

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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, 2002

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 X No _____

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes X No _____

Number of shares outstanding of each of the issuer's classes of common stock, as of November 12, 2002:

Common Stock, \$0.01 par value, 21,570,219 shares outstanding

PS BUSINESS PARKS, INC.

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PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2002	December 31, 2001
	(unaudited)	
<u>ASSETS</u>		
Cash and cash equivalents.....	\$ 4,625,000	\$ 3,076,000
Marketable securities	5,378,000	9,134,000
Real estate facilities, at cost:		
Land	286,300,000	287,182,000
Buildings and equipment	958,157,000	940,868,000
	1,244,457,000	1,228,050,000
Accumulated depreciation.....	(162,177,000)	(120,089,000)
	1,082,280,000	1,107,961,000
Property held for disposition, net	16,643,000	17,619,000
Land held for development or sale	11,527,000	10,629,000
	1,110,450,000	1,136,209,000
Investment in joint venture.....	901,000	974,000
Rent receivable.....	1,379,000	745,000
Interest receivable	31,000	137,000
Note receivable.....	200,000	7,450,000
Deferred rent receivables	11,879,000	9,601,000
Intangible assets, net	453,000	679,000
Other assets	2,840,000	1,950,000
Total assets	\$1,138,136,000	\$1,169,955,000
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
Accrued and other liabilities	\$ 33,309,000	\$ 39,822,000
Deferred gain on property disposition.....	-	5,366,000
Line of credit.....	-	100,000,000
Unsecured note payable	50,000,000	-
Note payable to affiliate	-	35,000,000
Mortgage notes payable	27,720,000	30,145,000
Total liabilities	111,029,000	210,333,000
Minority interest:		
Preferred units.....	197,750,000	197,750,000
Common units.....	166,436,000	162,141,000
Shareholders' equity:		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, 6,838 shares issued and outstanding at September 30, 2002 (4,840 shares issued and outstanding at December 31, 2001).....	170,950,000	121,000,000
Common stock, \$0.01 par value, 100,000,000 shares authorized, 21,552,887 shares issued and outstanding at September 30, 2002 (21,539,783 shares issued and outstanding at December 31, 2001)	216,000	215,000
Paid-in capital.....	421,510,000	422,161,000
Cumulative net income.....	218,878,000	174,860,000
Comprehensive income	211,000	108,000
Cumulative distributions.....	(148,844,000)	(118,613,000)
Total shareholders' equity.....	662,921,000	599,731,000
Total liabilities and shareholders' equity	\$1,138,136,000	\$1,169,955,000

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,	
	2002	2001	2002	2001
Revenues:				
Rental income	\$ 49,478,000	\$ 42,230,000	\$148,632,000	\$118,751,000
Facility management fees primarily from affiliates	191,000	170,000	577,000	499,000
Business services	24,000	75,000	93,000	308,000
Equity in income of joint venture.....	138,000	-	387,000	-
Interest and other income	47,000	350,000	647,000	1,671,000
	<u>49,878,000</u>	<u>42,825,000</u>	<u>150,336,000</u>	<u>121,229,000</u>
Expenses:				
Cost of operations.....	12,953,000	11,488,000	39,396,000	31,350,000
Cost of facility management.....	44,000	38,000	134,000	111,000
Cost of business services.....	88,000	147,000	376,000	460,000
Depreciation and amortization	14,595,000	10,679,000	42,885,000	30,058,000
General and administrative.....	1,194,000	1,037,000	3,398,000	3,157,000
Interest expense.....	1,115,000	538,000	4,098,000	932,000
	<u>29,989,000</u>	<u>23,927,000</u>	<u>90,287,000</u>	<u>66,068,000</u>
Income from continuing operations.....	19,889,000	18,898,000	60,049,000	55,161,000
Income from discontinued operations and properties held for sale	566,000	542,000	1,677,000	1,711,000
Income before gain on disposal of real estate, gain on investments and minority interest	20,455,000	19,440,000	61,726,000	56,872,000
Gain on disposal of real estate.....	2,041,000	-	7,407,000	-
Gain on investment in marketable securities....	16,000	-	41,000	15,000
Impairment charge on property held for sale....	(900,000)	-	(900,000)	-
Income before minority interest.....	<u>21,612,000</u>	<u>19,440,000</u>	<u>68,274,000</u>	<u>56,887,000</u>
Minority interest in income – preferred units...	(4,412,000)	(3,323,000)	(13,237,000)	(9,696,000)
Minority interest in income – common units....	<u>(3,356,000)</u>	<u>(3,268,000)</u>	<u>(11,019,000)</u>	<u>(10,047,000)</u>
Net income.....	<u>\$ 13,844,000</u>	<u>\$ 12,849,000</u>	<u>\$ 44,018,000</u>	<u>\$ 37,144,000</u>
Net income allocation:				
Allocable to preferred shareholders.....	\$ 3,933,000	\$ 2,839,000	\$ 11,483,000	\$ 6,014,000
Allocable to common shareholders	9,911,000	10,010,000	32,535,000	31,130,000
	<u>\$ 13,844,000</u>	<u>\$ 12,849,000</u>	<u>\$ 44,018,000</u>	<u>\$ 37,144,000</u>
Net income per common share:				
Basic	<u>\$ 0.46</u>	<u>\$ 0.45</u>	<u>\$ 1.51</u>	<u>\$ 1.38</u>
Diluted.....	<u>\$ 0.46</u>	<u>\$ 0.45</u>	<u>\$ 1.49</u>	<u>\$ 1.37</u>
Weighted average common shares outstanding:				
Basic	<u>21,552,000</u>	<u>22,210,000</u>	<u>21,548,000</u>	<u>22,610,000</u>
Diluted.....	<u>21,772,000</u>	<u>22,295,000</u>	<u>21,763,000</u>	<u>22,685,000</u>

See accompanying notes.

PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED September 30, 2002
(Unaudited)

	Preferred Stock		Common Stock		Paid-in Capital
	Shares	Amount	Shares	Amount	
Balances at December 31, 2001	4,840	\$121,000,000	21,539,783	\$ 215,000	\$422,161,000
Issuance of preferred stock.....	2,000	50,000,000	-	-	(1,674,000)
Repurchase of preferred stock.....	(2)	(50,000)	-	-	(1,000)
Exercise of stock options	-	-	12,666	1,000	296,000
Stock bonus awards.....	-	-	438	-	15,000
Stock option expense	-	-	-	-	343,000
Unrealized gain – appreciation in marketable securities	-	-	-	-	-
Comprehensive loss on interest rate swap	-	-	-	-	-
Net income	-	-	-	-	-
Distributions paid:					
Preferred stock	-	-	-	-	-
Common stock	-	-	-	-	-
Adjustment to reflect minority interest to underlying ownership interest	-	-	-	-	370,000
Balances at September 30, 2002	<u>6,838</u>	<u>\$170,950,000</u>	<u>21,552,887</u>	<u>\$ 216,000</u>	<u>\$421,510,000</u>

	Cumulative Net Income	Other Comprehensive Gain	Cumulative Distributions	Shareholders' Equity
	Balances at December 31, 2001	\$174,860,000	\$ 108,000	\$ (118,613,000)
Issuance of preferred stock.....	-	-	-	48,326,000
Repurchase of preferred stock.....	-	-	-	(51,000)
Exercise of stock options	-	-	-	297,000
Stock bonus awards.....	-	-	-	15,000
Stock option expense	-	-	-	343,000
Unrealized gain – appreciation in marketable securities	-	1,077,000	-	1,077,000
Comprehensive loss on interest rate swap	-	(974,000)	-	(974,000)
Net income	44,018,000	-	-	44,018,000
Distributions paid:				
Preferred stock	-	-	(11,483,000)	(11,483,000)
Common stock	-	-	(18,748,000)	(18,748,000)
Adjustment to reflect minority interest to underlying ownership interest	-	-	-	370,000
Balances at September 30, 2002	<u>\$218,878,000</u>	<u>\$ 211,000</u>	<u>\$(148,844,000)</u>	<u>\$ 662,921,000</u>

See accompanying notes.

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

For the Nine Months
 Ended September 30,

	2002	2001
Cash flows from operating activities:		
Net income	\$ 44,018,000	\$ 37,144,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of marketable securities	(41,000)	(15,000)
Gain on disposition of properties	(7,407,000)	-
Gain on disposition of joint venture properties	(265,000)	-
Stock option expense and stock bonuses	358,000	
Impairment charge on property held for sale.....	900,000	-
Depreciation and amortization expense.....	42,885,000	30,058,000
Minority interest in income	24,256,000	19,743,000
Increase in receivables and other assets	(3,760,000)	(1,056,000)
Increase (decrease) in accrued and other liabilities	(3,160,000)	6,233,000
Total adjustments	53,766,000	54,963,000
Net cash provided by operating activities.....	97,784,000	92,107,000
Cash flows from investing activities:		
Investment in marketable securities	-	(9,440,000)
Proceeds from sale of joint venture properties	553,000	-
Proceeds from liquidation of investments	4,823,000	6,079,000
Proceeds from disposition of properties.....	5,160,000	-
Acquisition of land and properties	(820,000)	(90,239,000)
Proceeds from note receivable	7,250,000	-
Capital improvements to real estate facilities	(17,421,000)	(7,346,000)
Development of real estate facilities	(2,778,000)	(9,534,000)
Net cash used in investing activities.....	(3,233,000)	(110,480,000)
Cash flows from financing activities:		
Proceeds from unsecured note payable.....	50,000,000	-
Repayment of borrowings from line of credit.....	(100,000,000)	-
Principal payments on mortgage notes payable.....	(2,425,000)	(617,000)
Repayment of borrowings from an affiliate.....	(35,000,000)	-
Net proceeds from the issuance of preferred stock	48,326,000	64,337,000
Net proceeds from the issuance of preferred operating partnership units.....	-	51,650,000
Redemption of common operating partnership units.....	-	(808,000)
Exercise of stock options	297,000	1,398,000
Repurchase of common stock	-	(38,975,000)
Repurchase of preferred stock	(51,000)	-
Distributions paid to preferred shareholders	(11,483,000)	(6,014,000)
Distributions paid to minority interests – preferred units	(13,237,000)	(9,696,000)
Distributions paid to common shareholders	(21,979,000)	(19,550,000)
Distributions paid to minority interests – common units.....	(7,450,000)	(6,356,000)
Net cash provided by (used in) financing activities.....	(93,002,000)	35,369,000
Net increase in cash and cash equivalents.....	1,549,000	16,996,000
Cash and cash equivalents at the beginning of the period.....	3,076,000	49,295,000
Cash and cash equivalents at the end of the period.....	\$ 4,625,000	\$ 66,291,000

See accompanying notes.

