PROLOGIS
Form 10-Q
November 07, 2007

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2007

o **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 01-12846

PROLOGIS

(Exact name of registrant as specified in its charter)

Maryland	**74-2604728**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
4545 Airport Way, Denver, Colorado	**80239**
(Address or principal executive offices)	**(Zip Code)**

(303) 567-5000

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 for the past 90 days.

Yes þ No o

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 þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Yes o No þ

The number of shares outstanding of the Registrant s common shares as of November 1, 2007 was 257,528,190.

PROLOGIS
INDEX

	Page Number(s
PART I. Financial Information	3
Item 1. Financial Statements:	3
Consolidated Statements of Earnings and Comprehensive Income Three and Nine months ended September 30, 2007 and 2006	3
Consolidated Balance Sheets September 30, 2007 and December 31, 2006	5
Consolidated Statements of Cash Flows Nine months ended September 30, 2007 and 2006	6
Notes to Consolidated Financial Statements	7
Report of Independent Registered Public Accounting Firm	29
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	30
Item 3. Quantitative and Qualitative Disclosures About Market Risk	48
Item 4. Controls and Procedures	49
PART II. Other Information	49
Item 1. Legal Proceedings	49
Item 1A. Risk Factors	49
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	50
Item 3. Defaults Upon Senior Securities	50
Item 4. Submission of Matters to a Vote of Security Holders	50
Item 5. Other Information	50
Item 6. Exhibits	50

Computation of Ratio of Earnings to Fixed Charges
Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Share Dividends
KPMG LLP Awareness Letter
Certification of Chief Executive Officer
Certification of Chief Financial Officer
Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

PART 1.
Item 1. Financial Statements

PROLOGIS
CONSOLIDATED STATEMENTS OF
EARNINGS AND COMPREHENSIVE INCOME
(Unaudited)
(In thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Revenues:				
Rental income	$ 282,579	$ 232,495	$ 813,114	$ 673,040
CDFS disposition proceeds:				
Developed and repositioned properties	735,428	311,840	2,092,081	1,050,704
Acquired property portfolios	2,406,795		2,406,795	
Property management and other fees and incentives	27,095	20,421	72,679	79,318
Development management and other income	10,321	11,099	23,936	26,525
Total revenues	3,462,218	575,855	5,408,605	1,829,587
Expenses:				
Rental expenses	73,473	58,547	212,664	170,723
Cost of CDFS dispositions:				
Developed and repositioned properties	572,668	234,216	1,488,343	821,054
Acquired property portfolios	2,338,186		2,338,186	
General and administrative	52,326	37,787	152,971	113,085
Depreciation and amortization	72,497	69,634	225,206	207,876
Other expenses	3,550	2,977	21,484	8,924
Total expenses	3,112,700	403,161	4,438,854	1,321,662
Operating income	349,518	172,694	969,751	507,925
Other income (expense):				
Earnings from unconsolidated property funds	46,688	11,215	81,456	78,629
Earnings from CDFS joint ventures and other unconsolidated investees	4,679	9,590	6,996	47,011
Interest expense	(107,964)	(77,417)	(287,255)	(216,933)
Interest income on notes receivable	2,950	3,914	9,107	13,236
Interest and other income, net	8,663	5,313	23,415	10,596
Total other income (expense)	(44,984)	(47,385)	(166,281)	(67,461)
Earnings before minority interest	304,534	125,309	803,470	440,464
Minority interest	(1,855)	(565)	(2,751)	(2,541)

Earnings before certain net gains	302,679	124,744	800,719	437,923
Gains recognized on dispositions of certain non-CDFS business assets	21,289		145,374	13,709
Foreign currency exchange gains, net	991	9,202	10,145	16,449
Earnings before income taxes	324,959	133,946	956,238	468,081
Income taxes:				
Current income tax expense	14,204	34,824	58,949	75,913
Deferred income tax expense (benefit)	11,892	(22,362)	5,710	(16,780)
Total income taxes	26,096	12,462	64,659	59,133
Earnings from continuing operations	298,863	121,484	891,579	408,948

(Continued)

Table of Contents

PROLOGIS
CONSOLIDATED STATEMENTS OF
EARNINGS AND COMPREHENSIVE INCOME (CONTINUED)
(Unaudited)
(In thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Discontinued operations:				
Income attributable to disposed properties and assets held for sale	328	6,601	1,856	17,760
Gains recognized on dispositions:				
Non-CDFS business assets	6,607	29,386	38,732	80,037
CDFS business assets		15,188	22,537	30,178
Total discontinued operations	6,935	51,175	63,125	127,975
Net earnings	305,798	172,659	954,704	536,923
Less preferred share dividends	6,354	6,354	19,065	19,062
Net earnings attributable to common shares	299,444	166,305	935,639	517,861
Other comprehensive income items:				
Foreign currency translation gains	88,700	17,106	93,366	50,761
Unrealized losses on derivative contracts, net	(9,987)	(17,447)	(9,234)	(15,080)
Comprehensive income	$ 378,157	$ 165,964	$ 1,019,771	$ 553,542
Weighted average common shares outstanding Basic	257,435	245,460	256,270	244,918
Weighted average common shares outstanding Diluted	267,871	256,233	267,177	255,559
Net earnings per share attributable to common shares Basic:				
Continuing operations	$ 1.13	$ 0.47	$ 3.40	$ 1.59
Discontinued operations	0.03	0.21	0.25	0.52
Net earnings per share attributable to common shares Basic	$ 1.16	$ 0.68	$ 3.65	$ 2.11
Net earnings per share attributable to common shares Diluted:				
Continuing operations	$ 1.09	$ 0.45	$ 3.27	$ 1.54
Discontinued operations	0.03	0.20	0.24	0.50

Net earnings per share attributable to common shares Diluted	$	1.12	$	0.65	$	3.51	$	2.04
Distributions per common share	$	0.46	$	0.40	$	1.38	$	1.20

The accompanying notes are an integral part of these Consolidated Financial Statements.

4

Table of Contents

PROLOGIS
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	September 30, 2007 (Unaudited)	Decembe 31, 2006
ASSETS		
l estate	$ 15,502,984	$ 13,953,9
s accumulated depreciation	1,340,046	1,280,2
	14,162,938	12,673,7
estments in and advances to unconsolidated investees	2,209,254	1,299,6
sh and cash equivalents	550,272	475,7
counts and notes receivable	400,993	439,7
ner assets	1,309,096	957,2
continued operations assets held for sale	18,519	57,1
al assets	$ 18,651,072	$ 15,903,5
LIABILITIES AND SHAREHOLDERS EQUITY		
bilities:		
ot	$ 9,574,635	$ 8,386,8
counts payable and accrued expenses	790,791	518,6
ner liabilities	774,314	546,1
continued operations assets held for sale	385	1,0
al liabilities	11,140,125	9,452,6
nority interest	69,102	52,2
areholders equity:		
ies C Preferred Shares at stated liquidation preference of $50.00 per share; $0.01 par value; 2,000 shares ued and outstanding at September 30, 2007 and December 31, 2006	100,000	100,0
ies F Preferred Shares at stated liquidation preference of $25.00 per share; $0.01 par value; 5,000 shares ued and outstanding at September 30, 2007 and December 31, 2006	125,000	125,0
ies G Preferred Shares at stated liquidation preference of $25.00 per share; $0.01 par value; 5,000 shares ued and outstanding at September 30, 2007 and December 31, 2006	125,000	125,0
mmon Shares; $0.01 par value; 257,282 shares issued and outstanding at September 30, 2007 and 250,912 res issued and outstanding at December 31, 2006	2,573	2,5
ditional paid-in capital	6,386,977	6,000,1
cumulated other comprehensive income	301,054	216,9
ained earnings (distributions in excess of net earnings)	401,241	(170,9

al shareholders equity	7,441,845	6,398,5
al liabilities and shareholders equity	$ 18,651,072	$ 15,903,5

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

PROLOGIS
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Operating activities:		
Net earnings	$ 954,704	$ 536,923
Minority interest share in earnings	2,751	2,541
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Straight-lined rents	(34,042)	(25,683)
Cost of share-based compensation awards	18,782	16,430
Depreciation and amortization	227,446	217,024
Amortization of deferred loan costs and net premium on debt	1,014	(5,272)
Gains recognized on dispositions of non-CDFS business assets	(184,106)	(93,746)
Impairment charges	12,600	
Equity in earnings from unconsolidated investees	(88,452)	(125,640)
Distributions from and changes in operating receivables of unconsolidated investees	50,258	86,118
Unrealized foreign currency exchange losses (gains)	11,706	(9,141)
Deferred income tax expense (benefit)	5,710	(16,780)
Increase in accounts receivable and other assets	(122,978)	(235,438)
Increase in accounts payable and accrued expenses and other liabilities	199,665	219,288
Net cash provided by operating activities	1,055,058	566,624
Investing activities:		
Real estate investments	(3,662,646)	(2,649,918)
Purchase of Macquarie ProLogis Trust (MPR), net of cash acquired	(1,137,028)	
Purchase of ownership interests in property funds		(259,248)
Cash paid in the Parkridge acquisition, net of cash acquired	(707,374)	
Tenant improvements and lease commissions on previously leased space	(50,095)	(53,415)
Recurring capital expenditures	(28,482)	(21,752)
Proceeds from dispositions of real estate assets	3,087,967	1,603,551
Proceeds from repayment of notes receivable, net	42,008	70,531
Increase in restricted cash for potential investment		(42,174)
Investments in and advances to unconsolidated investees	(507,378)	(126,129)
Return of investment from unconsolidated investees	39,087	100,188
Net cash used in investing activities	(2,923,941)	(1,378,366)
Financing activities:		
Proceeds from sales and issuances of common shares under various common share plans	26,664	123,926
Distributions paid on common shares	(354,152)	(293,829)

Minority interest distributions	(7,065)	(10,219)
Dividends paid on preferred shares	(19,065)	(19,062)
Debt and equity issuance costs paid	(8,602)	(8,727)
Net proceeds from lines of credit	119,017	701,870
Proceeds from issuance of debt to finance MPR and Parkridge acquisitions	1,719,453	
Proceeds from issuance of convertible senior notes	1,228,125	
Proceeds from issuance of senior notes, secured and unsecured debt	6,459	1,101,236
Payments on senior notes, secured and unsecured debt and assessment bonds	(787,391)	(473,829)
Net cash provided by financing activities	1,923,443	1,121,366
Effect of exchange rate changes on cash	19,921	5,810
Net increase in cash and cash equivalents	74,481	315,434
Cash and cash equivalents, beginning of period	475,791	203,800
Cash and cash equivalents, end of period	$ 550,272	$ 519,234

See Note 13 for information on non-cash investing and financing activities and other information.

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. General:

Business. ProLogis, collectively with our consolidated subsidiaries (we , our , us , the Company or ProLogis), publicly held real estate investment trust (REIT) that owns, operates and develops (directly and through our unconsolidated investees) primarily industrial distribution properties in North America, Europe and Asia. Our business consists of three reportable business segments: (i) property operations; (ii) fund management; and (iii) CDFS business. Our property operations segment represents the direct long-term ownership of industrial distribution and retail properties. Our fund management segment represents the long-term investment management of property funds and the properties they own. Our CDFS business segment primarily encompasses our development or acquisition of real estate properties that are generally contributed to a property fund in which we have an ownership interest and act as manager, or sold to third parties. See Note 12 for further discussion of our business segments.

Basis of Presentation. The accompanying Consolidated Financial Statements, presented in the U.S. dollar, are prepared in accordance with U.S. generally accepted accounting principles (GAAP). GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the date of the financial statements and revenue and expenses during the reporting period. Our actual results could differ from those estimates and assumptions. All material intercompany transactions with consolidated entities have been eliminated.

The accompanying unaudited interim financial information has been prepared according to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted in accordance with such rules and regulations. Our management believes that the disclosures presented in these financial statements are adequate to make the information presented not misleading. In our opinion, all adjustments and eliminations, consisting only of normal recurring adjustments, necessary to present fairly our financial position as of September 30, 2007 and our results of operations for the three and nine months ended September 30, 2007 and 2006 and cash flows for the nine months ended September 30, 2007 and 2006 have been included. The results of operations for such interim periods are not necessarily indicative of the results for the full year. The accompanying unaudited interim financial information should be read in conjunction with our December 31, 2006 Consolidated Financial Statements, as filed with the SEC in our Annual Report on Form 10-K.

Certain amounts included in the accompanying Consolidated Financial Statements for 2006 have been reclassified to conform to the 2007 financial statement presentation.

Adoption of New Accounting Pronouncements. In July 2006, Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* (FIN 48) was issued. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes* . FIN 48 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. The new standard also provides guidance on various income tax accounting issues, including derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 were effective for our fiscal year beginning January 1, 2007 and were applied to all tax positions upon initial adoption. Only tax positions that meet the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48 was reported as an adjustment to the opening balance of retained earnings for the year of adoption. We adopted the provisions of FIN 48 and, as a result, we recognized a $9.3 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. See Note 5 for further information.

Recent Accounting Pronouncements. 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 accordance with GAAP and expands disclosures about fair value measurements. SFAS 157 applies to other

accounting pronouncements that require or permit fair value measurements but does not require any new fair value

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

measurements. SFAS 157 is effective for our fiscal year beginning January 1, 2008. We are currently assessing what impact, if any, the adoption of SFAS 157 will have on our financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an Amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The provisions of SFAS 159 are effective for our fiscal year beginning January 1, 2008. We are currently assessing the impact, if any, of the provisions of SFAS 159 on our financial position and results of operations.

Proposed Accounting Pronouncements. The FASB has issued proposed FASB Staff Position No. APB-14a, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (the proposed FSP) that would require, if ratified, separate accounting for the debt and equity components of convertible instruments. The proposed FSP would require that the value assigned to the debt component would be the estimated fair value of a similar bond without the conversion feature, which would result in the debt being recorded at a discount. The debt would subsequently be accreted to its par value over its expected life with a rate of interest being reflected in earnings that reflects the market rate at issuance. The proposed FSP, if ratified in the form expected, would be effective January 1, 2008 and would be applied retrospectively to both new and existing convertible instruments, including the convertible notes that we issued in March 2007, and would result in approximately $28.0 million to $33.0 million of additional interest expense per annum.

2. Mergers and Acquisitions:

In February 2007, we purchased the industrial business and made a 25% investment in the retail business of Parkridge Holdings Limited (Parkridge), a European developer. The total purchase price was $1.3 billion, which was financed with $741.2 million in cash, the issuance of 4.8 million common shares (valued for accounting purposes at $71.01 per share for a total of $339.5 million) and the assumption of $194.9 million in debt and other liabilities. The assumption of debt includes $113.0 million of loans made by us to certain affiliates of Parkridge in November 2006, which were included in Accounts and Notes Receivable in our Consolidated Balance Sheet at December 31, 2006. The cash portion of the acquisition was funded with borrowings under our global senior credit facility (Global Line) and a new senior unsecured facility (see Note 10 for more information on the credit facilities).

The acquisition included 6.3 million square feet of operating distribution properties, including developments under construction, and 1,139 acres of land, primarily in Central Europe and the United Kingdom. We allocated the purchase price based on estimated fair values and recorded approximately $739.3 million of real estate assets, $156.3 million of investments in CDFS joint ventures and other unconsolidated investees, $58.1 million of cash and other tangible assets and $321.9 million of goodwill and other intangible assets included in Other Assets in our Consolidated Balance Sheet. The allocation of the purchase price was based upon preliminary estimates and assumptions and, accordingly, these allocations are subject to revision when final information is available. Revisions to the fair value allocations, which may be significant, will be recorded as adjustments to the purchase price allocation in subsequent periods and should not have a significant impact on our overall financial position or results of operations. The Parkridge acquisition would not have had a material impact on our consolidated results of operations for the nine months ended September 30, 2007 and 2006, and as such, we have not presented any pro forma financial information.

