtful Accounts: Rental revenue from our tenants is our principal source of revenue. We monitor the collectibility of our receivable balances including the deferred rent receivable on an on-going basis. Based on these reviews, we maintain an allowance for doubtful accounts for estimated losses resulting from the possible inability of our tenants to make required rent payments to us. Tenant receivables and deferred rent receivables are carried net of the allowances for uncollectible tenant receivables and deferred rent. As discussed below, determination of the adequacy of these allowances requires significant judgments and estimates. Estimate of the required allowance is subject to revision as the factors discussed below change and is sensitive to the effect of economic and market conditions on our tenants.

Tenant receivables consist primarily of amounts due for contractual lease payments, reimbursements of common area maintenance expenses, property taxes and other expenses recoverable from tenants. Determination of the adequacy of the allowance for uncollectible current tenant receivables is performed using a methodology that incorporates specific identification, aging analysis, an overall evaluation of the historical loss trends and the current economic and business environment. The specific identification methodology relies on factors such as the age and nature of the receivables, the payment history and financial condition of the tenant, the assessment of the tenant's ability to meet its lease obligations, and the status of negotiations of any disputes with the tenant. The allowance also includes a reserve based on historical loss trends not associated with any specific tenant. This reserve as well as the specific identification reserve is reevaluated quarterly based on economic conditions and the current business environment.

Deferred rents receivable represents the amount that the cumulative straight-line rental income recorded to date exceeds cash rents billed to date under the lease agreement. Given the longer-term nature of these types of receivables, determination of the adequacy of the allowance for unbilled deferred rents receivables is based primarily on historical loss experience. Management evaluates the allowance for unbilled deferred rents receivable using a specific identification methodology for significant tenants designed to assess their financial condition and ability to meet their lease obligations.

Impairment of Long-Lived Assets: The Company evaluates a property for potential impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. On a quarterly basis, the Company evaluates the whole portfolio for impairment based on current operating information. In the event that these periodic assessments reflect that the carrying amount of a property exceeds the sum of the undiscounted cash flows (excluding interest) that are expected to result from the use and eventual disposition of the property, the Company would recognize an impairment loss to the extent the carrying amount exceeded the estimated fair value of the property. The estimation of expected future net cash flows is inherently uncertain and relies on subjective assumptions dependent upon future and current market conditions and events that affect the ultimate value of the property. It requires management to make assumptions related to the property such as future rental rates, tenant allowances, operating expenditures, property taxes, capital improvements, occupancy levels, and the estimated proceeds generated from the future sale of the property. These assumptions could differ materially from actual results in future periods. Since SFAS No. 144 provides that the future cash flows used in this analysis be considered on an undiscounted basis, our historically established intent to hold properties over the long term directly decreases the likelihood of recording an impairment loss. If our strategy changes or if

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market conditions otherwise dictate an earlier sale date, an impairment loss could be recognized and such loss could be material.

Depreciation: We compute depreciation on our buildings and equipment using the straight-line method based on estimated useful lives of generally 30 and 5 years. A significant portion of the acquisition cost of each property is allocated to building and building components. The allocation of the acquisition cost to building and building components, as well as the determination of their useful lives, are based on estimates. If we do not appropriately allocate to these components or we incorrectly estimate the useful lives of these components, our computation of depreciation expense may not appropriately reflect the actual impact of these costs over future periods, which will affect net income. In addition, the net book value of real estate assets could be over or understated. The statement of cash flows, however, would not be affected.

Accruals of Operating Expenses: The Company accrues for property tax expenses, performance bonuses and other operating expenses each quarter based on historical trends and anticipated disbursements. If these estimates are incorrect, the timing of expense recognition will be affected.

Accruals for Contingencies: The Company is exposed to business and legal liability risks with respect to events that may have occurred, but in accordance with U.S. generally accepted accounting principles (GAAP) has not accrued for such potential liabilities because the loss is either not probable or not estimable. Future events and the result of pending litigation could result in such potential losses becoming probable and estimable, which could have a material adverse impact on our financial condition or results of operations.

Effect of Economic Conditions on the Company's Operations: Over the course of 2006, improving economic conditions in the United States were reflected in commercial real estate as market conditions allowed for higher rents throughout the Company's portfolio along with a continued reduction in rent concessions and tenant improvement allowances.

Subsequent to December 31, 2006, a tenant occupying approximately 134,000 square feet defaulted on its lease. The Company is currently pursuing legal action against the tenant and is uncertain of the outcome. While the Company historically has experienced a low level of write-offs due to bankruptcy, there is inherent uncertainty in a tenant's ability to continue paying rent if they are in bankruptcy. As of December 31, 2006 the Company had approximately 18,000 square feet occupied by a tenant protected by Chapter 11 of the U.S. Bankruptcy Code. Given the historical uncertainty of a tenant's ability to meet its lease obligations, we will continue to reserve any income that would have been realized on a straight line basis. Several other tenants have contacted us, requesting early termination of their lease, reduction in space under lease, rent deferment or abatement. At this time, the Company cannot anticipate what impact, if any, the ultimate outcome of these discussions will have on our operating results.

Effect of Economic Conditions on the Company's Primary Markets: The Company has concentrated its operations in nine markets. Each of these markets has been affected by changing economic conditions in some way. The Company's overall view of these markets as of December 31, 2006 is summarized below. During the year ended December 31, 2006, the Company has seen rental rates on executed leases increase by an average of 2.7% over the most recent in-place rents. Each of the nine markets that the Company owns assets in is subject to its own unique market influences. The Company has outlined the various market influences for each specific market below. In addition, the Company has compiled market occupancy information using third party reports for each of the respective markets. These sources are deemed to be reliable by the Company, but there can be no assurance that these reports are accurate.

The Company owns approximately 4.0 million square feet in Southern California. This is one of the healthiest markets in our portfolio. In 2006 the market experienced rising rental rates. Vacancy rates decreased slightly throughout Southern California with an average market vacancy rate of 5.3% for 2006. The rental rates on new transactions within the Company's properties improved by 6.7% over in-place rents. The Company's vacancy rate at December 31, 2006 was 3.8%.

The Company owns approximately 1.6 million square feet in Northern California with a concentration in Sacramento, the East Bay (Hayward and San Ramon) and the Silicon Valley (San Jose). The vacancy rates in these submarkets stand at 8.6%, 4.6% and 7.5%, respectively. Market rental rates dropped dramatically in 2006 and 2005

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as a result of an oversupply of commercial space and weak demand. During 2006, certain portions of the Northern California market began to experience improving demand for space, resulting in a slight decrease in market vacancy. The Company's vacancy rate at December 31, 2006 was 6.5%.

The Company owns approximately 1.2 million square feet in the Austin and Greater Houston markets. The Austin market has had a steady level of lease demand during 2006 which has enabled the Company to increase rental rates on new leases by approximately 12.3% over in-place rents. The Houston market continues to stabilize occupancy and rental rates. With a more diverse tenant base, this market has not been as significantly impacted as other parts of Texas that were more reliant on the telecommunications and technology industries, which contracted over the last several years. In addition, the strong oil and gas industry has helped stabilize and improve the Houston market. The Company's vacancy rate at December 31, 2006 was 7.8%.

The Company owns approximately 1.7 million square feet in the Dallas Metroplex market. The vacancy rate in Las Colinas, where most of the Company's properties are located, is 12.5%. During 2006, modest new construction continued, which included both speculative construction, as well as owner user construction. The Company believes that any such new construction could cause vacancy rates to rise and limit opportunities to increase rental rates. However, 2006 brought a higher level of leasing activity in the market than it had experienced over the past two years. The Company's vacancy rate at December 31, 2006 was 16.3%.

The Company owns approximately 3.6 million square feet in South Florida. On December 8, 2006, the Company acquired two assets with a combined total of 398,000 rentable square feet located in Palm Beach County. The assets, which are comprised of Boca Commerce Park and Wellington Commerce Park, was 97.8% occupied at the time of acquisition. Miami International Commerce Center (MICC) located in the Airport West submarket of Miami-Dade County had a vacancy rate of 1.2% compared with a vacancy rate for the entire submarket of 5.9%. MICC is located less than one mile from the cargo entrance of the Miami International Airport, which is considered one of the most active ports in the Southeast. Leasing activity is strong, resulting in better than market occupancy.

The Company owns approximately 2.9 million square feet in the Northern Virginia submarket of Washington D.C., where the average market vacancy rate was 8.6% for 2006. Washington D.C. submarkets have continued to be positively impacted by federal government spending and government contracting trends. The Company's vacancy rate at December 31, 2006 was 6.7%.

The Company owns approximately 1.8 million square feet in the Maryland submarket of Washington D.C. The portfolio is located primarily in Montgomery County and Silver Spring. The Company expects the business of the federal government, defense contractors and the biotech industry to remain stable in 2007. The Company's vacancy rate at December 31, 2006 was 4.4% compared to the 2006 market average of 8.8%.

The Company owns approximately 1.3 million square feet in the Beaverton submarket of Portland, Oregon. In 2006, the Company experienced improving lease terms as a result of increasing lease activity. The vacancy rate in this market is over 17.1%. On the supply side, the Company does not believe significant new construction starts will occur during 2007 as light demand and general availability had a negative impact on the market rental rates. The Company's vacancy rate at December 31, 2006 was 7.7%.

The Company owns approximately 679,000 square feet in the Phoenix market. Overall, the Phoenix market has been characterized by steady growth. However, average market rental rates have declined over the past several years as demand for space subsided. The vacancy rate in this market is over 7.3%. The Company's vacancy rate at December 31, 2006 was 8.4%.

Growth of the Company's Operations and Acquisitions and Dispositions of Properties: During 2005 and 2006, the Company focused on maximizing cash flow from its existing core portfolio of properties and through acquisitions and dispositions of properties, expanding its presence in existing markets through strategic acquisitions.

In 2006, the Company added 1.2 million square feet to its portfolio at an aggregate cost of \$180.3 million. The Company acquired WesTech Business Park, a 366,000 square foot office and flex park in Silver Spring, Maryland, for \$69.3 million; a 88,800 square foot multi-tenant flex buildings in Signal Hill, California, for \$10.7 million; a 107,300 square foot multi-tenant flex park in Chantilly, Virginia, for \$15.8 million; Meadows Corporate Park, a

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165,000 square foot multi-tenant office park in Silver Spring, Maryland, for \$29.9 million; Rogers Avenue, a 66,500 square foot multi-tenant industrial and flex park in San Jose, California, for \$8.4 million; and Boca Commerce Park and Wellington Commerce Park, two multi-tenant industrial, flex and storage parks, aggregating 398,000 square feet, located in Palm Beach County, Florida, for \$46.2 million. In connection with the Meadows Corporate Park purchase, the Company assumed a \$16.8 million mortgage with a fixed interest rate of 7.20% through November, 2011, at which time it can be prepaid without penalty. In addition, in connection with the Palm Beach County purchases, the Company assumed three mortgages with a combined total of \$23.8 million with a weighted average fixed interest rate of 5.84%. During 2005, the Company acquired a 233,000 square foot, multi-tenant flex and office property in San Diego, California, for \$35.1 million including the assumption of a \$15.0 million mortgage which bears an interest rate of 5.73% and matures on March 1, 2013. During 2004, the Company acquired a 165,000 square foot office complex in Fairfax, Virginia, for \$24.1 million. The Company plans to continue to build its presence in existing markets by acquiring high quality facilities in selected markets. The Company targets properties with below market rents which may offer it growth in rental rates above market averages, and which offer the Company the ability to achieve economies of scale resulting in more efficient operations.

