

DUKE REALTY CORP  
Form 10-Q  
November 09, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**  
**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended September 30, 2009

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-9044

**DUKE REALTY CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

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

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

**600 East 96<sup>th</sup> Street, Suite 100**

**Indianapolis, Indiana**  
(Address of Principal Executive Offices)

**46240**  
(Zip Code)

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

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

Yes  No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): YES  NO

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

Class	Outstanding at November 1, 2009
Common Stock, \$.01 par value per share	224,001,912 shares

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****DUKE REALTY CORPORATION AND SUBSIDIARIES****Consolidated Balance Sheets****(in thousands, except per share amounts)**

	September 30, 2009 (Unaudited)	December 31, 2008
<b><u>ASSETS</u></b>		
Real estate investments:		
Land and improvements	\$ 1,129,852	\$ 1,077,362
Buildings and tenant improvements	5,302,778	5,220,561
Construction in progress	144,748	159,330
Investments in and advances to unconsolidated companies	483,882	693,503
Undeveloped land	666,175	806,379
	7,727,435	7,957,135
Accumulated depreciation	(1,274,728)	(1,167,113)
Net real estate investments	6,452,707	6,790,022
Cash and cash equivalents	155,914	22,532
Accounts receivable, net of allowance of \$4,901 and \$1,777	23,880	28,026
Straight-line rent receivable, net of allowance of \$4,500 and \$4,086	132,763	123,863
Receivables on construction contracts, including retentions	32,446	75,100
Deferred financing costs, net of accumulated amortization of \$44,662 and \$38,046	45,997	47,907
Deferred leasing and other costs, net of accumulated amortization of \$228,147 and \$195,034	382,784	369,224
Escrow deposits and other assets	212,455	234,209
	\$ 7,438,946	\$ 7,690,883
<b><u>LIABILITIES AND EQUITY</u></b>		
Indebtedness:		
Secured debt	\$ 783,425	\$ 507,351
Unsecured notes	3,133,879	3,285,980
Unsecured lines of credit	15,299	483,659
	3,932,603	4,276,990
Construction payables and amounts due subcontractors, including retentions	66,790	105,227
Accrued real estate taxes	114,529	78,483
Accrued interest	40,701	56,376
Other accrued expenses	35,815	45,059
Other liabilities	203,426	187,425
Tenant security deposits and prepaid rents	37,142	41,348
Total liabilities	4,431,006	4,790,908
Shareholders' equity:		
Preferred shares (\$.01 par value); 5,000 shares authorized; 4,067 shares issued and outstanding	1,016,625	1,016,625

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Common shares (\$.01 par value); 400,000 shares authorized; 223,981 and 148,420 shares issued and outstanding	2,240	1,484
Additional paid-in capital	<b>3,265,270</b>	2,702,513
Accumulated other comprehensive income (loss)	<b>(6,440)</b>	(8,652)
Distributions in excess of net income	<b>(1,313,103)</b>	(867,951)
Total shareholders' equity	<b>2,964,592</b>	2,844,019
Noncontrolling interests	<b>43,348</b>	55,956
Total equity	<b>3,007,940</b>	2,899,975
	<b>\$ 7,438,946</b>	\$ 7,690,883

See accompanying Notes to Consolidated Financial Statements

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## DUKE REALTY CORPORATION AND SUBSIDIARIES

## Consolidated Statements of Operations

For the Three and Nine Months Ended September 30,

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	2009	2008	2009	2008
		(Revised)		(Revised)
<b>Revenues:</b>				
Rental and related revenue	\$ 224,013	\$ 215,264	\$ 669,713	\$ 638,512
General contractor and service fee revenue	100,880	93,316	335,412	271,847
	<b>324,893</b>	308,580	<b>1,005,125</b>	910,359
<b>Expenses:</b>				
Rental expenses	49,921	48,045	153,081	143,198
Real estate taxes	30,096	25,750	89,181	77,012
General contractor and Service Operations expenses	96,241	96,155	319,352	266,878
Depreciation and amortization	87,647	74,229	254,325	225,358
	<b>263,905</b>	244,179	<b>815,939</b>	712,446
<b>Other operating activities:</b>				
Equity in earnings of unconsolidated companies	2,364	204	7,353	17,184
Gain on disposition of Build-for-Sale properties		20,338		26,657
Earnings from sales of land		4,469	357	8,491
Undeveloped land carrying costs	(2,601)	(1,686)	(7,646)	(5,746)
Impairment charges	(285,168)	(2,474)	(302,637)	(5,273)
General and administrative expense	(11,233)	(10,448)	(34,713)	(29,500)
	<b>(296,638)</b>	10,403	<b>(337,286)</b>	11,813
Operating income (loss)	<b>(235,650)</b>	74,804	<b>(148,100)</b>	209,726
<b>Other income (expenses):</b>				
Interest and other income (expense), net	796	205	924	1,223
Interest expense	(57,719)	(50,071)	(161,746)	(146,001)
Gain (loss) on debt transactions	(13,631)		20,880	
Loss on business combinations			(999)	
Income (loss) from continuing operations before income taxes	<b>(306,204)</b>	24,938	<b>(289,041)</b>	64,948
Income tax benefit (expense)	(7,947)	4,239	(2,053)	4,915
Income (loss) from continuing operations	<b>(314,151)</b>	29,177	<b>(291,094)</b>	69,863
<b>Discontinued operations:</b>				
Income before impairment charges and gain on sales		466	36	3,092
Impairment charges			(772)	
Gain on sale of depreciable properties		1,299	5,168	11,940

