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PS BUSINESS PARKS INC/CA  
Form 10-K405  
March 22, 2002

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, 2001.

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  
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PS BUSINESS PARKS, INC.  
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(Exact name of registrant as specified in its charter)

California  
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95-4300881  
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(State or other jurisdiction of incorporation or organization)

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

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

Registrant's telephone number, including area code: (818) 244-8080  
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Securities registered pursuant to Section 12(b) of the Act

Title of each class -----	Name of each exchange on w -----
Common Stock, \$0.01 par value.....	American Stock Ex
Depository Shares Each Representing 1/1,000 of a Share of 91/4% Cumulative Preferred Stock, Series A, \$0.01 par value...	American Stock E
Depository Shares Each Representing 1/1,000 of a Share of 91/2% Cumulative Preferred Stock, Series D, \$0.01 par value...	American Stock E
Depository Shares Each Representing 1/1,000 of a Share of 83/4% Cumulative Preferred Stock, Series F, \$0.01 par value...	American Stock E

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

None  
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(Title of class)

Indicate by check mark whether the registrant (1) has filed all reports required

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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

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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. [X]

The aggregate market value of the voting stock held by non-affiliates of the registrant as of March 12, 2002:

Common Stock, \$0.01 par value, \$341,188,658 (computed on the basis of \$34.39 per share which was the reported closing sale price of the Company's Common Stock on the American Stock Exchange on March 12, 2002).

The number of shares outstanding of the registrant's class of common stock, as of March 14, 2002:

Common Stock, \$0.01 par value, 21,546,449 shares.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement to be filed in connection with the annual shareholders' meeting to be held in 2002 are incorporated by reference into Part III.

### PART I.

#### ITEM 1. BUSINESS

##### THE COMPANY

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PS Business Parks, Inc. ("PSB") is a fully-integrated, self-advised and self-managed real estate investment trust ("REIT") that acquires, develops, owns and operates commercial properties, primarily flex, multi-tenant office and industrial space. As of December 31, 2001, PSB owned approximately 75% of the common partnership units of PS Business Parks, L.P. (the "Operating Partnership" or "OP"). The remaining common partnership units were owned by Public Storage, Inc. ("PSI") and its affiliated entities. PSB, as the sole general partner of the Operating Partnership, has full, exclusive and complete responsibility and discretion in managing and controlling the Operating Partnership. Unless otherwise indicated or unless the context requires otherwise, all references to "the Company" mean PS Business Parks, Inc. and its subsidiaries, including the Operating Partnership.

As of December 31, 2001, the Company owned and operated approximately 14.8 million net rentable square feet of commercial space located in 9 states, representing a 17.5% increase in commercial square footage from December 31, 2000. The Company also managed approximately 1.7 million net rentable square feet on behalf of PSI and its affiliated entities, third party owners and a joint venture in which the Company held a 25% ownership interest.

HISTORY OF THE COMPANY: In a March 17, 1998 merger (the "Merger") of

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American Office Park Properties, Inc. ("AOPP") with and into the Company (which was formerly named "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. 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 affiliated 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 1997, as part of a reorganization, PSI and its consolidated partnerships contributed properties containing 2.9 million square feet of commercial space to AOPP and the Operating Partnership. During the remainder of 1997, AOPP acquired approximately 2 million square feet of additional commercial space from the Acquiport Corporations, subsidiaries of the New York State Common Retirement Fund, and approximately 0.6 million square feet of additional commercial space from other unaffiliated 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 commercial space located in Oregon and Texas from Principal Mutual Life Insurance Company 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 of commercial space from unaffiliated third parties: 483,000 square feet in Texas, 405,000 square feet in Northern Virginia and Maryland, 211,000 square feet in Northern California and 200,000 square feet in Arizona. In addition, the Company completed a 61,000 square foot development in Texas and a 66,000 square foot development in Oregon.

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During 2000, the Company acquired 0.3 million square feet of commercial space from Acquiport Two Corporation and 0.5 million square feet of commercial space from unaffiliated third parties: 454,000 square feet in Southern California, 210,000 square feet in Northern Virginia and 178,000 square feet in Northern California. In addition, the Company completed a 22,000 square foot development in Oregon. During 2000, the Company also disposed of 627,000 square feet of properties that did not meet its ongoing strategy. These dispositions resulted in aggregate net proceeds of \$23.8 million.

During 2001, the Company acquired 2.2 million square feet from unaffiliated third parties: 658,000 square feet in Northern Virginia, 685,000 square feet in Oregon and 905,000 square feet in Maryland. In addition, the Company completed a 97,000 square foot development in Oregon, a 141,000 square foot development in Northern Virginia and a 102,000 square foot development in Texas. During 2001, the Company also disposed of a 77,000 square foot property in San Diego, California and contributed 294,000 square feet of industrial space in Southern California to a joint venture.

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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 currently distributed to its shareholders.

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

**BUSINESS OF THE COMPANY:** The commercial properties owned by the Company consist of flex space, office space and industrial space. The Company owns approximately 11.2 million square feet of flex space. The Company defines "flex" space as buildings that are configured with a combination of part warehouse space and part office space and can be designed to fit a wide variety of uses. The warehouse component of the flex space has a variety of uses including light manufacturing and assembly, storage and warehousing, showroom, laboratory, distribution and research and development activities. The office component of flex space is complementary to the warehouse component by enabling businesses to accommodate management and production staff in the same facility. The Company also owns approximately 2.5 million square feet of low-rise suburban office space generally either in business parks that combine office and flex space or in desirable submarkets where the economics of the market demand an office build-out and approximately 1.1 million square feet of industrial space that have characteristics similar to the warehouse component of the flex space.

The Company's commercial properties typically consist of one to ten low-rise buildings located on three to fifty acres and containing from approximately 20,000 to 700,000 square feet of rentable space in the aggregate. 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 tenant base for the Company's facilities is diverse. The facilities can be bifurcated into those facilities that service small to medium-sized businesses and those that service larger businesses. Approximately 30% of the annual rents from the portfolio are from facilities that serve small to medium-sized businesses. A property in this facility type is typically divided into units ranging in size from 500 to 5,000 square feet and leases generally range from one to three years. The remaining 70% of the income is derived from facilities that serve larger businesses, with units ranging from 5,000 square feet to multiple buildings leased to a single tenant. The U.S. Government is the largest tenant and leases 361,000 square feet or approximately 3.7% of the Company's portfolio.

The Company intends to continue acquiring 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 of changing this policy at this time. Although the Company currently owns properties in nine states, it may expand its operations to other states. Properties are acquired

for both income and potential capital appreciation; there is no limitation on the amount that can be invested in any specific property.

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The Company may acquire land for the development of commercial properties. In general, the Company expects to acquire land that is adjacent to commercial properties that the Company already owns or is acquiring. The Company completed development of three facilities in 2001 and currently has no projects under development. The Company owned approximately 6.4 acres of land held for development in Northern Virginia, 27.3 acres in Portland, Oregon and 10.0 acres in Dallas, Texas as of December 31, 2001.

### OPERATING PARTNERSHIP

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

As the general partner of the Operating Partnership, the Company has the exclusive 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 PSI and affiliated entities. 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

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

**ISSUANCE OF ADDITIONAL PARTNERSHIP INTERESTS:** As the general partner of the Operating Partnership, the Company is authorized to cause the Operating Partnership from time to time to issue to partners of the Operating Partnership or to other persons additional partnership units in one or more classes, and in one or more series of any of such classes, with such designations, preferences and relative, participating, optional, or other special rights, powers and duties (which may be senior to the existing partnership units), as will be determined by the Company, in its sole and absolute discretion. 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 net proceeds raised in connection with the issuance of such shares of the Company.

**CAPITAL CONTRIBUTIONS:** No partner is required to make additional capital contributions to the Operating Partnership, except that the Company as the general partner is required to contribute the net proceeds of the sale of equity interests in the Company to the Operating Partnership in return for additional partnership units. A limited partner may be required to pay to the

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Operating Partnership any taxes paid by the Operating Partnership on behalf of that limited partner. No partner is required to pay to the Operating Partnership any deficit or negative balance which may exist in its capital account.

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

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

**PREFERRED UNITS:** As of December 31, 2001, the Operating Partnership had 7,910,000 preferred units owned by third parties with distribution rates ranging from 8 3/4% to 9 1/4% (per annum) with an aggregate stated value of \$197,750,000. 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. Each series of preferred units is exchangeable for Cumulative Redeemable Preferred Stock of the respective series of PS Business Parks, Inc. on or after the tenth anniversary of the date of issuance at the option of the Operating Partnership or a majority of the holders of the applicable series of preferred units.

As of December 31, 2001, the Company owned 2,200,000 preferred units with a stated value of \$55 million with terms substantially identical to the terms of the publicly traded depositary shares each representing 1/1,000 of a share of 9 1/4% Cumulative Preferred Stock, Series A of the Company and 2,640,000 preferred units with a stated value of \$66 million with terms substantially identical to the terms of the publicly traded depositary shares each representing 1/1,000 of a share of 9 1/2% Cumulative Preferred Stock, Series D of the Company. In addition, during January 2002, the Company acquired 2,000,000 preferred units with a stated value of \$50 million with terms substantially identical to the terms of the publicly traded depositary shares each representing 1/1,000 of a share of 8 3/4% Cumulative Preferred Stock, Series F of the Company.

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

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

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exercising its redemption right, in exchange for cash in the amount specified above as the "redemption amount" or by issuance of the "shares amount" (as defined in the Operating Partnership Agreement generally to mean the issuance of one share of the Company Common Stock for each unit of limited partnership interest redeemed).

A limited partner cannot exercise its redemption right if delivery of shares of Common Stock would be prohibited under the articles of incorporation of the Company or if 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.

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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

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Company, as general partner of the Operating Partnership, has agreed in the Operating Partnership Agreement with the limited partners of the Operating Partnership that it will not consummate a business combination in which the Company conducted a vote of shareholders unless the matter is also submitted to a vote of the partners.

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

**TAX PROTECTION PROVISIONS:** The Operating Partnership Agreement provides that, until 2007, the Operating Partnership may not sell any of 12 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 12 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 and the limited partners of the Operating Partnership will be indemnified and held harmless by the Operating Partnership for any act performed for, or on behalf of, the Operating Partnership, or in

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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.



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

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

### COST ALLOCATION AND ADMINISTRATIVE SERVICES

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Pursuant to a cost sharing and administrative services agreement, the Company shares costs with PSI and affiliated entities for certain administrative services. These services include employee relations, insurance, administration, management information systems, legal, income tax and office services. Under this agreement, costs are allocated to the Company in accordance with its proportionate share of these costs.

### COMMON OFFICERS AND DIRECTORS

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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.

### PROPERTY MANAGEMENT

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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 upon each anniversary date. The property management contracts with affiliates of PSI are cancelable by either party upon sixty days notice.

### MANAGEMENT

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Ronald L. Havner, Jr. (44), 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 (41), Vice President and Chief Financial Officer; Michael Lynch (49), Vice President-Acquisitions and Development; Stephen King (45), Vice President and Chief Operating Officer; Jeffrey Reinstein (38), Vice President-Business Services; Joseph Miller (38) Vice President and Corporate Controller; Angelique Benschneider (39), Vice President (Midwest Division); David Bischoff (50), Vice President (Eastern Division); Maria Hawthorne (42), Vice President (Northern Virginia Division); Bill McFaul (36) Vice President (Maryland Division); and Eileen Newkirk (53), Vice President (Pacific Northwest Division).

### REIT STRUCTURE

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If certain detailed conditions imposed by the Code and the related Treasury Regulations are met, an entity, such as the Company, that invests principally in real estate and that otherwise would be taxed as a corporation may elect to be treated as a REIT. The most important consequence to the Company of being treated as a REIT for federal income tax purposes is that this enables the Company 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.

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.

### GROWTH STRATEGY

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The Company's primary objective is to maximize shareholder value by achieving long-term growth in net asset value per share. Key elements of the Company's growth strategy include:

**INCREASE NET CASH FLOW OF EXISTING PROPERTIES:** The Company seeks to increase the net cash flow generated by its existing properties by (i) maximizing average occupancy rates, (ii) achieving higher levels of realized monthly rents per occupied square foot, and (iii) reducing its operating cost structure by improving operating efficiencies and economies of scale. The Company believes that its experienced property management personnel and comprehensive systems combined with increasing economies of scale will enhance the Company's ability to meet these goals. The Company seeks to increase occupancy rates and realized monthly rents per square foot by providing its field personnel with incentives to lease space to higher credit tenants and to maximize the return on investment in each lease transaction. The return for these incentive purposes is measured by the internal rate of return on each lease transaction after deducting tenant improvements and lease commissions. The Company seeks to reduce its cost structure by controlling capital expenditures associated with re-leasing space by acquiring and owning properties with easily reconfigured space that appeal to a wide range of tenants.

**FOCUS ON TARGETED MARKETS:** The Company intends to continue investing in markets that have characteristics which enable them to be competitive

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economically in the short and long-term. The Company believes that markets with above average population growth, education levels and personal income will produce better economic returns. As of December 31, 2001, 95% of the Company's square footage was located in these targeted core markets. Based on information provided by Claritas Inc., these markets have experienced over twice the population growth of the United States average over the past decade. In addition, these markets, on average, have 35% more college graduates and 23% more household income than the United States average. The Company targets individual properties in those markets that are close to important services and universities and have easy access to major transportation arteries.

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**USE KNOWLEDGE OF CORE MARKETS TO MAKE OPPORTUNISTIC ACQUISITIONS IN A FRAGMENTED INDUSTRY:** The Company believes its knowledge of its core 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 its core markets. According to Torto Wheaton Research, there was approximately 1.4 billion square feet of "flex" space facilities in the United States as of December 31, 2001. The Company as one of the largest operators of flex space owns less than 1% of the total market. The Company believes that the fragmented nature of this market creates opportunities for the Company to use its knowledge to make acquisitions on favorable terms. The Company expects that acquisitions from third parties will be its most significant source of growth in assets, revenue and funds from operations during fiscal 2002, if attractive investment opportunities continue to be available.

**REDUCE EXPENDITURES AND INCREASE OCCUPANCY RATES BY PROVIDING FLEXIBLE PROPERTIES AND ATTRACTING A DIVERSIFIED TENANT BASE:** By focusing on properties with easily reconfigured space, the Company can offer facilities that appeal to a wide range of potential tenants, which aids in reducing the capital expenditures associated with re-leasing space. Such property flexibility also allows the Company to better serve existing tenants by accommodating their inevitable expansion and contraction needs. In addition, the Company believes that a diversified tenant base and property flexibility helps it maintain high occupancy rates during periods when market demand is weak.