We may be required to make additional payments to the selling shareholders over the next several years (primarily through the issuance of our common shares) of up to £52.3 million (the currency equivalent of $106.4 million at September 30, 2007) upon the successful completion of pending land entitlements or achievement of certain incremental development profit targets.

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

3. Unconsolidated Investees:

Summary of Investments

Our investments in and advances to unconsolidated investees, which are accounted for under the equity method, are summarized by type of investee as follows (in thousands):

	September 30, 2007	December 31, 2006
Property funds	$ 1,722,778	$ 981,840
CDFS joint ventures and other unconsolidated investees	486,476	317,857
Totals	$ 2,209,254	$ 1,299,697

Property Funds

We recognize earnings or losses from our investments in unconsolidated property funds consisting of our proportionate share of the net earnings or losses of the property funds, including interest income on advances made to these investees, if any. In addition, we earn fees for providing services to the property funds. The amounts we have recognized from our investments in property funds are summarized as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Earnings from unconsolidated property funds:				
North America	$ 5,163	$ 5,874	$ 16,804	$ 53,731
Europe	37,167	2,973	51,635	16,622
Asia	4,358	2,368	13,017	8,276
Total earnings from unconsolidated property funds	$ 46,688	$ 11,215	$ 81,456	$ 78,629
Property management and other fees and incentives:				
North America	$ 11,487	$ 9,545	$ 31,258	$ 46,554
Europe	10,139	9,128	31,031	26,076
Asia	5,469	1,748	10,390	6,688
Total property management and other fees and incentives	$ 27,095	$ 20,421	$ 72,679	$ 79,318

In our CDFS business segment, we develop real estate properties primarily with the intent to contribute to a property fund in which we have an ownership interest and act as manager, or to sell to third parties. Additionally, we acquire properties with the intent to rehabilitate and/or reposition the property in the CDFS business segment prior to contributing to a property fund. This includes us acquiring a portfolio of properties with the intent of contributing the portfolio to an existing or future property fund. See Note 12 for further discussion of our CDFS business segment.

Upon contribution of developed properties to a property fund, we realize a portion of the profits from our development activities while at the same time allowing us to maintain a long-term ownership interest in our developed properties. This business strategy also provides liquidity to fund our future development activities and enhances future fee income. The property funds generally own operating properties that we have contributed to them, although certain

of the property funds have also acquired properties from third parties. We generally receive ownership interests in the property funds as part of the proceeds generated by the contributions of properties to maintain our ownership interest. We recognize our proportionate share of the earnings or losses of each property fund, earn fees for acting as the manager, and may earn additional fees by providing other services including, but not limited to, acquisition, development, construction management, leasing and financing activities. We may also earn incentive performance returns based on the investors returns over a specified period.

Table of Contents

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Information about our investments in the property funds is as follows (dollars in thousands):

	Ownership Percentage		Investment in and Advances to	
Property Fund	**September 30, 2007**	**December 31, 2006**	**September 30, 2007**	**December 31, 2006**
ProLogis California	50.0%	50.0%	$ 111,123	$ 112,915
ProLogis North American Properties Fund I	41.3%	41.3%	28,006	30,902
ProLogis North American Properties Fund V (1)		11.3%		53,331
ProLogis North American Properties Fund VI	20.0%	20.0%	37,184	39,149
ProLogis North American Properties Fund VII	20.0%	20.0%	31,594	31,816
ProLogis North American Properties Fund VIII	20.0%	20.0%	15,231	15,397
ProLogis North American Properties Fund IX	20.0%	20.0%	14,075	14,076
ProLogis North American Properties Fund X	20.0%	20.0%	15,623	15,399
ProLogis North American Properties Fund XI	20.0%	20.0%	31,016	31,871
ProLogis North American Industrial Fund (2)	23.3%	20.0%	102,169	72,053
ProLogis North American Industrial Fund II (1)	36.9%		296,927	
ProLogis North American Industrial Fund III (3)	20.0%		134,490	
ProLogis Mexico Industrial Fund (4)	20.0%		34,603	
ProLogis European Properties (PEPR) (5)	24.9%	24.0%	520,817	430,761
ProLogis European Properties Fund II (PEPF II) (6)	24.4%		74,594	
ProLogis Japan Properties Fund I	20.0%	20.0%	84,102	87,705
ProLogis Japan Properties Fund II (7)	20.0%	20.0%	184,438	46,465
ProLogis Korea Fund (8)	20.0%		6,786	
Totals			$ 1,722,778	$ 981,840

(1) On July 11, 2007, we completed the previously announced acquisition of all of the units in Macquarie ProLogis Trust, an Australian listed property trust (MPR). At the time of

acquisition, MPR owned approximately 89% of ProLogis North American Properties Fund V and certain other assets. The total consideration was approximately $2.0 billion consisting of cash of $1.2 billion and assumed liabilities of $0.8 billion. The cash portion of the acquisition was financed primarily with borrowings under a credit agreement with an affiliate of Citigroup USA, Inc. (Citigroup), consisting of a $473.1 million term loan and a $646.2 million convertible loan. As a result of this transaction, on July 11, 2007, we owned 100% of, and began consolidating, ProLogis North American Properties Fund V.

On August 27, 2007, Citigroup converted $546.2 million

of the convertible loan into equity of a newly formed property fund, ProLogis North American Industrial Fund II, which owns all of the real estate assets and debt obligations that were acquired or issued in connection with the MPR acquisition. We made an equity contribution of $100.0 million into the fund, which was used to repay the remaining balance on the convertible loan. The conversion resulted in Citigroup owning 63.1% and us owning 36.9% of the equity of ProLogis North American Industrial Fund II. We account for our investment under the equity method of accounting. Upon conversion, in both the three and nine months ended September 30, 2007, we

recognized net gains of $68.6 million (including $16.6 million of previously deferred gains from the initial contribution of the assets to ProLogis North American Properties Fund V) that are reflected in CDFS Acquired Property Portfolios in our Consolidated Statements of Earnings and Comprehensive Income. In addition, during the second quarter of 2007, we entered into foreign currency forward contracts to manage the foreign currency fluctuations of the purchase price of MPR. We recognized mark to market gains of $9.3 million in earnings for the second quarter of 2007 and additional gains of $17.3 million in the third quarter of 2007 upon settlement of the contracts. These gains are reflected in Foreign

Currency Exchange Gains in our Consolidated Statements of Earnings and Comprehensive Income.

(2) In February 2006, we formed the ProLogis North American Industrial Fund. We refer to the combined entities in which we have ownership interests as one property fund named North American Industrial Fund. Our ownership percentage is based on our ownership interests in these different entities. We are committed to offer to contribute substantially all of the properties we develop and stabilize in Canada and the United States to the North American Industrial Fund, subject to the property meeting certain leasing and other criteria. The North American

Industrial Fund has equity commitments, which expire in February 2009, aggregating approximately $1.4 billion from third party investors, of which $783.8 million was unfunded at September 30, 2007. In connection with the acquisition of MPR, discussed above, we acquired an additional 3% ownership interest in the North American Industrial Fund. During the nine months ended September 30, 2007, we contributed 86 buildings (20 CDFS and 66 non-CDFS) for aggregate proceeds of $791.8 million to the North American Industrial Fund.

(3) In July 2007, we formed a new property fund, ProLogis North American Industrial Fund III, to acquire a portfolio of 122 industrial properties from

a third party.
The total
consideration
for the
acquisition was

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

approximately $1.8 billion, including transaction costs. Our investment was made in cash and represents a 20% ownership interest in this newly formed property fund. The remaining 80% of the property fund is owned by an affiliate of Lehman Brothers, Inc., who provided interim debt financing to the property fund.

(4) In the third quarter of 2007, we formed a new property fund with several institutional investors, ProLogis Mexico Industrial Fund, which will invest in industrial properties in Mexico. This property fund expects to have total capitalization of approximately $1.5 billion, including $625 million of equity. We are

committed to offer to contribute all of our stabilized development properties available in Mexico and, in certain circumstances properties we acquire, to ProLogis Mexico Industrial Fund. ProLogis Mexico Industrial Fund has an equity commitment of $500.0 million from the third party investors, which expires August 2010 and under which $423.2 million was unfunded at September 30, 2007. In September 2007, we contributed 32 properties (21 CDFS and 11 non-CDFS) for aggregate proceeds of $228.4 million. This includes nine stabilized properties that were part of a portfolio of properties we had previously acquired with the intent to contribute to a new property fund at, or slightly above, our cost. The proceeds and

costs related to these nine properties are reflected in CDFS Acquired Property Portfolios in our Consolidated Statements of Earnings and Comprehensive Income. The proceeds and costs for the remaining 12 CDFS properties are included in CDFS Developed and Repositioned Properties in our Consolidated Statements of Earnings and Comprehensive Income.

(5) In September 2006, ProLogis European Properties (PEPR) completed an initial public offering (IPO) on the Euronext Amsterdam stock exchange in which the selling unitholders offered 49.8 million ordinary units. In connection with the IPO, we entered into a property contribution agreement under which we were committed to

offer to contribute certain stabilized properties to PEPR having an aggregate contribution value of 200 million. During the nine months ended September 30, 2007, we fulfilled our commitment by contributing 16 properties to PEPR for aggregate proceeds of $287.6 million. In July 2007, PEPR sold a portfolio of 47 properties, which resulted in a net gain of $155.8 million to PEPR and $38.2 million to us as our proportionate share.

(6) In July 2007, we formed a new European property fund, ProLogis European Properties Fund II (PEPF II). This property fund has a total capacity of up to 7.5 billion ($10.6 billion as of September 30, 2007), including equity of 3.0 billion

($4.2 billion as of September 30, 2007). Our initial ownership interest in PEPF II is 24.4%, including a 16.9% direct interest in PEPF II, along with a 7.5% indirect interest through our 24.9% investment in PEPR, which owns approximately 30% of PEPF II. We are committed to offer to contribute substantially all of the properties we develop and stabilize in Europe and, in certain circumstances properties we acquire, to PEPF II, subject to the property meeting certain leasing and other criteria. PEPF II has equity commitments from PEPR and third party investors of 2.5 billion ($3.5 billion as of September 30, 2007), which expire in August 2010, and of which 2.3 billion ($3.2 billion as of September 30,

2007) was unfunded at September 30, 2007. In September 2007, we contributed 24 buildings for aggregate proceeds of $863.3 million. This includes six stabilized properties that were part of a portfolio of properties we acquired in February 2007 as part of the Parkridge transaction, as discussed in Note 2, with the intent to contribute to a new property fund at, or slightly above, our cost. The proceeds and costs related to these six properties are reflected in CDFS Acquired Property Portfolios in our Consolidated Statements of Earnings and Comprehensive Income. The proceeds and costs for the remaining 18 CDFS properties are included in CDFS Developed and Repositioned Properties in our Consolidated Statements of

Earnings and Comprehensive Income.

(7) We are committed to offer to contribute all of the properties that we develop and stabilize in Japan through August 2008 to ProLogis Japan Properties Fund II, subject to the property meeting certain leasing and other criteria. During the nine months ended September 30, 2007, we contributed five properties to this property fund for aggregate proceeds of $642.9 million. In addition, the property fund has acquired nine properties from third parties and its investors acquired a portfolio of 17 properties in September 2007 for an aggregate purchase price of $735 million, through a joint venture in which we own 20% and our current partner in Japan Properties Fund II owns the remaining 80%. ProLogis Japan

Properties Fund II has an equity commitment of $600.0 million from our fund partner, which expires in August 2008, and under which $28.2 million was unfunded at September 30, 2007.

(8) In July 2007, ProLogis Korea Fund completed the acquisition of its first industrial building. The property fund, which was formed earlier in the year, will have a total expected capitalization of $500 million, including $250 million of equity. We are committed to offer to contribute substantially all of the properties we develop and stabilize in South Korea and, in certain circumstances properties we acquire, to ProLogis Korea Fund. ProLogis Korea Fund has an equity commitment from our fund partner of $200 million,

which expires in June 2010, and under which $179.4 million was unfunded at September 30, 2007.

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Summarized financial information of the property funds (for the entire entity, not our proportionate share) and our investment in such funds is presented below (dollars in millions):

	2007			
	North America	**Europe**	**Asia**	**Total**
For the three months ended September 30, 2007:				
Revenues	$ 161.6	$ 120.8	$ 47.3	$ 329.7
Net earnings (1)	$ 9.1	$ 148.6	$ 17.1	$ 174.8
For the nine months ended September 30, 2007:				
Revenues	$ 441.1	$ 361.0	$ 120.5	$ 922.6
Net earnings (1)	$ 42.6	$ 202.5	$ 53.2	$ 298.3
As of September 30, 2007:				
Total assets	$8,947.9	$5,997.7	$3,690.5	$18,636.1
Amounts due to us	$ 29.7	$ 16.3	$ 109.9	$ 155.9
Third party debt (2)	$5,230.8	$3,186.1	$1,801.5	$10,218.4
Total liabilities	$5,515.1	$3,465.4	$2,045.2	$11,025.7
Minority interest	$ 17.3	$ 11.0	$	$ 28.3
Equity	$3,415.5	$2,521.3	$1,645.3	$ 7,582.1
Our weighted average ownership (3)	28.0%	24.8%	20.0%	25.4%
Our investment balance (4)	$ 852.1	$ 595.4	$ 275.3	$ 1,722.8
Deferred proceeds, net of amortization (5)	$ 209.0	$ 173.9	$ 127.5	$ 510.4

	2006			
	North America	**Europe**	**Asia**	**Total**
For the three months ended September 30, 2006:				
Revenues	$ 126.0	$ 107.6	$ 33.0	$ 266.6
Net earnings	$ 26.3	$ 11.3	$ 8.9	$ 46.5
For the nine months ended September 30, 2006:				
Revenues	$ 360.8	$ 304.9	$ 86.9	$ 752.6
Net earnings (6)	$ 247.9	$ 71.1	$ 33.7	$ 352.7
As of December 31, 2006:				
Total assets	$5,462.7	$4,856.0	$1,958.3	$12,277.0
Amounts due to us	$ 6.7	$ 14.0	$ 75.2	$ 95.9
Third party debt (2)	$3,113.8	$2,615.6	$ 904.2	$ 6,633.6
Total liabilities	$3,357.1	$2,968.0	$1,054.2	$ 7,379.3
Minority interest	$ 5.5	$ 6.6	$	$ 12.1
Equity	$2,100.1	$1,881.4	$ 904.1	$ 4,885.6
Our weighted average ownership (3)	23.1%	24.0%	20.0%	23.0%
Our investment balance (4)	$ 416.8	$ 430.8	$ 134.2	$ 981.8
Deferred proceeds, net of amortization (5)	$ 112.8	$ 123.7	$ 66.2	$ 302.7

(1) Included in net earnings for Europe is a net gain of $155.8 million from the disposition of 47 properties from PEPR.

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

(2) As of September 30, 2007, we had not guaranteed any of the third party debt of the property funds. As of December 31, 2006, we had guaranteed $15.0 million of the borrowings of ProLogis North American Properties Fund V, which were repaid in January 2007 with proceeds from the issuance of secured debt.

(3) Represents our weighted average ownership interest in all property funds based on each entity s contribution to total assets, before depreciation, net of other liabilities.