Subsequent to December 31, 2006, the Company acquired Overlake Business Center, a 493,000 square foot multi-tenant office and flex business park located in Redmond, Washington, for \$76.0 million, including transaction costs. The park, which was 90.0% leased at the time of acquisition, has 171 tenants in 27 separate one and two story buildings.

During 2006, the Company sold a 30,500 square foot building located in Beaverton, Oregon, for \$4.4 million resulting in a gain of \$1.5 million. Additionally in 2006, the Company sold 32,400 square feet in Miami for a combined total of \$3.7 million, resulting in a gain of \$865,000.

In 2005, the Company sold Woodside Corporate Park located in Beaverton, Oregon. Net proceeds from the sales were \$64.5 million and the Company reported a gain of \$12.5 million. The sale consisted of 13 buildings comprising 574,000 square feet and 3.3 acres of adjacent land. The park was 76.8% leased at the time of the sale. In addition, the Company sold 8.2 acres of land in the Beaverton area for \$3.6 million resulting in a gain of \$1.8 million. Six units totaling 44,000 square feet and a small parcel of land at Miami International Commerce Center (MICC) were sold for a combined sales price of \$5.8 million resulting in an aggregate gain of \$1.9 million. The Company sold a retail center located at MICC consisting of 56,000 square feet for a sales price of \$12.2 million resulting in a gain of \$967,000.

In 2004, the Company sold a 43,000 square foot flex facility in Austin, Texas, for gross proceeds of \$1.2 million, a 30,500 square foot building in Beaverton, Oregon, for gross proceeds of \$3.1 million, a 10,000 and 7,100 square foot unit at MICC, with combined gross proceeds of \$1.9 million and two flex parks totaling 400,000 square feet in Maryland, for combined gross proceeds of \$44.2 million. In connection with these sales, the Company reported an aggregate gain of \$15.5 million.

Impact of Inflation: Although inflation has not been significant in recent years, it is still a factor in our economy and the Company continues to seek ways to mitigate its impact. A substantial portion of the Company's leases require tenants to pay operating expenses, including real estate taxes, utilities, and insurance, as well as increases in common area expenses, partially reducing the Company's exposure to inflation. During 2005 and 2006, the Company experienced a significant increase in certain operating costs including repairs and maintenance, property insurance and utility costs impacting the Company's overall profit margin. The Company anticipates that this inflationary pressure will likely continue in 2007.

Concentration of Portfolio by Region: Rental income, cost of operations and rental income less cost of operations, excluding depreciation and amortization or net operating income prior to depreciation and amortization (defined as NOI for purposes of the following table) from continuing operations are summarized for the year ended December 31, 2006 by major geographic region below. The Company uses NOI and its components as a measurement of the performance of its commercial real estate. Management believes that these financial measures provide them as well as the investor the most consistent measurement on a comparative basis of the performance of the commercial real estate and its contribution to the value of the Company. Depreciation and amortization have been excluded from these financial measures as they are generally not used in determining the value of commercial real estate by management or the investment community. Depreciation and amortization are generally not used in

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determining value as they consider the historical costs of an asset compared to its current value; therefore, to understand the effect of the assets' historical cost on the Company's results, investors should look at GAAP financial measures, such as total operating costs including depreciation and amortization. The Company's calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance calculated in accordance with generally accepted accounting principles. The table below reflects rental income, operating expenses and NOI from continuing operations for the year ended December 31, 2006 based on geographical concentration. The total of all regions is equal to the amount of rental income and cost of operations recorded by the Company in accordance with GAAP. We have also included the most comparable GAAP measure which includes total depreciation and amortization. The percent of totals by region reflects the actual contribution to rental income, cost of operations and NOI during the period from properties included in continuing operations (*in thousands*):

Region	Weighted Square Footage	Percent of Total	Rental Income	Percent of Total	Cost of Operations	Percent of Total	NOI	Percent of Total
Southern California	3,946	21.9%	\$ 61,227	25.3%	\$ 17,591	23.6%	\$ 43,636	26.1%
Northern California	1,512	8.4%	19,023	7.8%	5,043	6.8%	13,980	8.3%
Southern Texas	1,161	6.4%	10,472	4.3%	4,668	6.2%	5,804	3.5%
Northern Texas	1,689	9.4%	14,736	6.1%	5,811	7.8%	8,925	5.3%
South Florida	3,226	17.9%	24,673	10.2%	8,172	10.9%	16,501	9.9%
Virginia	2,844	15.7%	50,803	21.0%	14,286	19.1%	36,517	21.8%
Maryland	1,651	9.1%	35,419	14.6%	9,953	13.3%	25,466	15.2%
Oregon	1,342	7.4%	18,860	7.8%	6,401	8.6%	12,459	7.4%
Arizona	679	3.8%	7,001	2.9%	2,746	3.7%	4,255	2.5%
Total before depreciation and amortization	18,050	100.0%	242,214	100.0%	74,671	100.0%	167,543	100.0%
Depreciation and amortization					86,216		(86,216)	
Total			\$ 242,214		\$ 160,887		\$ 81,327	

Concentration of Credit Risk by Industry: The information below depicts the industry concentration of our tenant base as of December 31, 2006. The Company analyzes this concentration to minimize significant industry exposure risk.

Business services	11.5%
Government	11.1%
Financial services	10.4%
Contractors	9.5%
Computer hardware, software and related service	9.1%
Warehouse, transportation and logistics	9.1%
Health services	7.3%
Communications	5.8%

Retail	5.8%
Home furnishing	3.8%
Electronics	3.1%
	86.5%

The information below depicts the Company's top ten customers by annual rents as of December 31, 2006 (in thousands):

Tenants	Square Footage	Annual Rents (1)	% of Total Annual Rents
U.S. Government.	469	\$12,854	5.1%
Kaiser Permanente	194	3,693	1.5%
County of Santa Clara	97	3,191	1.3%
Intel	214	3,024	1.2%
Axcelis Technologies	89	1,802	0.7%
Wells Fargo	102	1,651	0.7%
AARP	102	1,542	0.6%
Northrop Grumman	58	1,539	0.6%
Raytheon	77	1,239	0.5%
MCI	72	1,227	0.5%
	1,474	\$31,762	12.7%

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(1) For leases expiring prior to December 31, 2007, annualized rental income represents income to be received under existing leases from December 31, 2006 through the date of expiration.

Comparison of 2006 to 2005

Results of Operations: Net income for the year ended December 31, 2006 was \$64.6 million compared to \$75.3 million for the year ended December 31, 2005. Net income allocable to common shareholders (net income less preferred stock distributions) for the year ended December 31, 2006 was \$16.6 million compared to \$32.3 million for the year ended December 31, 2005. Net income per common share on a diluted basis was \$0.77 for the year ended December 31, 2006 compared to \$1.47 for the year ended December 31, 2005 (based on weighted average diluted common shares outstanding of 21,646,000 and 22,018,000, respectively). The decrease was due to a reduction in income from discontinued operations of \$14.0 million combined with an increase in non-cash distributions associated with preferred equity redemptions of \$4.4 million, partially offset by the increase in income from continuing operations of \$3.3 million.

The following table presents the operating results of the properties for the years ended December 31, 2006 and 2005 in addition to other income and expense items affecting income from continuing operations. The Company breaks out Same Park operations to provide information regarding trends for properties the Company has held for the periods being compared (*in thousands, except per square foot data*):

	For the Years Ended December		
	31,		
	2006	2005	Change
Rental income:			
Same Park (17.3 million rentable square feet) (1)	\$ 227,073	\$ 218,981	3.7%
Other facilities (1.4 million rentable square feet) (2)	15,141	623	2,330.3%
Total rental income	242,214	219,604	10.3%
Cost of operations:			
Same Park	69,271	65,558	5.7%
Other facilities	5,400	154	3,406.5%
Total cost of operations	74,671	65,712	13.6%
Net operating income (3):			
Same Park	157,802	153,423	2.9%
Other facilities	9,741	469	1,977.0%
Total net operating income	167,543	153,892	8.9%
Other income and expenses:			
Facility management fees	625	579	7.9%
Interest and other income	6,874	4,888	40.6%
Interest expense	(2,575)	(1,330)	93.6%
Depreciation and amortization	(86,216)	(76,178)	13.2%
General and administrative	(7,046)	(5,843)	20.6%
Asset impairment due to casualty loss		(72)	(100.0%)
Income before discontinued operations and minority interest	\$ 79,205	\$ 75,936	4.3%
Same Park gross margin (4)	69.5%	70.1%	(0.9%)

Same Park weighted average for the period:

Occupancy		93.4%		92.3%	1.2%
Realized rent per square foot (5)	\$	14.09	\$	13.75	2.5%

- (1) See below for a definition of Same Park.
- (2) Represents operating properties owned by the Company as of December 31, 2006 that are not included in Same Park.
- (3) Net operating income (NOI) is an important measurement in the commercial real estate industry for determining the value of the real estate generating the NOI. See Concentration of Portfolio by Region above for more information on NOI. The Company s calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance in accordance with GAAP.
- (4)

Same Park gross margin is computed by dividing Same Park NOI by Same Park rental income.

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- (5) Same Park realized rent per square foot represents the Same Park rental income earned per occupied square foot.

Supplemental Property Data and Trends: In order to evaluate the performance of the Company's overall portfolio over two given years, management analyzes the operating performance of a consistent group of properties owned and operated throughout both those years. The Company refers to those properties as the Same Park facilities. For 2006 and 2005, the Same Park facilities constitute 17.3 million rentable square feet, which includes all assets in continuing operations that the Company owned and operated from January 1, 2005 through December 31, 2006, representing approximately 92.4% of the total square footage of the Company's portfolio for 2006.

Rental income, cost of operations and rental income less cost of operations, excluding depreciation and amortization, or net operating income prior to depreciation and amortization (defined as NOI for purposes of the following table) from continuing operations are summarized for the years ended December 31, 2006 and 2005 by major geographic region below. See Concentration of Portfolio by Region above for more information on NOI, including why the Company presents NOI and how the Company uses NOI. The Company's calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance calculated in accordance with generally accepted accounting principles.

The following table summarizes the Same Park operating results by major geographic region for the years ended December 31, 2006 and 2005. In addition, the table reflects the comparative impact on the overall rental income, cost of operations and NOI from properties that have been acquired since January 1, 2005 and the impact of such is included in Other Facilities in the table below (*in thousands*):

Region	Rental	Rental	Increase (Decrease)	Cost of	Cost of	Increase (Decrease)	NOI	NOI	Increase (Decrease)
	Income	Income		Operations	Operations		December	December	
	December	December		December	December		December	December	
	31,	31,		31,	31,		31,	31,	
	2006	2005		2006	2005		2006	2005	
Southern California	\$ 56,911	\$ 54,096	5.2%	\$ 15,926	\$ 14,843	7.3%	\$ 40,985	\$ 39,253	4.4%
Northern California	18,854	18,971	(0.6%)	5,006	4,583	9.2%	13,848	14,388	(3.8%)
Southern Texas	10,472	9,615	8.9%	4,668	4,115	13.4%	5,804	5,500	5.5%
Northern Texas	14,736	15,712	(6.2%)	5,811	5,337	8.9%	8,925	10,375	(14.0%)
South Florida	24,316	22,080	10.1%	8,041	7,767	3.5%	16,275	14,313	13.7%
Virginia	50,055	48,699	2.8%	14,056	13,881	1.3%	35,999	34,818	3.4%
Maryland	25,868	24,189	6.9%	6,616	6,490	1.9%	19,252	17,699	8.8%
Oregon	18,860	18,683	0.9%	6,401	5,883	8.8%	12,459	12,800	(2.7%)
Arizona	7,001	6,936	0.9%	2,746	2,659	3.3%	4,255	4,277	(0.5%)
	227,073	218,981	3.7%	69,271	65,558	5.7%	157,802	153,423	2.9%

Total Same Park Other Facilities	15,141	623	2,330.3%	5,400	154	3,406.5%	9,741	469	1,977.0%
Total before depreciation and amortization	242,214	219,604	10.3%	74,671	65,712	13.6%	167,543	153,892	8.9%
Depreciation and amortization				86,216	76,178	13.2%	(86,216)	(76,178)	13.2%
Total based on GAAP	\$ 242,214	\$ 219,604	10.3%	\$ 160,887	\$ 141,890	13.4%	\$ 81,327	\$ 77,714	4.6%

The discussion of regional information below relates to Same Park properties:

Southern California

This region includes San Diego, Orange and Los Angeles Counties. The increase in rental income was the result of a strong market supported by a diverse economy. The Company's weighted average occupancies for the region increased from 94.8% in 2005 to 96.2% in 2006. Realized rent per square foot increased 3.7% from \$15.57 per square foot for 2005 to \$16.14 per square foot in 2006. These markets experienced increasing rental rates and decreasing vacancy rates as a result of sustained strong economic conditions.

