BRANDYWINE REALTY TRUST
Form 10-Q
November 09, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2006

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from ____________ to ___________

Commission file number 001-9106

Brandywine Realty Trust

(Exact name of registrant as specified in its charter)

Maryland State or other jurisdiction of incorporation or organization	**23-2413352** (I.R.S. Employer Identification No.)
555 East Lancaster Avenue, **Radnor, Pennsylvania** (Address of principal executive offices)	**19087** (Zip Code)

(610) 325-5600

Registrant s telephone number

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, accelerated filer, or a non-accelerated filer. See definitions 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 Rule 12b-2 of the Exchange Act).
Yes No

A total of 88,249,748 Common Shares of Beneficial Interest, par value $0.01 per share, were outstanding as of November 7, 2006.

BRANDYWINE REALTY TRUST

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PART I - FINANCIAL INFORMATION

Item 1. - Financial Statements

BRANDYWINE REALTY TRUST

CONSOLIDATED BALANCE SHEETS

(unaudited, in thousands, except share and per share information)

	September 30, 2006	December 31, 2005
ASSETS		
Real estate investments:		
Operating properties	$4,871,978	$2,560,061
Accumulated depreciation	(499,141)	(390,333)
Operating real estate investments, net	4,372,837	2,169,728
Construction-in-progress	309,783	273,240
Land held for development	118,181	98,518
Total real estate investments, net	4,800,801	2,541,486
Cash and cash equivalents	16,538	7,174
Escrowed cash	20,153	18,498
Accounts receivable, net	23,400	12,874
Accrued rent receivable, net	67,283	47,034
Marketable securities	187,162	
Investment in unconsolidated ventures	78,288	13,331
Deferred costs, net	65,378	37,602
Intangible assets, net	325,119	78,097
Other assets	67,500	49,649
Total assets	$5,651,622	$2,805,745
LIABILITIES AND BENEFICIARIES EQUITY		
Mortgage notes payable	$892,935	$494,777
Secured note payable	181,759	
Unsecured notes	1,863,188	936,607
Unsecured credit facility	249,998	90,000
Accounts payable and accrued expenses	124,814	52,635
Distributions payable	43,752	28,880
Tenant security deposits and deferred rents	57,799	20,953
Acquired below market leases, net of accumulated amortization of $22,030 and $6,931	107,122	34,704
Other liabilities	14,927	4,466

Total liabilities	3,536,294	1,663,022
Minority interest - partners share of consolidated real estate ventures	109,074	37,861
Minority interest attributable to continuing operations - LP units	36,758	(2)
Commitments and contingencies (Note 16)		
Beneficiaries equity:		
Preferred Shares (shares authorized-20,000,000):		
7.50% Series C Preferred Shares, $0.01 par value; issued and outstanding-2,000,000 in 2006 and 2005	20	20
7.375% Series D Preferred Shares, $0.01 par value; issued and outstanding-2,300,000 in 2006 and 2005	23	23
Common Shares of beneficial interest, $0.01 par value; shares authorized 200,000,000; issued and outstanding-90,058,533 in 2006 and 56,179,075 in 2005	901	562
Additional paid-in capital	2,368,460	1,369,913
Cumulative earnings	399,647	413,282
Accumulated other comprehensive income (loss)	1,038	(3,169)
Cumulative distributions	(800,593)	(675,767)
Total beneficiaries equity	1,969,496	1,104,864
Total liabilities, minority interest, and beneficiaries equity	$5,651,622	$2,805,745

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

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BRANDYWINE REALTY TRUST

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited, in thousands, except share and per share information)

	For the three-month periods ended September 30,		**For the nine-month periods ended September 30,**	
	2006	**2005**	**2006**	**2005**
Revenue:				
Rents	$149,374	$80,288	$437,913	$241,207
Tenant reimbursements	23,802	11,710	58,203	34,716
Other	8,418	3,029	17,456	11,813
Total revenue	181,594	95,027	513,572	287,736
Operating Expenses:				
Property operating expenses	53,465	26,664	149,828	83,679
Real estate taxes	18,220	9,744	51,203	28,763
Depreciation and amortization	68,277	28,230	199,275	83,983
Administrative expenses	6,490	4,486	22,704	13,616
Total operating expenses	146,452	69,124	423,010	210,041
Operating income	35,142	25,903	90,562	77,695
Other Income (Expense):				
Interest income	2,479	304	7,702	966
Interest expense	(45,402)	(17,762)	(128,869)	(53,366)
Equity in income of real estate ventures	370	745	1,798	2,296
Net gain on sale of interests in real estate		4,640	2,608	4,640
Gain on termination of purchase contract	3,147		3,147	
Income (loss) before minority interest	(4,264)	13,830	(23,052)	32,231
Minority interest - partners share of consolidated real estate ventures	279	(41)	560	(213)
Minority interest attributable to continuing operations - LP units	276	(401)	1,267	(908)
Income (loss) from continuing operations	(3,709)	13,388	(21,225)	31,110
Discontinued operations:				
Income (loss) from discontinued operations	1,150	294	5,018	941
Net gain on disposition of discontinued operations	5,188	2,196	5,188	2,196
Minority interest - partners share of consolidated real estate ventures	(1,857)		(2,239)	

Minority interest attributable to discontinued operations - LP units	(208)	(84)	(376)	(108)
Income (loss) from discontinued operations	4,273	2,406	7,591	3,029
Net income (loss)	564	15,794	(13,634)	34,139
Income allocated to Preferred Shares	(1,998)	(1,998)	(5,994)	(5,994)
Income (loss) allocated to Common Shares	$(1,434)	$13,796	$(19,628)	$28,145
Basic earnings per Common Share:				
Continuing operations	$(0.06)	$0.20	$(0.30)	$0.45
Discontinued operations	0.05	0.04	0.08	0.05
	$(0.02)	$0.25	$(0.22)	$0.50
Diluted earnings per Common Share:				
Continuing operations	$(0.06)	$0.20	$(0.30)	$0.45
Discontinued operations	0.05	0.04	0.08	0.05
	$(0.02)	$0.24	$(0.22)	$0.50
Dividends declared per common share	$0.44	$0.44	$1.32	$1.32
Basic weighted average shares outstanding	90,042,270	56,071,973	89,963,541	55,734,114
Diluted weighted average shares outstanding	90,042,270	56,372,013	89,963,541	55,968,657

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

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BRANDYWINE REALTY TRUST

CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE INCOME

(unaudited, in thousands)

	For the three-month periods ended September 30,		For the nine-month periods ended September 30,	
	2006	**2005**	**2006**	**2005**
Net income (loss)	$564	$15,794	$(13,634)	$34,139
Other comprehensive income:				
Unrealized gain (loss) on derivative financial instruments	(1,070)		1,293	
Less: minority interest - consolidated real estate venture partner s share of unrealized gain (loss) on derivative financial instruments	525		(284)	
Realized gain on derivative financial instruments			3,266	
Reclassification of realized (gains)/losses on derivative financial instruments to operations, net	9	113	113	340
Unrealized gain (loss) on available-for-sale securities	595	(257)	(181)	(20)
Total other comprehensive income	59	(144)	4,207	320
Comprehensive income (loss)	$623	$15,650	$(9,427)	$34,459

