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MISSION WEST PROPERTIES INC

Form 10-Q

August 08, 2007

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

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

COMMISSION FILE NUMBER 1-8383

Mission West Properties, Inc.
(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of
incorporation or organization)

95-2635431

(I.R.S. Employer Identification
Number)

10050 Bandley Drive
Cupertino, California 95014-2188
(Address of principal executive offices)

Registrant's telephone number, including area code is (408) 725-0700

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

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

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS

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

19,640,087 shares outstanding as of July 31, 2007

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Mission West Properties, Inc.

FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2007

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PART I - Financial Information
 ITEM 1. Condensed Consolidated Financial Statements

MISSION WEST PROPERTIES, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (dollars in thousands, except share and per share amounts)
 (unaudited)

	June 30, 2007

ASSETS	
Real estate:	
Land	\$ 307,903
Buildings and improvements	766,515
Real estate related intangible assets	6,422

Total investments in properties	1,080,840
Less accumulated depreciation and amortization	(152,107)

Total investments in real estate, net	928,733
Cash and cash equivalents	39,053
Restricted cash	1,640
Deferred rent receivable, net	16,788
Investment in unconsolidated joint venture	2,914
Other assets, net	26,015

Total assets	\$1,015,143
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Liabilities:	
Mortgage notes payable	\$ 342,879
Mortgage notes payable (related parties)	9,443
Interest payable	1,343
Security deposits	6,595
Deferred rental income	6,891
Dividends and distributions payable	16,745
Accounts payable and accrued expenses	7,346

Total liabilities	391,242

Commitments and contingencies (Note 10)	
Minority interests	493,004

Stockholders' equity:	
Preferred stock, \$.001 par value, 20,000,000 shares authorized, none issued and outstanding	-
Common stock, \$.001 par value, 200,000,000 shares authorized, 19,640,087 and 19,443,587 shares issued and outstanding at June 30, 2007 and December 31, 2006	20
Paid-in capital	152,463
Accumulated deficit	(21,586)

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Total stockholders' equity	130,897
Total liabilities and stockholders' equity	\$1,015,143

The accompanying notes are an integral part of these condensed consolidated financial statements.

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MISSION WEST PROPERTIES, INC
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(dollars in thousands, except share and per share amounts)
(unaudited)

	Three months ended June 30, 2007	2006
Revenues:		
Rental revenue from real estate	\$21,283	\$22,060
Above market lease intangible asset amortization	-	(472)
Tenant reimbursements	3,254	2,954
Lease termination fees	168	12
Other income, including interest	959	1,085
Total revenues	25,664	25,639
Expenses:		
Property operating, maintenance and real estate taxes	4,616	4,164
Interest	5,046	5,193
Interest (related parties)	182	190
General and administrative	673	637
Depreciation and amortization of real estate	5,454	5,269
Total expenses	15,971	15,453
Income before equity in earnings of unconsolidated joint venture and minority interests	9,693	10,186
Equity in earnings of unconsolidated joint venture	350	351
Minority interests	(8,039)	(8,505)
Income from continuing operations	2,004	2,032
Discontinued operations, net of minority interests:		
Income attributable to discontinued operations	-	89
Income from discontinued operations	-	89
Net income to common stockholders	\$2,004	\$2,121
Net income to minority interests	\$8,039	\$8,968

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Income per common share from continuing operations:		
Basic	\$0.10	\$0.11
Diluted	\$0.10	\$0.11
Income per common share from discontinued operations:		
Basic	-	-
Diluted	-	-
Net income per common share to common stockholders:		
Basic	\$0.10	\$0.11
Diluted	\$0.10	\$0.11
Weighted average shares of common stock outstanding (basic)	19,639,928	19,028,240
Weighted average shares of common stock outstanding (diluted)	20,020,596	19,123,945

The accompanying notes are an integral part of these condensed consolidated financial statements.

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MISSION WEST PROPERTIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(unaudited)

Cash flows from operating activities:

Net income
Adjustments to reconcile net income to net cash provided by operating activities:
Minority interests income
Minority interest distributions
Depreciation and amortization of real estate and in-place leases
Amortization of above market lease
Equity in earnings of unconsolidated joint venture
Distributions from unconsolidated joint venture
Interest earned on restricted cash
Lease termination fee income related to restricted cash
Stock-based compensation expense
Other
Changes in operating assets and liabilities:
Deferred rent receivable
Other assets
Interest payable
Security deposits
Deferred rental income

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Accounts payable and accrued expenses

Net cash provided by operating activities

Cash flows from investing activities:

Improvements to real estate assets

Purchase of real estate

Restricted cash released for purchase of real estate

Excess restricted cash

Net cash used in investing activities

Cash flows from financing activities:

Principal payments on mortgage notes payable

Principal payments on mortgage notes payable (related parties)

Net proceeds from exercise of stock options

Minority interest distributions in excess of earnings

Dividends paid to common stockholders

Net cash used in financing activities

Net increase in cash and cash equivalents

Cash and cash equivalents, beginning of period

Cash and cash equivalents, end of period

Supplemental information:

Cash paid for interest

Supplemental schedule of non-cash investing and financing activities:

Issuance of common stock upon conversion of O.P. units

The accompanying notes are an integral part of these condensed consolidated financial statements.

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MISSION WEST PROPERTIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share and per square footage)

(unaudited)

1. ORGANIZATION AND FORMATION OF THE COMPANY

Mission West Properties, Inc. (the "Company") is a fully integrated, self-administered and self-managed real estate company that acquires and manages R&D/office properties in the portion of the San Francisco Bay Area commonly referred to as Silicon Valley. In July 1998, the Company purchased an approximate 12.11% of four existing limited partnerships (referred to collectively as the "operating partnerships") and obtained control of these partnerships by becoming the sole general partner in each one effective July 1, 1998 for financial accounting and reporting purposes. All limited partnership interests in the operating partnerships were converted into 59,479,633 operating partnership ("O.P.") units, which represented a limited partnership ownership interest of approximately 87.89% of the

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operating partnerships. The operating partnerships are the vehicles through which the Company holds its real estate investments, makes real estate acquisitions, and generally conducts its business.

On December 30, 1998, the Company was reincorporated under the laws of the State of Maryland through a merger with and into Mission West Properties, Inc. Accordingly, shares of the former company, Mission West Properties, a California corporation (no par), which were outstanding at December 30, 1998, were converted into shares of common stock, \$.001 par value per share, on a one-for-one basis.

As of June 30, 2007, the Company owns a controlling general partnership interest of 20.06%, 21.78%, 16.26% and 12.48% in Mission West Properties, L.P., Mission West Properties, L.P. I, Mission West Properties, L.P. II and Mission West Properties, L.P. III, respectively, which represents an 18.74% general partnership interest in the operating partnerships, taken as a whole, on a consolidated weighted average basis.

Through the operating partnerships, the Company owns interests in 110 R&D properties, all of which are located in Silicon Valley.

The Company has elected to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended. Accordingly, no provision has been made for income taxes for the three and six months ended June 30, 2007 and 2006.

BUSINESS SEGMENT INFORMATION

The Company's primary business is the ownership and management of R&D/office real estate with a geographic concentration in the Silicon Valley of the San Francisco Bay Area. Accordingly, the Company has concluded it currently has a single reportable segment for Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures about Segments of an Enterprise and Related Information," purposes.

2. BASIS OF PRESENTATION

PRINCIPLES OF CONSOLIDATION AND FINANCIAL STATEMENT PRESENTATION

The accompanying unaudited interim condensed consolidated financial statements of the Company have been prepared in accordance with Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission ("SEC") and, therefore, do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. In the opinion of the Company, however, the accompanying unaudited interim condensed consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the Company's consolidated financial position as of June 30, 2007, their consolidated results of operations for the three and six months ended June 30, 2007 and 2006, and their cash flows for the six months ended June 30, 2007 and 2006. All significant inter-company balances have been eliminated in consolidation. The condensed consolidated financial statements as of June 30, 2007 and for the three and six months ended June 30, 2007 and 2006 and related footnote disclosures are unaudited. The results of operations for the three and six months ended June 30, 2007 are not necessarily indicative of the results to be expected for the entire year.

The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

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The Company consolidates all variable interest entities ("VIE") in which it is deemed to be the primary beneficiary in accordance with FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities" ("FIN 46R"). As of June 30, 2007, the Company consolidated one VIE in the accompanying condensed consolidated balance sheets in connection with an assignment of a lease agreement with an unrelated party, M&M Real Estate Control & Restructuring, LLC. See Note 5 for further discussion of this transaction.

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MISSION WEST PROPERTIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except per share and per square footage)
(unaudited)

STOCK-BASED OPTION COMPENSATION ACCOUNTING

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment" ("SFAS 123R"), which addresses the accounting for stock options. SFAS 123R requires that the cost of all employee, director and consultant stock options, as well as other equity-based compensation arrangements, be reflected in the financial statements based on the estimated fair value of the awards. SFAS 123R is an amendment to SFAS 123, "Accounting for Stock-Based Compensation," and supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). SFAS 123R is applicable to any award that is settled or measured in stock, including stock options, restricted stock, stock appreciation rights, stock units, and employee stock purchase plans. At June 30, 2007, the Company had one stock-based compensation plan. The Company adopted the requirements of SFAS 123R effective January 1, 2006 using the modified prospective method of transition. The adoption of this standard did not have a material effect on the Company's condensed consolidated statements of operations, cash flows or financial position.