(4) The difference between our ownership interest of the property fund s equity and our

investment balance results principally from three types of transactions: (i) deferring a portion of the proceeds we receive from a contribution of one of our properties to a property fund as a result of our continuing ownership in the property (see below); (ii) recording additional costs associated with our investment in the property fund; and (iii) advances to the property funds.

(5) This amount is recorded as a reduction to our investment and represents the proceeds that were deferred when we contributed a property to a property fund due to our continuing ownership in the property.

(6) Included in net earnings for North America is $185.7 million representing the net gain

recognized by Funds II-IV upon termination in the first quarter of 2006 (see below).

On January 4, 2006, we purchased the 80% ownership interests in each of ProLogis North American Properties Funds II, III and IV (collectively Funds II-IV) from our fund partner. On March 1, 2006, we contributed substantially all of these assets and associated liabilities to the North American Industrial Fund, which was formed in February 2006 (see above). In connection with these transactions, we recognized the following amounts in the respective financial statement line items during the first quarter of 2006, after deferral of $17.9 million due to our then 20% ownership interest in the North American Industrial Fund (in thousands):

CDFS disposition proceeds developed and repositioned properties (1)	$12,492
Property management and other fees and incentives (2)	$21,958
Earnings from unconsolidated property funds (3)	$37,113

(1) Represents the recognition of proceeds that we had previously deferred as part of CDFS proceeds upon the initial contributions of the properties to Funds II-IV.

(2) Represents an incentive return we earned due to certain return levels achieved by our fund partner upon the termination of Funds II-IV.

(3) Represents our proportionate share of the gain on termination recognized by Funds II-IV.

CDFS joint ventures and other unconsolidated investees

At September 30, 2007, we had investments in entities that perform some of our CDFS business activities (the CDFS joint ventures) and investments in other unconsolidated investees. The CDFS joint ventures include entities that develop and own distribution properties and also include entities that develop land, multi-use, retail and residential

projects. The other unconsolidated investees primarily include entities that own a hotel property and office properties.

Table of Contents

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

The amounts we have recognized as our proportionate share of the earnings or losses from our investments in CDFS joints ventures and other unconsolidated investees are summarized as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
North America (1)	$ 949	$ 8,560	$ 5,016	$ 44,013
Europe	399	593	979	1,700
Asia	3,331	437	1,001	1,298
Total earnings from CDFS joint ventures and other unconsolidated investees	$ 4,679	$ 9,590	$ 6,996	$ 47,011

(1) During the three and nine months ended September 30, 2006, we recognized $8.0 million and $35.0 million, respectively, for our share of the earnings of a CDFS joint venture, LAAFB JV , that redeveloped and sold land parcels. This entity substantially completed its operations at the end of 2006.

Our investments in and advances to these entities are as follows (in thousands):

	September 30, 2007	December 31, 2006
CDFS joint ventures:		
North America	$ 58,063	$ 75,197
Europe (1)	165,624	8,499
Asia	158,151	119,614

Total CDFS joint ventures		381,838		203,310
Other unconsolidated investees		104,638		114,547
Total	$	486,476	$	317,857

(1) In February 2007, in connection with the Parkridge acquisition, we made a 25% investment in a mixed-use and retail development business of $146.9 million (see Note 2).

4. Long-Term Compensation:

We account for share based compensation in accordance with SFAS No. 123R, *Share Based Payment*, which we adopted January 1, 2006, utilizing the modified retrospective transition method. During the nine months ended September 30, 2007 and 2006, we recognized $18.8 million and $16.4 million of share based compensation expense, respectively. This includes expense related to awards granted to our outside trustees and is net of $7.9 million and $5.3 million in 2007 and 2006, respectively, that was capitalized due to our development and leasing activities. The share based compensation expense recognized in 2007 also includes $4.2 million of expense related to accelerated vesting of share options and awards of employees who terminated employment with us in March 2007.

Our long-term incentive plans provide for grants of share options, stock appreciation rights, full value awards and cash incentive awards to employees and other persons, including outside trustees. As of September 30, 2007, we have the following awards outstanding:

Share Options

We have granted various share options to our employees and trustees, subject to certain conditions. Each share option is exercisable into one common share. The holders of share options granted before 2001 earn dividend equivalent units (DEUs) each year until the earlier of the date the underlying share option is exercised or the expiration date of the underlying share option. Share options granted to employees generally have graded vesting over a four-year period and have an exercise price equal to the market price on the date of grant. Share options granted to employees since September 2006 have an exercise price equal to the closing market price of our common shares on the date at grant. Prior to September 2006, the exercise price was based on the average of the high and low prices on the date of grant. Share options granted to our outside trustees generally vest immediately. Share options are valued at the grant date using a Black-Scholes pricing model and compensation expense is recognized over the vesting period.

Table of Contents

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Full Value Awards

Restricted Share Units

Restricted share units (RSUs), are granted at a rate of one common share per RSU to certain employees. The RSUs are valued based upon the market price of a common share on the grant date. We recognize the value of the RSUs granted as compensation expense over the applicable vesting period, which generally is four or five years. In addition, annually we issue fully vested deferred share units to our trustees, which are expensed at the time of grant.

Contingent Performance Shares and Performance Share Awards

Certain employees are granted contingent performance shares (CPSs) and performance share awards (PSAs). The CPSs are earned based on our ranking in a defined subset of companies in the National Association of Real Estate Investment Trust s (NAREIT s) published index. These CPSs generally vest over a three-year period and the recipient must continue to be employed by us until the end of the vesting period. The amount of CPSs to be issued will be based on our ranking at the end of the performance period, and may range from zero to twice the targeted award, which, at September 30, 2007, was a maximum of 555,000 shares. For purposes of calculating compensation expense, we consider the CPSs to have a market condition and therefore, we have estimated the grant date fair value of the CPSs using a pricing valuation model. We recognize the value of the CPSs granted as compensation expense, utilizing the grant date fair value and the target shares, over the vesting period.

There were grants of PSAs through December 31, 2005 based on individual and company performance criteria. If a PSA is earned based on the performance criteria, the recipient must continue to be employed by us until the end of the vesting period before any portion of the grant is vested, generally two years. The PSAs are valued based upon the market price of a common share on grant date. We recognize the value of the PSAs granted as compensation expense over the vesting period.

These full value awards carry no voting rights during the vesting period, but do earn DEUs that are vested according to the underlying award. We account for DEUs as dividends, which are charged to retained earnings and factored into the computation of the fair value of the underlying share award at grant date.

Summary of Activity

The activity for the nine months ended September 30, 2007, with respect to our share options, is as follows:

	Options Outstanding		
	Number of Options	Weighted Average Exercise Price	Options Exercisable
Balance at December 31, 2006	8,464,053	$ 32.50	
Granted	4,656	$ 64.82	
Exercised	(989,462)	$ 26.82	
Forfeited	(101,021)	$ 47.39	
Balance at September 30, 2007	7,378,226	$ 33.08	5,442,159

The activity for the nine months ended September 30, 2007, with respect to our full value awards, is as follows:

	Number of Shares	Weighted Average Original Value	Number of Shares Vested
Balance at December 31, 2006	2,264,876		

Granted	262,973		
Exercised	(386,873)		
Forfeited	(24,225)		
Balance at September 30, 2007	2,116,751	$ 46.67	487,195

Table of Contents

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

5. Income Taxes:

We and one of our consolidated subsidiaries have elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, (the Code), and are not generally required to pay federal income taxes if we make distributions in excess of taxable income and meet the REIT requirements of the Code. We have elected taxable REIT subsidiary (TRS) status for certain of our consolidated subsidiaries, which operate primarily in the CDFS business segment. This enables us to provide services and enter into certain other types of transactions that would otherwise be considered impermissible for REITs. We recognize current income tax expense for the federal and state income taxes incurred by our TRSs and we are taxed in certain states in which we operate. In addition, many of the foreign countries where we have operations do not recognize REITs or do not accord REIT status under their respective tax laws to our entities that operate in their jurisdiction. Accordingly, we recognize income taxes for these jurisdictions, as appropriate. We also include interest and penalties, if any, associated with our unrecognized tax benefit liabilities in current income tax expense. During the nine months ended September 30, 2007 and 2006, cash paid for income taxes was $22.6 million and $36.9 million, respectively.

Deferred income tax expense is a function of the period s temporary differences (items that are treated differently for tax purposes than for financial reporting purposes), the utilization of tax net operating losses generated in prior years that had been previously recognized as deferred income tax assets and deferred income tax liabilities related to indemnification agreements related to certain contributions to property funds.

For federal income tax purposes, certain acquisitions have been treated as tax-free transactions resulting in a carry-over basis for tax purposes. For financial reporting purposes and in accordance with purchase accounting, we record all of the acquired assets and liabilities at the estimated fair values at the date of acquisition. For our TRSs, we recognize the deferred income tax liabilities that represent the tax effect of the difference between the tax basis carried over and the fair value of the tangible assets at the date of acquisition. As taxable income is generated in these subsidiaries, we recognize a deferred income tax benefit in earnings as a result of the reversal of the deferred income tax liability previously recorded at the acquisition date and we record current income tax expense representing the entire current income tax liability. Any increases or decreases that result from a change in circumstances in the deferred income tax liability recorded in connection with these acquisitions will be reflected as an adjustment to goodwill. During the nine months ended September 30, 2007, we reduced deferred tax liabilities and goodwill by $16.3 million.

The statute of limitations for our tax returns is generally three years, with our major tax jurisdictions being the United States, Luxembourg and the United Kingdom. As such, our tax returns that remain subject to examination are primarily from 2003 and thereafter, except for Catellus Development Corporation (Catellus) that we acquired in 2005. Certain 1999 and later federal and state income tax returns of Catellus are still open for audit or are currently under audit by the Internal Revenue Service and various state taxing authorities. As these audits are completed, the outcome may impact the liability for unrecognized tax benefits, as discussed below.

As discussed in Note 1, we adopted the provisions of FIN 48 on January 1, 2007 and, as a result, we recognized a $9.3 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to our January 1, 2007 balance of retained earnings. The term unrecognized tax benefits in FIN 48 refers to the differences between a tax position taken or expected to be taken in a tax return and the benefit measured and recognized in the financial statements. The unrecognized tax benefit liability of $189.5 million and $163.4 million, which included accrued interest of approximately $65.6 million and $45.2 million, at September 30, 2007 and December 31, 2006, respectively, principally includes estimated federal and state income tax liabilities associated with acquired companies. Any increases or decreases in the liabilities for unrecognized tax benefits associated with the potential income taxes related to an acquired company will be reflected as an adjustment to goodwill recorded as part of the transaction.

Indemnification Agreements

In connection with the formation of two of the property funds, ProLogis Mexico Industrial Fund and PEPF II, we entered into indemnification agreements, whereby we indemnify the funds for certain future capital gains tax liabilities that could be incurred by the funds associated with contributions of properties to the funds after a

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

specified date. Our contributions to the funds are structured as contributions of the shares of companies that own the real estate assets. Accordingly, the capital gains tax liabilities associated with the step up in the value, if any, of the underlying real estate assets is deferred and transferred to the funds at contribution. We have indemnified the funds to the extent that the funds: (i) incur capital gains tax as a result of a direct sale of the real estate asset, as opposed to a transaction in which the shares of the company owning the real estate asset are transferred or sold or (ii) are required to grant a discount to the buyer of shares under a share transfer transaction as a result of the funds transferring the embedded capital gain tax liability to the buyer of the shares in the transaction. The agreements limit the amount that is subject to our indemnification with respect to each property to 100% of the actual capital gains tax liabilities that are deferred and transferred by us to the funds at the time of the initial contribution. In addition, we have an indemnification to PEPR related to the properties that were contributed to PEPR since its IPO. In connection with our acquisition of MPR, we are no longer obligated under an indemnification we previously provided to ProLogis North American Properties Fund V and, accordingly, we recognized a deferred tax benefit of $6.3 million during the third quarter of 2007 for the reversal of the obligation. Pursuant to the indemnification agreements, we have recognized a liability of $20.0 million and $5.9 million at September 30, 2007 and December 31, 2006, respectively.

6. Discontinued Operations:

Discontinued operations represent a component of an entity that has either been disposed of or is classified as held for sale if both the operations and cash flows of the component have been or will be eliminated from ongoing operations of the entity as a result of the disposal transaction and the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction. Properties disposed of to third parties are considered to be discontinued operations unless such properties were developed under a pre-sale agreement. The results of operations of the component of the property or a business are reported as discontinued operations for all periods presented. A property is classified as held for sale when certain criteria are met. At such time, the respective assets and liabilities are presented separately on our balance sheet and depreciation and amortization is no longer recognized. Assets held for sale are reported at the lower of their carrying amount or their estimated fair value less the costs to sell the assets.

The operations of the 71 properties disposed of to third parties during 2007, as well as land subject to a ground lease, and the aggregate net gains recognized upon their disposition are presented as discontinued operations in our Consolidated Statements of Earnings and Comprehensive Income for all periods presented (also see the table below). In addition, the operations of 89 properties disposed of to third parties during the year ended December 31, 2006 are presented as discontinued operations for the three and nine months ended September 30, 2006. At September 30, 2007 and December 31, 2006, we had one and eight properties, respectively, that were classified as held for sale and accordingly, the respective assets and liabilities are presented separately in our Consolidated Balance Sheets. The operations of the property held for sale at September 30, 2007 are included in discontinued operations for all periods presented in our Consolidated Statements of Earnings and Comprehensive Income. Interest expense, if any, included in discontinued operations represents interest directly attributable to these properties.

Income attributable to discontinued operations is summarized as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2007	**2006**	**2007**	**2006**
Rental income	$ 549	$ 11,412	$ 7,066	$ 50,316
Rental expenses	(213)	(2,724)	(2,970)	(22,534)
Depreciation and amortization	(8)	(2,087)	(2,240)	(9,148)
Interest expense				(874)
	$ 328	$ 6,601	$ 1,856	$ 17,760

Income attributable to disposed properties and assets held for sale

Table of Contents

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

The following information relates to properties disposed of to third parties, during the periods presented, and recorded as discontinued operations (in thousands, except number of properties):

	Three months ended September 30,		Nine months ended September 30,	
	2007	**2006**	**2007**	**2006**
Non-CDFS business assets:				
Number of properties	16	17	67	53
Net proceeds from dispositions	$33,679	$ 80,014	$199,879	$433,747
Net gains from dispositions	$ 6,607	$ 29,386	$ 38,732	$ 80,037
CDFS business assets:				
Number of properties		7	4	12
Net proceeds from dispositions	$	$117,161	$173,298	$222,612
Net gains from dispositions	$	$ 15,188	$ 22,537	$ 30,178

7. Distributions and Dividends:

Common Share Distributions

Cash distributions of $0.46 per common share for each of the first, second and third quarters of 2007 were paid on February 28, 2007, May 31, 2007 and August 31, 2007, respectively, to holders of common shares of record on February 14, 2007, May 16, 2007 and August 16, 2007, respectively. Quarterly common share distributions paid in 2007 are based on the annual distribution level for 2007 of $1.84 per common share (as compared to $1.60 per common share in 2006) set by our Board of Trustees (Board) in December 2006. The payment of common share distributions is subject to the discretion of the Board and is dependent upon our financial condition and operating results, and may be adjusted at the discretion of the Board during the year.