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Income from discontinued operations		1,765	<b>4,432</b>	15,032
Net income (loss)	<b>(314,151)</b>	30,942	<b>(286,662)</b>	84,895
Dividends on preferred shares	<b>(18,363)</b>	(18,866)	<b>(55,089)</b>	(53,038)
Net (income) loss attributable to noncontrolling interests	<b>9,632</b>	(586)	<b>11,583</b>	(1,577)
Net income (loss) attributable to common shareholders	<b>\$ (322,882)</b>	\$ 11,490	<b>\$ (330,168)</b>	\$ 30,280
Basic net income (loss) per common share:				
Continuing operations attributable to common shareholders	<b>\$ (1.44)</b>	\$ .07	<b>\$ (1.73)</b>	\$ .10
Discontinued operations attributable to common shareholders		.01	<b>.02</b>	.10
Total	<b>\$ (1.44)</b>	\$ .08	<b>\$ (1.71)</b>	\$ .20
Diluted net income (loss) per common share:				
Continuing operations attributable to common shareholders	<b>\$ (1.44)</b>	\$ .07	<b>\$ (1.73)</b>	.10
Discontinued operations attributable to common shareholders		.01	<b>.02</b>	.10
Total	<b>\$ (1.44)</b>	\$ .08	<b>\$ (1.71)</b>	\$ .20
Weighted average number of common shares outstanding	<b>223,952</b>	146,966	<b>193,520</b>	146,680
Weighted average number of common shares and potential dilutive securities	<b>223,952</b>	154,836	<b>193,520</b>	154,623

See accompanying Notes to Consolidated Financial Statements

**Table of Contents****DUKE REALTY CORPORATION AND SUBSIDIARIES****Consolidated Statements of Cash Flows****For the nine months ended September 30,****(in thousands)****(Unaudited)**

	2009	2008 (Revised)
Cash flows from operating activities:		
Net income (loss)	\$ (286,662)	\$ 84,895
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation of buildings and tenant improvements	200,370	179,699
Amortization of deferred leasing and other costs	54,303	51,257
Amortization of deferred financing costs	10,134	10,134
Straight-line rent adjustment	(17,166)	(13,523)
Impairment charges	303,409	5,273
Gain on debt transactions	(20,880)	
Loss on business combination	999	
Earnings from land and depreciated property sales	(5,525)	(20,431)
Build-for-Sale operations, net	14,080	31,558
Construction contracts, net	2,482	(12,748)
Other accrued revenues and expenses, net	39,241	6,420
Operating distributions received in excess of equity in earnings from unconsolidated companies	8,973	6,730
<b>Net cash provided by operating activities</b>	<b>303,758</b>	<b>329,264</b>
Cash flows from investing activities:		
Development of real estate investments	(219,346)	(365,781)
Acquisition of real estate investments and related intangible assets	(16,591)	(20,123)
Acquisition of undeveloped land	(5,474)	(35,564)
Recurring tenant improvements, leasing costs and building improvements	(55,976)	(52,396)
Other deferred leasing costs	(11,190)	(18,930)
Other deferred costs and other assets	(6,355)	(8,392)
Proceeds from land and depreciated property sales, net	113,072	85,717
Capital distributions from unconsolidated companies		65,553
Capital contributions and advances to unconsolidated companies, net	(17,542)	(78,760)
<b>Net cash used for investing activities</b>	<b>(219,402)</b>	<b>(428,676)</b>
Cash flows from financing activities:		
Proceeds from issuance of common shares	551,594	14,020
Proceeds from issuance of preferred shares, net		290,014
Proceeds from unsecured debt issuance	500,000	325,000
Payments on and repurchases of unsecured debt	(624,875)	(225,000)
Proceeds from secured debt financings	285,339	
Payments on secured indebtedness including principal amortization	(8,823)	(43,103)
Payments on lines of credit, net	(468,360)	(12,358)
Distributions to common shareholders	(113,251)	(211,898)
Distributions to preferred shareholders	(55,089)	(53,038)
Distributions to noncontrolling interests, net	(399)	(10,481)