In the first quarter of 2007, stock options to purchase 710,000 shares of common stock were granted to four employees, three non-employee directors and four consultants, which options vest monthly for 48 months from date of grant, subject to continued employment or other service to the Company. Each option grant has a term of six years from the date of grant subject to earlier termination in certain events related to termination of employment. The options were granted at an exercise price of \$12.09 per share. The estimated fair value of the options granted in 2007 was \$1.45 per share on the date of grant using the Black-Scholes option pricing model with the following assumptions: dividend yield of 5.3%, volatility of 18.94%, risk free rates of 4.5% and an expected life of six years. All options were granted at the fair market value at the date of grant.

The following table shows the activity and detail for the 2004 Equity Incentive Plan.

	2004 Equity Incentive Plan	Weighted Average Option Price Per Share
	-----	-----
Balance, December 31, 2006	1,037,100	\$10.48
Options granted	710,000	\$12.09
Options exercised	-	

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Options cancelled	-	

Balance, June 30, 2007	1,747,100	\$11.13
	=====	

The Company measures compensation cost for its stock options at fair value on the date of grant and recognizes compensation expense relating to the remaining unvested portion of outstanding stock options at the time of adoption ratably over the vesting period, generally four years. The fair value of the Company's stock options is determined using the Black-Scholes option pricing model. Compensation expense related to the Company's share-based awards is included in general and administrative expenses in the Company's accompanying condensed consolidated statements of operations. Under SFAS 123R, the Company recorded approximately \$157 and \$59 of expense for the three months ended June 30, 2007 and 2006, respectively, and \$316 and \$118 of expense for share-based compensation relating to grants of stock options for the six months ended June 30, 2007 and 2006, respectively.

As of June 30, 2007, there was approximately \$807 of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under the compensation plan. That cost is expected to be recognized over a weighted-average period of 3.3 years.

MINORITY INTERESTS

Minority interests represent the separate private ownership of the operating partnerships by the Berg Group (defined as Carl E. Berg, his brother Clyde J. Berg, members of their respective immediate families, and certain entities they control) and other non-affiliate interests. As of June 30, 2007, these interests accounted for approximately 81.26% of the ownership interests in the real estate operations of the Company on a consolidated weighted average basis. Minority interests in net income is calculated by taking the net income of the operating partnerships (on a stand-alone basis) multiplied by the respective weighted average minority interests ownership percentage.

Allocation of corporate general and administrative expenses to the operating partnerships is performed based upon shares and operating partnership units outstanding for each operating partnership in relation to the total for all four operating partnerships.

RECLASSIFICATIONS

Certain reclassifications have been made to the previously reported 2006 condensed consolidated financial statements in order to conform to the 2007 presentation.

The following notes, which present interim disclosures as required by the SEC, highlight significant changes to the notes to the Company's December 31, 2006 audited consolidated financial statements and should be read together with the consolidated financial statements and notes thereto included in the Company's 2006 Annual Report on Form 10-K filed on March 15, 2007.

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MISSION WEST PROPERTIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except per share and per square footage)
(unaudited)

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3. REAL ESTATE

On April 20, 2007, the Company acquired three office/R&D buildings comprised of approximately 149,000 rentable square feet at Montague Expressway in Milpitas, California for approximately \$15,351. The acquisition was funded from a portion of the proceeds received from the Samaritan property sale, which was classified as restricted cash as of March 31, 2007. With the exception of one lease, the property was purchased without any long-term tenants.

On April 27, 2007, the Company acquired approximately five acres of vacant land in Morgan Hill, California, which could support approximately 73,000 rentable square feet of space. The land is currently zoned for industrial use. The acquisition price for this property was approximately \$2,297 and was funded from the remaining proceeds received from the Samaritan property sale, which was classified as restricted cash as of March 31, 2007.

4. RESTRICTED CASH

Restricted cash totaled approximately \$1,640 as of June 30, 2007. This amount represents cash held by the Company's consolidated VIE. The Company does not have possession or control over these funds or any right to receive them except in accordance with the payment terms of the lease agreement that has been assigned to the VIE.

5. VARIABLE INTEREST ENTITY

In December 2003, the FASB issued FIN 46R, a revision to FIN 46, which was issued in January 2003. Under FIN 46R, a variable interest entity must be consolidated by a company if that company is subject to a majority of the entity's expected losses or entitled to receive a majority of the entity's expected residual returns or both. FIN 46R requires disclosures about variable interest entities that a company is not required to consolidate, but in which it has a significant variable interest.

Under FIN 46R, for an entity to qualify as a VIE one or more of the following three characteristics must exist:

1. The equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support by any parties, including the equity holders.
2. The equity investors lack one or more of the following essential characteristics of a controlling financial interest:
 - a. The direct or indirect ability to make decisions about the entity's activities through voting or similar rights.
 - b. The obligation to absorb the expected loss of the entity.
 - c. The right to receive the expected residual returns of the entity.
3. The equity investors have voting rights that are not proportionate to their economic interests, and the activities of the entity involve or are conducted on behalf of an investor with a disproportionately small voting interest.

In March 2006, one of the Company's tenants, JDS Uniphase ("JDS"), entered into an assignment of lease agreement with an unrelated party, M&M Real Estate Control & Restructuring, LLC ("M&M"), in connection with leases for approximately 252,000 rentable square feet located in San Jose, California. M&M assumed all of JDS's remaining obligations under these leases, acquired certain personal property of JDS located on the premises and received a

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payment of approximately \$11,147. At the same time, the Company entered into a consent for assignment of lease with both parties and a mutual release agreement with JDS, pursuant to which all of the JDS's obligations under these leases have been effectively transferred to M&M. M&M must continue to perform all of the obligations under the assumed JDS leases and has the right to sublease any or all of the 252,000 rentable square feet vacated by JDS for the remainder of the current lease terms, which expire in 2006 and 2007. Under the terms of the agreement, the Company will receive monthly rent payments of approximately \$733 from April 2006 through December 2006, \$545 from January 2007 through August 2007 and \$330 from September 2007 through November 2007. Based upon the provisions of FIN 46R, the Company determined that M&M is a variable interest entity. The Company further determined that the Company is the primary beneficiary of this variable interest entity and therefore has consolidated this entity for financial reporting purposes. Upon consolidation, the Company recognized a lease termination fee of approximately \$11,147 in March 2006.

Factors considered by the Company in determining whether M&M should be considered a VIE for financial reporting purposes included the following:

- No equity was contributed by the partners in the formation of M&M.
- At present, the assignment of a lease is the only property under management by M&M.
- Because M&M is a newly formed entity it does not have an operating history that demonstrates its ability to finance its activities without additional subordinated financial support.

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MISSION WEST PROPERTIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(dollars in thousands, except per share and per square footage)

(unaudited)

- All revenues, other than interest income, are generated by M&M from the Company in the form of fees or commissions.

The Company remains at risk because if M&M's operating expenses exceed its interest income, fees and commissions there would be insufficient funds to meet the assigned lease obligation without additional financial support from equity holders or other parties. The Company, which had released the original tenant from its obligations under the lease, would have to absorb the majority of any loss, making it the primary beneficiary of M&M's activities.

6. STOCK TRANSACTIONS

During the six months ended June 30, 2007, two limited partners exchanged a total of 196,500 O.P. units for 196,500 shares of the Company's common stock under the terms of the Exchange Rights Agreement among the Company and all limited partners of the operating partnerships resulting in a reclassification of approximately \$2,606 from minority interests to paid-in capital. Neither the Company nor the operating partnerships received any proceeds from the issuance of the common stock in exchange for O.P. units.

7. DISCONTINUED OPERATIONS

Effective January 1, 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), which addresses financial accounting and reporting for the impairment and

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disposal of long lived assets. In general, income or loss attributable to the operations and sale of property and the operations related to property held for sale is classified as discontinued operations in the condensed consolidated statements of operations. Prior period condensed consolidated statements of operations presented in this report have been reclassified to reflect the income or loss related to properties that were sold and presented as discontinued operations in 2006. All periods presented in this report will likely require further reclassification in future periods if there are properties held for sale or property sales occur.

The Company classified three R&D properties as assets held for sale in the third quarter of 2006 and sold them in the fourth quarter of 2006, which qualified as discontinued operations. Condensed results of operations for these properties for the three and six months ended June 30, 2006 are as follows:

	Three Months Ended 2007	June 30, 2006
	-----	-----
		(dollars in thousands)
		(unaudited)
Revenues		
Rental revenue from real estate	-	\$ 740
Tenant reimbursements	-	112
Other income	-	3
	-----	-----
Total revenues	-	855
Expenses		
Property operating, maintenance and real estate taxes	-	147
Depreciation of real estate	-	156
	-----	-----
Total expenses	-	303
	-----	-----
Income from discontinued operations	-	552
Minority interest in earnings attributable to discontinued operations	-	(463)
	-----	-----
Income from discontinued operations	-	\$ 89
	=====	=====

8. NET INCOME PER SHARE

Basic operating net income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted operating net income per share is computed by dividing net income by the sum of the weighted-average number of common shares outstanding for the period plus the assumed exercise of all dilutive securities using the treasury stock method.

