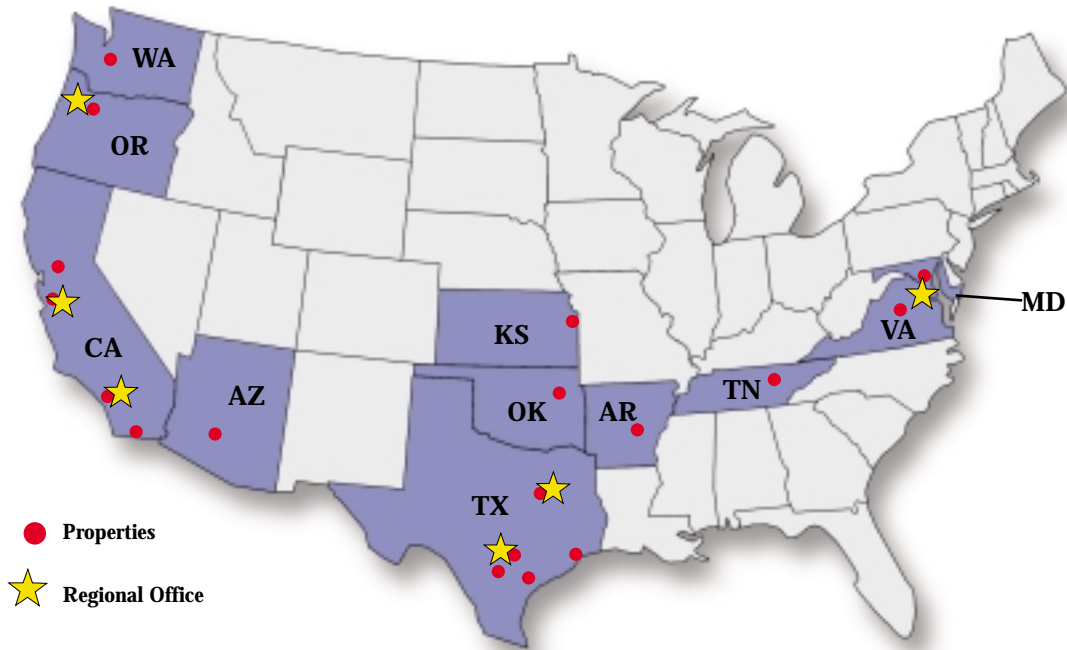




# PROPERTY LOCATIONS

**PS Business Parks, Inc.**  
(as of December 31, 1999)



## WESTERN DIVISION

**Number of Properties: 55**  
**Rentable Square Feet: 6,174,000**

### Southern California

*Number of Properties: 22*  
*Rentable Square Feet: 3,091,000*  
Buena Park  
Carson  
Cerritos  
Culver City  
Laguna Hills  
Lake Forest  
Lakewood  
Monterey Park  
San Diego  
Signal Hill  
Studio City  
Torrance

### Northern California

*Number of Properties: 10*  
*Rentable Square Feet: 1,317,000*  
Hayward  
Monterey  
Sacramento  
San Jose  
San Ramon  
South San Francisco

### Oregon

*Number of Properties: 17*  
*Rentable Square Feet: 1,169,000*  
Beaverton  
Milwaukie

### Washington

*Number of Properties: 1*  
*Rentable Square Feet: 28,000*  
Renton

### Arizona

*Number of Properties: 5*  
*Rentable Square Feet: 569,000*  
Mesa  
Phoenix  
Tempe

### Texas

*Number of Properties: 40*  
*Rentable Square Feet: 3,034,000*  
Austin  
Dallas  
Garland  
Houston  
Las Colinas  
Mesquite  
Missouri City  
Pasadena  
Plano  
Richardson  
San Antonio

### Oklahoma

*Number of Properties: 2*  
*Rentable Square Feet: 144,000*  
Broken Arrow  
Tulsa

### Kansas

*Number of Properties: 1*  
*Rentable Square Feet: 62,000*  
Overland Park

### Arkansas

*Number of Properties: 1*  
*Rentable Square Feet: 91,000*  
Little Rock

### Tennessee

*Number of Properties: 2*  
*Rentable Square Feet: 138,000*  
Nashville

### Virginia

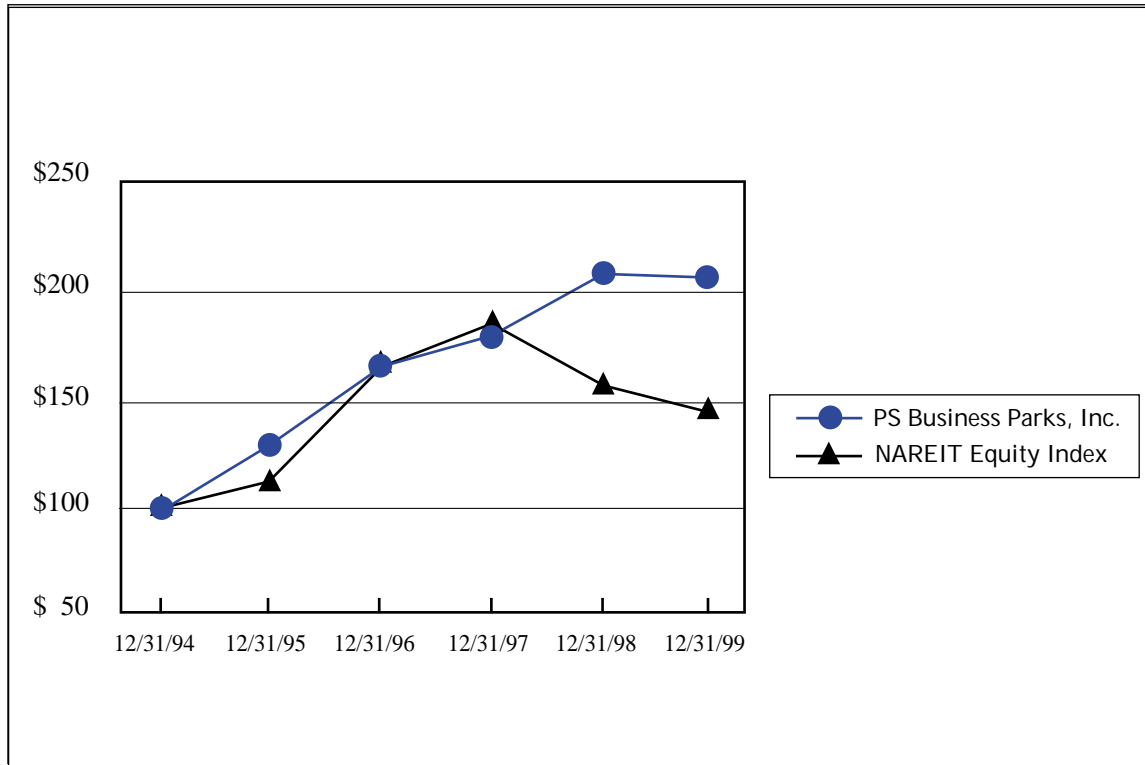
*Number of Properties: 18*  
*Rentable Square Feet: 1,612,000*  
Alexandria  
Chantilly  
Herndon  
Lorton  
Springfield  
Sterling  
Woodbridge

### Maryland

*Number of Properties: 6*  
*Rentable Square Feet: 1,104,000*  
Baltimore  
Beltsville  
Gaithersburg  
Landover  
Largo

## CUMULATIVE TOTAL RETURN

### PS Business Parks, Inc. and NAREIT Equity Index December 31, 1994 - December 31, 1999



	12/31/94	12/31/95	12/31/96	12/31/97	12/31/98	12/31/99
<b>PS Business Parks, Inc.</b>	\$100.00	\$124.67	\$155.25	\$183.35	\$207.49	\$206.20
<b>NAREIT Equity Index</b>	\$100.00	\$115.27	\$155.92	\$187.51	\$154.69	\$147.54

The graph set forth above compares the yearly change in the cumulative total shareholder return on the Common Stock (formerly Common Stock Series A) of the Company (formerly Public Storage Properties XI, Inc.) for the five-year period ended December 31, 1999 to the cumulative total return of the National Association of Real Estate Investment Trusts Equity Index ("NAREIT Equity Index") for the same period (total shareholder return equals price appreciation plus dividends). The stock price performance graph assumes that the value of the investment in the Company's Common Stock and the NAREIT Equity Index was \$100 on December 31, 1994 and that all dividends were reinvested. The stock price performance shown in the graph is not necessarily indicative of future price performance.

# LETTER TO SHAREHOLDERS

## PS Business Parks, Inc.

Our progress in 1999 was better than expected. Book value per share increased 2% from \$20.73 to \$21.17, net income per share increased 6% from \$1.51 to \$1.60 and funds from operations per share increased 15% from \$2.14 to \$2.45. We measure our progress on a per share basis, since changes in absolute size mean little unless translated into additional value per share.

Our total market capitalization increased 18% from \$792 million to \$932 million (\$74 million or 8% represents cash). The increase was attributable to the issuance of \$188 million of perpetual preferred securities (described below), offset by a \$13 million reduction in debt and a \$35 million decline in the market value of our common equity on a stable share base.

Share price performance was disappointing in light of our strong operating performance. The overall NAREIT equity index was negative 4.6%. The total return for our common shareholders was a negative 0.6%. This compares unfavorably to the NASDAQ and S&P 500 indexes, which provided returns in excess of 80% and 20%, respectively. Clearly, the outlook and relative performance for real estate securities has changed.

### BUSINESS

The Company's business is to provide space for small, medium and large businesses to conduct their business activities. This space is typically built out in what we call "flex space," which is clustered together in a series of buildings referred to as "business parks." "Flex" space is easily reconfigured to suit the needs of the Company's customers and consists of a combination of warehouse and office type space that can be designed to fit an almost limitless number of uses. We believe that the dynamic changes in today's business climate give our product a healthy future.

We continue to own and operate properties in seven major metropolitan centers across the country: Northern Virginia; Maryland; Dallas and Austin, Texas; Southern California (Los Angeles, Orange County and San Diego); Northern California and Portland, Oregon. These markets exhibit similar characteristics: above average job growth, above average income levels and a highly educated workforce. These attributes foster tremendous business formation and expansion and attract the "knowledge worker," which is increasingly important in today's economy. Our focus on these markets should enable us to achieve above average revenue growth in a positive economic climate and protect the value of our properties and customers in the event that the business climate turns negative.

### SOURCES OF GROWTH

The primary sources of growth for the Company in 1999 were:

1. Continued net operating income growth of our existing assets ("Same Park" portfolio);
2. Expansion of our portfolio in existing markets through acquisitions and developments; and
3. Capital raised at reasonable costs.

### "SAME PARK" OPERATIONS

The "Same Park" properties are those operated by the Company's current management team for the past two years. The Company acquired these properties during 1997 and therefore had a full year of operations to compare them to in 1999. We measure our performance on a "Same Park" basis similar to the way retailers measure their "Same Store" results. The focus at the operating level is to grow the revenues and control the expenses in a manner that is sustainable. As a shareholder, it is important to know whether management is increasing the value of the assets that it manages. The following table reflects the performance of our operating managers:

"Same Park" Properties	1999	1998	Change
	(Dollar Amount in Thousands)		
Rental income	\$ 72,641	\$ 67,191	8.1%
Cost of operations	22,838	22,491	1.5%
Net operating income (before depreciation)	\$ 49,803	\$ 44,700	11.4%
Gross margin	68.6%	66.5%	2.1%

As shareholders, we are benefiting twofold from the performance of the Company's operating personnel. First, revenues grew at a very acceptable rate of 8.1% in 1999. Second, more of that revenue is coming to the bottom line, as expenses have remained relatively flat. This resulted in a 2.1% increase in operating margins. Every dollar of revenue generated in 1999 translated into 68.6 cents of net operating income compared to 66.5 cents of net operating income in 1998. These benefits show up in the growth rate of net operating income, which increased 11.4% in 1999 versus 9.5% in 1998. Going forward, you should not expect this same level of growth in net operating income. Our parks are near full occupancy and rental rate growth has slowed due to increased competition from new construction. We will continue to work on expanding our gross profit margin through new technology and rationalizing our cost structure.

During 2000, we will expand the "Same Park" group of properties whose performance we report to you. The new portfolio will include acquisitions made in 1998 that were operated for all of 1999 and that we expect to own throughout the year 2000. The "Same Park" group will increase to 10.8 million square feet and represents approximately 87% of the total square footage of our portfolio at December 31, 1999.

## **ACQUISITIONS**

During 1999, we acquired approximately 1.3 million square feet of properties for \$103 million, all in markets in which we have operated for over five years. This represents a substantial reduction from 1998's acquisition volume of \$330 million. It does represent reasonable growth in the current capital constrained environment that most REIT's face. Our strategy is quite simple. We will continue to build presence in existing markets that enable us to:

1. Offer a broader variety of products (space sizes, locations, and types) to our customers;
2. Improve name recognition in those markets;
3. Improve our operating efficiencies; and
4. Develop quality properties on a smaller scale near our existing parks.

## **DEVELOPMENT**

We developed our first two properties in 1999. These represent a milestone for the Company since they were completed under the direction of our own management team. We used regional developers to perform the "heavy work" due to their local market expertise.

On average, property development offers a higher potential rate of return on invested capital than acquiring existing properties. However, the higher returns carry higher risks because the property is not established in its market and we must find those initial customers. For example, a new development must either pull 100 customers from existing properties in the market or attract them into the market. Conversely, an existing property must work to retain its customers. As a general rule, most properties lose 30-40% of their customers due to the customers' changing business circumstances or the owner's lack of appropriate service. We therefore have one-third the "customer risk" on an acquisition property compared with a development property. The developer must work harder, but is also rewarded with a higher initial return if everything works according to plan.

Our two developments in 1999 reflected these risks and returns. Both properties were contiguous to our existing parks in submarkets where we have a meaningful presence. The first development in Dallas, Texas was constructed and leased ahead of schedule. The second development in Beaverton, Oregon caught the tail end of the "Asian Flu" and leased slower and at a lower rental rate than projected. Both properties are generating initial rates of return that are higher than we would have otherwise achieved if the money had been invested in existing buildings.

We will continue to develop new properties. We currently have 360,000 square feet under construction, which will cost approximately \$40 million. We already have 20,000 of the 360,000 square feet pre-leased.

## **PREFERRED SECURITIES ISSUED**

During 1999, we issued two types of preferred securities totaling \$188 million. The "all in costs" for this capital are just under 9% per year, which seemed "high" at the time, but looks "cheap" compared to the prime rate of today. In last year's annual report, I discussed the attributes of perpetual preferred securities that we

would issue. Both types of our preferred securities have these attributes. We issued \$55 million in an underwritten public issuance of perpetual preferred stock. These shares trade on the American Stock Exchange under the symbol [PSB\\_pa](#). We also issued \$132.5 million in a private placement of perpetual preferred “partnership units” in our Operating Partnership. These units were issued to private partnerships which needed to purchase this type of security because of their unique business purpose. Other than their liquidity, the two securities are nearly identical. The partnership units will not be “tradable” for at least ten years, but we may redeem both of the preferred securities after five years.

A key attribute of perpetual preferred securities is the absence of refinancing risks. In 1999, we witnessed the implosion of several high profile companies because management “bet the farm” on their ability to get the appropriate financing after they bought the assets. Good business requires appropriate asset and liability management. As a general rule, when money is “cheap” assets are expensive and when money is “expensive” assets are cheap. This axiom is currently reflected in the pricing difference between common stocks of “real estate” based companies and “technology” based companies. Our financing strategy is to get the cheapest and lowest risk capital before we need it and invest the proceeds as opportunities arise. Unfortunately, it is rare that both situations occur at the same time. Uninvested capital may result in a “temporary negative spread” between the yield on the cash awaiting investment and its cost.

This was exactly our situation at year-end. Our cost of holding \$74 million in cash will be approximately 4% per year, or \$250,000 per month. Assuming investment opportunities become available, we will selectively deploy this capital. Otherwise, we will continue to pay the “holding” costs.

## **INVESTOR REPORTS DURING 2000**

During 1999, we expanded our quarterly earnings releases to include most of the information contained in our quarterly reports to shareholders. Accordingly, we will discontinue the quarterly reports to shareholders beginning in 2000 in order to reduce production and mailing costs. Shareholders who wish to have a copy of the quarterly earnings releases mailed to them should contact our investor services group at (818) 244-8080. This information will also be available on the Internet immediately following the release of our earnings report. The Company’s web site is [www.psbusinessparks.com](http://www.psbusinessparks.com).

## **SUMMARY**

The market environment for real estate securities may get worse before it gets better. There are several “countervailing” winds slowing the industry’s progress as contrasted to the rising tide which lifted all boats a few years ago. Liquidity will remain an issue, as capital continues to be withdrawn from the public real estate sector. This is occurring against a backdrop of rising interest rates, new construction and increased pessimism from the rating agencies. The contrarian or value investor might conclude that this is the opportune time to acquire real estate securities.

The positive side of this environment is a dramatic increase in management’s attention to becoming more efficient, focusing on operational details and examining alternative ways to generate long-term, sustainable growth which do not require tremendous amounts of new capital.

We believe we should succeed in this challenging environment for the following reasons:

1. The caliber and depth of our operating personnel and management;
2. The underlying strength of the markets in which we operate;
3. The ubiquitous demand for and quality of our product;
4. Our financial strength; and
5. The tremendous opportunity to further service our valuable customer base.

Ronald L. Havner, Jr.  
Chairman of the Board and CEO  
March 22, 2000

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

FORM 10-K

Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the fiscal year ended December 31, 1999.

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 or organization)

**95-4300881**

(I.R.S. Employer Identification No.)

**701 Western Avenue, Glendale, California 91201-2397**

(Address of principal executive offices) (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$0.01 par value.....	American Stock Exchange
Depository Shares Each Representing 1/1000 of a Shares of 9 ¼	
Cumulative Preferred Stock, Series A, \$0.01 par value .....	American Stock Exchange

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

**None**

(Title of class)

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

The aggregate market value of the voting stock held by non-affiliates of the registrant as of March 22, 2000:

Common Stock, \$0.01 par value, \$240,580,298 (computed on the basis of \$20.375 per share which was the reported closing sale price of the Company's Common Stock on the American Stock Exchange on March 22, 2000).

The number of shares outstanding of the registrant's class of common stock, as of March 22, 2000:

Common Stock, \$0.01 par value, 23,433,061 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement to be filed in connection with the annual shareholders' meeting to be held in 2000 are incorporated by reference into Part III.

## **PART I.**

### **ITEM 1. BUSINESS**

#### **Forward-Looking Statements**

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

#### **The Company**

PS Business Parks, Inc. (the “Company”) is a self-advised and self-managed real estate investment trust (“REIT”) that acquires, develops, owns and operates commercial properties, primarily multi-tenant office industrial or “flex” space. The Company is the sole general partner of PS Business Parks, L.P. (the “Operating Partnership”) through which the Company conducts most of its activities and owned, as of December 31, 1999, a 72.5% partnership interest. Substantially all of the remaining partnership interest is owned by Public Storage, Inc. (“PSI”) and its affiliates. As of December 31, 1999, PSI and its affiliates owned 27.0% of the Operating Partnership.

In a March 17, 1998 merger (the “Merger”) of American Office Park Properties, Inc. (“AOPP”) with and into the Company (formerly “Public Storage Properties XI, Inc.”), the Company acquired the commercial property business previously operated by AOPP and was renamed “PS Business Parks, Inc.” Concurrent with the Merger, the Company exchanged 11 mini-warehouses and two properties that combined mini-warehouse and commercial space for 11 commercial properties owned by PSI.

As of December 31, 1999, the Company and the Operating Partnership owned 125 commercial properties in 11 states containing approximately 12.4 million square feet of commercial space, representing a 13% increase in commercial square footage between December 31, 1998 and December 31, 1999. In addition, the Operating Partnership manages, on behalf of PSI and affiliated entities, an additional 37 commercial properties (approximately 1.0 million net rentable square feet) at December 31, 1999.

For financial accounting purposes, the Merger was accounted for as a reverse acquisition whereby AOPP was deemed to have acquired Public Storage Properties XI, Inc. However, PS Business Parks, Inc. (formerly Public Storage Properties XI, Inc.) is the continuing legal entity and registrant for both Securities and Exchange Commission filing purposes and income tax reporting purposes.

AOPP was originally organized in 1986 as a California corporation to serve as the manager of the commercial properties owned by PSI and its related entities. In January 1997, AOPP was reorganized to succeed to the commercial property business of PSI, becoming a fully integrated, self-advised and self-managed REIT. AOPP conducted substantially all of its business as the sole general partner of the Operating Partnership.

In January 1997, as part of a reorganization, PSI and its consolidated partnerships transferred 35 commercial properties to AOPP and the Operating Partnership. During April 1997, PSI transferred four additional commercial properties to the Operating Partnership. During the remainder of 1997, AOPP acquired six properties containing approximately 2 million square feet of commercial space from the Acquiport Corporations, subsidiaries of the New York State Common Retirement Fund, and four properties containing approximately 0.6 million square feet of commercial space from other third parties. At December 31, 1997, AOPP and the Operating Partnership owned 49 properties located in 10 states. The Operating Partnership also managed an additional 49 properties owned by PSI and its related entities (including the 13 properties acquired in the Merger). As of December 31, 1997, AOPP owned a 35.4% partnership interest in the Operating Partnership. The balance of the Operating Partnership was owned by PSI, its consolidated partnerships and certain third parties.

