

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2000

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-10709

**PS BUSINESS PARKS, INC.**

(Exact name of registrant as specified in its charter)

**California**  
(State or Other Jurisdiction  
of Incorporation)

**95-4300881**  
(I.R.S. Employer  
Identification Number)

**701 Western Avenue, Glendale, California 91201-2397**  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(818) 244-8080**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Number of shares outstanding of each of the issuer's classes of common stock, as of November 13, 2000:

Common Stock, \$0.01 par value, 23,047,985 shares outstanding

**PS BUSINESS PARKS, INC.**

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

	September 30, 2000 (unaudited)	December 31, 1999
<b><u>ASSETS</u></b>		
Cash and cash equivalents .....	\$ 56,613,000	\$ 74,220,000
Marketable securities .....	26,475,000	18,263,000
Real estate facilities, at cost:		
Land .....	207,052,000	194,140,000
Buildings and equipment .....	678,839,000	636,261,000
	885,891,000	830,401,000
Accumulated depreciation .....	(75,003,000)	(50,976,000)
	810,888,000	779,425,000
Properties held for disposition, net .....	-	14,235,000
Construction in progress .....	19,178,000	8,616,000
	830,066,000	802,276,000
Receivables .....	528,000	771,000
Deferred rent receivables .....	7,182,000	5,493,000
Intangible assets, net .....	1,056,000	1,282,000
Other assets .....	1,598,000	1,436,000
Total assets .....	\$ 923,518,000	\$ 903,741,000

**LIABILITIES AND SHAREHOLDERS' EQUITY**

Accrued and other liabilities .....	\$ 27,016,000	\$ 21,195,000
Mortgage notes payable .....	31,168,000	37,066,000
Total liabilities .....	58,184,000	58,261,000
Minority interest:		
Preferred units .....	144,750,000	132,750,000
Common units .....	159,740,000	157,199,000
Shareholders' equity:		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, 2,200 shares issued and outstanding at September 30, 2000 and December 31, 1999 .....	55,000,000	55,000,000
Common stock, \$0.01 par value, 100,000,000 shares authorized, 23,112,985 shares issued and outstanding at September 30, 2000 (23,645,461 shares issued and outstanding at December 31, 1999) .....	231,000	236,000
Paid-in capital .....	465,297,000	478,889,000
Cumulative net income .....	107,535,000	73,809,000
Other comprehensive income .....	6,480,000	-
Cumulative distributions .....	(73,699,000)	(52,403,000)
Total shareholders' equity .....	560,844,000	555,531,000
Total liabilities and shareholders' equity .....	\$ 923,518,000	\$ 903,741,000

See accompanying notes.

**PS BUSINESS PARKS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
**(Unaudited)**

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2000	1999	2000	1999
<b>Revenues:</b>				
Rental income.....	\$ 36,798,000	\$ 32,568,000	\$107,265,000	\$ 92,544,000
Facility management fees from affiliates.....	131,000	121,000	383,000	351,000
Business services.....	82,000	-	349,000	-
Interest income.....	1,035,000	581,000	3,046,000	845,000
Dividend income.....	439,000	11,000	1,297,000	40,000
	<u>38,485,000</u>	<u>33,281,000</u>	<u>112,340,000</u>	<u>93,780,000</u>
<b>Expenses:</b>				
Cost of operations.....	9,762,000	8,920,000	29,432,000	25,951,000
Cost of facility management.....	27,000	24,000	77,000	70,000
Cost of business services.....	78,000	-	142,000	-
Depreciation and amortization.....	9,449,000	7,594,000	26,723,000	21,641,000
General and administrative.....	995,000	742,000	2,859,000	2,339,000
Interest expense.....	502,000	977,000	1,246,000	2,658,000
	<u>20,813,000</u>	<u>18,257,000</u>	<u>60,479,000</u>	<u>52,659,000</u>
Income before disposition of real estate and minority interest.....	17,672,000	15,024,000	51,861,000	41,121,000
Gain on disposition of real estate.....	159,000	-	256,000	-
Income before minority interest.....	17,831,000	15,024,000	52,117,000	41,121,000
Minority interest in income – preferred units ...	(3,157,000)	(1,022,000)	(8,998,000)	(1,236,000)
Minority interest in income – common units ....	(3,203,000)	(3,347,000)	(9,393,000)	(9,533,000)
Net income.....	<u>\$ 11,471,000</u>	<u>\$ 10,655,000</u>	<u>\$ 33,726,000</u>	<u>\$ 30,352,000</u>
<b>Net income allocation:</b>				
Allocable to preferred shareholders.....	\$ 1,272,000	\$ 1,272,000	\$ 3,816,000	\$ 2,134,000
Allocable to common shareholders.....	10,199,000	9,383,000	29,910,000	28,218,000
	<u>\$ 11,471,000</u>	<u>\$ 10,655,000</u>	<u>\$ 33,726,000</u>	<u>\$ 30,352,000</u>
<b>Net income per common share:</b>				
Basic.....	<u>\$ 0.44</u>	<u>\$ 0.40</u>	<u>\$ 1.28</u>	<u>\$ 1.19</u>
Diluted.....	<u>\$ 0.44</u>	<u>\$ 0.40</u>	<u>\$ 1.28</u>	<u>\$ 1.19</u>
<b>Weighted average common shares outstanding:</b>				
Basic.....	<u>23,117,000</u>	<u>23,641,000</u>	<u>23,354,000</u>	<u>23,639,000</u>
Diluted.....	<u>23,216,000</u>	<u>23,724,000</u>	<u>23,426,000</u>	<u>23,713,000</u>

See accompanying notes.

**PS BUSINESS PARKS, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2000**  
**(Unaudited)**

	Preferred Stock		Common Stock		Paid-in Capital	Cumulative Net Income	Other Comprehensive Income	Cumulative Distributions	Shareholders' Equity
	Shares	Amount	Shares	Amount					
<b>Balances at December 31, 1999</b> .....	2,200	\$55,000,000	23,645,461	\$ 236,000	\$478,889,000	\$73,809,000	-	\$ (52,403,000)	\$ 555,531,000
Issuance of common stock:									
Conversion of common OP units.....	-	-	107,517	1,000	2,530,000	-	-	-	2,531,000
Exercise of stock options .....	-	-	12,607	-	193,000	-	-	-	193,000
Unrealized gain – appreciation in marketable securities.....	-	-	-	-	-	-	6,480,000	-	6,480,000
Repurchase of common stock.....	-	-	(652,600)	(6,000)	(14,775,000)	-	-	-	(14,781,000)
Net income .....	-	-	-	-	-	33,726,000	-	-	33,726,000
Distributions paid:									
Preferred stock.....	-	-	-	-	-	-	-	(3,816,000)	(3,816,000)
Common stock.....	-	-	-	-	-	-	-	(17,480,000)	(17,480,000)
Adjustment to reflect minority interest to underlying ownership interest.....	-	-	-	-	(1,540,000)	-	-	-	(1,540,000)
<b>Balances at September 30, 2000</b> .....	<u>2,200</u>	<u>\$55,000,000</u>	<u>23,112,985</u>	<u>\$ 231,000</u>	<u>\$465,297,000</u>	<u>\$107,535,000</u>	<u>\$ 6,480,000</u>	<u>\$ (73,699,000)</u>	<u>\$ 560,844,000</u>

See accompanying notes.

**PS BUSINESS PARKS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

	For the Nine Months Ended September 30,	
	2000	1999
<b>Cash flows from operating activities:</b>		
Net income.....	\$ 33,726,000	\$ 30,352,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense .....	26,723,000	21,641,000
Minority interest in income .....	18,391,000	10,769,000
Increase in receivables and other assets .....	(1,768,000)	(3,274,000)
Increase in accrued and other liabilities .....	5,823,000	3,257,000
Total adjustments .....	49,169,000	32,393,000
Net cash provided by operating activities .....	82,895,000	62,745,000
<b>Cash flows from investing activities:</b>		
Other investments.....	(1,732,000)	-
Acquisition of real estate facilities .....	(56,407,000)	(59,555,000)
Disposition of real estate facilities .....	23,634,000	-
Capital improvements to real estate facilities .....	(7,598,000)	(10,546,000)
Construction in progress.....	(13,790,000)	(11,567,000)
Net cash used in investing activities .....	(55,893,000)	(81,668,000)
<b>Cash flows from financing activities:</b>		
Borrowings from an affiliate .....	-	41,400,000
Repayment of borrowings from an affiliate .....	-	(41,400,000)
Loans to an affiliate .....	77,000,000	-
Repayment of loans to an affiliate.....	(77,000,000)	-
Borrowings from line of credit.....	-	14,000,000
Repayment of borrowings from line of credit .....	-	(26,500,000)
Principal payments on mortgage notes payable .....	(5,898,000)	(11,932,000)
Net proceeds from the issuance of common stock .....	193,000	161,000
Repurchase of common stock .....	(14,781,000)	-
Net proceeds from the issuance of preferred stock .....	-	53,086,000
Net proceeds from the issuance of preferred operating partnership units .....	11,700,000	129,695,000
Distributions paid to preferred shareholders .....	(3,816,000)	(2,134,000)
Distributions paid to minority interests – preferred units.....	(8,998,000)	(1,236,000)
Distributions paid to common shareholders.....	(17,480,000)	(17,729,000)
Distributions paid to minority interests – common units.....	(5,529,000)	(5,568,000)
Net cash (used in) provided by financing activities .....	(44,609,000)	131,843,000
Net (decrease) increase in cash and cash equivalents.....	(17,607,000)	112,920,000
Cash and cash equivalents at the beginning of the period .....	74,220,000	6,068,000
Cash and cash equivalents at the end of the period .....	\$ 56,613,000	\$ 118,988,000

See accompanying notes.