The computation for weighted average shares is detailed below:

Three Months Ended June 30, 2007	2006
-------------------------------------	------

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Weighted average shares outstanding (basic)	19,639,928	19,028,240	1
Incremental shares from assumed option exercise	380,668	95,705	
Weighted average shares outstanding (diluted)	20,020,596	19,123,945	1

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MISSION WEST PROPERTIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except per share and per square footage)
(unaudited)

Outstanding options to purchase 647,000 shares in 2006 were excluded from the computation of diluted net income per share under the treasury stock method because the option exercise price was greater than the weighted average exercise price of the Company's common stock during the period. The outstanding O.P. units, which are exchangeable at the unit holder's option, subject to certain conditions, for shares of common stock on a one-for-one basis have been excluded from the diluted net income per share calculation, as there would be no effect on the calculation after adding the minority interests' share of income back to net income. The total number of O.P. units outstanding at June 30, 2007 and 2006 was 85,009,699 and 85,235,999, respectively.

9. RELATED PARTY TRANSACTIONS

As of June 30, 2007, the Berg Group owned 77,378,148 O.P. units. The Berg Group's combined ownership of O.P. units and shares of common stock as of June 30, 2007 represented approximately 74% of the total equity interests, assuming conversion of all O.P. units outstanding into the Company's common stock.

As of June 30, 2007, debt in the amount of approximately \$9,443 was due the Berg Group under a mortgage note established on May 15, 2000 in connection with the acquisition of a 50% interest in Hellyer Avenue Limited Partnership, the obligor under the mortgage note. The mortgage note bears interest at 7.65% and is due in June 2010 with principal payments amortized over 20 years. Interest expense incurred in connection with the mortgage note was approximately \$182 and \$190 for the three months ended June 30, 2007 and 2006, respectively, and \$366 and \$381 for the six months ended June 30, 2007 and 2006, respectively.

During the first six months of 2007 and 2006, Carl E. Berg or entities controlled by Mr. Berg held financial interests in several companies that lease space from the operating partnerships, which include companies where Mr. Berg has a greater than 10% ownership interest. These related tenants contributed approximately \$361 and \$162 in rental revenue during the three months ended June 30, 2007 and 2006, respectively, and \$721 and \$324 in rental revenue during the six months ended June 30, 2007 and 2006, respectively.

Under the Company's charter, bylaws and agreements with the Berg Group, the individual members of the Berg Group are prohibited from acquiring or holding shares of the Company's common stock if such acquisition would result in their beneficial ownership percentage of the Company's common stock causing the Company to violate any REIT qualification requirement.

In March 2006, the Company and Fujitsu Limited, or Fujitsu, agreed to the

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termination of a lease for one building consisting of approximately 125,000 rentable square feet. Fujitsu is responsible for repairing damage to the building and with the Company's Independent Directors Committee approval has hired Berg & Berg Enterprises, LLC to perform the restoration work for a total of approximately \$4,500, which is substantially complete.

The Berg Group has an approximately \$2,500 commitment to complete certain tenant improvements in connection with the Company's 2002 acquisition of 5345 Hellyer Avenue in San Jose. The Company has recorded this portion of the purchase price paid to the Berg Group in "Other assets" on its condensed consolidated balance sheets. The Berg Group is in the process of satisfying this commitment to complete certain tenant improvements.

The Berg Group has an approximately \$7,500 commitment to complete an approximately 75,000 to 90,000 square foot building in connection with the Company's 2001 acquisition of 245 Caspian in Sunnyvale which is comprised of approximately three acres of unimproved land. The Company has recorded this portion of the purchase price paid to the Berg Group in "Other assets" on its condensed consolidated balance sheets. The Berg Group plans to satisfy this commitment to construct a building when requested by the Company following the approval of the Independent Directors Committee.

The Company currently leases office space owned by Berg & Berg Enterprises, Inc., an affiliate of Carl E. Berg and Clyde J. Berg, for the Company's headquarters. Rental amounts and overhead reimbursements paid to Berg & Berg Enterprises, Inc. were approximately \$24 and \$23 for the three months ended June 30, 2007 and 2006, respectively, and \$47 and \$45 for the six months ended June 30, 2007 and 2006, respectively.

10. COMMITMENTS AND CONTINGENCIES

Neither the operating partnerships, the Company's properties nor the Company are subject to any material litigation nor, to the Company's knowledge, is any material litigation threatened against the operating partnerships, the properties or the Company. From time to time, the Company is engaged in legal proceedings arising in the ordinary course of business. The Company does not expect any of such proceedings to have a material adverse effect on its cash flows, financial condition or results of operations. The Company is currently involved in the following legal proceedings, and does not believe the ultimate outcome of any of these proceedings will have a material adverse effect on its financial condition or operating results.

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MISSION WEST PROPERTIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except per share and per square footage)
(unaudited)

Mission West Properties, L.P. v. Republic Properties Corporation, et al. Santa Clara County Superior Court, Case No. CV 796249. Republic Properties Corporation ("RPC") is a former 50% partner with Mission West Properties, L.P. in the Hellyer Avenue Limited Partnership ("Hellyer LP"), which was formed in July 2000. Under the terms of the Hellyer LP partnership agreement and other related contracts, Mission West Properties, L.P. ("MWP") had the right to obtain RPC's entire interest in Hellyer LP in the event of certain payment defaults which occurred in August 2000. Therefore, on September 1, 2000, MWP, as the general partner of Hellyer LP, ceased all allocations of income and cash flow to RPC and exercised the right under the partnership agreement to cancel RPC's entire interest in the partnership. Following discussions with and approval by the Independent

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Directors Committee, the Company authorized the transfer of RPC's interest in Hellyer LP to Berg & Berg Enterprises, Inc. Under the Berg Land Holdings Option Agreement and the Acquisition Agreement dated as of May 14, 1998, the Independent Directors Committee had the right, but not the obligation, to reacquire the property interest and the related distributions related to the property interest at any time. The transfer was effective as of September 1, 2000. On November 20, 2000, RPC commenced a lawsuit against MWP in the Circuit Court of Maryland for Baltimore City. After lengthy litigation, which included a trial on the merits and subsequent appeals, in April 2006 Maryland's highest Court upheld an earlier Maryland Appeals Court ruling in favor of MWP, finding that the Circuit Court of Maryland could not assert personal jurisdiction over MWP in the RPC suit. The Court vacated the judgment and decision in the trial court and dismissed the entire Maryland suit. In February 2001, while the Maryland case was pending, the Company filed a suit against RPC in the Superior Court of the State of California for the County of Santa Clara. The case was stayed pending resolution of the Maryland case, and the Company dismissed its suit on March 4, 2005. In April 2005, RPC submitted a motion asking the Superior Court to reinstate the case, which the Court granted on May 25, 2005. On July 5, 2006, RPC filed a cross-complaint in the case seeking partnership distributions to which the Company demurred. The Court sustained the Company's demurrer with leave to amend. Subsequently, RPC filed an amended complaint and the Company submitted another demurrer seeking dismissal of the claims on statute of limitations grounds. On February 20, 2007, the Court overruled the Company's demurrer. The Company is in the process of seeking a writ from the California State Court of Appeal for the Sixth District directing the Superior Court to sustain the demurrer.

The Company has a receivable from a Berg Group affiliate for the amount of distributions it received as the successor to RPC's interest in Hellyer LP. Furthermore, the Company has never accounted for the 50% interest of RPC as its asset, and if it is ultimately determined that RPC should have retained that interest or it reacquires that interest, the Company's balance sheet and financial condition would not be impacted. Although to date, the Company has consolidated the assets, liabilities and operating results of Hellyer LP and allocated 50% of the operating income to the minority interest holder.

In January 2004, the Global Crossing Estate Representative, for Itself and the Liquidating Trustee of the Global Crossing Liquidating Trust v. Mission West Properties L.P. filed an action in United States Bankruptcy Court Southern District of New York Case No. 02-40188 (REG) asserting that payments of approximately \$815 made in the ordinary course of business within 90 days of the Global Crossing bankruptcy filing were avoidable preference payments. During the course of settlement discussions with Global Crossing's representative, the Company learned that it would receive only 2-3% of its unsecured claim of approximately \$16,711 for unpaid rent from the final distribution of the assets and proceeds of bankruptcy estate. On February 21, 2007, the Company and the Liquidating Trustee entered into a settlement agreement under which the \$815 claim against the Company was dismissed and the Company agreed to accept a payment of approximately \$301 as a final settlement of its unsecured claim for unpaid rent.

GUARANTEES AND INDEMNITIES

Under its articles of incorporation and bylaws, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer or director's serving in such capacity. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company believes the estimated fair value of these indemnification agreements is minimal and has recorded no liabilities for these agreements

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as of June 30, 2007.

The Company also enters into indemnification provisions under its agreements with other companies in the ordinary course of business, typically with lenders, joint venture partners, contractors, and tenants. Under these provisions the Company typically agrees to indemnify and hold harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of certain kinds of activities or inactions of the Company. These indemnification provisions generally survive termination of the underlying agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited. To date, the Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has recorded no liabilities for these agreements as of June 30, 2007.

SEISMIC ACTIVITY

The Company's properties are located in an active seismic area of Silicon Valley. Insurance policies currently maintained by the Company do not cover seismic activity, although they do cover losses from fires after an earthquake.

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MISSION WEST PROPERTIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except per share and per square footage)
(unaudited)

ENVIRONMENTAL ISSUES

The environmental investigations that have been conducted on the Company's properties have not revealed any environmental liability that the Company believes would have a material adverse effect on its financial condition, results of operations and assets, and the Company is not aware of any such liability. Nonetheless, it is possible that there are material environmental liabilities of which the Company is unaware. In addition, the Company cannot assure that future laws, ordinances, or regulations will not impose any material environmental liability, or that the current environmental condition of the properties has not been, or will not be, affected by tenants and occupants of the properties, by the condition of properties in the vicinity of the properties, or by third parties unrelated to the Company.