During 1998, the Company completed the Merger and acquired approximately 4.9 million square feet of commercial space, including 2.3 million square feet of space located in Oregon and Texas from Principal Mutual Life Insurance Company in May 1998 and 1.8 million square feet of commercial space located in California, Maryland, Virginia and Texas from other unaffiliated third parties.

During 1999, the Company acquired approximately 1.3 million square feet from unaffiliated third parties and completed development on two properties totaling 127,000 square feet. These additions continued to increase the Company's presence in existing markets, which the Company believes have the characteristics necessary for long-term growth. The Company acquired 483,000 square feet in Texas, 405,000 square feet in Northern Virginia/Maryland, 211,000 square feet in Northern California and 200,000 square feet in Arizona.

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

The Company's principal executive offices are located at 701 Western Avenue, Glendale, California 91201-2397. Its telephone number is (818) 244-8080.

The commercial properties owned by the Company and the Operating Partnership generally include both business park (industrial/flex space) and office space. The industrial space is used for, among other things, light manufacturing and assembly, storage and warehousing, distribution and research and development activities. Tenants who are renting industrial space also occupy most of the office space. The commercial properties typically consist of one to ten one-story buildings located on three to 20 acres and contain from approximately 10,000 to 500,000 square feet of rentable space (more than 50,000 square feet in the case of the freestanding properties). A property is typically divided into units ranging in size from 500 to 10,000 square feet. Leases generally range from one to ten years and some tenants have options to extend the original terms of their leases. Facilities are managed through either on-site management or area offices central to the facilities. Parking is open or covered. The ratio of parking spaces to rentable square feet ranges from two to six per thousand square feet depending upon the use of the property and its location. Office space generally requires a greater parking ratio than most industrial uses. The Company may acquire properties that do not have these characteristics.

The Company intends to continue to acquire commercial properties located throughout the United States. The Company's policy of acquiring commercial properties may be changed by its Board of Directors without shareholder approval. However, the Board of Directors has no intention to change this policy at this time. Although the Company currently operates properties in 13 states, it may expand its operations to other states. Properties are acquired both for income and potential capital appreciation; there is no limitation on the amount that can be invested in any specific property. Although there is no limitation on mortgage debt, the Company has no current intention to incur significant debt (other than short-term borrowings from time to time (including from PSI) to fund acquisitions). The Company may acquire land for the development of commercial properties. In general, the Company will acquire land that is adjacent to existing commercial properties that the Company owns or is acquiring. The Company currently has six facilities in various stages of development.

## **Operating Partnership**

The properties in which the Company has an equity interest generally will be owned by the Operating Partnership. This structure enables the Company to acquire interests in additional properties in transactions that could defer the contributors' tax consequences. This structure also enabled PSI and its consolidated partnerships to contribute interests in their properties and to defer until a later date the tax liabilities that they otherwise would have incurred if they had received Common Stock.

As the general partner of the Operating Partnership, the Company has the exclusive power under the Operating Partnership Agreement to manage and conduct the business of the Operating Partnership. The Board of Directors directs the affairs of the Operating Partnership by managing the Company's affairs. The Operating Partnership will be responsible for, and pay when due, its share of all administrative and operating expenses of the properties it owns under the terms of a cost sharing and administrative services agreement with an affiliate of PSI. See "Cost Allocation and Administrative Services."

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

## **Summary of the Operating Partnership Agreement**

The following summary of the Operating Partnership Agreement is qualified in its entirety by reference to the Operating Partnership Agreement, which has been filed as an exhibit with the Securities and Exchange Commission.

***Issuance of Additional Partnership Interests:*** As the general partner of the Operating Partnership, the Company is authorized to cause the Operating Partnership from time to time to issue to partners of the Operating Partnership or to other persons additional partnership units in one or more classes, and in one or more series of any of such classes, with such designations, preferences and relative, participating, optional, or other special rights, powers and duties (which may be senior to the existing partnership units), as will be determined by the Company, in its sole and absolute discretion. No such additional partnership units, however, will be issued to the Company unless (i) the agreement to issue the additional partnership interests arises in connection with the issuance of shares of the Company, which shares have designations, preferences and other rights, such that the economic interests are substantially similar to the designations, preferences and other rights of the additional partnership units that would be issued to the Company and (ii) the Company agrees to make a capital contribution to the Operating Partnership in an amount equal to the proceeds raised in connection with the issuance of such shares of the Company.

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

***Distributions:*** The Company, as general partner, is required to distribute at least quarterly the "available cash" (as defined in the Operating Partnership Agreement) generated by the Operating Partnership for such quarter. Distributions are to be made (i) first, with respect to any class of partnership interests having a preference over other classes of partnership interests; and (ii) second, in accordance with the partners' respective percentage interests on the "partnership record date" (as defined in the Operating Partnership Agreement). Commencing in 1998, the Operating Partnership's policy is to make distributions per unit (other than preferred units) that are equal to the per share distributions made by the Company with respect to its Common Stock, and in any case the per unit and per share distributions will be equal during partnership year 2000.

**Preferred Units:** As of December 31, 1999, the Operating Partnership had 5,310,000 preferred units outstanding with distribution rates ranging from 8 3/4% to 8 7/8%. The Operating Partnership has the right to redeem the preferred units on or after the fifth anniversary of the issuance date at the original capital contribution plus the cumulative priority return, as defined, to the redemption date to the extent not previously distributed. The preferred units are exchangeable for Cumulative Redeemable Preferred Stock of the respective series of PS Business Parks, Inc. on or after the tenth anniversary of the date of issuance at the option of the Operating Partnership or majority of the holders of the preferred units.

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

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

A limited partner cannot exercise its redemption right if delivery of shares of Common Stock would be prohibited under the 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 or certain antitrust laws, or would result in the Operating Partnership no longer being treated as a partnership for federal income tax purposes.

**Management:** The Operating Partnership is organized as a California limited partnership. The Company, as the sole general partner of the Operating Partnership has full, exclusive and complete responsibility and discretion in managing and controlling the Operating Partnership, except as provided in the Operating Partnership Agreement and by applicable law. The limited partners of the Operating Partnership have no authority to transact business for, or participate in the management activities or decisions of, the Operating Partnership except as provided in the Operating Partnership Agreement and as permitted by applicable law. However, the consent of the limited partners holding a majority of the interests of the limited partners (including limited partnership interests held by the Company) generally will be required to amend the Operating Partnership Agreement. Further, the Operating Partnership Agreement cannot be amended without the consent of each partner adversely affected if, among other things, the amendment would alter the partner's rights to distributions from the Operating Partnership (except as specifically permitted in the Operating Partnership Agreement), alter the redemption right, or impose on the limited partners an obligation to make additional capital contributions. The consent of all limited partners will be required to (i) take any action that would make it impossible to carry on the ordinary business of the Operating Partnership, except as otherwise provided in the Operating Partnership Agreement; or (ii) possess Operating Partnership property, or assign any rights in specific Operating Partnership property, for other than an Operating Partnership purpose except as otherwise provided in the Operating Partnership Agreement. In addition, without the consent of any adversely affected limited partner, the general partner may not perform any act that would subject a limited partner to liability as a general partner in any jurisdiction or any other liability except as provided in the Operating Partnership Agreement or under California law.

**Extraordinary Transactions:** The Operating Partnership Agreement provides that the Company may not engage in any business combination, defined to mean any merger, consolidation or other combination with or into another person or sale of all or substantially all of its assets, any reclassification, any recapitalization (other than

certain stock splits or stock dividends) or change of outstanding shares of common stock, unless (i) the limited partners of the Operating Partnership will receive, or have the opportunity to receive, the same proportionate consideration per unit in the transaction as shareholders of the Company (without regard to tax considerations); or (ii) limited partners of the Operating Partnership (other than the general partner) holding at least 60% of the interests in the Operating Partnership held by limited partners (other than the general partner) vote to approve the business combination. In addition, the Company, as general partner of the Operating Partnership, has agreed in the Operating Partnership Agreement with the limited partners of the Operating Partnership that it will not consummate a business combination in which the Company conducted a vote of shareholders unless the matter is also submitted to a vote of the partners. The foregoing provision of the Operating Partnership Agreement would under no circumstances enable or require the Company to engage in a business combination which required the approval of shareholders if the shareholders of the Company did not in fact give the requisite approval. Rather, if the shareholders did approve a business combination, the Company would not consummate the transaction unless the Company as general partner first conducts a vote of partners of the Operating Partnership on the matter. For purposes of the Operating Partnership vote, the Company shall be deemed to vote its partnership interest in the same proportion as the shareholders of the Company voted on the matter (disregarding shareholders who do not vote). The Operating Partnership vote will be deemed approved if the votes recorded are such that if the Operating Partnership vote had been a vote of shareholders, the business combination would have been approved by the shareholders. As a result of these provisions of the Operating Partnership, a third party may be inhibited from making an acquisition proposal that it would otherwise make, or the Company, despite having the requisite authority under its articles of incorporation, may not be authorized to engage in a proposed business combination.

***Tax Protection Provisions:*** The Operating Partnership Agreement provides that, until 2007, the Operating Partnership may not sell any of 13 designated properties in a transaction that will produce taxable gain for the contributing partner without the prior written consent of PSI. The Operating Partnership is not required to obtain PSI's consent if PSI and its affiliated partnerships do not continue to hold at the time of the sale at least 30% of their original interest in the Operating Partnership. Since PSI's consent is required only in connection with a taxable sale of one of the 13 designated properties, the Operating Partnership will not be required to obtain PSI's consent in connection with a "like-kind" exchange or other nontaxable transaction involving one of these properties.

***Indemnification:*** The Operating Partnership Agreement provides that the Company and its officers and directors will be indemnified and held harmless by the Operating Partnership for any act performed for, or on behalf of, the Operating Partnership, or in furtherance of the Operating Partnership's business unless it is established that (i) the act or omission of the indemnified person was material to the matter giving rise to the proceeding and either was committed in bad faith or was the result of active and deliberate dishonesty; (ii) the indemnified person actually received an improper personal benefit in money, property or services; or (iii) in the case of any criminal proceeding, the indemnified person had reasonable cause to believe that the act or omission was unlawful. The termination of any proceeding by judgment, order or settlement does not create a presumption that the indemnified person did not meet the requisite standards of conduct set forth above. The termination of any proceeding by conviction or upon a plea of nolo contendere or its equivalent, or an entry of an order of probation prior to judgment, creates a rebuttable presumption that the indemnified person did not meet the requisite standard of conduct set forth above. Any indemnification so made shall be made only out of the assets of the Operating Partnership.

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

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

### **Cost Allocation and Administrative Services**

Pursuant to a cost sharing and administrative services agreement, PSCC, Inc. ("PSCC") has been formed to serve as a cooperative cost allocation and administrative services clearing house that performs centralized administrative services for the Company, PSI and other property owners affiliated with PSI. These services include accounting and finance, employee relations, management information systems, legal, office services, marketing, administration and property management training. In addition, to take advantage of economies of scale, PSCC purchases supplies and services for the benefit of multiple property owners and allocates the costs of these supplies and services to the benefited property owners and employs and administers the payroll for employees required for the operation of the properties and the ownership entities. As to the Company, this agreement is not terminable until January 2002. The Company has no intention to terminate this agreement. The Company, PSI and certain other property owners own the capital stock of PSCC. Since the Company owns less than 10% of the capital stock of PSCC, the Company does not control the operations and activities of PSCC. Under this agreement, PSCC allocates costs to the Company in accordance with a methodology that is intended to fairly allocate charges among participating entities.

### **Common Officers and Directors**

Harvey Lenkin, the President of PSI, is a Director of both the Company and PSI. Ronald L. Havner, Jr., the Chairman and Chief Executive Officer of the Company, was Senior Vice President and Chief Financial Officer of PSI until December 1996 and is currently an employee of PSI. The Company engages additional executive personnel who render services exclusively for the Company. However, it is expected that officers of PSI will continue to render services for the Company as requested.

### **Management Agreement**

The Company continues to manage commercial properties owned by PSI and its affiliates, which are generally adjacent to mini-warehouses, for a fee of 5% of the gross revenues of such properties in addition to reimbursement of direct costs. The property management contract with PSI is for a seven-year term with the term extended one year each anniversary. The property management contracts with affiliates of PSI are cancelable by either party upon sixty days notice.

### **Management**

Ronald L. Havner, Jr. (42), President, Chairman and Chief Executive Officer, heads the Company's senior management team. Mr. Havner has been President and Chief Executive Officer of the Company or AOPP since December 1996. He became Chairman of the Company in March 1998. He was Senior Vice President and Chief Financial Officer of PSI from 1992 until December 1996. The Company's executive management includes: Jack Corrigan (39), Vice President and Chief Financial Officer and Michael Lynch (47), Vice President-Acquisitions and Development.

### **REIT Structure**

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

## **Investment Objective – Growth in Funds from Operations per Share**

The Company's primary objective is to maximize shareholder value by achieving long term growth in funds from operations per share. The Company intends to continue achieving this objective through internal growth of existing facilities combined with acquisitions of quality commercial properties in growth markets and submarkets. The Company intends to continue investing in properties and markets that have characteristics which enable them to be competitive in the short and long term. The Company seeks markets with above average population growth, education levels and personal income. In addition, the Company targets properties in those markets where it believes supply is constrained and where properties are close to important services and have easy access to major transportation arteries.

The Company attempts to limit the risk in its portfolio through attracting a diversified tenant base, both in size and industry focus. The Company's focus is on properties with easily reconfigured space and therefore appeals to a wide range of potential tenants. Such property flexibility also allows the Company to better serve existing tenants by accommodating their inevitable expansion and contraction needs. In addition, the Company's experience is that such property flexibility helps it maintain high occupancy rates including periods when market conditions are less favorable.

By focusing on properties with easily reconfigured space and a wide range of tenants, the Company seeks to control capital expenditures associated with re-leasing space. The Company also attempts to limit tenant improvement expenditures to those that are appropriate for a high number of users.

The Company seeks to provide a superior level of service to its tenants in order to achieve high occupancy and rental rates, as well as low turnover. The Company's property management offices are primarily located on-site, providing tenants with convenient access to management. On-site staff enables the Company's properties to be well maintained and to convey a sense of quality, order and security. The Company has significant experience in acquiring properties managed by others and thereafter improving tenant satisfaction, occupancy levels, renewal rates and rental income by implementing the Company's tenant service programs.

## **Competition**

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

The Company believes that the significant operating and financial experience of its executive officers and directors combined with the Company's capital structure, national investment scope, geographic diversity and economies of scale should enable the Company to continue to compete effectively with other entities.

## **Business Attributes**

The Company believes it possesses several distinguishing characteristics that enable it to compete effectively in the Office/Warehouse, "flex" space industry. The Company's facilities are part of a comprehensive system encompassing standardized procedures and integrated reporting and information networks. The Company believes it possesses the most experienced property operations group within this industry. The Company has a strong track record of growing revenues and net operating income for the properties it has operated for at least eight years. The Company is diversified geographically and by tenant. In addition, the Company has a consistent record of acquiring properties in selected markets at prices believed to be below replacement costs and which enables the Company to execute its growth strategies.

Financially, the Company has adopted a conservative policy characterized by a low payout ratio and minimal debt levels. These attributes are complemented by sponsorship from PSI, a widely known and respected REIT.

### **Growth Strategies**

The Company's growth strategies focus on improving the operating performance of its existing properties and on increasing its ownership of "flex-space" facilities through additional investments. Major elements of these strategies are as follows:

***Increase Net Cash Flow of Existing Properties:*** The Company seeks to increase the net cash flow generated by its existing properties by (i) increasing average occupancy rates and (ii) achieving higher levels of realized monthly rents per occupied square foot and (iii) reducing its operating cost structure by improving operating efficiencies and economies of scale. The Company believes that its proactive property management personnel and systems combined with strong markets and increasing economies of scale will enhance the Company's ability to meet these goals.

***Acquire Properties Owned or Operated by Others:*** The Company believes its presence in and knowledge of its markets enhances its ability to identify attractive acquisition opportunities and capitalize on the overall fragmentation in the "flex" space industry. The Company maintains local market information on rates, occupancies and competition in each of the markets in which it operates. The Company believes that the ten largest operators manage less than 15% of the total space of the 900 million square feet of "flex" space facilities in the United States as noted by Torto Wheaton Research. Similar to 1999, the Company expects third party acquisitions to be its most significant growth area during fiscal 2000, if attractive investment opportunities continue to be available.

***Develop Properties in Existing Markets:*** The Company's development strategy is to selectively construct new properties next to existing business parks. The properties are being developed using the expertise of local development companies. The Company plans to keep development activities below 10% of its portfolio.

### **Financing of the Company's Growth Strategies**

***Retain Operating Cash Flow:*** The Company seeks to retain significant funds (after funding its distributions and capital improvements) for additional investments and debt reduction. During the year ended December 31, 1999, the Company distributed 41% of its funds from operations ("FFO") allocable to common stock and retained \$38.1 million which was available for principal payments on debt and reinvestment into real estate assets. See "Management's Discussion and Analysis of Financial Condition and Results of Operations-Liquidity and Capital Resources."

***Revolving Line of Credit:*** The Company currently has an unsecured \$100 million ("Credit Facility") with Wells Fargo Bank, which the Company uses as a temporary source of acquisition financing. The Company seeks to ultimately finance all acquisitions with permanent capital to eliminate refinancing and interest rate risk.

***Access to Acquisition Capital:*** The Company believes that its strong financial position enables it to access capital to finance its growth. In 1998, the Company issued approximately \$322 million of common equity and common operating partnership units to finance its acquisitions. In 1999, the Company issued approximately \$188 million of preferred equity and preferred operating partnership units to finance its acquisitions. 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 FFO to combined fixed charges and preferred distributions of 3.0 to 1.0. Fixed charges include interest expense and capitalized interest. Preferred distributions include amounts paid to preferred shareholders and preferred OP unitholders. As of December 31, 1999 and for the year then ended, the leverage ratio was 24% and the FFO to combined fixed charges and preferred distributions ratio was 7.4 to 1.0. The Company plans to add leverage to its capital structure primarily through the use of preferred stock, but may assume debt in connection with acquisitions. This policy is subject to change depending upon market conditions.

### **Investments in Real Estate Facilities**

As of December 31, 1999, the Company had a total of 125 real estate facilities (12.4 million square feet) compared to 106 real estate facilities (10.9 million square feet) at December 31, 1998. The increase in the number of facilities was due to the acquisitions of facilities from unaffiliated third parties and the development of two properties.

### **Restrictions on Transactions with Affiliates**

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

### **Borrowings**

In August 1999, the Company extended its unsecured line of credit with Wells Fargo Bank. The Credit Facility has a borrowing limit of \$100 million and an expiration date of August 6, 2002. The expiration date may be extended by one year on each anniversary of the Credit Facility. Interest on outstanding borrowings is payable monthly. At the option of the Company, the rate of interest charged is equal to (i) the prime rate or (ii) a rate ranging from the London Interbank Offered Rate ("LIBOR") plus 0.75% to 1.35% depending on the Company's credit rating and coverage ratios, as defined (currently LIBOR plus 1.00%). In addition, the Company is required to pay an annual commitment fee of 0.25%.

Under covenants of the Credit Facility, the Company is required to (i) maintain a balance sheet leverage ratio (as defined) of less than 0.50 to 1.00, (ii) maintain interest and fixed charge coverage ratios (as defined) of not less than 2.25 to 1.0 and 1.75 to 1.0, respectively, (iii) maintain a minimum total shareholder's equity (as defined) and (iv) limit distributions to 95% of funds from operations. In addition, the Company is limited in its ability to incur additional borrowings (the Company is required to maintain unencumbered assets with an aggregate book value equal to or greater than two times the Company's unsecured recourse debt) or sell assets. The Company was in compliance with the covenants of the Credit Facility at December 31, 1999.

As of December 31, 1999, the Company had outstanding mortgage notes payable balances of approximately \$37 million and no balance outstanding on the Credit Facility. See Notes 6 and 7 to the consolidated financial statements for a summary of the Company's borrowings at December 31, 1999.

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

### **Employees**

As of December 31, 1999, the Company employed 105 individuals, primarily personnel engaged in property operations. The Company believes that its relationship with its employees is good and none of the employees are represented by a labor union.

### **Federal Income Tax**

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

### **Insurance**

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

### **Impact of Year 2000**

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations-Impact of Year 2000.”

## ITEM 2. PROPERTIES

As of December 31, 1999, the Company owned approximately 11.0 million square feet of “flex” space and 1.4 million square feet of suburban office concentrated primarily in seven major markets including Southern and Northern California, Southern and Northern Texas, Virginia, Maryland and Oregon. The weighted average occupancy rate as of December 31, 1999 was 96.2%.