**PS BUSINESS PARKS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	For the Nine Months Ended September 30,	
	2000	1999
<b>Supplemental schedule of non cash investing and financing activities:</b>		
Acquisitions of real estate facilities in exchange for minority interests and mortgage notes payable:		
Real estate facilities .....	\$ -	\$ (20,752,000)
Minority interest – common units .....	-	1,033,000
Mortgage notes payable .....	-	19,719,000
Conversion of common OP units into shares of common stock:		
Minority interest – common units .....	(2,531,000)	-
Common stock .....	1,000	-
Paid-in capital .....	2,530,000	-
Adjustment to reflect minority interest to underlying ownership interest:		
Minority interest – common units .....	1,540,000	1,252,000
Paid-in capital .....	(1,540,000)	(1,252,000)
Capitalization of developed properties:		
Real estate facilities .....	(3,228,000)	12,146,000
Construction in progress .....	3,228,000	(12,146,000)
Unrealized gain:		
Marketable securities .....	(6,480,000)	-
Other comprehensive income .....	6,480,000	-

See accompanying notes.

**PS BUSINESS PARKS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2000**

**1. Organization and description of business**

PS Business Parks, Inc. ("PSB") was incorporated in the state of California in 1990. As of September 30, 2000, PSB owned an approximate 74% general and limited partnership interest in PS Business Parks, L.P. (the "Operating Partnership" or "OP"). PSB, as the sole general partner of the Operating Partnership, has full, exclusive and complete responsibility and discretion in managing and controlling the Operating Partnership. PSB and the Operating Partnership are collectively referred to as the "Company."

The Company is a fully-integrated, self-advised and self-managed real estate investment trust ("REIT") that acquires, develops, owns and operates commercial properties containing commercial and industrial rental space. As of September 30, 2000, the Company owned and operated 123 commercial properties (approximately 12.1 million net rentable square feet) located in 9 states. In addition, the Company managed, on behalf of Public Storage, Inc. ("PSI") and affiliated entities, 39 commercial properties (approximately 1.3 million net rentable square feet).

**2. Summary of significant accounting policies**

*Basis of presentation*

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The preparation of the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from estimates. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2000 are not necessarily indicative of the results that may be expected for the year ended December 31, 2000. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 1999.

The condensed consolidated financial statements include the accounts of PSB and the Operating Partnership. All significant intercompany balances and transactions have been eliminated in the condensed consolidated financial statements.

*Cash and cash equivalents*

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. The carrying amount of cash and cash equivalents approximates fair value.

*Marketable securities*

The Company owns approximately one million common shares of Pacific Gulf Properties Inc. The investment is classified as "available-for-sale" in accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, Accounting for Certain Investments in Debt and Equity Securities. The investment is reflected on the balance sheet at fair market value. The unrealized gain of \$6,480,000 is excluded from earnings and reported in a separate component of shareholders' equity. Dividend income is recognized when earned.

**PS BUSINESS PARKS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2000**

*Real estate facilities*

Real estate facilities are recorded at cost. Costs related to the renovation or improvement of the properties are capitalized. Expenditures for repair and maintenance are expensed as incurred. Buildings and equipment are depreciated on the straight-line method over the estimated useful lives, which are generally 30 and 5 years, respectively.

Interest cost and property taxes incurred during the period of construction of real estate facilities are capitalized. The Company capitalized \$996,000 and \$584,000 of interest expense during the nine months ended September 30, 2000 and 1999, respectively.

*Intangible assets*

Intangible assets consist of property management contracts for properties managed, but not owned, by the Company. The intangible assets are being amortized over seven years. Intangible assets are net of accumulated amortization of \$1,100,000 and \$874,000 at September 30, 2000 and December 31, 1999, respectively.

*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 amount. 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. At September 30, 2000, no such indicators of impairment have been identified.

*Borrowings from and loans to affiliate*

The Company borrowed an aggregate of \$41.4 million from PSI and paid \$371,000 in interest expense during the period of January 19, 1999 through April 30, 1999. The notes bore interest at 5.5% (per annum) and were repaid as of April 30, 1999.

The Company loaned an aggregate of \$77 million to PSI and received \$153,000 in interest income during the period of January 5, 2000 through March 20, 2000. The notes bore interest at 5.9% (per annum) and were repaid as of March 20, 2000.

*Revenue and expense recognition*

All leases are classified as operating leases. Rental income is recognized on a straight-line basis over the terms of the leases. Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as revenue 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.

Property management fees are recognized in the period earned.

*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. Such amounts include amounts incurred by PSI on behalf of the Company, which were subsequently charged to the Company in accordance

**PS BUSINESS PARKS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2000**

with the allocation methodology pursuant to the cost allocation and administrative service agreement between the Company and PSI.

**PS BUSINESS PARKS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2000**

*Acquisition costs*

Internal acquisition costs are expensed as incurred.

*Income taxes*

During 1997, 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 95% 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 1999 and intends to continue to meet such requirements for 2000. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

*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 under the treasury stock method. "Basic" weighted average common shares outstanding excludes such effect. Earnings per share has been calculated as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2000	1999	2000	1999
Net income allocable to common shareholders.....	\$ 10,199,000	\$ 9,383,000	\$ 29,910,000	\$ 28,218,000
Weighted average common shares outstanding:				
Basic weighted average common shares outstanding .....	23,117,000	23,641,000	23,354,000	23,639,000
Net effect of dilutive stock options - based on treasury stock method using average market price .....	99,000	83,000	72,000	74,000
Diluted weighted average common shares outstanding .....	23,216,000	23,724,000	23,426,000	23,713,000
Basic earnings per common share.....	\$ 0.44	\$ 0.40	\$ 1.28	\$ 1.19
Diluted earnings per common share.....	\$ 0.44	\$ 0.40	\$ 1.28	\$ 1.19

*Reclassifications*

Certain reclassifications have been made to the condensed consolidated financial statements for 1999 in order to conform to the 2000 presentation.

**PS BUSINESS PARKS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2000**

**3. Real estate facilities**

The activity in real estate facilities for the nine months ended September 30, 2000 is as follows:

	Land	Buildings	Accumulated Depreciation	Total
Balances at December 31, 1999 ....	\$ 194,140,000	\$ 636,261,000	\$ (50,976,000)	\$ 779,425,000
Property acquisitions .....	14,549,000	41,858,000	-	56,407,000
Property dispositions .....	(1,995,000)	(9,748,000)	2,470,000	(9,273,000)
Developed projects .....	358,000	2,870,000	-	3,228,000
Capital improvements .....	-	7,598,000	-	7,598,000
Depreciation expense .....	-	-	(26,497,000)	(26,497,000)
Balances at September 30, 2000....	<u>\$ 207,052,000</u>	<u>\$ 678,839,000</u>	<u>\$ (75,003,000)</u>	<u>\$ 810,888,000</u>

During the nine months ended September 30, 2000, the Company incurred \$13.8 million in development costs. In April 2000, the Company completed and transferred to real estate facilities a 22,000 square foot development in Beaverton, Oregon of approximately \$3.2 million.

**4. Leasing activity**

The Company leases space in its real estate facilities to tenants under non-cancelable leases generally ranging from one to ten years. Future minimum rental revenues excluding recovery of expenses as of September 30, 2000 under these leases are as follows:

2000 (October – December) .....	\$ 30,241,000
2001 .....	104,452,000
2002 .....	76,604,000
2003 .....	54,491,000
2004 .....	38,027,000
Thereafter .....	53,446,000
	<u>\$ 357,261,000</u>

In addition to minimum rental payments, tenants pay reimbursements for their pro rata share of specified operating expenses, which amount to \$14,277,000 and \$12,369,000 for the nine months ended September 30, 2000 and 1999, respectively. These amounts are included as rental income and cost of operations in the accompanying condensed consolidated statements of income.

**5. Revolving line of credit**

In September 2000, the Company extended its unsecured line of credit (the "Credit Facility") with Wells Fargo Bank. The Credit Facility has a borrowing limit of \$100 million and an expiration date of August 6, 2003. The expiration date may be extended by one year on each anniversary of the Credit Facility. 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 0.75% to 1.35% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 1.00%). In addition, the Company is required to pay an annual commitment fee of 0.25%. The Company had no

**PS BUSINESS PARKS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2000**

outstanding balance and \$100 million available on its line of credit at September 30, 2000 and December 31, 1999.

**PS BUSINESS PARKS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2000**

The Credit Facility requires the Company to meet certain covenants including (i) maintain a balance sheet leverage ratio (as defined) of less than 0.50 to 1.00, (ii) maintain interest and fixed charge coverage ratios (as defined) of not less than 2.25 to 1.0 and 1.75 to 1.0, respectively, (iii) maintain a minimum total shareholders' equity (as defined) and (iv) limit distributions to 95% of funds from operations. 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) or sell assets. The Company was in compliance with the covenants of the Credit Facility at September 30, 2000.

**6. Mortgage notes payable**

Mortgage notes consist of the following:

	September 30, 2000	December 31, 1999
7.125% mortgage note, principal and interest payable monthly, due May 2006.....	\$ 8,617,000	\$ 8,751,000
8.190% mortgage note, principal and interest payable monthly, due March 2007.....	6,529,000	6,666,000
7.290% mortgage note, principal and interest payable monthly, due February 2009.....	6,298,000	6,372,000
7.280% mortgage note, principal and interest payable monthly, due February 2003.....	4,216,000	4,304,000
8.000% mortgage note, principal and interest payable monthly, due April 2003.....	2,045,000	2,108,000
8.500% mortgage note, principal and interest payable monthly, due July 2007 .....	1,861,000	1,898,000
8.000% mortgage note, principal and interest payable monthly, due April 2003.....	1,602,000	1,640,000
8.125% mortgage note extinguished in March 2000 .....	-	5,327,000
	\$31,168,000	\$37,066,000

At September 30, 2000, approximate principal maturities of mortgage notes payable are as follows:

2000 (October - December).....	\$ 196,000
2001 .....	829,000
2002 .....	895,000
2003 .....	7,871,000
2004 .....	696,000
Thereafter .....	20,681,000
	\$ 31,168,000

**PS BUSINESS PARKS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2000**

**7. Minority interests**

*Common units*

The Company presents the accounts of PSB and the Operating Partnership on a consolidated basis. Ownership interests in the Operating Partnership, other than PSB's interest, are classified as minority interest in the condensed consolidated financial statements. Minority interest in income consists of the minority interests' share of the condensed consolidated operating results.

Beginning one year from the date of admission as a limited partner and subject to certain limitations described below, each limited partner other than PSB has the right to require the redemption of its partnership interest.