ASSET DISPOSITIONS SUBJECT TO CERTAIN CONDITIONS

The Company has entered into sales agreements with unrelated parties subject to numerous material conditions, including but not limited to re-zoning of the property and negotiating certain agreements with the local municipality acceptable to the buyer. As a result of the conditions agreed to by the Company and the respective buyers, these assets do not meet the criteria set forth in SFAS 144 to be classified as assets held for sale. The following summarizes the assets for which the Company has executed sales contracts that are subject to material conditions as previously described:

Property	Number of Buildings	Rentable Square Feet	Acres
-----	-----	-----	-----

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Morse Avenue Sunnyvale, California	1	39,200	2.25
McCandless Drive Milpitas, California	8	427,000	23.03
Northport Loop Fremont, California	1	48,400	3.32

11. SUBSEQUENT EVENTS

On July 5, 2007, the Company paid dividends of \$0.16 per share of common stock to all common stockholders of record as of June 29, 2007. On the same date, the operating partnerships paid a distribution of \$0.16 per O.P. unit to all holders of O.P. units. Aggregate dividends and distributions amounted to approximately \$16,745.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the accompanying condensed consolidated financial statements and notes thereto under Part I, Item 1 of this Report and our audited consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K as of and for the year ended December 31, 2006. The results for the three and six months ended June 30, 2007 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2007. The following discussion includes forward-looking statements, including but not limited to, statements with respect to our future financial performance, operating results, plans and objectives. Actual results may differ materially from those currently anticipated depending upon a variety of factors, including those described under the sub-heading, "Forward-Looking Information," below.

FORWARD-LOOKING INFORMATION

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, and are including this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project" or similar expressions. Additionally, all disclosures under Part I, Item 3 constitute forward-looking statements. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain.

Factors that could have a material adverse effect on our operations and future prospects include, but are not limited to, the following:

- economic conditions generally and the real estate market specifically,
- the occupancy rates of the properties,
- rental rates on new and renewed leases,
- legislative or regulatory provisions (including changes to laws governing the taxation of REITs),

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- availability of capital,
- interest rates,
- competition,
- supply of and demand for R&D, office and industrial properties in our current and proposed market areas,
- tenant defaults and bankruptcies,
- lease term expirations and renewals, and
- changes in general accounting principles, policies and guidelines applicable to REITs.

In addition, the actual timing of development, construction, and leasing on any projects that we believe we may acquire in the future under the Berg Land Holdings Option Agreement is presently unknown, and reliance should not be placed on estimates concerning these projects. These risks and uncertainties, together with the other risks described under Part I, Item 1A - "Risk Factors" of our 2006 Annual Report on Form 10-K and from time to time in our other reports and documents filed with the Securities and Exchange Commission ("SEC"), should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

OVERVIEW

We acquire, market, lease, and manage R&D/office properties, primarily located in the Silicon Valley portion of the San Francisco Bay Area. As of June 30, 2007, we owned and managed 110 properties totaling approximately 7.8 million rentable square feet through four limited partnerships, or operating partnerships, for which we are the sole general partner. This class of property is designed for research and development and office uses and, in some cases, includes space for light manufacturing operations with loading docks. We believe that we have one of the largest portfolios of R&D/office properties in the Silicon Valley. As of June 30, 2007, the four tenants who each leased in excess of 300,000 rentable square feet from us were Microsoft Corporation, NEC Electronics America, Inc. (a subsidiary of NEC Electronics Corporation), Ciena Corporation and Apple Computer, Inc. For federal income tax purposes, we have operated as a self-managed, self-administered and fully integrated real estate investment trust ("REIT") since the beginning of fiscal 1999.

Our acquisition, growth and operating strategy incorporates the following elements:

- working with the Berg Group to take advantage of their abilities and resources to pursue development opportunities which we have an option to acquire, on pre-negotiated terms, upon completion and leasing;
- capitalizing on opportunistic acquisitions from third parties of high-quality R&D/office properties that provide attractive initial yields and significant potential for growth in cash-flow;
- focusing on general purpose, single-tenant Silicon Valley R&D/office properties for information technology companies in order to maintain low operating costs, reduce tenant turnover and capitalize on our relationships with these companies and our extensive knowledge of their real estate needs; and

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- maintaining prudent financial management principles that emphasize current cash flow while building long-term value, the acquisition of pre-leased properties to reduce development and leasing risks and the maintenance of sufficient liquidity to acquire and finance properties on desirable terms.

CURRENT ECONOMIC ENVIRONMENT

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All of our properties are located in the Northern California area known as Silicon Valley, which generally consists of portions of Santa Clara County, Southwestern Alameda County, Southeastern San Mateo County and Eastern Santa Cruz County. The Silicon Valley R&D property market has historically fluctuated with the local economy. The Silicon Valley economy and business activity have slowed markedly since 2001 after fast-paced growth in 1999 and 2000. According to a recent report by NAI BT Commercial Real Estate (the "BT Report"), the vacancy rate for Silicon Valley R&D property was approximately 18.3% in late 2006 and 17.6% at the end of the second quarter of 2007. Total vacant R&D square footage in Silicon Valley at the end of the second quarter of 2007 amounted to 27.1 million square feet, of which 17.7%, or 4.8 million square feet, was being offered under subleases. According to the BT Report, total positive net absorption (which is the computation of gross square footage leased less gross new square footage vacated for the period presented) in 2006 amounted to approximately 1.9 million square feet, but in the first six months of 2007, there was total positive net absorption of approximately 1.3 million square feet. According to the BT Report, the average asking market rent per square foot at the end of the second quarter of 2007 was \$1.14 compared to \$0.99 in late 2006. The Silicon Valley R&D property market has been characterized by a substantial number of submarkets, with rent and vacancy rates varying by submarket and location within each submarket, however, and individual properties within any particular submarket presently may be leased above or below the current average asking market rental rates within that submarket.

Our occupancy rate at June 30, 2007 was 67.8% compared to 63.0% at June 30, 2006. We believe that our occupancy rate could decline further going forward if key tenants seek the protection of bankruptcy laws, consolidate operations or discontinue operations. In addition, leases with respect to approximately 372,000 rentable square feet are expiring prior to the end of 2007. The properties subject to these leases may take anywhere from 24 to 36 months or longer to re-lease. We believe that the average 2007 renewal rental rates for our properties will be approximately equal to, or perhaps below, current market rents, but we cannot give any assurance that leases will be renewed or that available space will be re-leased at rental rates equal to or above the current quoted market rates.

Despite our strategic focus on single tenant properties and leases, in order to meet market conditions, we have been, and expect to continue leasing less than the entire premises of some of our R&D properties to a single tenant from time to time. Leasing our R&D properties, which generally have been built for single tenant occupancy, to multiple tenants can increase our leasing costs and operating expenses and reduce the profitability of our leasing activities.

If we are unable to lease a significant portion of any vacant space or space subject to expiring leases; if we experience significant tenant defaults as a result of the current economic downturn; if we are not able to lease space at or above current market rates; if we restructure existing leases and lower existing rents in order to retain tenants for an extended term; or if we increase our lease costs and operating expenses substantially to accommodate multiple tenants in our R&D properties, our results of operations and cash flows will be adversely affected. Furthermore, in this event it is probable that our board of directors will reduce the quarterly dividend on the common stock and the outstanding O.P. units. Our operating results and ability to pay dividends at current levels remain subject to a number of material risks, as indicated under the caption "Forward-Looking Information" above and in the section entitled "Risk Factors" in our most recent Annual Report on Form 10-K.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We prepare the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP"), which requires us to make certain estimates, judgments and assumptions

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that affect the reported amounts in the accompanying condensed consolidated financial statements, disclosure of contingent assets and liabilities and related footnotes. Accounting and disclosure decisions with respect to material transactions that are subject to significant management judgments or estimates include impairment of long lived assets, deferred rent reserves, and allocation of purchase price relating to property acquisitions and the related depreciable lives assigned. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that require management to make estimates, judgments and assumptions, giving due consideration to materiality, in certain circumstances that affect amounts reported in the condensed consolidated financial statements, and potentially result in materially different results under different conditions and assumptions. We believe that the following best describe our critical accounting policies:

BUSINESS COMBINATIONS. Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" ("SFAS 141"), was effective July 1, 2001. The acquisition costs of each property acquired prior to July 1, 2001 were allocated only to building, land and leasing commissions with building depreciation being computed based on an estimated weighted average composite useful life of 40 years and leasing commission amortization being computed over the term of the lease. Acquisitions of properties made subsequent to the effective date of SFAS 141 are based on an allocation of the acquisition cost to land, building, tenant improvements, and intangibles for at market, including lease origination and lease up period costs, and above and below market in place leases, and the determination of their useful lives are guided by a combination of SFAS 141 and management's estimates. Amortization expense of above and below

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market lease intangible asset is offset against rental revenue in the revenue section while amortization of in-place lease value intangible asset is included in depreciation and amortization of real estate in the expense section of our condensed consolidated statements of operations. If we do not appropriately allocate these components or we incorrectly estimate the useful lives of these components, our computation of depreciation and amortization expense may not appropriately reflect the actual impact of these costs over future periods, which will affect net income.