The following table contains information about properties owned by the Company and the Operating Partnership as of December 31, 1999:

City	Number of Properties	Rentable Square Footage			Occupancy at December 31, 1999
		Flex	Office	Total	
<b>Arkansas</b>					
Little Rock.....	1	91,064	-	91,064	90.3%
	1	91,064	-	91,064	90.3%
<b>Arizona</b>					
Mesa.....	1	78,038	-	78,038	100.0%
Phoenix.....	1	199,581	-	199,581	98.4%
Tempe.....	3	291,264	-	291,264	98.2%
	5	568,883	-	568,883	98.5%
<b>Northern California</b>					
Hayward.....	1	406,712	-	406,712	100.0%
Monterey .....	1	-	12,003	12,003	96.5%
Sacramento.....	2	364,507	-	364,507	88.1%
San Jose.....	2	387,631	-	387,631	97.6%
San Ramon.....	2	-	52,149	52,149	100.0%
So. San Francisco.....	2	93,775	-	93,775	100.0%
	10	1,252,625	64,152	1,316,777	96.0%
<b>Southern California</b>					
Buena Park.....	1	317,312	-	317,312	100.0%
Carson .....	1	77,255	-	77,255	96.3%
Cerritos.....	2	394,610	31,270	425,880	96.5%
Culver City.....	1	146,402	-	146,402	99.0%
Laguna Hills .....	2	613,947	-	613,947	100.0%
Lake Forest.....	1	296,597	-	296,597	98.4%
Lakewood .....	1	-	56,902	56,902	94.5%
Monterey Park .....	1	199,056	-	199,056	91.4%
San Diego .....	7	377,880	232,808	610,688	98.6%
Signal Hill.....	2	178,146	-	178,146	96.1%
Studio City.....	1	22,092	-	22,092	100.0%
Torrance.....	2	147,220	-	147,220	97.2%
	22	2,770,517	320,980	3,091,497	97.9%
<b>Kansas</b>					
Overland Park.....	1	61,836	-	61,836	89.9%
	1	61,836	-	61,836	89.9%

City	Number of Properties	Rentable Square Footage			Occupancy at December 31, 1999
		Flex	Office	Total	
<b>Maryland</b>					
Baltimore (1) .....	1	-	237,638	237,638	97.7%
Beltsville .....	1	307,791	-	307,791	100.0%
Gaithersburg .....	1	-	28,994	28,994	96.5%
Landover (2) .....	2	379,471	-	379,471	100.0%
Largo .....	1	149,918	-	149,918	100.0%
	6	837,180	266,632	1,103,812	99.4%
<b>Oklahoma</b>					
Broken Arrow.....	1	87,895	-	87,895	92.1%
Tulsa.....	1	56,566	-	56,566	86.4%
	2	144,461	-	144,461	89.9%
<b>Oregon</b>					
Beaverton .....	15	880,186	186,770	1,066,956	98.6%
Milwauke .....	2	101,578	-	101,578	93.3%
	17	981,764	186,770	1,168,534	98.1%
<b>Tennessee</b>					
Nashville .....	2	138,004	-	138,004	95.5%
	2	138,004	-	138,004	95.5%
<b>Texas</b>					
Austin .....	15	831,404	-	831,404	94.6%
Dallas .....	2	236,997	-	236,997	98.9%
Garland .....	1	36,458	-	36,458	100.0%
Houston .....	2	176,977	131,214	308,191	79.7%
Las Colinas (1) .....	12	843,112	-	843,112	91.9%
Mesquite.....	1	56,541	-	56,541	93.3%
Missouri City .....	1	66,000	-	66,000	100.0%
Pasadena.....	1	154,000	-	154,000	99.2%
Plano.....	1	184,809	-	184,809	100.0%
Richardson .....	2	116,800	-	116,800	95.1%
San Antonio .....	2	-	199,269	199,269	82.1%
	40	2,703,098	330,483	3,033,581	92.6%
<b>Virginia</b>					
Alexandria.....	3	154,782	53,737	208,519	97.9%
Chantilly (2).....	5	315,080	38,502	353,582	94.0%
Herndon (2) .....	2	193,623	50,750	244,373	99.1%
Lorton.....	1	246,520	-	246,520	94.6%
Springfield .....	2	59,756	90,374	150,130	97.5%
Sterling (2) .....	4	295,625	-	295,625	100.0%
Woodbridge.....	1	113,629	-	113,629	96.8%
	18	1,379,015	233,363	1,612,378	97.0%
<b>Washington</b>					
Renton.....	1	27,912	-	27,912	100.0%
	1	27,912	-	27,912	100.0%
Totals - 11 states .....	125	10,956,359	1,402,380	12,358,739	96.2%

(1) The Company owns two properties that are subject to a ground lease in Baltimore, Maryland and Las Colinas, Texas.

(2) Nine commercial properties serve as collateral to mortgage notes payable. See detailed listing in Schedule III.

Each of these properties will continue to be used for its current purpose. Competition exists in the market areas in which these properties are located. Barriers to entry are relatively low for competitors with the necessary capital and the Company will be competing for properties and tenants with entities that have greater financial resources than the Company. However, the Company believes that the current overall demand for commercial space is strong.

The Company has risks that tenants will default on leases and declare bankruptcy. Management believes these risks are mitigated through its geographic diversity and its diverse tenant base. As of December 31, 1999, tenants occupying approximately 22,000 square feet of commercial space have declared bankruptcy. However, all of the bankrupt tenants remain current on their monthly rental payments. In the Company's opinion, risk of loss due to property damage is adequately covered by insurance.

As of December 31, 1999, none of these properties has a book value of more than 10% of the Company's current total assets or accounts for more than 10% of its current aggregate gross revenues.

The following table sets forth the lease expirations for the properties owned as of December 31, 1999:

Year of Lease Expiration	Rentable Square Footage Subject to Expiring Leases	Annual Base Rents Under Expiring Leases	Percentage of Total Annual Base Rents Represented by Expiring Leases
1999	3,410,000	\$34,329,000	27.2%
2000	2,430,000	27,191,000	21.5%
2001	2,129,000	21,761,000	17.2%
2002	1,397,000	16,572,000	13.1%
2003	1,040,000	11,644,000	9.2%
Thereafter	1,119,000	14,780,000	11.8%
<b>Total</b>	<b>11,525,000</b>	<b>\$126,277,000</b>	<b>100.0%</b>

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

The properties contributed by PSI and affiliates during 1997 and 1998 were each subject to environmental audits within the two-year period ended December 31, 1995. In addition, for each of the properties acquired subsequent to December 31, 1995, and for each parcel of land purchased for development, an environmental investigation was conducted as part of the acquisition due diligence process. The environmental investigations 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, 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 property adjacent to Creekside Corporate Park is currently the subject of an environmental remedial investigation/feasibility study that is being conducted by the current and past owners of the property, pursuant to an order issued by the Oregon Department of Environmental Quality ("ODEQ"). As part of that study, ODEQ ordered the property owners to sample soil and groundwater on the Company's property to determine the nature and extent of contamination resulting from past industrial operations at the property subject to the study. The Company, which is not a party of the Order on Consent, executed separate Access Agreements with the property owners to allow access to its property to conduct the required sampling and testing. While the sampling and testing is ongoing, preliminary results indicate that the contamination from the property subject to the study have migrated onto a portion of Creekside Corporate Park owned by the Company.

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

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

Although the environmental investigations conducted to date 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 Properties has not been, or will not be, affected by tenants and occupants of the Properties, by the condition of properties in the vicinity of the Properties, or by third parties unrelated to the Company.

**Properties under Development:** The Company plans to develop office and "flex" properties that are located within or adjacent to existing parks. The properties will be developed using the expertise of local development companies. The development program is designed to enhance the Company's existing portfolio.

In June 1999, the Company completed a 61,000 square foot flex facility in its park in the Las Colinas submarket of Dallas, Texas. In July 1999, the Company completed a 66,000 square foot office building in its Woodside Business Park located in the Beaverton submarket of Portland, Oregon, adjacent to existing facilities of approximately 400,000 square feet. There was no pre-leasing on either development. In August 1999, the Dallas facility was 100% leased to facilitate the expansion of an existing tenant. As of March 2000, the Beaverton facility was approximately 83% leased.

The following table sets forth certain information regarding the Company's properties under development as of December 31, 1999:

Property Name	Location	Estimated Completion Date	Rentable Square Feet	Amount Invested
Creekside	Beaverton, OR	April 2000	22,000	\$ 1,964,000
Lafayette	Chantilly, VA	October 2000	136,000	1,627,000
Royal Tech 17	Las Colinas, TX	September 2000	100,000	2,000
Royal Tech 18	Las Colinas, TX	October 2001	100,000	2,000
Woodside	Beaverton, OR	TBD	136,000	2,954,000
Pinnacle	Chantilly, VA	TBD	91,000	2,067,000
			585,000	\$ 8,616,000

The Creekside project is located within the Company's Creekside Corporate Park where it has 600,000 square feet of existing flex/office space. The building is a single story office/flex building with glass exterior walls on four sides. It is zoned for office, R&D, assembly and light industrial. The Company currently has approximately 1,067,000 square feet of rentable space in Beaverton, Oregon. The project is expected to cost approximately \$3.9 million. Rent stabilization is expected by November 2000.

The Lafayette project consists of two single story flex buildings with glass storefront on three sides of the building. Typical building depth is a highly efficient 110 feet which can easily accommodate either multiple small tenants or full building users. The Company currently has approximately 354,000 square feet of rentable space in Chantilly, VA. The project is expected to cost approximately \$11.9 million. Rent stabilization is expected by April 2001.

Subsequent to year end, the Company acquired 21 acres of land in Las Colinas, Texas just east of the Dallas Ft. Worth International Airport with frontage along I-635 (LBJ Freeway). The Company will develop 200,000 square feet of single story brick and glass office/flex in two phases for an estimated cost of \$24 million. The first phase of approximately 100,000 square feet is expected to be shell complete by September 2000. The second phase will commence upon lease up of the first phase. The Company currently has approximately 843,000 square feet of rentable space in Las Colinas, TX.

The Company owns 8 acres of vacant land in the Woodside Corporate Park purchased in 1998. The land is permitted for a three building complex.

In the second quarter of 1999, 6.4 acres of land located in Chantilly, Virginia was purchased as part of a package of other properties that included 297,000 square feet of flex space. The proposed development is a four story office building.

### **ITEM 3. LEGAL PROCEEDINGS**

On November 3, 1999, the Company filed an action entitled *PS Business Parks, Inc. v. Larry Howard, et al.* (Case No. BC219580) in the Los Angeles Superior Court seeking damages in excess of \$1 million, as well as equitable relief. The complaint alleges that Mr. Howard and entities controlled by him engaged in unfair trade practices, including (1) negotiating kickbacks, secret rebates and/or unearned discounts from third party suppliers for "providing" Company business to those suppliers and (2) disrupting the Company's relationship with various suppliers. Mr. Howard is not an officer, employee or authorized agent of the Company.

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

Mary Jayne Howard, former executive vice president of the Company, is married to Mr. Howard. On March 7, 2000, Ms. Howard ceased employment with the Company. Ronald L. Havner, Jr., Chief Executive Officer of the Company, assumed Ms. Howard's operational responsibilities.

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

The Company did not submit any matter to a vote of security holders in the fourth quarter of the fiscal year ended December 31, 1999.

#### **ITEM 4A. EXECUTIVE OFFICERS**

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

Ronald L. Havner, Jr., age 42, has been Chairman, President and Chief Executive Officer of the Company since March 1998. From December 1996 until March 1998, Mr. Havner was Chairman, President and Chief Executive Officer of AOPP. He was Senior Vice President and Chief Financial Officer of PSI, an affiliated REIT, and Vice President of the Company and certain other REITs affiliated with PSI, until December 1996. Mr. Havner became an officer of PSI in 1986, prior to which he was in the audit practice of Arthur Andersen & Company. He is a member of the American Institute of Certified Public Accountants (AICPA), the National Association of Real Estate Investments Trusts (NAREIT) and the Urban Land Institute (ULI) and a Director of Business Machine Security, Inc. and Mobile Storage Group, Inc.

Jack E. Corrigan, age 39, a certified public accountant, has been Vice President, Chief Financial Officer and Secretary of the Company since June 1998. From February 1991 until June 1998, Mr. Corrigan was a partner of LaRue, Corrigan & McCormick with responsibility for the audit and accounting practice. He was Vice President and Controller of PSI (formerly Storage Equities, Inc.) from 1989 until February 1991.

J. Michael Lynch, age 47, has been Vice President-Director of Acquisitions and Development of the Company since June 1998. Mr. Lynch was Vice President of Acquisitions and Development of Nottingham Properties, Inc. from 1995 until May 1998. He has 16 years of real estate experience, primarily in acquisitions and development. From 1988 until 1995, Mr. Lynch was a development project manager for The Parkway Companies. From 1983 until 1988, he was an Assistant Vice President, Real Estate Investment Department of First Wachovia Corporation.

## PART II

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

#### a. Market Price of the Registrant's Common Equity:

The Common Stock (formerly Common Stock Series A) of the Company (then known as Public Storage Properties XI, Inc.) began trading on the American Stock Exchange on March 27, 1991 under the symbol PSM. In connection with the March 1998 merger of AOPP into the Company, the Company changed its name from Public Storage Properties XI, Inc. to PS Business Parks, Inc. and the Company's Common Stock Series A was reclassified as Common Stock and began trading on the American Stock Exchange under the symbol PSB.

The following table sets forth the high and low sales prices of the Common Stock (formerly Common Stock Series A) on the American Stock Exchange for the applicable periods:

Year	Quarter	Range	
		High	Low
1999	1 <sup>st</sup>	\$23-3/4	\$21-3/8
	2 <sup>nd</sup>	26-3/8	21-5/8
	3 <sup>rd</sup>	26	21-7/8
	4 <sup>th</sup>	24-1/8	20-1/4
1998	1 <sup>st</sup>	24-1/2	20-1/2
	2 <sup>nd</sup>	25-3/4	22-5/16
	3 <sup>rd</sup>	26-5/8	18-7/16
	4 <sup>th</sup>	24-3/8	18

As of March 24, 2000, there were approximately 744 holders of record of the Common Stock.

#### b. Dividends

Holders of Common Stock are entitled to receive distributions when and if declared by the Company's Board of Directors out of any funds legally available for that purpose. The Company is required to distribute at least 95% of its net taxable ordinary income prior to the filing of the Company's tax return and 85%, subject to certain adjustments, during the calendar year, to maintain its REIT status for federal income tax purposes. It is management's intention to pay distributions of not less than this required amount.

Distributions paid per share of Common Stock for 1999 and 1998 amounted to \$1.00 and \$1.10, respectively (distributions paid prior to March 17, 1998 refer to distributions paid on the AOPP common stock).

Since the second quarter of 1998, the Company has declared regular quarterly dividends of \$0.25 per common share. This reflects a decrease from the quarterly dividend of \$0.34 per common share which was paid to the previous shareholders of Public Storage Properties XI, Inc. through the first quarter of 1998. The Board of Directors has established a distribution policy to maximize the retention of operating cash flow and only distribute the minimum amount required for the Company to maintain its tax status as a REIT.

**ITEM 6. SELECTED FINANCIAL DATA (1)**

	For the Years Ended December 31,		For the Periods (2)		For the Years Ended December 31,	
	1999	1998	April 1, 1997 through December 31, 1997	January 1, 1997 through March 31, 1997	1996	1995
	(In thousands, except per share data)					
<b>Revenues:</b>						
Rental income.....	\$ 125,327	\$ 88,320	\$ 24,364	\$ 5,805	\$ -	\$ -
Facility management fees.....	471	529	709	247	2,133	2,044
Interest income.....	2,815	1,411	424	29	43	37
	<u>128,613</u>	<u>90,260</u>	<u>25,497</u>	<u>6,081</u>	<u>2,176</u>	<u>2,081</u>
<b>Expenses:</b>						
Cost of operations.....	34,891	26,073	9,837	2,493	-	-
Cost of facility management.....	94	77	129	60	514	570
Depreciation and amortization.....	29,762	18,908	4,375	820	-	-
General and administrative.....	3,153	2,233	1,248	213	1,143	319
Interest expense.....	3,153	2,361	1	-	-	-
	<u>71,053</u>	<u>49,652</u>	<u>15,590</u>	<u>3,586</u>	<u>1,657</u>	<u>889</u>
Income before minority interest, income taxes and extraordinary item.....	57,560	40,608	9,907	2,495	519	1,192
Minority interest in income – preferred units.....	(4,156)	-	-	-	-	-
Minority interest in income – common units.....	(11,954)	(11,208)	(6,753)	(1,813)	-	-
Income before income taxes and extraordinary item.....	41,450	29,400	3,154	682	519	1,192
Income tax expense (3).....	-	-	-	-	(216)	(472)
Income before extraordinary item.....	41,450	29,400	3,154	682	303	720
Extraordinary item, net of minority interest.....	(195)	-	-	-	-	-
Net income.....	<u>\$ 41,255</u>	<u>\$ 29,400</u>	<u>\$ 3,154</u>	<u>\$ 682</u>	<u>\$ 303</u>	<u>\$ 720</u>
<b>Net income allocation:</b>						
Allocable to preferred shareholders.....	\$ 3,406	\$ -	\$ -	\$ -	\$ -	\$ -
Allocable to common shareholders.....	37,849	29,400	3,154	682	303	720
	<u>\$ 41,255</u>	<u>\$ 29,400</u>	<u>\$ 3,154</u>	<u>\$ 682</u>	<u>\$ 303</u>	<u>\$ 720</u>
<b>Per Common Share:</b>						
Distribution.....	\$ 1.00	\$ 1.10	\$ 0.68	\$ 0.00	\$ 0.43	\$ 0.90
Net income – Basic.....	\$ 1.60	\$ 1.52	\$ 0.92	\$ 0.31	\$ 0.32	\$ 0.80
Net income – Diluted.....	\$ 1.60	\$ 1.51	\$ 0.92	\$ 0.31	\$ 0.32	\$ 0.80
Weighted average common shares-Basic.....	23,641	19,361	3,414	2,193	947	905
Weighted average common shares-Diluted.....	23,709	19,429	3,426	2,193	947	905
<b>Balance Sheet Data:</b>						
Total assets.....	\$ 903,741	\$ 709,414	\$ 323,454	\$ 136,922	\$ 1,941	\$ 1,110
Total debt.....	37,066	50,541	3,500	-	-	-
Minority interest – preferred units.....	132,750	-	-	-	-	-
Minority interest - common units.....	157,199	153,015	168,665	97,180	-	-
Preferred stock.....	55,000	-	-	-	-	-
Common shareholders' equity.....	\$ 500,531	\$ 489,905	\$ 142,958	\$ 36,670	\$ 1,734	\$ 1,041
<b>Other Data:</b>						
Net cash provided by operating activities.....	\$ 88,440	\$ 60,228	\$ 13,597	\$ 5,840	\$ 413	\$ 950
Net cash used in investing activities.....	(131,318)	(308,646)	(47,105)	(582)	-	-
Net cash provided by (used in) financing activities.....	111,030	250,602	31,443	(228)	(378)	(84)
Funds from operations (4).....	\$ 76,353	\$ 57,430	\$ 14,282	\$ 3,315	\$ 303	\$ 720
FO per share.....	\$ 2.45	\$ 2.14	\$ 1.33	\$ 0.41	\$ 0.32	\$ 0.80
Square footage owned at end of period.....	12,359	10,930	6,009	3,014	-	-

(1) The selected financial data for periods prior to March 17, 1998 refers to AOPP.

- (2) See Note 2 of the Notes to Consolidated Financial Statements.
- (3) During 1997, the Company qualified and intends 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.
- (4) 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 does not represent net income or cash flows from operations as defined by GAAP. FFO does not take into consideration scheduled principal payments on debt and capital improvements. Accordingly, FFO is not necessarily a substitute for cash flow or net income as a measure of liquidity or operating performance or ability to make acquisitions and capital improvements or ability to pay distributions or debt principal payments. Also, FFO as computed and disclosed by the Company may not be comparable to FFO computed and disclosed by other REITs.

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

The following discussion and analysis of the results of operations and financial condition of PS Business Parks, Inc. (the "Company") should be read in conjunction with the selected financial data and the Company's consolidated financial statements and notes thereto included elsewhere in the form 10-K. References to the Company for periods prior to March 17, 1998 refer to AOPP.

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

**Overview:** During 1999 and 1998, the Company focused on increasing cash flow from its existing core portfolio of properties, expanded its presence in existing markets through strategic acquisition and developments and strengthened its balance sheet primarily through the issuance of common and preferred stock/units at reasonable prices. By maintaining low leverage, the Company facilitated future growth.

During 1999, the Company added approximately 1.3 million square feet to its portfolio at an aggregate cost of approximately \$103 million. These acquisitions increase the Company's presence in its existing markets, which the Company believes have the characteristics necessary for long-term growth. The Company acquired 483,000 square feet in Texas for approximately \$32 million, 405,000 square feet in Northern Virginia/Maryland market for approximately \$41 million, 211,000 square feet in Northern California for approximately \$17 million and 200,000 square feet in Arizona for approximately \$13 million.