A limited partner that exercises its redemption right will receive cash from the Operating Partnership in an amount equal to the market value (as defined in the Operating Partnership Agreement) of the partnership interests redeemed. In lieu of the Operating Partnership redeeming the partner for cash, PSB, as general partner, has the right to elect to acquire the partnership interest directly from a limited partner exercising its redemption right, in exchange for cash in the amount specified above or by issuance of one share of PSB common stock for each unit of limited partnership interest redeemed.

A limited partner cannot exercise its redemption right if delivery of shares of PSB common stock would be prohibited under the applicable articles of incorporation, if the general partner believes that there is a 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 laws, or would result in the Operating Partnership no longer being treated as a partnership for federal income tax purposes.

At September 30, 2000, there were 7,335,839 OP units owned by minority interests (7,305,355 were owned by PSI and affiliated entities and 30,484 were owned by unaffiliated third parties). On a fully converted basis, assuming all 7,335,839 minority interest OP units were converted into shares of common stock of PSB at September 30, 2000, the minority interests would own approximately 24% of the common shares outstanding. At the end of each reporting period, PSB determines the amount of equity (book value of net assets) which is allocable to the minority interest based upon the ownership interest and an adjustment is made to the minority interest, with a corresponding adjustment to paid-in capital, to reflect the minority interests' equity in the Company.

*Preferred units*

On April 23, 1999, the Operating Partnership completed a private placement of 510,000 preferred units with a preferred distribution rate of 8 7/8%. The net proceeds from the placement of preferred units were approximately \$12.5 million and were used to repay borrowings from an affiliate.

On September 3, 1999, the Operating Partnership completed a private placement of 3,200,000 preferred units with a preferred distribution rate of 8 3/4%. The net proceeds from the placement of preferred units were approximately \$78 million and part of the proceeds was used to prepay a mortgage note payable of approximately \$8.5 million.

On September 7 and 23, 1999, the Operating Partnership completed private placements of 1,200,000 and 400,000 preferred units, respectively, with a preferred distribution rate of 8 7/8%. The net proceeds from the placement of preferred units were approximately \$39.2 million.

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On July 12, 2000 the Operating Partnership completed a private placement of 480,000 preferred units with a preferred distribution rate of 8 7/8%. The net proceeds from the placement of preferred units were approximately \$11.7 million.

The Operating Partnership has the right to redeem the preferred units on or after the fifth anniversary of the issuance date at the original capital contribution plus the cumulative priority return, as defined, to the redemption date to the extent not previously distributed. The preferred units are 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 majority of the holders of the preferred units. The Preferred Stock will have the same distribution rate and par value as the respective units and will have equivalent terms to those described in Note 9.

**8. Property management contracts**

The Operating Partnership manages industrial, office and retail facilities for PSI and entities affiliated with PSI. These facilities, all located in the United States, operate under the "Public Storage" or "PS Business Parks" name.

The property management contracts provide for compensation of five percent of the gross revenue of the facilities managed. Under the supervision of the property owners, the Operating Partnership coordinates rental policies, rent collections, marketing activities, the purchase of equipment and supplies, maintenance activities, and the selection and engagement of vendors, suppliers and independent contractors. In addition, the Operating Partnership assists and advises the property owners in establishing policies for the hire, discharge and supervision of employees for the operation of these facilities, including property managers, leasing, billing and maintenance personnel.

The property management contract with PSI is for a seven year term with the term being extended one year each anniversary. The property management contracts with affiliates of PSI are cancelable by either party upon sixty days notice.

**9. Shareholders' equity**

*Preferred stock*

On April 30, 1999, the Company issued 2,200,000 depositary shares each representing 1/1,000 of a share of 9 1/4% Cumulative Preferred Stock, Series A. Net proceeds from the public perpetual preferred stock offering were approximately \$53.1 million and were used to repay borrowings from an affiliate and a mortgage note payable of approximately \$11 million. The remaining proceeds were used for investment in real estate.

Holder of the Company's preferred stock will not be entitled to vote on most matters, except under certain conditions. In the event of a cumulative arrearage equal to six quarterly dividends, the holders of the preferred stock will have the right to elect two additional members to serve on the Company's Board of Directors until all events of default have been cured. At September 30, 2000, there were no dividends in arrears.

Except under certain conditions relating to the Company's qualification as a REIT, the preferred stock is not redeemable prior to April 30, 2004. On or after April 30, 2004, the preferred stock will be redeemable, at the option of the Company, in whole or in part, at \$25 per depositary share, plus any accrued and unpaid dividends.

The Company paid \$3,816,000 (\$1.734375 per depositary share) and \$2,134,000 (\$0.969965 per depositary share) in distributions to its preferred shareholders for the nine months ended September 30, 2000 and 1999, respectively.

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*Common stock*

On March 2, 2000, the Board of Directors authorized the repurchase from time to time of up to 1,000,000 shares of the Company's common stock on the open market or in privately negotiated transactions. On July 27, 2000, the Board of Directors authorized the repurchase of up to an additional 600,000 shares of the Company's common stock (for a total repurchase authorization of up to 1,600,000 shares) on the open market or in privately negotiated transactions. Purchases will be made subject to market conditions and other investment opportunities available to the Company. As of September 30, 2000, the Company repurchased 652,600 shares of common stock at an aggregate cost of approximately \$14.8 million.

On March 31, 2000, a holder of common OP units exercised its option and converted its 107,517 common OP units into an equal number of shares of PSB common stock. The conversion resulted in an increase in shareholders' equity and a corresponding decrease in minority interest of approximately \$2,531,000 representing the book value of the OP units at the time of conversion.

The Company paid \$17,480,000 (\$0.75 per common share) and \$17,729,000 (\$0.75 per common share) in distributions to its common shareholders for the nine months ended September 30, 2000 and 1999, respectively. Pursuant to restrictions on the Credit Facility, distributions may not exceed 95% of funds from operations, as defined.

*Equity stock*

In addition to common and preferred stock, the Company is authorized to issue 100,000,000 shares of Equity Stock. The Articles of Incorporation provide that the Equity Stock may be issued from time to time in one or more series and gives the Board of Directors broad authority to fix the dividend and distribution rights, conversion and voting rights, redemption provisions and liquidation rights of each series of Equity Stock.

**10. Recent accounting pronouncements**

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which is required to be adopted in years beginning after June 15, 2000. This statement provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. The Company is studying this statement to determine its effect on the consolidated financial statements and will adopt this statement in the year ending December 31, 2001.

**11. Commitments and contingencies**

The Company is subject to the risks inherent in the ownership and operation of commercial real estate. These include, among others, the risks normally associated with changes in the general economic climate, trends in the real estate industry, creditworthiness of tenants, competition, changes in tax laws, interest rate levels, the availability of financing and potential liability under environmental and other laws.

Substantially all of the 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 be material to the consolidated financial statements except as discussed below.

The Company acquired a property in Beaverton, Oregon ("Creekside Corporate Park") in May 1998. A property adjacent to Creekside Corporate Park is currently the subject of an environmental remedial investigation/feasibility study that is being conducted by the current and past owners of the property, pursuant to an order issued by the Oregon Department of Environmental Quality ("ODEQ"). As part of that study, ODEQ

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ordered the property owners to sample soil and groundwater on the Company's property to determine the nature and extent of contamination resulting from past industrial operations at the property subject to the study. The Company, which is not a party of the Order on Consent, executed separate Access Agreements with the property owners to allow access to its property to conduct the required sampling and testing. The sampling and testing is ongoing, and preliminary results from one area indicate that the contamination from the property subject to the study may have migrated onto a portion of Creekside Corporate Park owned by the Company.

There is no evidence that any past or current use of the Creekside Corporate Park property contributed in any way to the contamination that is the subject of the current investigation. Nevertheless, upon completion of the study, it is likely that removal or remedial measures will be required to address any contamination detected during the current investigation, including any contamination on or under the Creekside Corporate Park property. Because of the preliminary nature of the investigation, the Company cannot predict the outcome of the investigation, nor can it estimate the costs of any remediation or removal activities that may be required.

The Company believes that it bears no responsibility or liability for the contamination. In the event the Company is ultimately deemed responsible for any costs relating to this matter, the Company believes that the party from whom the property was purchased will be responsible for any expenses or liabilities that the Company may incur as a result of this contamination.

On November 3, 1999, the Company filed an action in the Los Angeles Superior Court seeking damages in excess of \$1 million, as well as equitable relief. The complaint alleges that Mr. Howard and entities controlled by him engaged in unfair trade practices, including (1) negotiating kickbacks, secret rebates and/or unearned discounts from third party suppliers for "providing" Company business to those suppliers and (2) disrupting the Company's relationship with various suppliers.

On or about February 14, 2000, Mr. Howard and entities controlled by him filed a cross-complaint against the Company, Public Storage, Inc., and several other cross-defendants alleging, among other things, (1) interference with Mr. Howard's contractual relations with various third party suppliers, (2) violation of Title VII of the Civil Rights Act and (3) abuse of process. None of the cross-complainants assigned any dollar amount in the cross-complaint to the claims. The Company intends to vigorously contest the claims in the cross-complaint.

In November 2000, Mary Jayne Howard, a former officer of the Company, filed a complaint for discrimination with the California Department of Fair Employment and Housing, requesting authorization to file a lawsuit against the Company. The complaint does not specify the damages, if any, and therefore the Company is not able to establish the materiality of the possible claim. The Company intends to vigorously contest any claims for discrimination by Ms. Howard.

The Company currently is neither subject to any other material litigation nor, to management's knowledge, is any material litigation currently threatened against the Company other than routine litigation and administrative proceedings arising in the ordinary course of business. Based on consultation with counsel, management believes that these items will not have a material adverse impact on the Company's condensed consolidated financial position or results of operations.