**DEVELOP NEW AMENITIES FOR TENANTS:** During 2000, the Company formed a new division to focus on developing and providing enhanced business service programs for tenants to increase tenant retention and revenues. These programs enable tenant access to sophisticated technology and telecommunications services. In addition, the Company created Tenant Advantage to allow its small and medium-sized business customers to purchase products and services directly from national suppliers at discounts usually reserved for large companies. The Company intends to continue to identify creative ways to develop and offer new services for its tenants.

**PROVIDE SUPERIOR PROPERTY MANAGEMENT:** The Company seeks to provide a superior level of service to its tenants in order to achieve high occupancy and rental rates, as well as minimize customer 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 established tenant service programs.

**DEVELOP NEW PROPERTIES IN EXISTING CORE MARKETS:** The Company's development strategy is to selectively construct new properties next to business

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parks in which it already owns properties. The Company develops these properties using the expertise of local development companies. The Company plans to keep development properties to less than 5% of its portfolio on a book value basis before deducting accumulated depreciation. In addition, the Company plans to limit development activity in 2002 to existing developments and developments that have been pre-leased.

### FINANCING STRATEGY

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

**RETAIN OPERATING CASH FLOW:** The Company seeks to retain significant funds (after funding its distributions and capital improvements) for additional investments and debt reduction. During the year ended December 31, 2001, the Company distributed 41% of its funds from operations ("FFO") to common shareholders/unitholders and retained \$43.3 million for principal payments on debt, repurchasing its common stock and reinvestment into real estate assets. See "Management's Discussion and Analysis of Financial Condition and Results of Operations-Liquidity and Capital Resources."

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**PERPETUAL PREFERRED STOCK/UNITS:** The primary source of leverage in the capital structure is perpetual preferred stock or the equivalent units in the operating partnership. This method of financing eliminates interest rate and refinancing risks because the dividend rate is fixed and the stated value or capital contribution is not required to be repaid.

**DEBT FINANCING:** The Company uses debt financing to a limited degree. This debt financing comes in three forms. 1) An unsecured \$100 million revolving line of credit with Wells Fargo Bank is used as a temporary short term source of acquisition financing, 2) the Company entered into a seven year unsecured \$50 million term loan facility with Fleet National Bank to provide flexibility under the line of credit but also continue to take advantage of the short-term interest rate environment and 3) the Company assumes mortgage debt in connection with property acquisitions.

**ACCESS TO ACQUISITION CAPITAL:** The Company believes that its strong financial position will enable it to access capital to finance its acquisitions. The Company targets a leverage ratio of 40% (defined as debt and preferred equity as a percentage of market capitalization). Market capitalization includes debt, preferred equity and the fair market value of the common shares and partnership units based upon the quoted market price. In addition, the Company targets a ratio of FFO to combined fixed charges and preferred distributions of 2.5 to 1.0. Fixed charges include interest expense and capitalized interest. Preferred distributions include amounts paid to preferred shareholders and preferred Operating Partnership unitholders. As of December 31, 2001 and for the year then ended, the leverage ratio was 35% and the FFO to combined fixed charges and preferred distributions ratio was 4.6 to 1.0. Subject to market conditions, the Company intends to add leverage to its capital structure primarily through the issuance of preferred stock or partnership units.

### COMPETITION

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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 sublease space and unleased developments are expected to further intensify competition among operators in certain market areas in which the Company operates.

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

INVESTMENTS IN REAL ESTATE FACILITIES  
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As of December 31, 2001, the Company owned and operated approximately 14.8 million net rentable square feet compared to 12.6 million net rentable square feet at December 31, 2000. The net increase in net rentable square feet was due to the acquisitions of facilities and the development of three properties, partially offset by property dispositions and the contribution of an industrial park to a joint venture.

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RESTRICTIONS ON TRANSACTIONS WITH AFFILIATES  
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The Company's Bylaws provide that the Company may engage in purchase or sale transactions with affiliates only if a 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  
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As of December 31, 2001, the Company had outstanding mortgage notes payable balances of approximately \$30 million, \$100 million outstanding on the Credit Facility and \$35 million in short term borrowings from PSI. See Notes 5 and 6 to the consolidated financial statements for a summary of the Company's borrowings at December 31, 2001.

In September 2000, the Company extended its Credit Facility with Wells Fargo Bank. The Credit Facility has a borrowing limit of \$100 million and a maturity date of August 6, 2003. The maturity date may be extended by one year on each anniversary of the Credit Facility upon request by the Company and approval by Wells Fargo Bank. Interest on outstanding borrowings is payable monthly. At the option of the Company, the rate of interest charged is equal to (i) the prime rate or (ii) a rate ranging from the London Interbank Offered Rate ("LIBOR") plus 0.75% to LIBOR plus 1.35% depending on the Company's credit

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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% of the borrowing limit.

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 1.00 and 1.75 to 1.00, respectively, (iii) maintain a minimum total shareholders' equity (as defined) and (iv) limit distributions to 95% of funds from operations. 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, 2001.

On February 28, 2002, the Company entered into a seven year \$50 million term loan agreement with Fleet National Bank. The note bears interest at LIBOR plus 1.45% and is due on February 20, 2009. The Company paid a one-time fee of 0.35% or \$175,000 for the facility. The Company expects to use the proceeds of the loan to reduce the amount drawn on its line of credit with Wells Fargo Bank.

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

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As of December 31, 2001, the Company employed 130 individuals, primarily personnel engaged in property operations. The Company believes that its relationship with its employees is good and none of the employees are represented by a labor union.

### INSURANCE

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The Company believes that its properties are adequately insured. Facilities operated by the Company have historically been covered by comprehensive insurance, including fire, earthquake, liability and extended coverage from nationally recognized carriers. The Company also anticipates a 25%-50% increase in insurance costs when its current policies expire in April 2002 due to the terrorist attacks of September 11, 2001. Because the Company's financing strategy generally does not include mortgage debt and because its facilities are generally not located in central business districts, the Company does not expect to incur the cost of insuring against terrorist acts.

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### ITEM 1A. RISK FACTORS

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

### PSI HAS SIGNIFICANT INFLUENCE OVER US.

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PSI owns a substantial number of our shares and of the units of our operating partnership: At February 28, 2002, PSI and its affiliates owned 25% of the outstanding shares of our common stock (44% upon conversion of its interest

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in our operating partnership) and 25% of the outstanding common units of our operating partnership (100% of the common units not owned by us). Consequently, PSI has the ability to significantly influence all matters submitted to a vote of our shareholders, including electing directors, changing our articles of incorporation, dissolving and approving other extraordinary transactions such as mergers, and all matters requiring the consent of the limited partners of the operating partnership. In addition, PSI's ownership may make it more difficult for another party to take over our company without PSI's approval.

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

OUR BOARD CAN SET THE TERMS OF CERTAIN SECURITIES WITHOUT SHAREHOLDER APPROVAL: Our board of directors is authorized, without shareholder approval, to issue up to 50,000,000 shares of preferred stock and up to 100,000,000 shares of equity stock, in each case in one or more series. Our board has the right to set the terms of each of these series of stock. Consequently, the board could set the terms of a series of stock that could make it difficult (if not impossible) for another party to take over our company even if it might be favorable to our public shareholders. Our articles of incorporation also contain other provisions that could have the same effect. We can also cause our operating partnership to issue additional interests for cash or in exchange for property.

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

OUR OPERATING PARTNERSHIP POSES ADDITIONAL RISKS TO US.  
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Limited partners of our operating partnership, including PSI, have the right to vote on certain changes to the partnership agreement. They may vote in a way that is contrary to the interest of our shareholders. Also, as general partner of our operating partnership, we are required to protect the interests of the limited partners of our operating partnership. The interests of the limited partners and of our shareholders may differ.

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

CERTAIN INSTITUTIONAL INVESTORS HAVE SPECIAL RIGHTS.  
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Certain institutional investors have rights, such as the right to approve nominees to our board of directors, the right to purchase our securities in certain circumstances and the right to require registration of their shares, not available to our public shareholders.

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

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

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

SINCE WE BUY AND OPERATE REAL ESTATE, WE ARE SUBJECT TO GENERAL REAL ESTATE  
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INVESTMENT AND OPERATING RISKS.  
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SUMMARY OF REAL ESTATE RISKS: We own and operate commercial properties and are subject to the risks of owning real estate generally and commercial properties in particular. These risks include:

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

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

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

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

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

WE MAY ENCOUNTER SIGNIFICANT DELAYS IN RELETTING VACANT SPACE,

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**RESULTING IN LOSSES OF INCOME:** When leases expire, we will incur expenses and we may not be able to release the space on the same terms. Certain leases provide tenants with the right to terminate early if they pay a fee. Our properties as of December 31, 2001 generally have lower vacancy rates than the average for the markets in which they are located, and leases for 35% of our space expire in 2002 or 2003 (leases for 60% of the space occupied by small tenants expire in such years). While we have estimated our cost of renewing leases that expire in 2002, our estimates could be wrong. If we are unable to release space promptly, if the terms are significantly less favorable than anticipated or if the costs are higher, we may have to reduce our distributions to shareholders.

**TENANT DEFAULTS AND BANKRUPTCIES MAY REDUCE OUR CASH FLOW AND DISTRIBUTIONS:** We may have difficulty in collecting from tenants in default, particularly if they declare bankruptcy. This could reduce our cash flow and distributions to shareholders.

**WE MAY BE ADVERSELY AFFECTED BY SIGNIFICANT COMPETITION AMONG COMMERCIAL PROPERTIES:** Many other commercial properties compete with our properties for tenants and we expect that new properties will be built in our markets. Also, we compete with other buyers, many of whom are larger than we are, in seeking to acquire commercial properties. Therefore, we may not be able to grow as rapidly as we would like.

**WE MAY BE ADVERSELY AFFECTED IF CASUALTIES TO OUR PROPERTIES ARE NOT COVERED BY INSURANCE:** We carry insurance on our properties that we believe is comparable to the insurance carried by other operators for similar properties. However, we could suffer uninsured losses that adversely affect us or even result in loss of properties. We might still remain liable on any mortgage debt related to that property.

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**THE ILLIQUIDITY OF OUR REAL ESTATE INVESTMENTS MAY PREVENT US FROM ADJUSTING OUR PORTFOLIO TO RESPOND TO MARKET CHANGES:** There may be delays and difficulties in selling real estate. Therefore, we cannot easily change our portfolio when economic conditions change. Also, tax laws limit a REIT's ability to sell properties held for less than four years.

**WE MAY BE ADVERSELY AFFECTED BY GOVERNMENTAL REGULATION OF OUR PROPERTIES:** Our properties are subject to various federal, state and local regulatory requirements, such as state and local fire and safety codes. If we fail to comply with these requirements, governmental authorities could fine us or courts could award damages against us. We believe our properties comply with all significant legal requirements. However, these requirements could change in a way that would reduce our cash flow and ability to make distributions to shareholders.

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

We acquired a property in Beaverton, Oregon ("Creekside Corporate

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

Based on the results of the site investigation, ODEQ has recommended a final remedy that would include permanent treatment of contaminants in the groundwater, including expanded groundwater extraction and treatment on all parcels of the former industrial property, including portions of Creekside Corporate Park. The estimated cost of this remedy is \$3.3 million over a 30-year time period. In the event we are ultimately deemed responsible for any costs relating to this matter, we believe that the party from whom the property was purchased will be responsible for any expenses or liabilities that we may incur as a result of this contamination. In addition, we believe we may have recourse against other potentially responsible parties, including, but not limited to, one or both of the owner/operators of the adjacent industrial facility. However, if we are deemed responsible for any expenses related to removal or remedial actions on the property, and we are not successful in obtaining reimbursement from one or more third parties, our operations and financial condition could be harmed.

WE MAY BE AFFECTED BY THE AMERICANS WITH DISABILITIES ACT: The Americans with Disabilities Act of 1990 requires that access and use by disabled persons of all public accommodations and commercial properties be facilitated. Existing commercial properties must be made accessible to disabled persons. While we have not estimated the cost of complying with this act, we do not believe the cost will be material.

OUR ABILITY TO CONTROL OUR PROPERTIES MAY BE ADVERSELY AFFECTED BY OWNERSHIP  
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THROUGH PARTNERSHIPS AND JOINT VENTURES.  
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We own most of our properties through our operating partnership. Our organizational documents do not limit our ability to invest funds with others in partnerships or joint ventures. During 2001, we entered into a joint venture arrangement. This type of investment may present additional risks. For example, our partners may have interests that differ from ours or that conflict with ours, or our partners may become bankrupt. In addition, the joint venture may default on its debt, which we have guaranteed under certain circumstances. We believe this risk is mitigated by the low level of debt (57% of the cost) in the joint venture.

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WE CAN CHANGE OUR BUSINESS POLICIES AND INCREASE OUR LEVEL OF DEBT WITHOUT  
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SHAREHOLDER APPROVAL.  
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Our board of directors establishes our investment, financing, distribution and other business policies and may change these policies without shareholder approval. Our organizational documents do not limit our level of debt. A change in our policies or an increase in our level of debt could adversely affect our operations or the price of our common stock.

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WE CAN ISSUE ADDITIONAL SECURITIES WITHOUT SHAREHOLDER APPROVAL.  
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We can issue preferred and common stock without shareholder approval. Holders of preferred stock have priority over holders of common stock, and the issuance of additional shares of common stock reduces the interest of existing holders in our company.

INCREASES IN INTEREST RATES MAY ADVERSELY AFFECT THE MARKET PRICE OF OUR COMMON  
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STOCK.  
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One of the factors that influences the market price of our common stock is the annual rate of distributions that we pay on our common stock, as compared with interest rates. Interest rates in late 2001 and early 2002 have been at historically low levels. An increase in interest rates may lead purchasers of REIT shares to demand higher annual distribution rates, which could adversely affect the market price of our common stock.

SHARES THAT BECOME AVAILABLE FOR FUTURE SALE MAY ADVERSELY AFFECT THE MARKET  
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PRICE OF OUR COMMON STOCK.  
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Substantial sales of our common stock, or the perception that substantial sales may occur, could adversely affect the market price of our common stock. Certain of our shareholders hold significant numbers of shares of our common stock and, subject to compliance with applicable securities laws, could sell their shares.

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

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### ITEM 2. PROPERTIES

As of December 31, 2001, the Company owned approximately 11.2 million square feet of "flex" space, 2.5 million square feet of suburban office and 1.1 million square feet of industrial space concentrated primarily in seven major markets consisting of Southern and Northern California, Southern and Northern Texas, Virginia, Maryland and Oregon. The weighted average occupancy rate at December 31, 2001 was 95.1% and the average rental rate per square foot was \$14.15.