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

	For the Nine Months Ended September 30,	
	2002	2001
Supplemental schedule of non cash investing and financing activities:		
Adjustment to reflect minority interest to underlying ownership interest:		
Minority interest – common units.....	\$ (370,000)	\$ (918,000)
Paid-in capital	370,000	918,000
Reclassification of developed properties:		
Real estate facilities	-	(28,507,000)
Construction in progress	-	28,507,000
Unrealized gain/loss:		
Marketable securities	(103,000)	740,000
Other comprehensive income (loss)	103,000	(740,000)

See accompanying notes.

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2002

1. Organization and description of business

PS Business Parks, Inc. ("PSB") was incorporated in the state of California in 1990. As of September 30, 2002, PSB owned approximately 75% of the common partnership units of PS Business Parks, L.P. (the "Operating Partnership" or "OP"). The remaining common partnership units were owned by Public Storage, Inc. ("PSI") and its affiliated entities. 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, 2002, the Company owned and operated approximately 14.8 million net rentable square feet of commercial space located in eight states. The Company also managed approximately 1.7 million net rentable square feet on behalf of PSI and its affiliated entities, third party owners and a joint venture in which the Company held a 25% equity ownership interest (See Note 2).

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 necessary for a fair presentation have been included and are of a normal recurring nature. Operating results for the three and nine months ended September 30, 2002 are not necessarily indicative of the results that may be expected for the year ended December 31, 2002. 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, 2001.

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.

Financial instruments

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

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2002

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

In July, 2002, the partnership entered into an interest rate swap agreement, which is accounted for as a cash flow hedge, to reduce the impact of changes in interest rates on a portion of its floating rate debt. The agreement, which covers \$50,000,000 of debt through July, 2004 effectively changes the interest rate exposure from floating rate to a fixed rate of 4.46%. Market gains and losses on the value of the swap are deferred and included in income over the life of the swap or related debt. For the three and nine months ended September 30, 2002, the transaction was determined to be an effective hedge. The Partnership records the differences paid or received on the interest rate swap in interest expense as payments are made or received.

Net interest differentials to be paid or received related to these contracts were accrued as incurred or earned. Included in comprehensive income is \$974,000 in unrealized loss related to the interest rate swap as of September 30, 2002. Upon termination of the contract, the related balance in comprehensive income is recognized into income or expense in the period the contract matures or is terminated.

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

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

Marketable securities

Marketable securities are 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. Investments are reflected on the balance sheet at fair market value based upon the quoted market price. Comprehensive income of approximately \$211,000 represents \$1,185,000 in unrealized gains from investments in marketable securities, offset by an unrealized loss of \$974,000 from the Company's interest rate swap contract. These items are 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, 2002

Real estate facilities

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

Interest cost and property taxes incurred during the period of construction of real estate facilities are capitalized. The Company capitalized \$288,000 and \$1,001,000 of interest expense during the nine months ended September 30, 2002 and 2001, respectively. As of September 30, 2002, all developed properties had been shell complete for at least one year and the Company was no longer capitalizing interest expense on these facilities.

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2002

Investment in joint venture

In October 2001, the Company formed a joint venture with an unaffiliated investor to own and operate an industrial park in the City of Industry submarket of Los Angeles County. The park, consisting of 294,000 square feet of industrial space, was acquired by the Company in December 2000 at a cost of approximately \$14.4 million. The property was contributed to the joint venture at its original cost. The partnership is capitalized with equity capital consisting of 25% from the Company and 75% from the unaffiliated investor in addition to a mortgage note payable.

In May 2002, the joint venture disposed of two buildings in the park totaling 47,000 square feet for approximately \$3 million (\$2.8 million net of closing costs). In September, 2002, the joint venture disposed of two additional buildings totaling 28,700 square feet for approximately \$2.2 million (\$2.0 million net of closing costs). The Company recognized its 25% share of the gain on the dispositions totaling \$265,000 (approximately \$1.0 million for the joint venture). As of September 30, 2002, the joint venture holds 10 buildings totaling 218,000 square feet which the joint venture is currently under contract to sell.

Summarized below is financial data for the joint venture as of September 30, 2002.

	For the nine months and period ended September 30, 2002
Total revenues	\$ 1,320,000
Gain on sale of real estate	1,043,000
Cost of operations	367,000
Depreciation and amortization	228,000
Interest expense	312,000
Other expenses	4,000
Total expenses	911,000
Net income	\$ 1,452,000
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Real estate, net	\$ 10,725,000
Total assets	12,368,000
Notes payable	5,004,000
Total liabilities	7,531,000
Partner's equity	4,841,000
The Company's investment at September 30, 2002	\$ 901,000

The joint venture has a variable rate mortgage obligation of approximately \$5 million, which currently bears interest at 5.45% per annum and is due on November 1, 2005. Under certain conditions, the Company has guaranteed repayment of the mortgage. The Company's investment is accounted for under the equity method in accordance with APB 18, "Equity Method of Accounting for Investments." In accordance with APB 18, the Company's share of the debt is netted against its share of the assets in determining the investment in the joint venture of \$901,000 and is not included in the Company's total liabilities.

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2002

Subsequent to September 30, 2002, the joint venture sold an additional two buildings totaling 48,276 square feet for net proceeds of approximately \$1.9 million. The joint venture recognized a gain of approximately \$577,000 and the Company's share was approximately \$200,000. The remaining buildings are under contract to be sold. The net proceeds are expected to be approximately \$7.5 million, resulting in an expected gain of approximately \$3.9 million. The Company's share of the gain would be approximately \$1.2 million. In addition, the Company would recognize an incentive fee of approximately \$1.6 million. There can be no assurance that these sales will be completed or the gains and incentive fees recognized.

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 \$1,703,000 and \$1,477,000 at September 30, 2002 and December 31, 2001, 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. In addition, the Company evaluates its assets held for disposition. Assets held for disposition are reported at the lower of their carrying amount or fair value, less cost of dispositions. At September 30, 2002, the Company determined that the net proceeds from the sale of one of its assets held for sale would be less than the carrying value, resulting in a \$900,000 impairment charge.

Loan from affiliate

The Company borrowed an aggregate of \$35 million from PSI in 2001. The note bore interest at 3.25% (per annum) and was repaid along with accrued interest expense of \$76,000 in January 2002. A portion of the proceeds from the Series F preferred stock issuance described in Note 9 was used to repay the note.

Insurance Coverage

The Company combines its insurance purchasing power with PSI through a captive insurance company controlled by PSI, STOR-Re Mutual Insurance Corporation (STOR-Re). STOR-Re provides limited property and liability insurance to the Company at commercially competitive rates. The Company and PSI also utilize unaffiliated insurance carriers to provide property and liability insurance in excess of STOR-Re's limitations. During the period ended September 30, 2002 and 2001, the Company paid approximately \$900,000 and \$675,000 in premiums to STOR-Re, respectively.

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. Deferred rent receivables represents rental revenue accrued on a straight-line basis in excess of rental revenue currently billed. Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as revenues in the period the applicable costs are incurred.

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2002

Lease Termination Fees

Certain leases have termination options whereby the lessee may terminate the lease prior to its expiration. In most circumstances, the lessee is required to pay a fee to terminate the lease. In general, these fees are calculated by adding two factors. 1) Unamortized leasing costs, including tenant improvements and broker commissions and 2) an amount to cover the cost of re-leasing the space. The Company accounts for these fees as follows: 1) reducing the balance in unamortized leasing costs 2) a reserve to cover estimated re-leasing costs and 3) the balance (if any) as revenue. During the nine months ended September 30, 2002 and 2001, the Company collected approximately \$1.5 million and \$0.3 million respectively in lease termination fees, and recognized \$0.3 million and \$0.3 million respectively as rental income. Approximately 5% of the Company's rental revenue is subject to termination options with approximately 3% exercisable through December 2003. In general, these leases provide for termination payments should the termination option be exercised.

Property management fees are recognized in the period earned.

The Company disposed of a property in San Diego for approximately \$9 million in November 2001 and deferred a gain of \$5,366,000 which was later recognized in 2002 when the buyer of the property obtained third party financing for the property and paid off most of its note to the Company. The note receivable balance remaining as of September 30, 2002 and December 31, 2001 was \$200,000 and \$7,450,000, respectively.

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.

Until December 31, 2001, we elected to adopt the disclosure requirements of FAS 123 but continued to account for stock-based compensation under APB 25. Effective January 1, 2002, we have adopted the Fair Value Method of accounting for stock options. As required by the transition requirements of FAS 123, we will recognize compensation expense in our income statement using the Fair Value Method only with respect to stock options issued after January 1, 2002, but continue to disclose the pro-forma impact of utilizing the Fair Value Method on stock options issued prior to January 1, 2002. As a result, included in the Company's income statement for the nine months ended September 30, 2002 is approximately \$343,000 in stock option compensation expense related to options granted after January 1, 2002. With respect to stock options granted prior to December 31, 2001, the Company would have reported net income of approximately \$43,415,000 and \$36,661,000 for the nine months ended September 30, 2002 and 2001, respectively, and reported diluted earnings per share of \$1.46 and \$1.35, respectively, had we accounted for these options under FAS 123 for options granted prior to December 31, 2001.

Income taxes

The Company believes it has qualified and intends to continue to qualify as a REIT, as defined in Section 856 of the Internal Revenue Code. As a REIT, the Company is not subject to federal income tax to the extent that it distributes its taxable income to its shareholders. A REIT must distribute at least 90% of its taxable income each year. In addition, REIT's 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 organizational and operating requirements to maintain its REIT status

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during 2001 and intends to continue to meet such requirements for 2002. 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 number of weighted average common shares outstanding. "Diluted" weighted average common shares outstanding includes the dilutive effect of stock options under the treasury stock method. "Basic" weighted average common shares outstanding excludes such effect. Earnings per share have been calculated as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2002	2001	2002	2001
Net income allocable to common shareholders	\$ 9,911,000	\$ 10,010,000	\$ 32,535,000	\$ 31,130,000
Weighted average common shares outstanding:				
Basic weighted average common shares outstanding	21,552,000	22,210,000	21,548,000	22,610,000
Net effect of dilutive stock options - based on treasury stock method using average market price.....	220,000	85,000	215,000	75,000
Diluted weighted average common shares outstanding	21,772,000	22,295,000	21,763,000	22,685,000
Basic earnings per common share	\$ 0.46	\$ 0.45	\$ 1.51	\$ 1.38
Diluted earnings per common share	\$ 0.46	\$ 0.45	\$ 1.49	\$ 1.37

Reclassifications

Certain reclassifications have been made to the condensed consolidated financial statements for 2001 in order to conform to the 2002 presentation.