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Forward-Looking Statements:** When used within this document, the words “expects,” “believes,” “anticipates,” “should,” “estimates,” and similar expressions are intended to identify “forward-looking statements” within the meaning of that term in Section 27A of the Securities Exchange Act of 1933, as amended, and in Section 21F of the Securities Exchange Act of 1934, as amended. Such forward-looking statements involve known and unknown risks, uncertainties and other factors. Actual results could differ materially from those set forth in the forward-looking statements as a result of various factors. Such factors include, but are not limited to, a change in economic conditions in the various markets served by the Company's operations which would adversely affect the level of demand for rental of commercial space and the cost structure of the Company, general real estate investment risks, competition, risks associated with acquisition and development activities and debt financing, environmental matters, general uninsured losses and seismic activity. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to publicly release the result of any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

**Overview:** During 2000 and 1999, the Company focused on increasing cash flow from its existing core portfolio of properties, expanded its presence in existing markets through strategic acquisitions and developments and strengthened its balance sheet primarily through the issuance of preferred stock/OP units at reasonable prices. By maintaining low leverage, the Company believes that future growth is facilitated. In addition, management identified five properties that did not meet its investment criteria and disposed of these properties during 2000. These properties totaled 627,000 square feet including 238,000 square feet in Baltimore, Maryland, 144,000 square feet in Tulsa, Oklahoma, 91,000 square feet in Little Rock, Arkansas and 154,000 square feet in Houston, Texas. Net proceed from these dispositions totaled \$23.6 million.

During the nine months ended September 30, 2000, the Company acquired 178,000 square feet in Northern California for approximately \$23.3 million and 161,000 square feet in Southern California for approximately \$25.4 million. In addition, the Company acquired 21 acres of land in Texas for approximately \$3.7 million for the development of two 100,000 square foot flex buildings.

During 1999, the Company added approximately 1.3 million square feet to its portfolio at an aggregate cost of approximately \$103 million. The Company acquired 483,000 square feet in Texas for approximately \$32 million, 405,000 square feet in Northern Virginia/Maryland market for approximately \$41 million, 211,000 square feet in Northern California for approximately \$17 million and 200,000 square feet in Arizona for approximately \$13 million.

**Results of Operations:** Net income for the three months ended September 30, 2000 was \$11,471,000 compared to \$10,655,000 for the same period in 1999. Net income allocable to common shareholders (net income less preferred stock dividends) for the three months ended September 30, 2000 was \$10,199,000 compared to \$9,383,000 for the same period in 1999. Net income per common share on a diluted basis was \$0.44 for the three months ended September 30, 2000 compared to \$0.40 for the same period in 1999 (based on weighted average diluted common shares outstanding of 23,216,000 and 23,724,000, respectively). Net income for the nine months ended September 30, 2000 was \$33,726,000 compared to \$30,352,000 for the same period in 1999. Net income allocable to common shareholders (net income less preferred stock dividends) for the nine months ended September 30, 2000 was \$29,910,000 compared to \$28,218,000 for the same period in 1999. Net income per common share on a diluted basis was \$1.28 for the nine months ended September 30, 2000 compared to \$1.19 for the same period in 1999 (based on weighted average diluted common shares outstanding of 23,426,000 and 23,713,000, respectively). The increases in net income and net income per share reflect the Company's growth in its asset base through the acquisition and development of commercial properties in addition to increased net operating income from its stabilized base of properties.

The Company's property operations account for almost all of the net operating income earned by the Company. The following table presents the pre-depreciation operating results of the properties for the three and nine months ended September 30, 2000 and 1999:

	Three Months Ended September 30,		Change
	2000	1999	
Rental income:			
"Same Park" facilities (107 facilities, 10.5 million net rentable square feet).....	\$30,900,000	\$29,055,000	6.4%
Other facilities.....	5,898,000	3,513,000	67.9%
Total rental income .....	<u>\$36,798,000</u>	<u>\$32,568,000</u>	<u>13.0%</u>
Cost of operations (excluding depreciation):			
"Same Park" facilities .....	\$8,043,000	\$8,026,000	0.2%
Other facilities.....	1,719,000	894,000	92.3%
Total cost of operations .....	<u>\$9,762,000</u>	<u>\$8,920,000</u>	<u>9.4%</u>
Net operating income (rental income less cost of operations):			
"Same Park" facilities .....	\$22,857,000	\$21,029,000	8.7%
Other facilities.....	4,179,000	2,619,000	59.6%
Total net operating income .....	<u>\$27,036,000</u>	<u>\$23,648,000</u>	<u>14.3%</u>
	Nine Months Ended September 30,		Change
	2000	1999	
Rental income:			
"Same Park" facilities (107 facilities, 10.5 million net rentable square feet).....	\$90,667,000	\$85,498,000	6.0%
Other facilities.....	16,598,000	7,046,000	135.6%
Total rental income .....	<u>\$107,265,000</u>	<u>\$92,544,000</u>	<u>15.9%</u>
Cost of operations (excluding depreciation):			
"Same Park" facilities .....	\$23,883,000	\$23,432,000	1.9%
Other facilities.....	5,549,000	2,519,000	120.3%
Total cost of operations .....	<u>\$29,432,000</u>	<u>\$25,951,000</u>	<u>13.4%</u>
Net operating income (rental income less cost of operations):			
"Same Park" facilities .....	\$66,784,000	\$62,066,000	7.6%
Other facilities.....	11,049,000	4,527,000	144.1%
Total net operating income .....	<u>\$77,833,000</u>	<u>\$66,593,000</u>	<u>16.9%</u>

Rental income and rental income less cost of operations or net operating income (“NOI”) prior to depreciation are summarized for the three months ended September 30, 2000 by major geographic regions below:

Region	Square Footage	Percent of Total	Rental Income	Percent of Total	NOI	Percent of Total
Southern California	3,254,000	26.9%	\$9,372,000	25.5%	\$7,192,000	26.6%
Northern California	1,495,000	12.4%	4,541,000	12.3%	3,488,000	12.9%
Southern Texas	1,032,000	8.5%	2,763,000	7.5%	1,746,000	6.5%
Northern Texas	1,849,000	15.3%	4,779,000	13.0%	3,366,000	12.5%
Virginia	1,612,000	13.3%	5,747,000	15.6%	4,230,000	15.6%
Maryland	866,000	7.2%	3,377,000	9.2%	2,349,000	8.7%
Oregon	1,191,000	9.8%	4,360,000	11.8%	3,544,000	13.1%
Other	797,000	6.6%	1,859,000	5.1%	1,121,000	4.1%
	<u>12,096,000</u>	<u>100.0%</u>	<u>\$36,798,000</u>	<u>100.0%</u>	<u>\$27,036,000</u>	<u>100.0%</u>

Rental income and rental income less cost of operations or net operating income (“NOI”) prior to depreciation are summarized for the nine months ended September 30, 2000 by major geographic regions below:

Region	Square Footage	Percent of Total	Rental Income	Percent of Total	NOI	Percent of Total
Southern California	3,254,000	26.9%	\$27,135,000	25.3%	\$20,725,000	26.6%
Northern California	1,495,000	12.4%	12,388,000	11.5%	9,294,000	11.9%
Southern Texas	1,032,000	8.5%	8,027,000	7.5%	4,840,000	6.2%
Northern Texas	1,849,000	15.3%	14,954,000	13.9%	10,495,000	13.5%
Virginia	1,612,000	13.3%	16,735,000	15.6%	12,198,000	15.7%
Maryland	866,000	7.2%	10,248,000	9.6%	7,243,000	9.3%
Oregon	1,191,000	9.8%	11,801,000	11.0%	9,431,000	12.1%
Other	797,000	6.6%	5,977,000	5.6%	3,607,000	4.6%
	<u>12,096,000</u>	<u>100.0%</u>	<u>\$107,265,000</u>	<u>100.0%</u>	<u>\$77,833,000</u>	<u>100.0%</u>

**Supplemental Property Data and Trends:** In order to evaluate the performance of the Company’s overall portfolio, management analyzes the operating performance of a consistent group of 107 properties (10.5 million net rentable square feet). These 107 properties (herein referred to as the “Same Park” facilities) have been owned and operated by the Company for the comparable periods. These properties do not include properties that have been sold during the year. The “Same Park” facilities represent approximately 87% of the square footage of the Company’s portfolio at September 30, 2000.

The following table summarizes the pre-depreciation historical operating results of the “Same Park” facilities excluding the effects of accounting for rental revenues on a straight-line basis.

**“Same Park” Facilities (107 Properties)**

	Three Months Ended September 30,		Change
	2000	1999	
Rental income <sup>(1)</sup> .....	\$ 30,290,000	\$ 28,219,000	7.3%
Cost of operations .....	8,043,000	8,026,000	0.2%
Net operating income .....	<u>\$ 22,247,000</u>	<u>\$ 20,193,000</u>	<u>10.2%</u>
Gross margin <sup>(2)</sup> .....	73.4%	71.6%	1.8%
<u>Weighted average for period:</u>			
Occupancy .....	97.1%	97.0%	0.1%
Annualized realized rent per sq. ft. <sup>(3)</sup> .....	\$11.84	\$11.03	7.3%

	Nine Months Ended September 30,		Change
	2000	1999	
Rental income <sup>(1)</sup> .....	\$ 89,018,000	\$ 83,148,000	7.1%
Cost of operations .....	23,883,000	23,432,000	1.9%
Net operating income .....	<u>\$ 65,135,000</u>	<u>\$ 59,716,000</u>	<u>9.1%</u>
Gross margin <sup>(2)</sup> .....	73.2%	71.8%	1.4%
<u>Weighted average for period:</u>			
Occupancy .....	97.2%	96.9%	0.3%
Annualized realized rent per sq. ft. <sup>(3)</sup> .....	\$11.59	\$10.86	6.7%

(1) Rental income does not include the effect of straight-line accounting.

(2) Gross margin is computed by dividing property net operating income by rental income.

(3) Realized rent per square foot represents the actual revenues earned per occupied square foot.