During 1998, the Company added 4.9 million square feet to its portfolio. The cost of these acquisitions was approximately \$378 million. The acquisitions added square footage to each of the Company's existing core markets. The Company acquired 1,687,000 square feet in Texas at an aggregate cost of approximately \$102 million; 1,001,000 square feet in Portland, Oregon at an aggregate cost of approximately \$115 million; 1,442,000 square feet in the Northern Virginia/Maryland market at an aggregate cost of approximately \$108 million; 422,000 square feet in Southern California at an aggregate cost of approximately \$25 million and 307,000 square feet in Northern California at an aggregate cost of approximately \$25 million. In addition, the Company acquired 62,000 square feet in the Merger at an aggregate cost of approximately \$3 million in a market the Company does not consider a core market.

### **Comparison of 1999 to 1998**

**Results of Operations:** Net income for the year ended December 31, 1999 was \$41,255,000 compared to \$29,400,000 for the same period in 1998. Net income allocable to common shareholders (net income less preferred

stock dividends) for the year ended December 31, 1999 was \$37,849,000 compared to \$29,400,000 for the same period in 1998. Net income per common share on a diluted basis was \$1.60 (based on weighted average diluted common shares outstanding of 23,709,000) for the year ended December 31, 1999 compared to net income per common share on a diluted basis of \$1.51 (based on weighted average diluted common shares outstanding of 19,429,000) for the year ended December 31, 1998. The increases in net income and net income per share reflect the Company's significant growth in its asset base through the acquisition of commercial properties in addition to increased net operating income from its stabilized base of properties.

The Company's property operations account for almost all of the net operating income earned by the Company. The following table presents the pre-depreciation operating results of the properties for the years ended December 31, 1999 and 1998:

	1999	1998	Change
<b>Rental income:</b>			
Facilities owned throughout each period (50 facilities owned throughout each period, 6.4 million net rentable square feet).....	\$63,356,000	\$58,755,000	7.8%
Facilities acquired subsequent to January 1998 (75 facilities, 6.0 million net rentable square feet).....	61,971,000	29,565,000	109.6%
Total rental income.....	<u>\$125,327,000</u>	<u>\$88,320,000</u>	<u>41.9%</u>
<b>Cost of operations (excluding depreciation):</b>			
Facilities owned throughout each period.....	\$19,297,000	\$18,855,000	2.3%
Facilities acquired subsequent to January 1998.....	15,594,000	7,218,000	116.0%
Total cost of operations.....	<u>\$34,891,000</u>	<u>\$26,073,000</u>	<u>33.8%</u>
<b>Net operating income (rental income less cost of operations):</b>			
Facilities owned throughout each period.....	\$44,059,000	\$39,900,000	10.4%
Facilities acquired subsequent to January 1998.....	46,377,000	22,347,000	107.5%
Total net operating income.....	<u>\$90,436,000</u>	<u>\$62,247,000</u>	<u>45.3%</u>

Rental income and rental income less cost of operations or net operating income ("NOI") prior to depreciation are summarized for the year ended December 31, 1999 by major geographic regions below:

Region	Square Footage	Percent of Total	Rental Income	Percent of Total	NOI	Percent of Total
Southern California ....	3,091,000	25.0%	\$33,962,000	27.1%	\$25,426,000	28.1%
Northern California.....	1,317,000	10.7%	12,376,000	9.9%	9,176,000	10.1%
Southern Texas .....	1,031,000	8.3%	9,899,000	7.9%	6,430,000	7.1%
Northern Texas .....	2,003,000	16.2%	16,094,000	12.8%	10,868,000	12.0%
Virginia .....	1,612,000	13.0%	18,824,000	15.0%	13,679,000	15.1%
Maryland .....	1,104,000	8.9%	13,615,000	10.9%	9,642,000	10.7%
Oregon .....	1,169,000	9.5%	14,684,000	11.7%	11,465,000	12.8%
Other.....	1,032,000	8.4%	5,873,000	4.7%	3,750,000	4.1%
	<u>12,359,000</u>	<u>100.0%</u>	<u>\$125,327,000</u>	<u>100.0%</u>	<u>\$90,436,000</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 62 properties (7.2 million net rentable square feet). These 62 properties in which the Company currently has an ownership interest (herein referred to as the "Same Park" facilities) have been managed by the Company since January 1998. 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.

Beginning with the first quarter of 2000, the Company will add 48 properties acquired in 1998 totaling approximately four million square feet to its “Same Park” facilities. These properties will have been owned and operated for the comparable periods and will provide a more comprehensive analysis of the portfolio’s operations. In addition, the Company will subtract two properties totaling approximately 392,000 square feet that it plans to sell during the next twelve months. The “Same Park” facilities will then total 10.8 million square feet and represent approximately 87% of the square footage of the Company’s existing portfolio.

**“Same Park” Facilities (62 Properties)**

	Year Ended December 31,		Change
	1999	1998 <sup>(4)</sup>	
Rental income <sup>(1)</sup> .....	\$ 72,641,000	\$ 67,191,000	8.1%
Cost of operations .....	22,838,000	22,491,000	1.5%
Net operating income .....	\$ 49,803,000	\$ 44,700,000	11.4%
 Gross margin <sup>(2)</sup> .....	 68.6%	 66.5%	 2.1%
 <u>Weighted average for period:</u>			
Occupancy .....	96.5%	94.5%	2.0%
Annualized realized rent per sq. ft. <sup>(3)</sup> .....	\$10.45	\$9.87	5.9%

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- (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.
  - (4) Operations for the year ended December 31, 1998 represent the historical operations of the 62 properties; however, the Company did not own all of the properties throughout the periods presented and therefore such operations are not reflected in the Company’s historical operating results. All such properties were owned effective March 17, 1998.

The following table summarizes the “Same Park” operating results by major geographic region for the year ended December 31, 1999 and 1998:

Region	Revenues 1999	Revenues 1998	Percent Increase	NOI 1999	NOI 1998	Percent Increase
Southern California .....	\$32,510,000	\$29,189,000	11.4%	\$23,678,000	\$20,317,000	16.5%
Northern California .....	8,337,000	7,673,000	8.7%	6,113,000	5,406,000	13.1%
Southern Texas .....	4,158,000	3,832,000	8.5%	2,161,000	1,928,000	12.1%
Northern Texas .....	2,952,000	2,825,000	4.5%	1,574,000	1,531,000	2.8%
Virginia .....	9,119,000	8,634,000	5.6%	6,102,000	5,654,000	7.9%
Maryland .....	9,065,000	8,662,000	4.7%	6,152,000	5,858,000	5.0%
Arizona .....	2,812,000	2,730,000	3.0%	1,737,000	1,749,000	(0.7%)
Other .....	3,688,000	3,646,000	1.1%	2,286,000	2,257,000	1.2%

<u>\$72,641,000</u>	<u>\$67,191,000</u>	<u>8.1%</u>	<u>\$49,803,000</u>	<u>\$44,700,000</u>	<u>11.4%</u>
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The increases noted above reflect the performance of the Company's existing markets. All major markets reflected increases in rental rates. There were some corresponding increases in operating expenses in Texas and Arizona due primarily to property tax increases.

**Facility Management Operations:** The Company's facility management accounts for a small portion of the Company's net operating income. During the year ended December 31, 1999, \$377,000 in net operating income was recognized from facility management operations compared to \$452,000 for the same period in 1998. Facility management fees have decreased due to the Company's acquisition of properties previously managed.

**Interest and Other Income:** Interest and other income reflects earnings on cash balances. Interest and other income was \$2,815,000 for the year ended December 31, 1999 compared to \$1,411,000 for the same period in 1998. The increase is attributable to increased average cash balances primarily due to the Company's issuance of preferred stock and preferred units in its Operating Partnership. Average cash balances for the year ended December 31, 1999 were approximately \$51.2 million, compared to \$28.2 million for the same period in 1998.

**Cost of Operations:** Cost of operations for the year ended December 31, 1999 was \$34,891,000 compared to \$26,073,000 for the same period in 1998. The increase is due primarily to the growth in the total square footage of the Company's portfolio of properties. Cost of operations as a percentage of rental income decreased from 29.5% for the year ended December 31, 1998 to 27.8% for the year ended December 31, 1999 as a result of increasing revenues combined with controlled expenses. Controlled expenses resulted from the economies of scale achieved through the acquisition of properties in existing markets. Cost of operations consists primarily of property taxes (\$10,931,000), property maintenance (\$6,051,000), utilities (\$6,020,000) and direct payroll (\$5,607,000) for the year ended December 31, 1999.

**Depreciation and Amortization Expense:** Depreciation and amortization expense for the year ended December 31, 1999 was \$29,762,000 compared to \$18,908,000 for the same period in 1998. The increase is due to the acquisition of real estate facilities in 1998 and 1999.

**General and Administrative Expense:** General and administrative expense was \$3,153,000 for the year ended December 31, 1999 compared to \$2,233,000 for the same period in 1998. The increase is due primarily to the growth in the size of the Company. Included in general and administrative costs are acquisition costs and abandoned transaction costs. Acquisition expenses for 1999 and 1998 were \$430,000 and \$844,000, respectively. Abandoned transaction costs for 1999 and 1998 were \$41,000 and \$65,000, respectively.

**Interest Expense:** Interest expense was \$3,153,000 for the year ended December 31, 1999 compared to \$2,361,000 for the same period in 1998. Interest expense consists of \$3,121,000 associated with mortgage notes and \$1,021,000 associated with the line of credit and temporary financing of acquisitions, net of \$989,000 of interest expense capitalized to ongoing construction projects for the year ending December 31, 1999.

**Minority Interest in Income:** Minority interest in income reflects the income allocable to equity interests in the Operating Partnership which are not owned by the Company. Minority interest in income for the year ended December 31, 1999 was \$16,049,000 (\$4,156,000 allocated to preferred unitholders and \$11,893,000 allocated to common unitholders) compared to \$11,208,000 allocated to common unitholders for the same period in 1998. The increase in minority interest in income is due primarily to the issuance of preferred operating partnership units and to a lesser extent, the issuance of additional common units in connection with the acquisition of real estate facilities and improved operating results.

## Comparison of 1998 to 1997

**Comparison with 1997 Results:** On March 31, 1997, PSI exchanged its non-voting preferred stock for voting common stock of AOPP in a transaction accounted for as a purchase of AOPP by PSI. As a result of PSI attaining a 95% ownership interest in AOPP voting common stock, the financial results for 1997 are presented separately for the period prior to the exchange transaction (January 1, 1997 to March 31, 1997) and subsequent to the exchange transaction (April 1, 1997 to December 31, 1997). To properly compare the operating results for the year ended December 31, 1997 to the same period in the current year, the amounts for 1997 have been combined as follows:

	April 1, 1997 through December 31, 1997	January 1, 1997 through March 31, 1997	For the Year Ended December 31, 1997
<b>Revenues:</b>			
Rental income .....	\$ 24,364,000	\$ 5,805,000	\$ 30,169,000
Facility management fees from affiliates .....	709,000	247,000	956,000
Interest income .....	424,000	29,000	453,000
	<u>25,497,000</u>	<u>6,081,000</u>	<u>31,578,000</u>
<b>Expenses:</b>			
Cost of operations .....	9,837,000	2,493,000	12,330,000
Cost of facility management.....	129,000	60,000	189,000
Depreciation and amortization .....	4,375,000	820,000	5,195,000
General and administrative .....	1,248,000	213,000	1,461,000
Interest expense.....	1,000	-	1,000
	<u>15,590,000</u>	<u>3,586,000</u>	<u>19,176,000</u>
Income before minority interest.....	9,907,000	2,495,000	12,402,000
Minority interest in income .....	<u>(6,753,000)</u>	<u>(1,813,000)</u>	<u>(8,566,000)</u>
Net income.....	<u>\$ 3,154,000</u>	<u>\$ 682,000</u>	<u>\$ 3,836,000</u>

**Results of Operations:** Net income for the year ended December 31, 1998 was \$29,400,000 compared to \$3,836,000 for the same period in 1997. Net income per common share on a diluted basis was \$1.51 (based on weighted average diluted common shares outstanding of 19,429,000) for the year ended December 31, 1998 compared to net income per common share on a diluted basis of \$1.23 (based on weighted average diluted common shares outstanding of 3,129,000) for the year ended December 31, 1997, representing an increase of 22.7%. The increases in net income and net income per share reflects the Company's significant growth in its asset base through the acquisition of commercial properties and increase in net operating income from the consistent group of properties.

The Company's property operations account for almost all of the net operating income earned by the Company. The following table presents the pre-depreciation operating results of the properties for the years ended December 31, 1998 and 1997:

	1998	1997	Change
Rental income:			
Facilities owned throughout each period (35 facilities, 3.0 million net rentable square feet).....	\$25,045,000	\$23,936,000	4.6%
Facilities acquired between March 31, 1997 and December 31, 1998 (71 facilities, 7.9 million net rentable square feet).....	<u>63,275,000</u>	<u>6,233,000</u>	<u>915.2%</u>
Total rental income.....	<u>\$88,320,000</u>	<u>\$30,169,000</u>	<u>192.8%</u>
Cost of operations (excluding depreciation):			
Facilities owned throughout each period.....	\$10,023,000	\$10,073,000	(0.5%)
Facilities acquired between March 31, 1997 and December 31, 1998.....	<u>16,050,000</u>	<u>2,257,000</u>	<u>611.1%</u>
Total cost of operations.....	<u>\$26,073,000</u>	<u>\$12,330,000</u>	<u>111.5%</u>
Net operating income (rental income less cost of operations):			
Facilities owned throughout each period.....	\$15,022,000	\$13,863,000	8.4%
Facilities acquired between March 31, 1997 and December 31, 1998.....	<u>47,225,000</u>	<u>3,976,000</u>	<u>1,087.8%</u>
Total net operating income.....	<u>\$62,247,000</u>	<u>\$17,839,000</u>	<u>248.9%</u>

Rental income and rental income less cost of operations or net operating income ("NOI") prior to depreciation are summarized for the year ended December 31, 1998 by major geographic regions below:

Region	Square Footage	Percent of Total	Rental Income	Percent of Total	NOI	Percent of Total
Southern California.....	3,085,000	28.2%	\$28,930,000	32.7%	\$20,803,000	33.4%
Northern California.....	1,105,000	10.1%	7,557,000	8.6%	5,513,000	8.9%
Virginia/Maryland.....	2,315,300	21.2%	22,710,000	25.7%	15,864,000	25.5%
Texas.....	2,489,700	22.8%	13,927,000	15.8%	8,865,000	14.2%
Oregon.....	1,102,300	10.0%	9,725,000	11.0%	7,652,000	12.3%
Other.....	<u>832,600</u>	<u>7.7%</u>	<u>5,471,000</u>	<u>6.2%</u>	<u>3,550,000</u>	<u>5.7%</u>
Total.....	<u>10,929,900</u>	<u>100.0%</u>	<u>\$88,320,000</u>	<u>100.0%</u>	<u>\$62,247,000</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 51 properties (4.2 million net rentable square feet). These 51 properties represent a mature group of properties that have been managed by the Company for at least three years and, as of March 17, 1998, were owned by the Company. 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 (51 Properties)**

	Year Ended December 31,		Change
	1998 <sup>(4)</sup>	1997 <sup>(4)</sup>	
Rental income <sup>(1)</sup> .....	\$ 38,927,000	\$ 36,760,000	5.9%
Cost of operations .....	14,718,000	14,655,000	0.4%
Net operating income .....	<u>\$ 24,209,000</u>	<u>\$ 22,105,000</u>	<u>9.5%</u>
Gross margin <sup>(2)</sup> .....	62.2%	60.1%	2.1%
<b><u>Weighted average for period:</u></b>			
Occupancy .....	95.1%	94.6%	0.5%
Annualized realized rent per sq. ft. <sup>(3)</sup> .....	\$9.74	\$9.24	5.4%

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- (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.
  - (4) Operations for the year ended December 31, 1998 and 1997 represent the historical operations of the 51 properties; however, the Company did not own all of the properties throughout the periods presented and therefore such operations are not reflected in the Company's historical operating results. All such properties were owned effective March 17, 1998.

The following table summarizes the operating results displayed above by major geographic regions:

	Revenues 1998	Revenues 1997	Percentage Increase	NOI 1998	NOI 1997	Percentage Increase
Southern California .....	\$14,965,000	\$14,362,000	4.2%	\$9,639,000	\$9,075,000	6.2%
Northern California .....	5,668,000	5,227,000	8.4%	3,836,000	3,472,000	10.5%
Virginia/Maryland .....	5,271,000	4,953,000	6.4%	3,314,000	2,854,000	16.1%
Texas .....	6,649,000	6,394,000	4.0%	3,407,000	3,206,000	6.3%
Arizona .....	2,728,000	2,477,000	10.1%	1,731,000	1,488,000	16.3%
Other .....	3,646,000	3,347,000	8.9%	2,282,000	2,010,000	13.5%
	<u>\$38,927,000</u>	<u>\$36,760,000</u>	<u>5.9%</u>	<u>\$24,209,000</u>	<u>\$22,105,000</u>	<u>9.5%</u>

The increases noted above reflect the performance of the Company's existing markets. All major markets reflected increases in rental rates without corresponding increases in expenses.

**Facility Management Operations:** The Company's net operating income from facility management accounts for a small portion of the Company's net operating income. During the year ended December 31, 1998, \$452,000 in net operating income was recognized from facility management operations compared to \$767,000 for the same period in 1997. Facility management fees have decreased due to the Company's acquisition of properties previously managed.

**Interest and Other Income:** Interest and other income reflects earnings on cash balances. Interest and other income was \$1,411,000 for the year ended December 31, 1998 compared to \$453,000 for the same period in 1997. The increase is attributable to increased average cash balances primarily due to the Company's issuance of common stock in January and May 1998 and the timing of investing these funds in newly acquired real estate facilities. Average cash balances for the year ended December 31, 1998 were approximately \$28 million, compared to \$9 million for the same period in 1997.

**Cost of Operations:** Cost of operations for the year ended December 31, 1998 was \$26,073,000 compared to \$12,330,000 for the same period in 1997. The increase is due primarily to the growth in the total square footage of the Company's portfolio of properties. Cost of operations as a percentage of rental income decreased from 40.9% for the year ended December 31, 1997 to 29.5% for the year ended December 31, 1998 as a result of economies of scale achieved through the acquisition of properties in existing markets. Cost of operations consists primarily of property taxes (\$6,967,000), property maintenance (\$4,643,000), utilities (\$4,558,000) and direct payroll (\$3,981,000) for the year ended December 31, 1998.

**Depreciation and Amortization Expense:** Depreciation and amortization expense for the year ended December 31, 1998 was \$18,908,000 compared to \$5,195,000 for the same period in 1997. The increase is due to the acquisitions of real estate facilities in 1997 and 1998.

**General and Administrative Expense:** General and administrative expense was \$2,233,000 for the year ended December 31, 1998 compared to \$1,461,000 for the same period in 1997. The increase is due to the increased size and acquisition activities of the Company. Included in general and administrative costs are acquisition costs and abandoned transaction costs. Acquisition expenses for 1998 and 1997 were \$844,000 and \$177,000 respectively. Abandoned transaction costs for 1998 and 1997 were \$65,000 and \$5,000, respectively.

**Interest Expense:** Interest expense was \$2,361,000 for the year ended December 31, 1998 compared to \$1,000 for the same period in 1997. The increase is attributable to mortgage notes assumed in connection with the acquisition of real estate facilities totaling approximately \$38 million (\$1.5 million in interest expense), temporary financing in connection with acquisitions (\$0.5 million in interest expense), costs to establish the line of credit (\$0.5 million) and commitment fees (\$0.1 million) net of \$268,000 of interest expense capitalized to ongoing construction projects.

**Minority Interest in Income:** Minority interest in income reflects the income allocable to equity interests in the Operating Partnership that are not owned by the Company. Minority interest in income for the year ended December 31, 1998 was \$11,208,000 compared to \$8,566,000 for the same period in 1997. The increase in minority interest in income is due to improved operating results and the issuance of additional Operating Partnership units, primarily in connection with the acquisition of real estate facilities on April 1, 1997.

## Liquidity and Capital Resources

Net cash provided by operating activities for the year ended December 31, 1999 and 1998 was \$88,440,000 and \$60,228,000, respectively. Management believes that its internally generated net cash provided by operating activities will continue to be sufficient to enable it to meet its operating expenses, capital improvements, debt service requirements and maintain the current level of distributions to shareholders.

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

	Year Ended December 31,	
	1999	1998
Net income.....	\$41,255,000	\$29,400,000
Depreciation and amortization.....	29,762,000	18,908,000
Minority interest in income.....	16,048,000	11,208,000
Change in working capital.....	1,375,000	712,000
Net cash provided by operating activities .....	<u>88,440,000</u>	<u>60,228,000</u>
Maintenance capital expenditures .....	(3,911,000)	(3,376,000)
Tenant improvements .....	(5,555,000)	(5,258,000)
Capitalized lease commissions .....	<u>(2,213,000)</u>	<u>(1,979,000)</u>
Funds available for distribution to shareholders, minority interests, acquisitions and other corporate purposes .....	76,761,000	49,615,000
Cash distributions to shareholders and minority interests .....	<u>(38,632,000)</u>	<u>(29,904,000)</u>
Excess funds available for principal payments on debt, investments in real estate and other corporate purposes .....	<u><u>\$38,129,000</u></u>	<u><u>\$19,711,000</u></u>

The Company's capital structure is characterized by a low level of leverage. As of December 31, 1999, the Company had eight fixed rate mortgage notes payable totaling \$37,066,000 which represented 4.2% of its total capitalization (based on book value, including minority interests and debt). The weighted average interest rate for the mortgage notes is 7.67%.