IMPAIRMENT OF LONG-LIVED ASSETS. We review real estate assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with SFAS No. 144, "Accounting for the Impairment and Disposal of Long-Lived Assets" ("SFAS 144"). If the carrying amount of the asset exceeds its estimated undiscounted net cash flow, before interest, we will recognize an impairment loss equal to the difference between its carrying amount and its estimated fair value. If impairment is recognized, the reduced carrying amount of the asset will be accounted for as its new cost. For a depreciable asset, the new cost will be depreciated over the asset's remaining useful life. Generally, fair values are estimated using discounted cash flow, replacement cost or market comparison analyses. The process of evaluating for impairment requires estimates as to future events and conditions, which are subject to varying market factors, such as the vacancy rates, future rental rates, lease periods, deferred maintenance and operating costs for R&D facilities in the Silicon Valley area and related submarkets. Therefore, it is reasonably possible that a change in estimate resulting from judgments as to future events could occur which would affect the recorded amounts of the property.

ALLOWANCE FOR DOUBTFUL ACCOUNTS AND DEFERRED RENT. We must estimate the uncollectibility of our accounts receivable based on the evaluation of our

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tenants' financial position, analyses of accounts receivable and current economic trends. We also make estimates for reserves against our deferred rent receivable for existing tenants with the potential of early termination, bankruptcy or ceasing operations. We charge or credit rental income for increases or decreases to our deferred rent reserves. Our estimates are based on our review of tenants' payment histories, the remaining lease term, whether or not the tenant is currently occupying our building, publicly available financial information and such additional information about their financial condition as tenants provide to us. The information available to us might lead us to overstate or understate these reserve amounts. The use of different estimates or assumptions could produce different results. Moreover, actual future collections of accounts receivable or reductions in future reported rental income due to tenant bankruptcies or other business failures could differ materially from our estimates.

CONSOLIDATED JOINT VENTURES. We, through an operating partnership, own three properties that are in joint ventures of which we have controlling interests. We manage and operate all three properties. The recognition of these properties and their operating results are 100% reflected on our condensed consolidated financial statements, with appropriate allocation to minority interests, because we have operational and financial control of the investments. We make judgments and assumptions about the estimated monthly payments made to our minority interest joint venture partners, which are reported with our periodic results of operations. Actual results may differ from these estimates under different assumptions or conditions.

INVESTMENT IN UNCONSOLIDATED JOINT VENTURE. We, through an operating partnership, have a 50% non-controlling limited partnership interest in one unconsolidated joint venture. This investment is not consolidated because we do not exercise significant control over major operating and financial decisions. We account for this joint venture interest using the equity method of accounting.

FAIR VALUE OF FINANCIAL INSTRUMENTS. Our financial instruments include cash and cash equivalents, accounts receivable, accounts payable, and debt. Considerable judgment is required in interpreting market data to develop estimates of fair value. Our estimates of fair value are not necessarily indicative of the amounts that we could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Cash and cash equivalents, accounts receivable, and accounts payable are carried at amounts that approximate their fair values due to their short-term maturities. The carrying amounts of our variable rate debt approximate fair value since the interest rates on these instruments are equivalent to rates currently offered to us. For fixed rate debt, we estimate fair value by using discounted cash flow analyses based on borrowing rates for similar kinds of borrowing arrangements.

STOCK-BASED COMPENSATION. In December 2004, the FASB issued SFAS 123R, which addresses the accounting for stock options. SFAS 123R requires that the cost of all employee, director and consultant stock options, as well as other equity-based compensation arrangements, be reflected in the financial statements based on the estimated fair value of the awards. SFAS 123R is an amendment to SFAS 123 and supersedes APB 25. SFAS 123R is applicable to any award that is settled or measured in stock, including stock options, restricted stock, stock appreciation rights, stock units, and employee stock purchase plans. We have adopted the requirements of SFAS 123R effective January 1, 2006 using the modified prospective method of transition. Accordingly, prior periods have not been restated. The adoption of this standard did not have a material effect on our condensed consolidated statements of operations or financial position. Compensation cost under SFAS 123R may differ due to different assumptions and treatment of forfeitures.

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REVENUE RECOGNITION. Rental revenue is recognized on the straight-line method of accounting required by GAAP under which contractual rent payment increases are recognized evenly over the lease term, regardless of when the rent payments are received by us. The difference between recognized rental income and rental cash receipts is recorded as "Deferred rent receivable" on the condensed consolidated balance sheets.

Rental revenue is affected if existing tenants terminate or amend their leases. We try to identify tenants who may be likely to declare bankruptcy, cease operations or are likely to seek a negotiated settlement of their obligation. By anticipating these events in advance, we expect to take steps to minimize their impact on our reported results of operations through lease renegotiations, reserves against deferred

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rent, and other appropriate measures. Our judgments and estimations about tenants' capacity to continue to meet their lease obligations will affect the rental revenue recognized. Material differences may result in the amount and timing of our rental revenue for any period if we made different judgments or estimations.

SFAS No. 66, "Accounting for Sales of Real Estate" ("SFAS 66"), establishes accounting standards for recognizing profit or loss on sales of real estate. The gain on the sale is only recognized proportionately as the seller receives payments from the purchaser. Interest income is recognized on an accrual basis, when appropriate.

Lease termination fees are recognized as other income when there is a signed termination letter agreement, all of the conditions of the agreement have been met, and when the tenant no longer has the right to occupy the property. These fees are paid by tenants who want to terminate their lease obligations before the end of the contractual term of the lease. We cannot predict or forecast the timing or amounts of future lease termination fees.

We recognize income from rent, tenant reimbursements and lease termination fees and other income once all of the following criteria are met in accordance with SEC Staff Accounting Bulletin 104:

- the agreement has been fully executed and delivered;
- services have been rendered;
- the amount is fixed and determinable; and
- collectibility is reasonably assured.

With regard to critical accounting policies, where applicable, we have explained and discussed the criteria for identification and selection, methodology in application and impact on the financial statements with the Audit Committee of our Board of Directors. The Audit Committee has reviewed the critical accounting policies we identified.

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RESULTS OF OPERATIONS

COMPARISON OF THE THREE AND SIX MONTHS ENDED JUNE 30, 2007 TO THE THREE AND SIX MONTHS ENDED JUNE 30, 2006

As of June 30, 2007, through our controlling interests in the operating partnerships, we owned 110 properties totaling approximately 7.8 million

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rentable square feet compared to 110 properties totaling approximately 7.9 million rentable square feet owned by us as of June 30, 2006. This represents a net decrease of approximately 1.3% in total rentable square footage, as we acquired three R&D properties consisting of approximately 148,600 rentable square feet and sold three R&D properties consisting of approximately 235,100 rentable square feet since the second quarter of 2006. Included in the 7.8 million rentable square feet are approximately 894,000 rentable square feet (or 17 buildings), which are in the process of being rezoned for residential development.

Rental revenue from real estate for the three and six months ended June 30, 2007 compared to the same three- and six-month periods in 2006 are as follows:

	Three Months Ended June 30,			% Chan Propert
	2007	2006	\$ Change	
-----				-----
(dollars in thousands)				
Same Property (1)	\$20,708	\$21,506	(\$798)	(3)
2006 Acquisitions	554	554	-	
2007 Acquisitions	21	-	21	1
	-----	-----	-----	
Total	\$21,283	\$22,060	(\$777)	(3)
	=====	=====	=====	
	Six Months Ended June 30,			% Chan Propert
	2007	2006	\$ Change	
-----				-----
(dollars in thousands)				
Same Property (1)	\$41,492	\$45,443	(\$3,951)	(8)
2006 Acquisitions	1,108	665	443	66
2007 Acquisitions	21	-	21	1
	-----	-----	-----	
Total	\$42,621	\$46,108	(\$3,487)	(7)
	=====	=====	=====	

(1) "Same Property" is defined as properties owned by us prior to 2007 that we still owned as of June 30, 2007.

RENTAL REVENUE FROM REAL ESTATE FROM CONTINUING OPERATIONS

For the quarter ended June 30, 2007, rental revenue from real estate decreased by approximately (\$0.8) million, or 3.5%, from \$22.1 million for the three months ended June 30, 2006 to \$21.3 million for the three months ended June 30, 2007. For the six months ended June 30, 2007, rental revenue from real estate decreased by approximately (\$3.5) million, or 7.6%, from \$46.1 million for the six months ended June 30, 2006 to \$42.6 million for the six months ended June 30, 2007. The decline in rental revenue resulted primarily from the loss of several tenants due to lease terminations, bankruptcy, relocation or cessation of their operations since June 30, 2006, all of which resulted from current adverse market conditions. Rental revenue was offset by amortization expense of approximately (\$0.5) million for the three months ended June 30, 2006, and (\$4.1) million and (\$0.9) million for the six months ended June 30, 2007 and 2006, respectively, for an above-market lease intangible asset. The increase was attributable to a lease termination. Our occupancy rate at June 30, 2007 was

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approximately 67.8%, compared to approximately 63.0% at June 30, 2006.