The following tables summarize the “Same Park” operating results by major geographic region for the three months ended September 30, 2000 and 1999:

Region	Revenues 2000	Revenues 1999	Increase	NOI 2000	NOI 1999	Increase (Decrease)
Southern California....	\$9,178,000	\$8,519,000	7.8%	\$6,935,000	\$6,221,000	11.4%
Northern California....	3,164,000	2,824,000	12.0%	2,440,000	2,105,000	15.9%
Southern Texas .....	2,430,000	2,246,000	8.2%	1,530,000	1,374,000	11.3%
Northern Texas .....	3,758,000	3,680,000	2.1%	2,644,000	2,431,000	8.8%
Virginia .....	4,175,000	3,766,000	10.9%	2,972,000	2,735,000	8.7%
Maryland.....	2,508,000	2,413,000	3.9%	1,845,000	1,784,000	3.4%
Oregon .....	3,862,000	3,598,000	7.3%	3,084,000	2,823,000	9.3%
Other .....	1,215,000	1,173,000	3.6%	797,000	720,000	10.7%
	<u>\$30,290,000</u>	<u>\$28,219,000</u>	<u>7.3%</u>	<u>\$22,247,000</u>	<u>\$20,193,000</u>	<u>10.2%</u>

The following tables summarize the “Same Park” operating results by major geographic region for the nine months ended September 30, 2000 and 1999:

Region	Revenues 2000	Revenues 1999	Increase	NOI 2000	NOI 1999	Increase (Decrease)
Southern California....	\$27,057,000	\$24,519,000	10.4%	\$20,586,000	\$18,108,000	13.7%
Northern California....	9,151,000	8,123,000	12.7%	7,004,000	6,085,000	15.1%
Southern Texas .....	7,011,000	6,733,000	4.1%	4,159,000	4,123,000	0.8%
Northern Texas .....	11,320,000	11,543,000	(1.9%)	7,749,000	7,747,000	0.0%
Virginia .....	12,160,000	11,011,000	10.4%	8,769,000	7,839,000	11.9%
Maryland.....	7,369,000	7,030,000	4.8%	5,452,000	5,166,000	5.5%
Oregon .....	11,325,000	10,752,000	5.3%	9,134,000	8,535,000	7.0%
Other .....	3,625,000	3,437,000	5.5%	2,282,000	2,113,000	8.0%
	<u>\$89,018,000</u>	<u>\$83,148,000</u>	<u>7.1%</u>	<u>\$65,135,000</u>	<u>\$59,716,000</u>	<u>9.1%</u>

The increases noted above reflect the performance of the Company’s existing markets. Southern and Northern California and Virginia continued to benefit from a strong economy. In Northern Texas, the decline in revenue relates primarily related to lower expense recoveries for the nine months ended September 30, 2000.

**Facility Management Operations:** The Company’s facility management accounts for a small portion of the Company’s net operating income. During the three months ended September 30, 2000, \$104,000 in net operating income was recognized from facility management operations compared to \$97,000 for the same period in 1999. During the nine months ended September 30, 2000, \$306,000 in net operating income was recognized from facility management operations compared to \$281,000 for the same period in 1999. Facility management fees have increased due to the increase in rental rates of the properties managed by the Company.

**Business Services:** The Company recently hired a Vice President to focus on creating new revenue opportunities for the Company and additional products and services for our customers. Currently the Company has begun receiving income from construction management fees and fees from telecommunication service providers. During the three months ended September 30, 2000, \$4,000 in net operating income was derived from such services compared to none for the same period in 1999. During the nine months ended September 30, 2000, \$207,000 in net operating income was derived from such services compared to none for the same period in 1999.

**Interest Income:** Interest income reflects earnings on cash balances. Interest income was \$1,035,000 for the three months ended September 30, 2000 compared to \$581,000 for the same period in 1999. Interest income was \$3,046,000 for the nine months ended September 30, 2000 compared to \$845,000 for the same period in 1999. The increase is attributable to increased average cash balances and higher interest rates. Average cash balances for the three months ended September 30, 2000 were approximately \$64 million compared to \$47 million for the same period in 1999. Average cash balances for the nine months ended September 30, 2000 were approximately \$68 million compared to \$24 million for the same period in 1999.

**Dividend Income:** Dividend income reflects earnings from marketable securities. Dividend income was \$439,000 for the three months ended September 30, 2000 compared to \$11,000 for the same period in 1999. Dividend income was \$1,297,000 for the nine months ended September 30, 2000 compared to \$40,000 for the same period in 1999. The increase is attributable to increased investments in marketable securities.

**Cost of Operations:** Cost of operations for the three months ended September 30, 2000 was \$9,762,000 compared to \$8,920,000 for the same period in 1999. Cost of operations for the nine months ended September 30, 2000 was \$29,432,000 compared to \$25,951,000 for the same period in 1999. Cost of operations for the three months ended September 30, 2000 consists primarily of property taxes (\$3,138,000), property maintenance (\$1,818,000), utilities (\$2,044,000) and direct payroll (\$1,467,000). Cost of operations for the nine months ended September 30, 2000 consists primarily of property taxes (\$9,481,000), property maintenance (\$5,399,000), utilities (\$5,143,000) and direct payroll (\$4,345,000). The increase is due primarily to the growth in the total square footage of the Company's portfolio of properties. Cost of operations as a percentage of rental income decreased from 27.4% to 26.5% and from 28.0% to 27.4% for the three and nine months ended September 30, 2000 and 1999, respectively, as a result of economies of scale achieved through the acquisition and development of properties in existing markets and the disposition of properties outside of our core markets.

**Depreciation and Amortization Expense:** Depreciation and amortization expense for the three months ended September 30, 2000 was \$9,449,000 compared to \$7,594,000 for the same period in 1999. Depreciation and amortization expense for the nine months ended September 30, 2000 was \$26,723,000 compared to \$21,641,000 for the same period in 1999. The increase is due to the acquisition and development of real estate facilities during 1999 and 2000.

**General and Administrative Expense:** General and administrative expense was \$995,000 for the three months ended September 30, 2000 compared to \$742,000 for the same period in 1999. General and administrative expense was \$2,859,000 for the nine months ended September 30, 2000 compared to \$2,339,000 for the same period in 1999. The increase is due primarily to the increased size and activities of the Company. Included in general and administrative costs are acquisition costs and abandoned transaction costs. Acquisition expenses were \$130,000 and \$139,000 for the three months ended September 30, 2000 and 1999, respectively. There were no abandoned transaction costs for the three months ended September 30, 2000 and 1999, respectively. Acquisition expenses were \$378,000 and \$324,000 for the nine months ended September 30, 2000 and 1999, respectively. Abandoned transaction costs were \$7,000 and \$30,000 for the nine months ended September 30, 2000 and 1999, respectively.

**Interest Expense:** Interest expense was \$502,000 for the three months ended September 30, 2000 compared to \$977,000 for the same period in 1999. Interest expense was \$1,246,000 for the nine months ended September 30, 2000 compared to \$2,658,000 for the same period in 1999. The decrease is attributable to decreased average debt balances during the period and greater capitalized interest in 2000 as a result of higher construction in progress. Interest expense of \$308,000 and \$174,000 was capitalized as part of building costs associated with properties under development during the three months ended September 30, 2000 and 1999, respectively. Interest expense of \$996,000 and \$584,000 was capitalized as part of building costs associated with properties under development during the nine months ended September 30, 2000 and 1999, respectively.

**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 for the three months ended September 30, 2000 was \$6,360,000 (\$3,157,000 allocated to preferred unitholders and \$3,203,000 allocated to common unitholders) compared to \$4,369,000 (\$1,022,000 allocated to preferred unitholders and \$3,347,000

allocated to common unitholders) for the same period in 1999. Minority interest in income for the nine months ended September 30, 2000 was \$18,391,000 (\$8,998,000 allocated to preferred unitholders and \$9,393,000 allocated to common unitholders) compared to \$10,769,000 (\$1,236,000 allocated to preferred unitholders and \$9,533,000 allocated to common unitholders) for the same period in 1999. The increase in minority interest in income is due primarily to the issuance of preferred operating partnership units in April and September of 1999.

### **Liquidity and Capital Resources**

Net cash provided by operating activities for the nine months ended September 30, 2000 and 1999 was \$82,895,000 and \$62,745,000, respectively. Management believes that its internally generated net cash provided by operating activities will continue to be sufficient to enable it to meet its operating expenses, capital improvements, debt service requirements and maintain the current level of distribution to shareholders.

The Company owns approximately one million shares of common stock of Pacific Gulf Properties, Inc. ("PAG") representing an investment of approximately \$20 million. On November 9, 2000, the shareholders of PAG approved the sale of its industrial property portfolio and the sale of its remaining assets and subsequent liquidation and dissolution. PAG expects to make a cash distribution to shareholders in December 2000 of up to \$25.50 per share from the sale proceeds. This would result in net proceeds of approximately \$25.5 million to the Company or \$5.5 million in excess of our original investment. The investment is currently reflected on the balance sheet at \$26.5 million reflecting the fair market value of the stock at September 30, 2000. The unrealized gain is not reflected in net income or FFO. There is no assurance that the Company will realize the estimated net proceeds.

The Company sold five properties for approximately \$23.6 million during the nine months ended September 30, 2000 at a gain of \$256,000. There are no additional property dispositions planned for the year 2000.

The following table summarizes the Company's ability to make capital improvements to maintain its facilities through the use of cash provided by operating activities. The remaining cash flow is available to the Company to pay distributions to shareholders, make principal payments on debt and to make investments in real estate.

	Nine Months Ended September 30,	
	2000	1999
Net income .....	\$33,726,000	\$30,352,000
Depreciation and amortization .....	26,723,000	21,641,000
Change in working capital.....	4,055,000	(17,000)
Minority interest in income .....	18,391,000	10,769,000
Net cash provided by operating activities .....	<u>82,895,000</u>	<u>62,745,000</u>
Maintenance capital expenditures .....	(2,301,000)	(2,153,000)
Tenant improvements.....	(3,058,000)	(3,857,000)
Capitalized lease commissions.....	<u>(2,239,000)</u>	<u>(1,479,000)</u>
Funds available for distributions to shareholders, minority interests, acquisitions and other corporate purposes.....	75,297,000	55,256,000
Cash distributions to shareholders and minority interests .....	<u>(35,823,000)</u>	<u>(26,667,000)</u>
Excess funds available for principal payments on debt, investments in real estate and other corporate purposes .....	<u>\$ 39,474,000</u>	<u>\$ 28,589,000</u>

The Company's capital structure is characterized by a low level of leverage. As of September 30, 2000, the Company had seven fixed rate mortgage notes payable totaling \$31,168,000 which represented 3.6% of its total

capitalization (based on book value, including minority interests and debt). The weighted average interest rate for the mortgage notes is 7.59%.