In August 1999, the Company extended its unsecured line of credit (the "Credit Facility") with Wells Fargo Bank. The Credit Facility has a borrowing limit of \$100 million and an expiration date of August 6, 2002. The expiration date may be extended by one year on each anniversary of the Credit Facility. Interest on outstanding borrowings is payable monthly. At the option of the Company, the rate of interest charged is equal to (i) the prime rate or (ii) a rate ranging from the London Interbank Offered Rate ("LIBOR") plus 0.75% to 1.35% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 1.00%). In addition, the Company is required to pay an annual commitment fee of 0.25%.

The Company expects to fund its growth strategies with permanent capital, including issuances of common and preferred stock and internally generated retained cash flows. In addition, the Company may sell properties that no longer meet its investment criteria. The Company may finance acquisitions on a temporary basis with borrowings from its line of credit. The Company intends to repay amounts borrowed under the credit facility from undistributed cash flow or, as market conditions permit and as determined to be advantageous, from the public or private placement of preferred and common stock or formation of joint ventures. The Company targets a leverage ratio of 40% and a Funds From Operations ("FFO") to combined fixed charges and preferred distributions ratio of 3.0 to 1.0. As of December 31, 1999 and for the year then ended, the leverage ratio was 24% and the FFO to combined fixed charges and preferred distributions coverage ratio was 7.4 to 1.0.

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

On September 3, 1999, the Operating Partnership completed a private placement of 3,200,000 preferred units with a preferred distribution rate of 8 3/4%. The net proceeds from the placement of preferred units were approximately \$78 million. A portion of the proceeds was used to prepay a mortgage note payable of approximately \$8.5 million. On September 7 and 23, 1999, the Operating Partnership completed private placements of 1,200,000 and 400,000 preferred units, respectively, with a preferred distribution rate of 8 7/8%. The net proceeds from the placement of preferred units were approximately \$39.2 million. At December 31, 1999, the Company had \$74.2 million of proceeds from these placements invested in short-term interest bearing accounts. The Company will evaluate opportunities to invest this capital in real estate assets over the next year.

In January 1998, the Company entered into an agreement with institutional investors whereby the Company agreed to issue 6,774,072 shares of its common stock for cash (\$155 million) in separate tranches. The first tranche, representing 2,185,187 share or \$50 million, was issued in January 1998. The Company incurred \$2.4 million in costs associated with the issuance. The remainder of the common shares (4,588,885) was issued on May 6, 1998 and the net proceeds (\$105 million) were used to repay short-term borrowings.

In May 1998, the Company completed two common stock offerings, raising net proceeds totaling \$118.9 million. In the first offering, the Company sold 4,000,000 shares of common stock to an underwriter, resulting in approximately \$95.2 million of net proceeds. These shares were resold to various institutional investors. A portion of the proceeds was used to retire debt incurred as a result of a \$190 million property portfolio acquisition. In the second common stock offering, the Company sold 1,025,800 common shares to an underwriter, resulting in net proceeds of \$23.7 million. These proceeds were used for subsequent acquisitions of commercial properties.

**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. 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. Also, FFO as computed and disclosed by the Company may not be comparable to FFO computed and disclosed by other REITs.

FFO for the Company is computed as follows:

	1999	1998
Net income allocable to common shareholders .....	\$37,849,000	\$29,400,000
Extraordinary item, net of minority interest .....	195,000	-
Depreciation and amortization.....	29,762,000	18,908,000
Minority interest in income – common units .....	11,954,000	11,208,000
Effects of straight line rents.....	(3,407,000)	(2,086,000)
Consolidated FFO allocable to common shareholders and minority interests .....	76,353,000	57,430,000
FFO allocated to minority interests – common units .....	(18,248,000)	(15,852,000)

FFO allocated to common shareholders ..... \$58,105,000 \$41,578,000

**Capital Expenditures:** During 1999, the Company incurred \$11.7 million or \$1.01 per weighted average square foot in maintenance capital expenditures, tenant improvements and capitalized leasing commissions. In addition, the Company made \$3.2 million of renovation expenditures on two properties in Texas. On a recurring annual basis, the Company expects \$0.90 to \$1.20 per square foot in recurring capital expenditures (\$11 - \$15 million based on square footage at December 31, 1999). In addition, the Company expects to make \$1.0 million in renovations on a property in Southern California.

During 1998, the Company incurred \$10.6 million or \$1.17 per weighted average square foot in maintenance capital expenditures, tenant improvements and capitalized leasing commissions. In addition, the Company made \$0.5 million of renovation expenditures.

**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 95% of its taxable income is distributed to its shareholders prior to filing of its tax return.

The Board of Directors declared a quarterly dividend of \$0.25 per common share on March 2, 2000. The Board of Directors has established a distribution policy to maximize the retention of cash flow. In addition, the Board of Directors declared a quarterly dividend of \$0.578125 per share on the depositary shares each represent 1/1,000 of a share of 9 1/4% Cumulative Preferred Stock, Series A. Distributions are payable on March 31, 2000 to shareholders of record as of the close of business on March 15, 2000.

#### **Impact of Year 2000 (“Y2K”)**

The “Y2K Issue” arises because many computerized systems use two digits rather than four to identify a year. Any of the Company’s computer programs or hardware with the Y2K issue that have date sensitive applications or embedded chips could recognize a date using “00” as the year 1900 rather than the year 2000. The same issue has been faced by the Company’s outside vendors, including those vendors in the banking and payroll processing areas. Any failure in these areas could result in disruptions of operations.

As a result of the Company’s assessment and remediation activities conducted in recent years, the Company experienced no significant disruptions in its operations, and believes that its information systems responded successfully to the Y2K date change.

At this time, the Company is not aware of any material problems that resulted from the Y2K date change at any of its outside vendors, including those vendors in the banking and payroll processing areas.

The Company will continue to monitor its information systems and those of its outside vendors throughout the year 2000 to ensure that any latent Y2K Issues that may arise are addressed promptly.

There can be no assurance that the Company has identified all potential Y2K Issues either within the Company’s information systems, at its outside vendors or at external agents. In addition, the impact of any unresolved or unidentified Y2K Issues on governmental entities and utility providers and the resulting impact upon the Company, as well as disruptions in the general economy, may be material but cannot be reasonable determined or quantified.

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

To limit the Company's exposure to market risk, the Company principally finances its operations and growth with permanent equity capital consisting either of common or preferred stock. At December 31, 1999, the Company's debt as a percentage of shareholders' equity (based on book values) was 6.7%.

The Company's market risk sensitive instruments include mortgage notes payable which totaled \$37,066,000 at December 31, 1999. Substantially all of the Company's mortgage notes payable bear interest at fixed rates. See Note 7 of the Notes to Consolidated Financial Statements for terms, valuations and approximate principal maturities of the mortgage notes payable as of December 31, 1999. Based on borrowing rates currently available to the Company, the carrying amount of debt approximates fair value.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The financial statements of the Company (AOPP for periods prior to March 17, 1998) at December 31, 1999 and 1998 and for the years ended December 31, 1999 and 1998, the period from April 1, 1997 through December 31, 1997 and the period from January 1, 1997 through March 31, 1997 and the report of Ernst & Young LLP, Independent Auditors, thereon and the related financial statement schedule, are included elsewhere herein. Reference is made to the Index of Financial Statements and Schedule in Item 14.

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

Not Applicable.

### **PART III**

#### **ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

The information required by this item with respect to directors is hereby incorporated by reference to the material appearing in the Company's definitive proxy statement to be filed in connection with the annual shareholders' meeting to be held in 2000 (the "Proxy Statement") under the caption "Election of Directors." Information required by this item with respect to executive officers is provided in Item 4A of this report. See "Executive Officers."

#### **ITEM 11. EXECUTIVE COMPENSATION**

The information required by this item is hereby incorporated by reference to the material appearing in the Proxy Statement under the captions "Compensation" and "Compensation Committee Interlocks and Insider Participation."

#### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The information required by this item is hereby incorporated by reference to the material appearing in the Proxy Statement under the captions "Election of Directors—Security Ownership of Certain Beneficial Owners" and "—Security Ownership of Management."

#### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information required by this item is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption "Compensation Committee Interlocks and Insider Participation—Certain Relationships and Related Transactions."

## PART IV

### **ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULE AND REPORTS ON FORM 8-K**

a. 1. Financial Statements

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

2. Financial Statements Schedule

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

3. Exhibits

See Index to Exhibits contained herein.

b. Reports on Form 8-K

The Company filed a Current Report on Form 8-K dated December 30, 1999 (filed January 10, 2000), as amended by Form 8-K/A dated December 30, 1999 (filed March 13, 2000) pursuant to Item 5, which filed Combined Statements of Certain Revenues and Certain Expenses for the Monroe/Lafayette Properties for the nine months ended September 30, 1999 and for the year ended December 31, 1998, Combined Statements of Certain Revenues and Certain Expenses for the Kohm Properties for the nine months ended September 30, 1999 and for the year ended December 31, 1998, Statements of Certain Revenues and Certain Operating Expenses for the Northpointe Property for the nine months ended September 30, 1999 and for the year ended December 31, 1998 and Combined Statements of Certain Revenues and Certain Operating Expenses for the R&B Properties for the nine months ended September 30, 1999 and for the year ended December 31, 1998.

c. Exhibits

See Index to Exhibits contained herein.

d. Financial Statement Schedules

Not applicable.

**PS BUSINESS PARKS, INC.**  
**EXHIBIT INDEX**  
(Item 14(c))

- 2.1 Amended and Restated Agreement and Plan of Reorganization among Registrant, American Office Park Properties, Inc. (“AOPP”) and Public Storage, Inc. (“PSI”) dated as of December 17, 1997. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 3.1 Restated Articles of Incorporation. Filed with Registrant's Registration Statement No. 333-78627 and incorporated herein by reference.
- 3.2 Certificate of Determination of Preferences of 8¾% Series C Cumulative Redeemable Preferred Stock of PS Business Parks, Inc. Filed with Registrant’s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 3.3 Certificate of Determination of Preferences of 8 7/8% Series X Cumulative Redeemable Preferred Stock of PS Business Parks, Inc. Filed with Registrant’s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 3.4 Amendment to Certificate of Determination of Preferences of 8 7/8% Series X Cumulative Redeemable Preferred Stock of PS Business Parks, Inc. Filed with Registrant’s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 3.5 Restated Bylaws. Filed with Registrant's Current Report on Form 8K dated March 17, 1998 and incorporated herein by reference.
- 10.1 Amended Management Agreement between Storage Equities, Inc. and Public Storage Commercial Properties Group, Inc. dated as of February 21, 1995. Filed with PSI’s Annual Report on Form 10-K for the year ended December 31, 1994 and incorporated herein by reference.
- 10.2 Registrant's 1997 Stock Option and Incentive Plan. Filed with Registrant's Registration Statement No. 333-48313 and incorporated herein by reference.
- 10.3 Agreement of Limited Partnership of PS Business Parks, L.P. Filed with Registrant’s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1998 and incorporated herein by reference.
- 10.4 Merger and Contribution Agreement dated as of December 23, 1997 among Acquiport Two Corporation, Acquiport Three Corporation, New York State Common Retirement Fund, American Office Park Properties, L.P., AOPP and AOPP Acquisition Corp. Three. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 10.5 Agreement Among Shareholders and Company dated as of December 23, 1997 among Acquiport Two Corporation, AOPP, American Office Park Properties, L.P. and PSI. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 10.6 Amendment to Agreement Among Shareholders and Company dated as of January 21, 1998 among Acquiport Two Corporation, AOPP, American Office Park Properties, L.P. and PSI. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 10.7 Non-Competition Agreement dated as of December 23, 1997 among PSI, AOPP, American Office Park Properties, L.P. and Acquiport Two Corporation. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.

- 10.8 Employment Agreement between AOPP and Ronald L. Havner, Jr. dated as of December 23, 1997. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 10.9 Employment Agreement between Registrant and J. Michael Lynch dated as of May 20, 1998. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1998 and incorporated herein by reference.
- 10.10 Common Stock Purchase Agreement dated as of January 23, 1998 among AOPP and the Investors signatory thereto. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 10.11 Registration Rights Agreement dated as of January 30, 1998 among AOPP and the Investors signatory thereto. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 10.12 Registration Rights Agreement dated as of March 17, 1998 between Registrant and Acquiport Two Corporation ("Acquiport Registration Rights Agreement"). Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1998 and incorporated herein by reference.
- 10.13 Letter dated May 20, 1998 relating to Acquiport Registration Rights Agreement. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1998 and incorporated herein by reference.
- 10.14 Revolving Credit Agreement dated August 6, 1998 among PS Business Parks, L.P., Wells Fargo Bank, National Association, as Agent, and the Lenders named therein. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1998 and incorporated herein by reference.
- 10.15 First Amendment to Revolving Credit Agreement dated as of August 19, 1999 among PS Business Parks, L.P., Wells Fargo Bank, National Association, as Agent, and the Lenders named therein. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 10.16 Form of Indemnity Agreement. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1998 and incorporated herein by reference.
- 10.17 Cost Sharing and Administrative Services Agreement dated as of November 16, 1995 by and among PSCC, Inc. and the owners listed therein. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1998 and incorporated herein by reference.
- 10.18 Amendment to Cost Sharing and Administrative Services Agreement dated as of January 2, 1997 by and among PSCC, Inc. and the owners listed therein. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1998 and incorporated herein by reference.
- 10.19 Accounts Payable and Payroll Disbursement Services Agreement dated as of January 2, 1997 by and between PSCC, Inc. and American Office Park Properties, L.P. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1998 and incorporated herein by reference.
- 10.20 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to 8 7/8% Series B Cumulative Redeemable Preferred Units, dated as of April 23, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and incorporated herein by reference.
- 10.21 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to 9 1/4% Series A Cumulative Redeemable Preferred Units, dated as of April 30, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and incorporated herein by reference.

- 10.22 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to 8 <sup>3</sup>/<sub>4</sub>% Series C Cumulative Redeemable Preferred Units, dated as of September 3, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 10.23 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to 8 <sup>7</sup>/<sub>8</sub>% Series X Cumulative Redeemable Preferred Units, dated as of September 7, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 10.24 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to Additional 8 <sup>7</sup>/<sub>8</sub>% Series X Cumulative Redeemable Preferred Units, dated as of September 23, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 11 Statement re: Computation of Earnings per Share. Filed herewith.
- 12 Statement re: Computation of Ratio of Earnings to Fixed Charges. Filed herewith.
- 23 Consent of Independent Auditors. Filed herewith.
- 27 Financial Data Schedule. Filed herewith.

## SIGNATURES

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

Dated: March 29, 2000

PS BUSINESS PARKS, INC.

BY: /s/ Ronald L. Havner, Jr.

Ronald L. Havner, Jr.  
President, Chairman of the Board and Chief  
Executive Officer

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

Signature	Title	Date
<u>/s/ Ronald L. Havner, Jr.</u> Ronald L. Havner, Jr.	President, Chairman of the Board and Chief Executive Officer (principal executive officer)	March 29, 2000
<u>/s/ Jack E. Corrigan</u> Jack E. Corrigan	Vice President and Chief Financial Officer (principal financial officer and principal accounting officer)	March 29, 2000
<u>/s/ Harvey Lenkin</u> Harvey Lenkin	Director	March 29, 2000
<u>/s/ Vern O. Curtis</u> Vern O. Curtis	Director	March 29, 2000
<u>/s/ James H. Kropp</u> James H. Kropp	Director	March 29, 2000
<u>/s/ Jack D. Steele</u> Jack D. Steele	Director	March 29, 2000
<u>/s/ Alan K. Pribble</u> Alan K. Pribble	Director	March 29, 2000
<u>/s/ Arthur M. Friedman</u> Arthur M. Friedman	Director	March 29, 2000

**PS BUSINESS PARKS, INC.**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES**

**(Item 14(a)(3) and Item 14(c))**

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

## REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying consolidated balance sheets of PS Business Parks, Inc. as of December 31, 1999 and 1998, and the related consolidated statements of income, shareholders' equity and cash flows for the years ended December 31, 1999 and 1998, the period from April 1, 1997 through December 31, 1997 and the period from January 1, 1997 through March 31, 1997. Our audits also included the financial statement schedule listed in the Index at Item 14(a). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of PS Business Parks, Inc. at December 31, 1999 and 1998, and the consolidated results of its operations and its cash flows for the years ended December 31, 1999 and 1998, the period from April 1, 1997 through December 31, 1997 and the period from January 1, 1997 through March 31, 1997 in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ ERNST & YOUNG LLP

Los Angeles, California  
January 31, 2000

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

	December 31, 1999	December 31, 1998
<b><u>ASSETS</u></b>		
Cash and cash equivalents .....	\$ 74,220,000	\$ 6,068,000
Real estate facilities, at cost:		
Land .....	194,140,000	176,241,000
Buildings and equipment .....	636,261,000	536,697,000
	830,401,000	712,938,000
Accumulated depreciation .....	(50,976,000)	(22,517,000)
	779,425,000	690,421,000
Properties held for disposition, net .....	14,235,000	-
Construction in progress .....	8,616,000	7,716,000
	802,276,000	698,137,000
Receivables .....	771,000	242,000
Deferred rent receivables .....	5,493,000	2,086,000
Intangible assets, net .....	1,282,000	1,583,000
Other assets .....	19,699,000	1,298,000
Total assets .....	\$ 903,741,000	\$ 709,414,000

**LIABILITIES AND SHAREHOLDERS' EQUITY**

Accrued and other liabilities .....	\$ 21,195,000	\$ 15,953,000
Line of credit .....	-	12,500,000
Mortgage notes payable .....	37,066,000	38,041,000
Total liabilities .....	58,261,000	66,494,000
Minority interest:		
Preferred units .....	132,750,000	-
Common units .....	157,199,000	153,015,000
Shareholders' equity:		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, 2,200 shares issued and outstanding at December 31, 1999 (none issued or outstanding at December 31, 1998) .....	55,000,000	-
Common stock, \$0.01 par value, 100,000,000 shares authorized, 23,645,461 shares issued and outstanding at December 31, 1999 (23,635,650 shares issued and outstanding at December 31, 1998) .....	236,000	236,000
Paid-in capital .....	478,889,000	482,471,000
Cumulative net income .....	73,809,000	32,554,000
Cumulative distributions .....	(52,403,000)	(25,356,000)
Total shareholders' equity .....	555,531,000	489,905,000
Total liabilities and shareholders' equity .....	\$ 903,741,000	\$ 709,414,000

See accompanying notes.

**PS BUSINESS PARKS, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**

	For the Year Ended December 31,		For the Periods (Note 2)	
	1999	1998	April 1, 1997 through December 31, 1997	January 1, 1997 through March 31, 1997
<b>Revenues:</b>				
Rental income .....	\$125,327,000	\$ 88,320,000	\$ 24,364,000	\$ 5,805,000
Facility management fees from affiliates .....	471,000	529,000	709,000	247,000
Interest and other income .....	2,815,000	1,411,000	424,000	29,000
	<u>128,613,000</u>	<u>90,260,000</u>	<u>25,497,000</u>	<u>6,081,000</u>
<b>Expenses:</b>				
Cost of operations .....	34,891,000	26,073,000	9,837,000	2,493,000
Cost of facility management .....	94,000	77,000	129,000	60,000
Depreciation and amortization .....	29,762,000	18,908,000	4,375,000	820,000
General and administrative .....	3,153,000	2,233,000	1,248,000	213,000
Interest expense .....	3,153,000	2,361,000	1,000	-
	<u>71,053,000</u>	<u>49,652,000</u>	<u>15,590,000</u>	<u>3,586,000</u>
Income before minority interest and extraordinary item.....	57,560,000	40,608,000	9,907,000	2,495,000
Minority interest in income – preferred units .....	(4,156,000)	-	-	-
Minority interest in income – common units .....	(11,954,000)	(11,208,000)	(6,753,000)	(1,813,000)
Income before extraordinary item.....	41,450,000	29,400,000	3,154,000	682,000
Extraordinary loss on early extinguishment of debt, net of minority interest.....	(195,000)	-	-	-
Net income .....	<u>\$ 41,255,000</u>	<u>\$ 29,400,000</u>	<u>\$ 3,154,000</u>	<u>\$ 682,000</u>
<b>Net income allocation:</b>				
Allocable to preferred shareholders .....	\$ 3,406,000	\$ -	\$ -	\$ -
Allocable to common shareholders .....	37,849,000	29,400,000	3,154,000	682,000
	<u>\$ 41,255,000</u>	<u>\$ 29,400,000</u>	<u>\$ 3,154,000</u>	<u>\$ 682,000</u>
<b>Net income per common share – basic:</b>				
Income before extraordinary item.....	\$ 1.61	\$ 1.52	\$ 0.92	\$ 0.31
Extraordinary loss, net of minority interest.....	(0.01)	-	-	-
Net income.....	<u>\$ 1.60</u>	<u>\$ 1.52</u>	<u>\$ 0.92</u>	<u>\$ 0.31</u>
<b>Net income per common share – diluted:</b>				
Income before extraordinary item.....	\$ 1.61	\$ 1.51	\$ 0.92	\$ 0.31
Extraordinary loss, net of minority interest.....	(0.01)	-	-	-
Net income.....	<u>\$ 1.60</u>	<u>\$ 1.51</u>	<u>\$ 0.92</u>	<u>\$ 0.31</u>

See accompanying notes.