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3. Real estate facilities

The activity in real estate facilities for the nine months ended September 30, 2002 is as follows:

	Land	Buildings	Accumulated Depreciation	Total
Balances at December 31, 2001	\$ 287,182,000	\$ 940,868,000	\$(120,089,000)	\$1,107,961,000
Property Dispositions	(889,000)	(2,617,000)	287,000	(3,219,000)
Developed projects	7,000	2,771,000	-	2,778,000
Capital improvements	-	17,155,000	-	17,155,000
Properties held for disposition	-	(20,000)	284,000	264,000
Depreciation expense	-	-	(42,659,000)	(42,659,000)
Balances at September 30, 2002....	<u>\$ 286,300,000</u>	<u>\$ 958,157,000</u>	<u>\$(162,177,000)</u>	<u>\$1,082,280,000</u>

During the nine months ended September 30, 2002, the Company incurred \$2,778,000 in development costs.

In the fourth quarter of 2001, the Company identified two properties that did not meet the Company's ongoing investment strategy. On October 8, 2002, the Company sold one of these properties for net proceeds of \$1.8 million and a gain of approximately \$100,000 which will be recognized in the fourth quarter of 2002. The other property is currently being marketed and has been designated as a property held for disposition at September 30, 2002. The Company anticipates the net proceeds for the property currently being marketed to result in a loss of approximately \$900,000. Accordingly, it recorded an impairment charge of \$900,000 at September 30, 2002.

During the third quarter of 2002, the Company identified two additional properties that did not meet the Company's ongoing investment criteria. One property located in Overland Park, Kansas, was sold on August 26, 2002 for \$5.3 million, resulting in net proceeds of \$5.1 million and a gain of approximately \$2 million. The other property, located in Landover Maryland, was sold on October 1, 2002 for approximately \$9.6 million, generating net proceeds of \$9.5 million and a gain of approximately \$1.2 million which will be recognized in the fourth quarter of 2002.

The following summarizes the condensed results of operations of the properties held for disposition as of September 30, 2002, which are also included in the condensed consolidated statements of income:

	For the Nine Months Ended September 30,	
	2002	2001
Rental income	\$ 2,622,000	\$ 2,625,000
Cost of operations	(1,260,000)	(1,278,000)
Net operating income	<u>\$ 1,362,000</u>	<u>\$ 1,347,000</u>

The Company may, at times, bring properties to market for disposition that it may or may not ultimately sell. These properties are not included in properties held for disposition due to the probability that the disposition will not occur (see note 8).

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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, 2002 under these leases are as follows:

2002 (September – December)	\$ 45,002,000
2003.....	153,202,000
2004.....	119,297,000
2005.....	84,785,000
2006.....	51,989,000
Thereafter	82,370,000
	\$ 536,645,000

In addition to minimum rental payments, tenants pay reimbursements for their pro rata share of specified operating expenses, which amounted to \$21,028,000 and \$16,846,000 for the nine months ended September 30, 2002 and 2001, respectively. These amounts are included as rental income and cost of operations in the accompanying condensed consolidated statements of income. Leases for approximately 5% of the Company's rental revenue is subject to termination options with leases for approximately 3% of the leased square footage exercisable through December 31, 2003. In general, these leases provide for termination payments should the termination options be exercised. The above table is prepared assuming such options are not exercised.

5. Bank Loans

In October 2002, 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 1, 2005. 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 0.65% to LIBOR plus 1.25% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 0.85%). In addition, the Company is required to pay an annual commitment fee of 0.25% of the borrowing limit. The Company had drawn \$0 and \$100 million on its line of credit at September 30, 2002 and December 31, 2001, respectively.

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 1.00 and 1.75 to 1.00, respectively, (iii) maintain a minimum total shareholders' equity (as defined) and (iv) limit distributions to 95% of funds from operations (as defined) for any four consecutive quarters. In addition, the Company is limited in its ability to incur additional borrowings (the Company is required to maintain unencumbered assets with an aggregate book value equal to or greater than two times the Company's unsecured recourse debt) or sell assets. The Company was in compliance with the covenants of the Credit Facility at September 30, 2002.

In February 2002, the Company entered into a seven year \$50 million unsecured term note agreement with Fleet National Bank. The note bears interest at LIBOR plus 1.45% per annum and is due on February 20, 2009. The Company paid a one-time facility fee of 0.35% or \$175,000 for the loan. The Company used the proceeds from the loan to reduce the amount drawn on the Credit Facility. During July, 2002, the Company entered into an

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interest rate swap transaction which resulted in a fixed rate for the term loan through July, 2004 at 4.46% per annum.

The unsecured note requires the Company to meet covenants that are substantially the same as the covenants in the Credit Facility. The Company was in compliance with the note covenants at September 30, 2002.

6. Mortgage notes payable

Mortgage notes consist of the following:	September 30, 2002	December 31, 2001
7.050% mortgage note, principal and interest payable monthly, due May 2006.....	\$ 8,218,000	\$ 8,374,000
8.190% mortgage note, principal and interest payable monthly, due March 2007.....	6,123,000	6,283,000
7.290% mortgage note, principal and interest payable monthly, due February 2009.....	6,078,000	6,164,000
7.280% mortgage note, principal and interest payable monthly, due February 2003.....	3,957,000	4,059,000
8.000% mortgage note, principal and interest payable monthly, due April 2003.....	1,856,000	1,930,000
8.500% mortgage note, principal and interest payable monthly, due July 2007	-	1,797,000
8.000% mortgage note, principal and interest payable monthly, due April 2003.....	1,488,000	1,538,000
	\$27,720,000	\$30,145,000

At September 30, 2002, approximate principal maturities of mortgage notes payable are as follows:

2002 (October - December).....	\$ 216,000
2003.....	7,811,000
2004.....	631,000
2005.....	680,000
2006.....	7,890,000
Thereafter	10,492,000
	\$ 27,720,000

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7. Minority interests

Common partnership 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 consolidated financial statements. Minority interest in income consists of the minority interests' share of the 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, or 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, 2002, there were 7,305,355 common units owned by PSI and affiliated entities and which are accounted for as minority interests. On a fully converted basis, assuming all 7,305,355 minority interest common units were converted into shares of common stock of PSB at September 30, 2002, the minority interest units would convert into approximately 25% of the common shares outstanding. At the end of each reporting period, the Company 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.

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Preferred partnership units

Through the Operating Partnership, the Company has issued the following preferred units in separate private placement transactions:

Date of Issuance	Series	Number of Units	Face Value	Preferred Distribution Rate
April, 1999	Series B	510	\$ 12,750,000	8 7/8%
September, 1999	Series C	3,200	80,000,000	8 3/4%
September, 2001	Series E	2,120	53,000,000	9 1/4%
September, 1999	Series X	1,600	40,000,000	8 7/8%
July, 2000	Series Y	480	12,000,000	8 7/8%
		<u>7,910</u>	<u>\$ 197,750,000</u>	

The Operating Partnership has the right to redeem preferred units on or after the fifth anniversary of the applicable 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 a majority of the holders of the respective preferred units. The Cumulative Redeemable Preferred Stock will have the same distribution rate and par value as the corresponding preferred units and will otherwise have equivalent terms to the other series of preferred stock described in Note 9.

8. Property management contracts

The Operating Partnership manages industrial, office and retail facilities for PSI and affiliated entities. These facilities, all located in the United States, operate under the "Public Storage" or "PS Business Parks" names. In addition, the Operating Partnership manages properties for third party owners and a joint venture.

The property management contracts provide for compensation of a percentage of the gross revenues 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 and leasing, billing and maintenance personnel.

The property management contract with PSI is for a seven year term with the term being automatically extended one year on each anniversary. At any time, either party may notify the other that the contract is not to be extended, in which case the contract will expire on the first anniversary of its then scheduled expiration date. The property management contracts with affiliates of PSI are cancelable by the affiliates upon sixty days notice and by the Operating Partnership upon seven years notice.

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9. Shareholders' equity

Preferred stock

The Company issued the following series of preferred stock in separate public offerings:

Date of Issuance	Series	Number of Units	Face Value	Preferred Distribution Rate
April, 1999	Series A	2,198	\$ 54,962,500	9 1/4%
May and June, 2001	Series D	2,640	65,987,500	9 1/2%
January, 2002	Series F	2,000	50,000,000	8 3/4%
		<u>6,838</u>	<u>\$ 170,950,000</u>	

Holders 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, 2002, 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 the following dates: Series A - April 30, 2004, Series D - May 10, 2006 and Series F - January 28, 2007. On or after the respective dates, the respective series of 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 may re-purchase shares of its preferred stock from time to time on the open market in separately negotiated transactions. During the quarter ended June 30, 2002, the Company repurchased 500 shares of Series D preferred stock with a face value of \$12,500 for \$12,823 or \$25.65 per share. During the quarter ended September 30, 2002, the Company repurchased 1,500 shares of Series A preferred stock with a face value of \$37,500 for \$38,266 or \$25.51 per share.

The Company paid \$11,483,000 and \$6,014,000 in distributions to its preferred shareholders for the nine months ended September 30, 2002 and 2001, respectively.

Common Stock

The Company's Board of Directors has authorized the repurchase from time to time of up to 4,500,000 shares of the Company's common stock on the open market or in privately negotiated transactions. For the nine months ended September 30, 2002, the Company has not repurchased any common stock. Since the inception of the program (March 2000), the Company has repurchased an aggregate total of 2,321,711 shares of common stock at an aggregate cost of approximately \$60.5 million (average cost of \$26.06 per share).

The Company paid \$18,748,000 (\$0.87 per common share) and \$19,550,000 (\$0.87 per common share) in distributions to its common shareholders for the nine months ended September 30, 2002 and 2001, respectively. Pursuant to restrictions imposed by the Credit Facility, distributions may not exceed 95% of funds from operations, as defined, for any four consecutive quarters.

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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 give 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 October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement addresses financial accounting and reporting for the disposal of long-lived assets and becomes effective for financial statements issued for fiscal years beginning after December 15, 2001. The Company adopted SFAS No. 144 on January 1, 2002 and its adoption resulted in the classification of results of operations of certain assets disposed of or held for sale to be reclassified as discontinued operations.

11. Commitments and contingencies

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

The Company acquired a property in Beaverton, Oregon ("Creekside Corporate Park") in May 1998. A portion of Creekside Corporate Park, as well as properties adjacent to Creekside Corporate Park, were the subject of an environmental investigation conducted by two current and past owner/operators of an industrial facility on adjacent property, pursuant to a Consent Decree issued by the Oregon Department of Environmental Quality ("ODEQ"). Results of that investigation indicate that the contamination from the industrial facility has migrated onto portions of Creekside Corporate Park owned by the Company. There is no evidence that the Company's 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, nor has the ODEQ alleged any such contribution.