Preferred Share Dividends

The annual dividends on our cumulative redeemable preferred shares are $4.27 per share (Series C) and $1.6875 per share (Series F and Series G). For the first, second and third quarters of 2007, we paid quarterly dividends of $1.0675 per share (Series C) and $0.4219 per share (Series F and Series G). Such dividends are payable quarterly in arrears on the last day of March, June, September and December. Dividends on preferred shares are payable when, and if, they have been declared by the Board, out of funds legally available for the payment of dividends.

8. Earnings Per Common Share:

We determine basic earnings per share based on the weighted average number of common shares outstanding during the period. We determine diluted earnings per share based on the weighted average number of common shares outstanding combined with the incremental weighted average effect from all outstanding potentially dilutive instruments.

Table of Contents

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

The following table sets forth the computation of our basic and diluted earnings per share (in thousands, except per share amounts):

	Three months ended September 30,		Nine months ended September 30,	
	2007	**2006**	**2007**	**2006**
Net earnings attributable to common shares	$ 299,444	$ 166,305	$ 935,639	$ 517,861
Minority interest (1)	947	565	3,409	2,541
Adjusted net earnings attributable to common shares	$ 300,391	$ 166,870	$ 939,048	$ 520,402
Weighted average common shares outstanding Basic	257,435	245,460	256,270	244,918
Incremental weighted average effect of conversion of limited partnership units	5,011	5,142	5,086	5,218
Incremental weighted average effect of share options and awards (2)	5,425	5,631	5,821	5,423
Weighted average common shares outstanding Diluted	267,871	256,233	267,177	255,559
Net earnings per share attributable to common shares Basic	$ 1.16	$ 0.68	$ 3.65	$ 2.11
Net earnings per share attributable to common shares Diluted	$ 1.12	$ 0.65	$ 3.51	$ 2.04

(1) Includes only the minority interest related to the convertible limited partnership units.

(2) Total weighted average potentially dilutive share options and awards outstanding (in thousands) were

10,062 and 10,966 for the three months ended September 30, 2007 and 2006, respectively, and 10,393 and 10,987 for the nine months ended September 30, 2007 and 2006, respectively. Substantially all were dilutive for both periods.

9. Real Estate:

Real estate assets owned directly by us primarily consist of income producing properties, properties under development and land held for future development. Our real estate assets, presented at cost, include the following (in thousands):

	September 30, 2007	December 31, 2006
Distribution operating properties (1):		
Improved land	$ 2,190,354	$ 2,227,953
Buildings and improvements	8,579,926	8,195,296
Retail operating properties (2):		
Improved land	77,446	77,808
Buildings and improvements	249,774	227,380
Land subject to ground leases and other	466,800	472,412
Properties under development, including cost of land (3)	1,242,359	964,842
Land held for development (4)	2,241,569	1,397,081
Other investments (5)	454,756	391,227
Total real estate assets	15,502,984	13,953,999
Less accumulated depreciation	1,340,046	1,280,206
Net real estate assets	$ 14,162,938	$ 12,673,793

(1) At September 30, 2007 and December 31, 2006, we had 1,365 and 1,446 distribution properties consisting of

200.9 million square feet and 203.6 million square feet, respectively.

(2) At September 30, 2007 and December 31, 2006, we had 31 and 27 retail properties consisting of 1.2 million square feet and 1.1 million square feet, respectively.

Table of Contents

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

(3) Properties under development consisted of 136 properties aggregating 36.6 million square feet at September 30, 2007 and 114 properties aggregating 30.0 million square feet at December 31, 2006. Our total expected investment upon completion of the properties under development at September 30, 2007 was approximately $2.8 billion.

(4) Land held for development consisted of 9,242 acres and 6,204 acres at September 30, 2007 and December 31, 2006, respectively.

(5) Other investments include: (i) restricted funds that are held in escrow pending the completion of

tax-deferred exchange transactions involving operating properties; (ii) earnest money deposits associated with potential acquisitions; (iii) costs incurred during the pre-acquisition due diligence process; (iv) costs incurred during the pre-construction phase related to future development projects, including purchase options on land and certain infrastructure costs; and (v) costs related to our corporate office buildings.

We directly own real estate assets in North America (Canada, Mexico and the United States), Europe (Belgium, the Czech Republic, France, Germany, Hungary, Italy, the Netherlands, Poland, Romania, Slovakia, Spain, Sweden and the United Kingdom) and Asia (China, Japan, South Korea and Singapore).

During the nine months ended September 30, 2007, we acquired 33 distribution properties aggregating 5.1 million square feet with a combined purchase price of $253.9 million, excluding the properties acquired in the Parkridge acquisition discussed in Note 2 and the MPR acquisition discussed in Note 3. During the nine months ended September 30, 2006, we acquired 62 distribution properties aggregating 11.5 million square feet with a combined purchase price of $627.1 million.

During the nine months ended September 30, 2007 and 2006, we recognized gains of $145.4 million and $13.7 million, respectively, on the contribution of certain non-CDFS properties to the property funds (77 in 2007 and 12 in 2006), from our property operations segment. In addition, we recognized previously deferred proceeds related to properties sold to a third party by a property fund. Due to our continuing involvement through our ownership in the property funds, these dispositions are not included in discontinued operations and the gains recognized represent the portion attributable to the third party ownership in the property funds that acquired the properties.

Included in other expenses for the nine months ended September 30, 2007, is an impairment charge of $12.6 million related to certain properties held and used in our property operations segment.

For our direct-owned properties, the largest customer and the 25 largest customers accounted for 2.8% and 20.3%, respectively, of our annualized collected base rents at September 30, 2007.

10. Debt:

Our debt consisted of the following (dollars in thousands):

	September 30, 2007		December 31, 2006	
	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding
Global line	3.87%	$ 2,533,087	3.56%	$ 2,462,796
Senior notes and other unsecured debt	5.76%	4,490,765	5.51%	4,445,092
Secured debt	6.55%	1,287,518	6.66%	1,445,021
Convertible notes	2.25%	1,230,356		
Assessment bonds	3.72%	32,909	3.85%	33,977
Totals	4.91%	$ 9,574,635	5.13%	$ 8,386,886

Our Global Line commitment fluctuates in U.S. dollars based on the underlying currencies and was $3.6 billion at September 30, 2007. The funds may be drawn under the Global Line in U.S. dollar, euro, Japanese yen, British pound sterling, Chinese renminbi, South Korean won and Canadian dollar. The weighted average interest rate

20

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

represents the weighted average interest rates using local currency rates on borrowings outstanding at the end of the period. In addition, we also have other credit facilities with total commitments of $70.9 million at September 30, 2007.

In February 2007 in connection with the Parkridge acquisition, as discussed in Note 2, we entered into a new multi-currency senior credit facility. This facility fluctuates in U.S. dollars based on the underlying currencies and the funds may be drawn in U.S. dollar, euro, Japanese yen and British pound sterling. In September 2007, the outstanding balance was paid down with proceeds from the contribution of certain of the Parkridge properties to PEPF II. As of September 30, 2007, the outstanding balance was $358.8 million and is included in senior notes and other unsecured debt above. Borrowings under this facility bear interest at a variable rate based upon the London Interbank Offered Rate (LIBOR) plus a margin and the facility matures in October 2009. This debt can be repaid at our option prior to maturity. The facility provides us the ability to re-borrow, within a specified period of time, any amounts repaid on the facility. As of September 30, 2007, we had available capacity to borrow $276.4 million under this facility.

On March 26, 2007, in a private placement, we issued $1.25 billion aggregate principal amount of 2.25% convertible senior notes due 2037, including the exercise of an over-allotment option (Convertible Notes). The aggregate net proceeds from this offering, after underwriters discounts, were approximately $1.23 billion. We used the net proceeds of the offering to repay a portion of the outstanding balance under our Global Line and for general corporate purposes.

The Convertible Notes are senior unsecured obligations of ProLogis and are convertible, under certain circumstances, for cash, our common shares or a combination of cash and our common shares, at our option, at a conversion rate of 13.0576 shares per $1,000 of principal amount of the notes. The initial conversion price of $76.58 represents a premium of 20% over the March 20, 2007 closing price of $63.82 of our common shares. The notes are redeemable at our option beginning in 2012 for the principal amount plus accrued and unpaid interest and at any time prior to maturity to the extent necessary to preserve our status as a REIT. Holders of the notes have the right to require us to repurchase their notes every five years beginning in 2012 and at any time prior to their maturity upon certain limited circumstances.

We intend to settle the principal balance of the Convertible Notes in cash and, therefore, we have not included the effect of the conversion of these notes in our computation of diluted earnings per share. Based on the conversion rate, 16.3 million shares would be required to settle the principal amount in shares. Such potentially dilutive shares, and the corresponding adjustment to interest expense, are not included in our computation of diluted earnings per share. The amount in excess of the principal balance of the notes (the Conversion Spread) will be settled in cash or, at our option, ProLogis common shares. When the Conversion Spread becomes dilutive to our earnings per share, (i.e. when our share price exceeds $76.58) we will include the shares in our computation of diluted earnings per share. The conversion option associated with the notes, when analyzed as a free standing instrument, meets the criteria under the Emerging Issues Task Force No. 00-19 *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s own Common Stock* , and therefore, we have accounted for the debt as a single instrument and not bifurcated the derivative instrument. See Note 1 for information on a proposed accounting pronouncement that, if issued in its current form, would impact our accounting for the Convertible Notes.

11. Shareholders Equity:

During the nine months ended September 30, 2007, we sold and/or issued common shares under various common share plans, including share-based compensation plans, as follows (in thousands):

	Shares	Proceeds
1999 dividend reinvestment and share purchase plan	50	$ 3,095
Long-term incentive plans	1,339	$25,697
Employee share purchase plan	23	$ 1,138

Limited partnership units were redeemed for 128,000 common shares during the nine months ended September 30, 2007.

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

In February 2007, we issued 4.8 million common shares in connection with the Parkridge acquisition that is discussed in Note 2.

12. Business Segments:

We have three reportable business segments:

Property operations representing the direct long-term ownership of industrial distribution and retail properties. Each operating property is considered an individual operating segment having similar economic characteristics that are combined within the reportable segment based upon geographic location. Included in this segment are properties we developed and properties we acquired and rehabilitated or repositioned within the CDFS business segment with the intention of contributing the property to a property fund or selling to a third party. All of the costs of our property management function for both our direct-owned portfolio and the properties owned by the property funds and managed by us are reported in rental expenses in the property operations segment. Our operations in the property operations business segment are in North America (Canada, Mexico and the United States), Europe (the Czech Republic, France, Germany, Hungary, Italy, the Netherlands, Poland, Romania, Slovakia, Sweden and the United Kingdom) and Asia (China, Japan, South Korea, and Singapore).

Fund management representing the long-term investment management of property funds and the properties they own. We recognize our proportionate share of the earnings or losses from our investments in unconsolidated property funds operating in North America, Europe and Asia. Along with the income recognized under the equity method, we include fees and incentives earned for services performed on behalf of the property funds and interest earned on advances to the property funds, if any. We utilize our leasing and property management expertise to efficiently manage the properties and the funds, and we report the costs as part of rental expenses in the property operations segment. Each investment in a property fund is considered to be an individual operating segment having similar economic characteristics that are combined within the reportable segment based upon geographic location. Our operations in the fund management segment are in North America (Mexico and the United States), Europe (Belgium, the Czech Republic, France, Germany, Hungary, Italy, the Netherlands, Poland, Slovakia, Spain, Sweden, and the United Kingdom), and Asia (Korea and Japan).

CDFS business primarily encompasses our development of real estate properties that are subsequently contributed to a property fund in which we have an ownership interest and act as manager, or sold to third parties. Additionally, we acquire properties with the intent to rehabilitate and/or reposition the property in the CDFS business segment prior to contributing to a property fund. The proceeds and related costs of these dispositions are presented as Developed and Repositioned Properties in the Consolidated Statements of Earnings and Comprehensive Income. In addition, we occasionally acquire a portfolio of properties with the intent of contributing the portfolio to an existing or future property fund. The proceeds and related costs of these dispositions are presented as Acquired Property Portfolios in the Consolidated Statements of Earnings and Comprehensive Income. We engage in mixed-use development activities, including redevelopment of military bases and airports. We also have investments in several unconsolidated entities that perform development activities and we include our proportionate share of their earnings or losses in this segment. Additionally, we include fees earned for development activities performed on behalf of customers or third parties, interest income earned on notes receivable related to asset sales and gains on the disposition of land parcels, including land subject to ground leases. The separate activities in this segment are considered to be individual operating segments having similar economic characteristics that are combined within the reportable segment based upon geographic location. Our CDFS business segment operations are in North America (Canada, Mexico and the United States), Europe (Belgium, the Czech Republic, France, Germany, Hungary,

Italy, the Netherlands, Poland, Romania, Slovakia, Spain, Sweden and the United Kingdom) and Asia (China, Japan and South Korea).

The assets of the CDFS business segment generally include our properties under development, land held for development and investments in and advances to CDFS joint ventures. During the period between the completion

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

of development, rehabilitation or repositioning of a property and the date the property is contributed to a property fund or sold to a third party, the property and its associated rental income and rental expenses are included in the property operations segment because the primary activity associated with the property during that period is leasing. Upon contribution or sale, the resulting gain is included in the income of the CDFS business segment. The assets of the fund management segment include our investments in and advances to the unconsolidated property funds.

We present the operations and net gains associated with properties sold to third parties generally as discontinued operations. In addition, as of September 30, 2007, we had one property classified as assets held for sale, whose operations are included in discontinued operations. Accordingly, these amounts are excluded from the segment presentation. See Note 6.