EQUITY IN EARNINGS FROM UNCONSOLIDATED JOINT VENTURE

As of June 30, 2007, we had investments in three R&D buildings, totaling 466,600 rentable square feet, through an unconsolidated joint venture, TBI-MWP, in which we acquired a 50% interest in January 2003 from the Berg Group under the Berg Land Holdings Option Agreement. We have a non-controlling limited partnership interest in this joint venture, which we account for using the equity method of accounting. For the three months ended June 30, 2007, we recorded equity in earnings from the unconsolidated joint venture of approximately \$0.35 million compared to equity in earnings of \$0.35 million for the same period in 2006. For the six-month periods ended June 30, 2007 and 2006, equity in earnings from the unconsolidated joint venture was approximately \$0.69 million and \$0.68 million, respectively. The occupancy rate for the properties owned by this joint venture at June 30, 2007 and 2006 was 100% and approximately 86.6%, respectively.

LEASE TERMINATION INCOME

Lease termination fees for the three months ended June 30, 2007 and 2006 were approximately \$0.2 million and \$12,000, respectively. Lease termination fees for the six months ended June 30, 2007 and 2006 were approximately \$10.3 million and \$16.1 million, respectively. These fees were paid by tenants who terminated their lease obligations before the end of the contractual term of the lease. We do not consider those transactions to be recurring items.

OTHER INCOME FROM CONTINUING OPERATIONS

Other income of approximately \$1.0 million for the three months ended June 30, 2007 included approximately \$0.5 million from interest, \$0.3 million from management fees and \$0.2 million from security deposit forfeitures and miscellaneous income. Other income of

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approximately \$1.1 million for the three months ended June 30, 2006 included approximately \$0.5 million from interest, \$0.3 million from management fees and \$0.3 million from the settlement of claims and miscellaneous income. For the six months ended June 30, 2007, other income of approximately \$4.0 million included approximately \$1.6 million from a forfeited deposit under a contract for the sale of property, \$1.3 million from interest, \$0.6 million from management fees, \$0.3 million from a bankruptcy settlement claim and \$0.2 million from security deposit forfeitures and miscellaneous income. For the six months ended June 30, 2006, other income of approximately \$1.8 million included approximately \$0.9 million from interest, \$0.5 million from management fees and \$0.4 million from bankruptcy settlement claims and miscellaneous income.

EXPENSES FROM CONTINUING OPERATIONS

Property operating expenses and real estate taxes during the second quarter of 2007 increased by approximately \$0.4 million, or 10.9%, from \$4.2 million to \$4.6 million for the three months ended June 30, 2006 and 2007, respectively, as in 2006 we benefited from real estate tax refunds of \$0.6 million that did not reoccur in the same period of 2007. Tenant reimbursements increased by approximately \$0.3 million, or 10.2%, from \$3.0 million for the three months ended June 30, 2006 to \$3.3 million for the three months ended June 30, 2007 due to higher occupancy. Certain expenses such as property insurance, real estate taxes, and other fixed operating expenses are not recoverable from vacant properties, however. For the six months ended June 30, 2007, property operating expenses and real estate taxes increased by approximately \$0.5 million, or 5.7%, from \$8.7 million for the six months ended June 30, 2006 to \$9.2 million for the six months ended June 30, 2007. General and administrative expenses increased by approximately \$0.1 million, or 5.7%, from \$0.6 million to \$0.7 million for the three months ended June 30, 2006 and 2007, respectively. For the six months ended June 30, 2006 and 2007, general and administrative expenses increased by

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approximately \$0.1 million, or 9.0%, from \$1.3 million to \$1.4 million, respectively. The increase in general and administrative expenses was primarily a result of higher salaries and wages and stock-based compensation expense.

Real estate depreciation and amortization expense increased by approximately \$0.2 million, or 3.5%, from \$5.3 million to \$5.5 million for the three months ended June 30, 2006 and 2007, respectively. Real estate depreciation and amortization expense increased by approximately \$1.1 million, or 10.1%, from \$10.6 million to \$11.7 million for the six months ended June 30, 2006 and 2007, respectively. The increase was attributable primarily to the write-offs of additional amortization expense relating to in-place lease value intangible asset pursuant to SFAS 141 in connection with two lease terminations and additional tenant improvements.

Interest expense decreased by approximately (\$0.1) million, or 2.8%, from \$5.2 million for the three months ended June 30, 2006 to \$5.1 million for the three months ended June 30, 2007 due to lower total debt in 2007. Interest expense (related parties) was approximately \$0.2 million in both three-month periods ended June 30, 2007 and 2006. Total debt outstanding, including amounts due related parties, decreased by approximately (\$10.0) million, or 2.8%, from \$362.4 million as of June 30, 2006 to \$352.3 million as of June 30, 2007. Overall interest expense, including amounts paid to related parties, for the quarter ended June 30, 2007 decreased by approximately (\$0.2) million compared to the same quarter a year ago.

Interest expense decreased by approximately (\$0.3) million, or 2.8%, from \$10.4 million for the six months ended June 30, 2006 to \$10.1 million for the six months ended June 30, 2007. Interest expense (related parties) did not change significantly for the six months ended June 30, 2007 compared to the same period in 2006.

INCOME FROM DISCONTINUED OPERATIONS

The following table depicts the amounts of income from discontinued operations for the three and six months ended June 30, 2006.

	Three Months Ended June 30, 2007	2006
	-----	-----
		(dollars in thousands)
		(unaudited)
Income attributable to discontinued operations	-	\$552
Minority interests in earnings attributable to discontinued operations	-	(463)
	-----	-----
Income from discontinued operations	-	\$ 89
	=====	=====

In accordance with our adoption of SFAS 144, in the third quarter of 2006 we classified three R&D properties as assets held for sale and sold them in the fourth quarter of 2006 and classified them as discontinued operations. The income to common stockholders and minority interests attributable to discontinued operations from these three R&D properties for the three months ended June 30, 2006 was approximately \$0.1 million and \$0.5 million, respectively. The income to common stockholders and minority interests attributable to discontinued operations from these three R&D properties for the six months ended June 30, 2006 was approximately \$0.2 million and \$0.9 million, respectively.

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NET INCOME TO COMMON STOCKHOLDERS AND NET INCOME TO MINORITY INTERESTS

Net income to common stockholders decreased by approximately (\$0.1) million, or 5.5%, from \$2.1 million for the three months ended June 30, 2006 to \$2.0 million for the same period in 2007. The minority interest portion of income decreased by approximately (\$0.9) million, or 10.4%, from \$8.9 million for the three months ended June 30, 2006 to \$8.0 million for the three months ended June 30, 2007. The decline in the quarter's net income for both common stockholders and minority interests was primarily due to lower rental income and higher operating expenses in the second quarter of 2007. For the six months ended June 30, 2007 and 2006, the minority interest portion of income was approximately \$21.9 million and \$32.4 million, respectively, and net income to common stockholders was

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approximately \$5.4 million and \$7.3 million, respectively. The decrease in net income for both common stockholders and minority interests in the first half of 2007 was primarily from the combination of lower rental income for the June 30, 2007 period and the realization of higher lease termination fees in the same period in 2006.

Minority interest in net income has been calculated by taking the net income of the operating partnerships (on a stand-alone basis) multiplied by the respective minority interest ownership percentage. Minority interests represent the ownership interest of all limited partners in the operating partnerships taken as a whole, which was approximately 81% and 82% as of June 30, 2007 and 2006, respectively.

CHANGES IN FINANCIAL CONDITION

The most significant changes in our financial condition during the three months ended June 30, 2007 resulted from the acquisition of three R&D properties and approximately five acres of vacant land. In addition, total stockholders' equity increased from the issuance of common stock upon the exchange of O.P. units.

At June 30, 2007, total investments in properties increased on a net basis by approximately \$32.5 million from December 31, 2006 primarily due to three R&D property acquisitions consisting of approximately 149,000 rentable square feet located in the Silicon Valley, the acquisition of 55 acres of vacant land located in the Silicon Valley and the construction of additional tenant improvements.

Total stockholders' equity, net, increased by approximately \$2.0 million from December 31, 2006 as we obtained additional capital from the issuance of 196,500 shares of our common stock for the exchange of O.P. units, offset with an increase in accumulated deficit of approximately (\$0.9) million. The newly issued shares of common stock increased additional paid-in capital by approximately \$2.9 million.

LIQUIDITY AND CAPITAL RESOURCES

We expect an increase in operating cash flows from our operating property portfolio in 2007 as compared to 2006. The increase in cash flows is resulting from early lease terminations. If we are unable to lease a significant portion of the approximately 372,000 rentable square feet scheduled to expire during the remainder of 2007 or an equivalent amount of our currently available space of approximately 2.5 million rentable square feet, our operating cash flows may be affected adversely. With the expectation of lower rental revenues for the remainder of 2007, we expect our properties' net operating income to show a year over year decline when compared to 2006 driven by excess capacity of commercial office and R&D space in the Silicon Valley. We are also subject to risks of

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decreased occupancy through tenant defaults and bankruptcies and potential reduction in rental rates upon renewal of properties, which would result in reduced cash flow from operations. Cash flows from lease terminations are non-recurring and to maintain or increase cash flows in the future we must re-lease our vacant properties.

We expect our principal source of liquidity for distributions to stockholders and O.P. unit holders, debt service, leasing commissions and recurring capital expenditures to come from cash provided by operations and/or borrowings under the line of credit with Santa Clara Valley National Bank ("SCVNB"). We expect these sources of liquidity to be adequate to meet projected distributions to stockholders and other presently anticipated liquidity requirements in 2007. We expect to meet our long-term liquidity requirements for the funding of property development, property acquisitions and other material non-recurring capital improvements through cash and investments, long-term secured and unsecured indebtedness and the issuance of additional equity securities by us. We have the ability to meet short-term obligations or other liquidity needs based on the line of credit with SCVNB. We expect our total interest expense to increase through new financing activities. In the remainder of 2007, we will be obligated to make payments totaling approximately \$5.6 million of debt principal under mortgage notes without regard to any debt refinancing or new debt obligations that we might incur, or optional payments of debt principal.