The following table contains information about properties owned by the Company and the Operating Partnership as of December 31, 2001:

City	Rentable Square Footage			Total
	Flex	Office	Industrial	
-----	-----	-----	-----	-----

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ARIZONA				
Mesa.....	78,038	-	-	78,038
Phoenix.....	199,581	-	-	199,581
Tempe.....	291,264	-	-	291,264
	568,883	-	-	568,883
NORTHERN CALIFORNIA				
Hayward.....	-	-	406,712	406,712
Monterey.....	-	12,003	-	12,003
Sacramento.....	-	366,203	-	366,203
San Jose.....	387,631	-	-	387,631
San Ramon.....	-	52,149	-	52,149
Santa Clara.....	178,132	-	-	178,132
So. San Francisco.....	93,775	-	-	93,775
	659,538	430,355	406,712	1,496,605
SOUTHERN CALIFORNIA				
Buena Park.....	-	-	317,312	317,312
Carson.....	77,255	-	-	77,255
Cerritos.....	-	31,270	394,610	425,880
Culver City.....	146,402	-	-	146,402
Irvine.....	-	160,499	-	160,499
Laguna Hills.....	613,947	-	-	613,947
Lake Forest.....	296,597	-	-	296,597
Lakewood.....	-	56,902	-	56,902
Monterey Park.....	199,056	-	-	199,056
San Diego.....	535,345	-	-	535,345
Signal Hill.....	178,146	-	-	178,146
Studio City.....	22,092	-	-	22,092
Torrance.....	147,220	-	-	147,220
	2,216,060	406,151	711,922	3,176,653
KANSAS				
Overland Park.....	61,836	-	-	61,836
	61,836	-	-	61,836

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City	Rentable Square Footage			Total
	Flex	Office	Industrial	
MARYLAND				
Beltsville.....	307,791	-	-	307,791
Gaithersburg.....	-	28,994	-	28,994
Landover (2).....	379,471	-	-	379,471
Largo.....	149,918	-	-	149,918

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Rockville.....	213,853	691,434	-	905,287
	-----	-----	-----	-----
	1,051,033	720,428	-	1,771,461
	-----	-----	-----	-----
OREGON				
Beaverton.....	1,524,005	346,376	-	1,870,381
Milwaukee.....	101,578	-	-	101,578
	-----	-----	-----	-----
	1,625,583	346,376	-	1,971,959
	-----	-----	-----	-----
TENNESSEE				
Nashville.....	138,004	-	-	138,004
	-----	-----	-----	-----
	138,004	-	-	138,004
	-----	-----	-----	-----
NORTHERN TEXAS				
Dallas.....	236,997	-	-	236,997
Garland.....	36,458	-	-	36,458
Houston.....	176,977	131,214	-	308,191
Las Colinas (1).....	944,743	-	-	944,743
Mesquite.....	56,541	-	-	56,541
Missouri City.....	66,000	-	-	66,000
Plano.....	184,809	-	-	184,809
Richardson.....	116,800	-	-	116,800
	-----	-----	-----	-----
	1,819,325	131,214	-	1,950,539
	-----	-----	-----	-----
SOUTHERN TEXAS				
Austin.....	832,548	-	-	832,548
San Antonio.....	-	199,269	-	199,269
	-----	-----	-----	-----
	832,548	199,269	-	1,031,817
	-----	-----	-----	-----
VIRGINIA				
Alexandria.....	208,519	-	-	208,519
Chantilly (2).....	494,618	-	-	494,618
Merrifield.....	302,723	355,127	-	657,850
Herndon (2).....	244,373	-	-	244,373
Lorton.....	246,520	-	-	246,520
Springfield.....	359,742	-	-	359,742
Sterling (2).....	295,625	-	-	295,625
Woodbridge.....	113,629	-	-	113,629
	-----	-----	-----	-----
	2,265,749	355,127	-	2,620,876
	-----	-----	-----	-----
WASHINGTON				
Renton.....	27,912	-	-	27,912
	-----	-----	-----	-----
	27,912	-	-	27,912
	-----	-----	-----	-----
Totals - 9 states.....	11,241,831	2,456,080	1,118,634	14,816,545
	=====	=====	=====	=====

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

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Colinas, Texas.

- (2) Eight commercial properties serve as collateral to mortgage notes payable. See detailed listing in Schedule III to the financial statements contained herein.

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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. The Company believes that while the current overall demand for commercial space has softened in 2001 and 2002, there is sufficient demand to maintain healthy occupancy rates.

The Company has risks that tenants will default on leases and declare bankruptcy. Management believes these risks are mitigated through the Company's geographic diversity and diverse tenant base. As of December 31, 2001, tenants occupying less than approximately 90,000 square feet of commercial space had declared bankruptcy and all of the bankrupt tenants were current on their monthly rental payments.

As of and for the year ended December 31, 2001, one of the Company's properties had a book value of more than 10% of the Company's total assets or accounted for more than 10% of its aggregate gross revenues. The property known as Metro Park North is a business park in Rockville, Maryland consisting of 17 buildings (905,000 square feet) including nine office buildings (691,000 square feet) and eight flex-space buildings (214,000 square feet). The property was purchased on December 27, 2001 and has a book value of \$127 million representing approximately 11% of the Company's total assets at December 31, 2001.

The following table sets forth information with respect to occupancy and rental rates at Metro Park North for each of the last five years:

	1997	1998	1999	2000
Occupancy Rate	98.2%	81.5%	75.9%	86.9%
Rental Rate per square foot	\$16.93	\$15.36	\$15.73	\$16.91

The following table sets forth information with respect to tenants occupying ten percent or more of the rentable square footage at Metro Park North:

Tenant Name	Square Feet	Annual Rent per Square Feet	Lease Expiration	Renewal Option
Lockheed Martin	24,552	\$23.17	9/30/05	1, 5-year
FDA	22,713	\$28.77	8/3/06	1, 5-year

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LSI	15,786	\$25.50	4/30/08	1, 5-year
Axcelis	105,015	\$15.93	12/31/04	1, 5-year
Fusing Lighting	25,051	\$14.25	12/31/02	1, 5-year
Montgomery TV	12,152	\$15.00	6/30/11	1, 5-year
FDA	53,227	\$18.08	12/31/02	1, 5-year
CAC	53,623	\$20.83	6/30/03	1, 5-year
FDA	113,912	\$19.07	11/14/05	1, 5-year
Hughes	53,806	\$23.62	8/31/05	1, 5-year
Montgomery Co.	38,800	\$22.95	10/7/04	1, 5-year

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The following table sets forth information with respect to lease expirations at Metro Park North:

Year of Lease Expiration	Rentable Square Footage Subject to Expiring Leases	Annual Base Rents Under Expiring Leases	Percent Base Rents
2002	85,559	\$1,478,000	
2003	108,373	2,073,000	
2004	219,472	3,819,000	
2005	317,321	7,179,000	
2006	74,976	1,975,000	
2007	-	-	
2008	15,786	403,000	
2009	3,150	74,000	
2010	-	-	
2011	15,560	265,000	
Thereafter	4,912	237,000	
<b>Total</b>	<b>845,109</b>	<b>\$17,503,000</b>	

The following table sets forth information with respect to tax depreciation at Metro Park North:

	Tax Basis	Rate of Depreciation	Method	Life In Years
Improvements	\$2,592,193	20.00%	MACRS, 200%DDB	5
Improvements	5,817,593	14.29%	MACRS, 200%DDB	7
Improvements	16,483,181	6.67%	MACRS, 150%DDB	15
Buildings	74,659,109	2.56%	MACRS, SL	39
<b>Total</b>	<b>\$109,552,076</b>			



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The Company's portfolio services two sets of customers with different characteristics. Approximately 70% of the Company's portfolio serves primarily large tenants. These tenants generally sign longer leases, require higher tenant improvements, are represented by a broker and are better credit tenants. The other 30% of the Company's portfolio serves primarily small tenants with average space requirements of 1,600 square feet and a shorter lease term duration. Tenant improvements are relatively small for these tenants and most leases are done in-house with no lease commissions. These tenants have lower credit profiles and delinquencies and bankruptcies are more frequent. The following tables set forth the lease expirations for the properties owned as of December 31, 2001 in addition to bifurcating the lease expirations on properties serving primarily small businesses and those properties serving primarily larger businesses:

LEASE EXPIRATIONS (ENTIRE PORTFOLIO) AS OF DECEMBER 31,

Year of Lease Expiration	Rentable Square Footage Subject to Expiring Leases	Annual Base Rents Under Expiring Leases	Percent Base Rents
2002	2,634,000	\$30,380,000	
2003	2,696,000	33,138,000	
2004	2,630,000	30,006,000	
2005	2,272,000	32,951,000	
2006	1,680,000	25,509,000	
Thereafter	2,162,000	31,232,000	
<b>Total</b>	<b>14,074,000</b>	<b>\$183,216,000</b>	

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LEASE EXPIRATIONS (SMALL TENANT PORTFOLIO) AS OF DECEMBER 31,

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

Year of Lease Expiration	Rentable Square Footage Subject to Expiring Leases	Annual Base Rents Under Expiring Leases	Percent Base Rents
2002	1,350,000	\$16,366,000	
2003	1,157,000	14,780,000	
2004	761,000	9,916,000	
2005	287,000	4,554,000	
2006	225,000	3,378,000	

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Thereafter	233,000	2,821,000
Total	4,013,000	\$51,815,000

LEASE EXPIRATIONS (LARGE TENANT PORTFOLIO) AS OF DECEMBER

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

Year of Lease Expiration	Rentable Square Footage Subject to Expiring Leases	Annual Base Rents Under Expiring Leases	Percent Base Rents
2002	1,284,000	\$14,014,000	
2003	1,539,000	18,358,000	
2004	1,869,000	20,090,000	
2005	1,985,000	28,397,000	
2006	1,455,000	22,131,000	
Thereafter	1,929,000	28,411,000	
Total	10,061,000	\$131,401,000	

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

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

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

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

Based on the results of the site investigation, ODEQ has recommended a final remedy that would include permanent treatment of contaminants in the groundwater, including expanded groundwater extraction and treatment on all parcels of the former industrial property, including portions of Creekside Corporate Park. The estimated cost of this remedy is \$3.3 million over a 30-year time period.

One of the two owner/operators that are conducting the investigation pursuant to the Order on Consent recently filed for Chapter 11 bankruptcy protection. It is not clear at this point what impact, if any, this filing will have on the implementation of the removal or remedial activities ordered by the ODEQ. It is possible that the ODEQ could require the Company to participate in the implementation of removal or remedial actions that may be required on the Company's property, or to pay a portion of the costs to do so. In the event the Company is ultimately deemed responsible for any costs relating to this matter, the Company believes that it may have recourse against the party from whom the property was purchased. In addition, the Company believes it may have recourse against other potentially responsible parties, including, but not limited to, one or both of the owner/operators of the adjacent industrial facility.

Although the other 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 Company's properties has not been, or will not be, affected by tenants and occupants of the Company's properties, by the condition of properties in the vicinity of the Company's properties, or by third parties unrelated to the Company.

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### ITEM 3. LEGAL PROCEEDINGS

On November 3, 1999, the Company filed an action titled PS Business Parks, Inc. v. Larry Howard et al. (Case No. BC219580) in Los Angeles Superior Court seeking damages in excess of \$1 million. The complaint alleges that Mr. Howard and entities controlled by him engaged in unfair trade practices. Some of the Company's claims have been dismissed on summary adjudication, and the balance is in the process of being referred to the arbitration proceedings described below for adjudication. Mr. Howard filed a cross-complaint which the Company intends to vigorously contest and which is also in the process of being referred to arbitration for adjudication.

On November 27, 2000, Mary Jayne Howard, a former officer of the Company filed a demand for arbitration with the American Arbitration Association alleging claims against the Company for breach of contract, gender

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discrimination, marital discrimination, and wrongful termination based on public policy. The demand seeks damages of approximately \$2 million. The Company plans to vigorously contest these claims. The Company has also filed in the arbitration a cross-claim against Ms. Howard alleging that she breached her fiduciary duties to the Company and committed fraud, among other claims, seeking damages in excess of \$1 million.

On February 2, 2000, the Company filed an action against Mary Piper, its former Vice President of operations, in Riverside County Superior Court, alleging claims for breach of fiduciary duties, fraud and deceit, constructive fraud, negligent misrepresentation, violation of Section 17000 of Business and Professions Code, violation of Section 17200 of the Business and Professions Code and culpable negligence. The Company's claims arose from Ms. Piper's alleged participation in a plan that resulted in the payment of improper kickbacks to Larry Howard, a former vendor of the Company and the husband of Mary Jayne Howard, a former officer of the Company. Ms. Piper subsequently filed a cross-complaint which the Company intends to vigorously contest.

### 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, 2001.

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### ITEM 4A. EXECUTIVE OFFICERS

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

Ronald L. Havner, Jr., age 44, 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., Mobile Storage Group, Inc. and Burnham Pacific Properties, Inc. Mr. Havner earned a Bachelor of Arts degree in Economics from the University of California, Los Angeles.

Jack E. Corrigan, age 41, 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. Mr. Corrigan earned a Bachelor of Science degree in Accounting from Loyola Marymount University.

J. Michael Lynch, age 49, 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 18 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. Mr. Lynch earned a Bachelor of Arts degree in Economics from Mt.

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St. Mary's College and a Masters of Architecture from the Virginia Polytechnic Institute.

Stephen S. King, age 45, has been Vice President, Chief Operating Officer of the Company since August 2001. Mr. King joined the Company as Vice President in April 2000 with responsibility for property operations for the Southwest Division. He became an executive officer of the Company in March 2001. From 1998 to April 2000, Mr. King was Vice President of Asset Management for The RREEF Funds with responsibility for over 10 million square feet of industrial property owned in a joint venture with the California Public Employees Retirement System (CalPERS). From 1989 through 1998, Mr. King was Assistant Vice President, Western Division for USAA Real Estate Company. He has over twenty years of development, construction, property management and leasing experience. Mr. King is a licensed California real estate broker and a member of the Institute for Real Estate Management (IREM) and the National Association of Industrial and Office Properties (NAIOP). Mr. King earned a Bachelor of Arts degree in Economics from Texas A&M.