In September 2000, the Company extended its unsecured line of credit (the "Credit Facility") with Wells Fargo Bank. The Credit Facility has a borrowing limit of \$100 million and an expiration date of August 6, 2003. The expiration date may be extended by one year on each anniversary of the Credit Facility. 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 0.75% to 1.35% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 1.00%). In addition, the Company is required to pay an annual commitment fee of 0.25%.

The Company expects to fund its growth strategies with permanent capital, including issuances of 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 line of credit. The Company intends to repay amounts borrowed under the Credit Facility from undistributed cash flow or, as market conditions permit and as determined to be advantageous, from the public or private placement of preferred and common stock/OP units or formation of joint ventures. The Company targets a leverage ratio of 40% and Funds from Operations ("FFO") to combined fixed charges and preferred distributions ratio of 3.0 to 1.0. As of September 30, 2000 and for the nine months then ended, the leverage ratio was 22% (based on the fair market capitalization) and the FFO to fixed charges and preferred distributions coverage ratio was 6.0 to 1.0.

In April 1999, the Company completed a private placement of preferred OP units and a public offering of depositary shares representing fractional interest in perpetual preferred stock resulting in net proceeds totaling \$65.6 million. The net proceeds from the placement of preferred OP units, completed April 23, 1999 were approximately \$12.5 million. The preferred OP units have a preferred distribution rate of 8 7/8% on a stated value of \$12.75 million. The preferred OP units have equivalent terms to those of perpetual preferred stock. Net proceeds from the public perpetual preferred stock offering completed April 30, 1999 were \$53.1 million. The preferred stock has a dividend rate of 9 1/4% on a stated value of \$55 million. Proceeds from the issuances were used to pay off borrowings from an affiliate and a portion was used to repay a mortgage note payable of approximately \$11 million. The remaining proceeds were used for investment in real estate.

On September 3, 1999, the Operating Partnership completed a private placement of 3,200,000 preferred units with a preferred distribution rate of 8 3/4%. The net proceeds from the placement of preferred units were approximately \$78 million. A portion of the proceeds was used to prepay a mortgage note payable of approximately \$8.5 million. On September 7 and 23, 1999, the Operating Partnership completed private placements of 1,200,000 and 400,000 preferred units, respectively, with a preferred distribution rate of 8 7/8%. The net proceeds from the placement of preferred units were approximately \$39.2 million.

On July 12, 2000 the Operating Partnership completed a private placement of 480,000 preferred units with a preferred distribution rate of 8 7/8%. The net proceeds from the placement of preferred units were approximately \$11.7 million and will be used for investment in real estate.

**Funds from Operations:** FFO is defined as net income, computed in accordance with generally accepted accounting principles ("GAAP"), before depreciation, amortization, minority interest in income, straight-line rent adjustments and extraordinary or non-recurring items. FFO is presented because the Company considers FFO to be a useful measure of the operating performance of a REIT which, together with net income and cash flows provides investors with a basis to evaluate the operating and cash flow performances of a REIT. FFO does not represent net income or cash flows from operations as defined by GAAP. FFO does not take into consideration scheduled principal payments on debt and capital improvements. Accordingly, FFO is not necessarily a substitute for cash flow or net income as a measure of liquidity or operating performance or ability to make acquisitions and capital improvements or ability to pay distributions or debt principal payments. Also, FFO as computed and disclosed by the Company may not be comparable to FFO computed and disclosed by other REITs.

FFO for the Company is computed as follows:

	Nine Months Ended September 30,	
	2000	1999
Net income allocable to common shareholders.....	\$ 29,910,000	\$ 28,218,000
Less: Gain on disposition of real estate.....	(256,000)	-
Depreciation and amortization.....	26,723,000	21,641,000
Minority interest in income – common units.....	9,393,000	9,533,000
Less: Straight-line rent adjustment.....	(1,951,000)	(2,544,000)
Consolidated FFO allocable to common shareholders and minority interests.....	63,819,000	56,848,000
FFO allocated to common minority interest – common units.....	(15,253,000)	(13,179,000)
FFO allocated to common shareholders.....	<u>\$ 48,566,000</u>	<u>\$ 43,669,000</u>

**Capital Expenditures:** During the nine months ended September 30, 2000, the Company incurred \$7.6 million in maintenance capital expenditures, tenant improvements and capitalized lease commissions. On a recurring annual basis, the Company expects \$0.90 to \$1.20 per square foot in recurring capital expenditures (an aggregate of \$11 - \$15 million based on square footage at September 30, 2000).

**Developments:** The Company is currently developing approximately 335,000 square feet of flex and office buildings in Northern Virginia, Dallas, Texas and Beaverton, Oregon at an aggregate cost of approximately \$37 million. Unfunded development costs are approximately \$23 million.

**Distributions:** The Company has elected and intends to qualify as a REIT for federal income tax purposes. As a REIT, the Company must meet, among other tests, sources of income, share ownership and certain asset tests. In addition, the Company is not taxed on that portion of its taxable income which is distributed to its shareholders provided that at least 95% of its taxable income is so distributed to its shareholders prior to filing of the Company's tax return.

The Board of Directors declared a quarterly dividend of \$0.25 per common share on November 8, 2000. In addition, the Board of Directors declared a quarterly dividend of \$0.578125 per share on the depositary shares each representing 1/1000 of a share of 9 ¼% Cumulative Preferred Stock, Series A. Distributions are payable on December 29, 2000 to shareholders of record as of the close of business on December 15, 2000.

**ITEM 3. 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 of either common or preferred stock. At September 30, 2000, the Company's debt as a percentage of shareholders' equity (based on book values) was 5.6%.

The Company's market risk sensitive instruments include mortgage notes payable which totaled \$31,168,000 at September 30, 2000. Substantially all of the Company's mortgage notes payable bear interest at fixed rates. See Note 6 of the Notes to Consolidated Financial Statements for terms, valuations and approximate principal maturities of the mortgage notes payable as of September 30, 2000. Based on borrowing rates currently available to the Company, the carrying amount of debt approximates fair value.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

In November 2000, Mary Jayne Howard, a former officer of the Company, filed a complaint for discrimination with the California Department of Fair Employment and Housing, requesting authorization to file a lawsuit against the Company. The complaint does not specify the damages, if any, and therefore the Company is not able to establish the materiality of the possible claim. The Company intends to vigorously contest any claims for discrimination by Ms. Howard.

### **ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

#### **(a) Exhibits**

- 2.1 Amended and Restated Agreement and Plan of Reorganization among Registrant, American Office Park Properties, Inc. ("AOPP") and Public Storage, Inc. ("PSI") dated as of December 17, 1997. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 3.1 Restated Articles of Incorporation. Filed with Registrant's Registration Statement No. 333-78627 and incorporated herein by reference.
- 3.2 Certificate of Determination of Preferences of 8 $\frac{3}{4}$ % Series C Cumulative Redeemable Preferred Stock of PS Business Parks, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 3.3 Certificate of Determination of Preferences of 8  $\frac{7}{8}$ % Series X Cumulative Redeemable Preferred Stock of PS Business Parks, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 3.4 Amendment to Certificate of Determination of Preferences of 8  $\frac{7}{8}$ % Series X Cumulative Redeemable Preferred Stock of PS Business Parks, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 3.5 Certificate of Determination of Preferences of 8  $\frac{7}{8}$ % Series Y Cumulative Redeemable Preferred Stock of PS Business Parks, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2000 and incorporated herein by reference.
- 3.6 Restated Bylaws. Filed with Registrant's Current Report on Form 8-K dated March 17, 1998 and incorporated herein by reference.
- 10.1 Amended Management Agreement between Storage Equities, Inc. and Public Storage Commercial Properties Group, Inc. dated as of February 21, 1995. Filed with PSI's Annual Report on Form 10-K for the year ended December 31, 1994 and incorporated herein by reference.
- 10.2 Registrant's 1997 Stock Option and Incentive Plan. Filed with Registrant's Registration Statement No. 333-48313 and incorporated herein by reference.
- 10.3 Agreement of Limited Partnership of PS Business Parks, L.P. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1998 and incorporated herein by reference.
- 10.4 Merger and Contribution Agreement dated as of December 23, 1997 among Acquiport Two Corporation, Acquiport Three Corporation, New York State Common Retirement Fund, American Office Park Properties, L.P., AOPP and AOPP Acquisition Corp. Three. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.

- 10.5 Agreement Among Shareholders and Company dated as of December 23, 1997 among Acquiport Two Corporation, AOPP, American Office Park Properties, L.P. and PSI. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 10.6 Amendment to Agreement Among Shareholders and Company dated as of January 21, 1998 among Acquiport Two Corporation, AOPP, American Office Park Properties, L.P. and PSI. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 10.7 Non-Competition Agreement dated as of December 23, 1997 among PSI, AOPP, American Office Park Properties, L.P. and Acquiport Two Corporation. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 10.8 Employment Agreement between AOPP and Ronald L. Havner, Jr. dated as of December 23, 1997. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 10.9 Employment Agreement between Registrant and J. Michael Lynch dated as of May 20, 1998. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1998 and incorporated herein by reference.
- 10.10 Common Stock Purchase Agreement dated as of January 23, 1998 among AOPP and the Investors signatory thereto. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 10.11 Registration Rights Agreement dated as of January 30, 1998 among AOPP and the Investors signatory thereto. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 10.12 Registration Rights Agreement dated as of March 17, 1998 between Registrant and Acquiport Two Corporation ("Acquiport Registration Rights Agreement"). Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1998 and incorporated herein by reference.
- 10.13 Letter dated May 20, 1998 relating to Acquiport Registration Rights Agreement. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1998 and incorporated herein by reference.
- 10.14 Revolving Credit Agreement dated August 6, 1998 among PS Business Parks, L.P., Wells Fargo Bank, National Association, as Agent, and the Lenders named therein. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1998 and incorporated herein by reference.
- 10.15 First Amendment to Revolving Credit Agreement dated as of August 19, 1999 among PS Business Parks, L.P., Wells Fargo Bank, National Association, as Agent, and the Lenders named therein. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 10.16 Second Amendment to Revolving Credit Agreement dated as of September 29, 2000 among PS Business Parks, L.P., Wells Fargo Bank, National Association, as Agent, and the Lenders named therein. Filed herewith.
- 10.17 Form of Indemnity Agreement. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1998 and incorporated herein by reference.
- 10.18 Cost Sharing and Administrative Services Agreement dated as of November 16, 1995 by and among PSCC, Inc. and the owners listed therein. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1998 and incorporated herein by reference.