Cash and cash equivalents increased by approximately \$5.3 million from \$33.8 million as of December 31, 2006 to \$39.1 million as of June 30, 2007 primarily from lease termination fees.

Restricted cash totaled approximately \$1.6 million as of June 30, 2007. This amount represents cash held by our VIE from a lease termination in 2006. We include this in our restricted cash under the principles of FIN 46R. We do not possess or control these funds or have any rights to receive them except as provided in the applicable agreements, however. The restricted cash is not available for distribution to stockholders.

DISTRIBUTIONS

On July 5, 2007, we paid dividends of \$0.16 per share of common stock to all common stockholders of record as of June 29, 2007. On the same date, the operating partnerships paid a distribution of \$0.16 per O.P. unit to all holders of O.P. units. Aggregate dividends and distributions amounted to approximately \$16.7 million. For the remainder of 2007, we expect to maintain our current quarterly dividend payment rate to common stockholders and O.P. unit holders of \$0.16 per share. However, distributions are declared at the discretion of our Board of Directors and are subject to actual cash available for distribution, our financial condition, capital requirements and such other factors, as our Board of Directors deems relevant.

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DEBT

At June 30, 2007, we had total indebtedness of approximately \$352.3 million, including \$342.9 million of fixed rate mortgage debt and \$9.4 million under the Berg Group mortgage note (related parties), as detailed in the table below. The Allianz and SCVNB loans contain certain financial loan and reporting covenants as defined in the loan agreements. As of June 30, 2007, we were in compliance with these loan covenants.

CONTRACTUAL OBLIGATIONS

The following table identifies the contractual obligations as of June 30, 2007 that will impact our liquidity and cash flow in future periods:

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	2007	2008	2009	2010	2011
	(dollars in thousands)				
Long-Term Debt Obligations (1)	\$5,578	\$121,589	\$9,561	\$10,105	\$10,68
Operating Lease Obligations (2)	48	24	-	-	
Total	\$5,626	\$121,613	\$9,561	\$10,105	\$10,68

- (1) Our long-term debt obligations are set forth in detail in the schedule below.
- (2) Our operating lease obligations relate to a lease of our corporate office facility from a related party.

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The following table sets forth information regarding debt outstanding as of June 30, 2007:

Debt Description	Maturity	Interest	Collateral Properties	Balance
(dollars in thousands)				
Line of Credit:				
Santa Clara Valley National Bank		Not Applicable		-
Mortgage Notes Payable(related parties):		5300 & 5350 Hellyer Ave., San Jose, CA		\$ 9,443
Mortgage Notes Payable(1):				
Prudential Ins. Co. of America(2)		10300 Bubb Road, Cupertino, CA		113,789
		10500 N. De Anza Blvd., Cupertino, CA		
		4050 Starboard Drive, Fremont, CA		
		45700 Northport Loop, Fremont, CA		
		45738 Northport Loop, Fremont, CA		
		450 National Ave., Mountain View, CA		
		6311 San Ignacio Avenue, San Jose, CA		
		6321 San Ignacio Avenue, San Jose, CA		
		6325 San Ignacio Avenue, San Jose, CA		
		6331 San Ignacio Avenue, San Jose, CA		
		6341 San Ignacio Avenue, San Jose, CA		
		6351 San Ignacio Avenue, San Jose, CA		
		3236 Scott Boulevard, Santa Clara, CA		
		3560 Bassett Street, Santa Clara, CA		
		3570 Bassett Street, Santa Clara, CA		
		3580 Bassett Street, Santa Clara, CA		
		1135 Kern Avenue, Sunnyvale, CA		
		1212 Bordeaux Lane, Sunnyvale, CA		
		1230 E. Arques, Sunnyvale, CA		
		1250 E. Arques, Sunnyvale, CA		

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	1170 Morse Avenue, Sunnyvale, CA	
	1600 Memorex Drive, Santa Clara, CA	
	1688 Richard Avenue, Santa Clara, CA	
	1700 Richard Avenue, Santa Clara, CA	
	3540 Bassett Street, Santa Clara, CA	
	3542 Bassett Street, Santa Clara, CA	
	3544 Bassett Street, Santa Clara, CA	
	3550 Bassett Street, Santa Clara, CA	
Northwestern Mutual Life Ins. Co.(4)	1750 Automation Parkway, San Jose, CA	86,702
	1756 Automation Parkway, San Jose, CA	
	1762 Automation Parkway, San Jose, CA	
	6320 San Ignacio Avenue, San Jose, CA	
	6540-6541 Via Del Oro, San Jose, CA	
	6385-6387 San Ignacio Ave., San Jose, CA	
	2251 Lawson Lane, Santa Clara, CA	
	1325 McCandless Drive, Milpitas, CA	
	1650-1690 McCandless Dr., Milpitas, CA	
	20605-20705 Valley Green Dr., Cupertino, CA	
Allianz Life Ins. Co.(Allianz Loan I) (5)	5900 Optical Court, San Jose, CA	24,217
Allianz Life Ins. Co.(Allianz Loan II) (5)	5325-5345 Hellyer Avenue, San Jose, CA	118,171
	1768 Automation Parkway, San Jose, CA	
	2880 Scott Boulevard, Santa Clara, CA	
	2890 Scott Boulevard, Santa Clara, CA	
	2800 Scott Boulevard, Santa Clara, CA	
	20400 Mariani Avenue, Cupertino, CA	
	10450-10460 Bubb Road, Cupertino, CA	

		342,879

TOTAL		-----
		\$352,322
		=====

- (1) Mortgage notes payable generally require monthly installments of principal and interest ranging from approximately \$177,000 to \$840,000 over various terms extending through the year 2025. The weighted average interest rate of mortgage notes payable was 5.84% at June 30, 2007.
- (2) The Prudential Insurance loan is payable in monthly installments of approximately \$827,000, which includes principal (based upon a 30-year amortization) and interest. A limited partner who is not a member of the Berg Group has guaranteed approximately \$12.0 million of this debt. Costs and fees incurred with obtaining this loan aggregated approximately \$900,000, which were deferred and amortized over the loan period.
- (3) Interest rate equal to LIBOR plus 1.75%. The Santa Clara Valley National Bank line of credit contains certain financial loan and reporting covenants as defined in the loan agreements, including minimum tangible net worth and debt service coverage ratio. As of June 30, 2007, the Company was in compliance with these loan covenants.
- (4) The Northwestern loan is payable in monthly installments of approximately \$696,000, which includes principal (based upon a 20-year amortization) and interest. Costs and fees incurred with obtaining this loan aggregated approximately \$675,000, which were deferred and amortized over the loan period.
- (5) The Allianz loans are payable in monthly aggregate installments of approximately \$1,017,000, which includes principal (based upon a 20-year

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amortization) and interest. Costs and fees incurred with obtaining these loans aggregated approximately \$1,089,000, which were deferred and amortized over the loan periods. The Allianz loans contain certain customary covenants as defined in the loan agreements. As of June 30, 2007, the Company was in compliance with these loan covenants.

At June 30, 2007, our debt to total market capitalization ratio, which is computed as our total debt outstanding divided by the sum of total debt outstanding plus the market value of common stock (based upon the closing price of \$13.94 per share on June 29, 2007) on a fully diluted basis, including the conversion of all O.P. units into common stock, was approximately 19.4%. On June 29, 2007, the last trading day for the quarter, total market capitalization was approximately \$1.82 billion.

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At June 30, 2007, the outstanding balance remaining under certain notes that we owed to the operating partnerships was approximately \$1.9 million. The due date of these notes has been extended to September 30, 2008. The principal amount of these notes, along with the interest expense, which is interest income to the operating partnerships, is eliminated in consolidation and is not included in the corresponding line items within the condensed consolidated financial statements. However, the interest income earned by the operating partnerships, which is interest expense to us, in connection with this debt, is included in the calculation of minority interests as reported on the condensed consolidated statement of operations, thereby reducing our net income by this same amount. At present, our only means for repayment of this debt is through distributions that we receive from the operating partnerships that are in excess of the amount of dividends to be paid to our stockholders or by raising additional equity capital.

HISTORICAL CASH FLOWS

COMPARISON OF THE SIX MONTHS ENDED JUNE 30, 2007 TO THE SIX MONTHS ENDED JUNE 30, 2006

Net cash provided by operating activities for the six months ended June 30, 2007 was approximately \$24.4 million compared to \$19.8 million for the same period in 2006. Cash flow increases came primarily from lease termination fees, a forfeited deposit under a contract for the sale of property, and rent payments from M&M, LLC in 2007 (see Note 5 of Notes to Condensed Consolidated Financial Statements in Part I, Item 1, above). Higher leasing commission payments (included in other assets) in 2007 compared to 2006 reduced the amount of the overall increase in cash flows.