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

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BRANDYWINE REALTY TRUST
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Nine-month periods ended September 30,	
	2006	**2005**
Cash flows from operating activities:		
Net income (loss)	$(13,634)	$34,139
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation	143,893	63,588
Amortization:		
Deferred financing costs	2,063	1,939
Deferred leasing costs	8,394	6,425
Acquired above (below) market leases, net	(6,067)	(1,050)
Assumed lease intangibles	50,471	14,854
Deferred compensation costs	2,332	1,618
Straight-line rent	(23,486)	(10,852)
Provision for doubtful accounts	2,970	600
Real estate venture income in excess of distributions	(162)	(697)
Net gain on sale of interests in real estate	(7,797)	(6,820)
Gain on termination of purchase contract	(3,147)	
Minority interest	788	1,229
Changes in assets and liabilities:		
Accounts receivable	2,515	4,469
Other assets	(13,185)	(12,837)
Accounts payable and accrued expenses	36,192	5,861
Tenant security deposits and deferred rents	30,635	628
Other liabilities	904	672
Net cash from operating activities	213,679	103,766
Cash flows from investing activities:		
Acquisition of Prentiss	(935,856)	
Acquisition of properties	(169,462)	(92,674)
Sales of properties, net	258,931	29,428
Gain on termination of purchase contract	3,147	
Capital expenditures	(180,771)	(136,801)
Investment in marketable securities	183	404
Investment in unconsolidated Real Estate Ventures	(643)	(258)
Escrowed cash	(492)	1,806
Cash distributions from unconsolidated Real Estate Ventures in excess of equity in income	2,444	390
Leasing costs	(30,524)	(8,445)
Net cash from investing activities	(1,053,043)	(206,150)
Cash flows from financing activities:		

Proceeds from Credit Facility borrowings	462,000	250,000
Repayments of Credit Facility borrowings	(302,002)	(62,000)
Proceeds from mortgage notes payable	20,520	
Repayments of mortgage notes payable	(29,327)	(13,565)
Proceeds from term loan	750,000	
Repayments of term loan	(750,000)	
Proceeds from unsecured notes	847,818	
Proceeds from forward starting swap termination	3,266	
Repayments on employee stock loans	60	50
Debt financing costs	(6,991)	(234)
Exercise of stock options	9,120	19,283
Repurchases of Common Shares and minority interest units	(34,481)	(240)
Distributions paid to shareholders	(110,094)	(79,752)
Distributions to minority interest holders	(11,161)	(3,164)
Net cash from financing activities	848,728	110,378
Increase (decrease) in cash and cash equivalents	9,364	7,994
Cash and cash equivalents at beginning of period	7,174	15,346
Cash and cash equivalents at end of period	$16,538	$23,340
Supplemental disclosure:		
Cash paid for interest, net of capitalized interest	$99,987	$27,374
Supplemental disclosure of non-cash activity:		
Common shares issued in the Prentiss acquisition	1,021,269	
Operating Partnership units issued in the Prentiss acquisition	64,103	
Operating Partnership units issued in propety acquistions	13,819	
Mortgage notes payable assumed in the Prentiss acquisition	532,607	
Secured note payable assumed in the Prentiss acquisition	186,116	

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

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BRANDYWINE REALTY TRUST

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006

1. THE COMPANY

Brandywine Realty Trust, a Maryland real estate investment trust (collectively with its subsidiaries, the Company), is a self-administered and self-managed real estate investment trust, or REIT, active in acquiring, developing, redeveloping, leasing and managing office and industrial properties. As of September 30, 2006, the Company owned 277 office properties, 23 industrial facilities and one mixed-use property (collectively, the Properties) containing an aggregate of approximately 30.0 million net rentable square feet. As of September 30, 2006, the Company owned economic interests in 11 unconsolidated real estate ventures that contain approximately 2.7 million net rentable square feet and in four consolidated real estate ventures that own 15 office properties containing approximately 1.5 million net rentable square feet (collectively, the Real Estate Ventures). The Properties and the properties owned by the Real Estate Ventures are located in or in areas surrounding Philadelphia, Pennsylvania; Wilmington, Delaware; Austin, Texas; Dallas, Texas; Richmond, Virginia; Northern and Southern California; Southern and Central New Jersey; and Northern Virginia.

As more fully described in Note 3, on January 5, 2006, the Company acquired Prentiss Properties Trust (Prentiss) pursuant to an Agreement and Plan of Merger (the Merger Agreement) that the Company entered into with Prentiss on October 3, 2005.

The Company owns its assets through Brandywine Operating Partnership, L.P. a Delaware limited partnership (the Operating Partnership). The Company is the sole general partner of the Operating Partnership and, as of September 30, 2006, owned a 95.4% interest in the Operating Partnership. The Company conducts its third-party real estate management services business primarily through four management companies (collectively, the Management Companies), Brandywine Realty Services Corporation (BRSCO), BTRS, Inc., Brandywine Properties I Limited, Inc. (BPI), and Brandywine Properties Management, L.P. (BPM). BRSCO, BTRS, Inc. and BPI are taxable REIT subsidiaries. The Operating Partnership owns a 95% interest in BRSCO and the remaining 5% interest is owned by a partnership comprised of a current executive and former executive of the Company, each of whom is a member of the Company s Board of Trustees. The Operating Partnership owns, directly and indirectly, 100% of each of BTRS, Inc., BPI and BPM.

As of September 30, 2006, the Management Companies were managing properties containing an aggregate of approximately 43.1 million net rentable square feet, of which approximately 30.0 million net rentable square feet related to Properties owned by the Company and approximately 13.1 million net rentable square feet related to properties owned by third parties and certain Real Estate Ventures.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared by the Company without audit except as to the balance sheet as of December 31, 2005, which has been derived from audited data, pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the included disclosures are adequate to make the information presented not misleading. In the opinion of management, all adjustments (consisting solely of normal recurring matters) for a fair statement of the financial

position of the Company as of September 30, 2006, the results of its operations for the three- and nine-month periods ended September 30, 2006 and 2005 and its cash flows for the nine-month periods ended September 30, 2006 and 2005 have been included. The results of operations for such interim periods are not necessarily indicative of the results for a full year. These consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and footnotes included in the Company s 2005 Annual Report on Form 10-K. Certain prior period amounts have been reclassified to conform to the current period presentation.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006

Principles of Consolidation

The accompanying consolidated financial statements include all accounts of the Company, and its majority-owned and/or controlled subsidiaries. The portion of these entities not owned by the Company is presented as minority interest as of and during the periods consolidated. All intercompany accounts and transactions have been eliminated in consolidation.

When the Company obtains an economic interest in an entity, the Company evaluates the entity to determine if the entity is deemed a variable interest entity (VIE), and if the Company is deemed to be the primary beneficiary, in accordance with FASB Interpretation No. 46R, Consolidation of Variable Interest Entities (FIN 46R). The Company consolidates (i) entities that are VIEs where the Company is deemed to be the primary beneficiary and (ii) entities that are non-VIEs which the Company controls. Entities that the Company accounts for under the equity method (i.e., at cost, increased or decreased by the Company s share of earnings or losses, less distributions) include (i) entities that are VIEs where the Company is not deemed to be the primary beneficiary and (ii) entities that are non-VIEs which the Company does not control, but over which the Company has the ability to exercise significant influence. The Company will reconsider its determination of whether an entity is a VIE and who the primary beneficiary is if certain events occur that are likely to cause a change in the original determinations.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Management makes significant estimates regarding revenue, impairment of long-lived assets, allowance for doubtful accounts and deferred costs.

Operating Properties

Operating properties are carried at historical cost less accumulated depreciation and impairment losses. The cost of operating properties reflects their purchase price or development cost. Costs incurred for the acquisition and renovation of an operating property are capitalized to the Company s investment in that property. Ordinary repairs and maintenance are expensed as incurred. Major replacements and betterments, which improve or extend the life of the asset, are capitalized and depreciated over their estimated useful lives. Fully-depreciated assets are removed from the accounts.

SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, required us to separately report as discontinued operations the historical operating results attributable to operating properties sold or held for sale and the applicable gain or loss on the disposition of the properties. The consolidated statements of operations for prior periods are also adjusted to conform to this classification. In all cases, gains and losses are recognized using the full accrual method of accounting. Gains relating to transactions which do not meet the requirements of the full accrual method of accounting are deferred and recognized when the full accrual method of accounting criteria are met.

Purchase Price Allocation

The Company allocates the purchase price of properties to net tangible and identified intangible assets acquired based on fair values. Above-market and below-market in-place lease values for acquired properties are recorded based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) the Company s estimate of the fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. Capitalized above-market lease values are amortized as a reduction of rental income over the remaining non-cancelable terms of the respective leases. Capitalized below-market lease values are amortized as an increase to rental income over the remaining non-cancelable terms of the respective leases, including any fixed-rate renewal periods.