Jeffrey H. Reinstein, age 38, has been Vice President-Business Services of the Company since May 2000. From March 1997 until April 2000, Mr. Reinstein was the President and Chief Operating Officer of Barrister Executive Suites and was responsible for overseeing and managing all activities for the company including operations, business development, marketing, human resources, finance and accounting. From May 1987 to October 1996, Mr. Reinstein held various positions for Weyerhaeuser Financial Investments, Inc. where he was involved in developing, managing, leasing, financing and disposing of all types of real estate assets. Mr. Reinstein earned a Bachelor of Science degree in Business Administration from California State University, Northridge.

Joseph E. Miller, age 38, was promoted to Vice President, Corporate Controller in December 2001 with responsibilities for financial and operational accounting, reporting, and analysis. Mr. Miller joined the Company in August 2001 as Vice President, Property Operations Controller focusing on operational systems and processes. Previously, Mr. Miller was Corporate Controller for Maguire Partners, a prominent Los Angeles commercial real estate developer, owner, and manager, from May 1987 to August 2001. Prior to joining Maguire Partners, Mr. Miller was an audit manager at Ernst & Young with a focus on real estate clients. Mr. Miller is a Certified Public Accountant and has earned a

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Bachelor of Science degree in Business Administration from California State University, Northridge, and a Masters of Business Administration from the University of Southern California.

Angelique A. Benschneider, age 39, joined the Company as Vice President in November 2000 with responsibility for property operations for the Midwest Division. Ms. Benschneider became an executive officer of the Company in March 2001. From 1999 to November 2000, Ms. Benschneider was a Senior Asset Manager for Amerishop Real Estate Services, where she was responsible for retail portfolio performance for the Company on the East Coast. From 1996 to 1999, Ms. Benschneider was a General Manager for GIC Real Estate, Inc. and was responsible for the management and leasing of Thanksgiving Tower, a 1,500,000 square foot high rise office tower. Mrs. Benschneider has extensive experience in regional malls, working on the redevelopment of the 2,900,000 square foot King of Prussia Mall in Philadelphia, Pennsylvania. Ms. Benschneider earned a Bachelor of Science degree in Business Administration from the University of North Texas and a Masters of Business Administration from the University of Texas, Dallas.

David C. Bischoff, age 50, has been Vice President of the Company since

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August 1999 with responsibility for property operations for the Eastern Division. He became an executive officer of the Company in March 2001. From June 1996 to July 1999, Mr. Bischoff was Managing Director in the Client Advisory Group with CB Richard Ellis (CBRE) with responsibility for overseeing, directing and managing all the various business services (property management, leasing, appraisal, acquisition and disposition) provided by CBRE to several large institutional clients. From September 1984 to May 1996, Mr. Bischoff held a variety of positions with ABKB Realty Advisors (acquired by LaSalle Advisors) responsible for several pension fund clients, with responsibilities including raising and investing capital, selecting, directing and managing the personnel and business services provided by third party firms, and financing and ultimate disposition of client assets. Mr. Bischoff earned an Associates of Arts degree from the Philadelphia Community College.

Maria R. Hawthorne, age 42, has been a Vice President of the Company since June 2001 with responsibility for property operations for the Northern Virginia Division. Mrs. Hawthorne has been with the Company and its predecessors for the past sixteen years. From July 1994 to June 2002, Mrs. Hawthorne was a Regional Manager of the Company. From August 1988 to July 1994, Mrs. Hawthorne was the Director of Leasing and Property Manager for AOPP. Ms. Hawthorne earned a Bachelor of Arts degree in International Relations from Pomona College.

William A. McFaul, age 36, was promoted to Vice President of PS Business Parks, Inc. in December 2001 with responsibility for property operations for the Maryland Division. Mr. McFaul has been with the Company since July 1999. Mr. McFaul became a Regional Manager in January 2001 with responsibility for property operations of the Maryland Region and was a Senior Property Manager from July 1999 until December 2000. Prior to joining PS Business Parks, Mr. McFaul worked for The Rouse Company, a national real estate development firm, for ten years holding various positions in leasing and operations. Mr. McFaul earned a Bachelor of Science degree in Business Administration and a Masters of Business Administration from Loyola College in Maryland.

Eileen M. Newkirk, age 53, has been a Vice President of the Company since March 2000 with responsibility for property operations for the Pacific Northwest Division. Ms. Newkirk became an executive officer of the Company in March 2001. From August 1998 to March 2000, Ms. Newkirk was a Regional Manager of the Company. From 1997 to 1998, Ms. Newkirk held the position of United States Facilities Manager for N-Cube, a high tech company based in Foster City, California. From 1994 to 1997, she was a Property Manager for AOPP. Prior to joining AOPP, Ms. Newkirk held a variety of development and operations management positions, including the management of a Class A central business district high-rise. Ms. Newkirk maintains an Oregon real estate license.

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

Year	Quarter	Range	
		High	Low
		-----	-----

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2001	1st	\$28.10	\$26.50
	2nd	\$29.57	\$25.80
	3rd	\$28.30	\$26.00
	4th	\$32.95	\$29.75
2000	1st	\$22.88	\$19.88
	2nd	\$25.13	\$20.25
	3rd	\$28.13	\$23.88
	4th	\$28.79	\$25.75

As of February 7, 2002, there were approximately 688 holders of record of the Common Stock.

b. Dividends

Holders of Common Stock are entitled to receive distributions when, as and if declared by the Company's Board of Directors out of any funds legally available for that purpose. The Company is required to distribute at least 90% of its 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 these required amounts.

Distributions paid per share of Common Stock for 2001 and 2000 amounted to \$1.31 and \$1.00 per year, respectively. Since the second quarter of 1998 and through the fourth quarter of 2000, the Company had declared regular quarterly dividends of \$0.25 per common share. In March 2001, the Board of Directors increased the quarterly dividends from \$0.25 to \$0.29 per common share. In December 2001, the Board of Directors declared a special dividend of \$0.15 per common share. 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. Pursuant to restrictions contained in the Credit Facility, distributions may not exceed 95% of funds from operations, as defined.

c. Issuance of Unregistered Securities

On September 21, 2001, the Operating Partnership issued 2,120,000 preferred units with a preferred distribution rate of 9 1/4%. The Operating Partnership received net proceeds from the sale of these preferred units of approximately \$51.6 million. The Operating Partnership sold the preferred units in a private placement in reliance on an exemption from the registration requirements of the Securities Act pursuant to Section 4(2) and Rule 506 of Regulation D promulgated thereunder. The preferred units were issued to a single institutional "accredited investor" within the meaning of Regulation D.

ITEM 6. SELECTED FINANCIAL DATA (1)

The following sets forth selected consolidated and combined financial and operating information on a historical basis for the Company and its predecessors. The following information should be read in conjunction with the consolidated financial statements and notes thereto of the Company included elsewhere in this Form 10-K.

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	For the Years Ended December 31,			
	2001	2000	1999	1998
(In thousands, except per share)				
<b>Revenues:</b>				
Rental income.....	\$ 167,062	\$ 144,171	\$ 125,327	\$ 88,000
Facility management fees primarily from affiliates.....	683	539	471	
Business services.....	353	547	-	
Equity in income of joint venture.....	25	-	-	
Interest income.....	2,251	4,076	2,356	1,000
Dividend income.....	17	1,301	459	
	170,391	150,634	128,613	90,000
<b>Expenses:</b>				
Cost of operations.....	45,214	39,290	34,891	26,000
Cost of facility management.....	152	111	94	
Cost of business services.....	572	344	-	
Depreciation and amortization.....	41,067	35,637	29,762	18,000
General and administrative.....	4,320	3,954	3,153	2,000
Interest expense.....	1,715	1,481	3,153	2,000
	93,040	80,817	71,053	49,000
Income before disposition of investments, minority interest and extraordinary item.....	77,351	69,817	57,560	40,000
Gain on investment in marketable securities.....	8	7,849	-	
Gain on disposition of properties.....	-	256	-	
Income before minority interest and extraordinary item.....	77,359	77,922	57,560	40,000
Minority interest in income - preferred units.....	(14,107)	(12,185)	(4,156)	
Minority interest in income - common units.....	(13,382)	(14,556)	(11,954)	(11,000)
Income before extraordinary item.....	49,870	51,181	41,450	29,000
Extraordinary item, net of minority interest.....	-	-	(195)	
Net income.....	\$ 49,870	\$ 51,181	\$ 41,255	\$ 29,000
<b>Net income allocation:</b>				
Allocable to preferred shareholders...	\$ 8,854	\$ 5,088	\$ 3,406	\$ 29,000
Allocable to common shareholders.....	41,016	46,093	37,849	
	\$ 49,870	\$ 51,181	\$ 41,255	\$ 29,000
<b>Per Common Share:</b>				
Distribution (3).....	\$ 1.31	\$ 1.00	\$ 1.00	\$ 1.00
Net income - Basic.....	\$ 1.84	\$ 1.98	\$ 1.60	\$ 1.00



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Net income - Diluted.....	\$ 1.83	\$ 1.97	\$ 1.60	\$ 1
Weighted average common shares-Basic....	22,350	23,284	23,641	19,
Weighted average common shares-Diluted..	22,435	23,365	23,709	19,

### Balance Sheet Data:

-----				
Total assets.....	\$ 1,169,955	\$ 930,756	\$ 903,741	\$ 709,
Total debt.....	165,145	30,971	37,066	50,
Minority interest - preferred units.....	197,750	144,750	132,750	
Minority interest - common units.....	162,141	161,728	157,199	153,
Preferred stock.....	121,000	55,000	55,000	
Common shareholders' equity.....	\$ 478,731	\$ 509,343	\$ 500,531	\$ 489,

### Other Data:

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Net cash provided by operating activities.....	\$ 126,677	\$ 111,197	\$ 88,440	\$ 60,
Net cash used in investing activities...	(318,367)	(77,468)	(131,318)	(308,
Net cash provided by (used in) financing activities.....	145,471	(58,654)	111,030	250,
Funds from operations (4).....	\$ 93,568	\$ 85,977	\$ 76,353	\$ 57,
Square footage owned at end of period...	14,817	12,600	12,359	10,

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

(2) Prior to March 31, 1997, control of AOPP was held by entities other than PSI. As a result of PSI acquiring a majority of the voting common stock and control of AOPP 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.

(3) In March 2001, the Board of Directors increased the annual distribution to \$1.16 per common share. In December 2001, the Board of Directors declared a special distribution of \$0.15 per common share.

(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. The Company believes that in order to facilitate a clear understanding of the Company's operating results, FFO should be analyzed in conjunction with net income as presented in the Company's consolidated financial statements included elsewhere in this Form 10-K.

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### 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.

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

**EFFECT OF ECONOMIC CONDITIONS ON THE COMPANY'S OPERATIONS:** During 2001, the Company was affected by the slowdown in economic activity in the United States in most of its primary markets. These effects were exacerbated by the terrorist attacks of September 11, 2001 and the related aftermath. These effects include a decline in occupancy rates and a reduction in market rates throughout the portfolio, slower than expected lease-up of our development properties, lower interest rates on invested cash and the expectation that insurance costs will rise upon expiration of our policies in March 2002.

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

The Company's three development properties were 63% leased as of December 31, 2001, but they have not been leased as rapidly as the Company had anticipated. The development properties consist of a 102,000 square foot development in the Las Colinas submarket of Dallas, Texas that was 100% leased, a 141,000 square foot flex development in Northern Virginia that was 60% leased, and a 94,000 square foot development in the Beaverton submarket of Portland, Oregon that was 27% leased. The interest of tenants in the Oregon property has been significantly affected by the economic slowdown.

Historically, the Company has raised capital prior to identifying opportunities to deploy the capital. This has generally resulted in some short-term earnings dilution. Interest rates on cash investments have declined 350 basis points over the twelve months ended December 31, 2001, resulting in a significantly greater dilution to earnings from holding capital waiting to be

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deployed. During this period of low interest rates, the Company has determined that the cost of this strategy currently exceeds the benefits derived from it. As a result, the Company has used its line of credit and other short-term borrowing sources to provide the capital to complete acquisitions.

The Company also anticipates a 25%-50% increase in insurance costs when our current policies expire in April 2002 due to the terrorist attacks of September 11, 2001. The Company does not expect the increase to materially impact its results since insurance expense represents less than 3% of the

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Company's operating costs and the Company believes that most of the cost can be passed along to the Company's customers in accordance with the applicable lease agreements.

**EFFECT OF ECONOMIC CONDITIONS ON THE COMPANY'S PRIMARY MARKETS:** The Company has concentrated its operations in seven major markets. Each of these markets has been affected by the slowdown in economic activity. The Company's overall view of these markets is summarized below as of December 31, 2001. For purposes of market occupancy statistics, the Company has compiled these statistics using broker reports for these respective markets. These sources are deemed to be reliable by the Company, but there can be no assurance that these reports are accurate.

The Company owns approximately 1.9 million square feet in the Beaverton sub market of Portland, Oregon. The average vacancy rate in this market is 18% for office and 11% for flex. Leasing activity slowed dramatically during 2001, but is beginning to show signs of improvement. On the supply side, a significant amount of flex and office space was added in 2001, but the Company does not believe significant new construction starts will occur in 2002. The Company's vacancy rate is 3.4%.

The Company owns approximately 1.5 million square feet in Northern California with a concentration in South San Francisco, Santa Clara and San Jose. The vacancy rate in this market stands at 20% or more throughout most of the Bay Area. Market rates dropped dramatically in 2001 and continue to decrease and are now at approximately the same level they were at in 1999, and most construction starts have been postponed or terminated. The Company's vacancy rate is 2.7%.

The Company owns approximately 3.5 million square feet in Southern California (including its partial ownership in a joint venture). This is one of the most stable markets in the country but continues to experience slowing. Vacancy rates have increased throughout Southern California for flex, industrial and office, ranging from 5% to 25%, depending on sub-markets and product type, and the rental rates for the Company's properties have dropped slightly. The Company's vacancy is 1.3% in San Diego, 1.0% in Los Angeles and 2.5% in Orange County.

The Company owns approximately 0.8 million square feet in Austin, Texas. This market experienced a drastic increase in office and flex vacancy, running at 19% and 17%, respectively. One half of the office vacancy is due to sub-lease space. Construction deliveries of office and flex space continue to add to the vacancy rate resulting in downward pressure on rental rates. The Company's vacancy rate is 8.7%.

The Company owns approximately 1.9 million square feet in Northern Texas. The vacancy rate in Las Colinas, where most of the Company's properties are concentrated, is 19.5% for flex and 23% for office. Over the 12 months ended

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December 31, 2001, the number of new properties constructed has decreased, virtually no new construction has commenced and very little pre-leasing of space has occurred. The Company believes that any such new construction will cause vacancy rates to rise. Leasing activity has slowed overall and sub-leasing is continuing to increase in the Telecom Corridor. The Company's vacancy rate is 3.9%.