The Company, which is not a party to the Consent Decree, executed separate Access Agreements with the two owner/operators to allow access to portions of Creekside Corporate Park to conduct the required sampling and testing, and to permit one of the owner/operators subject to the Consent Decree to construct, install and operate a groundwater treatment system on a portion of Creekside Corporate Park owned by the Company. Operation and maintenance of this groundwater treatment system, which is required by the Interim Remedial Action Plan approved by ODEQ, is the sole responsibility of the owner/operator, and not the Company.

Based on the remedial investigation/feasibility study, ODEQ has selected a final remedy that would include permanent treatment of contaminants in the groundwater, including expanded groundwater extraction and treatment on all parcels of the former industrial property, including portions of Creekside Corporate Park. The estimated cost of this remedy is \$2.8 million over a 30-year time period.

ODEQ has commenced negotiations with the two owner/operators and the Company, along with other similarly situated owners of property adjacent to the industrial facility, to reach a settlement pursuant to which the selected remedy be implemented. It is possible that the ODEQ could require the Company to participate in the implementation of removal or remedial actions that may be required on the Company's property, or to pay a portion of the costs to do so. One of the two owner/operators that conducted the investigation filed for Chapter

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11 bankruptcy protection. It is not clear at this point what impact, if any, this filing will have on the negotiations regarding remedy implementation.

In the event the Company is ultimately deemed responsible for any costs relating to this matter, the Company believes that it may have recourse against the party from whom the property was purchased. In addition, the Company believes it may have recourse against other potentially responsible parties, including, but not limited to, one or both of the owner/operators of the adjacent industrial facility. Based on recent discussions with the ODEQ and other potentially responsible parties, the Company has estimated its share of the costs of the remediation at \$250,000. The Company has accrued these estimated costs and included the expense in general and administrative costs.

Although environmental investigations conducted to date on other properties owned by the Company have not revealed any environmental liability that the Company believes would have a material adverse effect on the Company's business, assets or results of operations, and the Company is not aware of any such liability, it is possible that these investigations did not reveal all environmental liabilities or that there are material environmental liabilities of which the Company is unaware. No assurances can be given that (i) future laws, ordinances, or regulations will not impose any material environmental liability, or (ii) the current environmental condition of the Company's properties has not been, or will not be, affected by tenants and occupants of the Company's properties, by the condition of properties in the vicinity of the Company's properties, or by third parties unrelated to the Company.

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. Management believes that the environmental issues will not have a material adverse impact on the Company's condensed consolidated financial position or results of operations.

12. Subsequent Event

During October, 2002, the Operating Partnership completed a private placement of 800,000 preferred units with a preferred distribution rate of 7.95%. The net proceeds from the placement of preferred units were approximately \$19.5 million.

In October 2002, 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 1, 2005. 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 LIBOR plus 1.25% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 0.85%). In addition, the Company is required to pay an annual commitment fee of up to 0.25% of the borrowing limit. In connection with the extension, the Company paid Wells Fargo Bank a one-time fee of \$320,000. The Company had drawn \$0 and \$100 million on its line of credit at September 30, 2002 and December 31, 2001, respectively.

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

Forward-Looking Statements: Forward-looking statements are made throughout this Quarterly Report on Form 10-Q. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects," "seeks," "estimates," and similar expressions are intended to identify forward-looking statements. There are a number of important factors that could cause the results of the Company to differ materially from those indicated by such forward-looking statements, including those detailed under the heading "Item 2A. Risk Factors." In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. Moreover, we assume no obligation to update these forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

Overview

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

Revenue Recognition: We recognize revenue in accordance with Staff Accounting Bulletin No. 101 of the Securities and Exchange Commission, Revenue Recognition in Financial Statements (SAB 101), as amended. SAB 101 requires that four basic criteria must be met before revenue can be recognized. The criteria is that persuasive evidence of an arrangement exists, the delivery has occurred or services rendered, the fee is fixed and determinable and collectibility is reasonably assured.

Allowance for Doubtful Accounts: Rental revenue from our tenants is our principal source of revenue. We monitor the collectibility of our receivable balances including the deferred rent receivable on an on-going basis. Based on these reviews, we establish a provision, and maintain an allowance, for doubtful accounts for estimated losses resulting from the possible inability of our tenants to make required rent payments to us. An allowance for doubtful accounts is recorded during each period and is netted against rental revenue in our consolidated statements of operations. The allowance for doubtful accounts, which represents the cumulative allowances less write-offs of uncollectible rent, is netted against tenant and other receivables on our consolidated balance sheets. If we incorrectly determine the collectibility of our revenue, the timing and amount of our reported revenue could be affected.

Impairment of Long-Lived Assets: We are required to record at fair value any of our long-lived assets that we have determined to be permanently impaired. Our long-lived assets consist primarily of our investments in real estate. The fair value of our investments in real estate depends on the future cash flows from operations of the properties. If the estimated future cash flow of the property results in a determination that the fair value is less than our carrying value, an impairment may be recognized if we determine the loss to be permanent. As of September 30, 2002, the Company does not consider any of its long-lived assets included in continuing operations to be impaired. The Company has recognized an impairment loss of \$900,000 on one of its properties held for sale because the net proceeds from sale is expected to be less than the carrying value. An impairment loss could have a material adverse impact on our financial condition and results of operations.

Depreciation: We compute depreciation on our buildings and equipment using the straight-line method based on estimated useful lives of generally 30 and 5 years. A significant portion of the acquisition cost of each property is allocated to building and building components (usually 80-85%). The allocation of the acquisition cost to building and its components and the determination of the useful life are based on

management's estimates. If we do not allocate appropriately to building or related components or incorrectly estimate the useful life of our properties, the timing and/or the amount of depreciation expense will be affected. In addition, the net book value of real estate assets could be over or understated. The statement of cash flows, however, would not be affected.

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

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

Qualification as a REIT – Income Tax Expense: We believe that we have been organized and operated, and we intend to continue to operate, as a qualifying REIT under the Internal Revenue Code and applicable state laws. A qualifying REIT generally does not pay corporate level income taxes on its taxable income that is distributed to its shareholders, and accordingly, we do not pay or record as an expense income tax on the share of our taxable income that is distributed to shareholders.

Given the complex nature of the REIT qualification requirements, the ongoing importance of factual determinations and the possibility of future changes in our circumstances, we cannot provide any assurance that we actually have satisfied or will satisfy the requirements for taxation as a REIT for any particular taxable year. For any taxable year that we fail or failed to qualify as a REIT and applicable relief provisions did not apply, we would be taxed at the regular corporate rates on all of our taxable income, whether or not we made or make any distributions to our shareholders. Any resulting requirement to pay corporate income tax, including any applicable penalties or interest, could have a material adverse impact on our financial condition or results of operations. Unless entitled to relief under specific statutory provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year during which qualifications was lost. There can be no assurance that we would be entitled to any statutory relief.

Effect of Economic Conditions on the Company's Operations: During 2001 and continuing into 2002, the Company has been affected by the slowdown in economic activity in the United States in most of its primary markets. These effects were exacerbated by the terrorist attacks of September 11, 2001 and the related aftermath. These effects include a decline in occupancy rates, a reduction in market rental rates throughout the portfolio, slower than expected lease-up of the Company's development properties, increased tenant defaults and the termination of leases pursuant to early termination options.

The reduction in occupancies and market rental rates has been the result of several factors related to general economic conditions. There are more businesses contracting than expanding, more businesses failing than starting-up and general uncertainty for businesses, resulting in slower decision-making and requests for shorter-term leases. There is also more competing vacant space, including substantial amounts of sub-lease space, in many of the Company's markets. Many of the Company's properties have lower vacancy rates than the average rates for the markets in which they are located; consequently, the Company may have difficulty in maintaining its occupancy rates as leases expire. An extended economic slowdown will put additional downward pressure on occupancies and market rental rates. The economic slowdown and the abundance of space alternatives available to customers has led to pressure for greater rent concessions, more generous tenant improvement allowances and higher broker commissions.

These economic conditions have also resulted in the erosion of tenant credit quality throughout the portfolio. As a result, more tenants are contacting us regarding their economic viability, including those that could be material to our revenue base and more tenants are electing to terminate their leases early under lease termination options. To a certain extent, these economic conditions have affected two of our largest tenants representing a combined 2% of the Company's revenues. Leases with Worldcom and two related entities generate 0.9% of the Company's revenues. Worldcom's recent bankruptcy may adversely affect the continuity of that revenue. Another large tenant representing approximately 1% of revenues has recently defaulted on its lease obligations and has requested a modification of its lease. The Company is currently negotiating with the tenant to resolve the matter and the outcome is unknown. Several other of our large tenants have contacted us, requesting early termination of their lease, rent reduction in space under lease, rent deferment or abatement. At this time, the Company cannot anticipate what impact, if any, the ultimate outcome of these discussions will have on our operating results.

The Company's two development properties were 57% leased in the aggregate as of September 30, 2002, but they have not been leased as rapidly as the Company had anticipated. The development properties consist of a 141,000 square foot flex development in Northern Virginia that was 80% leased, and a 97,000 square foot development in the Beaverton submarket of Portland, Oregon that was 26% leased.

Growth of the Company's Operations: During 2001 and continuing into 2002, the Company focused on maximizing cash flow from its existing core portfolio of properties, seeking to expand its presence in existing markets through strategic acquisitions and developments and strengthening its balance sheet, primarily through the issuance of preferred stock/units. The Company has historically maintained low debt and overall leverage levels, including preferred stock/units, which should give it the flexibility for future growth without the issuance of additional common stock.

During the nine months ended September 30, 2002, the Company did not complete any acquisitions. The Company plans to continue to seek to build its presence in existing markets by acquiring high quality facilities in selected markets. The Company targets properties with below market rents which may offer it growth in rental rates above market averages and which offer the Company the ability to achieve economies of scale resulting in more efficient operations.

During the third quarter of 2002, one property located in Overland Park, Kansas totaling 62,000 square feet was sold on August 26, 2002 for \$5.3 million resulting in net proceeds of \$5.1 million and a gain of approximately \$2 million for financial accounting purposes. This was the Company's only facility in Kansas.

During October, 2002, the Company sold a property located in Landover, Maryland totaling 125,000 square feet. The property was sold for approximately \$9.6 million generating net proceeds of \$9.5 million and a gain of approximately \$1.2 million for financial accounting purposes which will be recognized in the fourth quarter of 2002. In addition, the Company sold a property located in San Antonio, Texas totaling 43,000 square feet. The property was sold for approximately \$2 million generating net proceeds of \$1.8 million and a gain of approximately \$100,000 for financial accounting purposes which will be recognized in the fourth quarter of 2002.