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Other intangible assets also include amounts representing the value of tenant relationships and in-place leases based on the Company s evaluation of the specific characteristics of each tenant s lease and the Company s overall relationship with the respective tenant. The Company estimates the cost to execute leases with terms similar to the remaining lease terms of the in-place leases, including leasing commissions, legal and other related expenses. This intangible asset is amortized to expense over the remaining term of the respective leases. Company estimates of value are made using methods similar to those used by independent appraisers or by using independent appraisals. Factors considered by the Company in this analysis include an estimate of the carrying costs during the expected lease-up periods considering current market conditions and costs to execute similar leases. In estimating carrying costs, the Company includes real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, which primarily range from three to twelve months. The Company also considers information obtained about each property as a result of its pre-acquisition due diligence, marketing and leasing activities in estimating the fair value of the tangible and intangible assets acquired. The Company also uses the information obtained as a result of its pre-acquisition due diligence as part of its consideration of FIN 47, and when necessary, will record a conditional asset retirement obligation as part of its purchase price.

Characteristics considered by the Company in allocating value to its tenant relationships include the nature and extent of the Company s business relationship with the tenant, growth prospects for developing new business with the tenant, the tenant s credit quality and expectations of lease renewals, among other factors. The value of tenant relationship intangibles is amortized over the remaining initial lease term and expected renewals, but in no event longer than the remaining depreciable life of the building. The value of in-place leases is amortized over the remaining non-cancelable term of the respective leases and any fixed-rate renewal periods.

In the event that a tenant terminates its lease, the unamortized portion of each intangible, including market rate adjustments, in-place lease values and tenant relationship values, would be charged to expense.

Revenue Recognition and Accounts Receivable

Rental revenue is recognized on the straight-line basis from the later of the date of the commencement of the lease or the date of acquisition of the property subject to existing leases, which averages minimum rents over the terms of the leases. The cumulative difference between lease revenue recognized under this method and contractual lease payment terms is recorded as accrued rent receivable on the accompanying balance sheets. The straight-line rent adjustment increased revenue by approximately $7.5 million and $23.0 million for the three- and nine-month periods ended September 30, 2006 and approximately $4.3 million and $10.2 million for the three- and nine-month periods ended September 30, 2005. Tenant receivables and accrued rent receivables are carried net of the allowances for doubtful accounts of $8.8 million as of September 30, 2006 and $4.9 million as of December 31, 2005. The allowance is based on management s evaluation of the collectability of receivables, taking into account tenant specific considerations as well as the overall credit of the tenant portfolio. The leases also typically provide for tenant reimbursement of a portion of common area maintenance and other operating expenses. Other income is recorded when earned and is primarily comprised of termination fees received from tenants, bankruptcy settlement fees, third party leasing commissions, and third party management fees. Other income includes net termination fees of $4.7 million and $6.5 million for the three- and nine-month periods ended September 30, 2006, and $1.0 million and $5.9 million for the three- and nine-month periods ended September 30, 2005. Deferred rents represent rental revenue received from tenants prior to their due dates.

Stock-based Compensation Plans

The Company maintains shareholder-approved equity incentive plans. The Compensation Committee of the Company s Board of Trustees authorizes awards under these plans. In May 2005, the Company s shareholders approved an amendment to the Amended and Restated 1997 Long-Term Incentive Plan (the 1997 Plan) that increased the number of common shares that may be issued or subject to award under the 1997 Plan from 5,000,000 to 6,600,000. The May 2005 amendment provided that 500,000 of the shares under the 1997 Plan are available solely for awards under options and share appreciation rights that have an exercise or strike price not less than the market price of the common shares on the date of award, and the remaining 6,100,000 shares are available for any type of award under the 1997 Plan. Incentive stock options may not be granted at exercise prices less than fair value of the shares at the time of grant. All options awarded by the Company to date are non-qualified stock options that generally vested over two to five years. As of September 30, 2006, 2.6 million shares remained available for future award under the 1997 Plan. As part of the Company s January 2006 acquisition of Prentiss, the Company assumed Prentiss three share incentive plans. As of September 30, 2006, approximately 1,685,676 common shares remain available for issuance or subject to award under the assumed Prentiss share incentive plans; however, any such issuances or awards under the assumed Prentiss plan may be made only to those Company employees who had been employed by Prentiss immediately prior to the Company s acquisition of Prentiss or to those Company employees hired after the Prentiss acquisition.

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On January 1, 2002, the Company began to expense the fair value of stock-based compensation awards granted subsequent to January 1, 2002, over the applicable vesting period as a component of general and administrative expenses in the Company s consolidated statements of income. In the three- and nine-month periods ended September 30, 2006 the Company recognized $887,000 and $2,332,000 of stock-based compensation expense. In the three- and nine-month periods ended September 30, 2005 the Company recognized $684,000 and $2,072,000 of stock-based compensation expense.

For stock-based compensation awards granted prior to 2002, the Company accounted for stock options issued under the recognition and measurement provisions of APB No.25, *Accounting for Stock Issued to Employees and Related Interpretations*. Under this method, no stock-based compensation expense was recognized. Because stock options granted prior to 2002 vested over a three-year term, the resulting compensation cost based on the fair value of the awards on the date of grant, on a pro forma basis, would have been expensed in 2003, 2004, and 2005. Accordingly, had the Company applied the fair value recognition provisions of SFAS 123, the net income applicable to common shares would remain the same on a pro forma basis for the three- and nine-month periods ended September 30, 2006, and would have been reduced by $124,000 and $380,000 for the three- and nine-month periods ended September 30, 2005, with no change in basic or diluted net income per share.

Accounting for Derivative Instruments and Hedging Activities

The Company accounts for its derivative instruments and hedging activities under SFAS No. 133 (SFAS 133), *Accounting for Derivative Instruments and Hedging Activities*, and its corresponding amendments under SFAS No. 138, *Accounting for Certain Derivative Instruments and Hedging Activities An Amendment of SFAS 133*. SFAS 133 requires the Company to measure every derivative instrument (including certain derivative instruments embedded in other contracts) at fair value and record them in the balance sheet as either an asset or liability. For derivatives designated as fair value hedges, the changes in fair value of both the derivative instrument and the hedged item are recorded in earnings. For derivatives designated as cash flow hedges, the effective portions of changes in the fair value of the derivative are reported in other comprehensive income. Changes in fair value of derivative instruments and ineffective portions of hedges are recognized in earnings in the current period. For the three- and nine-month periods ended September 30, 2006 and 2005, the Company was not party to any derivative contract designated as a fair value hedge.

The Company actively manages its ratio of fixed-to-floating rate debt. To manage its fixed and floating rate debt in a cost-effective manner, the Company, from time to time, enters into interest rate swap agreements as cash flow hedges, under which it agrees to exchange various combinations of fixed and/or variable interest rates based on agreed upon notional amounts.

Income Taxes

The Company and its subsidiary REITs elect to be taxed as real estate investment trusts under Sections 856-860 of the Internal Revenue Code. In order to maintain its qualification as a REIT, the Company is required, among other things, to distribute at least 90% of its REIT taxable income to its shareholders and meet certain tests regarding the nature of its income and assets. As a REIT, the Company is not subject to federal income tax with respect to that portion of its income which meets certain criteria and is distributed annually to the shareholders. Accordingly, no provision for

federal income taxes is included in the accompanying consolidated financial statements. The Company plans to continue to operate so that it meets the requirements for taxation as a REIT. Many of these requirements, however, are highly technical and complex. If the Company were to fail to meet these requirements, the Company would be subject to federal income tax. The Company is subject to certain state and local taxes. Provision for such taxes has been included in general and administrative expenses in the Company s consolidated statements of operations.