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Cash settlement of interest rate swaps		(14,625)
Deferred financing costs	(17,110)	(3,661)
<b>Net cash provided by financing activities</b>	<b>49,026</b>	54,870
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>133,382</b>	(44,542)
Cash and cash equivalents at beginning of period	22,532	48,012
Cash and cash equivalents at end of period	\$ 155,914	\$ 3,470
Non-cash investing and financing activities:		
Conversion of Limited Partner Units to common shares	\$ 626	\$ 5,499
Assumption of secured debt for real estate acquisitions	\$	\$ 39,480
Contribution of property to, net of debt assumed by, unconsolidated companies	\$ 8,054	\$ 113,688
Consolidation of previously unconsolidated companies	\$ 206,852	\$
Distribution of property from partner in unconsolidated company	\$	\$ 28,577

See accompanying Notes to Consolidated Financial Statements

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## DUKE REALTY CORPORATION AND SUBSIDIARIES

## Consolidated Statement of Changes in Equity

For the nine months ended September 30, 2009

(in thousands, except per share data)

(Unaudited)

	Common Shareholders							
	Preferred	Common	Additional	Accumulated	Distributions	Non-		
	Stock	Stock	Paid-in	Other	in Excess of	controlling		Total
			Capital	Income	Net Income	Interests		
				(Loss)				
<b>Balance at December 31, 2008</b>	<b>\$ 1,016,625</b>	<b>\$ 1,484</b>	<b>\$ 2,702,513</b>	<b>\$ (8,652)</b>	<b>\$ (867,951)</b>	<b>\$ 55,956</b>		<b>\$ 2,899,975</b>
Comprehensive Income:								
Net loss					(275,079)	(11,583)		(286,662)
Derivative instrument activity				2,212				2,212
Comprehensive loss								\$ (284,450)
Issuance of common shares		752	551,110					551,862
Stock based compensation plan activity		2	11,023		(1,733)			9,292
Conversion of Limited Partner Units		2	624			(626)		
Distributions to preferred shareholders					(55,089)			(55,089)
Distributions to common shareholders (\$0.59 per share)					(113,251)			(113,251)
Distributions to noncontrolling interests, net						(399)		(399)
<b>Balance at September 30, 2009</b>	<b>\$ 1,016,625</b>	<b>\$ 2,240</b>	<b>\$ 3,265,270</b>	<b>\$ (6,440)</b>	<b>\$ (1,313,103)</b>	<b>\$ 43,348</b>		<b>\$ 3,007,940</b>

See accompanying Notes to Consolidated Financial Statements

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**DUKE REALTY CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. General Basis of Presentation**

The interim consolidated financial statements included herein have been prepared by Duke Realty Corporation (the Company) without audit. The 2008 year-end consolidated balance sheet data included in this Quarterly Report on Form 10-Q (this Report) was derived from our audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (GAAP). Our audited financial statements, as adjusted for the retrospective application of new accounting standards, are included as Exhibit 99.2 to a Current Report on Form 8-K filed on July 22, 2009. The financial statements have been prepared in accordance with GAAP for interim financial information and in accordance with Rule 10-01 of Regulation S-X of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenue and expenses during the reporting period. Our actual results could differ from those estimates and assumptions. These financial statements should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included herein and the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008 or on our Current Report on Form 8-K filed on July 22, 2009.

We believe we qualify as a real estate investment trust (REIT) under the provisions of the Internal Revenue Code of 1986, as amended. Substantially all of our Rental Operations (see Note 9) are conducted through Duke Realty Limited Partnership (DRLP). We owned approximately 97.1% of the common partnership interests of DRLP (Units) at September 30, 2009. At the option of the holders, subject to certain restrictions, the remaining Units are redeemable for shares of our common stock on a one-to-one basis and earn dividends at the same rate as shares of our common stock. If determined to be necessary in order to continue to qualify as a REIT, we may elect to purchase the Units for an equivalent amount of cash rather than issuing shares of common stock upon redemption. We conduct our Service Operations (see Note 9) through Duke Realty Services LLC, Duke Realty Services Limited Partnership and Duke Construction Limited Partnership, which is owned through a taxable REIT subsidiary. The consolidated financial statements include our accounts and the accounts of our majority-owned or controlled subsidiaries. In this Report, unless the context indicates otherwise, the terms we, us and our refer to the Company and those entities owned or controlled by the Company.