The Company owns approximately 2.6 million square feet in Northern Virginia, where the vacancy rate grew from 3.9% to 11.9% during 2001. Prospective tenants in the sub-markets near downtown and the D.C. Beltway, such as Ballston, Alexandria and Merrifield, have shown increased interest in renting space recently, primarily as a result of the demand for space by the GSA and government contractors. Vacancy rates have risen to over 20% in the sub-markets in the western technology corridor, such as Herndon, Chantilly and Sterling, primarily as a result of the decline in the technology sector. The Company's vacancy rate in is 3.1%.

The Company owns approximately 1.8 million square feet in Maryland. In Montgomery County, Maryland's 1-270 Corridor vacancy rates are 10% for office and 8% for flex space. The Company expects that the business of the GSA, defense contractors and the biotech industry will continue to grow in 2002. With most 2002 construction deliveries pre-leased, the Company expects that the vacancy rate will remain flat or decline. The Company's vacancy rate is 5%.

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**GROWTH OF THE COMPANY'S OPERATIONS:** During 2000 and 2001, the Company focused on increasing cash flow from its existing core portfolio of properties, expanding its presence in existing markets through strategic acquisitions and developments and strengthening its balance sheet, primarily through the issuance of preferred stock/units. The Company has maintained low debt and overall leverage levels including preferred stock/units which give it the flexibility for future growth without the issuance of additional common stock.

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

During 2000, the Company added approximately 0.8 million square feet to its portfolio at an aggregate cost of approximately \$82 million. The Company acquired 454,000 square feet in Southern California for \$40 million, 178,000 square feet in Northern California for \$23 million and 210,000 square feet in Northern Virginia for approximately \$19 million. In addition, the Company completed development of a property totaling 22,000 square feet in Oregon for approximately \$3 million. The Company also disposed of five properties in non-core markets aggregating 627,000 square feet for approximately \$23.8 million.

During 1999, the Company added approximately 1.3 million square feet to

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its portfolio at an aggregate cost of approximately \$103 million. The Company acquired 483,000 square feet in Texas for approximately \$32 million, 405,000 square feet in Northern Virginia/Maryland market for approximately \$41 million, 211,000 square feet in Northern California for approximately \$17 million and 200,000 square feet in Arizona for approximately \$13 million. In addition, the Company completed development of two properties totaling 127,000 square feet in Oregon and Texas for approximately \$14 million.

### COMPARISON OF 2001 TO 2000

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RESULTS OF OPERATIONS: Net income for the year ended December 31, 2001 was \$49,870,000 compared to \$51,181,000 for the same period in 2000. Net income allocable to common shareholders (net income less preferred stock dividends) for the year ended December 31, 2001 was \$41,016,000 compared to \$46,093,000 for the same period in 2000. Net income per common share on a diluted basis was \$1.83 for the year ended December 31, 2001 compared to \$1.97 for the same period in 2000 (based on weighted average diluted common shares outstanding of 22,435,000 and 23,365,000, respectively). The decreases in net income and net income per common share reflect a non-recurring realized and unrealized gain on the Company's investment in the common stock of Pacific Gulf Properties, Inc. ("PAG") recognized in the prior year.

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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, 2001 and 2000:

	Years Ended December 31,	
	2001	2000
Rental income:		
"Same Park" facilities (11.4 million net rentable square feet).....	\$140,844,000	\$133,386,000
Other facilities.....	26,218,000	10,785,000
	\$167,062,000	\$144,171,000
	=====	=====
Cost of operations (excluding depreciation):		
"Same Park" facilities.....	\$36,385,000	\$35,061,000
Other facilities.....	8,829,000	4,229,000
	\$45,214,000	\$39,290,000
	=====	=====
Net operating income (rental income less cost of operations):		
"Same Park" facilities (1).....	\$104,459,000	\$98,325,000
Other facilities.....	17,389,000	6,556,000
	\$121,848,000	\$104,881,000
	=====	=====

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(1) See "Supplemental Property Data and Trends" below for a definition of "Same Park" facilities.

Rental income and rental income less cost of operations or net operating income prior to depreciation (defined as "NOI" for purposes of the following tables) are summarized for the year ended December 31, 2001 by major geographic region below:

Region	Square Footage	Percent of Total	Rental Income	Percent of Total	N
Southern California	3,177,000	22%	\$44,053,000	26%	\$32,
Northern California	1,495,000	10%	19,576,000	12%	14,
Southern Texas	1,032,000	7%	11,796,000	7%	7,
Northern Texas	1,951,000	13%	19,828,000	12%	13,
Virginia	2,621,000	18%	34,338,000	21%	25,
Maryland	1,771,000	12%	10,112,000	6%	7,
Oregon	1,973,000	13%	19,868,000	12%	16,
Other	797,000	5%	7,491,000	4%	4,
	-----	-----	-----	-----	-----
	14,817,000	100%	\$167,062,000	100%	\$121,
	=====	=====	=====	=====	=====

**SUPPLEMENTAL PROPERTY DATA AND TRENDS:** In order to evaluate the performance of the Company's overall portfolio, management analyzes the operating performance of a consistent group of properties constituting 11.4 million net rentable square feet ("Same Park" facilities). The Company currently has an ownership interest in these properties and has owned and operated them for the comparable periods. These properties do not include properties that have been acquired or sold during 2000 and 2001. The "Same Park" facilities represent approximately 90% of the weighted average square footage of the Company's portfolio for 2001.

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The following table summarizes the pre-depreciation historical operating results of the "Same Park" facilities excluding the effects of accounting for rental revenues on a straight-line basis for the years ended December 31, 2001 and 2000.

### "Same Park" Facilities (11.4 million square feet)

	Years Ended December 31,	
	2001	2000
Rental income (1).....	\$ 139,239,000	\$ 131,347,000
Cost of operations.....	36,385,000	35,061,000
	-----	-----
Net operating income.....	\$ 102,854,000	\$ 96,286,000
	=====	=====

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Gross margin (2).....	73.9%	73.3%
Weighted average for period:		
-----		
Occupancy.....	95.6%	96.8%
Annualized realized rent per square foot.(3).....	\$12.78	\$11.90

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- (1) Rental income is presented on a cash basis and excludes the effect of straight-line accounting of \$1,904,000 and \$2,204,000 for the years ended December 31, 2001 and 2000, respectively.
  - (2) Gross margin is computed by dividing property net operating income by rental income.
  - (3) Realized rent per square foot represents the actual revenues earned per occupied square foot.

The following tables summarize the "Same Park" operating results prior to depreciation by major geographic region for the years ended December 31, 2001 and 2000:

Region	Revenues 2001	Revenues 2000	Increase	NOI 2001	NOI 2000
-----	-----	-----	-----	-----	-----
Southern California.....	\$37,275,000	\$35,011,000	6.5%	\$28,702,000	\$26,900,000
Northern California.....	16,697,000	14,719,000	13.5%	12,610,000	10,700,000
Southern Texas.....	9,413,000	8,799,000	6.7%	6,289,000	5,700,000
Northern Texas.....	19,076,000	18,680,000	2.1%	13,058,000	12,800,000
Virginia.....	23,198,000	21,952,000	5.7%	16,868,000	15,900,000
Maryland.....	9,853,000	9,808,000	0.5%	7,598,000	7,300,000
Oregon.....	16,293,000	15,179,000	7.3%	13,343,000	12,200,000
Other.....	7,434,000	7,199,000	3.2%	4,386,000	4,300,000
	-----	-----	-----	-----	-----
	\$139,239,000	\$131,347,000	6.0%	\$102,854,000	\$96,200,000
	=====	=====	=====	=====	=====

The increases noted above reflect the performance of the Company's existing markets. Northern California benefited from the expiration of leases with below market rents, as did all other markets to a lesser extent, resulting in revenue and NOI increases in all of our markets.

**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, 2001, \$531,000 in net operating income was recognized from facility management operations compared to \$428,000 for the same period in 2000. Facility management fees have increased due to the increase in rental rates of the properties managed by the Company and additional properties brought under management during 2000 and 2001.

**BUSINESS SERVICES:** Business services include construction management fees and fees from telecommunication service providers. During the year ended

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December 31, 2001, the Company incurred a net operating loss of \$219,000 from such services compared to net operating income of \$203,000 recognized for the same period in 2000. Business services revenues have declined due to the bankruptcies of Darwin Networks, Winstar and Teligent. Expenses have increased as a result of a full year of operations in 2001.

**EQUITY IN INCOME OF JOINT VENTURE:** On October 23, 2001, the Company formed a joint venture with an unaffiliated investor to own and operate an industrial park in the City of Industry submarket of Los Angeles County. The Company recognized income of \$25,000 in 2001 which represented the Company's 25% equity interest in the joint venture.

**INTEREST INCOME:** Interest income reflects earnings on interest bearing investments. Interest income was \$2,251,000 for the year ended December 31, 2001 compared to \$4,076,000 for the same period in 2000. The decrease is attributable to lower interest rates and lower average cash balances. Weighted average interest bearing investments and effective interest rates for the year ended December 31, 2001 were approximately \$53 million and 4.2% compared to \$62 million and 6.5% for the same period in 2000.

**DIVIDEND INCOME:** Dividend income reflects dividends received from marketable securities. Dividend income was \$17,000 for the year ended December 31, 2001 compared to \$1,301,000 for the same period in 2000. Dividend income decreased due to the liquidation of PAG during the year ended December 31, 2001.

**COST OF OPERATIONS:** Cost of operations was \$45,214,000 for the year ended December 31, 2001 compared to \$39,290,000 for the same period in 2000. The increase is due primarily to the growth in the square footage of the Company's portfolio of properties. Cost of operations as a percentage of rental income decreased from 27.3% in 2000 to 27.1% in 2001 as a result of economies of scale achieved through the acquisition and development of properties in core markets and the disposition of properties outside of the Company's core markets. Cost of operations for the year ended December 31, 2001 consists primarily of property taxes (\$14,241,000), property maintenance (\$9,386,000), utilities (\$8,046,000) and direct payroll (\$6,957,000).

**DEPRECIATION AND AMORTIZATION EXPENSE:** Depreciation and amortization expense was \$41,067,000 for the year ended December 31, 2001 compared to \$35,637,000 for the same period in 2000. The increase is due to the acquisition and development of real estate facilities during 2000 and 2001 and recurring capitalized expenditures.

**GENERAL AND ADMINISTRATIVE EXPENSE:** General and administrative expense was \$4,320,000 for the year ended December 31, 2001 compared to \$3,954,000 for the same period in 2000. The increase is due primarily to the increased size and activities of the Company offset by a decrease in legal costs. Included in general and administrative costs are internal acquisition costs and abandoned transaction costs. Internal acquisition expenses were \$587,000 and \$553,000 for the year ended December 31, 2001 and 2000, respectively. Abandoned transaction costs was \$7,000 for both the years ended December 31, 2001 and 2000. Legal costs were \$176,000 and \$837,000 for the years ended December 31, 2001 and 2000, respectively. Legal costs were higher in 2000 as a result of the litigation matters described in Item 3 of this Form 10-K.

**INTEREST EXPENSE:** Interest expense was \$1,715,000 for the year ended December 31, 2001 compared to \$1,481,000 for the same period in 2000. The increase is primarily attributable to increased average debt balances during the period and greater capitalized interest in 2000 as a result of more construction in progress. Interest expense of \$1,091,000 and \$1,415,000 was capitalized as part of building costs associated with properties under development during the years ended December 31, 2001 and 2000, respectively.



MINORITY INTEREST IN INCOME: Minority interest in income reflects the income allocable to equity interests in the Operating Partnership that are not owned by the Company. Minority interest in income was \$27,489,000 (\$14,107,000 allocated to preferred unitholders and \$13,382,000 allocated to common unitholders) for the year ended December 31, 2001 compared to \$26,741,000 (\$12,185,000 allocated to preferred unitholders and \$14,556,000 allocated to common unitholders) for the same period in 2000. The increase in minority interest in income is due primarily to the issuance of preferred operating partnership units during 2000 and 2001 and higher earnings at the operating partnership level, partially offset by a conversion of units to common stock during 2000.

GAIN ON INVESTMENT IN MARKETABLE SECURITIES: Gain on investments in marketable securities was \$8,000 for the year ended December 31, 2001 compared to \$7,849,000 for the same period in 2000. The Company received a liquidating distribution from PAG of approximately \$21.8 million and recognized a non-recurring gain of approximately \$7.8 million during the year ended December 31, 2000.

DISPOSITION OF PROPERTIES: Certain properties that were identified as not meeting the Company's ongoing investment strategy were designated for sale in 2000 and 2001. The Company disposed of a property in San Diego with 77,000 square feet for approximately \$9 million in November 2001 and deferred a gain of \$5,366,000. The Company disposed of five properties aggregating 627,000 square feet for approximately \$23.8 million during the year ended December 31, 2000 at a gain of \$256,000.

COMPARISON OF 2000 TO 1999

RESULTS OF OPERATIONS: Net income for the year ended December 31, 2000 was \$51,181,000 compared to \$41,255,000 for the same period in 1999. Net income allocable to common shareholders (net income less preferred stock dividends) for the year ended December 31, 2000 was \$46,093,000 compared to \$37,849,000 for the same period in 1999. Net income per common share on a diluted basis was \$1.97 for the year ended December 31, 2000 compared to \$1.60 for the same period in 1999 (based on weighted average diluted common shares outstanding of 23,365,000 and 23,709,000, respectively). The increases in net income and net income per common share reflect the Company's growth in its asset base through the acquisition and development of commercial properties, increased net operating income from its stabilized base of properties, a non-recurring realized and unrealized gain on the Company's investment in the common stock of PAG and the repurchase of common shares.