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September 30, 2006

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 provides guidance for using fair value to measure assets and liabilities. This statement clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing the asset or liability. SFAS No. 157 establishes a fair value hierarchy, giving the highest priority to quoted prices in active markets and the lowest priority to unobservable data. SFAS No. 157 applies whenever other standards require assets or liabilities to be measured at fair value. This statement is effective in fiscal years beginning after November 15, 2007. We believe that the adoption of this standard on January 1, 2008 will not have a material effect on our consolidated financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 (SAB 108), which becomes effective beginning on January 1, 2007. SAB 108 provides guidance on the consideration of the effects of prior period misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 provides for the quantification of the impact of correcting all misstatements, including both the carryover and reversing effects of prior year misstatements, on the current year financial statements. If a misstatement is material to the current year financial statements, the prior year financial statements should also be corrected, even though such revision was, and continues to be, immaterial to the prior year financial statements. Correcting prior year financial statements for immaterial errors would not require previously filed reports to be amended. Such correction should be made in the current period filings. The Company is currently evaluating the impact of adopting SAB 108.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on description, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 becomes effective on January 1, 2007. The Company is currently evaluating the impact of adopting FIN 48 but does not expect it to have a material impact on the consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets, an Amendment of SFAS No. 140.* SFAS No. 156 requires separate recognition of a servicing asset and a servicing liability each time an entity undertakes an obligation to service a financial asset by entering into a service contract. This statement also requires that servicing assets and liabilities be initially recorded at fair value and subsequently adjusted to the fair value at the end of each reporting period. This statement is effective in fiscal years beginning after September 15, 2006. The Company does not expect the adoption of this standard on January 1, 2007 to have a material effect on the consolidated financial statements.

In February 2006, the FASB issued SFAS No.155, *Accounting for Certain Hybrid Financial Instruments An Amendment of FASB No. 133 and 140.* The purpose of SFAS No.155 is to simplify the accounting for certain hybrid financial instruments by permitting fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. SFAS No. 155 also eliminates the restriction on passive

derivative instruments that a qualifying special-purpose entity may hold. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year beginning after September 15, 2006. The Company does not expect the adoption of this standard on January 1, 2007 to have a material effect on the consolidated financial statements.

In October 2005, the FASB issued Staff Position No. 13-1 Accounting for Rental Costs Incurred during a Construction Period (FSP FAS 13-1). FSP FAS 13-1 addresses the accounting for rental costs associated with operating leases that are incurred during the construction period. FSP FAS 13-1 makes no distinction between the right to use a leased asset during the construction period and the right to use that asset after the construction period. Therefore, rental costs associated with ground or building operating leases that are incurred during a construction period shall be recognized as rental expense, allocated over the lease term in accordance with SFAS No. 13 and Technical Bulletin 85-3. The terms of FSP FAS 13-1 are not applicable to lessees that account for the sale or rental of real estate projects in accordance with SFAS No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects. FSP FAS 13-1 was effective for the first reporting period beginning after December 15, 2005. Retrospective application in accordance with SFAS 154 is permitted but not required. The adoption of FSP FAS 13-1 did not have a material effect on the consolidated financial statements of the Company.

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In September 2005, the Emerging Issues Task Force issued EITF 04-05, Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights (EITF 04-05). The scope of EITF 04-05 is limited to limited partnerships or similar entities that are not variable interest entities under FIN 46R. The Task Force reached a consensus that the general partners in a limited partnership (or similar entity) are presumed to control the entity regardless of the level of their ownership and, accordingly, may be required to consolidate the entity. This presumption may be overcome if the agreements provide the limited partners with either (a) the substantive ability to dissolve (liquidate) the limited partnership or otherwise remove the general partners without cause or (b) substantive participating rights. If it is deemed that the limited partners rights overcome the presumption of control by a general partner of the limited partnership, the general partner shall account for its investment in the limited partnership using the equity method of accounting. EITF 04-05 was effective immediately for all arrangements created or modified after September 29, 2005. For all other arrangements, application of EITF 04-05 is required effective for the first reporting period in fiscal years beginning after December 15, 2005 (i.e., effective January 1, 2006 for the Company) using either a cumulative-effect-type adjustment or using a retrospective application. The adoption of EITF 04-05 did not have an effect on the Company s consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections (SFAS 154). SFAS 154 replaces APB No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements and establishes retrospective application as the required method for reporting a change in accounting principle. SFAS 154 provides guidance for determining whether a retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company adopted SFAS 154 on January 1, 2006 and this adoption had no effect on the Company s financial position and results of operations.

In March 2005, the FASB issued FIN 47, *Accounting for Conditional Asset Retirement Obligations*, an interpretation of FASB Statement No. 143, *Asset Retirement Obligations*. FIN 47 provides clarification of the term conditional asset retirement obligation as used in SFAS 143, defined as a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the company. Under this standard, a company must record a liability for a conditional asset retirement obligation if the fair value of the obligation can be reasonably estimated. FIN 47 became effective in the Company s fiscal quarter ended December 31, 2005. The Company adopted FIN 47 as required effective December 31, 2005 and the initial application of FIN 47 did not have a material effect on the consolidated financial statements of the Company.

In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment (SFAS 123(R)). SFAS 123(R) is an amendment of SFAS 123 and requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. The cost is required to be measured based on the fair value of the equity or liability instruments issued. SFAS 123(R) also contains additional minimum disclosures requirements including, but not limited to, the valuation method and assumptions used, amounts of compensation capitalized and modifications made. The effective date of SFAS 123(R) was subsequently amended by the SEC to be as of the beginning of the first interim or annual reporting period of the first fiscal year that begins on or after December 15, 2005, and allows several different methods of transition. The Company adopted SFAS 123(R) using the prospective method on January 1,

2006. This adoption did not have a material effect on our consolidated financial statements.

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3. REAL ESTATE INVESTMENTS

As of September 30, 2006 and December 31, 2005, the carrying value of the Company s operating properties was as follows (amounts in thousands):

	September 30, 2006	**December 31, 2005**
Land	$764,916	$456,736
Building and improvements	3,733,658	1,951,252
Tenant improvements	373,404	152,073
	4,871,978	2,560,061
Less: accumulated depreciation	(499,141)	(390,333)
Operating real estate investments, net	$4,372,837	$2,169,728

Acquisitions and Dispositions

The Company s acquisitions are accounted for by the purchase method. The results of each acquired property are included in the Company s results of operations from their respective purchase dates.

2006

On January 5, 2006, the Company acquired Prentiss Properties Trust (Prentiss) pursuant to an Agreement and Plan of Merger (the Merger Agreement) that the Company entered into with Prentiss on October 3, 2005. In conjunction with the Company s acquisition of Prentiss, designees of The Prudential Insurance Company of America (Prudential) acquired certain of Prentiss properties that contain an aggregate of approximately 4.32 million net rentable square feet for a total consideration of approximately $747.7 million. Through its acquisition of Prentiss (and after giving effect to the Prudential acquisition of certain of Prentiss properties), the Company acquired a portfolio of 79 office properties (including 13 properties that are owned by consolidated joint ventures and 7 properties that are owned by an unconsolidated joint venture) that contain an aggregate of 14.0 million net rentable square feet. The results of the operations of Prentiss have been included in the Company s condensed consolidated financial statements since January 5, 2006.

Subsequent to its acquisition of Prentiss and the related sale of certain properties to Prudential, the Company sold eleven of the acquired properties that contain an aggregate of 2.3 million net rentable square feet and one parcel of land containing 10.9 acres.

The Company funded the approximately $1.05 billion cash portion of the merger consideration, related transaction costs and prepayments of approximately $543.3 million in Prentiss mortgage debt at the closing of the merger through (i) a $750 million unsecured term loan that matures on January 4, 2007; (ii) approximately $676.5 million of cash

from Prudential s acquisition of certain of the Prentiss properties; and (iii) approximately $195.0 million through borrowing under a revolving credit facility.