During 2001, the Company added approximately 2.2 million square feet of space to its portfolio at an aggregate cost of approximately \$303 million. These acquisitions increased the Company's presence in its existing markets. The Company acquired 658,000 square feet in Northern Virginia for approximately \$88 million, 685,000 square feet in Oregon for approximately \$88 million and 905,000 square feet in Maryland for approximately \$127 million. In addition, the Company completed development of three properties totaling 339,000 square feet in Northern Virginia, Portland and Dallas for approximately \$28.5 million. The Company also disposed of a property aggregating 77,000 square feet for approximately \$9 million. The Company also formed a joint venture to own and operate an industrial park. This park, consisting of 294,000 square feet, was acquired in December 2000 at a cost of approximately \$14.4 million and was contributed to the joint venture at its original cost for a 25% equity interest in the joint venture.

Results of Operations

Results of Operations: Net income for the three months ended September 30, 2002 was \$13,844,000 compared to \$12,849,000 for the same period in 2001. Net income allocable to common shareholders (net income less preferred stock dividends) for the three months ended September 30, 2002 was \$9,911,000 compared to \$10,010,000 for the same period in 2001. Net income per common share on a diluted basis was \$0.46 for the three months ended September 30, 2002 compared to \$0.45 for the same period in 2001 (based on weighted average diluted common shares outstanding of 21,772,000 and 22,295,000 at September 30, 2002 and 2001, respectively). Net income per common share, excluding income from discontinued operations and properties held for sale, was \$0.43 on both a basic and diluted basis for the three months ended September 30, 2002 compared to \$0.43 basic and \$0.42 diluted for the same period in 2001. The increase was due to gains on disposition of assets offset by an increase in depreciation expense as a result of property acquisitions in 2001 and an impairment charge for a property held for sale.

Net income for the nine months ended September 30, 2002 was \$44,018,000 compared to \$37,144,000 for the same period in 2001. Net income allocable to common shareholders (net income less preferred stock dividends) for the nine months ended September 30, 2002 was \$32,535,000 compared to \$31,130,000 for the same period in 2001. Net income per common share on a diluted basis was \$1.49 for the nine months ended September 30, 2002 compared to \$1.37 for the same period in 2001 (based on weighted average diluted common shares outstanding of 21,763,000 and 22,685,000, respectively). Net income per common share, excluding income from discontinued operations and properties held for sale, was \$1.43 basic or \$1.42 on a diluted basis for the nine months ended September 30, 2002 compared to \$1.30 basic and diluted for the same period in 2001. Net income allocable to common shareholders for the first nine months of 2002 included recognizing gains on dispositions of properties totaling \$7.4 million or \$0.26 per share, the Company's share of gains on disposition of four buildings in its joint venture of \$265,000 or approximately \$0.01 per share and a \$900,000 impairment charge or approximately \$0.03 per share, for one of its properties held for sale that was determined to have a carrying value greater than its anticipated sales price. The net income per diluted share before the recognition of these gains on dispositions and impairment charges was \$1.26 or \$0.11 less than the same period in 2001. The decrease was the result of an increase in depreciation expense as a result of property acquisitions in 2001, offset partially by the net operating income from the acquired properties, net of financing costs.

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:

	Three Months Ended September 30,		Change
	2002	2001	
Rental income:			
“Same Park” facilities (11.8 million net rentable square feet)	\$37,825,000	\$37,521,000	0.8%
Other facilities (3.0 million net rentable square feet)	11,653,000	4,709,000	147.5%
Total rental income	<u>\$49,478,000</u>	<u>\$42,230,000</u>	17.2%
Cost of operations (excluding depreciation):			
“Same Park” facilities	\$10,053,000	\$10,090,000	(0.4%)
Other facilities	2,900,000	1,398,000	107.4%
Total cost of operations	<u>\$12,953,000</u>	<u>\$11,488,000</u>	12.8%
Net operating income (rental income less cost of operations):			
“Same Park” facilities	\$27,772,000	\$27,431,000	1.2%
Other facilities	8,753,000	3,311,000	164.4%
Total net operating income	<u>\$36,525,000</u>	<u>\$30,742,000</u>	18.8%
	Nine Months Ended September 30,		Change
	2002	2001	
Rental income:			
“Same Park” facilities (11.8 million net rentable square feet)	\$114,049,000	\$111,675,000	2.1%
Other facilities (3.0 million net rentable square feet)	34,583,000	7,076,000	388.7%
Total rental income	<u>\$148,632,000</u>	<u>\$118,751,000</u>	25.2%
Cost of operations (excluding depreciation):			
“Same Park” facilities	\$29,974,000	\$29,004,000	3.3%
Other facilities	9,422,000	2,346,000	301.6%
Total cost of operations	<u>\$39,396,000</u>	<u>\$31,350,000</u>	25.7%
Net operating income (rental income less cost of operations):			
“Same Park” facilities	\$84,075,000	\$82,671,000	1.7%
Other facilities	25,161,000	4,730,000	431.9%
Total net operating income	<u>\$109,236,000</u>	<u>\$87,401,000</u>	25.0%

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, 2002 by major geographic region below:

Region	Square Footage	Percent of Total	Rental Income	Percent of Total	NOI	Percent of Total
Southern California	3,176,000	21.5%	\$10,642,000	21.5%	\$8,114,000	22.2%
Northern California	1,495,000	10.1%	5,383,000	10.9%	4,235,000	11.6%
Southern Texas	1,032,000	7.0%	2,244,000	4.5%	1,530,000	4.2%
Northern Texas	1,951,000	13.2%	5,197,000	10.5%	3,522,000	9.6%
Virginia	2,621,000	17.8%	9,884,000	20.0%	7,109,000	19.5%
Maryland	1,771,000	12.0%	6,854,000	13.9%	4,988,000	13.7%
Oregon	1,973,000	13.4%	7,593,000	15.3%	6,141,000	16.8%
Other	736,000	5.0%	1,681,000	3.4%	886,000	2.4%
	<u>14,755,000</u>	<u>100.0%</u>	<u>\$49,478,000</u>	<u>100.0%</u>	<u>\$36,525,000</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, 2002 by major geographic region below:

Region	Square Footage	Percent of Total	Rental Income	Percent of Total	NOI	Percent of Total
Southern California	3,176,000	21.5%	\$32,151,000	21.6%	\$24,435,000	22.4%
Northern California	1,495,000	10.1%	15,946,000	10.7%	12,452,000	11.4%
Southern Texas	1,032,000	7.0%	6,826,000	4.6%	4,452,000	4.1%
Northern Texas	1,951,000	13.2%	16,056,000	10.8%	11,273,000	10.3%
Virginia	2,621,000	17.8%	29,760,000	20.0%	21,151,000	19.4%
Maryland	1,771,000	12.0%	19,930,000	13.4%	14,497,000	13.3%
Oregon	1,973,000	13.4%	22,938,000	15.4%	18,218,000	16.7%
Other	736,000	5.0%	5,025,000	3.5%	2,758,000	2.4%
	<u>14,755,000</u>	<u>100.0%</u>	<u>\$148,632,000</u>	<u>100.0%</u>	<u>\$109,236,000</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 properties constituting 11.8 million net rentable square feet ("Same Park" facilities). The Company currently has an ownership interest in these properties and has owned and operated them for the comparable periods. These properties do not include properties that have been acquired or sold during 2001 and 2002. The "Same Park" facilities represent approximately 80% of the weighted average square footage of the Company's portfolio at September 30, 2002.

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

"Same Park" Facilities (11.8 million square feet)

	Three Months Ended September 30,		Change
	2002	2001	
Rental income ⁽¹⁾	\$ 37,411,000	\$ 37,265,000	0.4%
Cost of operations	10,053,000	10,090,000	(0.4%)
Net operating income.....	<u>\$ 27,358,000</u>	<u>\$ 27,175,000</u>	0.7%
Gross margin ⁽²⁾	73.1%	72.9%	0.2%
<u>Weighted average for period:</u>			
Occupancy.....	93.9%	95.6%	(1.7%)
Annualized realized rent per occupied sq. ft. ⁽³⁾	\$13.46	\$13.17	2.2%

	Nine Months Ended September 30,		Change
	2002	2001	
Rental income ⁽¹⁾	\$112,301,000	\$110,574,000	1.6%
Cost of operations	29,974,000	29,004,000	3.3%
Net operating income.....	<u>\$ 82,327,000</u>	<u>\$ 81,570,000</u>	0.9%
Gross margin ⁽²⁾	73.3%	73.8%	(0.5%)
<u>Weighted average for period:</u>			
Occupancy.....	94.6%	96.1%	(1.5%)
Annualized realized rent per occupied sq. ft. ⁽³⁾	\$13.36	\$12.96	3.1%

(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, 2002 and 2001:

Region	Revenues 2002	Revenues 2001	Increase (Decrease)	NOI 2002	NOI 2001	Increase (Decrease)
Southern California....	\$10,529,000	\$10,435,000	0.9%	\$7,934,000	\$7,916,000	0.2%
Northern California....	5,325,000	4,983,000	6.9%	4,148,000	3,742,000	10.8%
Southern Texas	2,220,000	2,300,000	(3.5%)	1,488,000	1,480,000	0.5%
Northern Texas	4,755,000	4,790,000	(0.7%)	3,147,000	3,183,000	(1.1%)
Virginia.....	6,130,000	6,376,000	(3.9%)	4,346,000	4,573,000	(5.0%)
Maryland.....	2,144,000	2,190,000	(2.1%)	1,654,000	1,678,000	(1.4%)
Oregon.....	4,645,000	4,575,000	1.5%	3,797,000	3,798,000	0.0%
Other.....	1,663,000	1,616,000	3.0%	844,000	805,000	4.8%
	<u>\$37,411,000</u>	<u>\$37,265,000</u>	0.4%	<u>\$27,358,000</u>	<u>\$27,175,000</u>	0.7%

The increases noted above reflect the performance of the Company's existing markets. Northern California benefited from strong results in the Sacramento portfolio combined with the renewals in 2001 of our three largest leases in Northern California. Decreases reflected above were primarily due to declining occupancy levels and declining rental rates. Southern Texas continued to experience declines in occupancy. The decrease in Virginia is primarily the result of a building leased to the U.S. Government that was not paying rent until October 2002. In addition, vacancy rates increased and rents decreased in Virginia due to the softness in the Herndon and Chantilly submarkets. Total revenues include rental income that was determined to be uncollectible and was written-off in the amount of \$106,000 and \$101,000 for the three months ended September 30, 2002 and 2001, respectively.