Reconciliations are presented below for: (i) each reportable business segment s revenue from external customers to our total revenues; (ii) each reportable business segment s net operating income from external customers to our earnings before minority interest; and (iii) each reportable business segment s assets to our total assets. Our chief operating decision makers rely primarily on net operating income and similar measures to make decisions about allocating resources and assessing segment performance. The applicable components of our revenues, earnings before minority interest and total assets are allocated to each reportable business segment s revenues, net operating income and assets. Items that are not directly assignable to a segment, such as certain corporate income and expenses, are reflected as reconciling items. The following reconciliations are presented in thousands:

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2007	**2006**	**2007**	**2006**
Revenues:				
Property operations (1):				
North America	$ 229,453	$ 203,756	$ 659,066	$ 603,050
Europe	33,300	10,006	86,239	23,943
Asia	9,234	9,185	36,774	20,057
Total property operations segment	271,987	222,947	782,079	647,050
Fund management (2):				
North America	16,650	15,419	48,062	100,285
Europe	47,306	12,101	82,666	42,698
Asia	9,827	4,116	23,407	14,964
Total fund management segment	73,783	31,636	154,135	157,947
CDFS business (3):				
North America	2,311,787	40,534	2,752,240	337,725
Europe	844,567	6,863	1,125,590	444,887
Asia	2,917	289,141	656,114	351,281
Total CDFS business segment	3,159,271	336,538	4,533,944	1,133,893
Total segment revenues	3,505,041	591,121	5,470,158	1,938,890
Other North America	10,592	9,548	31,035	25,990
Reconciling item (4)	(53,415)	(24,814)	(92,588)	(135,293)
Total revenues	$ 3,462,218	$ 575,855	$ 5,408,605	$ 1,829,587
Net operating income:				
Property operations (5):				
North America	$ 169,955	$ 152,027	$ 471,663	$ 450,965
Europe	24,609	7,253	65,506	16,486
Asia	6,621	8,288	29,101	17,994
Total property operations segment	201,185	167,568	566,270	485,445
Fund management (2):				
North America	16,650	15,419	48,062	100,285
Europe	47,306	12,101	82,666	42,698
Asia	9,827	4,116	23,407	14,964
Total fund management segment	73,783	31,636	154,135	157,947

CDFS business (6):				
North America	96,593	21,187	234,635	119,339
Europe	145,084	5,867	223,854	102,375
Asia	3,304	72,405	240,386	82,545
Total CDFS business segment	244,981	99,459	698,875	304,259
Total segment net operating income	519,949	298,663	1,419,280	947,651
Other North America	7,921	6,380	21,580	16,872
Reconciling items:				
Earnings (losses) from other unconsolidated investees	902	(95)	4,971	3,583
General and administrative expenses	(52,326)	(37,787)	(152,971)	(113,085)
Depreciation and amortization expense	(72,497)	(69,634)	(225,206)	(207,876)
Other expenses	(114)	(114)	(344)	(344)
Interest expense	(107,964)	(77,417)	(287,255)	(216,933)
Interest and other income, net	8,663	5,313	23,415	10,596
Total reconciling items	(223,336)	(179,734)	(637,390)	(524,059)
Total earnings before minority interest	$ 304,534	$ 125,309	$ 803,470	$ 440,464

24

Table of Contents

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

	September 30, 2007	December 31, 2006
Assets:		
Property operations (7):		
North America	$ 7,631,892	$ 7,960,432
Europe	1,760,195	1,295,207
Asia	771,360	633,623
Total property operations segment	10,163,447	9,889,262
Fund management:		
North America	852,041	416,909
Europe	595,411	430,761
Asia	275,326	134,170
Total fund management segment	1,722,778	981,840
CDFS business:		
North America	1,572,915	1,312,883
Europe	2,422,396	1,456,064
Asia	946,131	802,464
Total CDFS business segment	4,941,442	3,571,411
Total segment assets	16,827,667	14,442,513
Other North America	486,598	488,987
Reconciling items:		
Investments in and advances to other unconsolidated investees	104,638	114,547
Cash and cash equivalents	550,272	475,791
Accounts receivable	98,908	129,880
Other assets	564,470	194,649
Discontinued operations assets held for sale	18,519	57,158
Total reconciling items	1,336,807	972,025
Total assets	$ 18,651,072	$ 15,903,525

(1) Includes rental income of our distribution and retail properties.

(2) Includes fund management fees and incentive revenue and our share of the earnings or losses recognized under the equity method from our investments in unconsolidated property funds along with interest earned on advances to the property funds, if any. See Note 3 to the Consolidated Financial Statements for further information.

(3) Includes proceeds from CDFS property dispositions, fees earned from customers and third parties for development activities, interest income on notes receivable related to asset dispositions and our share of the earnings or losses recognized under the equity method from our investments in CDFS joint ventures.

(4) Amount represents the earnings or losses recognized under the equity method from our investments in unconsolidated property funds and CDFS joint ventures and interest income on notes receivable related to asset dispositions. These items are not presented as a component of revenues in our Consolidated Statements of Earnings and Comprehensive Income.

(5) Includes rental income less rental expenses of our distribution and retail properties. Included in rental expenses are the costs of managing the properties owned by the property funds.

(6) Includes net gains on CDFS property dispositions, fees earned from customers and third parties for development

activities, interest income on notes receivable related to asset dispositions and our share of earnings or losses recognized under the equity method from our investments in CDFS joint ventures, offset partially by land holding costs and the write-off of previously capitalized pursuit costs associated with potential CDFS business assets when it becomes likely the assets will not be acquired or developed.

Table of Contents

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

(7) Includes properties that were developed or acquired in the CDFS business segment and are pending contribution to a property fund or sale to a third party, as follows (in thousands):

	September 30, 2007		December 31, 2006	
	Number of Properties	Investment	Number of Properties	Investment
North America	85	$ 881,768	114	$ 1,190,706
Europe	98	1,696,426	69	1,273,314
Asia	47	750,476	22	596,981
Total	230	$ 3,328,670	205	$ 3,061,001

13. Supplemental Cash Flow Information:

Non-cash investing and financing activities for the nine months ended September 30, 2007 and 2006 are as follows:

We received $292.3 million and $163.3 million of ownership interests in unconsolidated property funds as a portion of our proceeds from the contribution of properties to these property funds during the nine months ended September 30, 2007 and 2006, respectively. In addition, in 2007 we recorded $51.6 million in potential liabilities for future obligations we may have associated with these transactions.

In connection with the acquisition of all of the units in MPR in July 2007 (see Note 3), we assumed $828.3 million of debt and reallocated our equity investment of $47.7 million to assets acquired.

As a result of the conversion by Citigroup of its convertible loan into equity of ProLogis North American Industrial Fund II in August 2007, we now own 36.9% of the equity of the property fund and account for our investment under the equity method of accounting. This resulted in the disposition of $2.0 billion of real estate assets and $1.9 billion of associated debt in exchange for an equity investment of $219.1 million and the recognition of a gain.

We capitalized portions of the total cost of our share-based compensation awards of $7.9 million and $5.3 million to the investment basis of our real estate and other assets during the nine months ended September 30, 2007, and 2006, respectively.

We assumed $23.5 million and $81.7 million of secured debt and other liabilities during the nine months ended September 30, 2007 and 2006, respectively, in connection with the acquisition of properties.

During the nine months ended September 30, 2007, we recorded $18.9 million of minority interest liabilities associated with investments made during this period in entities, which we consolidate and own less than 100%.

We settled $3.6 million and $6.5 million of minority interest liabilities with the conversion of limited partnership units into 128,000 common shares and 180,000 common shares during the nine months ended September 30, 2007 and 2006, respectively.

We recognized net gains in our Accumulated Other Comprehensive Income related to foreign currency translation and derivative activity of $126.0 million and $60.0 million during the nine months ended September 30, 2007 and 2006, respectively.

As partial consideration for properties we contributed in March 2006 to the North American Industrial Fund, we received ownership interests of $62.1 million, representing a 20% ownership interest, and the property fund assumed $677.2 million of secured debt and short-term borrowings. See Note 3 for further discussion of this transaction.

Table of Contents

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

In connection with the purchase in January 2006 of the 80% ownership interests from our fund partner in Funds II-IV, we assumed $418.0 million of secured debt. See Note 3 for further discussion of this transaction.

During June 2006, as partial consideration for the sale of a property, the third party buyer assumed an outstanding mortgage note for $42.9 million.

The amount of interest paid in cash, net of amounts capitalized, for the nine months ended September 30, 2007 and 2006 was $247.9 million and $196.3 million, respectively.

See also the discussion of the Parkridge acquisition in Note 2, the MPR transaction in Note 3 and the discussion of FIN 48 and other income tax matters in Note 5.

14. Derivative Financial Instruments:

We use derivative financial instruments to manage our risk associated with interest and foreign currency exchange rate fluctuations on existing or anticipated obligations and transactions. We do not use derivative financial instruments for trading purposes.

The following table summarizes the activity in our derivative instruments (in millions):

	For the nine months ended September 30,					
	2007			2006		
	Foreign Currency Put Options (1)	Foreign Currency Forwards (2)	Interest Rate Swaps (3)	Foreign Currency Put Options (1)	Foreign Currency Forwards (2)	Interest Rate Swaps (3)
Notional amounts at January 1	$ 54.7	$ 661.0	$	$	$	$
New contracts		2,637.1	959.2	169.3	239.3	350.0
Matured or expired contracts	(54.7)	(1,796.8)	(959.2)	(75.5)	(239.3)	
Notional amounts at September 30	$	$ 1,501.3	$	$ 93.8	$	$ 350.0

(1) The foreign currency put option contracts are paid in full at execution and are related to our operations in Europe and Japan. These contracts do not qualify for hedge accounting treatment and are marked-to-market through earnings

in Foreign Currency Exchange Gains, Net, at the end of each period. We recognized a net gain of $0.2 million and a net loss of $1.2 million in earnings for the nine months ended September 30, 2007 and 2006, respectively.

(2) The foreign currency forward contracts are designed to primarily manage the foreign currency fluctuations of certain intercompany loans. These contracts allow us to sell pounds sterling and euros at a fixed exchange rate to the U.S. dollar. We had an aggregate $1.5 billion notional amount of forward contracts related to intercompany loans at September 30, 2007. These contracts are not designated as hedges and are marked-to-market through earnings in Foreign Currency Exchange Gains,

Net. We recognized a net loss of $89.4 million and a net gain of $2.4 million in earnings for the nine months ended September 30, 2007 and 2006, respectively. These amounts are substantially offset by the remeasurement gains and losses recognized on the intercompany loans over the term of the loan, also recorded in Foreign Currency Exchange Gains, Net.

During the second quarter of 2007, we purchased several foreign currency forward contracts to manage the foreign currency fluctuations of the purchase price of MPR (see Note 3). These contracts allowed us to sell Australian dollars at a fixed exchange rate to the U.S. dollar. Derivative instruments used to manage the foreign currency fluctuations of an anticipated business combination do not qualify for

hedge accounting treatment and are marked-to-market through earnings in Foreign Currency Exchange Gains, Net. The contracts settled in July 2007 in connection with the completed acquisition and resulted in the recognition of a net gain of $26.6 million in earnings for the nine months ended September 30, 2007.

(3) During 2007, we entered into several interest rate swap contracts associated with three primary anticipated debt issuances:

Table of Contents

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

In February 2007, we entered into contracts with an aggregate notional amount of $500.0 million associated with a future debt issuance. All of these contracts were designated as cash flow hedges, qualified for hedge accounting treatment and allowed us to fix a portion of the interest rate associated with the anticipated issuance of senior notes. In March 2007, in connection with the issuance of the convertible notes (see Note 10), we unwound the contracts, recognized a decrease in value of $1.4 million associated with these contracts in other comprehensive income in shareholders equity and began amortizing as an increase to interest expense as interest payments are made on the senior notes.

In June 2007, we entered into a contract with a notional amount of $188.0 million, which represented our share of future debt issuances of a new property fund we formed in July 2007, the ProLogis North American Industrial Fund III (see Note 3). This contract qualifies for hedge accounting treatment by the fund and any future changes in value will be recognized in other comprehensive income within equity of the fund. We guarantee the property fund s performance on this contract.

In June 2007, we entered into contracts with an aggregate notional amount of $271.2 million associated with future debt issuances of a new property fund we formed in July 2007, the ProLogis North American Industrial Fund II (see Note 3). These contracts did not qualify for hedge accounting treatment by us and were marked-to-market resulting in additional interest expense of $0.8 million for the nine months ended September 30, 2007. These contracts were transferred to ProLogis North American Industrial Fund II following the establishment of the fund, at which time the contracts qualified for hedge accounting treatment by the fund and any future changes in value will be recognized in other comprehensive income within equity of the fund.

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Trustees and Shareholders
ProLogis:

We have reviewed the accompanying consolidated balance sheet of ProLogis and subsidiaries as of September 30, 2007, the related consolidated statements of earnings and comprehensive income for the three-month and nine-month periods ended September 30, 2007 and 2006, and the related consolidated statements of cash flows for the nine-month periods ended September 30, 2007 and 2006. These consolidated financial statements are the responsibility of ProLogis management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of ProLogis and subsidiaries as of December 31, 2006, and the related consolidated statements of earnings, shareholders equity and comprehensive income, and cash flows for the year then ended (not presented herein); and in our report dated February 27, 2007, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2006, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

KPMG LLP
Denver, Colorado
November 6, 2007

Table of Contents

ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our Consolidated Financial Statements and the related notes included in Item 1 of this report and our 2006 Annual Report on Form 10-K.

Certain statements contained in this discussion or elsewhere in this report may be deemed forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as expects , anticipates , intends , plans , believes , seeks , estimates , variations of such words and similar expressions are int identify such forward-looking statements, which generally are not historical in nature. All statements that address operating performance, events or developments that we expect or anticipate will occur in the future including statements relating to rent and occupancy growth, development activity and changes in sales or contribution volume of developed properties, general conditions in the geographic areas where we operate and the availability of capital in existing or new property funds are forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Although we believe the expectations reflected in any forward-looking statements are based on reasonable assumptions, we can give no assurance that our expectations will be attained and therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. Some of the factors that may affect outcomes and results include, but are not limited to: (i) national, international, regional and local economic climates; (ii) changes in financial markets, interest rates and foreign currency exchanges rates; (iii) increased or unanticipated competition for our properties; (iv) risks associated with acquisitions; (v) maintenance of real estate investment trust (REIT) status; (vi) availability of financing and capital; (vii) changes in demand for developed properties; and (viii) those additional factors discussed in Item 1A. Risk Factors of our 2006 Annual Report on Form 10-K. Unless the context otherwise requires, the terms we , us and our refer to ProLogis and our consolidated subsidiaries.

Management s Overview

We are a self-administered and self-managed REIT that operates a global network of real estate properties, primarily industrial distribution properties. The primary business drivers across the globe continue to be the need for greater distribution network efficiency and the growing focus on global trade. Our focus on our customers expanding needs has enabled us to become the world s largest owner, manager and developer of industrial distribution properties.

Our business is organized into three reportable business segments: (i) property operations; (ii) fund management; and (iii) CDFS business. Our property operations segment represents the direct long-term ownership of distribution and retail properties. Our fund management segment represents the long-term investment management of property funds and the properties they own. Our CDFS business segment primarily encompasses our development or acquisition of real estate properties that are rehabilitated and/or repositioned, and subsequently contributed to a property fund in which we have an ownership interest and act as manager, or sold to third parties.

We generate and seek to increase revenues, earnings, funds from operations (FFO), as defined below, and cash flows through our segments primarily as follows:

Property Operations Segment We earn rent from our customers under long-term operating leases, including reimbursements of certain operating costs, in the distribution and retail properties that we own directly in North America, Europe and Asia. We expect to grow our revenue through the selective acquisition of properties and increases in rental rates and, to a limited extent, increases in occupancy rates in our existing properties. Our strategy is to achieve the increases in rental rates and occupancy primarily through continued focus on our customers global needs for distribution space on the three continents in which we operate and use of the ProLogis Operating System®.

Fund Management Segment We recognize our proportionate share of the earnings or losses from our investments in unconsolidated property funds operating in North America, Europe and Asia. Along with the income recognized under the equity method, we include fees and incentives earned for services performed on behalf of the property funds and interest earned on advances to the property funds in this segment. We earn

fees for services provided to the property funds, such as property management, asset management, acquisition, financing, leasing and development fees. We may earn incentives based on the return provided to the fund partners. We expect growth in income recognized to come from newly created property funds, like those discussed below, and growth in existing property funds. The growth in the existing property funds is expected to come primarily from additional properties the funds will acquire, generally from us, and increased rental revenues in the property funds due, in part, to the leasing and property management efforts from our property operations segment.

CDFS Business Segment We recognize income primarily from the contributions of developed, rehabilitated and repositioned properties and acquired portfolios of properties to the property funds and from dispositions to third parties. In addition, we: (i) earn fees from our customers or other third parties for development activities that we perform on their behalf; (ii) recognize interest income on notes receivable related to asset dispositions; (iii) recognize net gains from the disposition of land parcels, including land subject to ground leases; and (iv) recognize our proportionate share of the earnings or losses generated by development joint ventures in which we have an investment. We expect growth in income in this segment to come primarily from the continued development of high-quality distribution and retail properties in our key markets in North America, Europe and Asia, resulting in the contribution to property funds or sale to third parties. In addition, we expect to increase our land and other mixed-use development activities for development management fees and sales to third parties.

Summary of the nine months ended September 30, 2007

The fundamentals of our business continued to be strong in 2007. We completed several significant property fund transactions during the third quarter of 2007, which are discussed in more detail below.