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The following table summarizes the fair value of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

	At January 5, 2006
Real estate investments	
Land - operating	$282,584
Building and improvements	1,942,728
Tenant improvements	120,610
Construction in progress and land inventory	57,329
Total real estate investments acquired	2,403,251
Rent receivables	6,031
Other assets acquired:	
Intangible assets:	
In-place leases	187,907
Relationship values	98,382
Above-market leases	26,352
Total intangible assets acquired	312,641
Investment in real estate ventures	66,921
Investment in marketable securities	193,089
Other assets	8,868
Total other assets	581,519
Total assets acquired	2,990,801
Liabilities assumed:	
Mortgage notes payable	532,607
Unsecured notes	264,726
Security deposits and deferred rent	6,475
Other liabilities:	
Below-market leases	78,911
Other liabilities	43,995
Total other liabilities assumed	122,906
Total liabilities assumed	926,714
Minority interest	104,658

Net assets acquired	$1,959,429

In the acquisition of Prentiss, each then outstanding Prentiss common share was converted into the right to receive 0.69 of a Brandywine common share and $21.50 in cash (the Per Share Merger Consideration) except that 497,884 Prentiss common shares held in the Prentiss Deferred Compensation Plan converted solely into 720,737 Brandywine common shares. In addition, each then outstanding unit (each, a Prentiss OP Unit) of limited partnership interest in the Prentiss operating partnership subsidiary was, at the option of the holder, converted into Prentiss Common Shares with the right to receive the Per Share Merger Consideration or 1.3799 Class A Units of the Operating Partnership (Brandywine Class A Units). Accordingly, based on 49,375,723 Prentiss common shares outstanding and 139,000 Prentiss OP Units electing to receive merger consideration at closing of the acquisition, the Company issued 34,541,946 Brandywine common shares and paid an aggregate of approximately $1.05 billion in cash to the accounts of the former Prentiss shareholders. Based on 1,572,612 Prentiss OP Units outstanding at closing of the acquisition that did not elect to receive merger consideration, the Operating Partnership issued 2,170,047 Brandywine Class A Units. In addition, options issued by Prentiss that were exercisable for an aggregate of 342,662 Prentiss common shares were converted into options exercisable for an aggregate of 496,037 Brandywine common shares at a weighted average exercise price of $22.00 per share. Through its acquisition of Prentiss the Company also assumed approximately $611.2 million in aggregate principal amount of Prentiss debt.

Each Brandywine Class A Unit that was issued in the merger is subject to redemption at the option of the holder. The Operating Partnership may, at its option, satisfy the redemption either for an amount, per unit, of cash equal to the then market price of one Brandywine common share (based on the prior ten-day trading average) or for one Brandywine common share.

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For purposes of computing the total purchase price reflected in the financial statements, the common shares, operating units, restricted shares and options that were issued in the Prentiss transaction were valued based on the average trading price per Brandywine common share of $29.54. The average trading price was based on the average of the high and low trading prices for each of the two trading days before, the day of and the two trading days after the merger was announced (i.e., September 29, September 30, October 3, October 4 and October 5).

The Company considered the provisions of FIN 47 for these acquisitions and, where necessary, recorded a conditional asset retirement obligation as part of the purchase price. The aggregate asset retirement recorded in connection with the Prentiss acquisition was approximately $2.7 million.

Pro forma information relating to the acquisition of Prentiss is presented below as if Prentiss was acquired and the related financing transactions occurred on January 1, 2005. These pro forma results are not necessarily indicative of the results which actually would have occurred if the acquisition had occurred on the first day of the periods presented, nor does the pro forma financial information purport to represent the results of operations for future periods (in thousands, except per share amounts):

	Nine-month periods ended September 30,	
	2006	**2005**
	(unaudited)	
Pro forma revenue	$516,976	$485,473
Pro forma loss from continuing operations	(20,876)	(13,160)
Pro forma loss allocated to common shares	(19,279)	(16,125)
Earnings per common share from continuing operations		
Basic as reported	$(0.30)	$0.45
Basic as pro forma	$(0.30)	$(0.21)
Diluted - as reported	$(0.30)	$0.45
Diluted - as pro forma	$(0.30)	$(0.21)
Earnings per common share		
Basic as reported	$(0.22)	$0.51
Basic as pro forma	$(0.21)	$(0.18)
Diluted - as reported	$(0.22)	$0.51

Diluted - as pro forma	$(0.21)	$(0.18)

In addition to the acquisition activity related to Prentiss, during the nine-month period ended September 30, 2006, the Company acquired four office properties containing 681,688 net rentable square feet and 76.6 acres of developable land for an aggregate purchase price of $180.6 million. In addition to sales of assets acquired in the Prentiss merger, the Company sold two office properties containing 216,554 net rentable square feet and two parcels of land containing 6.8 acres for an aggregate $43.5 million, realizing net gains totaling $6.0 million.

In addition to the acquisition activity related to Prentiss, during the three-month period ended September 30, 2006, the Company acquired two office properties containing 443,581 net rentable square feet for $133.2 million. In addition to sales of assets acquired in the Prentiss merger, the Company sold two office properties containing 216,554 net rentable square feet for $38.6 million, realizing net gains totaling $3.4 million.

2005

During the nine-month period ended September 30, 2005, the Company acquired one industrial property containing 385,884 net rentable square feet, two office properties containing 283,511 net rentable square feet and 36.4 acres of developable land for an aggregate purchase price of $94.5 million. The Company sold one industrial property containing 385,884 net rentable square feet and three parcels of land containing 18.0 acres for an aggregate $30.2 million, realizing net gains totaling $6.8 million.

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During the three-month period ended September 30, 2005, the Company acquired two office properties containing 283,511 net rentable square feet and 8.0 acres of developable land for an aggregate purchase price of $52.7 million. The Company sold one industrial property containing 385,884 net rentable square feet and three parcels of land containing 18.0 acres for an aggregate $30.2 million, realizing net gains totaling $6.8 million.

4. INVESTMENT IN UNCONSOLIDATED VENTURES

As of September 30, 2006, the Company had an aggregate investment of approximately $76.0 million in 11 unconsolidated Real Estate Ventures (net of returns of investment). The Company or Prentiss formed these ventures with unaffiliated third parties to develop office properties or to acquire land in anticipation of possible development of office properties. Nine of the Real Estate Ventures own 15 office buildings that contain an aggregate of approximately 2.7 million net rentable square feet, one Real Estate Venture developed a hotel property that contains 137 rooms and one Real Estate Venture is developing an office property located in Albemarle County, VA.

The Company also has investments in four real estate ventures that are variable interest entities under FIN No. 46R and of which the Company is the primary beneficiary.

The Company accounts for its non-consolidating interests in its Real Estate Ventures using the equity method. Non-consolidating ownership interests range from 6% to 50%, subject to specified priority allocations in certain of the Real Estate Ventures. The Company s investments, initially recorded at cost, are subsequently adjusted for the Company s share of the Real Estate Ventures income or loss and cash contributions and distributions.

The amounts reflected below (except for Company s share of equity and income) are based on the historical financial information of the individual Real Estate Ventures. One of the Real Estate Ventures, acquired in connection with the Prentiss acquisition, had a negative equity balance on a historical cost basis as a result of historical depreciation and distribution of excess financing proceeds. The Company reflected its acquisition of this Real Estate Venture interest at its relative fair value as of the date of the purchase of Prentiss. The difference between allocated cost and the underlying equity in the net assets of the investee is accounted for as if the entity were consolidated (i.e., allocated to the Company s relative share of assets and liabilities with an adjustment to recognize equity in earnings for the appropriate additional depreciation/amortization).

The following is a summary of the financial position of the Real Estate Ventures as of September 30, 2006 and December 31, 2005 (in thousands):

	September 30, 2006	**December 31, 2005**
Operating property, net of accumulated depreciation	$360,194	$286,601
Other assets	50,739	32,267
Liabilities	28,009	24,855
Debt	328,388	205,018

Equity	54,536	88,995
Company s investment in real estate ventures	76,032	13,331

In addition to its $76.0 million investment in the 11 unconsolidated Real Estate Ventures, the Company also has an investment of $2.3 million in Prentiss Properties Capital Trust I and Prentiss Properties Capital Trust II that is accounted for using the cost method of accounting. The investment, which is included in investment in unconsolidated ventures at September 30, 2006, was acquired by the Company as part of the Prentiss acquisition on January 5, 2006.