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, 2000 and 1999:

Years Ended  
December 31,

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	2000	1999
	-----	-----
Rental income:		
"Same Park" facilities (107 facilities, 10.5 million net rentable square feet).....	\$121,489,000	\$114,445,000
Other facilities.....	22,682,000	10,882,000
	-----	-----
Total rental income.....	\$144,171,000	\$125,327,000
	=====	=====
Cost of operations (excluding depreciation):		
"Same Park" facilities.....	\$31,835,000	\$30,983,000
Other facilities.....	7,455,000	3,908,000
	-----	-----
Total cost of operations.....	\$39,290,000	\$34,891,000
	=====	=====
Net operating income (rental income less cost of operations):		
"Same Park" facilities.....	\$89,654,000	\$83,462,000
Other facilities.....	15,227,000	6,974,000
	-----	-----
Total net operating income.....	\$104,881,000	\$90,436,000
	=====	=====

Rental income and rental income less cost of operations or net operating income prior to depreciation (defined as "NOI" for purposes of the following tables) are summarized for the year ended December 31, 2000 by major geographic region below:

Region	Square Footage	Percent of Total	Rental Income	Percent of Total	N
-----	-----	-----	-----	-----	-----
Southern California	3,548,000	28.1%	\$37,670,000	26.1%	\$28,8
Northern California	1,495,000	11.8%	16,977,000	11.8%	12,6
Southern Texas	1,032,000	8.2%	11,084,000	7.7%	6,6
Northern Texas	1,849,000	14.7%	19,183,000	13.3%	13,2
Virginia	1,822,000	14.5%	22,375,000	15.5%	16,4
Maryland	866,000	6.9%	12,592,000	8.7%	9,1
Oregon	1,191,000	9.5%	16,653,000	11.6%	13,3
Other	797,000	6.3%	7,637,000	5.3%	4,6
	-----	-----	-----	-----	-----
	12,600,000	100.0%	\$144,171,000	100.0%	\$104,8
	=====	=====	=====	=====	=====

SUPPLEMENTAL PROPERTY DATA AND TRENDS: In order to evaluate the performance of the Company's overall portfolio, management analyzes the operating performance of a consistent group of 107 properties (constituting 10.5 million net rentable square feet). These 107 properties (herein referred to as the "Same Park" facilities) have been owned and operated by the Company for the comparable periods. These properties do not include properties that have been acquired or sold during 1999 and 2000. The "Same Park" facilities represented approximately 84% of the square footage of the Company's portfolio at December

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31, 2000.

The following table summarizes the pre-depreciation historical operating results of the "Same Park" facilities excluding the effects of accounting for rental revenues on a straight-line basis for the years ended December 31, 2000 and 1999.

"Same Park" Facilities (10.5 million square feet)

	Years Ended December 31,	
	2000	1999
Rental income (1).....	\$ 119,632,000	\$ 111,334,000
Cost of operations.....	31,835,000	30,983,000
Net operating income.....	\$ 87,797,000	\$ 80,351,000
Gross margin (2).....	73.4%	72.2%
Weighted average for period:		
Occupancy.....	97.0%	96.7%
Annualized realized rent per sq. ft.(3).....	\$11.71	\$10.93

(1) Rental income is presented on a cash basis and excludes the effect of straight-line accounting of \$2,204,000 and \$3,407,000 for the years ended December 31, 2000 and 1999, respectively.

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

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

The following tables summarize the "Same Park" operating results prior to depreciation by major geographic region for the years ended December 31, 2000 and 1999:

Region	Revenues 2000	Revenues 1999	Increase	NOI 2000	NOI 1999
Southern California.....	\$36,160,000	\$33,116,000	9.2%	\$27,591,000	\$24,800,000
Northern California.....	12,005,000	10,888,000	10.3%	9,143,000	8,100,000
Southern Texas.....	9,666,000	8,996,000	7.4%	5,613,000	5,400,000
Northern Texas.....	15,971,000	15,236,000	4.8%	11,103,000	10,100,000
Virginia.....	15,988,000	14,739,000	8.5%	11,699,000	10,600,000
Maryland.....	9,805,000	9,406,000	4.2%	7,397,000	6,800,000
Oregon.....	15,174,000	14,333,000	5.9%	12,257,000	11,300,000
Other.....	4,863,000	4,620,000	5.3%	2,994,000	2,800,000
	\$119,632,000	\$111,334,000	7.5%	\$87,797,000	\$80,351,000

The increases noted above reflect the performance of the Company's existing markets. Southern and Northern California continued to benefit from a strong economy, as did all other markets to a lesser extent, resulting in revenue and NOI (prior to depreciation) increases in all of our markets.

**FACILITY MANAGEMENT OPERATIONS:** Facility management accounted for a small portion of the Company's net operating income. During the year ended December 31, 2000, \$428,000 in net operating income was recognized from facility management operations compared to \$377,000 for the same period in 1999. Facility management fees have increased due to the increase in rental rates of the properties managed by the Company and an additional property brought under management during 2000.

**BUSINESS SERVICES:** The Company hired a Vice President in 2000 to focus on creating new revenue opportunities for the Company and additional products and services for our customers. The Company began receiving income in 2000 from construction management fees and fees from telecommunication service providers. During the year ended December 31, 2000, \$203,000 in net operating income was derived from such services compared to none for the same period in 1999.

**INTEREST INCOME:** Interest income reflects earnings on cash balances. Interest income was \$4,076,000 for the year ended December 31, 2000 compared to \$2,356,000 for the same period in 1999. The increase is attributable to higher interest rates and higher average cash balances. Weighted average cash balances and effective interest rates for the year ended December 31, 2000 were approximately \$62 million and 6.5% compared to \$43 million and 5.5% for the same period in 1999.

**DIVIDEND INCOME:** Dividend income reflects dividends received from marketable securities, primarily the Company's investment in PAG. Dividend income was \$1,301,000 for the year ended December 31, 2000 compared to \$459,000 for the same period in 1999. The increase is attributable to the Company's increased investment in PAG beginning in the third quarter of 1999.

**COST OF OPERATIONS:** Cost of operations for the year ended December 31, 2000 was \$39,290,000 compared to \$34,891,000 for the same period in 1999. The increase is due primarily to the growth in the square footage of the Company's portfolio of properties. Cost of operations as a percentage of rental income decreased from 27.8% in 1999 to 27.3% in 2000 as a result of economies of scale achieved through the acquisition and development of properties in core markets and the disposition of properties outside of the Company's core markets. Cost of operations for the year ended December 31, 2000 consists primarily of property taxes (\$12,590,000), property maintenance (\$7,401,000), utilities (\$5,615,000) and direct payroll (\$6,189,000).

**DEPRECIATION AND AMORTIZATION EXPENSE:** Depreciation and amortization expense for the year ended December 31, 2000 was \$35,637,000 compared to \$29,762,000 for the same period in 1999. The increase is due to the acquisition and development of real estate facilities during 1999 and 2000 and recurring capitalized expenditures.

**GENERAL AND ADMINISTRATIVE EXPENSE:** General and administrative expense was \$3,954,000 for the year ended December 31, 2000 compared to \$3,153,000 for the same period in 1999. The increase is due primarily to the increased size and activities of the Company and legal costs related to litigation matters

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described in Item 3 of this Form 10-K. Included in general and administrative costs are internal acquisition costs and abandoned transaction costs. Internal acquisition expenses were \$553,000 and \$430,000 for the years ended December 31, 2000 and 1999, respectively. Abandoned transaction costs were \$7,000 and \$41,000 for the years ended December 31, 2000 and 1999, respectively. Legal costs were \$837,000 and \$147,000 for the years ended December 31, 2000 and 1999, respectively.

**INTEREST EXPENSE:** Interest expense was \$1,481,000 for the year ended December 31, 2000 compared to \$3,153,000 for the same period in 1999. The decrease is attributable to decreased average debt balances during the period and greater capitalized interest in 2000 as a result of more construction in progress. Interest expense of \$1,415,000 and \$989,000 was capitalized as part of building costs associated with properties under development during the years ended December 31, 2000 and 1999, respectively.

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**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, 2000 was \$26,741,000 (\$12,185,000 allocated to preferred unitholders and \$14,556,000 allocated to common unitholders) compared to \$16,049,000 (\$4,156,000 allocated to preferred unitholders and \$11,893,000 allocated to common unitholders) for the same period in 1999. The increase in minority interest in income is due primarily to the issuance of preferred operating partnership units during 1999 and 2000 and higher earnings at the operating partnership level, partially offset by a conversion of units to common stock during 2000.

**GAIN ON INVESTMENT IN PAG:** At December 31, 2000, the Company owned approximately one million shares of common stock of PAG. PAG began the process of liquidating its assets in 2000. On December 15, 2000, the Company received an initial liquidating distribution from PAG of approximately \$21.8 million and recognized a non-recurring gain of approximately \$7.8 million during the year ended December 31, 2000.

**DISPOSITION OF PROPERTIES:** Certain properties that were identified as not meeting the Company's ongoing investment strategy were designated for sale in 2000. The Company sold five properties aggregating 627,000 square feet for approximately \$23.8 million during the year ended December 31, 2000 at a gain of \$256,000.

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### LIQUIDITY AND CAPITAL RESOURCES

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Net cash provided by operating activities for the year ended December 31, 2001 and 2000 was \$126,677,000 and \$111,197,000, 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 and debt service requirements, and to maintain the level of distributions to shareholders in addition to providing additional retained cash for future growth, debt repayment and stock repurchases. There are various factors, however, that could cause net cash provided by operating activities to be less than management anticipates, including the factors set forth in Item 1A "Risk Factors". In particular, leases for 35% of the space in the Company's properties expire in 2002 or 2003 (leases for 60% of the space occupied by small

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tenants expire in such years). If the Company is not able to maintain the occupancy rate of its properties, which in many of the Company's markets is significantly higher than the average for such markets, the Company's retained cash flow will decrease and if there is substantial deterioration in occupancy rates, the Company may have to reduce its level of distributions and/or increase the level of its borrowings.

The Company disposed of a property in San Diego with 77,000 square feet for approximately \$9 million in November 2001 and deferred a gain of \$5,366,000. The Company disposed of five properties in non-core markets for approximately \$23.8 million during the year ended December 31, 2000 at a gain of \$256,000.

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

	Years Ended D
	2001
Net income.....	\$49,870,000
Gain on disposition of properties.....	-
Gain on investment in Pacific Gulf Properties, Inc.....	(8,000)
Depreciation and amortization.....	41,067,000
Minority interest in income.....	27,489,000
Change in working capital.....	8,259,000
	126,677,000
Net cash provided by operating activities.....	126,677,000
Maintenance capital expenditures.....	(4,202,000)
Tenant improvements.....	(4,926,000)
Capitalized lease commissions.....	(2,513,000)
	115,036,000
Funds available for distribution to shareholders, minority interests, acquisitions and other corporate purposes.....	115,036,000
Cash distributions to common and preferred shareholders and minority interests.....	(61,559,000)
	\$53,477,000
Excess funds available for principal payments on debt, investments in real estate and other corporate purposes.....	\$53,477,000

The Company's capital structure is characterized by a low level of leverage. As of December 31, 2001, the Company had seven fixed rate mortgage notes payable totaling \$30,145,000 which represented 2.7% of its total capitalization (based on book value, including minority interests and debt). As of December 31, 2001, the weighted average interest rate for the mortgage notes was 7.56% and the weighted average maturity was 4.4 years.

The Company used its short-term borrowing capacity to complete acquisitions totaling \$303 million in 2001. The Company borrowed \$100 million from its line of credit and \$35 million from PSI. The remaining balance was funded from the issuance of preferred stock and preferred units in the operating

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partnership totaling \$116 million and existing cash of \$52 million. During January 2002, the Company issued 2,000,000 depository shares, each representing 1/1,000 of a share of 8 3/4% Cumulative Preferred Stock, Series F, resulting in net proceeds of \$48.4 million. This was used to repay PSI and to increase financial flexibility.

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

The Company expects to fund its growth strategies primarily with permanent capital, including the issuance of common and preferred stock and internally generated retained cash flows and to a lesser extent with secured or unsecured debt. In addition, the Company may sell properties that no longer meet its investment criteria. The Company may finance acquisitions on a temporary basis with borrowings from its Credit Facility. The Company intends to repay amounts borrowed under the Credit Facility from undistributed cash flow or, as market conditions permit and as determined to be advantageous, from the public or private placement of preferred and common stock/OP units of the Company or Operating Partnership or the formation of joint ventures. The Company targets a leverage ratio of 40% (defined as debt and preferred equity as a percentage of market capitalization). In addition, the Company targets a ratio of Funds from Operations ("FFO") to combined fixed charges and preferred distributions of 3.0 to 1.0. As of December 31, 2001 and for the year then ended, the leverage ratio was 35% and the FFO to fixed charges and preferred distributions coverage ratio was 4.6 to 1.0.

During 1999, the Company issued 2,200,000 depository shares, each representing 1/1,000 of a share of 9 1/4% Cumulative Preferred Stock, Series A. The net proceeds of \$53.1 million were used to repay borrowings from PSI and a mortgage note payable of approximately \$11 million. The remaining proceeds were used for investment in real estate. During 2001, the Company issued 2,640,000 depository shares, each representing 1/1,000 of a share of 9 1/2% Cumulative Preferred Stock, Series D. The net proceeds of \$64.3 million were used for investment in real estate and general corporate purposes.

During 1999, the Operating Partnership issued 2,110,000 preferred units with a preferred distribution rate of 8 7/8% and 3,200,000 preferred units with a preferred distribution rate of 8 3/4%. The net proceeds of approximately \$129.6 million were used to repay borrowings from PSI and a mortgage note payable of approximately \$8.5 million. The remaining proceeds were used for investment in real estate and general corporate purposes. During 2000, the Operating Partnership issued 480,000 preferred units with a preferred distribution rate of 8 7/8%. The net proceeds of \$11.7 million were used for investment in real estate. During 2001, the Operating Partnership issued 2,120,000 preferred units with a preferred distribution rate of 9 1/4%. The net proceeds of \$51.6 million were used for investment in real estate.

In September 2000, the Company extended its Credit Facility with Wells Fargo Bank. The Credit Facility has a borrowing limit of \$100 million and an expiration date of August 6, 2003. The expiration date may be extended by one year on each anniversary of the Credit Facility. Interest on outstanding borrowings is payable monthly. At the option of the Company, the rate of interest charged is equal to (i) the prime rate or (ii) a rate ranging from the London Interbank Offered Rate ("LIBOR") plus 0.75% to LIBOR plus 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

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fee of 0.25% of the borrowing limit.

In October 2001, the Company formed a joint venture with an unaffiliated investor to own and operate an industrial park in the City of Industry submarket of Los Angeles County. The park, consisting of 294,000 square feet of industrial space, was acquired in December 2000 at a cost of approximately \$14.4 million. The property was contributed to the joint venture at its original cost. The joint venture is capitalized with equity capital consisting of 25% from the Company and 75% from the unaffiliated joint venture partner. The joint venture has a variable rate mortgage obligation of \$7,015,000, which currently bears interest at a rate of 5.45% per annum and matures on November 1, 2005. The Company has guaranteed repayment of this

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obligation, but the obligation is not included in the Company's total liabilities set forth on its balance sheet in the financial statements. See Note 2 to the Financial Statements included in this Form 10-K.