Northern California

This region includes Sacramento, South San Francisco, the East Bay and the Silicon Valley submarkets that had been affected by high vacancy due in part to failed technology companies. Economic conditions in the Silicon Valley submarkets began to show some signs of recovery as demand for space increased and rents started to stabilize. The Company's weighted average occupancies outperformed the market with occupancy increasing from 93.2% in 2005 to 94.7% in 2006. Realized rent per square foot decreased 2.1% from \$13.56 per square foot in 2005 compared to \$13.27 per square foot in 2006.

Table of Contents*Southern Texas*

This region, which includes Austin and Houston, is one of the Company's markets that has faced challenging market conditions with the Company's operating results continuing to be impacted by the effects of sharply reduced market rental rates, higher vacancies and business failures. During 2006, the Company's Southern Texas portfolio experienced a moderate level of activity which was evidenced in the occupancy improvement within the portfolio. The Company's weighted average occupancies increased from 85.9% in 2005 to 89.5% in 2006. Realized rent per square foot increased 4.6% from \$9.64 per square foot in 2005 to \$10.08 per square foot in 2006.

Northern Texas

This region consists of the Dallas market. This market has been impacted by high vacancy levels and rent roll downs due to general availability of space, modest economic drivers and ongoing development. However, leasing activity in the market increased modestly during 2006. The Company's weighted average occupancies for the region decreased from 85.9% in 2005 to 80.3% in 2006. The decrease was primarily due to the early 2006 expiration of 198,000 square feet previously leased to Citigroup. As of December 31, 2006, all of this space has been re-leased. Realized rent per square foot increased 0.4% from \$10.82 per square foot in 2005 to \$10.86 per square foot in 2006.

South Florida

This region consists of the Company's business park located in the submarket of Miami-Dade County. The park is located less than one mile from the Miami International Airport. The Company's weighted average occupancies for the park increased from 92.8% in 2005 to 96.4% in 2006. Realized rent per square foot increased 5.9% from \$7.44 per square foot in 2005 to \$7.88 in 2006. Operating expenses for the year ended December 31, 2006 increased by 3.5% over the same period in 2005 due primarily to repairs and maintenance related to the continued clean-up from hurricane damage sustained in 2005 along with increased insurance and utility costs.

Virginia

This region includes the major Northern Virginia suburban markets surrounding the greater Washington D.C. metropolitan area. The greater Washington D.C. market continues to demonstrate solid fundamentals with sustained demand for space, improving rental rates and lower concessions. A major contributor to the market strength was tied to government contracting and defense spending. Approximately 11.7% of the existing leases in this market were executed prior to 2002, which was considered a high point in the market. This has and will continue to result in some rental rate roll downs as these leases are replaced at market rates. The Company's weighted average occupancies decreased from 95.4% in 2005 to 94.8% in 2006. Realized rent per square foot increased 3.3% from \$18.33 per square foot in 2005 to \$18.94 per square foot in 2006.

Maryland

This region consists of facilities primarily in Montgomery County. Considered part of the greater Washington D.C. market, Maryland continues to experience solid market demand. In more recent years this submarket has had a significant amount of sublease space, which placed increased pressure on rental rates and vacancy. This supply of sublease space has decreased, thereby decreasing downward pressure on rental rates. Approximately 7.4% of the existing leases in this market were executed prior to 2002, which was considered a high point in the market. This has and will continue to result in some rental rate roll downs. The Company's weighted average occupancies increased from 95.4% in 2005 to 97.4% in 2006. Considered part of the Washington DC Metro market, Maryland is experiencing improving market conditions due primarily to higher levels of government contracting. Realized rent per square foot increased 4.8% from \$20.47 per square foot in 2005 to \$21.45 per square foot in 2006.

Oregon

This region consists primarily of two business parks in the Beaverton submarket of Portland, Oregon. Portland has been one of the markets hardest hit by the technology slowdown. In 2003 and 2004, the slowdown resulted in early lease terminations, low levels of tenant retention and significant declines in rental rates. During 2005 and continuing in 2006, the market experienced higher levels of leasing activity, with rental rates declining significantly from in-place rents and higher leasing concessions. The Company's weighted average occupancies increased from

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86.2% in 2005 to 90.0% in 2006. Realized rent per square foot decreased 3.2% from \$16.15 per square foot in 2005 to \$15.63 per square foot in 2006.

Arizona

The Arizona region consists primarily of properties in the Phoenix and Tempe areas, where rents are moderately increasing and rent concessions have been reduced. The Company's weighted average occupancies in the region decreased from 94.5% in 2005 to 94.0% in 2006. Realized rent per square foot increased 1.6% from \$10.81 per square foot in 2005 to \$10.98 in 2006.

Facility Management Operations: The Company's facility management operations account for a small portion of the Company's net income. During the year ended December 31, 2006, \$625,000 of revenue was recognized from facility management fees compared to \$579,000 for the year ended December 31, 2005.

Cost of Operations: Cost of operations, excluding discontinued operations, was \$74.7 million for the year ended December 31, 2006 compared to \$65.7 million for the year ended December 31, 2005. The increase was due primarily to the growth in the square footage of the Company's portfolio of properties. Cost of operations as a percentage of rental income increased slightly from 29.9% in 2005 to 30.8% in 2006. Cost of operations for the year ended December 31, 2006 consisted primarily of the following items: property taxes (\$21.1 million); property maintenance (\$17.1 million); utilities (\$15.2 million); and payroll (\$12.0 million) as compared to cost of operations for the year ended December 31, 2005 which consisted primarily of the following items: property taxes (\$19.5 million); property maintenance (\$15.1 million); utilities (\$12.8 million); and payroll (\$10.2 million).

Depreciation and Amortization Expense: Depreciation and amortization expense, excluding discontinued operations, was \$86.2 million for the year ended December 31, 2006 compared to \$76.2 million for the year ended December 31, 2005. The increase is primarily due to the acquisitions in 2006, as well as depreciation expense on capital and tenant improvements acquired during 2005.

General and Administrative Expense: General and administrative expense was \$7.0 million for the year ended December 31, 2006 compared to \$5.8 million for the year ended December 31, 2005. General and administrative expenses for the year ended December 31, 2006 consisted mainly of the following items: expenses which relate to the accounting, finance, and executive divisions of the Company, which primarily consist of payroll expenses (\$2.9 million); professional fees, including expenses related to outside accounting, tax, legal and investor services (\$1.2 million); stock compensation expense (\$2.2 million); and other various expenses. General and administrative expenses for the year ended December 31, 2005 consisted mainly of the following items: expenses which relate to the accounting, finance, and executive divisions of the Company, which primarily consist of payroll expenses (\$3.0 million); professional fees, including expenses related to outside accounting, tax, legal and investor services (\$1.1 million); stock compensation expense (\$634,000); and other various expenses. The increase in stock compensation expense was primarily due to the long term incentive plan for senior management put into place in the first quarter of 2006.

Interest and Other Income: Interest and other income reflects earnings on cash balances and dividends on marketable securities in addition to miscellaneous income items. Interest income was \$6.8 million for the year ended December 31, 2006 compared to \$4.8 million for the year ended December 31, 2005. Interest income for the year ended December 31, 2006 primarily related to interest earned on cash balances which earned approximately 4.9% interest compared to 3.1% in 2005.

Interest Expense: Interest expense was \$2.6 million for the year ended December 31, 2006 compared to \$1.3 million for the year ended December 31, 2005. The increase is primarily attributable to the mortgages assumed in connection with the purchase of Rose Canyon Business Park in San Diego, California, Meadows Corporate Park in Silver Spring, Maryland and Wellington Commerce Park and Boca Commerce Park in Palm Beach County, Florida.

Gain on Disposition of Real Estate: Included in income from discontinued operations are gains on dispositions of real estate for the year ended December 31, 2006 of \$2.3 million compared to \$18.1 million for the year ended December 31, 2005. During the year ended December 31, 2006, the Company disposed of five properties, four in Miami and one in Oregon. The four properties in Miami generated an aggregate gain of \$865,000 with the remaining one property in Oregon providing a net gain of \$1.5 million. In 2005, the Company disposed of eight

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properties, one in Oregon and seven in Miami, as well as, three parcels of land in Oregon and a small parcel of land in Miami. The property in Beaverton, Oregon generated a gain of \$12.5 million with the remaining properties and land providing a net gain of \$5.6 million.

Minority Interest in Income: Minority interest in income reflects the income allocable to equity interests in the Operating Partnership that are not owned by the Company. Minority interest in income was \$16.8 million (\$11.2 million allocated to preferred unit holders and \$5.7 million allocated to common unit holders) for the year ended December 31, 2006 compared to \$21.5 million (\$10.7 million allocated to preferred unit holders and \$10.9 million allocated to common unit holders) for the year ended December 31, 2005. The decrease was primarily due to the reduction of gain on disposition of real estate and income from sold properties allocated to minority interest offset with an increase in additional distributions to preferred unit holders for redemption of preferred partnership units.

Comparison of 2005 to 2004

Results of Operations: Net income for the year ended December 31, 2005 was \$75.3 million compared to \$62.1 million for the year ended December 31, 2004. Net income allocable to common shareholders (net income less preferred stock distributions) for the year ended December 31, 2005 was \$32.3 million compared to \$29.1 million for the year ended December 31, 2004. Net income per common share on a diluted basis was \$1.47 for the year ended December 31, 2005 compared to \$1.33 for the year ended December 31, 2004 (based on weighted average diluted common shares outstanding of 22,018,000 and 21,960,000, respectively). The increase was due to the increase in rental income of \$8.7 million and interest income of \$4.5 million partially offset by an increase in cost of operations of \$2.7 million and depreciation of \$6.2 million.