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The following is a summary of results of operations of the Real Estate Ventures for the three- and nine-month periods ended September 30, 2006 and 2005 (in thousands):

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2006	2005	2006	2005
Revenue	$19,189	$14,800	$57,623	$46,938
Operating expenses	7,696	7,123	22,433	24,573
Interest expense, net	5,282	3,238	15,356	8,844
Depreciation and amortization	4,826	2,255	14,998	6,697
Net income	1,385	2,184	4,836	6,824
Company s share of income (Company basis)	370	745	1,798	2,296

As of September 30, 2006, the Company had guaranteed repayment of approximately $0.6 million of loans for the Real Estate Ventures. The Company also provides customary environmental indemnities in connection with construction and permanent financing both for its own account and on behalf of the Real Estate Ventures.

5. INTANGIBLE ASSETS

As of September 30, 2006 and December 31, 2005, the Company s intangible assets were comprised of the following (in thousands):

	September 30, 2006		
	Total Cost	Accumulated Amortization	Deferred Costs, net
In-place lease value	$231,177	$ (48,032)	$183,145
Tenant relationship value	133,062	(16,518)	116,544
Above market leases acquired	38,177	(12,747)	25,430
Total	$402,416	$ (77,297)	$325,119

December 31, 2005

	Total Cost	Accumulated Amortization	Deferred Costs, net
In-place lease value	$47,965	$ (12,575)	$35,390
Tenant relationship value	37,845	(5,606)	32,239
Above market leases acquired	14,404	(3,936)	10,468
Total	$100,214	$ (22,117)	$78,097

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6. MORTGAGE NOTES PAYABLE

The following table sets forth information regarding the Company s mortgage indebtedness outstanding at September 30, 2006 and December 31, 2005 (in thousands):

Property / Location	September 30, 2006	December 31, 2005	Effective Interest Rate			Maturity Date
111 Arrandale Blvd	$	$ 1,043	8.65	%		Aug-06
429 Creamery Way		2,927	8.30	%		Sep-06
Interstate Center	608	766	6.19	%	(b)	Mar-07
440 & 442 Creamery Way	5,462	5,581	8.55	%		Jul-07
Norriton Office Center	5,127	5,191	8.50	%		Oct-07
481 John Young Way	2,311	2,360	8.40	%		Nov-07
400 Commerce Drive	11,849	11,989	7.12	%		Jun-08
Two Logan Square	71,636	72,468	5.78	%	(a)	Jul-09
The Bluffs	10,700		6.00	%	(a)	Jul-09
Pacific Ridge	14,500		6.00	%	(a)	Aug-09
Pacific View/Camino	26,000		6.00	%	(a)	Aug-09
Computer Associates Building	31,000		6.00	%	(a)	Aug-09
200 Commerce Drive	5,860	5,911	7.12	%	(a)	Jan-10
Presidents Plaza	30,900		6.00	%	(a)	May-10
1333 Broadway	24,521		5.18	%	(a)	May-10
The Ordway	46,309		7.95	%	(a)	Aug-10
World Savings Center	27,583		7.91	%	(a)	Nov-10
Plymouth Meeting Exec.	44,253	44,687	7.00	%	(a)	Dec-10
Four Tower Bridge	10,661	10,763	6.62	%		Feb-11
Arboretum I, II, III & V	22,917	23,238	7.59	%		Jul-11
Midlantic Drive/Lenox Drive/DCC I	62,930	63,803	8.05	%		Oct-11
Research Office Center	42,314		7.64	%	(a)	Oct-11
Concord Airport Plaza	38,601		7.20	%	(a)	Jan-12
Six Tower Bridge	14,830	15,083	7.79	%		Aug-12
Newtown Square/Berwyn Park/Libertyview	63,576	64,429	7.25	%		May-13
Coppell Associates	3,794		6.89	%		Dec-13
Southpoint III	5,031	5,431	7.75	%		Apr-14
Tysons Corner	100,000		4.84	%	(a)	Aug-15
Coppell Associates	16,600		5.75	%		Mar-16
Grande A	59,816	61,092	7.48	%		Jul-27
Grande A		11,456				Jul-27
Grande A		1,551				Jul-27
Grande B	77,925	79,036	7.48	%		Jul-27

Principal balance outstanding	877,614	488,805
Plus: unamortized fixed-rate debt premiums	15,321	5,972
Total mortgage indebtedness	$892,935	$494,777

(a) Loans were assumed upon acquisition of the related property. Interest rates presented above reflect the market rate at the time of acquisition.

(b) For loans that bear interest at a variable rate, the rates in effect at September 30, 2006 have been presented.

During the three-month periods ended September 30, 2006 and 2005, the Company s weighted-average interest rate on its mortgage notes payable was 6.16% and 7.21%, respectively.

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7. UNSECURED NOTES

The following table sets forth information regarding the Company s unsecured notes outstanding (in thousands):

Year of Maturity	September 30, 2006	December 31, 2005	Maturity	Stated Interest Rate	Effective Interest Rate
2008	113,000	113,000	Dec-08	4.34 %	4.34 % (a)
2009	300,000		Apr-09	Libor + 0.45 %	5.41 % (a)
2009	275,000	275,000	Nov-09	4.50 %	4.62 % (a)
2010	300,000	300,000	Dec-10	5.625 %	5.61 % (a)
2012	300,000		Apr-12	5.75 %	5.77 % (a)
2014	250,000	250,000	Nov-14	5.40 %	5.53 % (a)
2016	250,000		Apr-16	6.00 %	5.95 % (a)
2035	27,062		Mar-35	Libor + 1.25 %	6.57 %
2035	25,774		Apr-35	Libor + 1.25 %	6.57 %
2035	25,774		Jul-35	Libor + 1.25 %	6.57 %
Total face amount	$1,866,610	$938,000			
Less: unamortized discounts	(3,422)	(1,393)			
Total unsecured notes	$1,863,188	$936,607			

(a) Rates include the effect of amortization related to discounts and costs related to settlement of treasury lock agreements.

On March 28, 2006, the Operating Partnership consummated the public offering of (1) $300,000,000 aggregate principal amount of its unsecured floating rate notes due 2009 (the 2009 Notes), (2) $300,000,000 aggregate principal amount of its 5.75% notes due 2012 (the 2012 Notes) and (3) $250,000,000 aggregate principal amount of its 6.00% notes due 2016 (the 2016 Notes). The Company guaranteed the payment of principal and interest on the 2009 Notes, the 2012 Notes and the 2016 Notes.

The indenture relating to the $300 million 2009, $275 million 2009, $300 million 2010, $300 million 2012, $250 million 2014 and $250 million 2016 unsecured notes contains various financial restrictions and requirements, including (1) a leverage ratio not to exceed 60%, (2) a secured debt leverage ratio not to exceed 40%, (3) a debt service coverage ratio of greater than 1.5 to 1.0, and (4) an unencumbered asset value of not less than 150% of unsecured debt. In addition, the note purchase agreement relating to the 2008 unsecured notes contains covenants that are similar to the above covenants.

8. SECURED NOTE PAYABLE

As the result of a voluntary defeasance that was completed in the fourth quarter of 2005 by Prentiss, the Company has a secured note payable with a maturity date of February 2007. As of September 30, 2006, the outstanding balance on the secured note payable is $181.8 million. On October 7, 2005, Prentiss exercised the right to complete a voluntary defeasance of its $180.1 million PPREFI portfolio loan collateralized by certain properties acquired by the Company. Pursuant to the defeasance, Prentiss transferred the mortgage loan to an unrelated successor entity along with the proceeds necessary to acquire U.S. Treasury Securities sufficient to cover debt service including both interest and principal payments from the defeasance date through maturity of the loan. The U.S. Treasury Securities of approximately $182.3 million relating to this defeasance are included in investment in marketable securities on the balance sheet. The loan may be repaid at par beginning in November 2006. The Company intends to elect to prepay the loan at par when allowed to do so, at which point the Company expects to receive the proceeds of the sales of the securities in excess of the loan balance.