**2. New Accounting Pronouncements**

**Fair Value Accounting**

Based on the guidance provided by the Financial Accounting Standards Board (FASB), we only implemented the new accounting standards on fair value measurements as of January 1, 2008, for financial instruments. The new standard on fair value measurements (FASB Accounting Standard Codification (ASC) 820) was adopted on January 1, 2009 for nonfinancial long-lived asset groups that may be measured at fair value for an impairment assessment, reporting units measured at fair value in the first step of the goodwill impairment test, and nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination.

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Additional transition guidance, which was effective for us on April 1, 2009, provides criteria to enable a determination to be made as to whether or not a market is active. If markets are determined to be inactive, then an analysis is required as to whether an individual market transaction is not indicative of fair value, potentially requiring fair value to be estimated utilizing inputs other than market transactions.

Further authoritative guidance regarding valuation methodologies that are acceptable for measuring the fair value of a liability will become effective for us on October 1, 2009. We do not expect the new guidance to have a material impact on our results of operations or financial position.

Assets and liabilities recorded at fair value on the consolidated balance sheets are categorized based on the inputs to the valuation techniques as follows:

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities to which we have access.

Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

## **Convertible Debt Accounting**

On January 1, 2009, we adopted a new accounting standard (FASB ASC 470) for convertible debt instruments that may be settled in cash upon conversion. This new standard requires separate accounting for the debt and equity components of certain convertible instruments. Our 3.75% Exchangeable Senior Notes ( Exchangeable Notes ), issued in November 2006, have an exchange rate of 20.47 common shares per \$1,000 principal amount of the notes, representing an exchange price of \$48.85 per share of our common stock. The Exchangeable Notes are subject to the accounting changes required by this new standard, which requires that the value assigned to the debt component equal the estimated fair value of debt with similar contractual cash flows, but without the conversion feature, resulting in the debt being recorded at a discount. The resulting debt discount will be amortized over the period from its issuance through November 2011, the first optional redemption date, as additional non-cash interest expense. We are required to apply this new accounting standard retrospectively to prior periods.

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At September 30, 2009, the Exchangeable Notes had \$235.4 million of principal outstanding, an unamortized discount of \$6.7 million and a net carrying amount of \$228.7 million. The carrying amount of the equity component was \$34.7 million at September 30, 2009. Subsequent to the implementation of the new standard, interest expense is recognized on the Exchangeable Notes at an effective rate of 5.6%. The increase to interest expense (in thousands) on the Exchangeable Notes, which led to a corresponding decrease to net income, for the three and nine months ended September 30, 2009 and 2008 is summarized as follows:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Interest expense on Exchangeable Notes, excluding effect of accounting for convertible debt	<b>\$ 3,499</b>	\$ 5,391	<b>\$ 12,631</b>	\$ 16,172
Effect of accounting for convertible debt	<b>1,321</b>	1,646	<b>4,296</b>	4,865
<b>Total interest expense on Exchangeable Notes</b>	<b>\$ 4,820</b>	\$ 7,037	<b>\$ 16,927</b>	\$ 21,037

**Purchase Accounting**

On January 1, 2009, we adopted a new accounting standard (FASB ASC 805) on purchase accounting, which requires acquisition related costs to be immediately expensed as period costs. This new standard also requires that 100% of the assets and liabilities of an acquired entity, as opposed to the amount proportional to the portion acquired, must be recorded at fair value upon an acquisition and that a gain or loss must be recognized for the difference between the fair value and the carrying value of any existing ownership interests in acquired entities. Finally, this new standard requires that contingencies arising from a business combination be recorded at fair value if the acquisition date fair value can be determined during the measurement period.

**Noncontrolling Interests**

On January 1, 2009, we adopted a new accounting standard (FASB ASC 810) on noncontrolling interests, which requires noncontrolling interests (previously referred to as minority interests) to be reported as a component of total equity, resulting in changes to the presentation of the noncontrolling interests in the consolidated balance sheets and statements of operations. This new standard also modifies the accounting for changes in the level of ownership in consolidated subsidiaries. The reclassification of noncontrolling interests on the consolidated statements of operations caused an increase of \$586,000 and \$1.6 million, inclusive of the noncontrolling interest share of the effect of convertible debt accounting, to previously reported net income for the three and nine months ended September 30, 2008, respectively.

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### **Participating Securities**

During the first quarter of 2009, we adopted a new accounting standard (FASB ASC 260-10) on participating securities, which we have applied retrospectively to prior period calculations of basic and diluted earnings per common share. Pursuant to this new standard, certain of our share-based awards are considered participating securities because they earn dividend equivalents that are not forfeited even if the underlying award does not vest.