The following tables summarize the "Same Park" operating results by major geographic region for the nine months ended September 30, 2002 and 2001:

Region	Revenues 2002	Revenues 2001	Increase (Decrease)	NOI 2002	NOI 2001	Increase (Decrease)
Southern California....	\$31,787,000	\$30,647,000	3.7%	\$24,049,000	\$23,193,000	3.7%
Northern California....	15,630,000	14,336,000	9.0%	12,130,000	10,910,000	11.2%
Southern Texas	6,728,000	7,053,000	(4.6%)	4,365,000	4,693,000	(7.0%)
Northern Texas	14,325,000	14,087,000	1.7%	9,838,000	9,679,000	1.6%
Virginia.....	18,398,000	19,345,000	(4.9%)	12,836,000	14,129,000	(9.2%)
Maryland.....	6,299,000	6,496,000	(3.0%)	4,919,000	4,962,000	(0.9%)
Oregon.....	14,172,000	13,612,000	4.1%	11,503,000	11,126,000	3.4%
Other.....	4,962,000	4,998,000	(0.7%)	2,687,000	2,878,000	(6.6%)
	<u>\$112,301,000</u>	<u>\$110,574,000</u>	1.6%	<u>\$82,327,000</u>	<u>\$81,570,000</u>	0.9%

The increases noted above reflect the performance of the Company's existing markets. Northern California benefited from strong results in the Sacramento portfolio combined with the renewals in 2001 of our three largest leases in Northern California. Decreases reflected above were primarily due to declining occupancy levels and declining rental rates. Southern Texas continued to experience declines in occupancy. The decrease in Virginia is primarily the result of a building leased to the U.S. Government that was not paying rent until October 2002. In addition, vacancy rates increased and rents decreased in Virginia due to the softness in the Herndon and Chantilly submarkets. The substantial decline in NOI from our peripheral markets is primarily the result of the timing of certain expenses during the first quarter. Total revenues include rental income that was determined to be

uncollectible and was written-off in the amount of \$389,000 and \$328,000 for the nine months ended September 30, 2002 and 2001, respectively.

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, 2002, \$147,000 in net operating income was recognized from facility management operations compared to \$132,000 for the same period in 2001. During the nine months ended September 30, 2002, the Company generated net operating income of \$443,000 compared to \$388,000 for the same period in 2001. Facility management fees have increased due primarily to additional properties brought under management.

Business Services: Business services include construction management fees and fees from telecommunications service providers. During the three months ended September 30, 2002, Business Services generated a net operating loss of \$64,000 compared to a net operating loss of \$72,000 for the same period in 2001. During the nine months ended September 30, 2002, Business Services generated a net operating loss of \$283,000 compared to net operating loss of \$152,000 for the same period in 2001. Business services revenue has declined primarily due to the bankruptcies of Darwin Networks, Winstar and Teligent, telecommunication service providers.

Interest and Other Income: Interest and other income reflects earnings on cash balances and dividends on marketable securities. Interest income was \$47,000 for the three months ended September 30, 2002 compared to \$346,000 for the same period in 2001. Interest income was \$643,000 for the nine months ended September 30, 2002 compared to \$1,659,000 for the same period in 2001. The decrease is attributable to lower average cash balances and interest rates. Average cash balances and effective interest rates for the three months ended September 30, 2002 were approximately \$10 million and 2.0% compared to \$39 million and 3.5% for the same period in 2001. Average cash balances and effective interest rates for the nine months ended September 30, 2002 were approximately \$20 million and 2.1% compared to \$51 million and 4.4% for the same period in 2001.

Cost of Operations: Cost of operations for the three months ended September 30, 2002 was \$12,953,000 compared to \$11,488,000 for the same period in 2001. Cost of operations for the nine months ended September 30, 2002 was \$39,396,000 compared to \$31,350,000 for the same period in 2001. The increase is due primarily to the growth in the square footage of the Company's portfolio of properties. Costs of operations for those properties in our "Same Park" facilities decreased 0.4% for the three months ended September 30, 2002 and increased 3.3% for the nine months ended September 30, 2002. Cost of operations as a percentage of rental income for the nine months ended September 30, 2002 was fairly consistent at 26.5% compared to 26.4% for the same period in 2001.

Depreciation and Amortization Expense: Depreciation and amortization expense for the three months ended September 30, 2002 was \$14,595,000 compared to \$10,679,000 for the same period in 2001. Depreciation and amortization expense for the nine months ended September 30, 2001 was \$42,885,000 compared to \$30,058,000 for the same period in 2001. The increase is primarily due to depreciation expense on real estate facilities acquired or developed during 2001.

General and Administrative Expense: General and administrative expense was \$1,194,000 for the three months ended September 30, 2002 compared to \$1,037,000 for the same period in 2001. General and administrative expense was \$3,398,000 for the nine months ended September 30, 2002 compared to \$3,157,000 for the same period in 2001. Included in general and administrative costs are acquisition costs. Acquisition expenses were \$102,000 and \$136,000 for the three months ended September 30, 2002 and 2001, respectively. Acquisition expenses were \$416,000 and \$453,000 for the nine months ended September 30, 2002 and 2001, respectively. In addition, general and administrative expenses also includes approximately \$343,000 in stock option compensation expense for the nine months ended September 30, 2002 related to stock options granted after January 1, 2002.

Interest Expense: Interest expense was \$1,115,000 for the three months ended September 30, 2002 compared to \$538,000 for the same period in 2001. Interest expense was \$4,098,000 for the nine months ended

September 30, 2002 compared to \$932,000 for the same period in 2001. The increase is primarily attributable to increased debt balances in 2002 due to the use of the Company's credit facilities to fund acquisitions completed during the fourth quarter of 2001. Interest expense of \$0 and \$103,000 was capitalized as part of building costs associated with properties under development during the three months ended September 30, 2002 and 2001, respectively. Interest expense of \$288,000 and \$1,001,000 was capitalized as part of building costs associated with properties under development during the nine months ended September 30, 2002 and 2001, respectively. As of September 30, 2002, all developed properties had been shell complete for at least one year. The Company has, therefore, discontinued capitalization of interest on these facilities.

Gain on Disposition of Real Estate: Gain on sale of real estate was \$7,407,000 for the nine months ended September 30, 2002. The gain primarily results from the Company's disposal of a property in San Diego for approximately \$9 million in November 2001 and deferral of gain of \$5,366,000 which was later recognized in the first quarter of 2002 when the buyer of the property obtained third party financing for the property and paid off most of its note to the Company. In addition, the Company sold a property located in Overland Park, Kansas for approximately \$5.3 million, resulting in a gain of approximately \$2 million.

Gain on Investment in Marketable Securities: Gain on investments in marketable securities was \$41,000 for the nine months ended September 30, 2002 compared to \$15,000 for the same period in 2001.

Impairment Charge on Property Held for Sale: The Company has recognized an impairment loss of \$900,000 in the third quarter of 2002 on one of its properties held for sale because the net proceeds from the sale are expected to be less than the carrying value.

Minority Interest in Income: Minority interest in income reflects the income allocable to equity interests in the Operating Partnership that are not owned by the Company. Minority interest in income was \$7,768,000 (\$4,412,000 allocated to preferred unitholders and \$3,356,000 allocated to common unitholders) for the three months ended September 30, 2002 compared to \$6,591,000 (\$3,323,000 allocated to preferred unitholders and \$3,268,000 allocated to common unitholders) for the same period in 2001. Minority interest income for the nine months ended September 30, 2001 was \$24,256,000 (\$13,237,000 allocated to preferred unitholders and \$11,019,000 allocated to common unitholders) compared to \$19,743,000 (\$9,696,000 allocated to preferred unitholders and \$10,047,000 allocated to common unitholders) for the same period in 2001. The increase in minority interest in income is due primarily to the issuance of preferred operating partnership units during 2001 and higher earnings at the Operating Partnership level.

Liquidity and Capital Resources

Net cash provided by operating activities for the nine months ended September 30, 2002 and 2001 was \$97,784,000 and \$92,107,000, respectively. Management believes that the Company's internally generated net cash provided by operating activities will continue to be sufficient to enable it to meet its operating expenses, capital improvements and debt service requirements and to maintain the current level of distributions to shareholders.

The following table summarizes the Company's cash flow from operating activities:

	Nine Months Ended September 30,	
	2002	2001
Net income	\$44,018,000	\$37,144,000
Gain on sale of marketable securities	(41,000)	(15,000)
Gain on disposal of properties	(7,407,000)	-
Gain on disposition of joint venture properties.....	(265,000)	-
Stock option expense and stock bonuses	358,000	-
Impairment charge on property held for sale	900,000	-
Depreciation and amortization.....	42,885,000	30,058,000
Minority interest in income.....	24,256,000	19,743,000
Change in working capital	(6,920,000)	5,177,000
Net cash provided by operating activities	<u>97,784,000</u>	<u>92,107,000</u>
Maintenance capital expenditures.....	(3,508,000)	(2,589,000)
Tenant improvements	(7,313,000)	(3,091,000)
Capitalized lease commissions	<u>(2,861,000)</u>	<u>(1,666,000)</u>
Funds available for distributions to shareholders, minority interests, acquisitions and other corporate purposes	84,102,000	84,761,000
Cash distributions to shareholders and minority interests.....	<u>(54,149,000)</u>	<u>(41,616,000)</u>
Excess funds available for principal payments on debt, investments in real estate and other corporate purposes	<u>\$ 29,953,000</u>	<u>\$ 43,145,000</u>

The Company's capital structure is characterized by a relatively low level of leverage. As of September 30, 2002, the Company had six fixed rate mortgage notes payable totaling \$27,720,000, which represented 1.9% of its total capitalization (based on book value, including minority interest and debt). The weighted average interest rate for the mortgage notes is 7.50% per annum.

The Company used its short-term borrowing capacity to complete acquisitions totaling \$303 million in 2001. The Company borrowed \$100 million from its line of credit and \$35 million from PSI. The remaining balance was funded from proceeds of the issuance of preferred stock and preferred units in the Operating Partnership totaling \$116 million and existing cash of \$52 million. During January 2002, the Company issued 2,000,000 depositary shares, each representing 1/1,000 of a share of 8 ¾% Cumulative Preferred Stock, Series F, resulting in net proceeds of \$48.3 million. This was used to repay PSI and to increase financial flexibility.

In February 2002, the Company entered into a seven year \$50 million term loan agreement with Fleet National Bank. The note bears interest at LIBOR plus 1.45% and is due on February 20, 2009. The Company paid a one-time fee of 0.35% or \$175,000 for the facility. The Company used the proceeds of the loan to reduce the

amount drawn on its Credit Facility with Wells Fargo Bank. In July, 2002, the Company entered into an interest rate swap transaction which had the effect of fixing the rate on the term loan for two years at 4.46% per annum.

During October, 2002, the Operating Partnership completed a private placement of 800,000 preferred units with a preferred distribution rate of 7.95%. The net proceeds from the placement of preferred units were approximately \$19.5 million.