We increased our net operating income from our property operations segment to $566.3 million for the nine months ended September 30, 2007 from $485.4 million for the same period in 2006. The increase of 17% was primarily a result of us owning a larger operating portfolio during the first nine months of 2007 over the same period in 2006, as well as an increase in same store net operating income (as defined below) for these assets. Our direct-owned operating portfolio has increased due to acquisitions and development of 311 operating properties and decreased due to contributions and dispositions of 388 properties, resulting in a direct-owned operating portfolio of 1,396 properties at September 30, 2007. The timing of our contributions impacts the net operating income recognized in this segment.

Our net operating income from the fund management segment was $154.1 million for the nine months ended September 30, 2007, compared to $157.9 million for the same period in 2006. In the third quarter of 2007, we recognized $38.2 million that represented our proportionate share of the gain recognized by ProLogis European Properties (PEPR) upon the sale of certain properties. In the first quarter of 2006, we recognized $59.1 million of earnings and incentive returns associated with the termination of three of the unconsolidated property funds as further discussed below. Excluding these items, net operating income from this segment increased $17.1 million, or 17%, due primarily to an increase in the number of properties managed by us on behalf of the property funds.

We increased our total operating portfolio of distribution and retail properties owned or managed, including direct-owned properties, and properties owned by the property funds and CDFS joint ventures, to 444.2 million square feet at September 30, 2007 from 391.4 million square feet at December 31, 2006. This increase is primarily in the portfolio of properties owned by the property funds due to contributions by us and acquisitions from third parties. Our stabilized leased percentage (as defined below) was 95.5% at September 30, 2007, compared with 95.3% at December 31, 2006. Our same store net operating income increased by 5.7% and our same store average occupancy increased by 3.1% in the first nine months of 2007 over the same period in 2006. Same store rental rates increased 8.4% in the first nine months of 2007.

Net operating income of the CDFS business segment increased for the nine months ended September 30, 2007 to $698.9 million from $304.3 million for the same period in 2006. This increase of 130% was due primarily to increased levels of contributions brought about by increased development and fund management activity, as well as the acquisition of MPR and subsequent formation of a new fund that resulted in gains of $68.6 million and is further discussed below. During the nine months ended September 30, 2007, we started development on projects with a total expected cost

at completion of $2.0 billion and completed development projects with a total expected cost of $1.7 billion. We believe our strong development and leasing activity, along with the access to capital through the property funds, will continue to support our contribution activity to the property funds.

Key Transactions in 2007

In February 2007, we purchased the industrial business and made a 25% investment in the retail business of Parkridge, a European developer. The total purchase price was $1.3 billion and resulted in the addition of 6.3 million square feet of operating distribution properties and 1,139 acres of land for future development (see Note 2 to our Consolidated Financial Statements in Item 1).

In March 2007, we issued $1.25 billion of 2.25% convertible senior notes due 2037 (see Note 10 to our Consolidated Financial Statements in Item 1).

In the first nine months of 2007, we generated aggregate net proceeds of $5.3 billion and recognized aggregate gains of $879.0 million from contributions and dispositions of properties as follows:

Contributions of CDFS developed and repositioned properties and sales of land generated $2.1 billion of proceeds and $603.7 million of gains. This is subsequent to the deferral of $160.4 million of proceeds related to our ongoing ownership in the property funds that acquired the properties.

Contributions of acquired CDFS property portfolios generated $2.4 billion of proceeds and $68.6 million of gains. This is subsequent to the deferral of $53.7 million of proceeds related to our continuing ownership in the three new property funds that acquired these portfolios of properties. We acquired these portfolios of properties with the intent to contribute them to a new or existing property fund at, or slightly above, our cost.

Dispositions of 71 CDFS and non-CDFS properties and one parcel of land subject to a ground lease, to third parties, which are included in discontinued operations, generated net proceeds of $373.2 million and $61.3 million of gains.

The contribution of 66 non-CDFS properties to ProLogis North American Industrial Fund and 11 non-CDFS properties to ProLogis Mexico Industrial Fund, generated net proceeds of $391.7 million and gains of $145.4 million, subsequent to the deferral of $36.2 million of proceeds related to our ongoing ownership in the property funds that acquired the properties.

On July 11, 2007, we closed on the acquisition of all of the units in MPR, an Australian listed property trust that had an 88.7% ownership interest in ProLogis North American Properties Fund V. This transaction resulted in us owning 100% of the assets until August 27, 2007, when the lender converted certain of the bridge debt into equity of a new property fund, ProLogis North American Industrial Fund II, in which we have a 36.9% equity interest (see Note 3 to our Consolidated Financial Statements in Item 1 for additional information on these transactions).

During the nine months ended September 30, 2007, in addition to the Parkridge and MPR acquisitions, we acquired an aggregate 5.1 million square feet of operating properties with a total expected investment of $273.7 million. These properties were primarily acquired in our CDFS business segment for future contribution to a property fund.

In the third quarter of 2007, we formed two new property funds, ProLogis European Properties II (PEPF II) and ProLogis Mexico Industrial Fund, that will be the primary investment vehicles to acquire all of the properties we develop and stabilize in Europe and Mexico, respectively. We made our first contributions of properties to these property funds in September.

We announced the formation of ProLogis Korea Fund, which made its first acquisition of a property in South Korea in July 2007.

We formed a new property fund, Prologis North American Industrial Fund III, which completed the acquisition of $1.8 billion of distribution properties in North America from a third party.

Table of Contents

Results of Operations

Nine months ended September 30, 2007 and 2006

Information for the nine months ended September 30, regarding net earnings attributable to common shares was as follows:

		2007	2006
Net earnings attributable to common shares (in thousands)		$ 935,639	$ 517,861
Net earnings per share attributable to common shares	Basic	$ 3.65	$ 2.11
Net earnings per share attributable to common shares	Diluted	$ 3.51	$ 2.04

The increase in net earnings in 2007 over 2006 is primarily due to increased gains on contributions of CDFS and non-CDFS properties to property funds, improved property operating performance and increased gains on sales of land.

Portfolio Information

In the discussion that follows, we present the results of operations by reportable business segment. See Note 12 to our Consolidated Financial Statements in Item 1 for further description of our segments. Our total operating portfolio of properties includes distribution and retail properties owned by us and distribution properties owned by the property funds and CDFS joint ventures. Our operating portfolio also includes properties that were developed or acquired in our CDFS business segment and are pending contribution to a property fund or disposition to a third party. The operating portfolio does not include properties under development or any other properties owned by the CDFS joint ventures, other than distribution properties, and was as follows (square feet in thousands):

	September 30, 2007		December 31, 2006		September 30, 2006	
Reportable Business Segment	**Number of Properties**	**Square Feet**	**Number of Properties**	**Square Feet**	**Number of Properties**	**Square Feet**
Property operations (1)	1,396	202,159	1,473	204,674	1,477	203,264
Fund management	1,097	236,958	843	181,273	801	173,001
CDFS business (2)	33	5,070	32	5,474	29	4,760
Totals	2,526	444,187	2,348	391,421	2,307	381,025

(1) Our operating portfolio includes properties that were developed or acquired in our CDFS business segment and are pending contribution to a property fund or disposition to a third party as follows (square feet in thousands):

	Number of Properties	Square Feet
September 30, 2007	230	50,727
December 31, 2006	205	49,792
September 30, 2006	161	41,732

(2) Only includes distribution properties owned by the CDFS joint ventures. We include our wholly owned CDFS properties in the property operations segment (see above).

The stabilized operating properties owned by us, the property funds and CDFS joint ventures were 95.5% leased at September 30, 2007, 95.3% leased at December 31, 2006 and 95.2% leased at September 30, 2006. The stabilized properties are those properties where the capital improvements, repositioning efforts, new management and new marketing programs for acquisitions or the marketing programs in the case of newly developed properties, have been completed and in effect for a sufficient period of time to achieve stabilization. A property generally enters the stabilized pool at the earlier of 12 months from acquisition or completion or when it becomes substantially occupied, which we generally define as 93.0%.

Same Store Analysis

We evaluate the operating performance of the properties included in each of our three reportable business segments using a same store analysis because the population of properties in this analysis is consistent from

period to period, thereby eliminating the effects of changes in the composition of the portfolio on performance measures. We include properties owned directly and indirectly, by the property funds and by the CDFS joint ventures, in the same store analysis. Accordingly, we define the same store portfolio of operating properties for each period as those properties that have been in operation throughout the full period in both the current and prior year. When a property is disposed of to a third party, it is removed from the population for all periods presented. The same store portfolio aggregated 333.0 million square feet at September 30, 2007.

Same store results were as follows:

Net operating income generated by the same store portfolio (defined for the same store analysis as rental income, excluding termination and renegotiation fees, less rental expenses) increased 5.7% for the nine months ended September 30, 2007 over the same period in 2006, due to a 6.4% increase in rental income, partially offset by a 9.0% increase in rental expenses.

Average occupancy in the same store portfolio increased 3.1% for the nine months ended September 30, 2007 over the same period in 2006.

The same store portfolio s rental rates associated with leasing activity for space that has been previously leased by us increased by 8.4% for the nine months ended September 30, 2007. During the same period of 2006, same store rental rates increased 1.0%.

We believe the factors that impact net operating income, rental rates and average occupancy in the same store portfolio are the same as for the total portfolio. In order to derive an appropriate measure of period-to-period operating performance, the percentage change computation removes the effects of foreign currency exchange rate movements by computing each property s components in that property s functional currency.

Rental income computed under GAAP applicable to the properties included in the same store portfolio is adjusted to remove the net termination and renegotiation fees recognized in each period. Net termination and renegotiation fees and adjustments excluded from rental income for the same store portfolio (including properties directly owned and properties owned by the property funds and CDFS joint ventures) were $2.6 million and $3.2 million for the nine months ended September 30, 2007 and 2006, respectively. Net termination and renegotiation fees represent the gross fee negotiated to allow a customer to terminate or renegotiate their lease, offset by the write-off of the asset recognized due to the adjustment to straight-line rents over the lease term, if any. Removing the net termination fees from the same store calculation of rental income allows us to evaluate the growth or decline in each property s rental income without regard to items that are not indicative of the property s recurring operating performance.

In computing the percentage change in rental expenses, the rental expenses applicable to the properties in the same store portfolio include property management expenses for our direct-owned properties. These expenses are based on the property management fee that is provided for in the individual agreements under which our wholly owned management company provides property management services to each property (generally, the fee is based on a percentage of revenues). On consolidation, the management fee income earned by the management company and the management fee expense recognized by the properties are eliminated and the direct costs of providing property management services are recognized as part of our rental expenses reported under GAAP.

Operational Outlook

Changes in economic conditions will generally affect customer leasing decisions and absorption of new distribution properties. Since late 2004, we have experienced strong customer demand and continued strengthening in occupancies across our global markets. Growth in global trade continues to support our market fundamentals, which in turn, supports the consistent leasing activity in our global development pipeline. During the twelve-month period ending September 30, 2007, we executed 103.1 million square feet of leases, including 31.7 million square feet of initial leasing activity in new developments and repositioned acquisitions, bringing our stabilized portfolio to 95.5% leased at September 30, 2007. We consider our stabilized portfolio to be substantially occupied and, therefore, do not expect our overall leased percentage to increase much above the current level. Market rental rates are increasing in many of our markets and we have experienced positive rental rate growth, in the aggregate, for the past six quarters. As a result, we expect to continue to see increasing rents in most of our markets and absorption of

available space in our global development pipeline to continue to be strong for the remainder of 2007. An important fundamental to our long-term growth is repeat business with our global customers. Historically, approximately half of the space leased in our newly developed properties is with repeat customers (55.5% for 2007).

Property Operations Segment

The net operating income of the property operations segment consists of rental income and rental expenses from the distribution and retail operating properties that we own directly. The costs of our property management function for both our direct-owned portfolio and the properties owned by the property funds are all reported in rental expenses in the property operations segment. The rental income and expenses of operating properties that we developed or acquired in the CDFS business segment are included in the property operations segment during the interim period from the date of completion or acquisition through the date the properties are contributed or sold. See Note 12 to our Consolidated Financial Statements in Item 1 for a reconciliation of net operating income to earnings before minority interest. The net operating income from the property operations segment, excluding amounts presented as discontinued operations in our Consolidated Financial Statements, was as follows (in thousands).

	Nine months ended September 30,	
	2007	**2006**
Rental income	$ 782,079	$ 647,050
Rental expenses	215,809	161,605
Total net operating income property operations segment	$ 566,270	$ 485,445

The number and composition of operating properties that we own throughout the periods and the timing of contributions impact rental income and rental expenses for each period. As discussed earlier, on July 11, 2007, we completed the acquisition of MPR, which resulted in us consolidating the operating results until August 27, when the lender converted certain of the bridge debt into equity in ProLogis North American Industrial Fund II. At that time, we owned 36.9% of the equity of the property fund and began accounting for our investment under the equity method of accounting in our Fund Management Segment. This segment includes the rental income and expenses of those properties, during the time we owned them in our direct owned portfolio. When a property is contributed to a property fund, we begin reporting our share of the earnings of the property under the equity method in the fund management segment. However, the overhead costs incurred by us to provide the management services to the property fund continue to be reported as part of rental expenses. The increases in rental income and rental expenses, in 2007 over 2006, are due principally to the increase in properties owned during the period due to the MPR acquisition, the timing of contributions and increases in the net operating income of the same store properties we own directly. Under the terms of our lease agreements, some or all of our rental expenses are recovered from customers. These rental expense recoveries of $162.6 million and $130.3 million for the nine months ended September 30, 2007 and 2006, respectively, are included in rental income and offset some of the increases in rental expenses. The increase in the number of properties under management has also contributed to the increase in rental expenses.

Fund Management Segment

The net operating income of the fund management segment consists of: (i) earnings or losses recognized under the equity method from our investments in the property funds; (ii) fees and incentives earned for services performed on behalf of the property funds; and (iii) interest earned on advances to the property funds, if any. The net earnings or losses of the property funds include the following income and expense items of the property funds, in addition to rental income and rental expenses: (i) interest income and interest expense; (ii) depreciation and amortization expenses; (iii) general and administrative expenses; (iv) income tax expense; (v) foreign currency exchange gains and losses; and (vi) gains on dispositions of properties. The fluctuations in income we recognize in any given period are generally the result of: (i) variances in the income and expense items of the property funds; (ii) the size of the portfolio and occupancy levels in each period; (iii) changes in our ownership interest; and (iv) fluctuations in foreign currency exchange rates at which we translate our share of net earnings to U.S. dollars, if applicable. The costs of the property

management function performed by us for the properties owned by the property funds are reported in the property operations segment and the costs of the fund management function are included in our general and administrative expenses. See Notes 3 and 12 to our Consolidated Financial Statements in Item 1 for additional information on the property funds and for a reconciliation of net operating income to earnings before minority interest.

The net operating income from the fund management segment was as follows (in thousands):

	Nine months ended September 30,	
	2007	2006
North American property funds (1)	$ 48,062	$ 100,285
European property funds (2)	82,666	42,698
Asian property funds (3)	23,407	14,964
Total net operating income fund management segment	$ 154,135	$ 157,947

(1) Represents the income earned by us from our investments in property funds in North America. We had interests in 12 and 10 funds at September 30, 2007 and 2006, respectively. Our ownership interests ranged from 20.0% to 50.0% at September 30, 2007. These property funds on a combined basis owned 763 and 496 properties at September 30, 2007 and 2006, respectively.