The effect of including the share-based awards as participating securities resulted in a decrease to basic net income attributable to common shareholders of approximately \$409,000 and \$1.2 million in the three and nine months ended September 30, 2008, respectively. Because those share-based awards were included as participating securities for computation of basic net income per share, applying the treasury stock method to those share-based awards would have been anti-dilutive for computing diluted earnings per share, thus the implementation of this new standard also resulted in a decrease to diluted net income attributable to common shareholders of approximately \$409,000 and \$1.2 million and a reduction in dilutive potential shares outstanding of approximately 508,000 and 482,000 in the three and nine months ended September 30, 2008, respectively.

### **Subsequent Events**

During the second quarter of 2009, we adopted a new accounting standard (FASB ASC 855) on subsequent events, which codifies authoritative guidance within the GAAP hierarchy for the accounting for, and disclosure of, subsequent events. This new standard does not change our existing accounting practices for subsequent events, as it is a codification of authoritative guidance that was previously included in generally accepted auditing standards.

### **Interim Fair Value of Financial Instruments Disclosures**

During the second quarter of 2009, we adopted a new accounting standard (FASB ASC 825) on interim disclosures regarding the fair value of financial instruments, which requires the fair value of our debt to be disclosed on a quarterly basis in the notes to the financial statements. These disclosures were previously only required to be made annually. The required disclosures are made in Note 5.

### **FASB Codification**

During the third quarter of 2009, we adopted the FASB's new codification standard, which reorganized all existing authoritative pronouncements from the various U.S. accounting standard setters into one comprehensive body of literature. The codification has no effect on any of our accounting policies.

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In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* ( SFAS 167 ). SFAS 167 eliminates the primarily quantitative model currently in effect to determine the primary beneficiary of a variable interest entity ( VIE ) and replaces it with a qualitative model that focuses on which entities have the power to direct the activities of the VIE as well as the obligation or rights to absorb the VIE's losses or receive its benefits. SFAS 167 will also require assessments at each reporting period of which party within the VIE is considered the primary beneficiary and will require a number of new disclosures related to VIEs. The reconsideration of the initial determination of VIE status is still based on the occurrence of certain events. SFAS 167 will be effective for fiscal years and interim periods beginning after November 15, 2009. We are still evaluating the effect of adopting SFAS 167.

**3. Consolidation of Retail Joint Ventures**

Through March 31, 2009, we were a member in two retail real estate joint ventures with a retail developer. Both entities were jointly controlled by us and our partner, through equal voting interests, and were accounted for as unconsolidated subsidiaries under the equity method. As of April 1, 2009, we had made combined equity contributions of \$37.9 million to the two entities and we also had combined outstanding principal and accrued interest of \$173.0 million on advances to the two entities.

We advanced \$2.0 million to the two entities, who then distributed the \$2.0 million to our partner in exchange for the redemption of our partner's membership interests, effective April 1, 2009, at which time we obtained 100% control of the voting interests of both entities. We entered these transactions to gain control of these two entities because it will allow us to operate or dispose of the entities in a manner that best serves our capital needs.

In conjunction with the redemption of our partner's membership interests, we entered a profits interest agreement that entitles our former partner to additional payments should the combined sales of the two acquired entities, as well as the sale of another retail real estate joint venture that we and our partner still jointly control, result in an aggregate profit. Aggregate profit on the sale of these three projects will be calculated by using a formula defined in the profits interest agreement. We have estimated that the fair value of the potential additional payment to our partner is insignificant and, thus, did not recognize a liability at the acquisition date.

A summary of the fair value of amounts recognized for each major class of assets and liabilities acquired is as follows (in thousands):

Operating rental properties	\$ 176,038
Undeveloped land	6,500
<b>Total real estate investments</b>	<b>182,538</b>
Other assets	3,987
Lease related intangible assets	24,350
<b>Total assets acquired</b>	<b>210,875</b>
Liabilities assumed	(4,023)
<b>Net recognized value of acquired assets and liabilities</b>	<b>\$ 206,852</b>

The fair values recognized from the real estate and related assets acquired were primarily determined using the income approach. The most significant assumptions in the fair value estimates were the discount rates and the exit capitalization rates. The estimates of fair value were determined to have primarily relied upon Level 3 inputs.

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We recognized a loss of \$999,000 upon acquisition, which represents the difference between the fair value of the recognized assets and the carrying value of our pre-existing equity interest. The acquisition date fair value of the net recognized assets as compared to the acquisition date carrying value of our outstanding advances and accrued interest, as well as the acquisition date carrying value of our pre-existing equity interests, is shown as follows (in thousands):

Net fair value of acquired assets and liabilities	\$ 206,852
Less advances to acquired entities eliminated upon consolidation	(173,006)
Less acquisition date carrying value of equity in acquired entities	(34,845)
Loss on business combination	\$ (999)

Since April 1, 2009, the results of operations for both acquired entities have been included in continuing operations in our consolidated financial statements. Due to our significant pre-existing ownership and financing positions in the two acquired entities, the inclusion of their results of operations did not have a material effect on our operating income.