Net cash used in investing activities was approximately (\$1.8) million and (\$0.8) million for the six months ended June 30, 2007 and 2006, respectively. Cash used in investing activities during the six months ended June 30, 2007 related principally to the acquisition of 50 acres of vacant land at the Morgan Hill Ranch in Morgan Hill, California for approximately \$25.5 million, the acquisition of five acres of vacant land at the Morgan Hill Ranch in Morgan Hill, California for approximately \$2.3 million and the acquisition of three R&D properties at Montague Expressway in Milpitas, California for approximately \$15.4 million. All three acquisitions were completed as a tax-deferred exchange transaction involving our former R&D properties at 2033-2243 Samaritan Drive in San Jose, California. The remaining excess restricted cash of approximately \$0.6 million was transferred to our general cash account. Capital expenditures for real estate improvements were approximately \$2.4 million for the six months ended June 30, 2007.

Net cash used in investing activities during the six months ended June 30, 2006

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related principally to the acquisition of the property at 233 South Hillview Drive in Milpitas, California for approximately \$13.5 million, pursuant to a tax-deferred exchange transaction involving our former R&D property at 800 Embedded Way in San Jose, California. Excess restricted cash of approximately \$1.8 million from the sale of 800 Embedded Way was transferred to our general cash account. Capital expenditures for real estate improvements were approximately \$0.2 million for the six months ended June 30, 2006.

Net cash used in financing activities was approximately (\$17.4) million for the six months ended June 30, 2007 compared to approximately (\$10.9) million for the six months ended June 30, 2006. During the first six months of 2007, we used approximately \$5.4 million to pay outstanding debt, paid approximately \$6.3 million of dividends to common stockholders and paid \$5.7 million to minority interests for distributions in excess of earnings. During the same period in 2006, we received approximately \$0.2 million from stock option exercises, used approximately \$5.2 million to pay outstanding debt and paid approximately \$5.9 million of dividends to common stockholders.

FUNDS FROM OPERATIONS ("FFO")

FFO is a non-GAAP financial measurement used by real estate investment trusts to measure and compare operating performance. As defined by NAREIT, FFO represents net income (loss) before minority interest of O.P. unit holders, computed in accordance with GAAP, plus non-recurring events other than "extraordinary items" under GAAP, excluding gains and losses from sales of depreciable operating properties, plus real estate related depreciation and amortization, excluding amortization of deferred financing costs and depreciation of non-real estate assets, and after adjustments for unconsolidated partnerships and joint ventures. FFO does include impairment losses for properties held for sale and held for use. Management considers FFO to be an appropriate supplemental measure of our operating and financial performance because when compared year over year, it reflects the impact to operations from trends in occupancy rates, rental rates, operating costs, general and administrative expenses and interest costs, providing a perspective not immediately apparent from net income. In addition, management believes that FFO provides useful information about our financial performance when compared to other REITs because FFO is generally recognized as the industry standard for reporting the operations of REITs. In addition to the disclosure of operating earnings per share, we will continue to use FFO as a measure of our performance. FFO should not be considered as an alternative for net income as a measure of profitability nor is it comparable to cash flows provided by operating activities determined in accordance with GAAP, nor is FFO necessarily indicative of funds available to meet our cash needs, including the need to make cash distributions to satisfy REIT requirements. For example, FFO is not adjusted for payments of debt principal required under our debt service obligations.

Our definition of FFO also assumes conversion at the beginning of the period of all convertible securities, including minority interests represented by O.P. Units that might be exchanged for common stock. FFO does not represent the amount available for management's discretionary use; as such funds may be needed for capital replacement or expansion, debt service obligations or other commitments and uncertainties.

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Furthermore, FFO is not comparable to similarly entitled items reported by other REITs that do not define FFO exactly as we do.

FFO for the three and six months ended June 30, 2007 and 2006, as reconciled to net income to common stockholders, are summarized in the following table:

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	Three Months Ended June 30,		
	2007	2006	
	(dollars in thousands)		
Net income to common stockholders	\$ 2,004	\$ 2,121	\$ 5
Add:			
Minority interests(1)	7,922	8,855	21
Depreciation & amortization of real estate(2)	6,028	5,978	12
FFO	\$15,954	\$16,954	\$39

- (1) Minority interests in net income is calculated by taking the net income of the operating partnerships (on a stand-alone basis) multiplied by the respective weighted average minority interests ownership percentage. The minority interests for third parties totaling approximately \$117 and \$113 for the three months ended June 30, 2007 and 2006, respectively, and \$241 and \$248 for the six months ended June 30, 2007 and 2006, respectively, was deducted from total minority interests in calculating FFO.
- (2) Includes our portion of depreciation and amortization of real estate and leasing commissions from our unconsolidated joint venture totaling approximately \$189 and \$211 for the three months ended June 30, 2007 and 2006, respectively, and \$379 and \$422 for the six months ended June 30, 2007 and 2006, respectively. Also includes our amortization of leasing commissions of approximately \$384 and \$342 for the three months ended June 30, 2007 and 2006, respectively, and \$760 and \$770 for the six months ended June 30, 2007 and 2006, respectively. Amortization of leasing commissions is included in the property operating, maintenance and real estate taxes line item in the Company's condensed consolidated statements of operations.

The decline in FFO year-over-year was primarily due to lower rental and termination fee income and higher amortization expense for an above-market lease intangible asset in 2007 compared to 2006.

DISTRIBUTION POLICY

Our board of directors determines the amount and timing of distributions to our stockholders. The board of directors will consider many factors prior to making any distributions, including the following:

- the amount of cash available for distribution;
- our financial condition;
- whether to reinvest funds rather than to distribute such funds;
- our committed and projected capital expenditures;
- the amount of cash required for new property acquisitions, including acquisitions under existing agreements with the Berg Group;
- the amount of our annual debt service requirements;
- prospects of tenant renewals and re-leases of properties subject to expiring leases;
- cash required for re-leasing activities;
- the annual distribution requirements under the REIT provisions of the federal income tax laws; and
- such other factors as the board of directors deems relevant.

We cannot assure you that we will be able to meet or maintain our cash distribution objectives.

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IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

We do not believe recently issued accounting standards will materially impact our financial position, results of operations, or cash flows.

In June 2006, the FASB issued Interpretation 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in our financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." The provisions of FIN 48 are effective for our fiscal year beginning January 1, 2007. The adoption of FIN 48 on January 1, 2007 is not expected to have a significant impact on our consolidated results of operations or financial position.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective for our fiscal year beginning January 1, 2008. We are currently evaluating the impact of the provisions of SFAS 157 and currently cannot estimate the impact to our consolidated results of operations or financial position.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not generally hold market risk sensitive instruments for trading purposes. We use fixed and variable rate debt to finance our operations. Our exposure to market risk for changes in interest rates relates primarily to our current variable rate debt and future debt obligations. We are vulnerable to significant fluctuations of interest rates on our floating rate debt and pricing on our future debt. We manage our market risk by monitoring interest rates where we try to recognize the unpredictability of the financial markets and seek to reduce potentially adverse effect on the results of our operations. This takes frequent evaluation of available lending rates and examination of opportunities to reduce interest expense through new sources of debt financing. Several factors affecting the interest rate risk include governmental monetary and tax policies, domestic and international economics and other factors that are beyond our control. The following table provides information about the principal cash flows, weighted average interest rates, and expected maturity dates for debt outstanding as of June 30, 2007. The current terms of this debt are described in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources." For fixed rate debt, we estimate fair value by using discounted cash flow analyses based on borrowing rates for similar kinds of borrowing arrangements.

For fixed rate debt, the table presents the assumption that the outstanding principal balance at June 30, 2007 will be paid according to scheduled principal payments and that we will not prepay any of the outstanding principal balance.

Six Months Remaining	Year Ending December 31,				
	2007	2008	2009	2010	2011
Fixed Rate Debt:					

(dollars in thousands)

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Secured notes payable	\$5,578	\$121,589	\$9,561	\$10,105	\$10,681
Weighted average interest rate	5.84%	5.84%	5.84%	5.84%	5.84%

The primary market risks we face are interest rate fluctuations. We pay lower rates of interest in periods of decreasing interest rates and higher rates of interest in periods of increasing interest rates. All of our debt is denominated in United States dollars. We had no interest rate caps or interest rate swap contracts at June 30, 2007.

As of June 30, 2007, we had no interest rate risk since there was no variable rate debt outstanding.

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ITEM 4. CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

We strive to maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b) we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer, President and Vice President of Finance, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer, President and Vice President of Finance concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e)) were effective as of June 30, 2007.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There was no material change in our internal control over financial reporting during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Legal proceedings are incorporated herein by reference from Part I "Item 1. - Notes to Condensed Consolidated Financial Statements - Note 10 - Commitments and Contingencies."

ITEM 1A. RISK FACTORS

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While we attempt to identify, manage and mitigate risks and uncertainties associated with our business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. In addition to the other information contained in this report, you should carefully review the factors discussed under Item 1A of our 2006 Form 10-K which describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our business, financial condition, results of operations, cash flows, and future prospects. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations.

ITEM 6. EXHIBITS

- 31.1 Section 1350 Certificate of CEO
- 31.2 Section 1350 Certificate of President & COO
- 31.3 Section 1350 Certificate of Principal Financial Officer
- 32 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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Signatures

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

Mission West Properties, Inc.
(Registrant)

Date: August 8, 2007

By: /s/ Carl E. Berg

Carl E. Berg
Chief Executive Officer

Date: August 8, 2007

By: /s/ Wayne N. Pham

Wayne N. Pham
Vice President of Finance and Controller
(Principal Accounting Officer and Duly
Authorized Officer)

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