The following table presents the operating results of the properties for the years ended December 31, 2005 and 2004 in addition to other income and expense items affecting income from continuing operations. The Company breaks out Same Park operations to provide information regarding trends for properties the Company has held for the periods being compared (*in thousands, except per square foot data*):

	For the Years Ended December		
	31,		
	2005	2004	Change
Rental income:			
Same Park (17.1 million rentable square feet) (1)	\$ 215,715	\$ 209,191	3.1%
Other facilities (398,000 rentable square feet) (2)	3,889	1,746	122.7%
Total rental income	219,604	210,937	4.1%
Cost of operations:			
Same Park	64,316	62,288	3.3%
Other facilities	1,396	706	97.7%
Total cost of operations	65,712	62,994	4.3%
Net operating income (3):			
Same Park	151,399	146,903	3.1%
Other facilities	2,493	1,040	139.7%
Total net operating income	153,892	147,943	4.0%
Other income and expenses:			
Facility management fees	579	624	(7.2%)
Interest and other income	4,888	406	1103.9%

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Interest expense	(1,330)	(3,054)	(56.5%)
Depreciation and amortization	(76,178)	(69,942)	8.9%
General and administrative	(5,843)	(4,628)	26.3%
Asset impairment due to casualty loss	(72)		100.0%
Income before discontinued operations and minority interest	\$ 75,936	\$ 71,349	6.4%
Same Park gross margin (4)	70.2%	70.2%	
Same Park weighted average for the period:			
Occupancy	92.3%	89.0%	3.7%
Realized rent per square foot (5)	\$ 13.68	\$ 13.75	(0.5%)

(1) See below for a definition of Same Park.

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- (2) Represents operating properties owned by the Company as of December 31, 2005 that are not included in Same Park.

- (3) Net operating income (NOI) is an important measurement in the commercial real estate industry for determining the value of the real estate generating the NOI. See Concentration of Portfolio by Region above for more information on NOI. The Company s calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance in accordance with GAAP.

- (4) Same Park gross margin is computed by dividing Same Park NOI by Same Park rental income.

- (5) Same Park realized rent per square foot represents the Same Park rental income earned per occupied square foot.

Supplemental Property Data and Trends: In order to evaluate the performance of the Company's overall portfolio over two given years, management analyzes the operating performance of a consistent group of properties owned and operated throughout both those years. The Company refers to those properties as the Same Park facilities. For 2005 and 2004, the Same Park facilities constitute 17.1 million rentable square feet, which includes all assets in continuing operations that the Company owned and operated from January 1, 2004 through December 31, 2005, representing approximately 97.7% of the total square footage of the Company's portfolio for 2005.

Rental income, cost of operations and rental income less cost of operations, excluding depreciation and amortization, or net operating income prior to depreciation and amortization (defined as NOI for purposes of the following table) from continuing operations are summarized for the years ended December 31, 2005 and 2004 by major geographic region below. See Concentration of Portfolio by Region above for more information on NOI, including why the Company presents NOI and how the Company uses NOI. The Company's calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance calculated in accordance with generally accepted accounting principles.

The following table summarizes the Same Park operating results by major geographic region for the years ended December 31, 2005 and 2004. In addition, the table reflects the comparative impact on the overall rental income, cost of operations and NOI from properties that have been acquired since January 1, 2004 and the impact of such is included in Other Facilities in the table below (*in thousands*):

Region	Rental	Rental	Increase (Decrease)	Cost of	Cost of	Increase (Decrease)	NOI	NOI	Increase (Decrease)
	Income December 31, 2005	Income December 31, 2004		Operations December 31, 2005	Operations December 31, 2004		December 31, 2005	December 31, 2004	
Southern California	\$ 54,099	\$ 51,796	4.4%	\$ 14,850	\$ 14,151	4.9%	\$ 39,249	\$ 37,645	4.3%
Northern California	18,971	19,493	(2.7%)	4,583	4,576	0.2%	14,388	14,917	(3.5%)
Southern Texas	9,615	9,653	(0.4%)	4,115	4,189	(1.8%)	5,500	5,464	0.7%
Northern Texas	15,712	14,162	10.9%	5,337	5,466	(2.4%)	10,375	8,696	19.3%
South Florida	22,080	20,286	8.8%	7,767	7,190	8.0%	14,313	13,096	9.3%
Virginia	45,430	44,379	2.4%	12,632	12,199	3.5%	32,798	32,180	1.9%
Maryland	24,189	24,421	(1.0%)	6,490	6,262	3.6%	17,699	18,159	(2.5%)
Oregon	18,683	18,413	1.5%	5,883	5,497	7.0%	12,800	12,916	(0.9%)
Arizona	6,936	6,588	5.3%	2,659	2,758	(3.6%)	4,277	3,830	11.7%
Total Same Park	215,715	209,191	3.1%	64,316	62,288	3.3%	151,399	146,903	3.1%
	3,889	1,746	122.7%	1,396	706	97.7%	2,493	1,040	139.7%

Other
Facilities

Total before
depreciation
and
amortization
Depreciation
and
amortization

219,604	210,937	4.1%	65,712	62,994	4.3%	153,892	147,943	4.0%
			76,178	69,942	8.9%	(76,178)	(69,942)	8.9%

Total based
on GAAP

\$ 219,604	\$ 210,937	4.1%	\$ 141,890	\$ 132,936	6.7%	\$ 77,714	\$ 78,001	(0.4%)
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The discussion of regional information below relates to Same Park properties:

Southern California

This region includes San Diego, Orange and Los Angeles Counties. Rental income and NOI for 2005 were slightly higher than 2004 due to an increase in weighted average occupancy and increasing rental rates. Weighted average occupancies have increased from 93.0% in 2004 to 94.8% in 2005. Realized rent per square foot increased 2.4% from \$15.21 per square foot for 2004 to \$15.57 per square foot in 2005. The increases in this market were reflective of the general strength of the Southern California real estate market.

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This region includes Sacramento, South San Francisco, the East Bay and the Silicon Valley, a submarket that continues to be impacted by an over supply of commercial space due in part to failed technology companies. Rental income and NOI decreased from 2004 to 2005 primarily due to the loss of a large tenant in the San Jose portfolio. Weighted average occupancies outperformed the market, yet they decreased from 95.0% in 2004 to 93.2% in 2005 primarily due to a bankruptcy and early termination of a 91,000 square foot tenant in the San Ramon portfolio. Realized rent per square foot decreased 0.8% from \$13.68 per square foot in 2004 compared to \$13.57 per square foot in 2005.

Southern Texas

This region, which includes Austin and Houston, faced challenging market conditions with the Company's operating results continuing to be impacted by the effects of sharply reduced market rental rates, higher vacancies and business failures. These effects on rental revenue were mitigated by reduced operating costs, primarily in payroll. Weighted average occupancies increased from 83.2% in 2004 to 85.9% in 2005. Despite an increase in occupancy, realized rent per square foot decreased 3.5% from \$9.95 per square foot in 2004 to \$9.60 per square foot in 2005.

Northern Texas

This region includes the Dallas area. The increase in rental income and NOI were due primarily to increased occupancies and rental rates. This market continued to be impacted by high vacancy levels due to general availability of space, modest economic drivers and ongoing development. Weighted average occupancies increased from 82.8% in 2004 to 85.9% in 2005. Realized rent per square foot increased 6.8% from \$10.14 per square foot in 2004 to \$10.83 per square foot in 2005.

South Florida

This region includes the Miami area. The Company's assets continue to outperform the market. Rental income and net operating income increases were a result of occupancy increases. Weighted average occupancies increased from 84.0% in 2004 to 92.9% in 2005. Realized rent per square foot decreased 1.6% from \$7.58 in 2004 to \$7.46 in 2005.

Virginia

This region includes all major Northern Virginia suburban submarkets surrounding the Washington D.C. metropolitan area. The Washington DC Metro market is considered one of the Company's strongest markets driven largely by increased government contracting and defense spending. In many situations the Company was able to reduce tenant concessions and increase rental rates, yet the Company still had a number of leases executed prior to 2002, which was considered a high point in the market. This continued to result in some rental rate roll downs in the Virginia submarket. The increase in revenue was offset by increasing operating expenses, primarily utilities, resulting in a slight increase in NOI. Weighted average occupancies decreased from 96.5% in 2004 to 95.6% in 2005. Realized rent per square foot increased 3.4% from \$17.54 per square foot in 2004 to \$18.13 per square foot in 2005.

Maryland

This region consists primarily of facilities in Montgomery County. Weighted average occupancies increased from 91.2% in 2004 to 95.4% in 2005. Considered part of the Washington DC Metro market, Maryland experienced improving market conditions due primarily to higher levels of government contracting. Realized rent per square foot decreased 5.3% from \$21.63 per square foot in 2004 to \$20.49 per square foot in 2005. The decrease in rental rates was a result of certain large tenants re-leasing at rates below expiring rental rates. The higher rental rates were tied to leases transacted during a high point in this commercial real estate market prior to 2002.

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This region consists primarily of two business parks in the Beaverton submarket of Portland. Oregon was one of the markets hardest hit by the technology slowdown. In 2003 and 2004, the slowdown resulted in early lease terminations, low levels of tenant retention and significant declines in rental rates. During 2005, the market experienced higher levels of leasing activity, with rental rates declining significantly from in-place rents and higher leasing concessions. Weighted average occupancies increased from 78.2% in 2004 to 86.2% in 2005. Realized rent per square foot decreased 8.0% from \$17.55 per square foot in 2004 to \$16.15 per square foot in 2005.

Arizona

The Arizona region consists primarily of properties in the Phoenix and Tempe areas. The Company's weighted average occupancies in the region increased from 92.5% in 2004 to 94.5% in 2005. Realized rent per square foot increased 3.1% from \$10.49 per square foot in 2004 to \$10.81 per square for in 2005.

Facility Management Operations: The Company's facility management operations account for a small portion of the Company's net income. During the year ended December 31, 2005, \$579,000 of revenue was recognized from facility management fees compared to \$624,000 for the year ended December 31, 2004.

Cost of Operations: Cost of operations, excluding discontinued operations, was \$65.7 million for the year ended December 31, 2005 compared to \$63.0 million for the year ended December 31, 2004. The increase was due primarily to the growth in the square footage of the Company's portfolio of properties. Cost of operations as a percentage of rental income remained flat at 29.9% for 2004 and 2005. Cost of operations for the year ended December 31, 2005 consisted primarily of the following items: property taxes (\$19.5 million); property maintenance (\$15.1 million); utilities (\$12.8 million); and payroll (\$10.2 million) as compared to cost of operations for the year ended December 31, 2004 which consisted primarily of the following items: property taxes (\$19.2 million); property maintenance (\$14.2 million); utilities (\$11.3 million); and payroll (\$10.5 million).

Depreciation and Amortization Expense: Depreciation and amortization expense, excluding discontinued operations, was \$76.2 million for the year ended December 31, 2005 compared to \$69.9 million for the year ended December 31, 2004. The increase was primarily due to depreciation expense on capital put in place in 2005 and at the end of 2004.

General and Administrative Expense: General and administrative expense was \$5.8 million for the year ended December 31, 2005 compared to \$4.6 million for the year ended December 31, 2004. General and administrative expenses for the year ended December 31, 2005 consisted mainly of the following items: expenses which relate to the accounting, finance, and executive divisions of the Company, which primarily consist of payroll expenses (\$3.0 million); professional fees, including expenses related to outside accounting, tax, legal and investor services (\$1.1 million); stock compensation expense (\$634,000); and other various expenses. General and administrative expenses for the year ended December 31, 2004 consisted mainly of the following items: expenses which relate to the accounting, finance, and executive divisions of the Company, which primarily consist of payroll expenses (\$2.4 million); professional fees, including expenses related to Sarbanes Oxley Section 404 (SOX 404) Compliance, outside accounting, tax, legal and investor services (\$1.3 million); stock compensation expense (\$93,000); and other various expenses. During 2004, the Company incurred approximately \$600,000 related to its efforts to ensure compliance with SOX 404. While management experienced the ongoing costs of ensuring compliance with SOX 404 during 2005, the amount decreased substantially as a significant portion of the work that was previously performed by third parties was performed by company employees. The increase in payroll expenses was due to higher levels of salary and related costs resulting from the changes to the Company's senior management team.