**4. Reclassifications**

Certain amounts in the accompanying consolidated financial statements for 2008 have been reclassified to conform to the 2009 consolidated financial statement presentation.

**5. Indebtedness**

The following table summarizes the book value and changes in the fair value of our debt for the nine months ended September 30, 2009 (in thousands):

	Book Value at 12/31/08	Book Value at 9/30/09	Fair Value at 12/31/08	Total Realized Losses/(Gains)	Issuances/ Payoffs	Adjustments to Fair Value	Fair Value at 9/30/09
Fixed rate secured debt	\$ 499,061	\$ 769,006	\$ 438,049	\$	\$ 278,500	\$ (7,019)	\$ 709,530
Variable rate secured debt	8,290	14,419	8,290		6,839	(710)	14,419
Fixed rate unsecured notes	3,285,980	3,133,879	2,196,689	(42,028)	(124,875)	1,056,254	3,086,040
Unsecured lines of credit	483,659	15,299	477,080		(468,360)	5,422	14,142
Total	\$ 4,276,990	\$ 3,932,603	\$ 3,120,108	\$ (42,028)	\$ (307,896)	\$ 1,053,947	\$ 3,824,131

*Fixed Rate Secured Debt*

In February, March and July 2009, we borrowed a total of \$270.0 million from three 10-year fixed rate secured debt financings that are secured by 32 existing rental properties. The secured debt bears interest at a weighted average rate of 7.7% and matures at various points in 2019. In June 2009, we borrowed \$8.5 million from two 6.5% 10-year fixed rate mortgages due in 2019, secured by two newly acquired properties. One of our consolidated subsidiaries also borrowed \$6.8 million, bearing interest at LIBOR plus 2.70% and maturing in April 2012, on a secured construction loan during the three-month period ended September 30, 2009.

We utilized a discounted cash flow methodology in order to determine the fair value of our fixed rate secured debt. The net present value of the difference between future contractual interest payments and future interest payments based on our estimate of a current market rate represents the difference between the book value and the fair value. Our estimate of a current market rate is based upon the rate at which we estimate we could obtain similar borrowings when considering current market conditions. The current market rates we utilized were internally estimated; therefore, we have concluded that our determination of fair value for our fixed rate secured debt was primarily based upon Level 3 inputs.





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In February 2009, we repaid \$124.0 million of 6.83% corporate unsecured debt at its scheduled maturity date. During the nine-month period ended September 30, 2009, we also repurchased portions of various series of senior unsecured notes, both on the open market and through cash tender offers, for \$500.9 million. The total face value of these repurchases was \$542.9 million. We recognized a gain of \$27.5 million on the repurchases after writing off applicable issuance costs and other accounting adjustments. The aforementioned gains on repurchase, were partially offset by a \$6.6 million charge to write off fees paid for a cancelled secured debt transaction.

In August 2009, we issued \$500.0 million of unsecured notes in two equal tranches. The first \$250.0 million of the unsecured notes mature in February 2015 and bear interest at an effective rate of 7.50% while the other \$250.0 million of the notes mature in August 2019 and bear interest at an effective rate of 8.38%.

We utilized multiple broker estimates in estimating the fair value of our fixed rate unsecured debt. Our unsecured notes are thinly traded and, in many cases, the broker estimates were not based upon comparable transactions. As such, we have determined that our estimation of the fair value of our fixed rate unsecured debt was primarily based upon Level 3 inputs.

The indentures (and related supplemental indentures) governing our outstanding series of notes also require us to comply with financial ratios and other covenants regarding our operations. We were in compliance with all such covenants as of September 30, 2009.

*Unsecured Lines of Credit*

Our unsecured lines of credit as of September 30, 2009 are described as follows (in thousands):

Description	Borrowing Capacity	Maturity Date	Outstanding Balance at September 30, 2009
Unsecured Line of Credit DRLP	\$ 1,300,000	January 2010	\$
Unsecured Line of Credit Consolidated Subsidiary	\$ 30,000	July 2011	\$ 15,299

We have historically used the DRLP unsecured line of credit to fund development activities, acquire additional rental properties and provide working capital. We repaid all outstanding amounts on this line of credit during the third quarter of 2009. This line of credit provides us with an option to obtain borrowings from financial institutions that participate in the line, at rates that may be lower than the stated interest rate, subject to certain restrictions. The stated rate on the DRLP unsecured line of credit, as of September 30, 2009, was LIBOR plus .65%. We may, at our sole discretion, exercise an option to extend the maturity date of the DRLP line of credit to January 2011. This line of credit also contains various financial covenants that require us to meet financial ratios and defined levels of performance, including those related to fixed charge coverage, variable rate indebtedness, consolidated net worth and debt-to-asset value (with asset value being defined in the DRLP line of credit agreement). As of September 30, 2009, we were in compliance with all covenants under this line of credit.