FUNDS FROM OPERATIONS: FFO is defined as net income, computed in accordance with generally accepted accounting principles ("GAAP"), before depreciation, amortization, minority interest in income, straight line rent adjustments and extraordinary or non-recurring items. FFO is presented because the Company considers FFO to be a useful measure of the operating performance of a REIT which, together with net income and cash flows provides investors with a basis to evaluate the operating and cash flow performances of a REIT. FFO does not represent net income or cash flows from operations as defined by GAAP. FFO does not take into consideration scheduled principal payments on debt or capital improvements. The Company believes that in order to facilitate a clear understanding of the Company's operating results, FFO should be analyzed in conjunction with net income as presented in the Company's consolidated financial statements included elsewhere in this Form 10-K. 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:

	Years Ended D
	2001
Net income allocable to common shareholders.....	\$41,016,000
Less: Gain on investment in PAG.....	(8,000)
Less: Gain on disposition of properties.....	-
Depreciation and amortization.....	41,067,000
Depreciation from joint venture.....	15,000
Minority interest in income - common units.....	13,382,000
Effects of straight line rents.....	(1,904,000)
	-----
Consolidated FFO allocable to common shareholders and minority interests.	93,568,000
FFO allocated to minority interests - common units.....	(23,018,000)
	-----
FFO allocated to common shareholders.....	\$70,550,000
	=====



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**CAPITAL EXPENDITURES:** During 2001, the Company incurred \$11.6 million or \$0.91 per weighted average square foot in maintenance capital expenditures, tenant improvements and capitalized leasing commissions. On a recurring annual basis, the Company expects \$0.90 to \$1.20 per square foot in recurring capital expenditures (\$13 - \$18 million based on square footage at December 31, 2001). In addition, the Company expects to make \$18 million in additional capital expenditures in 2002. These investments include reserves to bring acquired properties up to the Company's standards of \$6.6 million, first generation tenant improvements and leasing commissions on development properties of \$7 million and the renovation of properties in Southern California and Northern Virginia totaling \$4.4 million.

During 2000, the Company incurred \$11.8 million or \$0.96 per weighted average square foot in maintenance capital expenditures, tenant improvements and capitalized leasing commissions.

**STOCK REPURCHASE:** On November 7, 2001, the Board of Directors increased the number of common shares authorized to be repurchased from 2,500,000 to 4,500,000. The shares may be repurchased periodically on the open market or in privately negotiated transactions. The Company repurchased 1,599,111 shares of common stock and 30,484 common units at an aggregate cost of approximately \$43.9 million and \$808,000, respectively during the year ended December 31, 2001. Since inception of the program (March 2000) through December 31, 2001, the Company has repurchased 2,321,711 shares of common stock and 30,484 common units at an aggregate cost of approximately \$61.4 million. Any significant reduction in the Company's net cash from operations will limit the Company's ability to repurchase shares or units.

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

**RELATED PARTY TRANSACTIONS:** At February 28, 2002, PSI owns 25% of the outstanding shares of the Company's common stock (44% upon conversion of its interest in the Operating Partnership) and 25% of the outstanding common units of the Operating Partnership (100% of the common units not owned by the Company). Ronald L. Havner, Jr., the Company's Chairman, President and Chief Executive Officer, is also an employee of PSI. As of December 31, 2001, the Company had \$35 million in short-term borrowings from PSI. The notes bore interest at 3.25% and were repaid as of January 28, 2002. Pursuant to a cost sharing and administrative services agreement, the Company shares costs with PSI and affiliated entities for certain administrative services. These services include employee relations, insurance, administration, management information systems, legal, income tax and office services. Under this agreement, costs are allocated to the Company in accordance with its proportionate share of these costs. Finally, the Company provides property management services for properties owned by PSI and its affiliates for a fee of 5% of the gross revenues of such properties in addition to reimbursement of direct costs.

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

To limit the Company's exposure to market risk, the Company principally finances its operations and growth with permanent equity capital consisting either of common or preferred stock. At December 31, 2001, the Company's debt as a percentage of shareholders' equity (based on book values) was 27.5%.

The Company's market risk sensitive instruments include mortgage notes payable which totaled \$30,145,000 at December 31, 2001. All of the Company's mortgage notes payable bear interest at fixed rates. See Note 6 of the Notes to Consolidated Financial Statements for terms, valuations and approximate principal maturities of the mortgage notes payable as of December 31, 2001. 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 at December 31, 2001 and 2000 and for the years ended December 31, 2001, 2000 and 1999 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 to Consolidated Financial Statements and Schedules in Item 14.

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

Not Applicable.

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## 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 2002 (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

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reference to the material appearing in the Proxy Statement under the caption "Compensation Committee Interlocks and Insider Participation-Certain Relationships and Related Transactions."

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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 is filed as part of this report.

3. Exhibits

See Index to Exhibits contained herein.

b. Reports on Form 8-K

The Registrant filed a Current Report on Form 8-K dated October 8, 2001 (filed October 9, 2001) pursuant to Item 9, relating to Regulation FD Disclosure.

The Registrant filed a Current Report on Form 8-K dated November 20, 2001 (filed November 21, 2001) pursuant to Item 9, relating to Regulation FD Disclosure.

The Registrant filed a Current Report on Form 8-K dated November 20, 2001 (filed November 27, 2001), as amended by Form 8-K/A dated November 20, 2001 (filed December 18, 2001) pursuant to Item 5, which filed Combined Statements of Certain Revenues and Certain Operating Expenses for the Prosperity Business Campus for the nine months ended September 30, 2001 and for the year ended December 31, 2000 and Combined Statements of Certain Revenues and Certain Operating Expenses for the Cornell Oaks Corporate Center for the nine months ended September 30, 2001 and for the year ended December 31, 2000.

c. Exhibits

See Index to Exhibits contained herein.

d. Financial Statement Schedules

Not applicable.

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PS BUSINESS PARKS, INC.  
EXHIBIT INDEX  
(Items 14(a)(3) and 14(c))

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- 2.1 Amended and Restated Agreement and Plan of Reorganization among Registrant, American Office Park Properties, Inc. ("AOPP") and Public Storage, Inc. ("PSI") dated as of December 17, 1997. Filed with Registrant's Registration Statement No. 333-45405 and incorporated herein by reference.
- 3.1 Restated Articles of Incorporation. Filed with Registrant's Registration Statement No. 333-78627 and incorporated herein by reference.
- 3.2 Certificate of Determination of Preferences of 8 3/4% Series C Cumulative Redeemable Preferred Stock of PS Business Parks, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 3.3 Certificate of Determination of Preferences of 8 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 Certificate of Determination of Preferences of 8 7/8% Series Y Cumulative Redeemable Preferred Stock of PS Business Parks, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2000 and incorporated herein by reference.
- 3.6 Certificate of Determination of Preferences of 9 1/2% Series D Cumulative Redeemable Preferred Stock of PS Business Parks, Inc. Filed with Registrant's Current Report on Form 8-K dated May 7, 2001 and incorporated herein by reference.
- 3.7 Amendment to Certificate of Determination of Preferences of 9 1/2% Series D 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, 2001 and incorporated herein by reference.
- 3.8 Certificate of Determination of Preferences of 9 1/4% Series E 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, 2001 and incorporated herein by reference.
- 3.9 Certificate of Determination of Preferences of 8.750% Series F Cumulative Redeemable Preferred Stock of PS Business Parks, Inc. Filed with Registrant's Current Report on Form 8-K dated January 18, 2002 and incorporated herein by reference.
- 3.10 Restated Bylaws. Filed with Registrant's Current Report on Form 8-K dated March 17, 1998 and incorporated herein by reference.
- 10.1 Amended Management Agreement between Storage Equities, Inc. and Public Storage Commercial Properties Group, Inc. dated as of February 21, 1995. Filed with PSI's Annual Report on Form 10-K for

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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.
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- 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 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.
- 10.5 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.
- 10.6 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.
- 10.7\*\* 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.
- 10.8\*\* 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.
- 10.9 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.
- 10.10 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.
- 10.11 Second Amendment to Revolving Credit Agreement dated as of September 29, 2000 among PS Business Parks, L.P., Wells Fargo Bank, National Association, as Agent, and the Lenders named therein. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2000 and incorporated herein by reference.
- 10.12 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.

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- 10.13 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.
- 10.14 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.
- 10.15 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.
- 10.16 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

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Report on Form 10-Q for the quarterly period ended March 31, 1999 and incorporated herein by reference.

- 10.17 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.
- 10.18 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to 8 3/4% Series C Cumulative Redeemable Preferred Units, dated as of September 3, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 10.19 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to 8 7/8% Series X Cumulative Redeemable Preferred Units, dated as of September 7, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 10.20 Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. Relating to Additional 8 7/8% Series X Cumulative Redeemable Preferred Units, dated as of September 23, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.
- 10.21 Amendment to Agreement of Limited Partnership of PS Business Parks L.P. Relating to 8 7/8% Series Y Cumulative Redeemable Preferred Units, dated as of July 12, 2000. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2000 and incorporated herein by reference.
- 10.22 Amendment to Agreement of Limited Partnership of PS Business Parks L.P. Relating to 9 1/2% Series D Cumulative Redeemable Preferred Units, dated as of May 10, 2001. Filed with Registrant's Quarterly

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Report on Form 10-Q for the quarterly period ended March 31, 2001 and incorporated herein by reference.

- 10.23 Amendment No. 1 to Amendment to Agreement of Limited Partnership of PS Business Parks L.P. Relating to 9 1/2% Series D Cumulative Redeemable Preferred Units, dated as of June 18, 2001. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2001 and incorporated herein by reference.
- 10.24 Amendment to Agreement of Limited Partnership of PS Business Parks L.P. Relating to 9 1/4% Series E Cumulative Redeemable Preferred Units, dated as of September 21, 2001. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2001 and incorporated herein by reference.
- 10.25 Amendment to Agreement of Limited Partnership of PS Business Parks L.P. Relating to 8 3/4% Series F Cumulative Redeemable Preferred Units, dated as of January 18, 2002. Filed herewith.
- 10.26 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.
- 10.27 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.
- 10.28 Third Amendment to Revolving Credit Agreement dated as of February 15, 2002 among PS Business Parks, L.P., Wells Fargo Bank, National Association, as Agent, and the Lenders named therein. Filed herewith.

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- 10.29 Term Loan Agreement dated as of February 20, 2002 among PS Business Parks, L.P. and Fleet National Bank, as Agent. Filed herewith.
- 12 Statement re: Computation of Ratio of Earnings to Fixed Charges. Filed herewith.
- 21 List of Subsidiaries
- 23 Consent of Independent Auditors. Filed herewith.

- \* Compensatory benefit plan.  
\*\* Management contract.

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### 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.

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Dated: March 14, 2002

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



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PS BUSINESS PARKS, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES

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

Report of Independent Auditors.....

Consolidated balance sheets as of December 31, 2001 and 2000.....

Consolidated statements of income for the years ended December 31, 2001, 2000 and 1999.....

Consolidated statement of shareholders' equity for the years ended December 31, 2001, 2000 and 1999.....

Consolidated statements of cash flows for the years ended December 31, 2001, 2000 and 1999.....

Notes to consolidated financial statements.....

Schedule:

III - Real estate and accumulated depreciation.....

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, 2001 and 2000, and the related consolidated statements of income, shareholders' equity and cash flows for the years ended December 31, 2001, 2000 and 1999. 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

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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, 2001 and 2000, and the consolidated results of its operations and its cash flows for the years ended December 31, 2001, 2000 and 1999 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 30, 2002

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PS BUSINESS PARKS, INC.  
CONSOLIDATED BALANCE SHEETS

	December 31, 2001
	-----
ASSETS	
Cash and cash equivalents.....	\$ 3,076,000
Marketable securities.....	9,134,000
Real estate facilities, at cost:	
Land.....	288,792,000
Buildings and equipment.....	948,899,000
	-----
	1,237,691,000
Accumulated depreciation.....	(121,609,000)
	-----
	1,116,082,000
Properties held for disposition, net.....	9,498,000
Land held for development.....	10,629,000
Construction in progress.....	-
	-----
	1,136,209,000
Investment in joint venture.....	974,000
Rent receivable.....	745,000

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Interest receivable.....	137,000
Note receivable.....	7,450,000
Deferred rent receivables.....	9,601,000
Intangible assets, net.....	679,000
Other assets.....	1,950,000
	-----
Total assets.....	\$ 1,169,955,000
	=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Accrued and other liabilities.....	\$ 39,822,000
Deferred gain on property disposition.....	5,366,000
Line of credit.....	100,000,000
Notes payable to affiliate.....	35,000,000
Mortgage notes payable.....	30,145,000
	-----
Total liabilities.....	210,333,000
Minority interest:	
Preferred units.....	197,750,000
Common units.....	162,141,000
Shareholders' equity:	
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, 4,840 and 2,200 shares issued and outstanding at December 31, 2001 and December 31, 2000, respectively...	121,000,000
Common stock, \$0.01 par value, 100,000,000 shares authorized, 21,539,783 and 23,044,635 shares issued and outstanding at December 31, 2001 and December 31, 2000, respectively.....	215,000
Paid-in capital.....	422,161,000
Cumulative net income.....	174,860,000
Comprehensive gain.....	108,000
Cumulative distributions.....	(118,613,000)
	-----
Total shareholders' equity.....	599,731,000
	-----
Total liabilities and shareholders' equity...	\$ 1,169,955,000
	=====

See accompanying notes.

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PS BUSINESS PARKS, INC.  
CONSOLIDATED STATEMENTS OF INCOME

	For the Years E	
	2001	2000
	-----	-----
Revenues:		
Rental income.....	\$ 167,062,000	\$ 144,000,000
Facility management fees primarily from affiliates.....	683,000	
Business services.....	353,000	
Equity in income of joint venture.....	25,000	

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Interest income.....	2,251,000	4
Dividend income.....	17,000	1
	170,391,000	150
Expenses:		
Cost of operations.....	45,214,000	39
Cost of facility management.....	152,000	
Cost of business services.....	572,000	
Depreciation and amortization.....	41,067,000	35
General and administrative.....	4,320,000	3
Interest expense.....	1,715,000	1
	93,040,000	80
Income before disposition of investments, minority interest and extraordinary item.....	77,351,000	69
Gain on investment in marketable securities.....	8,000	7
Gain on disposition of properties.....	-	
	77,359,000	77
Income before minority interest and extraordinary item.....	(14,107,000)	(12)
Minority interest in income - preferred units.....	(13,382,000)	(14)
Minority interest in income - common units.....		
	49,870,000	51
Income before extraordinary item.....		
Extraordinary loss on early extinguishment of debt, net of minority interest.....	-	
	\$ 49,870,000	\$ 51
Net income.....	\$ 49,870,000	\$ 51
Net income allocation:		
Allocable to preferred shareholders.....	\$ 8,854,000	\$ 5
Allocable to common shareholders.....	41,016,000	46
	\$ 49,870,000	\$ 51
Net income per common share - basic:		
Income before extraordinary item.....	\$ 1.84	\$
Extraordinary loss, net of minority interest.....	-	
	\$ 1.84	\$
Net income.....	\$ 1.84	\$
Net income per common share - diluted:		
Income before extraordinary item.....	\$ 1.83	\$
Extraordinary loss, net of minority interest.....	-	
	\$ 1.83	\$
Net income.....	\$ 1.83	\$
Weighted average common shares outstanding:		
Basic.....	22,350,000	23
	22,435,000	23
Diluted.....	22,435,000	23

See accompanying notes.