**PS BUSINESS PARKS, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**

Weighted average common shares outstanding:

Basic .....	<u>23,641,000</u>	<u>19,361,000</u>	<u>3,414,000</u>	<u>2,193,000</u>
Diluted.....	<u>23,709,000</u>	<u>19,429,000</u>	<u>3,426,000</u>	<u>2,193,000</u>

See accompanying notes.

**PS BUSINESS PARKS, INC.**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**

	Preferred Stock		Common Stock		Paid-in Capital	Cumulative Net Income	Cumulative Distributions	Shareholders' Equity
	Shares	Amount	Shares	Amount				
<b>Balances at December 31, 1996</b> .....	899,608	9,000	94,697	1,000	1,573,000	151,000	-	1,734,000
Issuance of preferred stock in exchange for real estate facilities .....	1,198,680	12,000	-	-	19,988,000	-	-	20,000,000
Net income .....	-	-	-	-	-	682,000	-	682,000
Issuance of common stock for cash .....	-	-	4,797	-	80,000	-	-	80,000
Adjustment to reflect cost of PSI's investment in PSB .....	-	-	-	-	13,194,000	(833,000)	-	12,361,000
Exchange of preferred stock for common stock .....	(2,098,288)	(21,000)	2,098,288	21,000	-	-	-	-
Adjustment to reflect minority interest to underlying ownership interest .....	-	-	-	-	1,813,000	-	-	1,813,000
<b>Balances at March 31, 1997</b> .....	-	-	2,197,782	22,000	36,648,000	-	-	36,670,000
Issuance of common stock for cash .....	-	-	2,025,769	20,000	33,780,000	-	-	33,800,000
Issuance of common stock in exchange for real estate facilities .....	-	-	3,504,758	35,000	75,939,000	-	-	75,974,000
Net income .....	-	-	-	-	-	3,154,000	-	3,154,000
Distributions paid .....	-	-	-	-	-	-	(3,550,000)	(3,550,000)
Adjustment to reflect minority interest to underlying ownership interest .....	-	-	-	-	(3,090,000)	-	-	(3,090,000)
<b>Balances at December 31, 1997</b> .....	-	-	7,728,309	77,000	143,277,000	3,154,000	(3,550,000)	142,958,000
Issuance of common stock:								
Conversion of OP units .....	-	-	1,785,007	18,000	33,005,000	-	-	33,023,000
Private offerings, net of costs .....	-	-	6,774,072	68,000	152,533,000	-	-	152,601,000
Exercise of stock options .....	-	-	39,024	-	651,000	-	-	651,000
In connection with a business combination .....	-	-	2,283,438	23,000	46,787,000	-	-	46,810,000
Public offerings, net of costs .....	-	-	5,025,800	50,000	118,810,000	-	-	118,860,000
Net income .....	-	-	-	-	-	29,400,000	-	29,400,000
Distributions paid .....	-	-	-	-	-	-	(21,806,000)	(21,806,000)
Adjustment to reflect minority interest to underlying ownership interest .....	-	-	-	-	(12,592,000)	-	-	(12,592,000)
<b>Balances at December 31, 1998</b> .....	-	-	23,635,650	236,000	482,471,000	32,554,000	(25,356,000)	489,905,000
Issuance of preferred stock, net of costs .....	2,200	55,000,000	-	-	(1,936,000)	-	-	53,064,000
Issuance of common stock .....	-	-	9,811	-	179,000	-	-	179,000
Net income .....	-	-	-	-	-	41,255,000	-	41,255,000

See accompanying notes.

**PS BUSINESS PARKS, INC.**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**

Distributions paid:									
Preferred stock .....	-	-	-	-	-	-	-	(3,406,000)	(3,406,000)
Common stock .....	-	-	-	-	-	-	-	(23,641,000)	(23,641,000)
Adjustment to reflect minority interest to underlying ownership interest .....	-	-	-	-	(1,825,000)	-	-	-	(1,825,000)
<b>Balances at December 31, 1999</b> .....	<u>2,200</u>	<u>\$55,000,000</u>	<u>23,645,461</u>	<u>\$ 236,000</u>	<u>\$ 478,889,000</u>	<u>\$ 73,809,000</u>	<u>\$ (52,403,000)</u>	<u>\$ 555,531,000</u>	<u>\$ 555,531,000</u>

See accompanying notes.

**PS BUSINESS PARKS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	For the Periods (Note 2)			
	For the Year Ended December 31, 1999	For the Year Ended December 31, 1998	April 1, 1997 through December 31, 1997	January 1, 1997 through March 31, 1997
<b>Cash flows from operating activities:</b>				
Net income .....	\$ 41,255,000	\$ 29,400,000	\$ 3,154,000	\$ 682,000
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization expense.....	29,762,000	18,908,000	4,375,000	820,000
Minority interest in income .....	16,049,000	11,208,000	6,753,000	1,813,000
Increase in receivables and other assets .....	(3,868,000)	(1,913,000)	(1,465,000)	(400,000)
Increase in accrued and other liabilities .....	5,242,000	2,625,000	780,000	2,925,000
Total adjustments .....	<u>47,185,000</u>	<u>30,828,000</u>	<u>10,443,000</u>	<u>5,158,000</u>
Net cash provided by operating activities .....	<u>88,440,000</u>	<u>60,228,000</u>	<u>13,597,000</u>	<u>5,840,000</u>
<b>Cash flows from investing activities:</b>				
Other investments .....	(18,470,000)	-	-	-
Acquisition of real estate facilities .....	(82,087,000)	(289,415,000)	(44,122,000)	-
Acquisition cost of business combination.....	-	(424,000)	-	-
Construction in progress.....	(14,550,000)	(7,716,000)	-	-
Capital improvements to real estate facilities .....	(16,211,000)	(11,091,000)	(2,983,000)	(582,000)
Net cash used in investing activities .....	<u>(131,318,000)</u>	<u>(308,646,000)</u>	<u>(47,105,000)</u>	<u>(582,000)</u>
<b>Cash flows from financing activities:</b>				
Borrowings from an affiliate.....	41,400,000	179,000,000	3,500,000	-
Repayment of borrowings from an affiliate .....	(41,400,000)	(182,500,000)	-	-
Borrowings from line of credit .....	14,000,000	12,500,000	-	-
Repayment of borrowings from line of credit.....	(26,500,000)	-	-	-
Principal payments on mortgage notes payable.....	(20,694,000)	(606,000)	-	-
Decrease (increase) in receivable from affiliate.....	-	-	1,135,000	(308,000)
Net proceeds from the issuance of common stock.....	179,000	272,112,000	33,800,000	80,000
Net proceeds from the issuance of preferred stock.....	53,064,000	-	-	-
Net proceeds from the issuance of preferred operating partnership units .....	129,613,000	-	-	-
Distributions paid to preferred shareholders .....	(3,406,000)	-	-	-
Distributions paid to minority interests - preferred units.....	(4,156,000)	-	-	-
Distributions paid to common shareholders .....	(23,641,000)	(21,806,000)	(3,550,000)	-
Distributions paid to minority interests - common units.....	(7,429,000)	(8,098,000)	(3,442,000)	-
Net cash provided by (used in) financing activities .....	<u>111,030,000</u>	<u>250,602,000</u>	<u>31,443,000</u>	<u>(228,000)</u>
Net increase (decrease) in cash and cash equivalents.....	68,152,000	2,184,000	(2,065,000)	5,030,000
Cash and cash equivalents at the beginning of the period.....	6,068,000	3,884,000	5,949,000	919,000
Cash and cash equivalents at the end of the period .....	<u>\$ 74,220,000</u>	<u>\$ 6,068,000</u>	<u>\$ 3,884,000</u>	<u>\$ 5,949,000</u>
<b>Supplemental disclosures:</b>				
Interest paid .....	<u>\$ 3,053,000</u>	<u>\$ 2,629,000</u>	<u>\$ 1,000</u>	<u>\$ -</u>

See accompanying notes.

**PS BUSINESS PARKS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	For the Year Ended December 31, 1999	For the Year Ended December 31, 1998	For the Periods (Note 2)	
			April 1, 1997 through December 31, 1997	January 1, 1997 through March 31, 1997
<b>supplemental schedule of non cash investing and financial activities:</b>				
Acquisitions of real estate facilities and associated assets and liabilities in exchange for preferred stock, minority interests, and mortgage notes payable:				
Real estate facilities .....	\$ (20,752,000)	\$ (44,592,000)	\$ (146,207,000)	\$ (117,180,000)
Other assets (deposits on real estate acquisitions).....	-	800,000	-	-
Accrued and other liabilities .....	-	3,531,000	4,419,000	-
Minority interest – common units .....	1,033,000	1,614,000	65,084,000	97,180,000
Preferred stock .....	-	-	-	12,000
Common stock.....	-	-	35,000	-
Paid-in capital .....	-	-	75,939,000	19,988,000
Mortgage notes payable .....	19,719,000	38,647,000	-	-
Intangible assets .....	-	-	730,000	-
Business combination:				
Real estate facilities .....	-	(48,305,000)	-	-
Other assets .....	-	(452,000)	-	-
Accrued and other liabilities .....	-	1,523,000	-	-
Common stock .....	-	23,000	-	-
Paid-in capital.....	-	46,787,000	-	-
Conversion of OP units into shares of common stock:				
Minority interest – common units .....	-	(33,023,000)	-	-
Common stock .....	-	18,000	-	-
Paid-in capital.....	-	33,005,000	-	-
Adjustment to reflect minority interest to underlying ownership interest:				
Minority interest.....	1,825,000	12,592,000	3,090,000	(1,813,000)
Paid in capital.....	(1,825,000)	(12,592,000)	(3,090,000)	1,813,000
Exchange of preferred stock for common stock:				
Preferred stock.....	-	-	-	(21,000)
Common stock.....	-	-	-	21,000
Adjustment to acquisition cost (see Note 2):				
Real estate facilities .....	-	(1,315,000)	-	(7,146,000)
Accumulated depreciation.....	-	-	-	(820,000)
Intangible assets .....	-	1,315,000	-	(4,395,000)
Paid-in capital .....	-	-	-	13,194,000
Cumulative net income .....	-	-	-	(833,000)
Capitalization of developed projects:				
Real estate facilities .....	13,650,000	-	-	-

See accompanying notes.

**PS BUSINESS PARKS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Construction in progress .....	(13,650,000)	-	-	-
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**PS BUSINESS PARKS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 1999**

**1. Organization and description of business**

*Organization*

PS Business Parks, Inc. ("PSB" or the "Company"), a California corporation, is the successor to American Office Park Properties, Inc. ("AOPP") which merged with and into Public Storage Properties XI, Inc. ("PSP 11") on March 17, 1998 (the "Merger"). The name of the Company was changed to "PS Business Parks, Inc." in connection with the Merger. See Note 3 for a description of the Merger and its terms.

Based upon the terms of the Merger, the transaction for financial reporting and accounting purposes has been accounted for as a reverse acquisition whereby AOPP is deemed to have acquired PSP11. However, PSP11 is the continuing legal entity and registrant for both Securities and Exchange Commission filing purposes and income tax reporting purposes. All subsequent references to PSB or the Company for periods prior to March 17, 1998 shall refer to AOPP.

On January 2, 1997, in connection with the reorganization of the commercial property operations of Public Storage, Inc. ("PSI") and affiliated entities, PSB formed a partnership (the "Operating Partnership") whereby PSB became the general partner. Concurrent with the formation of the Operating Partnership, PSI and affiliated entities contributed commercial properties to the Operating Partnership in exchange for operating partnership units ("OP units"). In addition, PSI contributed commercial properties to PSB in exchange for shares of non-voting participating preferred stock, and such properties were immediately contributed by PSB along with its commercial property management operations and cash to the Operating Partnership for OP units.

Subject to certain limitations as described in Note 8, holders of OP units, other than PSB, have the right to require PSB to redeem such holders' OP units at any time or from time to time beginning on the date that is one year after the date on which such limited partner is admitted to the Operating Partnership.

*Description of business*

PSB is a fully integrated, self-managed real estate investment trust ("REIT") that acquires, owns, operates and develops commercial properties containing commercial and industrial rental space. From 1986 through 1996, PSB's sole business activity consisted of the management of commercial properties owned primarily by PSI and affiliated entities.

Commencing in 1997, PSB began to own and operate commercial properties on its own behalf. At December 31, 1999, PSB and the Operating Partnership collectively owned and operated 125 commercial properties (approximately 12.4 million net rentable square feet) located in 11 states. In addition, the Operating Partnership managed 37 commercial properties (approximately 1.0 million net rentable square feet) on behalf of PSI and affiliated entities.

**2. Summary of significant accounting policies**

*Basis of presentation*

The consolidated financial statements include the accounts of PSB and the Operating Partnership. All significant intercompany balances and transactions have been eliminated in the consolidated financial statements. At December 31, 1999, PSB owned approximately 72.5% of the common units of the Operating Partnership. PSB, as the sole general partner of the Operating Partnership, has full, exclusive and complete

**PS BUSINESS PARKS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 1999**

responsibility and discretion in managing and controlling the Operating Partnership. Historical financial data of PSP11 have not been included in the historical financial statements of PSB.

On March 31, 1997, PSB and PSI agreed to exchange the non-voting participating preferred stock held by PSI for 2,098,288 shares of voting common stock of PSB. After the exchange, PSI owned in excess of 95% of the outstanding common voting common stock of PSB and PSB accounted for the transaction as if PSI acquired PSB in a transaction accounted for as a purchase. Accordingly, PSB reflected PSI's cost of its investment in PSB in accordance with Accounting Principles Board Opinion No. 16. As a result of PSI attaining control of PSB, the carrying value of PSB's assets and liabilities were adjusted to reflect PSI's acquisition cost of its controlling interest in PSB of approximately \$35 million. As a result, the carrying value of real estate facilities was increased approximately \$8.0 million, intangible assets increased approximately \$4.4 million and paid in capital increased approximately \$12.4 million.

Prior to March 31, 1997, control of PSB was held by entities other than PSI. As a result of PSI acquiring a majority of the voting common stock and control of PSB on March 31, 1997, the 1997 consolidated financial statements are presented separately for the period prior to March 31, 1997 (January 1, 1997 through March 31, 1997) and the period subsequent to March 31, 1997 (April 1, 1997 through December 31, 1997) when control was held by PSI.

*Use of estimates*

The preparation of the 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 consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

*Cash and cash equivalents*

PSB considers all highly liquid investments with an original maturity of three months or less at the date of purchase to be cash equivalents. The carrying amount of cash and cash equivalents approximates fair value.

*Real estate facilities*

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

Interest cost and property taxes incurred during the period of construction of real estate facilities are capitalized. Construction in progress and developed projects includes \$1,257,000 and \$268,000 of interest costs capitalized at December 31, 1999 and 1998, respectively. The Company capitalized \$989,000 and \$268,000 during the years ended December 31, 1999 and 1998, respectively.

*Intangible assets*

Intangible assets consist of property management contracts for properties managed, but not owned, by PSB. The intangible assets are being amortized over seven years. As properties managed are subsequently acquired by PSB, the unamortized basis of intangible assets related to such property is included in the cost of acquisition of such properties. During April 1997, PSB acquired four properties from PSI and included in the cost of real

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estate facilities for such properties is \$730,000 of cost previously classified as intangible assets. In connection with the Merger, PSB acquired 13 properties and included in the cost of such properties is \$1,315,000 (net of accumulated amortization of \$194,000) of costs previously classified as intangible assets. Intangible assets are net of accumulated amortization of \$874,000 and \$573,000 at December 31, 1999 and 1998, respectively.

*Evaluation of asset impairment*

PSB evaluates its assets used in operations, by identifying indicators of impairment and by comparing the sum of the estimated undiscounted future cash flows for each asset to the asset's carrying amount. When indicators of impairment are present and the sum of the undiscounted future cash flows is less than the carrying value of such asset, an impairment loss is recorded equal to the difference between the asset's current carrying value and its value based on discounting its estimated future cash flows. At December 31, 1999, no such indicators of impairment have been identified.

Assets held for disposition are reported at the lower of carrying amount or fair value less selling costs.

*Note payable to and borrowings from affiliate*

The Company borrowed \$3.5 million from PSI during 1997. The notes bore interest at 6.97% (per annum) and were repaid as of January 31, 1998.

The Company borrowed \$179 million from PSI during 1998. The notes bore interest at 6.91% (per annum) and were repaid as of May 27, 1998.

The Company borrowed \$41.4 million from PSI during 1999. The notes bore interest at 5.50% (per annum) and were repaid as of April 30, 1999.

*Stock-based compensation*

PSB has elected to adopt the disclosure requirements of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," but will continue to account for stock-based compensation under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees."

*Stock split and stock dividend*

On January 1, 1997, the number of outstanding shares of preferred and common stock increased as a result of a 10 for 1 stock split. In March 1997, the preferred stock of PSB was converted into common stock on a share for share basis. In December 1997, PSB declared a common stock dividend at a rate of 0.01583 shares for each common share outstanding. Similarly, the Operating Partnership's outstanding OP units were adjusted to reflect the stock dividend. No adjustment was made to the outstanding OP units for the January 1997 stock split, as the issuance of OP units during 1997 already reflected the stock split.

On March 17, 1998, in connection with the merger, PSB's common shares were converted into 1.18 shares of PSP11. Similarly, holders of OP units received an additional 0.18 OP units for each outstanding OP unit held at the time of the merger.

References in the consolidated financial statements and notes thereto with respect to shares of preferred stock, common stock, stock options, and OP units and the related per share/unit amounts have been retroactively

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adjusted to reflect the January 1997 stock split, the December 1997 stock dividend and the March 1998 conversion in connection with the Merger.

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*Revenue and expense recognition*

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

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

Property management fees are recognized in the period earned.

*General and administrative expense*

General and administrative expense includes executive compensation, office expense, professional fees, state income taxes, cost of acquisition personnel and other such administrative items. Such amounts include amounts incurred by PSI on behalf of PSB, which were subsequently charged to PSB in accordance with the allocation methodology pursuant to the cost allocation and administrative service agreement between PSB and PSI.

*Acquisition costs*

Internal acquisition costs are expensed as incurred.

*Income taxes*

During 1997, PSB qualified and intends to continue to qualify as a real estate investment trust ("REIT"), as defined in Section 856 of the Internal Revenue Code. As a REIT, PSB is not subject to federal income tax to the extent that it distributes its taxable income to its shareholders. In addition, REITs are subject to a number of organizational and operating requirements. If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to federal income tax (including any applicable alternative minimum tax) based on its taxable income using corporate income tax rates. Even if the Company qualifies for taxation as a REIT, the Company may be subject to certain state and local taxes on its income and property and to federal income and excise taxes on its undistributed taxable income. PSB believes it met all organizational and operating requirements to maintain its REIT status during 1999, 1998 and 1997. In addition, PSP11 (the legal entity for income tax reporting purposes subsequent to the March 17, 1998 merger) believes it has also met these requirements during 1998 and 1997. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

The difference between book income and taxable income primarily results from timing differences consisting of depreciation expense and unearned rental income.

*Net income per common share*

Per share amounts are computed using the weighted average common shares outstanding. "Diluted" weighted average common shares outstanding include the dilutive effect of stock options under the treasury stock method. "Basic" weighted average common shares outstanding excludes such dilutive effect. Earnings per share has been calculated as follows:

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Net income allocable to common shareholders .....	<u>\$37,849,000</u>	<u>\$ 29,400,000</u>	<u>\$ 3,154,000</u>	<u>\$ 682,000</u>
Weighted average common shares outstanding:				
Basic weighted average common shares outstanding.....	23,641,000	19,361,000	3,414,000	2,193,000
Net effect of dilutive stock options - based on treasury stock method using average market price.....	<u>68,000</u>	<u>68,000</u>	<u>12,000</u>	<u>-</u>
Diluted weighted average common shares outstanding .....	<u>23,709,000</u>	<u>19,429,000</u>	<u>3,426,000</u>	<u>2,193,000</u>
Basic earnings per common share .....	<u>\$ 1.60</u>	<u>\$ 1.52</u>	<u>\$ 0.92</u>	<u>\$ 0.31</u>
Diluted earnings per common share .....	<u>\$ 1.60</u>	<u>\$ 1.51</u>	<u>\$ 0.92</u>	<u>\$ 0.31</u>

*Segment Reporting*

Effective January 1, 1998, PSB adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 established standards for the way public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. SFAS 131 also establishes standards for related disclosures about products and services, geographic areas, and major customers. As management views the Company as operating in a single segment as described in Note 1, the adoption of SFAS No. 131 did not affect PSB's disclosure of segment information.

*Reclassifications*

Certain reclassifications have been made to the consolidated financial statements for 1998 in order to conform to the 1999 presentation.