The consolidated subsidiary's unsecured line of credit allows for borrowings up to \$30.0 million at a rate of LIBOR plus .85% (equal to 1.10% for outstanding borrowings as of September 30, 2009). This unsecured line of credit is used to fund development activities within the consolidated subsidiary and matures in July 2011 with, at our option, a 12-month extension option.

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To the extent that there are outstanding borrowings, we utilize a discounted cash flow methodology in order to estimate the fair value of our unsecured lines of credit. The net present value of the difference between future contractual interest payments and future interest payments based on our estimate of a current market rate represents the difference between the book value and the fair value. Our estimate of a current market rate is based upon the rate, considering current market conditions and our specific credit profile, at which we estimate we could obtain similar borrowings. The current market rate we utilized was internally estimated; therefore, we have concluded that our determination of fair value for our unsecured lines of credit was primarily based upon Level 3 inputs.

**6. Shareholders Equity**

In April 2009, we issued 75.2 million shares of common stock for net proceeds of \$551.9 million. The proceeds from this offering were contributed to DRLP in exchange for additional Units in DRLP and were used to repay outstanding borrowings under the DRLP unsecured line of credit and for other general corporate purposes.

**7. Related Party Transactions**

We provide property management, leasing, construction and other tenant related services to unconsolidated companies in which we have equity interests. For the nine months ended September 30, 2009 and 2008, respectively, we earned management fees of \$6.2 million and \$5.6 million, leasing fees of \$2.9 million and \$1.9 million and construction and development fees of \$8.6 million and \$9.6 million from these companies. We recorded these fees based on contractual terms that approximate market rates for these types of services and we have eliminated our ownership percentage of these fees in the consolidated financial statements.

**8. Net Income (Loss) Per Common Share**

Basic net income (loss) per common share is computed by dividing net income (loss) attributable to common shareholders, less dividends on share-based awards expected to vest, by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per common share is computed by dividing the sum of basic net income (loss) attributable to common shareholders and the noncontrolling interest in earnings allocable to Units not owned by us (to the extent the Units are dilutive), by the sum of the weighted average number of common shares outstanding and, to the extent they are dilutive, limited partnership Units outstanding, as well as any potential dilutive securities for the period.

The following table reconciles the components of basic and diluted net income (loss) per common share for the three and nine months ended September 30, 2009 and 2008, respectively (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net income (loss) attributable to common shareholders	\$ (322,882)	\$ 11,490	\$ (330,168)	\$ 30,280
Less: Dividends on share-based awards expected to vest	(391)	(409)	(1,366)	(1,218)
Basic net income (loss) attributable to common shareholders	(323,273)	11,081	(331,534)	29,062
Noncontrolling interest in earnings of common unitholders (1)		605		1,615
Diluted net income (loss) attributable to common shareholders	\$ (323,273)	\$ 11,686	\$ (331,534)	\$ 30,677
Weighted average number of common shares outstanding	223,952	146,966	193,520	146,680
Weighted average partnership Units outstanding (1)		7,638		7,727
Other potential dilutive shares (2)		232		216
Weighted average number of common shares and potential dilutive securities	223,952	154,836	193,520	154,623



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- (1) The partnership Units are anti-dilutive for the three and nine months ended September 30, 2009, as a result of the net loss for both periods. Therefore, 6,646 and 6,711 Units (in thousands) are excluded from the weighted average number of common shares and potential dilutive securities for the three and nine months ended September 30, 2009, respectively, and \$9,545 and \$11,410 noncontrolling interest in earnings of common unitholders (in thousands) is excluded from diluted net loss attributable to common shareholders for the three and nine months ended September 30, 2009, respectively.
- (2) Excludes (in thousands of shares) 7,692 and 7,280 of anti-dilutive shares for the three months ended September 30, 2009 and 2008, respectively, and 7,810 and 7,648 of anti-dilutive shares for the nine months ended September 30, 2009 and 2008, respectively, related to stock-based compensation plans. Also excludes (in thousands of shares) the Exchangeable Notes that have 7,326 and 9,192 of anti-dilutive shares for the three and nine months ended September 30, 2009, respectively, and 11,760 of anti-dilutive shares for the three and nine months ended September 30, 2008.