Interest and Other Income: Interest and other income reflects earnings on cash balances and dividends on marketable securities in addition to miscellaneous income items. Interest income was \$4.8 million for the year ended December 31, 2005 compared to \$308,000 for the year ended December 31, 2004. Interest income for the year ended December 31, 2005 primarily related to interest earned on cash balances which generally earned approximately 3.1% interest compared to less than 2% in 2004. Additionally, based on the preferred equity activity and property dispositions during 2005, the Company's average cash on hand of \$132.2 million was significantly more than the average cash on hand during 2004 of \$22.7 million.

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Interest Expense: Interest expense was \$1.3 million for the year ended December 31, 2005 compared to \$3.1 million for the year ended December 31, 2004. The decrease is attributable to the payoff of the line of credit, a mortgage note payable and an affiliate loan in 2004. No interest expense was capitalized as part of building costs associated with properties under development during the years ended December 31, 2005 and 2004.

Gain on Disposition of Real Estate: Included in income from discontinued operations are gains on dispositions of real estate for the year ended December 31, 2005 of \$18.1 million compared to \$15.5 million for the year ended December 31, 2004. In 2005, the Company disposed of eight properties, one in Oregon and seven in Miami, as well as, three parcels of land in Oregon and a small parcel of land in Miami. The property in Beaverton, Oregon generated a gain of \$12.5 million with the remaining properties and land providing a net gain of \$5.6 million. During the year ended December 31, 2004, the Company disposed of six properties, two in Maryland, two in Miami, one in Texas and one in Oregon. The two properties in Maryland generated an aggregate gain of \$15.2 million with the remaining four properties providing a net gain of \$300,000.

Minority Interest in Income: Minority interest in income reflects the income allocable to equity interests in the Operating Partnership that are not owned by the Company. Minority interest in income was \$21.5 million (\$10.7 million allocated to preferred unit holders and \$10.9 million allocated to common unit holders) for the year ended December 31, 2005 compared to \$30.0 million (\$20.2 million allocated to preferred unit holders and \$9.8 million allocated to common unit holders) for the year ended December 31, 2004. The decrease in minority interest in income was due primarily to the redemptions of preferred operating partnership units during 2004.

Liquidity and Capital Resources

Cash and cash equivalents decreased \$134.2 million from \$200.4 million at December 31, 2005 to \$66.3 million at December 31, 2006. The primary reasons for the decrease were property acquisitions, net change in preferred equity, and the repurchase of common stock partially offset by retained operating cash flow.

Net cash provided by operating activities for the years ended December 31, 2006 and 2005 was \$165.5 million and \$149.4 million, respectively. Management believes that the Company's internally generated net cash provided by operating activities will continue to be sufficient to enable it to meet its operating expenses, capital improvements and debt service requirements and to maintain the current level of distributions to shareholders in addition to providing additional retained cash for future growth, debt repayment, and stock repurchases.

Net cash used in investing activities was \$170.0 million for the year ended December 31, 2006 compared to cash provided by investing activities of \$24.4 million for the year ended December 31, 2005. The change between years was \$194.4 million or 797.0% and was primarily due to cash paid for acquisitions for two properties in Maryland, a property in Virginia, two properties in California and two in Florida for a combined total of \$139.0 million. Proceeds from the disposition of real estate facilities for the year ended December 31, 2006 was \$7.7 million compared to \$84.8 million in the prior year. During the years ended December 31, 2006 and 2005 the Company used \$39.2 million and \$40.3 million for capital improvements to real estate facilities, respectively. The decrease of \$1.1 million or 2.8% resulted from decreased transaction costs.

Net cash used in financing activities was \$129.7 million and \$13.1 million for the years ended December 31, 2006 and 2005. The change of \$116.6 million is primarily the result of an increase of \$106.9 million in preferred equity redemptions and a decrease of \$6.6 million in net proceeds from the issuance of preferred equity. As a result of the 2006 transactions, the Company decreased its preferred equity outstanding from 33.5% of its market capitalization at December 31, 2005 to 25.2% at December 31, 2006. Additionally, the Company repurchased \$16.1 million of common stock for the year ended December 31, 2006 compared to \$14.5 million for the year ended December 31, 2005.

The Company's capital structure is characterized by nominal debt. As of December 31, 2006, the Company had seven fixed rate mortgage notes payable totaling \$67.0 million, which represented approximately 2.4% of its total market capitalization. The Company calculates market capitalization by adding (1) the liquidation preference of the Company's outstanding preferred equity, (2) principal value of the Company's outstanding mortgages and (3) the total number of common shares and common units outstanding at December 31, 2006 multiplied by the closing price of the stock on that date. The weighted average interest rate for the mortgage notes is approximately 6.11% per

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annum. The Company had approximately 9.0% of its properties, based on net book value, encumbered at December 31, 2006.

During 2006, the Company issued an aggregate of \$95.0 million of preferred equity with a rate of 7.375%. Proceeds from the various offerings were used to redeem higher rate preferred equity of \$118.9 million with a weighted average rate of 9.389%.

In August of 2005, the Company modified the term of its line of credit (the Credit Facility) with Wells Fargo Bank. The Credit Facility has a borrowing limit of \$100.0 million and matures on August 1, 2008. Interest on outstanding borrowings is payable monthly. At the option of the Company, the rate of interest charged is equal to (i) the prime rate or (ii) a rate ranging from the London Interbank Offered Rate (LIBOR) plus 0.50% to LIBOR plus 1.20% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 0.65%). In addition, the Company is required to pay an annual commitment fee ranging from 0.15% to 0.30% of the borrowing limit (currently 0.20%). In connection with the modification of the Credit Facility, the Company paid a fee of \$450,000, which will be amortized over the life of the Credit Facility. The Company had no balance outstanding on its Credit Facility at December 31, 2006 and 2005. The Company repaid in full the \$95.0 million outstanding on its line of credit in January, 2004, and subsequently borrowed \$138.0 million on its line of credit in 2004 which was repaid in full prior to December 31, 2004.

As of December 31, 2003, the Company had \$100.0 million in short-term borrowings from PSI. The note bore interest at 1.4% and was due on March 9, 2004. The Company repaid the note in full during the first quarter of 2004.

In February, 2002, the Company entered into a seven year \$50.0 million term loan agreement with Fleet National Bank. The interest on the note was at LIBOR plus 1.45% and it had an original maturity of February 20, 2009. The Company paid a one-time fee of 0.35% or \$175,000 for the facility. In July, 2002, the Company entered into an interest rate swap transaction which had the effect of fixing the rate on the term loan through July, 2004 at 4.46% per annum. In February, 2004, the Company repaid in full the \$50.0 million outstanding on the term loan.

During 2004, the Company issued an aggregate of \$437.8 million of preferred equity with an average rate of 7.23%. Proceeds from the various offerings were used to redeem higher rate preferred equity aggregating \$185.6 million with an average rate of 8.93%. In addition, proceeds were used to provide permanent financing for the Company's acquisitions made in 2003 and 2004 by enabling the Company to repay, in full, the balances outstanding on the Company's note with PSI, the Credit Facility and the term loan.

The Company's funding strategy has been to use permanent capital, including common and preferred stock, and internally generated retained cash flows. In addition, the Company may sell properties that no longer meet its investment criteria. The Company may finance acquisitions on a temporary basis with borrowings from its Credit Facility. The Company targets a ratio of funds from operations (FFO) to combined fixed charges and preferred distributions of 3.0 to 1.0. Fixed charges include interest expense and capitalized interest. Preferred distributions include amounts paid to preferred shareholders and preferred Operating Partnership unit holders. For the year ended December 31, 2006, the FFO to fixed charges and preferred distributions coverage ratio was 2.9 to 1.0, excluding the effects of Emerging Issues Task Force (EITF) Topic D-42.

Non-GAAP Supplemental Disclosure Measure: Funds from Operations: Management believes that FFO is a useful supplemental measure of the Company's operating performance. The Company computes FFO in accordance with the White Paper on FFO approved by the Board of Governors of the National Association of Real Estate Investment Trusts (NAREIT). The White Paper defines FFO as net income, computed in accordance with GAAP, before depreciation, amortization, minority interest in income and extraordinary items. Management believes that FFO provides a useful measure of the Company's operating performance and when compared year over year, reflects the impact to operations from trends in occupancy rates, rental rates, operating costs, development activities, general and administrative expenses and interest costs, providing a perspective not immediately apparent from net income.

FFO should be analyzed in conjunction with net income. However, FFO should not be viewed as a substitute for net income as a measure of operating performance or liquidity as it does not reflect depreciation and amortization costs or the level of capital expenditure and leasing costs necessary to maintain the operating performance of the

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Company's properties, which are significant economic costs and could materially impact the Company's results of operations.

Management believes FFO provides useful information to the investment community about the Company's operating performance when compared to the performance of other real estate companies as FFO is generally recognized as the industry standard for reporting operations of REITs. Other REITs may use different methods for calculating FFO and, accordingly, our FFO may not be comparable to other real estate companies.

FFO for the Company is computed as follows (in thousands):

	For the Years Ended December 31,				
	2006	2005	2004	2003	2002
Net income allocable to common shareholders	\$ 16,647	\$ 32,283	\$ 29,123	\$ 33,312	\$ 42,018
Gain on sale of marketable and other securities				(2,043)	(41)
Gain on disposition of real estate	(2,328)	(18,109)	(15,462)	(2,897)	(9,023)
Equity income from sale of joint venture properties				(1,376)	(861)
Depreciation and amortization	86,243	77,420	73,793	59,107	58,144
Depreciation from joint venture					63
Minority interest in income common units	5,673	10,869	9,760	11,345	14,243
Consolidated FFO allocable to common shareholders and minority interests	106,235	102,463	97,214	97,448	104,543
FFO allocated to minority interests common units	(27,005)	(25,810)	(24,401)	(24,657)	(26,291)
FFO allocated to common shareholders	\$ 79,230	\$ 76,653	\$ 72,813	\$ 72,791	\$ 78,252

FFO allocated to common shareholders and minority interests for the year ended December 31, 2006 increased \$3.8 million over the year ended December 31, 2005. FFO for the years ended December 31, 2006 and 2005 included non-cash distributions of \$4.7 million and \$301,000, respectively, related to the application of EITF Topic D-42 and the redemption of preferred equity. Excluding these non-cash adjustments, the increase in FFO was a result of increased income from operations.

Capital Expenditures: During the years ended December 31, 2006, 2005 and 2004, the Company incurred \$34.1 million, \$35.8 million and \$43.6 million, respectively, in recurring capital expenditures or \$1.89, \$2.01 and \$2.42 per weighted average square foot, respectively. The Company defines recurring capital expenditures as those necessary to maintain and operate its commercial real estate at its current economic value. The Company expects the higher levels of transactions to continue into 2007 as a result of competition in difficult markets. The following depicts actual capital expenditures for the years ended December 31,: (in thousands)

	2006	2005	2004
Recurring capital expenditures	\$ 34,096	\$ 35,821	\$ 43,614
Property renovations and other capital expenditures	5,131	4,519	8,455
Total capital expenditures	\$ 39,227	\$ 40,340	\$ 52,069

Stock Repurchase: The Company's Board of Directors has authorized the repurchase, from time to time, of up to 4.5 million shares of the Company's common stock on the open market or in privately negotiated transactions. During the year ended December 31, 2006, the Company repurchased 309,100 shares of common stock at a cost of \$16.1 million. During the year ended December 31, 2005, the Company repurchased 361,400 shares of common stock at a cost of \$16.6 million. Since inception through December 31, 2006, the Company has repurchased an aggregate of

3.3 million shares of common stock at an aggregate cost of \$102.6 million (average cost of \$31.18 per share).