Beginning in August of 2007, we own 36.9% of a property fund that owns 100% of the real estate assets previously owned by

ProLogis North American Properties Fund V. In addition, we formed two other property funds in North America that made their first property acquisitions in the third quarter.

In January 2006, we purchased the 80% ownership interests from our fund partner in Funds II-IV and subsequently contributed substantially all of the assets and associated liabilities to the North American Industrial Fund. In connection with this transaction, we earned an incentive return of $22.0 million and we recognized $37.1 million in income, representing our proportionate share of the net gain recognized by Funds II-IV upon termination.

(2) Represents the income earned by us from our investments in

two property funds in Europe, PEPR and PEPF II. PEPF II was formed and made its first acquisition from us in the third quarter of 2007. On a combined basis, these funds owned 273 and 275 properties at September 30, 2007 and 2006, respectively. Our ownership interest in PEPR was 24.9% at September 30, 2007. Our ownership interest in PEPF II was 24.4% due to our direct ownership interest of 16.9% and our indirect 7.5% interest through our ownership in PEPR, which owns a 30% interest in PEPF II. In July 2007, PEPR sold a portfolio of 47 properties that resulted in our recognition of a $38.2 million gain, which represents our proportionate share of the gain recognized by PEPR.

(3) Represents the income earned

by us from our 20% ownership interest in two property funds in Japan and one property fund in South Korea, which made its first acquisition of a property from a third party during the third quarter of 2007. These property funds on a combined basis owned 61 and 30 properties at September 30, 2007 and 2006, respectively, including a portfolio of 17 properties in Japan that were purchased from a third party during the third quarter of 2007.

See Note 3 to our Consolidated Financial Statements in Item 1 for more details of the transactions and new property funds discussed above.

CDFS Business Segment

Net operating income from the CDFS business segment consists of: (i) gains resulting from the contributions and dispositions of properties, generally developed by us or acquired with the intent to rehabilitate and/or reposition or to start a new property fund; (ii) gains from the dispositions of land parcels, including land subject to ground leases; (iii) fees earned for development services provided to customers and third parties; (iv) interest income earned on notes receivable related to property dispositions; (v) our proportionate share of the earnings or losses of CDFS joint ventures; and (vi) certain costs associated with the potential acquisition of CDFS business assets and land holding costs. See Note 12 to our Consolidated Financial Statements in Item 1 for a reconciliation of net operating income to earnings before minority interest.

Table of Contents

For the nine months ended September 30, 2007, our net operating income in this segment was $698.9 million as compared to $304.3 million for the same period in 2006, an increase of $394.6 million. In 2007 and 2006, 33.6% and 39.2% of the net operating income of this operating segment was generated in North America, 32.0% and 33.7% was generated in Europe and 34.4% and 27.1% was generated in Asia, respectively.

The CDFS business segment s net operating income includes the following components (in thousands):

	Nine months ended September 30,	
	2007	2006
CDFS transactions in continuing operations:		
Disposition proceeds, prior to deferral (1)	$ 4,694,898	$ 1,088,323
Proceeds deferred and not recognized (2)	(214,057)	(52,026)
Recognition of previously deferred amounts (2)	18,035	14,407
Cost of CDFS dispositions (1)	(3,826,529)	(821,054)
Net gains	672,347	229,650
Development management and other income	23,936	26,525
Interest income on notes receivable	9,107	13,236
Net earnings from CDFS joint ventures (3)	2,025	43,428
Other expenses and charges	(8,540)	(8,580)
Total net operating income CDFS business segment	$ 698,875	$ 304,259
CDFS transactions recognized as discontinued operations (4):		
Disposition proceeds	$ 173,298	$ 222,612
Cost of dispositions	(150,761)	(192,434)
Net CDFS gains in discontinued operations	$ 22,537	$ 30,178

(1) During the nine months ended September 30, 2007, we contributed 71 developed and repositioned properties to the property funds (32 in North America, 34 in Europe and five in Japan) and we contributed 168 properties that were acquired property

portfolios to the property funds (162 in North America and six in Europe). This compares with 2006 when we contributed 40 developed and repositioned buildings to the property funds (16 in North America, 19 in Europe and five in Japan). In addition, we recognized net gains of $80.5 million and $20.2 million from the disposition of land parcels during the nine months ended September 30, 2007 and 2006, respectively.

(2) When we contribute a property to an entity in which we have an ownership interest, we do not recognize a portion of the proceeds in our computation of the gain resulting from the contribution. The amount of the proceeds that we defer is based on our continuing ownership interest in the

contributed property that arises due to our ownership interest in the entity acquiring the property. We defer this portion of the proceeds by recognizing a reduction to our investment in the applicable unconsolidated investee. We adjust our proportionate share of the earnings or losses that we recognize under the equity method in later periods to reflect the entity s depreciation expense as if the depreciation expense was computed on our lower basis in the contributed property rather than on the entity s basis in the contributed property. If a loss results when a property is contributed, the entire loss is recognized when it is known.

When a property that we originally

contributed to an unconsolidated investee is disposed of to a third party, we recognize a gain during the period that the disposition occurs related to the proceeds we had previously deferred, in addition to our proportionate share of the gain or loss recognized by the entity. Further, during periods when our ownership interest in a property fund decreases, we recognize gains to the extent that proceeds were previously deferred to coincide with our new ownership interest in the property fund.

(3) Represents the net earnings or losses we recognized under the equity method from our investments in CDFS joint ventures. During the nine months ended September 30, 2006, we recognized

$35.0 million for our share of the earnings of a CDFS joint venture, LAAFB JV, that redeveloped and sold land parcels. This entity substantially completed its operations at the end of 2006.

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(4) Includes four CDFS properties aggregating 0.5 million square feet and one land parcel subject to a ground lease, and 12 CDFS business properties aggregating 1.7 million square feet, which were sold to third parties during the nine months ended September 30, 2007 and 2006, respectively, that met the criteria to be presented as discontinued operations.

See Note 3 to our Consolidated Finance Statements in Item 1 for more details of significant contribution activity to certain property funds.

The level and timing of income generated from the CDFS business segment is dependent on several factors, including but not limited to: (i) our ability to develop and timely lease properties; (ii) our ability to acquire properties that eventually can be contributed to property funds after rehabilitating or repositioning; (iii) our ability to identify and secure sites for redevelopment; (iv) our ability to generate a profit from these activities; and (v) our success in raising capital to be used by the property funds to acquire the properties we have to contribute. The margins earned in this segment may vary quarter to quarter depending on a number of factors, including the type of property contributed, the market in which the land parcel and property are located, and other market conditions. There can be no assurance we will be able to maintain or increase the current level of net operating income in this segment. Overall, we believe that the continued demand for state-of-the-art distribution properties has resulted in improved leasing activity in our global development pipeline, which helps support our CDFS business segment. We continue to monitor leasing activity and general economic conditions as it pertains to the CDFS business segment.

Other Components of Income

General and Administrative Expenses

General and administrative expenses were $153.0 million and $113.1 million for the nine months ended September 30, 2007 and 2006, respectively. The increases in general and administrative expenses are due primarily to our continued investment in the infrastructure necessary to support our business growth and continued expansion into international markets, the increase in our fund management business, our growing portfolio of properties through acquisitions and development and the growth in our CDFS business segment. This increase in infrastructure includes additional headcount and a higher level of performance based compensation. Strengthening foreign currencies account for a portion of the increase when our international operations are translated into US dollars at consolidation. Also in

2007, we recognized $8.0 million of employee departure costs, including $5.0 million related to the departure of our Chief Financial Officer in March 2007 and $3.0 million related to employees whose responsibilities became redundant after the acquisition of Parkridge.

Depreciation and Amortization

Depreciation and amortization expenses were $225.2 million and $207.9 million for the nine months ended September 30, 2007 and 2006, respectively. The increase in 2007 over 2006 is due to acquired real estate assets and intangible lease assets and, to a lesser extent, improvements made to the properties in our property operations segment.

Other Expenses

During the second quarter of 2007, we recognized an impairment charge of $12.6 million related to certain properties held and used in our property operations segment.

Table of Contents

Interest Expense

The following table presents the components of interest expense (in thousands):

	Nine months ended September 30,	
	2007	2006
Gross interest expense	$ 370,138	$ 291,826
Amortization of premium, net	(6,813)	(10,574)
Amortization of deferred loan costs	7,827	5,482
Interest expense before capitalization	371,152	286,734
Capitalization of interest	(83,897)	(69,801)
Net interest expense	$ 287,255	$ 216,933

The increase in interest expense for the nine months ended September 30, 2007, as compared with the same period in 2006, is due to increases in our borrowings, resulting from individual and portfolio acquisitions, including the MPR and Parkridge acquisitions, increased development activity and our increased investments in property funds and CDFS joint ventures, offset somewhat by a decrease in our weighted average interest rates and additional capitalized interest. The decrease in our weighted average interest rates is due primarily to our issuance of $1.25 billion of convertible senior notes in March 2007 with a coupon rate of 2.25%. The increase in capitalized interest for the nine months ended September 30, 2007, as compared with the same period in 2006, is due to the increase in our development activities.

Gains Recognized on Dispositions of Certain Non-CDFS Business Assets

During the nine months ended September 30, 2007 and 2006, we recognized gains of $145.4 million and $13.7 million on the disposition of 77 properties and 12 properties, respectively, from our property operations segment to certain of the unconsolidated property funds. Due to our continuing involvement through our ownership in the property funds, these dispositions are not included in discontinued operations and the gains recognized represent the portion attributable to the third party ownership in the property funds that acquired the properties.

Foreign Currency Exchange Gains, net

We and certain of our foreign consolidated subsidiaries have intercompany or third party debt that is not denominated in the entity s functional currency. When the debt is remeasured against the functional currency of the entity, a gain or loss can result. To mitigate our foreign currency exchange exposure, we borrow in the functional currency of the borrowing entity when appropriate. Certain of our intercompany debt is remeasured with the resulting adjustment recognized as a cumulative translation adjustment in accumulated other comprehensive income in shareholders equity. This treatment is applicable to intercompany debt that is deemed to be long-term in nature. If the intercompany debt is deemed short-term in nature, when the debt is remeasured, we recognize a gain or loss in earnings. Additionally, we utilize derivative financial instruments to manage certain foreign currency exchange risks, including put option contracts with notional amounts corresponding to a portion of our projected net operating income from our operations in Europe and Japan and forward contracts designed to manage foreign currency fluctuations of certain intercompany loans. See Note 14 to our Consolidated Financial Statements in Item 1 for more information on our derivative financial instruments.

During the nine months ended September 30, 2007 and 2006, we recognized net gains of $10.1 million and $16.4 million, respectively. During the second quarter of 2007, we purchased several foreign currency forward contracts to manage the foreign currency fluctuations of the purchase price of MPR, which was denominated in Australian dollars. As contracts used to manage the foreign currency fluctuations of an anticipated business combination do not qualify for hedge accounting treatment, these contracts were marked-to-market through earnings. During the nine months ended September 30, 2007, we recognized net gains of $26.6 million, from the remeasurement in the second quarter ($9.3 million gain) and the settlement in the third quarter ($17.3 million gain), in connection

with the completed acquisition, of these contracts. We recognized net losses of $16.5 million and net gains of $16.4 million on our third party and intercompany debt transactions during the nine months ended September 30, 2007 and 2006, respectively.

Table of Contents

Income Taxes

During the nine months ended September 30, 2007 and 2006, our current income tax expense was $58.9 million and $75.9 million, respectively. We recognize current income tax expense for the income taxes incurred by our taxable REIT subsidiaries and in certain foreign jurisdictions, primarily related to our CDFS business. We also include in current income tax expense the interest associated with our unrecognized tax benefit liabilities. Our current income tax expense fluctuates from period to period based primarily on the timing of our taxable CDFS income and changes in tax and interest rates.

During the nine months ended September 30, 2007, we recognized deferred tax expense of $5.7 million, compared with deferred tax benefits of $16.8 million in the same period of 2006. The deferred tax expense in 2007 relates primarily to tax indemnification agreements we entered into during the third quarter of 2007 in connection with the formation of PEPF II and the ProLogis Mexico Industrial Fund, net of the benefit recognized from the termination of the indemnification previously provided to ProLogis North American Properties Fund V. The remaining change in deferred taxes is due primarily to timing. See Note 5 to our Consolidated Financial Statements in Item 1.

Discontinued Operations

Discontinued operations represent a component of an entity that has either been disposed of or is classified as held for sale if both the operations and cash flows of the component have been or will be eliminated from ongoing operations of the entity as a result of the disposal transaction and the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction. The results of operations of the component of the entity that has been classified as discontinued operations are reported separately as such in the statements of earnings. During the nine months ended September 30, 2007 and the year ended December 31, 2006, we disposed of 71 and 89 properties, respectively, as well as land subject to a ground lease in 2007, to third parties that were previously included in our property operations segment. The results of operations for these properties, as well as the gain recognized upon disposition, are included in discontinued operations. In addition, as of September 30, 2007, we had one property classified as held for sale and therefore, the results of operations of this property are also included in discontinued operations. See Note 6 to our Consolidated Financial Statements in Item 1.

Three Months Ended September 30, 2007 and 2006

The changes in net earnings attributable to common shares and its components for the three months ended September 30, 2007, as compared to the three months ended September 30, 2006, are similar to the changes for the nine month periods ended on the same dates other than as separately discussed above.

Environmental Matters

A majority of the properties acquired by us were subjected to environmental reviews either by us or the previous owners. While some of these assessments have led to further investigation and sampling, none of the environmental assessments have revealed an environmental liability that we believe would have a material adverse effect on our business, financial condition or results of operations.

We record a liability for the estimated costs of environmental remediation to be incurred in connection with certain operating properties we acquire, as well as certain land parcels we acquire in connection with the planned development of the land. The liability is established to cover the environmental remediation costs, including cleanup costs, consulting fees for studies and investigations, monitoring costs and legal costs relating to cleanup, litigation defense, and the pursuit of responsible third parties. We purchase various environmental insurance policies to mitigate our exposure to environmental liabilities. We are not aware of any environmental liability that we believe would have a material adverse effect on our business, financial condition or results of operations.

Table of Contents

Liquidity and Capital Resources

Overview

We consider our ability to generate cash from operating activities, contributions and dispositions of properties and from available financing sources to be adequate to meet our anticipated future development, acquisition, operating, debt service and shareholder distribution requirements.

Our credit facilities provide liquidity and financial flexibility, which allows us to efficiently respond to market opportunities and execute our business strategy on a global basis. Regular repayments of our credit facilities are necessary to allow us to maintain adequate liquidity. We anticipate future repayments of the borrowings under our credit facilities will be funded primarily through cash flow from operations, the proceeds from future property contributions and dispositions and from proceeds generated by future issuances of debt or equity securities, depending on market conditions.

On July 11, 2007, we completed the previously announced acquisition of all of the units in MPR. At the time of acquisition, MPR owned approximately 89% of ProLogis North American Properties Fund V and certain other assets. The total consideration was approximately $2.0 billion consisting of cash of $1.2 billion and assumed liabilities of $0.8 billion. The cash portion of the acquisition was financed primarily with borrowings under a credit agreement with an affiliate of Citigroup USA, Inc. (Citigroup), consisting of a $473.1 million term loan and a $646.2 million convertible loan. As a result of this transaction, on July 11, 2007, we owned 100% of and began consolidating ProLogis North American Properties Fund V.