**9. Segment Reporting**

We have three reportable operating segments, the first two of which consist of the ownership and rental of office and industrial real estate investments. The operations of our office and industrial properties, along with our healthcare and retail properties, are collectively referred to as Rental Operations. Our healthcare and retail properties do not meet the quantitative thresholds for separate presentation as reportable segments. The third reportable segment consists of providing various real estate services such as property management, maintenance, leasing, development and construction management to third-party property owners and joint ventures, as well as our Build-for-Sale operations (defined below), and is collectively referred to as Service Operations. Our reportable segments offer different products or services and are managed separately because each segment requires different operating strategies and management expertise.

Gains on sale of properties developed or acquired with the intent to sell ( Build-for-Sale properties) are classified as part of the income of the Service Operations business segment. The periods of operation for Build-for-Sale properties prior to sale were of short duration.

Other revenue consists of other operating revenues not identified with one of our operating segments. Interest expense and other non-property specific revenues and expenses are not allocated to individual segments in determining our performance measure.

We assess and measure our overall operating results based upon an industry performance measure referred to as Funds From Operations ( FFO ), which management believes is a useful indicator of our consolidated operating performance. FFO is used by industry analysts and investors as a supplemental operating performance measure of a REIT. The National Associations of Real Estate Investment Trusts ( NAREIT ) created FFO as a supplemental measure of REIT operating performance that excludes historical cost depreciation, among other items, from net income determined in accordance with GAAP. FFO is a non-GAAP financial measure. The most comparable GAAP measure is net income (loss) attributable to common shareholders. Consolidated basic FFO attributable to common shareholders should not be considered as a substitute for net income or any other measures derived in accordance with GAAP and may not be comparable to other similarly titled measures of other companies. FFO is calculated in accordance with the definition that was adopted by the Board of Governors of NAREIT. We do not allocate certain income and expenses ( Non-Segment Items as shown in the table below) to our operating segments. Thus, the operational performance measure presented here on a segment-level basis represents net earnings excluding depreciation expense, as well as excluding the Non-Segment Items not allocated, and is not meant to present FFO as defined by NAREIT.

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

Management believes that the use of consolidated basic FFO attributable to common shareholders, combined with net income (which remains the primary measure of performance), improves the understanding of operating results of REITs among the investing public and makes comparisons of REIT operating results more meaningful. Management believes that, by excluding gains or losses related to sales of previously depreciated real estate assets and excluding real estate asset depreciation and amortization, investors and analysts are able to readily identify the operating results of the long-term assets that form the core of a REIT's activity and assist in comparing these operating results between periods or as compared to different companies.

The following table shows (i) the revenues for each of the reportable segments and (ii) a reconciliation of consolidated basic FFO attributable to common shareholders to net income (loss) attributable to common shareholders for the three and nine months ended September 30, 2009 and 2008, respectively (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
<b>Revenues</b>				
Rental Operations:				
Office	\$ 142,259	\$ 140,237	\$ 427,662	\$ 416,713
Industrial	63,837	62,856	194,636	184,691
Non-reportable Rental Operations segments	15,352	8,014	38,097	22,374
Service Operations	100,880	93,316	335,412	271,847
Total Segment Revenues	322,328	304,423	995,807	895,625
Other Revenue	2,565	4,157	9,318	14,734
Consolidated Revenue from continuing operations	324,893	308,580	1,005,125	910,359
Discontinued Operations		3,880	2,282	17,387
Consolidated Revenue	\$ 324,893	\$ 312,460	\$ 1,007,407	\$ 927,746
<b>Reconciliation of Consolidated Basic Funds From Operations</b>				
Net earnings excluding depreciation and Non-Segment Items				
Office	\$ 84,246	\$ 84,648	\$ 250,689	\$ 251,572
Industrial	48,761	49,283	147,123	141,471
Non-reportable Rental Operations segments	10,120	5,174	24,691	14,029
Service Operations	4,639	17,499	16,060	31,626
	147,766	156,604	438,563	438,698
Non-Segment Items:				
Interest expense	(57,719)	(50,071)	(161,746)	(146,001)
Impairment charges	(285,168)	(2,474)	(302,637)	(5,273)
Interest and other income	796	205	924	1,223
General and administrative expenses	(11,233)	(10,448)	(34,713)	(29,500)
Gain on land sales		4,469	357	8,491
Undeveloped land carrying costs	(2,601)	(1,686)	(7,646)	(5,746)
Gain (loss) on debt transactions	(13,631)		20,880	
Loss on business combinations			(999)	
Income tax benefit (expense)	(7,947)	4,239	(2,053)	4,915
Other non-segment income	869	2,364	4,948	11,230
Net (income) loss attributable to noncontrolling interests	9,632	(586)	11,583	(1,577)