**3. Business combination**

On March 17, 1998, AOPP merged into PSP11, a publicly traded real estate investment trust and an affiliate of PSI. Upon consummation of the Merger of AOPP into PSP11, the surviving corporation was renamed "PS Business Parks, Inc." (PSB as defined in Note 1). In connection with the Merger:

- Each outstanding share of PSP11 common stock, which did not elect cash, continued to be owned by current holders. A total of 106,155 PSP11 common shares elected to receive cash of \$20.50 per share.

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- Each share of PSP11 common stock Series B and each share of PSP11 common stock Series C converted into 0.8641 shares of PSP11 common stock.
- Each share of AOPP common stock converted into 1.18 shares of PSP11 common stock.
- Concurrent with the Merger, PSP11 exchanged 11 mini-warehouses and two properties that combine mini-warehouse and commercial space for 11 commercial properties owned by PSI. The fair value of each group of real estate facilities was approximately \$48 million.

The Merger has been accounted for as a reverse merger whereby PSB is treated as the accounting acquirer using the purchase method. This has been determined based upon the following: (i) the former shareholders and unitholders of PSB owned in excess of 80% of the merged companies and (ii) the business focus post-Merger will continue to be that of PSB's which includes the acquisition, ownership and management of commercial properties. Prior to the Merger, PSP11's business focus has been primarily on the ownership and operation of its self-storage facilities which represented approximately 81% of its portfolio.

Allocations of the total acquisition cost to the net assets acquired were made based upon the fair value of PSP11's assets and liabilities as of the date of the Merger. The acquisition cost and the fair market values of the assets acquired and liabilities assumed in the Merger are summarized as follows:

<b><u>Acquisition cost:</u></b>	
Issuance of common stock.....	\$46,810,000
Cash .....	424,000
Total acquisition cost.....	<u>\$47,234,000</u>

<b><u>Allocation of acquisition cost:</u></b>	
Real estate facilities .....	\$48,305,000
Other assets .....	452,000
Accrued and other liabilities .....	<u>(1,523,000)</u>
Total allocation.....	<u>\$47,234,000</u>

The historical operating results of PSP11 prior to the Merger have not been included in PSB's historical operating results. Pro forma data for the year ended December 31, 1998 and 1997 as though the Merger and related exchange of properties had been effective at the beginning of fiscal 1997 are as follows:

	For the Years Ended December 31,	
	1998	1997
Revenues .....	\$ 92,137,000	\$ 40,615,000
Net income .....	\$ 30,159,000	\$ 7,042,000
Net income per share – basic .....	\$ 1.52	\$ 1.30
Net income per share – diluted .....	\$ 1.52	\$ 1.30

The pro forma data does not purport to be indicative either of the results of operations that would have occurred had the Merger occurred at the beginning of fiscal 1997 or of the future results of PSB.

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**4. Real estate facilities**

The activity in real estate facilities for the years ended December 31, 1999 and 1998, the period from April 1, 1997 through December 31, 1997 and the period from January 1, 1997 through March 31, 1997 is as follows:

	Land	Buildings	Accumulated Depreciation	Total
Balances at December 31, 1996.....	\$ -	\$ -	\$ -	\$ -
Acquisitions from affiliates .....	35,154,000	82,026,000	-	117,180,000
Adjustment to reflect PSI's acquisition cost (Note 2).....	-	7,146,000	820,000	7,966,000
Capital improvements .....	-	582,000	-	582,000
Depreciation expense.....	-	-	(820,000)	(820,000)
Balances at March 31, 1997.....	35,154,000	89,754,000	-	124,908,000
Acquisition from affiliates .....	6,682,000	17,294,000	-	23,976,000
Acquisitions from third parties .....	49,918,000	116,435,000	-	166,353,000
Capital improvements .....	-	2,983,000	-	2,983,000
Depreciation expense.....	-	-	(3,982,000)	(3,982,000)
Balances at December 31, 1997.....	91,754,000	226,466,000	(3,982,000)	314,238,000
Property acquisitions .....	70,087,000	263,920,000	-	334,007,000
Acquired in connection with the Merger.....	14,400,000	33,905,000	-	48,305,000
Adjustment from intangible assets	-	1,315,000	-	1,315,000
Capital improvements .....	-	11,091,000	-	11,091,000
Depreciation expense.....	-	-	(18,535,000)	(18,535,000)
Balances at December 31, 1998.....	176,241,000	536,697,000	(22,517,000)	690,421,000
Property acquisitions .....	18,705,000	84,134,000	-	102,839,000
Developed projects .....	3,725,000	9,925,000	-	13,650,000
Property held for disposition .....	(4,531,000)	(10,706,000)	1,002,000	(14,235,000)
Capital improvements .....	-	16,211,000	-	16,211,000
Depreciation expense.....	-	-	(29,461,000)	(29,461,000)
Balances at December 31, 1999.....	<u>\$194,140,000</u>	<u>\$636,261,000</u>	<u>\$ (50,976,000)</u>	<u>\$ 779,425,000</u>

The unaudited adjusted basis of real estate facilities for Federal income tax purposes was approximately \$712 million at December 31, 1999.

Certain properties have been identified as not meeting the Company's ongoing investment strategy and have been designated as properties held for disposition at December 31, 1999. These properties are currently being marketed and the Company anticipates a gain on the sale in the next year. The following summarizes the condensed results of operations of the properties held for disposition which are included in the consolidated statements of income for the years ended December 31, 1999 and 1998, the period from April 1, 1997 through December 31, 1997 and the period from January 1, 1997 through March 31, 1997. Historical operating results may not be comparable since one of the properties held for disposition was acquired during the periods presented.

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	For the Year Ended December 31, 1999	For the Year Ended December 31, 1998	For the Period April 1 through December 31, 1997	For the Period January 1 through March 31, 1997
Rental income .....	\$ 4,283,000	\$ 4,056,000	\$ 1,761,000	\$ 85,000
Cost of operations .....	1,605,000	1,661,000	756,000	45,000
Net operating income .....	<u>\$ 2,678,000</u>	<u>\$ 2,395,000</u>	<u>\$ 1,005,000</u>	<u>\$ 40,000</u>

**5. 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 December 31, 1999 under these leases are as follows:

2000.....	\$ 98,798,000
2001.....	73,313,000
2002.....	50,962,000
2003.....	34,177,000
2004.....	21,692,000
Thereafter .....	38,941,000
	<u>\$ 317,883,000</u>

In addition to minimum rental payments, tenants pay reimbursements for their pro rata share of specified operating expenses, which amounted to \$16,591,000, \$10,357,000, \$2,597,000 and \$509,000 for the years ended December 31, 1999 and 1998, the period from April 1, 1997 through December 31, 1997 and the period from January 1, 1997 through March 31, 1997, respectively. These amounts are included as rental income and cost of operations in the accompanying statements of income.

**6. Revolving line of credit**

In August 1999, the Company extended its unsecured line of credit (the "Credit Facility") with Wells Fargo Bank. The Credit Facility has a borrowing limit of \$100 million and an expiration date of August 6, 2002. The expiration date may be extended by one year on each anniversary of the Credit Facility. Interest on outstanding borrowings is payable monthly. At the option of the Company, the rate of interest charged is equal to (i) the prime rate or (ii) a rate ranging from the London Interbank Offered Rate ("LIBOR") plus 0.75% to 1.35% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 1.00%). In addition, the Company is required to pay an annual commitment fee of 0.25%. At December 31, 1999, the Company had \$100 million available and no outstanding balance on the line of credit. At December 31, 1998, the Company had \$12.5 million outstanding on the line of credit at an interest rate of 5.93%.

The Credit Facility requires the Company to meet certain covenants including: (i) maintain a balance sheet leverage ratio (as defined) of less than 0.50 to 1.00, (ii) maintain interest and fixed charge coverage ratios (as defined) of not less than 2.25 to 1.0 and 1.75 to 1.0, respectively, (iii) maintain a minimum total shareholder's equity (as defined) and (iv) limit distributions to 95% of funds from operations. In addition, the Company is limited in its ability to incur additional borrowings (the Company is required to maintain unencumbered assets

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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 December 31, 1999.

**7. Mortgage notes payable**

Mortgage notes at December 31, 1999 and 1998 consist of the following:

	1999	1998
7.625% mortgage note.....	\$ -	\$ 11,418,000
7.125% mortgage note, secured by one commercial property with an approximate carrying amount of \$19,642,000, principal and interest payable monthly, due May 2006.....	8,751,000	8,905,000
8.400% mortgage note.....	-	8,672,000
8.190% mortgage note, secured by one commercial property with an approximate carrying amount of \$12,897,000, principal and interest payable monthly, due March 2007 .....	6,666,000	-
7.290% mortgage note, secured by one commercial property with an approximate carrying amounts totaling \$8,474,000, principal and interest payable monthly, due February 2009 .....	6,372,000	-
8.125% mortgage note, secured by one commercial property with an approximate carrying amount of \$12,251,000, principal and interest payable monthly, due July 2005.....	5,327,000	5,416,000
7.280% mortgage note, secured by two commercial properties with approximate carrying amounts totaling \$7,998,000, principal and interest payable monthly, due February 2003 .....	4,304,000	-
8.000% mortgage note, secured by one commercial property with an approximate carrying amount of \$5,658,000, principal and interest payable monthly, due April 2003 .....	2,108,000	-
8.500% mortgage note, secured by one commercial property with an approximate carrying amount of \$3,601,000, principal and interest payable monthly, due July 2007.....	1,898,000	1,939,000
8.000% mortgage note, secured by one commercial property with an approximate carrying amount of \$3,426,000, principal and interest payable monthly, due April 2003 .....	1,640,000	1,691,000
	\$37,066,000	\$38,041,000

At December 31, 1999, approximate principal maturities of mortgage notes payable are as follows:

2000.....	\$ 6,095,000
2001.....	829,000
2002.....	895,000
2003.....	7,870,000
2004.....	696,000
Thereafter .....	20,681,000
	\$ 37,066,000

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The mortgage notes have a weighted average interest rate of 7.67% and an average maturity of 5.6 years. Based on borrowing rates currently available to the Company, the carrying amount of debt approximates fair value.

On November 12, 1999, the Company prepaid a mortgage note payable of approximately \$8.5 million. The prepayment penalty of \$195,000 (net of minority interest of \$61,000) is included as an extraordinary loss on early extinguishment of debt for the year ended December 31, 1999.

**8. Minority interests – common units**

The Company presents the accounts of PSB and the Operating Partnership on a consolidated basis. Ownership interests in the Operating Partnership, other than PSB's interest, are classified as minority interest in the 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, 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 December 31, 1999, there were 7,443,356 OP units owned by minority interests (7,305,355 were owned by PSI and affiliated entities and 138,001 were owned by unaffiliated third parties). On a fully converted basis, assuming all 7,443,356 minority interest OP units were converted into shares of common stock of PSB at December 31, 1999, the minority interests would own approximately 23.9% of the common shares outstanding. At the end of each reporting period, PSB determines the amount of equity (book value of net assets) which is allocable to the minority interest based upon the ownership interest and an adjustment is made to the minority interest, with a corresponding adjustment to paid-in capital, to reflect the minority interests' equity in the Company.

**9. Minority interest – preferred units**

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

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

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

The Operating Partnership has the right to redeem the preferred units on or after the fifth anniversary of the issuance date at the original capital contribution plus the cumulative priority return, as defined, to the redemption date to the extent not previously distributed. The preferred units are exchangeable for Cumulative Redeemable Preferred Stock of the respective series of PS Business Parks, Inc. on or after the tenth anniversary of the date of issuance at the option of the Operating Partnership or majority of the holders of the preferred units. The Preferred Stock will have the same distribution rate and par value as the respective units and will have equivalent terms to those described in Note 11.

**10. Property management contracts**

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

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

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

**11. Shareholders' equity**

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

On January 7, 1998, a holder of OP units exercised its option and converted its 1,785,007 OP units into an equal number of shares of PSB common stock. The conversion resulted in an increase in shareholders' equity and a corresponding decrease in minority interest of approximately \$33,023,000 representing the book value of the OP units at the time of conversion.

In January 1998, PSB entered into an agreement with a group of institutional investors under which PSB agreed to issue up to 6,774,072 shares of common stock at \$22.88 per share in cash (an aggregate of \$155 million) in separate tranches. The first tranche, representing 2,185,187 shares or \$50 million, was issued in January 1998. PSB incurred \$2.4 million in costs associated with the issuance. The remainder of the common shares (4,588,885 common shares) was issued on May 6, 1998 and the net proceeds (\$105 million) were used to fund a portion of the cost to acquire commercial properties in May 1998.

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In May 1998, PSB completed two common stock offerings, raising net proceeds in aggregate totaling \$118.9 million through the issuance of 5,025,800 common shares. A portion of the net proceeds was used in connection with a \$190 million property portfolio acquisition.

On April 30, 1999, PSB issued 2,200,000 depositary shares each representing 1/1,000 of a share of 9 ¼% Cumulative Preferred Stock, Series A. Net proceeds from the public perpetual preferred stock offering were approximately \$53.1 million and were used to repay borrowings from an affiliate and a mortgage note payable of approximately \$11 million. The remaining proceeds were used for investment in real estate.

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 December 31, 1999, there were no dividends in arrears.

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

The Company paid distributions to its common shareholders totaling \$23,641,000 (\$1.00 per common share), \$21,806,000 (\$1.10 per common share) and \$3,550,000 (\$0.68 per common share) in 1999, 1998 and 1997, respectively. The Company paid distributions to its preferred shareholders totalling \$3,406,000 (1.548090 per depositary share) in 1999. No preferred distributions were paid in 1998 and 1997. Pursuant to restrictions on the Credit Facility, distributions may not exceed 95% of funds from operations, as defined.

**12. Stock options**

PSB has a 1997 Stock Option Plan (the "Plan"). Under the Plan, PSB has granted non-qualified options to certain directors, officers and key employees to purchase shares of PSB's common stock at a price no less than the fair market value of the common stock at the date of grant. Generally, options under the Plan vest over a three-year period from the date of grant at the rate of one third per year and expire ten years after the date of grant.

At December 31, 1999, there were 1,500,000 options authorized to grant. Information with respect to the Plan is as follows:

	Number of Options	Exercise Price	Weighted Average Exercise Price
Outstanding at December 31, 1996.....	-	-	-
Granted .....	305,570	\$16.69 - 22.88	\$16.80
Exercised.....	-	-	-
Canceled.....	-	-	-
Outstanding at December 31, 1997.....	305,570	\$16.69 - \$22.88	\$16.80
Granted .....	222,500	22.88 - 25.00	24.01
Exercised.....	(39,024)	16.69	16.69
Canceled.....	-	-	-
Outstanding at December 31, 1998.....	489,046	16.69 - 25.00	\$20.09
Granted .....	11,000	24.69 - 24.75	24.70
Exercised.....	(7,191)	16.69	16.69
Canceled.....	(10,497)	16.69 - 25.00	18.67
Outstanding at December 31, 1999.....	482,358	\$16.69 - \$25.00	\$20.28

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	Number of Options	Exercise Price	Weighted Average Exercise Price
Exercisable at:			
December 31, 1998.....	62,828	\$16.69 - \$22.88	\$16.87
December 31, 1999.....	226,417	\$16.69 - \$25.00	\$19.16

PSB adopted the disclosure requirement provision of SFAS No. 123 in accounting for stock-based compensation issued to employees. As of December 31, 1999 and 1998, there were 482,358 and 489,046 options outstanding, respectively, that were subject to SFAS No. 123 disclosure requirements. The fair value of these options was estimated utilizing prescribed valuation models and assumptions as of each respective grant date. Based on the results of such estimates, management determined that there was no material effect on net income or earnings per share for the years ended December 31, 1999 and 1998, the period from April 1, 1997 through December 31, 1997 and the period from January 1, 1997 through March 31, 1997. The remaining contractual lives were 7.9 and 8.9 years, respectively at December 31, 1999 and 1998.

**13. Recent accounting pronouncements**

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

**14. Supplementary quarterly financial data (unaudited)**

	Three Months Ended			
	March 31, 1998	June 30, 1998	September 30, 1998	December 31, 1998
Revenues .....	\$ 14,788,000	\$ 21,911,000	\$ 26,277,000	\$ 27,284,000
Net income allocable to common shareholders .....	\$ 4,330,000	\$ 7,046,000	\$ 9,748,000	\$ 8,276,000
<u>Per share data:</u>				
Net income - Basic .....	\$0.38	\$0.38	\$0.41	\$0.35
Net income - Diluted.....	\$0.38	\$0.38	\$0.41	\$0.35

	Three Months Ended			
	March 31, 1999	June 30, 1999	September 30, 1999	December 31, 1999
Revenues .....	\$ 29,251,000	\$ 31,248,000	\$ 33,281,000	\$ 34,833,000
Income before extraordinary item...	\$ 9,442,000	\$ 9,393,000	\$ 9,383,000	\$ 11,098,000
Net income allocable to common shareholders .....	\$ 9,442,000	\$ 9,393,000	\$ 9,383,000	\$ 9,631,000
<u>Per share data:</u>				
Income before extraordinary item - Basic .....	\$0.40	\$0.40	\$0.40	\$0.42

**PS BUSINESS PARKS, INC.**  
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Income before extraordinary item				
-Diluted.....	\$0.40	\$0.40	\$0.40	\$0.42

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**15. Commitments and contingencies**

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

Substantially all of the properties have been subjected to Phase I environmental reviews. Such reviews have not revealed, nor is management aware of, any probable or reasonably possible environmental costs that management believes would be material to the consolidated financial statements except as discussed below.

The Company acquired a property in Beaverton, Oregon ("Creekside Corporate Park") in May 1998. A property adjacent to Creekside Corporate Park is currently the subject of an environmental remedial investigation/feasibility study that is being conducted by the current and past owners of the property, pursuant to an order issued by the Oregon Department of Environmental Quality ("ODEQ"). As part of that study, ODEQ ordered the property owners to sample soil and groundwater on the Company's property to determine the nature and extent of contamination resulting from past industrial operations at the property subject to the study. The Company, which is not a party of the Order on Consent, executed separate Access Agreements with the property owners to allow access to its property to conduct the required sampling and testing. The sampling and testing is ongoing, and preliminary results from one area indicate that the contamination from the property subject to the study may have migrated onto a portion of Creekside Corporate Park owned by the Company.

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

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

On November 3, 1999, the Company filed an action in the Los Angeles Superior Court seeking damages in excess of \$1 million, as well as equitable relief. The complaint alleges that Mr. Howard and entities controlled by him engaged in unfair trade practices, including (1) negotiating kickbacks, secret rebates and/or unearned discounts from third party suppliers for "providing" Company business to those suppliers and (2) disrupting the Company's relationship with various suppliers (See Note 16).

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

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**16. Subsequent events**

The Company loaned an aggregate of \$77 million to PSI during the period of January 5, 2000 through March 8, 2000. The notes bore interest at 5.9% per year and were repaid as of March 20, 2000.

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

On March 2, 2000, the Board of Directors authorized the repurchase from time to time of up to 1,000,000 shares of the Company's common stock on the open market or in privately negotiated transactions. Purchases will be made subject to market conditions and other investment opportunities available to the Company. As of March 13, 2000, the Company repurchased 212,400 shares at an average price of \$21.43 per share.