- 10.19 Amendment to Cost Sharing and Administrative Services Agreement dated as of January 2, 1997 by and among PSCC, Inc. and the owners listed therein. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1998 and incorporated herein by reference.
  - 10.20 Accounts Payable and Payroll Disbursement Services Agreement dated as of January 2, 1997 by and between PSCC, Inc. and American Office Park Properties, L.P. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1998 and incorporated herein by reference.
  - 10.21 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to 8 7/8% Series B Cumulative Redeemable Preferred Units, dated as of April 23, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and incorporated herein by reference.
  - 10.22 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to 9 1/4% Series A Cumulative Redeemable Preferred Units, dated as of April 30, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and incorporated herein by reference.
  - 10.23 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to 8 3/4% Series C Cumulative Redeemable Preferred Units, dated as of September 3, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
  - 10.24 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to 8 7/8% Series X Cumulative Redeemable Preferred Units, dated as of September 7, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
  - 10.25 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to Additional 8 7/8% Series X Cumulative Redeemable Preferred Units, dated as of September 23, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
  - 10.26 Amendment to Agreement of Limited Partnership of PS Business Parks L.P. Relating to 8 7/8% Series Y Cumulative Redeemable Preferred Units, dated as of July 12, 2000. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2000 and incorporated herein by reference.
  - 11 Statement re: Computation of Earnings per Share. Filed herewith.
  - 12 Statement re: Computation of Ratio of Earnings to Fixed Charges. Filed herewith.
  - 27 Financial Data Schedule. Filed herewith.
- (b) Reports on Form 8-K
- None.

## **SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: November 13, 2000

PS BUSINESS PARKS, INC.

BY: /s/ Jack Corrigan

Jack Corrigan

Vice President and Chief Financial Officer

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**Exhibit 10.16**

SECOND AMENDMENT TO REVOLVING CREDIT AGREEMENT

dated as of September 29, 2000

among

PS BUSINESS PARKS, L.P.,

THE LENDERS LISTED HEREIN,

and

WELLS FARGO BANK, NATIONAL ASSOCIATION,  
as Agent

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## SECOND AMENDMENT TO REVOLVING CREDIT AGREEMENT

THIS SECOND AMENDMENT TO REVOLVING CREDIT AGREEMENT (this "Amendment") dated as of September 29, 2000 among PS BUSINESS PARKS, L.P., a California limited partnership (the "Borrower"), the lenders listed on the signature pages hereof ("Lenders"), and WELLS FARGO BANK, NATIONAL ASSOCIATION, as agent and representative for the Lenders (in such capacity, the "Agent").

WHEREAS, Borrower, the Agent and the Lenders entered into that certain Revolving Credit Agreement dated as of August 6, 1998 (the "Original Agreement"), which Original Agreement was amended by that certain First Amendment to Revolving Credit Agreement dated as of August 19, 1999 (the "First Amendment") among the Borrower, the Agent and the Lenders (the Original Agreement as amended by the First Amendment being referred to herein as the "Modified Credit Agreement");

WHEREAS, Borrower, the Lenders and the Agent wish to extend the Maturity Date to August 6, 2003 and make certain other amendments to the Modified Credit Agreement. The Modified Credit Agreement, as modified by this Amendment may be referred to herein as the "Credit Agreement";

NOW, THEREFORE, in consideration of the premises and of the mutual covenants and agreements hereinafter set forth, the Borrower, the Lenders and the Agent agree as follows:

### ARTICLE I.

#### the AMENDMENTS

SECTION 1.1. Definitions. The following terms shall be added to, or shall be substituted in lieu of the corresponding terms in, Section 1.1 of the Modified Credit Agreement:

"Maturity Date" means at any time, the then-applicable maturity date specified hereunder. The initial Maturity Date shall be August 6, 2003, although such date may be extended by the Lenders as provided in Section 2.5.2 hereof.

"Net Worth" means, at any date, the consolidated stockholders' equity of the Borrower (including minority interests in the Borrower) and the Consolidated Entities, excluding any amounts attributable to mandatorily redeemable preferred stock (other than preferred stock redeemable solely with common stock); provided, solely for purposes of this definition, the consolidated stockholders' equity will be adjusted to add the net additions to accumulated depreciation and amortization occurring subsequent to December 31, 1999.

SECTION 1.2. Extension. Section 2.5.2 of the Modified Credit Agreement is hereby deleted in its entirety and the following shall be substituted in lieu thereof:

2.5.2. Extension. Borrowers may request extensions of the Maturity Date by making such request to Agent ("Extension Notice") in writing at least ninety (90) days prior to each anniversary of the Closing Date (commencing with the anniversary falling on August 6, 2001). The Agent and the Lenders have no obligation to extend the Maturity Date and the Maturity Date shall not be extended unless (i) the Borrower is in full compliance with all of the terms, conditions and covenants of this Agreement at the time of request and on the applicable anniversary Date, (ii) all of the Lenders and the Agent have agreed to do so in writing, (iii) Borrower shall, on or prior to the applicable anniversary, have executed and delivered to the Agent an extension agreement in the form provided by Agent, and (iv) Borrower shall, on or prior to the applicable anniversary, provided all Lenders shall have approved the request, have remitted to the Agent any extension fee, and have satisfied any other conditions to extension, agreed to between Borrower and the Agent. If Borrower's request for extension is approved and the other foregoing conditions are met, then (i) the extension of the Maturity Date shall be for a period of one (1) year and

(ii) such extension shall be effective as of the applicable anniversary. The Agent and the Lenders shall have a period of forty-five (45) days from receipt of written notice of Borrowers' intention to extend the Maturity Date to approve such extension, in their sole and absolute discretion. If Borrower has not received written notice of the Lenders' intention to extend the Maturity Date within such forty-five (45) day period, then the extension request shall be deemed to be not approved. If an extension is granted, Borrower may request subsequent one (1) year extensions subject to the same criteria and procedures established in this Section 2.5.2. As an example, in order to extend the initial Maturity Date, Borrower must notify Agent at least ninety (90) days prior to August 6, 2001. If approved, the Maturity Date would then be extended from August 6, 2003 to August 6, 2004. In the event that Borrower's initial request for extension is not granted, any subsequent request for extension is not granted, or Borrower does not request an extension pursuant to this Section 2.5.2, then, commencing on the Maturity Date, Borrower shall no longer be able to obtain Loans hereunder and all outstanding Loans shall become all due and payable.

SECTION 1.3. Financial Information. Section 4.5.1 of the Modified Credit Agreement is hereby amended by deleting the dates "December 31, 1997" and "December 31, 1998" and substituting in lieu thereof the dates "December 31, 1998" and "December 31, 1999" respectively. Section 4.5.2 of the Modified Credit Agreement is hereby amended by deleting the words "June 30, 1999" and substituting in lieu thereof the words "June 30, 2000".

SECTION 1.4. Minimum Tangible Net Worth. Section 6.4.3 of the Modified Credit Agreement is hereby deleted in its entirety and the following shall be substituted in lieu thereof:

6.4.3. Minimum Tangible Net Worth. Tangible Net Worth of Borrower and Guarantor shall not be less than, at any time: (i) \$800,000,000 plus (ii) ninety percent (90%) of Equity Offering Net Proceeds.

## ARTICLE II.

### Conditions to Effectiveness of this Amendment

The closing hereunder shall occur on the date when each of the following conditions is satisfied (or waived by the Agent and the Lenders) (the "Amendment Date"), each document to be dated the Amendment Date unless otherwise indicated:

- (a) the Borrower, the Agent and each of the Lenders shall have executed and delivered to the Borrower and the Agent a duly executed original of this Amendment;
- (b) Guarantor shall have executed and delivered to the Agent a duly executed consent to this Amendment reaffirming Guarantor's obligations under the Guaranty;
- (c) the Agent shall have received all documents the Agent may reasonably request relating to the existence of the Borrower and Guarantor, the authority for and the validity of this Amendment and the other Loan Documents, and any other matters relevant hereto, all in form and substance satisfactory to the Agent. Such documentation shall include, without limitation, the agreement of limited partnership of the Borrower, as well as the certificate of limited partnership of the Borrower, both as amended, modified or supplemented to the Amendment Date, certified to be true, correct and complete by a senior officer of the Borrower as of a date not more than ten (10) days prior to the Amendment Date, as well as the articles of incorporation and bylaws of Guarantor, as amended, modified or supplemented to the Amendment Date, certified to be true, correct and complete by a senior officer of Guarantor as of a date not more than ten (10) days prior to the Amendment Date;
- (d) the Borrower and Guarantor shall have taken all actions required to authorize the execution and delivery of this Amendment and the other Loan Documents and the performance thereof by the Borrower and Guarantor, as the case may be;
- (e) the Agent shall have received, for its and any other Lender's account and the account of Gibson, Dunn & Crutcher LLP, all fees due and payable pursuant to the Fee Letter dated September 29, 2000 between Borrower and Agent and the Modified Credit Agreement on or before the Amendment Date; and

- (f) no Default or Event of Default shall have occurred.

### ARTICLE III.

#### Representations of Borrower

The Borrower hereby represents and warrants to the Agent and each of the Lenders the following:

(a) All of the representations and warranties contained in the Modified Credit Agreement are true and correct on and as of the date hereof and will be true and correct after giving effect to this Amendment; the foregoing representation and warranty is not intended to modify Section 7.1.4 of the Credit Agreement.

(b) No event which constitutes a Default or an Event of Default under the Modified Credit Agreement, as amended hereby, has occurred and is continuing, or would result from the execution and delivery of this Amendment.

(c) The Borrower has the power and authority to execute and deliver this Amendment and to perform its obligations under the Modified Credit Agreement, as amended hereby, and under the Notes; and all such action has been duly authorized by all necessary proceeding on its part. Each of the Modified Credit Agreement, this Amendment and the Notes has been duly and validly executed and delivered by the Borrower and constitutes the valid and legally binding obligation of the Borrower enforceable in accordance with its terms, except as limited by moratorium, bankruptcy, reorganization, insolvency or other laws affecting creditor's rights generally or by the exercise of judicial discretion in accordance with general principles of equity.