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Redemption of Preferred Equity: On May 10, 2006, the Company redeemed 2.6 million depositary shares of its 9.500% Cumulative Preferred Stock, Series D for \$65.9 million. In accordance with EITF Topic D-42, the redemption resulted in a reduction of net income allocable to common shareholders of \$1.7 million for the year ended December 31, 2006 equal to the excess of the redemption amount over the carrying amount of the redeemed securities.

On December 15, 2006, the Company called 2.0 million depositary shares (\$50.0 million) of its 8.750% Cumulative Preferred Stock, Series F for January 29, 2007 redemption. The Company reported the excess of the redemption amount over the carrying amount, \$1.7 million, as an additional allocation of net income to preferred shareholders and a corresponding reduction of net income allocable to common shareholders and common unit holders for the year ended December 31, 2006.

On September 21, 2006 the Company redeemed 2.1 million units of its 9.250% Series E Cumulative Redeemable Preferred Units for \$53.0 million. The Company reported the excess of the redemption amount over the carrying amount, \$1.4 million, as an additional allocation of net income to preferred unit holders and a corresponding reduction of net income allocable to common shareholders and common unit holders for the year ended December 31, 2006.

Distributions: The Company has elected and intends to qualify as a REIT for federal income tax purposes. In order to maintain its status as a REIT, the Company must meet, among other tests, sources of income, share ownership and certain asset tests. As a REIT, the Company is not taxed on that portion of its taxable income that is distributed to its shareholders provided that at least 90% of its taxable income is distributed to its shareholders prior to the filing of its tax return.

Related Party Transactions: At December 31, 2006, PSI owned 25.4% of the outstanding shares of the Company's common stock and 25.5 % of the outstanding common units of the operating partnership (100.0% of the common units not owned by the Company). Assuming conversion of its partnership units PSI would own 44.5% of the outstanding shares of the Company's common stock. Ronald L. Havner, Jr., the Company's chairman, is also the Chief Executive Officer, President and a Director of PSI. Harvey Lenkin is a Director of both the Company and PSI.

Pursuant to a cost sharing and administrative services agreement, the Company shares costs with PSI and affiliated entities for certain administrative services. These costs totaled \$320,000 in 2006 and are allocated among PSI and its affiliates in accordance with a methodology intended to fairly allocate those costs. In addition, the Company provides property management services for properties owned by PSI and its affiliates for a fee of 5% of the gross revenues of such properties in addition to reimbursement of direct costs. These management fee revenues recognized under management contracts with affiliated parties totaled \$625,000 in 2006. In December of 2006, the Company bought two properties in Palm Beach County, Florida, portions of which will be managed by PSI.

Off-Balance Sheet Arrangements: The Company does not have any off-balance sheet arrangements.

Contractual Obligations: The table below summarizes projected payments due under our contractual obligations as of December 31, 2006 (*in thousands*):

Contractual Obligations	Total	Payments Due by Period			
		Less than 1 year	1 3 years	3 5 years	More than 5 years
Mortgage notes payable (principal and interest)	\$ 85,408	\$ 10,018	\$ 14,473	\$ 26,478	\$ 34,439
Total	\$ 85,408	\$ 10,018	\$ 14,473	\$ 26,478	\$ 34,439

The Company is scheduled to pay cash dividends of \$48.9 million per year on its preferred equity outstanding as of December 31, 2006. Dividends are paid when and if declared by the Company's Board of Directors and accumulate if not paid. Shares and units of preferred equity are redeemable by the Company in order to preserve its status as a REIT and are also redeemable five years after issuance.

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ITEM 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

To limit the Company's exposure to market risk, the Company principally finances its operations and growth with permanent equity capital consisting either of common stock or preferred equity. At December 31, 2006, the Company's debt as a percentage of shareholders' equity and minority interest (based on book values) was 5.0%.

The Company's market risk sensitive instruments include mortgage notes payable of \$67.0 million at December 31, 2006. All of the Company's mortgage notes payable bear interest at fixed rates. See Notes 2, 5, and 6 to Consolidated Financial Statements for the terms, valuations and approximate principal maturities of the Company's mortgage notes payable and the line of credit as of December 31, 2006. Based on borrowing rates currently available to the Company, combined with the amount of fixed rate debt outstanding, the difference between the carrying amount of debt and its fair value is insignificant.

ITEM 8. *FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA*

The financial statements of the Company at December 31, 2006 and 2005 and for the years ended December 31, 2006, 2005 and 2004 and the report of Ernst & Young LLP, Independent Registered Public Accounting Firm, thereon and the related financial statement schedule, are included elsewhere herein. Reference is made to the Index to Consolidated Financial Statements and Schedules in Item 15.

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

Not Applicable.

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ITEM 9A. CONTROLS AND PROCEDURES

Management's Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures as defined in SEC Rule 13a-15(e) that are designed to ensure that information required to be disclosed in its reports under the Securities Exchange Act of 1934 is processed, recorded, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of management including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures as of December 31, 2006. Based on the foregoing, the Chief Executive Officer and Chief Financial Officer concluded, as of that time, that the Company's disclosure controls and procedures were effective at the reasonable assurance level.

There was no change in the Company's internal control over financial reporting that occurred during the three months ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. The Company may make changes in its internal control processes from time to time in the future.

Management's Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 using the criteria set forth in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2006, the Company's internal control over financial reporting was effective based on those criteria.

Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2006, has been audited by Ernst & Young LLP, the independent registered public accounting firm who also audited the Company's consolidated financial statements. Ernst & Young LLP's report on management's assessment of the Company's internal control over financial reporting appears below.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
PS Business Parks, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that PS Business Parks, Inc. (the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). PS Business Parks, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that PS Business Parks, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, PS Business Parks, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of PS Business Parks, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006 of PS Business Parks, Inc. and our report dated February 23, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California
February 23, 2007

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ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item with respect to directors is hereby incorporated by reference to the material appearing in the Company's definitive proxy statement to be filed in connection with the annual shareholders' meeting to be held in 2007 (the Proxy Statement) under the caption Election of Directors.

Information required by this item with respect to executive officers is provided in Item 4A of this report. See Executive Officers of the Registrant.

Information required by this item with respect to the nominating process, the audit committee and the audit committee financial expert is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption Corporate Governance.

Information required by this item with respect to a code of ethics is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption Corporate Governance. We have adopted a code of ethics that applies to our principal executive officer, principal financial officer and principal accounting officer, which is available on our website at www.psbusinessparks.com. The information contained on the Company's website is not a part of, or incorporated by reference into, this Annual Report on Form 10-K. Any amendments to or waivers of the code of ethics granted to the Company's executive officers or the controller will be published promptly on our website or by other appropriate means in accordance with SEC rules.

Information required by this item with respect to the compliance with Section 16(a) is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption Section 16(a) Beneficial Ownership Reporting Compliance.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is hereby incorporated by reference to the material appearing in the Proxy Statement under the captions Corporate Governance, Executive Compensation, Corporate Governance Compensation Committee Interlocks and Insider Participation and Report of the Compensation Committee.

Table of Contents**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this item with respect to security ownership of certain beneficial owners and management is hereby incorporated by reference to the material appearing in the Proxy Statement under the captions Stock Ownership of Certain Beneficial Owners and Management.

The following table sets forth information as of December 31, 2006 on the Company's equity compensation plans:

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants, and Rights	(b) Weighted Average Exercise Price of Outstanding Options, Warrants, and Rights	(c) Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in Column(a))
Equity compensation plans approved by security holders	816,171	\$ 42.05	1,307,011
Equity compensation plans not approved by security holders		\$	
Total	816,171*	\$ 42.05*	1,307,011*

* Amounts include restricted stock units

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is hereby incorporated by reference to the material appearing in the Proxy Statement under the captions Corporate Governance and Certain Relationships and Related Transactions.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Audit Fees: Audit fees include fees generated by all services performed by Ernst & Young LLP to comply with generally accepted auditing standards or for services related to the audit and review of the Company's financial statements. Audit fees billed (or expected to be billed) to the Company by Ernst & Young LLP for audit of the Company's consolidated financial statements and internal control over financial reporting, review of the consolidated financial statements included in the Company's quarterly reports on Form 10-Q and services in connection with the Company's registration statements and securities offerings totaled \$382,000 for 2006 and \$322,000 for 2005.

Audit-Related Fees: Audit related fees representing professional fees provided by Ernst & Young LLP in connection with the audit of the Company's 401(K) savings plan and property acquisition audits totaled \$53,000 for 2006. During 2005, Ernst & Young LLP did not bill the Company for audit related services

Tax Fees: Tax fees billed (or expected to be billed) to the Company by Ernst & Young LLP for tax compliance and consulting services totaled \$149,000 for 2006 and \$165,000 for 2005.

All Other Fees: During 2006 and 2005, Ernst & Young LLP did not bill the Company for any services other than audit, audit-related and tax services.

The Audit Committee of the Company approves in advance all services performed by Ernst & Young LLP. The Audit Committee has delegated pre-approval authority to the Chairman of the Audit Committee provided that the Chairman shall report any pre-approval decisions to the Audit Committee at its next scheduled meeting.

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

a. 1. Financial Statements

The financial statements listed in the accompanying Index to Consolidated Financial Statements and Schedules are filed as part of this report.

2. Financial Statements Schedule

The financial statements schedule listed in the accompanying Index to Consolidated Financial Statements and Schedules are filed as part of this report.

3. Exhibits

The exhibits listed in the Exhibit Index immediately preceding such exhibits are filed with or incorporated by reference in this report.

b. Exhibits

The exhibits listed in the Exhibit Index immediately preceding such exhibits are filed with or incorporated by reference in this report.

c. Financial Statement Schedules

Not applicable.

PS BUSINESS PARKS, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES
(Item 15(a)(1) and Item 15(a)(2))

	Page
<u>Report of Independent Registered Public Accounting Firm</u>	52
<u>Consolidated balance sheets as of December 31, 2006 and 2005</u>	53
<u>Consolidated statements of income for the years ended December 31, 2006, 2005 and 2004</u>	54
<u>Consolidated statements of shareholders' equity for the years ended December 31, 2006, 2005 and 2004</u>	55
<u>Consolidated statements of cash flows for the years ended December 31, 2006, 2005 and 2004</u>	56
<u>Notes to consolidated financial statements</u>	58
Schedule:	
<u>III Real estate and accumulated depreciation</u>	74

All other schedules have been omitted since the required information is not present or not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements or notes thereto.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
PS Business Parks, Inc.