The Company's funding strategy is to use permanent capital, including common and preferred stock, and internally generated retained cash flows. In addition, the Company may sell properties that no longer meet its investment criteria. The Company may finance acquisitions on a temporary basis with borrowings from its Credit Facility. The Company targets a leverage ratio of 40% (defined as debt and preferred equity as a percentage of market capitalization). In addition, the Company targets a ratio of Funds from Operations ("FFO") to combined fixed charges and preferred distributions of 3.0 to 1.0. As of September 30, 2002, the leverage ratio was 31% and the FFO to fixed charges and preferred distributions coverage ratio was 3.8 to 1.0 for the three months ended September 30, 2002.

In October 2002, the Company extended its Credit Facility with Wells Fargo Bank. The Credit Facility has a borrowing limit of \$100 million and an expiration date of August 1, 2005. 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 0.65% to LIBOR plus 1.25% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 0.85%). In addition, the Company is required to pay an annual commitment fee of up to 0.25% of the borrowing limit. In connection with the extension, the Company paid Wells Fargo Bank a one-time fee of \$320,000. As of September 30, 2002, there was no balance outstanding on the Credit Facility.

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 or capital improvements. The Company believes that in order to facilitate a clear understanding of the Company's operating results, FFO should be analyzed in conjunction with net income as presented in the Company's consolidated financial statements included elsewhere in this Form 10-Q. 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 make distributions or debt principal payments.

FFO as computed and disclosed by the Company may not be comparable to FFO computed and disclosed by other REITs. The Company calculates FFO as follows:

	Nine Months Ended September 30,	
	2002	2001
Net income allocable to common shareholders	\$ 32,535,000	\$ 31,130,000
Less: Gain on investment in marketable securities	(41,000)	(15,000)
Less: Gain on disposition of real estate.....	(7,407,000)	-
Less: Equity income from sale of joint venture properties	(265,000)	-
Impairment charge on property held for sale	900,000	-
Depreciation and amortization	42,885,000	30,058,000
Depreciation from joint venture.....	57,000	-
Minority interest in income – common units	11,019,000	10,047,000
Less: Straight-line rent adjustment	(2,278,000)	(1,171,000)
Consolidated FFO allocable to common shareholders and minority interests	77,405,000	70,049,000
FFO allocated to common minority interest – common units.....	(19,583,000)	(17,092,000)
FFO allocated to common shareholders	<u>\$ 57,822,000</u>	<u>\$ 52,957,000</u>

Capital Expenditures: On a recurring annual basis, the Company expects to incur between \$0.90 and \$1.20 per square foot in recurring capital expenditures (\$13-\$18 million based on square footage at September 30, 2002). In addition, the Company expects to make \$5 million in additional capital expenditures during the remainder of 2002. These investments include improvements to bring acquired properties up to the Company's standards of \$2 million, first generation tenant improvements and leasing commissions on development properties of \$1 million and the renovation of properties in Southern California, Northern Virginia, Arizona and Maryland totaling \$2 million. During the nine months ended September 30, 2002, the Company incurred approximately \$20.2 million in capital expenditures. These included \$13.7 million in maintenance capital expenditures, tenant improvements and capitalized leasing commissions, \$0.7 million to bring acquired properties up to the Company's standards, \$2.8 million in first generation tenant improvements and leasing commissions on developed properties and \$3.0 million in property renovations.

Stock Repurchase: The Company's Board of Directors has authorized the repurchase from time to time of up to 4,500,000 shares of the Company's common stock on the open market or in privately negotiated transactions. The Company has not repurchased any common stock in 2002. In addition, the Company may re-purchase shares of its preferred stock from time to time on the open market in separately negotiated transactions. During the quarter ended June 30, 2002, the Company repurchased 500 shares of Series D preferred stock with a face value of \$12,500 for \$12,823 or \$25.65 per share. During the quarter ended September 30, 2002, the Company repurchased 1,500 shares of Series A preferred stock with a face value of \$37,500 for \$38,266 or \$25.51 per share.

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

Related Party Transactions: At September 30, 2002, PSI owns 25% of the outstanding shares of the Company's common stock (44% upon conversion of its interest in the Operating Partnership) and 25% of the outstanding common units of the Operating Partnership (100% of the common units not owned by the Company).

Ronald L. Havner, Jr., the Company's chairman and chief executive officer, is also the vice-chairman, chief executive officer and a director of PSI. As of December 31, 2001, the Company had \$35 million in short-term borrowings from PSI. The notes bore interest at 3.25% and were repaid as of January 28, 2002. Pursuant to a cost sharing and administrative services agreement, the Company shares costs with PSI and affiliated entities for certain insurance and administrative services. These costs are allocated by PSI and its affiliates in accordance with a methodology intended to fairly allocate those costs. In addition, the Company provides property management services for properties owned by PSI and its affiliates for a fee of 5% of the gross revenues of such properties in addition to reimbursement of direct costs. Also, in June 2002, the Company purchased land adjacent to its Metro Park North facility from PSI at PSI's cost (approximately \$1,100,000). Finally, the Company combines its insurance purchasing power with PSI through a captive insurance company controlled by PSI, STOR-Re Mutual Insurance Corporation ("Stor-Re"). Stor-Re provides limited property and liability insurance to the Company at commercially competitive rates. The Company and PSI also utilize unaffiliated insurance carriers to provide property and liability insurance in excess of Stor-Re's limitations.

ITEM 2A. RISK FACTORS

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

PSI has significant influence over us.

PSI owns a substantial number of our shares and of the units of our operating partnership: At September 30, 2002, PSI and its affiliates owned 25% of the outstanding shares of our common stock (44% upon conversion of its interest in our operating partnership) and 25% of the outstanding common units of our operating partnership (100% of the common units not owned by us). Also, Ronald L. Havner, Jr., our chairman of the board and chief executive officer, is also vice-chairman, chief executive officer and a director of PSI and Harvey Lenkin, one of our directors, is president and a director of PSI. Consequently, PSI has the ability to significantly influence all matters submitted to a vote of our shareholders, including electing directors, changing our articles of incorporation, dissolving and approving other extraordinary transactions such as mergers, and all matters requiring the consent of the limited partners of the operating partnership. In addition, PSI's ownership may make it more difficult for another party to take over our company without PSI's approval.

Provisions in our organizational documents may prevent changes in control.

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

Our board can set the terms of certain securities without shareholder approval: Our board of directors is authorized, without shareholder approval, to issue up to 50,000,000 shares of preferred stock and up to 100,000,000 shares of equity stock, in each case in one or more series. Our board has the right to set the terms of each of these series of stock. Consequently, the board could set the terms of a series of stock that could make it difficult (if not impossible) for another party to take over our company even if it might be favorable to our public shareholders. We can also cause our operating partnership to issue additional interests for cash or in exchange for property.

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

Our operating partnership poses additional risks to us.

Limited partners of our operating partnership, including PSI, have the right to vote on certain changes to the partnership agreement. They may vote in a way that is contrary to the interest of our shareholders. Also, as

general partner of our operating partnership, we are required to protect the interests of the limited partners of our operating partnership. The interests of the limited partners and of our shareholders may differ.

We cannot sell certain properties without PSI's approval.

Before 2007, we may not sell 12 specified properties without PSI's approval. Since PSI would be taxed on a sale of these properties, the interests of PSI and our other shareholders may differ as to the best time to sell.

An institutional investor has registration rights.

An institutional investor has the right to require registration of its shares.

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

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

Our cash flow would be reduced if our predecessor failed to qualify as a REIT: For us to qualify to be taxed as a REIT, our predecessor, American Office Park Properties, also needed to qualify to be taxed as a REIT. We believe American Office Park Properties qualified as a REIT beginning in 1997 until its March 1998 merger with us. If it is determined that it did not qualify as a REIT, we could also lose our REIT qualification. Before 1997, our predecessor was a taxable corporation and, to qualify as a REIT, was required to distribute all of its cumulative retained profits before the end of 1996. Because a determination of the precise amount of profits retained by a company over a sustained period of time is very difficult, there is some risk that not all of American Office Park Properties' profits were so distributed. While we believe American Office Park Properties qualified as a REIT since 1997, we did not obtain an opinion of an outside expert at the time of its merger with us.

We may need to borrow funds to meet our REIT distribution requirements: To qualify as a REIT, we must generally distribute to our shareholders 90% of our taxable income. Our income consists primarily of our share of our operating partnership's income. We intend to make sufficient distributions to qualify as a REIT and otherwise avoid corporate tax. However, differences in timing between income and expenses and the need to make nondeductible expenditures such as capital improvements and principal payments on debt could force us to borrow funds to make necessary shareholder distributions.

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

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

- the national, state and local economic climate and real estate conditions, such as oversupply of or reduced demand for space and changes in market rental rates;
- how prospective tenants perceive the attractiveness, convenience and safety of our properties;
- our ability to provide adequate management, maintenance and insurance;
- our ability to collect rent from tenants on a timely basis;

- the expense of periodically renovating, repairing and reletting spaces;
- increasing operating costs, including real estate taxes, insurance and utilities, if these increased costs cannot be passed through to tenants;
- changes in tax, real estate and zoning laws;
- increase in new developments;
- tenant bankruptcies;
- sublease space; and
- concentration in non-rated private companies.

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

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

During 2001 and 2002, we were affected by the slowdown in economic activity in the United States in most of our primary markets. These effects were exacerbated by the terrorist attacks of September 11, 2001 and the related aftermath. These effects included a decline in occupancy rates and a reduction in market rates throughout the portfolio, slower than expected lease-up of our development properties, lower interest rates on invested cash and a rise in insurance costs. An extended economic slowdown will put additional downward pressure on occupancies and market rental rates and may lead to pressure for greater rent concessions, or generous tenant improvement allowances and higher broker commissions.

We may encounter significant delays in reletting vacant space, resulting in losses of income: When leases expire, we will incur expenses and we may not be able to release the space on the same terms. Certain leases provide tenants with the right to terminate early if they pay a fee. Our properties as of September 30, 2002 generally have lower vacancy rates than the average for the markets in which they are located, and leases for 24% of our space expire in 2002 or 2003 (leases for 40% of the space occupied by small tenants expire in such years). While we have estimated our cost of renewing leases that expire in 2002, our estimates could be wrong. If we are unable to release space promptly, if the terms are significantly less favorable than anticipated or if the costs are higher, we may have to reduce our distributions to shareholders.

Tenant defaults and bankruptcies may reduce our cash flow and distributions: We may have difficulty in collecting from tenants in default, particularly if they declare bankruptcy. This could reduce our cash flow and distributions to shareholders.