### ARTICLE IV.

#### MISCELLANEOUS

SECTION 4.1 Capitalized Terms The capitalized terms used herein which are defined in the Modified Credit Agreement and not otherwise defined herein shall have the meanings specified therein.

SECTION 4.2 Ratification The Modified Credit Agreement, as hereby amended, is in all respects ratified and confirmed, and all other rights and powers created thereby or thereunder shall be and remain in full force and effect.

SECTION 4.3 Counterparts This Amendment may be executed in several counterparts, and each counterpart, when so executed and delivered, shall constitute an original instrument, and all such separate counterparts shall constitute one and the same instrument.

SECTION 4.4 Governing Law THIS AMENDMENT AND THE OTHER LOAN DOCUMENTS AND THE RIGHTS AND OBLIGATIONS OF THE PARTIES HEREUNDER AND THEREUNDER SHALL BE CONSTRUED IN ACCORDANCE WITH AND BE GOVERNED BY THE LAWS OF THE STATE OF CALIFORNIA EXCEPT TO THE EXTENT PREEMPTED BY FEDERAL LAW (WITHOUT GIVING EFFECT TO THE PRINCIPLES THEREOF RELATING TO CONFLICTS OF LAW).

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed by their respective authorized officers as of the day and year first above written.

**Borrower:**

PS BUSINESS PARKS, L.P.,  
a California limited partnership

By: PS BUSINESS PARKS, INC.,  
a California corporation,  
General Partner

By: /s/ Jack Corrigan  
Name: Jack Corrigan  
Title: Vice President

Address: PS BUSINESS PARKS, L.P.  
701 Western Avenue  
Glendale, California 91201  
Attn: Chief Financial Officer  
Telephone: (818) 244-8080  
Telecopier: (818) 244-9267

**Agent:**

Wells Fargo Bank, National Association

By: /s/ Sharon Fisher

Name: Sharon Fisher

Title: Vice President

Address:

Wells Fargo Bank, National Association

2030 Main Street, 8th Floor

Irvine, California 92614

Attention: Office Manager

Telephone: (949) 251-4300

Telecopier: (949) 851-9728

**Lender:**

Wells Fargo Bank, National Association

By: /s/ Sharon Fisher

Name: Sharon Fisher

Title: Vice President

Address:

Wells Fargo Bank, National Association

2030 Main Street, 8th Floor

Irvine, California 92614

Attention: Office Manager

Telephone: (949) 251-4300

Telecopier: (949) 851-9728

**LIBOR LENDING  
OFFICE:**

Wells Fargo Bank, National Association

2120 East Park Place, Suite 100

El Segundo, California 90245

Attention: Anne Colvin

Telephone: (310) 335-9458

Telecopier: (310) 615-1014

CONSENT OF GUARANTOR

The undersigned, PS BUSINESS PARKS, INC., a California corporation ("Guarantor"), (i) hereby consents to the foregoing Second Amendment to Revolving Credit Agreement dated as of September 29, 2000 (the "Second Amendment") among PS BUSINESS PARKS, L.P., a California limited partnership ("Borrower"), the lenders listed therein (the "Lenders") and WELLS FARGO BANK, NATIONAL ASSOCIATION, as Agent (in such capacity, the "Agent"), and (ii) hereby reaffirms its obligations under that certain General Continuing Repayment Guaranty dated as of August 6, 1998 made by Guarantor in favor of the Lenders and the Agent pursuant to which, among other things, Guarantor guarantees the payment and performance of Borrower's obligations under the Revolving Credit Agreement dated as of August 6, 1998 among Borrower, the Lenders and the Agent, as amended by each of the First Amendment to Revolving Credit Agreement dated as of August 19, 1999 among Borrower, the Lenders and the Agent and the Second Amendment.

PS BUSINESS PARKS, INC.,  
a California corporation

By: /s/ Jack Corrigan  
Name: Jack Corrigan  
Title: Vice President

**PS BUSINESS PARKS, INC.**  
**EXHIBIT 11**  
**STATEMENT RE: COMPUTATION OF EARNINGS PER SHARE**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2000	1999	2000	1999
<b>Basic and Diluted Earnings Per Share:</b>				
Net income allocable to common shareholders.....	\$ 10,199,000	\$ 9,383,000	\$ 29,910,000	\$ 28,218,000
Weighted average common shares outstanding:				
Basic weighted average common shares outstanding .....	23,117,000	23,641,000	23,354,000	23,639,000
Net effect of dilutive stock options - based on treasury stock method using average market price .....	99,000	83,000	72,000	74,000
Diluted weighted average common shares outstanding ....	<u>23,216,000</u>	<u>23,724,000</u>	<u>23,426,000</u>	<u>23,713,000</u>
Basic earnings per common share.....	\$ 0.44	\$ 0.40	\$ 1.28	\$ 1.19
Diluted earnings per common share.....	<u>\$ 0.44</u>	<u>\$ 0.40</u>	<u>\$ 1.28</u>	<u>\$ 1.19</u>

**PS BUSINESS PARKS, INC.**

**EXHIBIT 12:**

**STATEMENT RE: COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES**

	Nine Months Ended September 30,	
	2000	1999
Net income .....	\$ 33,726,000	\$ 30,352,000
Minority interest .....	18,391,000	10,769,000
Interest expense.....	1,246,000	2,658,000
Earnings available to cover fixed charges .....	<u>\$ 53,363,000</u>	<u>\$ 43,779,000</u>
Fixed charges (1).....	\$ 2,242,000	\$ 3,242,000
Preferred distributions .....	12,814,000	3,370,000
Combined fixed charges and preferred distributions .....	<u>\$ 15,056,000</u>	<u>\$ 6,612,000</u>
Ratio of earnings to fixed charges .....	<u>23.8</u>	<u>13.50</u>
Ratio of earnings to combined fixed charges and preferred distributions.....	<u>3.54</u>	<u>6.62</u>

	Years Ended December 31,				
	1999	1998	1997	1996	1995
Net income .....	\$41,255,000	\$29,400,000	\$ 3,836,000	\$ 519,000	\$ 1,192,000
Minority interest .....	16,049,000	11,208,000	8,566,000	-	-
Interest expense.....	3,153,000	2,361,000	1,000	-	-
Earnings available to cover fixed charges .....	<u>\$60,457,000</u>	<u>\$42,969,000</u>	<u>\$12,403,000</u>	<u>\$ 519,000</u>	<u>\$ 1,192,000</u>
Fixed charges (1).....	\$ 4,142,000	\$ 2,629,000	\$ 1,000	\$ -	\$ -
Preferred distributions .....	7,562,000	-	-	-	-
Combined fixed charges and preferred distributions.....	<u>\$11,704,000</u>	<u>\$ 2,629,000</u>	<u>\$ 1,000</u>	<u>\$ -</u>	<u>\$ -</u>
Ratio of earnings to fixed charges.	<u>14.60</u>	<u>16.34</u>	<u>12,403</u>	<u>N/A</u>	<u>N/A</u>
Ratio of earnings to combined fixed charges and preferred distributions.....	<u>5.17</u>	<u>16.34</u>	<u>12,403</u>	<u>N/A</u>	<u>N/A</u>

(1) Fixed charges include interest expense plus capitalized interest.

**PS BUSINESS PARKS, INC.**  
**EXHIBIT 12**  
**STATEMENT RE: COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES**

Supplemental disclosure of Ratio of Funds from Operations (“FFO”) to fixed charges:

	Nine Months Ended September 30,	
	2000	1999
FFO .....	\$ 63,819,000	\$ 56,848,000
Interest expense.....	1,246,000	2,658,000
Minority interest in income – preferred units.....	8,998,000	1,236,000
Preferred dividends.....	3,816,000	2,134,000
Adjusted FFO available to cover fixed charges.....	<u>\$ 77,879,000</u>	<u>\$ 62,876,000</u>
Fixed charges (1).....	\$ 2,242,000	\$ 3,242,000
Preferred distributions.....	12,814,000	3,370,000
Combined fixed charges and preferred distributions.....	<u>\$ 15,056,000</u>	<u>\$ 6,612,000</u>
Ratio of FFO to fixed charges .....	<u>34.74</u>	<u>19.39</u>
Ratio of FFO to combined fixed charges and preferred distributions.....	<u>5.17</u>	<u>9.51</u>

	Years Ended December 31,				
	1999	1998	1997	1996	1995
FFO.....	\$76,353,000	\$57,430,000	\$17,597,000	\$ 303,000	\$ 720,000
Interest expense.....	3,153,000	2,361,000	1,000	-	-
Minority interest in income – preferred units .....	4,156,000	-	-	-	-
Preferred dividends.....	3,406,000	-	-	-	-
Adjusted FFO available to cover fixed charges .....	<u>\$87,068,000</u>	<u>\$59,791,000</u>	<u>\$17,598,000</u>	<u>\$ 303,000</u>	<u>\$ 720,000</u>
Fixed charges (1).....	\$ 4,142,000	\$ 2,629,000	\$ 1,000	\$ -	\$ -
Preferred distributions.....	7,562,000	-	-	-	-
Combined fixed charges and preferred distributions.....	<u>\$11,704,000</u>	<u>\$ 2,629,000</u>	<u>\$ 1,000</u>	<u>\$ -</u>	<u>\$ -</u>
Ratio of FFO to fixed charges.....	<u>21.02</u>	<u>22.74</u>	<u>17,598</u>	<u>N/A</u>	<u>N/A</u>
Ratio of FFO to combined fixed charges and preferred distributions.....	<u>7.44</u>	<u>22.74</u>	<u>17,598</u>	<u>N/A</u>	<u>N/A</u>

(1) Fixed charges include interest expense plus capitalized interest.

**PS BUSINESS PARKS. INC.**  
**EXHIBIT 27 - FINANCIAL DATA SCHEDULE**  
**ARTICLE 5 OF REGULATION S-X**

<NAME>	PS Business Parks, Inc.
<MULTIPLIER>	1
<CURRENCY>	U.S. \$
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