9. UNSECURED CREDIT FACILITY

The Company utilizes credit facility borrowings for general business purposes, including the acquisition, development and redevelopment of properties and the repayment of other debt. In December 2005, the Company replaced its then existing credit facility with a $600.0 million unsecured credit facility (the Credit Facility) that matures in December 2009, subject to a one-year extension option. Borrowings under the Credit Facility generally bear interest at LIBOR plus a spread over LIBOR ranging from 0.55% to 1.10% based on the Company s unsecured senior debt rating. The Company has the option to increase the Credit Facility to $800.0 million subject to the absence of any defaults and the Company s ability to acquire additional commitments from its existing lenders or new lenders. As of September 30, 2006, the Company had $250.0 million of borrowings and $23.4 million of letters of credit outstanding under the Credit Facility, leaving $326.6 million of unused availability. For the nine-month periods ended September 30, 2006 and 2005, the weighted-average interest rate on the Company s unsecured credit facilities, including the effect of interest rate hedges, was 5.80% during 2006 and 4.40% during 2005.

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The Credit Facility requires the maintenance of certain ratios related to minimum net worth, debt-to-total capitalization and fixed charge coverage and various non-financial covenants.

10. RISK MANAGEMENT AND USE OF FINANCIAL INSTRUMENTS

Risk Management

In the normal course of its on-going business operations, the Company encounters economic risk. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk on its interest-bearing liabilities. Credit risk is the risk of inability or unwillingness of tenants to make contractually required payments. Market risk is the risk of declines in the value of properties due to changes in rental rates, interest rates or other market factors affecting the valuation of properties held by the Company.

Use of Derivative Financial Instruments

The Company s use of derivative instruments is limited to the utilization of interest rate agreements or other instruments to manage interest rate risk exposures and not for speculative purposes. The principal objective of such arrangements is to minimize the risks and/or costs associated with the Company s operating and financial structure, as well as to hedge specific transactions. The counterparties to these arrangements are major financial institutions with which the Company and its affiliates may also have other financial relationships. The Company is potentially exposed to credit loss in the event of non-performance by these counterparties. However, because of the high credit ratings of the counterparties, the Company does not anticipate that any of the counterparties will fail to meet these obligations as they come due. The Company does not hedge credit or property value market risks.

The Company formally assesses, both at inception of the hedge and on an on-going basis, whether each derivative is highly-effective in offsetting changes in cash flows of the hedged item. If management determines that a derivative is not highly-effective as a hedge or if a derivative ceases to be a highly-effective hedge, the Company will discontinue hedge accounting prospectively.

Concentration of Credit Risk

Concentrations of credit risk arise when a number of tenants related to the Company s investments or rental operations are engaged in similar business activities, or are located in the same geographic region, or have similar economic features that would cause their inability to meet contractual obligations, including those to the Company, to be similarly affected. The Company regularly monitors its tenant base to assess potential concentrations of credit risk. Management believes the current credit risk portfolio is reasonably well diversified and does not contain any unusual concentration of credit risk. No tenant accounted for 5% or more of the Company s rents during the three- and nine-month periods ended September 30, 2006 or 2005.

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11. DISCONTINUED OPERATIONS

For the three- and nine-month periods ended September 30, 2006, income from discontinued operations relates to thirteen properties that the Company sold during 2006, including eleven properties that were acquired by the Company as part of its acquisition of Prentiss. The following table summarizes the revenue and expense information for properties classified as discontinued operations for the three- and nine-month periods ended September 30, 2006 (in thousands):

	Three-month period ended September 30, 2006	Nine-month period ended September 30, 2006
Revenue:		
Rents	$2,445	$13,660
Tenant reimbursements	288	2,226
Other		230
Total revenue	2,733	16,116
Expenses:		
Property operating expenses	913	5,048
Real estate taxes	353	2,152
Depreciation & amortization	319	3,545
Total operating expenses	1,585	10,745
Operating income	1,148	5,371
Interest income	2	14
Interest expense		(367)
Income from discontinued operations before gain on sale of interests in real estate and minority interest	1,150	5,018
Net gain on sale of interests in real estate	5,188	5,188
Minority interest - partners share of net gain on sale	(1,757)	(1,757)
Minority interest - partners share of consolidated real estate venture	(100)	(482)
Minority interest attributable to discontinued operations - LP units	(208)	(376)
Income from discontinued operations	$4,273	$7,591

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For the three- and nine-month periods ended September 30, 2005, income from discontinued operations relates to three properties that the Company sold during 2005 and 2006. The following table summarizes the revenue and expense information for the property classified as discontinued operations for the three- and nine-month periods ended September 30, 2005 (in thousands):

	Three-month period ended September 30, 2005	Nine-month period ended September 30, 2005
Revenue:		
Rents	$1,134	$3,231
Tenant reimbursements	115	269
Other	1	13
Total revenue	1,250	3,513
Expenses:		
Property operating expenses	486	1,151
Real estate taxes	122	443
Depreciation & amortization	348	978
Total operating expenses	956	2,572
Operating income	294	941
Interest income		
Interest expense		
Income from discontinued operations before gain on sale of interests in real estate and minority interest	294	941
Net gain on sale of interests in real estate	2,196	2,196
Minority interest attributable to discontinued operations - LP units	(84)	(108)
Income from discontinued operations	$2,406	$3,029

Discontinued operations have not been segregated in the consolidated statements of cash flows. Therefore, amounts for certain captions will not agree with respective data in the consolidated statements of operations.

12. MINORITY INTEREST IN OPERATING PARTNERSHIP AND JOINT VENTURES

The Company is the sole general partner of the Operating Partnership and, as of September 30, 2006, owned a 95.4% interest in the Operating Partnership. On September 18, 2006, the Operating Partnership declared a $0.44 per unit cash distribution to holders of Class A Units totaling $2.0 million. On August 15, 2006 the Company acquired, through the

Operating Partnership, two office properties in Northern Virginia. In connection with these acquisitions, the Operating Partnership issued 424,608 Class A Units valued at $32.546 per unit totaling $13.8 million.

As of September 30, 2006 the Company owned interests in four consolidated real estate ventures that own 15 office properties containing approximately 1.5 million net rentable square feet. Minority interest in joint ventures represents the portion of these consolidated real estate ventures not owned by the Company.

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13. BENEFICIARIES EQUITY

Earnings per Share (EPS)

The following table details the number of shares and net income used to calculate basic and diluted earnings per share (in thousands, except share and per share amounts; results may not add due to rounding):

	Three-month periods ended September 30,			
	2006		2005	
	Basic	Diluted	Basic	Diluted
Income (loss) from continuing operations	$(3,709)	$(3,709)	$13,388	$13,388
Income (loss) from discontinued operations	4,273	4,273	2,406	2,406
Income allocated to Preferred Shares	(1,998)	(1,998)	(1,998)	(1,998)
Net income available to common shareholders	$(1,434)	$(1,434)	$13,796	$13,796
Weighted-average shares outstanding	90,042,270	90,042,270	56,071,973	56,071,973
Options				300,040
Total weighted-average shares outstanding	90,042,270	90,042,270	56,071,973	56,372,013
Earnings per Common Share:				
Continuing operations	$(0.06)	$(0.06)	$0.20	$0.20
Discontinued operations	0.05	0.05	0.04	0.04
	$(0.02)	$(0.02)	$0.25	$0.24

	Nine-month periods ended September 30,			
	2006		2005	
	Basic	Diluted	Basic	Diluted
Income (loss) from continuing operations	$(21,225)	$(21,225)	$31,110	$31,110
Income (loss) from discontinued operations	7,591	7,591	3,029	3,029
Income allocated to Preferred Shares	(5,994)	(5,994)	(5,994)	(5,994)

Net income available to common shareholders	$(19,628)	$(19,628)	$28,145	$28,145
Weighted-average shares outstanding	89,963,541	89,963,541	55,734,114	55,734,114
Options				234,543
Total weighted-average shares outstanding	89,963,541	89,963,541	55,734,114	55,968,657
Earnings per Common Share:				
Continuing operations	$(0.30)	$(0.30)	$0.45	$0.45
Discontinued operations	0.08	0.08	0.05	0.05
	$(0.22)	$(0.22)	$0.50	$0.50

Securities (including Class A Units of the Operating Partnership) totaling 4,893,669 and 1,945,267 as of September 30, 2006 and 2005, respectively, were excluded from the earnings per share computations because their effect would have been antidilutive.