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

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	Preferred Stock		Common Stock	
	Shares	Amount	Shares	Amount
Balances at December 31, 1998.....	-	-	23,635,650	236,000
Issuance of preferred stock, net of costs.....	2,200	55,000,000	-	-
Exercise of stock options.....	-	-	9,811	-
Net income.....	-	-	-	-
Distributions paid:				
Preferred stock.....	-	-	-	-
Common stock.....	-	-	-	-
Adjustment to reflect minority interest to underlying ownership interest.....	-	-	-	-
Balances at December 31, 1999.....	2,200	55,000,000	23,645,461	236,000
Issuance of common stock:				
Conversion of common OP units.....	-	-	107,517	1,000
Exercise of stock options...	-	-	14,257	-
Repurchase of common stock.....	-	-	(722,600)	(7,000)
Net income.....	-	-	-	-
Distributions paid:				
Preferred stock.....	-	-	-	-
Common stock.....	-	-	-	-
Adjustment to reflect minority interest to underlying ownership interest.....	-	-	-	-
Balances at December 31, 2000.....	2,200	55,000,000	23,044,635	230,000
Issuance of preferred stock, net of costs.....	2,640	66,000,000	-	-
Issuance of common stock:				
Exercise of stock options...	-	-	94,259	1,000
Unrealized gain - appreciation in marketable securities	-	-	-	-
Repurchase of common stock.....	-	-	(1,599,111)	(16,000)
Net income.....	-	-	-	-
Distributions paid:				
Preferred stock.....	-	-	-	-
Common stock.....	-	-	-	-
Adjustment to reflect minority interest to underlying ownership interest.....	-	-	-	-
Balances at December 31, 2001.....	4,840	\$121,000,000	21,539,783	\$215,000

	Other		
Cumulative	Comprehensive	Cumulative	Share
Net Income	Income	Distributions	

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Balances at December 31, 1998.....	32,554,000	-	(25,356,000)	489,
Issuance of preferred stock, net of costs.....	-	-	-	53,
Exercise of stock options.....	-	-	-	
Net income.....	41,255,000	-	-	41,
Distributions paid:				
Preferred stock.....	-	-	(3,406,000)	(3,
Common stock.....	-	-	(23,641,000)	(23,
Adjustment to reflect minority interest to underlying ownership interest.....	-	-	-	(1,
Balances at December 31, 1999.....	73,809,000	-	(52,403,000)	555,
Issuance of common stock:				
Conversion of common OP units.....	-	-	-	2,
Exercise of stock options...	-	-	-	
Repurchase of common stock.....	-	-	-	(16,
Net income.....	51,181,000	-	-	51,
Distributions paid:				
Preferred stock.....	-	-	(5,088,000)	(5,
Common stock.....	-	-	(23,241,000)	(23,
Adjustment to reflect minority interest to underlying ownership interest.....	-	-	-	(
Balances at December 31, 2000.....	124,990,000	-	(80,732,000)	564,
Issuance of preferred stock, net of costs.....	-	-	-	64,
Issuance of common stock:				
Exercise of stock options...	-	-	-	1,
Unrealized gain - appreciation in marketable securities	-	108,000	-	
Repurchase of common stock.....	-	-	-	(43,
Net income.....	49,870,000	-	-	49,
Distributions paid:				
Preferred stock.....	-	-	(8,854,000)	(8,
Common stock.....	-	-	(29,027,000)	(29,
Adjustment to reflect minority interest to underlying ownership interest.....	-	-	-	1,
Balances at December 31, 2001.....	\$174,860,000	\$108,000	\$(118,613,000)	\$599,

See accompanying notes.

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PS BUSINESS PARKS, INC.  
STATEMENTS OF CASH FLOWS

For the Years E

2001

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### Cash flows from operating activities:

Net income.....	\$ 49,870,000	\$ 51,1
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on investment in marketable securities.....	(8,000)	(7,8
Gain on disposition of properties.....	-	(2
Depreciation and amortization expense.....	41,067,000	35,6
Minority interest in income.....	27,489,000	26,7
Increase in receivables and other assets.....	(2,642,000)	(2,0
Increase in accrued and other liabilities.....	10,901,000	7,7
	-----	-----
Total adjustments.....	76,807,000	60,0
	-----	-----
Net cash provided by operating activities.....	126,677,000	111,1
	-----	-----

### Cash flows from investing activities:

Distribution from Pacific Gulf Properties, Inc.....	-	21,7
Sale of marketable securities.....	6,401,000	
Investment in marketable securities.....	(9,441,000)	(1,7
Acquisition of real estate facilities.....	(301,960,000)	(82,3
Disposition of properties.....	1,175,000	23,7
Distribution from investment in joint venture.....	13,122,000	
Capital improvements to real estate facilities.....	(12,760,000)	(19,1
Land held for development and construction in progress.....	(14,904,000)	(19,8
	-----	-----
Net cash used in investing activities.....	(318,367,000)	(77,4
	-----	-----

### Cash flows from financing activities:

Borrowings from an affiliate.....	35,000,000	
Borrowings from line of credit.....	100,000,000	
Repayment of borrowings from line of credit.....	-	
Principal payments on mortgage notes payable.....	(826,000)	(6,0
Net proceeds from the issuance of common stock.....	1,603,000	2
Repurchase of common stock.....	(43,926,000)	(16,6
Redemption of common operating partnership units.....	(808,000)	
Net proceeds from the issuance of preferred stock.....	64,337,000	
Net proceeds from the issuance of preferred operating partnership units.....	51,650,000	11,6
Distributions paid to preferred shareholders.....	(8,854,000)	(5,0
Distributions paid to minority interests - preferred units...	(14,107,000)	(12,1
Distributions paid to common shareholders.....	(29,027,000)	(23,2
Distributions paid to minority interests - common units.....	(9,571,000)	(7,3
	-----	-----
Net cash provided by (used in) financing activities.....	145,471,000	(58,6
	-----	-----

Net (decrease) increase in cash and cash equivalents.....	(46,219,000)	(24,9
Cash and cash equivalents at the beginning of the period.....	49,295,000	74,2
	-----	-----

Cash and cash equivalents at the end of the period.....	\$ 3,076,000	\$ 49,2
	=====	=====

### Supplemental disclosures:

Interest paid.....	\$ 2,121,000	\$ 2,8
	=====	=====

See accompanying notes.

	For the Years E	
	2001	20
Supplemental schedule of non cash investing and financing activities:		
Acquisitions of real estate facilities and associated assets and liabilities in exchange for minority interests and mortgage notes payable:		
Real estate facilities.....	\$ -	\$ -
Other assets (deposits on real estate acquisitions).....	-	-
Accrued and other liabilities.....	-	-
Minority interest - common units.....	-	-
Mortgage notes payable.....	-	-
Conversion of common OP units into shares of common stock:		
Minority interest - common units.....	-	(2,5
Common stock.....	-	-
Paid-in capital.....	-	2,5
Adjustment to reflect minority interest to underlying ownership interest:		
Minority interest - common units.....	(1,277,000)	1
Paid-in capital.....	1,277,000	(1
Transfer of developed properties to real estate facilities:		
Real estate facilities.....	(29,479,000)	(3,2
Construction in progress.....	29,479,000	3,2
Disposition of property:		
Real estate facilities.....	3,265,000	
Deferred gain on property disposition.....	5,360,000	
Note receivable.....	(7,450,000)	
Investment in joint venture:		
Real estate facilities.....	14,096,000	
Investment in joint venture.....	(14,096,000)	
Unrealized gain:		
Marketable securities.....	(108,000)	
Other comprehensive income.....	108,000	

See accompanying notes.

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PS BUSINESS PARKS, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 2001

1. Organization and description of business

Organization

PS Business Parks, Inc. ("PSB") was incorporated in the state of California in 1990. As of December 31, 2001, PSB owned approximately 75% of the common partnership units of PS Business Parks, L.P. (the "Operating Partnership"



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or "OP"). The remaining common partnership units were owned by Public Storage, Inc. ("PSI") and its affiliated entities. PSB, as the sole general partner of the Operating Partnership, has full, exclusive and complete responsibility and discretion in managing and controlling the Operating Partnership. PSB and the Operating Partnership are collectively referred to as the "Company."

### Description of business

The Company is a fully-integrated, self-advised and self-managed real estate investment trust ("REIT") that acquires, develops, owns and operates commercial properties containing commercial and industrial rental space. As of December 31, 2001, the Company owned and operated approximately 14.8 million net rentable square feet of commercial space located in 9 states. The Company also managed approximately 1.7 million net rentable square feet on behalf of PSI and its affiliated entities, third party owners and a joint venture in which the Company held a 25% ownership interest (See Note 2).

## 2. Summary of significant accounting policies

### Basis of presentation

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

### 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 estimates.

### Financial instruments

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

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

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Financial assets that are exposed to credit risk consist primarily of cash and cash equivalents and accounts receivable. Cash and cash equivalents, which consist of short-term investments, including commercial paper, are

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only invested in entities with investment grade ratings. Accounts receivable are not a significant portion of total assets and are comprised of a large number of customers.

### Marketable securities

Marketable securities at December 31, 2001 are classified as "available-for-sale" in accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Investments are reflected on the balance sheet at fair market value based upon the quoted market price. The unrealized gain of \$108,000 is excluded from earnings and reported in a separate component of shareholders' equity. Dividend income is recognized when earned.

The Company owned approximately one million common shares of Pacific Gulf Properties Inc ("PAG") at December 31, 2000. On December 15, 2000, the Company received a liquidating cash distribution of approximately \$21.8 million and recognized a gain of approximately \$6.1 million in excess of its original investment. The investment was classified as "trading securities" in accordance with SFAS No. 115. The investment was reflected on the balance sheet at fair market value based upon the quoted market price, resulting in an unrealized gain of \$1.7 million which was included in earnings. The Company sold its remaining investment in Pacific Gulf Properties Inc. during the year ended December 31, 2001 and recognized a gain of \$15,000.

### Real estate facilities

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

Interest cost and property taxes incurred during the period of construction of real estate facilities are capitalized. The Company capitalized \$1,091,000, \$1,415,000 and \$989,000 of interest expense and \$321,000, \$64,000 and \$56,000 of property taxes during the years ended December 31, 2001, 2000 and 1999, respectively.

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### Investment in joint venture

In October 2001, the Company formed a joint venture with an unaffiliated investor to own and operate an industrial park in the City of Industry submarket of Los Angeles County. The park, consisting of 294,000 square feet of industrial space, was acquired in December 2000 at a cost of approximately \$14.4 million. The property was contributed to the joint venture at its original cost. The partnership is capitalized with equity capital consisting of 25% from the Company and 75% from the unaffiliated investor and mortgage note payable. Summarized below is financial data for the joint venture as of December 31, 2001.

	For the Year Ended December 31, 2001
	-----
Rental income .....	\$ 253,000
Other income .....	76,000

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Total revenues .....	329,000
Cost of operations .....	134,000
Depreciation and amortization .....	59,000
Other expenses .....	46,000
Total expenses .....	239,000
Net income .....	\$ 90,000
-----	
Real estate, net .....	\$14,779,000
Total assets .....	15,022,000
Notes payable .....	7,015,000
Total liabilities .....	9,391,000
Partner's equity .....	5,631,000
The Company's investment at December 31, 2001 .....	\$ 974,000

The joint venture has a variable rate mortgage obligation of \$7,015,000, which currently bears interest at 5.45% per annum and is due on November 1, 2005. Under certain conditions, the Company has guaranteed repayment of the mortgage. The debt is not included in the Company's total liabilities. The Company's investment is accounted for under the equity method in accordance with APB 18, "Equity Method of Accounting for Investments." The Company's share of the debt is netted against its share of the assets in determining the investment in the joint venture of \$974,000.

Intangible assets

Intangible assets consist of property management contracts for properties managed, but not owned, by the Company. The intangible assets are being amortized over seven years. Accumulated amortization was \$1,477,000 and \$1,175,000 at December 31, 2001 and December 31, 2000, respectively.

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Evaluation of asset impairment

The Company evaluates its assets used in operations, by identifying indicators of impairment and by comparing the sum of the estimated undiscounted future cash flows for each asset to the asset's carrying amount. When indicators of impairment are present and the sum of the undiscounted future cash flows is less than the carrying value of such asset, an impairment loss is recorded equal to the difference between the asset's current carrying value and its value based on discounting its estimated future cash flows. In addition, the Company evaluates its assets held for disposition. Assets held for disposition are reported at the lower of their carrying amount or fair value, less cost of dispositions. At December 31, 2001, no such indicators of impairment have been identified.

Borrowings from and loans to affiliate

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

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

The Company borrowed an aggregate of \$35 million from PSI and paid \$10,000 in interest expense during the period of December 27, 2001 through December 31, 2001. The notes bore interest at 3.25% (per annum) and were repaid as of January 28, 2002.

### Stock-based compensation

The Company 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."

### Revenue and expense recognition

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

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

Property management fees are recognized in the period earned.

### General and administrative expense

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

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### Acquisition costs

In March 1998, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board issued guidance (the "97-11 Guidance") with respect to Issue No. 97-11, "Accounting for Internal Acquisition Costs Relating to Real Estate Property Acquisitions." The 97-11 Guidance provides that a company shall expense internal pre-acquisition costs (such as costs of an internal acquisitions department) related to the purchase of an operating property. The Company does not capitalize such internal pre-acquisition costs with respect to the acquisition of operating real estate facilities. Accordingly, the 97-11 Guidance had no impact upon the consolidated financial statements.

### Income taxes

The Company qualified and intends to continue to qualify as a REIT, as

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defined in Section 856 of the Internal Revenue Code. As a REIT, the Company is not