We may be adversely affected by significant competition among commercial properties: Many other commercial properties compete with our properties for tenants and we expect that new properties will be built in our markets. Also, we compete with other buyers, many of whom are larger than we are, in seeking to acquire commercial properties. Therefore, we may not be able to grow as rapidly as we would like.

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

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

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

We may incur significant environmental remediation costs: Under various federal, state and local environmental laws an owner or operator of real estate interests may have to clean spills or other releases of hazardous or toxic substances on or from a property. Certain environmental laws impose liability whether or not the owner knew of, or was responsible for, the presence of the hazardous or toxic substances. In some cases, liability may exceed the value of the property. The presence of toxic substances, or the failure to properly remedy any resulting contamination, may make it more difficult for the owner or operators to sell, lease or operate its property or to borrow money using its property as collateral. Future environmental laws may impose additional material liabilities on us.

We acquired a property in Beaverton, Oregon ("Creekside Corporate Park") in May 1998 that was the subject of an environmental investigation conducted by two current and past owner/operators of an industrial facility on adjacent property, pursuant to an Consent Decree issued by the Oregon Department of Environmental Quality ("ODEQ"). There is no evidence that our 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, nor has the ODEQ alleged any such contribution, and we are not a party to the Consent.

Based on the results of the remedial investigation/feasibility study, ODEQ has selected a final remedy that would include permanent treatment of contaminants in the groundwater, including expanded groundwater extraction and treatment on all parcels of the former industrial property, including portions of Creekside Corporate Park. The estimated cost of this remedy is \$2.8 million over a 30-year time period. In the event we are ultimately deemed responsible for any costs relating to this matter, we believe that the party from whom the property was purchased will be responsible for any expenses or liabilities that we may incur as a result of this contamination. In addition, we believe we may have recourse against other potentially responsible parties, including, but not limited to, one or both of the owner/operators of the adjacent industrial facility. However, if we are deemed responsible for any expenses related to removal or remedial actions on the property, and we are not successful in obtaining reimbursement from one or more third parties, our operations and financial condition could be harmed.

Based on recent discussions with the ODEQ and other potentially responsible parties, the Company has estimated its share of the costs of the remediation at \$250,000. The Company has accrued these estimated costs and included the expense in general and administrative costs.

We may be affected by the Americans with Disabilities Act: The Americans with Disabilities Act of 1990 requires that access and use by disabled persons of all public accommodations and commercial properties be facilitated. Existing commercial properties must be made accessible to disabled persons. While we have not estimated the cost of complying with this act, we do not believe the cost will be material.

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

We own most of our properties through our operating partnership. Our organizational documents do not limit our ability to invest funds with others in partnerships or joint ventures. During 2001, we entered into a joint venture arrangement that holds property subject to debt. This type of investment may present additional risks. For example, our partners may have interests that differ from ours or that conflict with ours, or our partners may become bankrupt. In addition, the joint venture may default on its debt, which we have guaranteed under certain circumstances. We believe this risk is mitigated by the low level of debt (57% of the cost in the joint venture) and the financial strength of our joint venture partner.

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

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

We can issue additional securities without shareholder approval.

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

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

One of the factors that influences the market price of our common stock is the annual rate of distributions that we pay on our common stock, as compared with interest rates. Interest rates in late 2001 and early 2002 have been at historically low levels. An increase in interest rates may lead purchasers of REIT shares to demand higher annual distribution rates, which could adversely affect the market price of our common stock.

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

Substantial sales of our common stock, or the perception that substantial sales may occur, could adversely affect the market price of our common stock. Certain of our shareholders hold significant numbers of shares of our common stock and, subject to compliance with applicable securities laws, could sell their shares.

We depend on key personnel.

We depend on our executive officers, including Ronald L. Havner, Jr., our chief executive officer and Joseph D. Russell, Jr., our president. The loss of Mr. Havner, Mr. Russell or other executive officers could adversely affect our operations. We maintain no key person insurance on our executive officers.

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, 2002, the Company's debt as a percentage of shareholders' equity (based on book values) was 11.7%.

The Company's market risk sensitive instruments include mortgage notes payable which totaled \$27,720,000 at September 30, 2002. 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, 2002. Based on borrowing rates currently available to the Company, the carrying amount of debt approximates fair value.

In July, 2002, the partnership entered into an interest rate swap agreement to reduce the impact of changes in interest rates on a portion of its floating rate debt. The agreement effectively changes the interest rate exposure from floating rate to a fixed rate of 4.46%. The Partnership records the differences paid or received on the interest rate swap in interest expense as payments are made or received. The Company had an unrealized loss of \$974,000 which was included in comprehensive income as of September 30, 2002.

ITEM 4. CONTROLS AND PROCEDURES

(a) *Evaluation of disclosure controls and procedures.* Based on their evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934) as of a date within 90 days of the filing date of this Quarterly Report on Form 10-Q, the Company's chief executive officer and chief financial officer have concluded that the Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and are operating in an effective manner.

(b) *Changes in internal controls.* There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their most recent evaluation.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In previous filings with the Securities and Exchange Commission, the Company has disclosed litigation involving former Company officers. This litigation has been settled on terms that did not materially affect the Company's financial condition or results of operations.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

12 Statement re: Computation of Ratio of Earnings to Fixed Charges. Filed herewith.

99.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. Filed herewith.

(b) Reports on Form 8-K

The Registrant filed a Current Report on Form 8-K dated September 11, 2002 (filed September 12, 2002) pursuant to Item 5 and Item 7, which filed certain exhibits relating to the announcement of the Company's new President.

The Registrant filed a Current Report on Form 8-K dated November 11, 2002 (filed November 12, 2002) pursuant to Item 9, relating to Regulation FD Disclosure.

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 14, 2002

PS BUSINESS PARKS, INC.

BY: /s/ Jack Corrigan

Jack Corrigan

Vice President and Chief Financial Officer

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

	Nine Months Ended September 30,	
	2002	2001
Net income	\$ 44,018,000	\$ 37,144,000
Minority interest	24,256,000	19,743,000
Interest expense	4,098,000	932,000
Equity income from sale of joint venture properties	(265,000)	-
Earnings available to cover fixed charges	\$ 72,107,000	\$ 57,819,000
Fixed charges (1)	\$ 4,386,000	\$ 1,933,000
Preferred distributions	24,720,000	15,710,000
Combined fixed charges and preferred distributions	\$ 29,106,000	\$ 17,643,000
Ratio of earnings to fixed charges	16.44	29.91
Ratio of earnings to combined fixed charges and preferred distributions	2.48	3.28

	Years Ended December 31,				
	2001	2000	1999	1998	1997
Net income.....	\$49,870,000	\$51,181,000	\$41,255,000	\$29,400,000	\$ 3,836,000
Minority interest	27,489,000	26,741,000	16,049,000	11,208,000	8,566,000
Interest expense	1,715,000	1,481,000	3,153,000	2,361,000	1,000
Earnings available to cover fixed charges	\$79,074,000	\$79,403,000	\$60,457,000	\$42,969,000	\$12,403,000
Fixed charges (1)	\$ 2,806,000	\$ 2,896,000	\$ 4,142,000	\$ 2,629,000	\$ 1,000
Preferred distributions	22,961,000	17,273,000	7,562,000	-	-
Combined fixed charges and preferred distributions	\$25,767,000	\$20,169,000	\$11,704,000	\$ 2,629,000	\$ 1,000
Ratio of earnings to fixed charges	28.18	27.42	14.60	16.34	12,403
Ratio of earnings to combined fixed charges and preferred distributions.....	3.07	3.94	5.17	16.34	12,403

(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,	
	2002	2001
FFO.....	\$ 77,405,000	\$ 70,049,000
Interest expense	4,098,000	932,000
Minority interest in income – preferred units.....	13,237,000	9,696,000
Preferred dividends.....	11,483,000	6,014,000
Adjusted FFO available to cover fixed charges.....	<u>\$ 106,223,000</u>	<u>\$ 86,691,000</u>
Fixed charges (1).....	\$ 4,386,000	\$ 1,933,000
Preferred distributions	24,720,000	15,710,000
Combined fixed charges and preferred distributions	<u>\$ 29,106,000</u>	<u>\$ 17,643,000</u>
Ratio of FFO to fixed charges	<u>24.22</u>	<u>44.85</u>
Ratio of FFO to combined fixed charges and preferred distributions	<u>3.65</u>	<u>4.91</u>

	Years Ended December 31,				
	2001	2000	1999	1998	1997
FFO.....	\$ 93,568,000	\$ 85,977,000	\$ 76,353,000	\$ 57,430,000	\$ 17,597,000
Interest expense	1,715,000	1,481,000	3,153,000	2,361,000	1,000
Minority interest in income – preferred units	14,107,000	12,185,000	4,156,000	-	-
Preferred dividends.....	8,854,000	5,088,000	3,406,000	-	-
Adjusted FFO available to cover fixed charges	<u>\$118,244,000</u>	<u>\$104,731,000</u>	<u>\$ 87,068,000</u>	<u>\$ 59,791,000</u>	<u>\$ 17,598,000</u>
Fixed charges (1).....	\$ 2,806,000	\$ 2,896,000	\$ 4,142,000	\$ 2,629,000	\$ 1,000
Preferred distributions	22,961,000	17,273,000	7,562,000	-	-
Combined fixed charges and preferred distributions	<u>\$ 25,767,000</u>	<u>\$ 20,169,000</u>	<u>\$ 11,704,000</u>	<u>\$ 2,629,000</u>	<u>\$ 1,000</u>
Ratio of FFO to fixed charges	<u>42.14</u>	<u>36.16</u>	<u>21.02</u>	<u>22.74</u>	<u>17,598</u>
Ratio of FFO to combined fixed charges and preferred distributions.....	<u>4.59</u>	<u>5.19</u>	<u>7.44</u>	<u>22.74</u>	<u>17,598</u>

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

Exhibit 99.1
Certification of CEO and CFO Pursuant to
18 U.S.C. Section 1350,
as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report on Form 10-Q of PS Business Parks, Inc. (the "Company") for the quarterly period ending September 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Ronald L. Havner Jr., as Chief Executive Officer of the Company, and Jack Corrigan, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Ronald L. Havner, Jr.
Name: Ronald L. Havner, Jr.
Title: Chief Executive Officer
Date: November 14, 2002

/s/ Jack Corrigan
Name: Jack Corrigan
Title: Chief Financial Officer
Date: November 14, 2002

This certification accompanies the Report pursuant to § 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of §18 of the Securities Exchange Act of 1934, as amended.

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Ronald L. Havner, Jr., Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of PS Business Parks, Inc;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Ronald L. Havner, Jr.
[Signature]
Chief Executive Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Jack Corrigan, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of PS Business Parks, Inc;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Jack Corrigan
[Signature]
Chief Financial Officer