Common and Preferred Stock

On September 18, 2006, the Company declared a distribution of $0.44 per Common Share, totaling $39.8 million, which was paid on October 16, 2006 to shareholders of record as of October 5, 2006. On September 18, 2006, the Company declared distributions on its Series C Preferred Shares and Series D Preferred Shares to holders of record as of September 30, 2006. These shares are entitled to a preferential return of 7.50% and 7.375%, respectively. Distributions paid on October 16, 2006 to holders of Series C Preferred Shares and Series D Preferred Shares totaled $0.9 million and $1.1 million, respectively.

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Common Stock Repurchases

The Company repurchased 1,180,200 shares during the nine month period ending September 30, 2006 for an aggregate consideration of $34.5 million under its share repurchase program. As of September 30, 2006, the Company may purchase an additional 2,319,800 shares under the plan. Repurchases may be made from time to time in the open market or in privately negotiated transactions, subject to market conditions and compliance with legal requirements. The share repurchase program does not contain any time limitation and does not obligate the Company to repurchase any shares. The Company may discontinue the program at any time.

In September 2006, the Company obtained separate authorization to repurchase its common stock in connection with the October 2006 Debt Offering (see Note 18). Concurrently with the October 2006 Debt Offering, pursuant to such separate authorization, 1,829,000 shares were repurchased and retired at an average purchase price of $32.80 per share (approximately $60.0 million in aggregate value). Due to the fact that the Company completed the offering on October 3, 2006, no additional repurchases may be made pursuant to this authorization

Stock Based Compensation

Stock Options

At September 30, 2006, the Company had 1,368,878 options outstanding under its shareholder approved equity incentive plan. No options were unvested as of September 30, 2006 and therefore there is no remaining unrecognized compensation expense associated with these options. Option activity as of September 30, 2006 and changes during the nine months ended September 30, 2006 were as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in 000 s)
Outstanding at January 1, 2006	1,276,722	$26.82	2.15	1,888
Prentiss options converted to Company options as part of the Prentiss acquisition (see Note 3)	496,037	22.00	2.01	4,841
Exercised	(403,881)	20.25	0.55	3,860
Forfeited				
Outstanding at September 30, 2006	1,368,878			
Vested at September 30, 2006	1,368,878	$26.44	1.92	7,285

Exercisable at September 30, 2006	1,368,878	$26.44	1.92	7,285

There were no option awards granted to employees during the three-and nine-month periods ended September 30, 2006 and 2005.

The Company has the ability and intent to issue shares upon stock option exercises. Historically, the Company has issued new common shares to satisfy such exercises.

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Restricted Stock Awards

The Company s primary form of share-based compensation has been restricted shares issued under a shareholder approved equity incentive plan that authorizes various equity-based awards. As of September 30, 2006, 347,377 restricted shares were outstanding and vest over five years from the initial grant date. The remaining compensation expense to be recognized for the 347,377 restricted shares outstanding at September 30, 2006 was approximately $9.8 million. That expense is expected to be recognized over a weighted average remaining vesting period of 1.7 years. For the three-month and nine-month periods ended September 30, 2006, the Company recognized $744,000 and $2,189,000 of compensation expense related to outstanding restricted shares. The following table summarizes the Company s restricted share activity for the nine-months ended September 30, 2006:

	Shares	Weighted Average Grant Date Fair value
Non-vested at January 1, 2006	315,027	$25.71
Granted	239,469	30.42
Vested	(160,972)	26.28
Forfeited	(46,147)	29.21
Non-vested at September 30, 2006	347,377	$28.23

Outperformance Program

On August 28, 2006, the Compensation Committee of the Company s Board of Trustees adopted a long-term incentive compensation program (the outperformance program). The Company will make payments (in the form of common shares) to executive-participants under the outperformance program only if total shareholder return exceeds percentage hurdles established under the outperformance program. The dollar value of any payments will depend on the extent to which our performance exceeds the hurdles. The Company established the outperformance program under the 1997 Plan.

The Compensation Committee adopted the outperformance program following extensive analysis of long-term, performance-based, executive compensation programs. In its analysis, the Compensation Committee considered data and recommendations of an independent compensation consulting firm, alternative approaches to compensation both within and outside of the REIT industry and the Company s current short and long-term compensation arrangements. The Compensation Committee believes that the outperformance program will enhance the Company s compensation goals. These goals include: (1) attracting best-in-class talent, (2) retaining our key leaders, (3) providing incentives for

future performance and (4) aligning the long-term interests of the Company s executives with the interests of the Company s shareholders.

If the total shareholder return (share price appreciation plus cash dividends) during a three-year measurement period exceeds either of two hurdles (with one hurdle keyed to the greater of a fixed percentage and an industry-based index, and the other hurdle keyed to a fixed percentage), then the Company will fund an incentive compensation pool in accordance with a formula and make pay-outs from the compensation pool in the form of vested and restricted common shares. The awards issued are accounted for in accordance with FASB No. 123R. The fair value of the awards on the date of grant, as adjusted for estimated forfeitures, was approximately $5.6 million and will be amortized into expense over the five-year period beginning on the date of grant using a graded vesting attribution model. The fair value of $5.6 million on the date of grant represents approximately 89.9% of the total that may be awarded; the remaining amount available will be valued when the awards are granted to individuals. For the three-month and nine-month periods ended September 30, 2006, the Company recognized $143,000 of compensation expenses related to the outperformance program.

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14. SEGMENT INFORMATION

The Company currently manages its portfolio within nine segments: (1) Pennsylvania West, (2) Pennsylvania North, (3) New Jersey, (4) Urban, (5) Richmond, Virginia, (6) California North, (7) California South, (8) Mid-Atlantic and (9) Southwest. The Pennsylvania West segment includes properties in Chester, Delaware and Montgomery counties in the Philadelphia suburbs of Pennsylvania. The Pennsylvania North segment includes properties north of Philadelphia in Berks, Bucks, Cumberland, Dauphin, Lehigh and Montgomery counties. The New Jersey segment includes properties in counties in the southern part of New Jersey including Burlington, Camden and Mercer counties and in Bucks County, Pennsylvania. The Urban segment includes properties in the City of Philadelphia, Pennsylvania and the state of Delaware. The Richmond, Virginia segment includes properties primarily in Albemarle, Chesterfield and Henrico counties, the City of Richmond and Durham, North Carolina. The California North segment includes properties in the City of Oakland and Concord. The California South segment includes properties in the City of Carlsbad and San Diego. The Mid-Atlantic segment includes properties in Northern Virginia and the City of Bethesda and Rockville, Maryland. The Southwest segment includes properties in Dallas and Travis counties of Texas. Corporate is responsible for cash and investment management, development of certain real estate properties during the construction period, and certain other general support functions.

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Segment information as of and for the three-month periods ended September 30, 2006 and 2005 is as follows (in thousands):

	Pennsylvania West	**Pennsylvania North**	**New Jersey**	**Urban**	**Richmond, Virginia**	**California North**	**California South**	**Mid-Atlantic**	**Southwest**	**Cor**
As of September 30, 2006:										
Real estate investments, at cost:										
Operating properties	$916,128	$536,002	$594,322	$413,727	$245,019	$393,639	$95,920	$1,191,798	$485,423	$
Construction-in-progress										30
Land held for development										11
As of December 31, 2005:										
Real estate investments, at cost:										
Operating properties	$867,089	$558,803	$562,832	$351,407	$219,930	$	$	$		