**PS BUSINESS PARKS, INC.**  
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Description	Location	Encumbrances	Initial Cost to Company		Cost Capitalized Subsequent to Acquisition	Gross Amount at Which Carried at December 31, 1999			Accumulated Depreciation	Date Acquired	Depreciable Lives (Years)
			Land	Buildings and Improvements	Buildings and Improvements	Land	Buildings and Improvements	Totals			
I-435 .....	Overland Park, KS	\$-	\$890	\$2,176	\$98	\$890	\$2,274	\$3,164	\$139	3/17/98	5-30
Produce .....	San Francisco, CA	-	771	1,886	26	771	1,912	2,683	116	3/17/98	5-30
Crenshaw II .....	Torrance, CA	-	1,861	4,938	440	1,861	5,378	7,239	567	4/12/97	5-30
Airport .....	San Francisco, CA	-	897	2,387	90	897	2,477	3,374	239	4/12/97	5-30
Christopher Ave.....	Gaithersburg, MD	-	466	1,203	95	466	1,298	1,764	132	4/12/97	5-30
Monterey Park.....	Monterey Park, CA	-	3,078	7,862	330	3,078	8,192	11,270	803	1/1/97	5-30
Calle Del Oaks.....	Monterey, CA	-	282	706	110	282	816	1,098	86	1/1/97	5-30
Milwaukie I.....	Milwaukie, OR	-	690	1,754	345	690	2,099	2,789	242	1/1/97	5-30
Edwards Road.....	Cerritos, CA	-	450	1,217	202	450	1,419	1,869	142	1/1/97	5-30
Milwaukie II .....	Milwaukie, OR	-	435	1,103	167	435	1,270	1,705	87	1/1/97	5-30
Rainier.....	Renton, WA	-	330	889	153	330	1,042	1,372	102	1/1/97	5-30
Lusk .....	San Diego, CA	-	1,500	3,738	355	1,500	4,093	5,593	403	1/1/97	5-30
Eisenhower.....	Alexandria, VA	-	1,440	3,635	329	1,440	3,964	5,404	388	1/1/97	5-30
McKellips.....	Tempe, AZ	-	195	522	39	195	561	756	55	1/1/97	5-30
Crenshaw.....	Torrance, CA	-	450	1,131	87	450	1,218	1,668	84	1/1/97	5-30
Old Oakland Rd.....	San Jose, CA	-	3,458	8,765	428	3,458	9,193	12,651	902	1/1/97	5-30
Junipero.....	Signal Hill, CA	-	900	2,510	53	900	2,563	3,463	225	1/1/97	5-30
Watson Plaza .....	Lakewood, CA	-	930	2,360	106	930	2,466	3,396	239	1/1/97	5-30
Northgate Blvd. ....	Sacramento, CA	-	1,710	4,567	341	1,710	4,908	6,618	459	1/1/97	5-30
Camino Del Rio S. ....	San Diego, CA	-	930	2,388	364	930	2,752	3,682	271	1/1/97	5-30
Uplander.....	Culver City, CA	-	3,252	8,157	1,375	3,252	9,532	12,784	965	1/1/97	5-30
University .....	Tempe, AZ	-	2,160	5,454	562	2,160	6,016	8,176	597	1/1/97	5-30
E. 28 <sup>th</sup> Street .....	Signal Hill, CA	-	1,500	3,749	290	1,500	4,039	5,539	392	1/1/97	5-30
W. Main .....	Mesa, AZ	-	675	1,692	230	675	1,922	2,597	186	1/1/97	5-30
S. Edward.....	Tempe, AZ	-	645	1,653	345	645	1,998	2,643	198	1/1/97	5-30
Leapwood Ave.....	Carson, CA	-	990	2,496	556	990	3,052	4,042	313	1/1/97	5-30
Downtown Center.....	Nashville, TN	-	660	1,681	478	660	2,159	2,819	209	1/1/97	5-30
Airport South .....	Nashville, TN	-	660	1,657	171	660	1,828	2,488	178	1/1/97	5-30
Great Oaks.....	Woodbridge, VA	-	1,350	3,398	180	1,350	3,578	4,928	346	1/1/97	5-30
W. Concord Cir .....	Broken Arrow, OK	-	840	2,174	114	840	2,288	3,128	217	1/1/97	5-30
John Barrow .....	Little Rock, AR	-	780	1,998	95	780	2,093	2,873	202	1/1/97	5-30
S. Peoria.....	Tulsa, OK	-	375	962	35	375	997	1,372	96	1/1/97	5-30
Ventura Blvd. II.....	Studio City, CA	-	621	1,530	168	621	1,698	2,319	172	1/1/97	5-30
Largo 95.....	Largo, MD	-	3,085	7,332	398	3,085	7,730	10,815	638	9/24/97	5-30

**PS BUSINESS PARKS, INC.**  
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Gunston.....	Lorton, VA	-	4,146	17,872	256	4,146	18,128	22,274	1,510	6/17/98	5-30
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**PS BUSINESS PARKS, INC.**  
**SCHEDULE III - REAL ESTATE AND ACCUMULATED DEPRECIATION**  
**DECEMBER 31, 1999**  
**(DOLLARS IN THOUSANDS)**

Description	Location	Encumbrances	Initial Cost to Company		Cost Capitalized Subsequent to Acquisition	Gross Amount at Which Carried at December 31, 1999			Accumulated Depreciation	Date Acquired	Depreciable Lives (Years)
			Land	Buildings and Improvements	Buildings and Improvements	Land	Buildings and Improvements	Totals			
Canada.....	Lake Forest, CA	-	5,508	13,785	890	5,508	14,675	20,183	723	12/23/97	5-30
Ridge Route.....	Laguna Hills, CA	-	16,261	39,559	647	16,261	40,206	56,467	2,783	12/23/97	5-30
Lake Forest Commerce Park .	Laguna Hills, CA	-	2,037	5,051	167	2,037	5,218	7,255	628	12/23/97	5-30
Buena Park Industrial Center .	Buena Park, CA	-	3,245	7,703	655	3,245	8,358	11,603	622	12/23/97	5-30
Cerritos Business Center .....	Cerritos, CA	-	4,218	10,273	581	4,218	10,854	15,072	784	12/23/97	5-30
Parkway Commerce Center ...	Hayward, CA	-	4,398	10,433	654	4,398	11,087	15,485	785	12/23/97	5-30
Northpointe E.....	Sterling, VA	-	1,156	2,957	31	1,156	2,988	4,144	226	12/10/97	5-30
Ammendale .....	Beltsville, MD	-	4,278	18,380	721	4,278	19,101	23,379	2,338	1/13/98	5-30
Centrepoinete .....	Landover, MD	8,751	3,801	16,708	949	3,801	17,657	21,458	1,816	3/20/98	5-30
Shaw Road.....	Sterling, VA	5,327	2,969	10,008	474	2,969	10,482	13,451	1,200	3/9/98	5-30
Creekside-Phase 1.....	Beaverton, OR	-	4,519	13,651	354	4,519	14,005	18,524	1,380	5/4/98	5-30
Creekside-Phase 2 Bldg-4.....	Beaverton, OR	-	832	2,542	30	832	2,572	3,404	250	5/4/98	5-30
Creekside-Phase 2 Bldg-5.....	Beaverton, OR	-	521	1,603	-	521	1,603	2,121	157	5/4/98	5-30
Creekside-Phase 2 Bldg-1.....	Beaverton, OR	-	1,326	4,035	78	1,326	4,113	5,442	410	5/4/98	5-30
Creekside-Phase 3.....	Beaverton, OR	-	1,353	4,101	72	1,353	4,173	5,526	415	5/4/98	5-30
Creekside-Phase 5.....	Beaverton, OR	-	1,741	5,301	75	1,741	5,376	7,117	537	5/4/98	5-30
Creekside-Phase 6.....	Beaverton, OR	-	2,616	7,908	163	2,616	8,071	10,687	813	5/4/98	5-30
Creekside-Phase 7.....	Beaverton, OR	-	3,293	9,938	46	3,293	9,984	13,277	985	5/4/98	5-30
Creekside-Phase 8.....	Beaverton, OR	-	1,140	3,644	26	1,140	3,670	4,810	350	5/4/98	5-30
Woodside-Phase 1 .....	Beaverton, OR	-	2,987	8,982	120	2,987	9,102	12,089	902	5/4/98	5-30
Woodside-Phase 2 Bldg-6 .....	Beaverton, OR	-	255	784	38	255	822	1,077	91	5/4/98	5-30
Woodside-Phase 2 Bldg-7&8 .	Beaverton, OR	-	2,101	6,386	148	2,101	6,534	8,635	653	5/4/98	5-30
Woodside-Sequent 1.....	Beaverton, OR	-	2,890	8,672	27	2,890	8,699	11,589	862	5/4/98	5-30
Woodside-Sequent 5.....	Beaverton, OR	-	3,093	9,279	2	3,093	9,281	12,374	919	5/4/98	5-30
Northpointe G.....	Sterling, VA	1,898	824	2,964	76	824	3,040	3,864	263	6/11/98	5-30
Spectrum 95 .....	Landover, MD	-	1,610	7,129	201	1,610	7,330	8,940	533	9/30/98	5-30
Las Plumas .....	San Jose, CA	-	4,379	12,889	313	4,379	13,202	17,581	865	12/31/98	5-30
Lafayette.....	Chantilly, VA	-	671	4,179	4	671	4,183	4,854	212	01/29/99	5-30
Woodside-Greystone.....	Beaverton, OR	-	1,262	6,966	203	1,262	7,169	8,431	127	7/15/99	5-30
Dulles South.....	Chantilly, VA	1,945	599	3,098	-	599	3,098	3,697	82	6/30/99	5-30
Sullyfield Circle.....	Chantilly, VA	2,359	774	3,712	3	774	3,715	4,489	106	6/30/99	5-30
Park East I & II.....	Chantilly, VA	6,666	2,324	10,875	14	2,324	10,889	13,213	316	6/30/99	5-30
Park East III.....	Chantilly, VA	6,372	1,527	7,154	-	1,527	7,154	8,681	207	6/30/99	5-30
Northpointe Business Center .	Sacramento, CA	-	3,030	13,825	70	3,030	13,895	16,925	347	7/29/99	5-30

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Corporate Park Phoenix .....	Phoenix, AZ	-	2,761	10,269	11	2,761	10,280	13,041	3	12/30/99	5-30
So. Shaver.....	Pasadena, TX	-	464	1,184	160	464	1,344	1,808	130	1/1/97	5-30
Lamar Boulevard.....	Austin, TX	-	2,528	6,596	1,652	2,528	8,248	10,776	799	1/1/97	5-30
N. Barker's Landing.....	Houston, TX	-	1,140	3,003	505	1,140	3,508	4,648	351	1/1/97	5-30
One Park Ten.....	San Antonio, TX	-	1,500	4,266	3,026	1,500	7,292	8,792	702	1/1/97	5-30
Park Terrace .....	San Antonio, TX	-	360	987	277	360	1,264	1,624	124	1/1/97	5-30

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Description	Location	Encumbrances	Initial Cost to Company		Cost	Gross Amount at Which Carried at			Accumulated	Date	Depreciable
			Land	Buildings and	Capitalized	Land	Improvements	Totals			
				Improvements	Subsequent to		Improvements				(Years)
					Acquisition						
La Prada .....	Mesquite, TX	-	495	1,235	95	495	1,330	1,825	129	1/1/97	5-30
NW Highway .....	Garland, TX	-	480	1,203	33	480	1,236	1,716	119	1/1/97	5-30
Quail Valley .....	Missouri City, TX	-	360	918	78	360	996	1,356	96	1/1/97	5-30
Business Parkway I .....	Richardson, TX	-	759	3,372	199	759	3,571	4,330	359	5/4/98	5-30
The Summit .....	Plano, TX	-	1,536	6,654	838	1,536	7,492	9,028	806	5/4/98	5-30
Northgate II .....	Dallas, TX	-	1,274	5,505	613	1,274	6,118	7,392	673	5/4/98	5-30
Empire Commerce .....	Dallas, TX	-	304	1,545	84	304	1,629	1,933	140	5/4/98	5-30
Royal Tech – Digital .....	Las Colinas, TX	-	319	1,393	9	319	1,402	1,721	133	5/4/98	5-30
Royal Tech – Springwood .....	Las Colinas, TX	-	894	3,824	94	894	3,918	4,812	380	5/4/98	5-30
Royal Tech – Regent .....	Las Colinas, TX	-	606	2,615	233	606	2,848	3,454	287	5/4/98	5-30
Royal Tech – Bldg 7 .....	Las Colinas, TX	-	246	1,061	-	246	1,061	1,307	102	5/4/98	5-30
Royal Tech – NFTZ .....	Las Colinas, TX	-	1,517	6,499	109	1,517	6,608	8,125	644	5/4/98	5-30
Royal Tech – Olympus .....	Las Colinas, TX	-	1,060	4,531	12	1,060	4,543	5,603	441	5/4/98	5-30
Royal Tech – Honeywell .....	Las Colinas, TX	-	548	2,347	7	548	2,354	2,902	228	5/4/98	5-30
Royal Tech – Bldg 12 .....	Las Colinas, TX	-	1,466	6,263	7	1,466	6,270	7,736	609	5/4/98	5-30
Royal Tech – Bldg 13 .....	Las Colinas, TX	-	955	4,080	50	955	4,130	5,085	403	5/4/98	5-30
Royal Tech – Bldg 14 .....	Las Colinas, TX	-	2,010	10,242	-	2,010	10,242	12,251	926	5/4/98	5-30
Business Parkway II .....	Richardson, TX	-	40	196	4	40	200	241	17	5/4/98	5-30
Royal Tech – Bldg 15 .....	Irving, TX	-	1,307	5,600	170	1,307	5,770	7,077	459	11/4/98	5-30
Westchase Corporate Park .....	Houston, TX	-	2,173	7,338	5	2,173	7,343	9,516	2	12/30/99	5-30
Ben White 1 .....	Austin, TX	-	789	3,571	-	789	3,571	4,360	219	12/31/98	5-30
Ben White 5 .....	Austin, TX	-	761	3,444	15	761	3,459	4,220	213	12/31/98	5-30
McKalla 3 .....	Austin, TX	-	662	2,994	15	662	3,009	3,671	186	12/31/98	5-30
McKalla 4 .....	Austin, TX	-	749	3,390	24	749	3,414	4,163	213	12/31/98	5-30
Mopac 6 .....	Austin, TX	-	307	1,390	53	307	1,443	1,750	93	12/31/98	5-30
Waterford A .....	Austin, TX	-	597	2,752	-	597	2,752	3,349	156	1/06/99	5-30
Waterford B .....	Austin, TX	-	367	1,677	-	367	1,677	2,044	57	5/20/99	5-30
Waterford C .....	Austin, TX	-	1,144	5,225	2	1,144	5,227	6,371	178	5/20/99	5-30
McNeil 6 .....	Austin, TX	-	437	2,013	8	437	2,021	2,458	115	1/6/99	5-30
Rutland 11 .....	Austin, TX	-	325	1,536	10	325	1,546	1,871	86	1/6/99	5-30
Rutland 12 .....	Austin, TX	-	535	2,487	39	535	2,526	3,061	147	1/6/99	5-30
Rutland 13 .....	Austin, TX	-	469	2,190	5	469	2,195	2,664	123	1/6/99	5-30
Rutland 14 .....	Austin, TX	-	535	2,422	16	535	2,438	2,973	151	12/31/98	5-30
Rutland 19 .....	Austin, TX	-	158	762	3	158	765	923	42	1/6/99	5-30

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Description	Location	Encumbrances	Initial Cost to Company		Cost Capitalized Subsequent to Acquisition		Gross Amount at Which Carried at December 31, 1999		Accumulated Depreciation	Date Acquired	Depreciable Lives (Years)
			Land	Buildings and Improvements	Buildings and Improvements	Land	Buildings and Improvements	Totals			
Royal Tech - Bldg 16	Las Colinas, TX	-	2,464	2,703	114	2,464	2,817	5,281	56	7/1/99	5-30
Monroe Business Center .....	Herndon, VA	-	5,926	13,944	892	5,926	14,836	20,762	1,483	8/1/97	5-30
B & O.....	Baltimore, MD	-	4,067	9,522	1,776	4,067	11,298	15,365	1,102	8/1/97	5-30
Lusk II-R&D .....	San Diego, CA	-	1,081	2,644	133	1,081	2,777	3,858	173	3/17/98	5-30
Lusk II-Office.....	San Diego, CA	-	1,229	3,005	294	1,229	3,299	4,528	217	3/17/98	5-30
Norris Cn-Office.....	San Ramon, CA	-	792	1,939	185	792	2,124	2,916	239	3/17/98	5-30
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Norris Cn-R&D .....	San Ramon, CA	-	696	1,703	79	696	1,782	2,478	12	3/17/98	5-30
Northpointe D.....	Sterling, VA	1,640	787	2,882	9	787	2,891	3,678	252	6/11/98	5-30
Monroe II.....	Herndon, VA	2,108	811	4,967	164	811	5,131	5,942	284	1/29/99	5-30
Kearny Mesa-Office .....	San Diego, CA	-	790	1,933	356	790	2,289	3,079	156	3/17/98	5-30
Kearny Mesa-R&D.....	San Diego, CA	-	2,108	5,156	146	2,108	5,302	7,410	322	3/17/98	5-30
Bren Mar-Office.....	Alexandria, VA	-	573	1,401	412	573	1,813	2,386	158	3/17/98	5-30
Lusk III .....	San Diego, CA	-	1,906	4,662	217	1,906	4,879	6,785	301	3/17/98	5-30
Bren Mar-R&D.....	Alexandria, VA	-	1,627	3,979	78	1,627	4,057	5,684	246	3/17/98	5-30
Alban Road-Office.....	Springfield, VA	-	989	2,418	527	989	2,945	3,934	199	3/17/98	5-30
Alban Road-R&D.....	Springfield, VA	-	948	2,318	110	948	2,428	3,376	150	3/17/98	5-30
			<u>\$37,066</u>	<u>\$198,671</u>	<u>\$615,771</u>	<u>\$31,196</u>	<u>\$198,671</u>	<u>\$646,967</u>	<u>\$845,638</u>	<u>\$51,978</u>	

**PS BUSINESS PARKS, INC.**  
**SCHEDULE III - REAL ESTATE AND ACCUMULATED DEPRECIATION**  
**DECEMBER 31, 1999**

A summary of activity for real estate and accumulated depreciation is as follows:

Reconciliation of real estate:

	Years Ended December 31,		
	1999	1998	1997
Balance at beginning of period.....	\$ 712,938,000	\$ 318,220,000	\$ -
Additions during period:			
Acquisitions.....	102,839,000	378,321,000	314,655,000
Developed projects .....	13,650,000	-	-
Property held for disposition.....	(15,237,000)	-	-
Additional costs relating to prior year's acquisitions.....	-	5,306,000	-
Improvements .....	16,211,000	11,091,000	3,565,000
Balance at close of period .....	<u>\$830,401,000</u>	<u>\$ 712,938,000</u>	<u>\$ 318,220,000</u>

Reconciliation of accumulated depreciation:

	Years Ended December 31,		
	1999	1998	1997
Balance at beginning of period.....	\$ 22,517,000	\$ 3,982,000	\$ -
Additions during period:			
Property held for disposition.....	(1,002,000)	-	-
Depreciation.....	29,461,000	18,535,000	3,982,000
Balance at close of period .....	<u>\$ 50,976,000</u>	<u>\$ 22,517,000</u>	<u>\$ 3,982,000</u>

The unaudited adjusted basis of real estate facilities for Federal income tax purposes was approximately \$712 million at December 31, 1999.

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

	For the Year Ended December 31, 1999	For the Year Ended December 31, 1998	For the Period April 1 through December 31, 1997	For the Period January 1, through March 31, 1997
<b>Basic and Diluted Earnings Per Share:</b>				
Net income allocable to common shareholders .....	\$ 37,849,000	\$ 29,400,000	\$ 3,154,000	\$ 682,000
Weighted average common shares outstanding:				
Basic weighted average common shares outstanding .....	23,641,000	19,361,000	3,414,000	2,193,000
Net effect of dilutive stock options – based on treasury stock method using average market price .....	68,000	68,000	12,000	-
Diluted weighted average common shares outstanding ...	23,709,000	19,429,000	3,426,000	2,193,000
Basic earnings per common share .....	\$ 1.60	\$ 1.52	\$ 0.92	\$ 0.31
Diluted earnings per common share .....	\$ 1.60	\$ 1.51	\$ 0.92	\$ 0.31

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

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

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

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

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

**CONSENT OF INDEPENDENT AUDITORS**

We consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-48313) of PS Business Parks, Inc. pertaining to the PS Business Parks, Inc. 1997 Stock Option and Incentive Plan, and the Registration Statement on Form S-3 (No. 333-78627) and in the related prospectus of our report dated January 31, 2000 with respect to the consolidated financial statement and schedule of PS Business Parks, Inc. included in the Annual Report (Form 10-K) for the year ended December 31, 1999 filed with the Securities and Exchange Commission.

/s/ ERNST & YOUNG LLP

Los Angeles, California  
March 29, 2000

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

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<EPS-DILUTED>	1.60

# CORPORATE DATA

## PS Business Parks, Inc.

### *Corporate Headquarters*

701 Western Avenue  
Glendale, California 91201  
818.244.8080  
818.242.0566 Fax

### *Website*

[www.psbusinessparks.com](http://www.psbusinessparks.com)

### *Board of Directors*

RONALD L. HAVNER, JR.  
President, Chairman of the Board and  
Chief Executive Officer

VERN O. CURTIS  
Director

ARTHUR M. FRIEDMAN  
Director

JAMES H. KROPP  
Director

HARVEY LENKIN  
Director

ALAN K. PRIBBLE  
Director

JACK D. STEELE  
Director

### *Transfer Agent*

American Stock Transfer & Trust Company  
40 Wall Street, 46th Floor  
New York, NY 10005

### *Independent Auditors*

Ernst & Young LLP  
Los Angeles, CA

### *Stock Listing*

PS Business Parks, Inc. is traded on the American  
Stock Exchange under the symbol "PSB."



### *Executive Officers*

RONALD L. HAVNER, JR.  
President, Chairman of the Board and  
Chief Executive Officer

JACK E. CORRIGAN  
Vice President, Chief Financial Officer  
and Secretary

J. MICHAEL LYNCH  
Vice President and Director of Acquisitions  
and Development

### *Other Corporate Officers*

GLENN H. BENOIST  
Vice President

DAVID C. BISCHOFF  
Vice President

M. BRETT FRANKLIN  
Vice President

STEPHEN S. KING  
Vice President

EILEEN M. NEWKIRK  
Vice President

VINCENT R. CHAN  
Corporate Controller

STEVEN M. HEATH  
Property Operations Controller

### *Property Management*

PATRICIA D. ABBOTT  
Regional Manager

LISA M. FREITAS  
Regional Manager

MARIA A. HAWTHORNE  
Regional Manager

KATHLEEN L. JOHNSON  
Regional Manager

BRENDA K. LOVE  
Regional Manager

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