We have audited the accompanying consolidated balance sheets of PS Business Parks, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of PS Business Parks, Inc. at December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of PS Business Parks, Inc.'s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 23, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California
February 23, 2007

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**PS BUSINESS PARKS, INC.
CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2006	2005
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents	\$ 66,282	\$ 200,447
Real estate facilities, at cost:		
Land	439,777	383,308
Buildings and equipment	1,353,442	1,189,815
	1,793,219	1,573,123
Accumulated depreciation	(441,336)	(355,228)
	1,351,883	1,217,895
Properties held for disposition, net		5,366
Land held for development	9,011	9,011
	1,360,894	1,232,272
Rent receivable	2,080	2,678
Deferred rent receivables	21,454	18,650
Other assets	12,154	9,631
Total assets	\$ 1,462,864	\$ 1,463,678
LIABILITIES AND SHAREHOLDERS EQUITY		
Accrued and other liabilities	\$ 42,394	\$ 39,126
Preferred stock called for redemption	50,000	
Mortgage notes payable	67,048	25,893
Total liabilities	159,442	65,019
Minority interests:		
Preferred units	82,750	135,750
Common units	165,469	169,451
Commitments and Contingencies		
Shareholders' equity:		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, 22,900 and 23,734 shares issued and outstanding at December 31, 2006 and 2005, respectively	572,500	593,350
Common stock, \$0.01 par value, 100,000,000 shares authorized, 21,311,005 and 21,560,593 shares issued and outstanding at December 31, 2006 and 2005, respectively	213	215
Paid-in capital	398,048	407,380
Cumulative net income	483,403	418,823
Cumulative distributions	(398,961)	(326,310)

Total shareholders' equity	1,055,203	1,093,458
Total liabilities and shareholders' equity	\$ 1,462,864	\$ 1,463,678

See accompanying notes.

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PS BUSINESS PARKS, INC.
CONSOLIDATED STATEMENTS OF INCOME

	For the Years Ended December 31,		
	2006	2005	2004
	(In thousands, except per share data)		
Revenues:			
Rental income	\$ 242,214	\$ 219,604	\$ 210,937
Facility management fees	625	579	624
Total operating revenues	242,839	220,183	211,561
Expenses:			
Cost of operations	74,671	65,712	62,994
Depreciation and amortization	86,216	76,178	69,942
General and administrative	7,046	5,843	4,628
Total operating expenses	167,933	147,733	137,564
Other income and expenses:			
Interest and other income	6,874	4,888	406
Interest expense	(2,575)	(1,330)	(3,054)
Total other income and expenses	4,299	3,558	(2,648)
Asset impairment due to casualty loss		72	
Income from continuing operations before minority interests	79,205	75,936	71,349
Minority interests in continuing operations:			
Minority interest in income preferred units			
Distributions to preferred unit holders	(9,789)	(10,350)	(17,106)
Redemption of preferred operating partnership units	(1,366)	(301)	(3,139)
Minority interest in income common units	(5,113)	(5,611)	(4,540)
Total minority interests in continuing operations	(16,268)	(16,262)	(24,785)
Income from continuing operations	62,937	59,674	46,564
Discontinued operations:			
Income (loss) from discontinued operations	(125)	2,769	5,337
Gain on disposition of real estate	2,328	18,109	15,462
Minority interest in income attributable to discontinued operations common units	(560)	(5,258)	(5,220)
Income from discontinued operations	1,643	15,620	15,579
Net Income	64,580	75,294	62,143
Net income allocable to preferred shareholders:			
Preferred stock distributions			
Preferred stock distributions	44,553	43,011	31,154
Redemptions of preferred stock	3,380		1,866

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Total preferred stock distributions	47,933	43,011	33,020
Net income allocable to common shareholders	\$ 16,647	\$ 32,283	\$ 29,123
Net income per common share basic:			
Continuing operations	\$ 0.70	\$ 0.76	\$ 0.62
Discontinued operations	\$ 0.08	\$ 0.72	\$ 0.72
Net income	\$ 0.78	\$ 1.48	\$ 1.34
Net income per common share diluted:			
Continuing operations	\$ 0.69	\$ 0.76	\$ 0.62
Discontinued operations	\$ 0.08	\$ 0.71	\$ 0.71
Net income	\$ 0.77	\$ 1.47	\$ 1.33
Weighted average common shares outstanding:			
Basic	21,335	21,826	21,767
Diluted	21,646	22,018	21,960

See accompanying notes.

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PS BUSINESS PARKS, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Preferred Stock Shares	Amount	Common Stock Shares	Amount	Paid-in Capital	Cumulative Net Income/(Loss)	Other Comprehensive Income/(Loss)	Cumulative Distributions	Shareholders' Equity
(In thousands, except share data)									
Balances at December 31, 2003	6,747	\$ 168,673	21,565,528	\$ 216	\$ 420,778	\$ 281,386	\$ (535)	\$ (199,690)	\$ 670,828
Issuance of preferred stock, net of costs	15,800	395,000			(13,870)				381,130
Redemption of preferred stock	(2,113)	(52,823)			1,866			(1,866)	(52,823)
Exercise of stock options			269,710	2	6,956				6,958
Stock compensation Shelf registration			4,429		1,365				1,365
Comprehensive income: Change in unrealized loss on interest rate swap					(101)				(101)
Net income						62,143	535		62,143
Comprehensive income									62,678
Distributions: Preferred stock								(31,154)	(31,154)
Common stock Adjustment to minority interests underlying ownership								(25,274)	(25,274)
					3,357				3,357
Balances at December 31, 2004	20,434	510,850	21,839,667	218	420,351	343,529		(257,984)	1,016,964
Issuance of preferred stock, net of costs	3,300	82,500			(2,873)				79,627
Repurchase of common stock			(361,400)	(4)	(16,628)				(16,632)
			70,364	1	1,936				1,937

Exercise of stock options									
Stock compensation			11,962		2,588				2,588
Net income						75,294			75,294
Distributions:									
Preferred stock							(43,011)		(43,011)
Common stock							(25,315)		(25,315)
Adjustment to minority interests underlying ownership					2,006				2,006
Balances at December 31, 2005	23,734	593,350	21,560,593	215	407,380	418,823	(326,310)		1,093,458
Issuance of preferred stock, net of costs	3,800	95,000			(2,798)				92,202
Redemption of preferred stock	(2,634)	(65,850)			1,658		(1,658)		(65,850)
Preferred stock called for redemption	(2,000)	(50,000)			1,722		(1,722)		(50,000)
Repurchase of common stock			(309,100)	(3)	(16,114)				(16,117)
Exercise of stock options			37,900	1	1,366				1,367
Stock compensation			21,612		2,286				2,286
Net income						64,580			64,580
Distributions:									
Preferred stock							(44,553)		(44,553)
Common stock							(24,718)		(24,718)
Adjustment to minority interests underlying ownership					2,548				2,548
Balances at December 31, 2006	22,900	\$ 572,500	21,311,005	\$ 213	\$ 398,048	\$ 483,403	\$	\$ (398,961)	\$ 1,055,203

See accompanying notes.

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PS BUSINESS PARKS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2006	2005	2004
	(In thousands)		
Cash flows from operating activities:			
Net income	\$ 64,580	\$ 75,294	\$ 62,143
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	86,243	77,420	73,793
In-place lease adjustment	232	155	156
Lease incentives net of tenant improvement reimbursements	440	144	
Amortization of mortgage premium	(76)		
Minority interest in income	16,828	21,520	30,005
Gain on disposition of properties	(2,328)	(18,109)	(15,462)
Impairment of assets from casualty loss		72	
Stock compensation expense	2,845	1,060	914
Increase in receivables and other assets	(3,741)	(5,004)	(4,172)
Increase (decrease) in accrued and other liabilities	492	(3,124)	4,581
 Total adjustments	 100,935	 74,134	 89,815
 Net cash provided by operating activities	 165,515	 149,428	 151,958
 Cash flows from investing activities:			
Capital improvements to real estate facilities	(39,227)	(40,340)	(52,069)
Acquisition of real estate facilities	(138,973)	(20,073)	(22,323)
Proceeds from disposition of real estate	7,714	84,802	48,284
Insurance proceeds from casualty loss	500		
 Net cash (used in) provided by investing activities	 (169,986)	 24,389	 (26,108)
 Cash flows from financing activities:			
Borrowings on credit facility			138,000
Repayments of borrowings on credit facility			(233,000)
Repayment of borrowings from an affiliate			(100,000)
Principal payments on mortgage notes payable	(762)	(472)	(8,327)
Repayment of unsecured notes payable			(50,000)
Net proceeds from the issuance of preferred stock	92,448	79,627	381,130
Net proceeds from the issuance of preferred units		19,465	41,533
Exercise of stock options	1,367	1,937	6,958
Shelf registration costs			(101)
Repurchase of common stock	(16,117)	(14,465)	
Redemption of preferred units	(53,000)	(12,000)	(132,750)
Redemption of preferred stock	(65,850)		(52,823)
Distributions paid to preferred shareholders	(44,799)	(43,011)	(31,154)

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Distributions paid to minority interests preferred units	(9,789)	(10,350)	(17,689)
Distributions paid to common shareholders	(24,718)	(25,315)	(25,274)
Distributions paid to minority interests common units	(8,474)	(8,474)	(8,474)
Net cash used in financing activities	(129,694)	(13,058)	(91,971)
Net increase (decrease) in cash and cash equivalents	(134,165)	160,759	33,879
Cash and cash equivalents at the beginning of the period	200,447	39,688	5,809
Cash and cash equivalents at the end of the period	\$ 66,282	\$ 200,447	\$ 39,688

Supplemental disclosures:

Interest paid, net of interest capitalized	\$ 2,575	\$ 1,330	\$ 3,434
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See accompanying notes.

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PS BUSINESS PARKS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2006	2005	2004
	(In thousands)		
Supplemental schedule of non cash investing and financing activities:			
Adjustment to minority interest to underlying ownership:			
Minority interest common units	\$ 1,182	\$ 2,240	\$ 218
Paid-in capital	\$ (1,182)	\$ (2,240)	\$ (218)
Effect of EITF Topic D-42			
Cumulative distributions	\$ 3,380	\$	\$ 1,866
Minority interest common units	\$ 1,366	\$ 301	\$ 3,139
Paid-in capital	\$ (4,746)	\$ (301)	\$ (5,005)
Mortgage note payable assumed in property acquisition:			
Real estate facilities	\$ 41,993	\$ 14,998	\$
Mortgage notes payable	\$ (41,993)	\$ (14,998)	\$
Accrued lease inducements:			
Other assets	\$	\$ 1,985	\$
Accrued and other liabilities	\$	\$ (1,985)	\$
Accrued stock repurchase:			
Paid-in capital	\$	\$ 2,167	\$
Accrued and other liabilities	\$	\$ (2,167)	\$
Unrealized loss:			
Comprehensive (income) loss on interest rate swap	\$	\$	\$ 535
Other comprehensive income (loss)	\$	\$	\$ (535)

See accompanying notes.

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**PS BUSINESS PARKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2006**

1. Organization and description of business

Organization

PS Business Parks, Inc. (PSB) was incorporated in the state of California in 1990. As of December 31, 2006, PSB owned approximately 75% of the common partnership units of PS Business Parks, L.P. (the Operating Partnership or OP). The remaining common partnership units were owned by Public Storage, Inc. (PSI). PSB, as the sole general partner of the Operating Partnership, has full, exclusive and complete responsibility and discretion in managing and controlling the Operating Partnership. PSB and the Operating Partnership are collectively referred to as the Company.

Description of business

The Company is a fully-integrated, self-advised and self-managed real estate investment trust (REIT) that acquires, develops, owns and operates commercial properties, primarily multi-tenant flex, office and industrial space. As of December 31, 2006, the Company owned and operated approximately 18.7 million rentable square feet of commercial space located in eight states. The Company also manages approximately 1.4 million rentable square feet on behalf of PSI and its affiliated entities.

2. Summary of significant accounting policies

Basis of presentation

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

Use of estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from estimates.

Allowance for doubtful accounts

We monitor the collectibility of our receivable balances including the deferred rent receivable on an on-going basis. Based on these reviews, we maintain an allowance for doubtful accounts for estimated losses resulting from the possible inability of our tenants to make required rent payments to us. A provision for doubtful accounts is recorded during each period. The allowance for doubtful accounts, which represents the cumulative allowances less write-offs of uncollectible rent, is netted against tenant and other receivables on our consolidated balance sheets. Tenant receivables are net of an allowance for uncollectible accounts totaling \$300,000 at December 31, 2006 and 2005.

Financial instruments

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

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

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

In June, 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133 Accounting for Derivative Instruments and Hedging Activities, (SFAS No. 133, as amended by SFAS No. 138). The Statement requires the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value and reflected as income or expense. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings.

In July, 2002, the Operating Partnership entered into an interest rate swap agreement, which was accounted for as a cash flow hedge, in order to reduce the impact of changes in interest rates on a portion of its floating rate debt. The agreement, which covered \$50.0 million of debt through July, 2004, effectively changed the interest rate exposure from floating rate to a fixed rate of 4.46%. Market gains and losses on the value of the swap were deferred and included in income over the life of the swap or related debt. The difference paid on the interest rate swap of \$557,000 for the year ended December 31, 2004 was recorded in interest expense as incurred. For the years ended December 31, 2006 and 2005, there were no interest differentials paid on the interest rate swap. Net interest differentials paid or received related to these contracts were accrued as incurred or earned. There was no unrealized loss related to the interest rate swap included in other comprehensive income as of December 31, 2006 or 2005 as the swap agreement was eliminated in 2004.

Real estate facilities

Real estate facilities are recorded at cost. Costs related to the renovation or improvement of the properties are capitalized. Expenditures for repairs and maintenance are expensed as incurred. Expenditures that are expected to benefit a period greater than 24 months and exceed \$2,000 are capitalized and depreciated over the estimated useful life. Buildings and equipment are depreciated on the straight-line method over the estimated useful lives, which are generally 30 and 5 years, respectively. Leasing costs in excess of \$1,000 for leases with terms greater than two years are capitalized and depreciated over their estimated useful lives. Leasing costs for leases of less than two years or less than \$1,000 are expensed as incurred.

Interest cost and property taxes incurred during the period of construction of real estate facilities are capitalized. The Company did not capitalize any interest expense in 2006, 2005 or 2004. The Company did not capitalize any property taxes during the years ended December 31, 2006 and 2005. The Company capitalized \$46,000 of property taxes during the year ended December 31, 2004.

Properties Held for Disposition

The Company accounts for properties held for disposition in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets . An asset is classified as an asset held for disposition when it meets the requirements of SFAS No. 144, which include, among other criteria, the approval of the sale of the asset, the asset has been marketed for sale and the Company expects that the sale will likely occur within the next twelve months. Upon classification of an asset as held for disposition, the net book value of the asset is included on the balance sheet as properties held for disposition, depreciation of the asset is ceased and the operating results of the asset are included in discontinued operations.

Table of Contents*Intangible assets*

Intangible assets include above-market and below-market in-place lease values of acquired properties based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. The capitalized above-market and below-market lease values (included in other assets in the accompanying consolidated balance sheet) are amortized, net, to rental income over the remaining non-cancelable terms of the respective leases. The Company amortized \$232,000, \$155,000 and \$156,000 of intangible assets resulting from the above and below market lease values during the years ended December 31, 2006, 2005 and 2004, respectively. As of December 31, 2006, the value of in-place leases was \$656,000, net of \$535,000 of accumulated amortization. As of December 31, 2005, the value of in-place leases was \$455,000, net of \$304,000 of accumulated amortization.

Evaluation of asset impairment

The Company evaluates its assets used in operations by identifying indicators of impairment and by comparing the sum of the estimated undiscounted future cash flows for each asset to the asset's carrying value. When indicators of impairment are present and the sum of the undiscounted future cash flows is less than the carrying value of such asset, an impairment loss is recorded equal to the difference between the asset's current carrying value and its value based on discounting its estimated future cash flows. In addition, the Company evaluates its assets held for disposition for impairment. Assets held for disposition are reported at the lower of their carrying value or fair value, less cost of disposition. At December 31, 2006, the Company did not consider any assets to be impaired.

Asset impairment due to casualty loss

It is the Company's policy to record as a casualty loss or gain, in the period the casualty occurs, the differential between (a) the book value of assets destroyed and (b) any insurance proceeds that we expect to receive in accordance with our insurance contracts. Potential proceeds from insurance that are subject to any uncertainties, such as interpretation of deductible provisions of the governing agreements, the estimation of costs of restoration, or other such items, are treated as contingent proceeds in accordance with SFAS No. 5, and not recorded until the uncertainties are satisfied.

For the year ended December 31, 2006, one of our real estate assets located in Southern California was damaged as a result of a fire. We have estimated that the costs to restore this facility will be approximately \$392,000. We have third-party insurance, subject to certain deductibles, that covers restoration of physical damage and the loss of income due to the physical damage incurred. We expect our insurers to pay all of the costs associated with the fire. The net book value of the assets destroyed was approximately \$266,000 combined with approximately \$126,000 of non-capitalized expense incurred in 2006. Accordingly, no casualty loss was recorded for the year ended December 31, 2006.

For the year ended December 31, 2005, several of our real estate assets located in South Florida were damaged as a result of a series of hurricanes. We have estimated that the costs to restore these facilities will be approximately \$2.3 million. We have third-party insurance, subject to certain deductibles, that covers restoration of physical damage and the loss of income due to the physical damage incurred. We expect our insurers to pay approximately \$1.6 million of the physical damage, and the net book value of the assets destroyed was approximately \$1.1 million combined with approximately \$510,000 of non-capitalized expense incurred in 2005. Accordingly, we have recorded a casualty loss of \$72,000 for the year ended December 31, 2005. No material casualty losses were recorded for the year ended December 31, 2004.

These amounts are based upon estimates and are subject to change as we and our insurers (i) more fully evaluate the extent of physical damage, which may not be fully determinable until commencement of repairs, (ii) develop detailed restoration plans and (iii) evaluate the impact of local conditions in the building labor and supplies markets for restoration costs.

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Stock-based compensation

On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment, which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. SFAS No. 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends SFAS No. 95, Statement of Cash Flows. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Effective January 1, 2006, the Company adopted SFAS No. 123(R) using the modified prospective method. Due to the Company adopting the Fair Value Method of accounting for stock options effective January 1, 2002, the adoption of this standard did not have a material impact on the results of operations or the financial position of the Company. See Note 10.

Revenue and expense recognition

Revenue is recognized in accordance with Staff Accounting Bulletin No. 104 of the Securities and Exchange Commission, Revenue Recognition in Financial Statements (SAB 104). SAB 104 requires that four basic criteria must be met before revenue can be recognized: persuasive evidence of an arrangement exists; the delivery has occurred or services rendered; the fee is fixed and determinable; and collectibility is reasonably assured. All leases are classified as operating leases. Rental income is recognized on a straight-line basis over the terms of the leases. Straight-line rent is recognized for all tenants with contractual increases in rent that are not included on the Company's credit watch list. Deferred rent receivables represent rental revenue recognized on a straight-line basis in excess of billed rents. Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as revenues in the period the applicable costs are incurred.

Costs incurred in connection with leasing (primarily tenant improvements and leasing commissions) are capitalized and amortized over the lease period.

Gains/Losses from sales of real estate

The Company recognizes gains from sales of real estate at the time of sale using the full accrual method, provided that various criteria related to the terms of the transactions and any subsequent involvement by us with the properties sold are met. If the criteria are not met, the Company defers the gains and recognizes them when the criteria are met or using the installment or cost recovery methods as appropriate under the circumstances.

General and administrative expense

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

Related party transactions

Pursuant to a cost sharing and administrative services agreement, the Company shares costs with PSI and affiliated entities for certain administrative services. These costs totaled \$320,000, \$335,000 and \$327,000 for the years ended December 31, 2006, 2005 and 2004, respectively. In addition, the Company provides property management services for properties owned by PSI and its affiliates for a fee of 5% of the gross revenues of such properties in addition to reimbursement of direct costs. These management fee revenues recognized under management contracts with affiliated parties totaled \$625,000, \$579,000 and \$562,000 for the years ended December 31, 2006, 2005 and 2004, respectively. In December of 2006, the Company bought two properties in Palm Beach County, Florida, portions of which will be managed by PSI. As of December 31, 2006 and 2005, the Company has amounts due from PSI of \$871,000 and \$551,000, respectively, for these contracts, as well as for amounts paid by the Company on behalf of PSI.

Table of Contents*Income taxes*

The Company qualified and intends to continue to qualify as a REIT, as defined in Section 856 of the Internal Revenue Code. As a REIT, the Company is not subject to federal income tax to the extent that it distributes its taxable income to its shareholders. A REIT must distribute at least 90% of its taxable income each year. In addition, REITs are subject to a number of organizational and operating requirements. If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to federal income tax (including any applicable alternative minimum tax) based on its taxable income using corporate income tax rates. Even if the Company qualifies for taxation as a REIT, the Company may be subject to certain state and local taxes on its income and property and to federal income and excise taxes on its undistributed taxable income. The Company believes it met all organization and operating requirements to maintain its REIT status during 2006, 2005 and 2004 and intends to continue to meet such requirements. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

Accounting for preferred equity issuance costs

In accordance with Emerging Issues Task Force (EITF) Topic D-42, the Company records its issuance costs as a reduction to paid-in capital on its balance sheet at the time the preferred securities are issued and reflects the carrying value of the preferred stock at the stated value. The Company reduces the carrying value of preferred stock by the issuance costs at the time it notifies the holders of preferred stock or units of its intent to redeem such shares or units.

Net income per common share

Per share amounts are computed using the weighted average common shares outstanding. Diluted weighted average common shares outstanding include the dilutive effect of stock options and restricted stock units under the treasury stock method. Basic weighted average common shares outstanding excludes such effect. Earnings per share has been calculated as follows for the years ended December 31, *(in thousands, except per share data)*:

	2006	2005	2004
Net income allocable to common shareholders	\$ 16,647	\$ 32,283	\$ 29,123
Weighted average common shares outstanding:			
Basic weighted average common shares outstanding	21,335	21,826	21,767
Net effect of dilutive stock compensation based on treasury stock method using average market price	311	192	193
Diluted weighted average common shares outstanding	21,646	22,018	21,960
Net income per common share Basic	\$ 0.78	\$ 1.48	\$ 1.34
Net income per common share Diluted	\$ 0.77	\$ 1.47	\$ 1.33

Options to purchase approximately 20,000, 80,000 and 80,000 shares for the years ended December 31 2006, 2005 and 2004, respectively, were not included in the computation of diluted net income per share because such options were considered anti-dilutive.

Segment Reporting

The Company views its operations as one segment.

Reclassifications

Certain reclassifications have been made to the consolidated financial statements for 2005 and 2004 in order to conform to the 2006 presentation.

Table of Contents**3. Real estate facilities**

The activity in real estate facilities for the years ended December 31, 2006, 2005 and 2004 is as follows (*in thousands*):

	Land	Buildings	Accumulated Depreciation	Total
Balances at December 31, 2003	\$ 363,719	\$ 1,066,252	\$ (207,546)	\$ 1,222,425
Acquisition of real estate	4,669	19,419		24,088
Disposition of real estate		(2,063)	1,046	(1,017)
Capital improvements, net		49,933		49,933
Depreciation expense			(73,793)	(73,793)
Transfer to properties held for Disposition		(1,136)	1,217	