On August 27, 2007, Citigroup converted $546.2 million of the convertible loan into equity of a newly formed property fund, ProLogis North American Industrial Fund II, which owns all of the real estate assets and debt obligations that were acquired or issued in connection with the MPR acquisition. We made an equity contribution of $100.0 million into the fund, which was used to repay the remaining balance on the convertible loan. The conversion resulted in Citigroup owning 63.1% and us owning 36.9% of the equity of ProLogis North American Industrial Fund II. We account for our investment under the equity method of accounting. Upon conversion, in both the three and nine months ended September 30, 2007, we recognized net gains of $68.6 million (including $16.6 million of previously deferred gains from the initial contribution of the assets to ProLogis North American Properties Fund V) that are reflected in CDFS Acquired Property Portfolios in our Consolidated Statements of Earnings and Comprehensive Income in Item I.

In addition to common share distributions and preferred share dividend requirements, we expect our primary short and long-term cash needs will consist of the following for the remainder of 2007 and future years:

- development of properties directly and additional investment in joint ventures in the CDFS business segment;
- acquisitions of properties or portfolios of properties in the CDFS business segment primarily for future contribution to property funds;
- acquisitions of land for future development in the CDFS business segment;
- investments in current or future unconsolidated property funds;
- direct acquisitions of operating properties and/or portfolios of operating properties in key distribution markets for direct, long-term investment in the property operations segment;
- capital expenditures on properties; and
- scheduled principal and interest payments.

We expect to fund cash needs for the remainder of 2007 and future years primarily with cash from the following sources, all subject to market conditions:

- property operations;

fees and incentives earned for services performed on behalf of the property funds;

proceeds from the contributions of properties to property funds;

proceeds from the disposition of land parcels and properties to third parties;

borrowing capacity under our Global Line or other credit facilities;

assumption of debt in connection with acquisitions; and

proceeds from the issuance of equity or debt securities, including sales under various common share plans.

Commitments related to future contributions to Property Funds

We are committed to offer to contribute substantially all of the properties we develop and stabilize in Canada and the United States to the North American Industrial Fund. The North American Industrial Fund has equity commitments, which expire in February 2009, aggregating approximately $1.4 billion from third party investors, of which $783.8 million was unfunded at September 30, 2007.

We are committed to offer to contribute all of our stabilized development properties available in Japan to ProLogis Japan Properties Fund II through August 2008. ProLogis Japan Properties Fund II has an equity commitment of $600.0 million from our fund partner, which expires in August 2008, and under which $28.2 million was unfunded at September 30, 2007.

We are committed to offer to contribute substantially all of the properties we develop and stabilize in Europe and, in certain circumstances properties we acquire, to PEPF II. PEPF II has equity commitments, which expire in August 2010, aggregating approximately 2.5 billion ($3.5 billion as of September 30, 2007) from third party investors and PEPR, of which 2.3 billion ($3.2 billion as of September 30, 2007) was unfunded at September 30, 2007.

We are committed to offer to contribute all of our stabilized development properties available in Mexico and, in certain circumstances properties we acquire, to ProLogis Mexico Industrial Fund. ProLogis Mexico Industrial Fund has equity commitments, which expire in August 2010, aggregating approximately $500.0 million from third party investors, of which $423.2 million was unfunded at September 30, 2007.

We are committed to offer to contribute substantially all of the properties we develop and stabilize in South Korea and, in certain circumstances properties we acquire, to ProLogis Korea Fund. ProLogis Korea Fund has an equity commitment from our fund partner of $200 million, which expires in June 2010, and under which $179.4 million was unfunded at September 30, 2007.

These property funds are committed to acquire such properties, subject to certain exceptions, including that the properties meet certain specified leasing and other criteria, and that the property funds have available capital. We believe that, while the current capital commitments and borrowing capacities of these property funds may be expended prior to the expiration dates of these commitments, each property fund will have sufficient debt or equity capital to acquire the properties that we expect to offer to contribute during 2007 and 2008. Should the property funds choose not to acquire, or not have sufficient capital available to acquire a property that meets the specified criteria, the rights under the agreement with regard to that specific property will terminate. We continually explore our options related to both new and existing property funds to support the business objectives of our CDFS business segment.

There can be no assurance that if these property funds do not acquire the properties we have available, we will be able to secure other sources of capital such that we can contribute or sell these properties in a timely manner and continue to generate profits from our development activities in a particular reporting period.

Cash Provided by Operating Activities

Net cash provided by operating activities was $1.1 billion and $566.6 million for the nine months ended September 30, 2007 and 2006, respectively. The increase in cash provided by operating activities in 2007 over 2006 is due primarily to the increase in earnings, adjusted for non-cash items, which is more fully discussed above. Cash provided by operating activities exceeded the cash distributions paid on common shares and dividends paid on preferred shares in both periods.

Cash Investing and Cash Financing Activities

For the nine months ended September 30, 2007 and 2006, investing activities used net cash of $2.9 billion and $1.4 billion, respectively. The following are the more significant activities for both periods presented:

On July 11, 2007, we completed the acquisition of MPR for total consideration of approximately $2.0 billion, consisting of $1.2 billion of cash and the assumption of debt and other liabilities of $0.8 billion. The cash portion was financed by the issuance of a $473.1 million term loan and a $646.2 million convertible loan with an affiliate of Citigroup. On August 27, 2007, Citigroup converted $546.2 million of the convertible loan into equity of a newly created property fund, ProLogis North American Industrial Fund II and we made a $100.0 million equity contribution to the property fund, which it used to repay the remaining balance on the convertible loan.

In February 2007, we purchased the industrial business and made a 25% investment in the retail business of Parkridge. The total purchase price was $1.3 billion of which we paid cash of $741.2 million. See Note 2 to our Consolidated Financial Statements in Item 1 for more details of this transaction.

We invested $3.7 billion in real estate during the nine months ended September 30, 2007, excluding the MPR and Parkridge acquisitions, and $2.7 billion for the same period in 2006. These amounts include the acquisition of operating properties (33 properties and 62 properties with an aggregate purchase price of $253.9 million and $627.1 million in 2007 and 2006, respectively); acquisitions of land for future development; costs for current and future development projects; and recurring capital expenditures and tenant improvements on existing operating properties. At September 30, 2007, we had 136 distribution and retail properties aggregating 36.6 million square feet under development, with a total expected investment of $2.8 billion.

We invested cash of $507.4 million and $168.3 million during the nine months ended September 30, 2007 and 2006, respectively, in new, existing and potential unconsolidated investees, including the $100.0 million invested in Prologis North American Industrial Fund II and excluding the investment in the Parkridge retail business. In January 2006, we invested $55.0 million in a preferred interest in ProLogis North American Properties Fund V, which we subsequently sold in August 2006.

We received proceeds from unconsolidated investees as a return of investment of $39.1 million and $100.2 million during the nine months ended September 30, 2007 and 2006, respectively. The proceeds in 2007 include $18.7 million received from the liquidation of an investment in an unconsolidated investee.

We generated net cash from contributions and dispositions of properties and land parcels of $3.1 billion and $1.6 billion during the nine months ended September 30, 2007 and 2006, respectively.

We invested cash of $259.2 million in connection with the purchase of our fund partner s ownership interests in Funds II-IV during the first quarter of 2006. See Note 3 to our Consolidated Financial Statements in Item 1 for more details of this transaction.

We generated net cash proceeds from payments on notes receivable of $42.0 million and $70.5 million during the nine months ended September 30, 2007 and 2006, respectively.

For the nine months ended September 30, 2007 and 2006, financing activities provided net cash of $1.9 billion and $1.1 billion, respectively. The following are the more significant activities for both periods presented:

In March 2007, we issued $1.25 billion aggregate principal amount of 2.25% convertible senior notes due 2037. We used the net proceeds of the offering to repay a portion of the outstanding balance under our Global Line and for general corporate purposes.

During 2007, we received proceeds of $1.1 billion and $600.1 million under facilities used to partially finance the MPR and Parkridge acquisitions (see Note 3 and Note 10, respectively, to our Consolidated Financial Statements in Item 1).

On our lines of credit, including the Global Line, we had net borrowings of $119.0 million and $701.9 million for the nine months ended September 30, 2007 and 2006, respectively.

On our other debt, we had net payments of $780.9 million and net borrowings of $627.4 million for the nine months ended September 30, 2007 and 2006, respectively. In 2006, we received proceeds from the issuance of $850.0 million of senior notes, which were offset slightly by payments made on our senior notes, secured debt and assessment bonds.

We generated proceeds from the sale and issuance of common shares of $26.7 million and $123.9 million for the nine months ended September 30, 2007 and 2006, respectively.

We paid distributions of $354.2 million and $293.8 million to our common shareholders during the nine months ended September 30, 2007 and 2006, respectively. We paid dividends on preferred shares of $19.1 million for both the nine months ended September 30, 2007 and 2006.

Borrowing Capacities

At September 30, 2007, we had available credit facilities, including the Global Line, of $3.7 billion. Under these facilities, at September 30, 2007, we had outstanding borrowings of $2.5 billion and letters of credit outstanding of $153.0 million with participating lenders, resulting in remaining borrowing capacity of $1.0 billion.

Off-Balance Sheet Arrangements

Liquidity and Capital Resources of Our Unconsolidated Investees

We had investments in and advances to unconsolidated investees of $2.2 billion at September 30, 2007, of which $1.7 billion related to our investments in the property funds. Summarized financial information for the property funds (for the entire entity, not our proportionate share) at September 30, 2007 is presented below (dollars in millions):

	Total Assets	Third Party Debt (1)	Our Ownership %
ProLogis European Properties	$ 5,078.5	$ 2,688.9	24.9
ProLogis European Properties Fund II	919.2	497.2	24.4
ProLogis California	599.4	321.1	50.0
ProLogis North American Properties Fund I	325.4	242.3	41.3
ProLogis North American Properties Fund VI	500.0	307.0	20.0
ProLogis North American Properties Fund VII	378.7	228.8	20.0
ProLogis North American Properties Fund VIII	187.5	112.0	20.0
ProLogis North American Properties Fund IX	191.0	120.9	20.0
ProLogis North American Properties Fund X	216.6	135.0	20.0
ProLogis North American Properties Fund XI	224.1	65.7	20.0
ProLogis North American Industrial Fund	2,033.4	1,210.6	23.3
ProLogis North American Industrial Fund II	2,223.4	1,282.6	36.9
ProLogis North American Industrial Fund III	1,796.7	1,067.7	20.0
ProLogis Mexico Industrial Fund	271.8	137.1	20.0
ProLogis Japan Properties Fund I	1,203.7	538.4	20.0
ProLogis Japan Properties Fund II	2,454.6	1,257.1	20.0
ProLogis Korea Fund	32.2	6.0	20.0
Total property funds	$ 18,636.2	$ 10,218.4	

(1) As of September 30, 2007, we had no outstanding guarantees related to any debt of the unconsolidated property funds.

Contractual Obligations

Distribution and Dividend Requirements

Our common share distribution policy is to distribute a percentage of our cash flow that ensures we will meet the distribution requirements of the Code relating to a REIT while still allowing us to maximize the cash retained to meet other cash needs such as capital improvements and other investment activities. Because depreciation is a non-cash expense, cash flow typically will be greater than operating income and net earnings.

In December 2006, our Board approved an increase in the annual distribution for 2007 from $1.60 to $1.84 per common share. The payment of common share distributions is dependent upon our financial condition and operating results and may be adjusted at the discretion of the Board during the year. We paid a distribution of $0.46 per common

share for the first, second and third quarters of 2007 on February 28, 2007, May 31, 2007 and August 31, 2007.

At September 30, 2007, we had three series of preferred shares outstanding. The annual dividend rates on preferred shares are $4.27 per Series C preferred share, $1.69 per Series F preferred share and $1.69 per Series G preferred share. The dividends are payable quarterly in arrears on the last day of each quarter.

Pursuant to the terms of our preferred shares, we are restricted from declaring or paying any distribution with respect to our common shares unless and until all cumulative dividends with respect to the preferred shares have been paid and sufficient funds have been set aside for dividends that have been declared for the then current dividend period with respect to the preferred shares.

Other Commitments

At September 30, 2007, we had letters of intent or contingent contracts, subject to final due diligence, for the acquisition of properties aggregating approximately 2.6 million square feet at an estimated total acquisition cost of approximately $134 million. These transactions are subject to a number of conditions and we cannot predict with certainty that they will be consummated.

New Accounting Pronouncements

See Note 1 to our Consolidated Financial Statements in Item 1.

Funds from Operations

FFO is a non-GAAP measure that is commonly used in the real estate industry. The most directly comparable GAAP measure to FFO is net earnings. Although NAREIT has published a definition of FFO, modifications to the NAREIT calculation of FFO are common among REITs, as companies seek to provide financial measures that meaningfully reflect their business. FFO, as we define it, is presented as a supplemental financial measure. We do not use FFO as, nor should it be considered to be, an alternative to net earnings computed under GAAP as an indicator of our operating performance or as an alternative to cash from operating activities computed under GAAP as an indicator of our ability to fund our cash needs.

FFO is not meant to represent a comprehensive system of financial reporting and does not present, nor do we intend it to present, a complete picture of our financial condition and operating performance. We believe net earnings computed under GAAP remains the primary measure of performance and that FFO is only meaningful when it is used in conjunction with net earnings computed under GAAP. Further, we believe our consolidated financial statements, prepared in accordance with GAAP, provide the most meaningful picture of our financial condition and our operating performance.

NAREIT s FFO measure adjusts net earnings computed under GAAP to exclude historical cost depreciation and gains and losses from the sales of previously depreciated properties. We agree that these two NAREIT adjustments are useful to investors for the following reasons:

(a) historical cost accounting for real estate assets in accordance with GAAP assumes, through depreciation charges, that the value of real estate assets diminishes predictably over time. NAREIT stated in its White Paper on FFO since real estate asset values have historically risen or fallen with market conditions, many industry investors have considered presentations of operating results for real estate companies that use historical cost accounting to be insufficient by themselves. Consequently, NAREIT s definition of FFO reflects the fact that real estate, as an asset class, generally appreciates over time and depreciation charges required by GAAP do not reflect the underlying economic realities.

(b) REITs were created as a legal form of organization in order to encourage public ownership of real estate as an asset class through investment in firms that were in the business of long-term ownership and management of real estate. The exclusion, in NAREIT s definition of FFO, of gains and losses from the sales of previously depreciated operating real estate assets allows investors and analysts to readily identify the operating results of the long-term assets that form the core of a REIT s activity and assists in comparing those operating results between periods. We include the gains and losses from dispositions of properties acquired or developed in our CDFS business segment and our proportionate share of the gains and losses from dispositions recognized by the property funds in our definition of FFO.

At the same time that NAREIT created and defined its FFO concept for the REIT industry, it also recognized that management of each of its member companies has the responsibility and authority to publish financial information that it regards as useful to the financial community. We believe financial analysts, potential investors and shareholders who review our operating results are best served by a defined FFO measure that includes other adjustments to net earnings computed under GAAP in addition to those included in the NAREIT defined measure of FFO.

Our defined FFO measure excludes the following items from net earnings computed under GAAP that are not excluded in the NAREIT defined FFO measure:

(i) deferred income tax benefits and deferred income tax expenses recognized by our subsidiaries;

(ii) current income tax expense related to acquired tax liabilities that were recorded as deferred tax liabilities in an acquisition, to the extent the expense is offset with a deferred income tax benefit in GAAP earnings that is excluded from our defined FFO measure;

(iii) certain foreign currency exchange gains and losses resulting from certain debt transactions between us and our foreign consolidated subsidiaries and our foreign unconsolidated investees;

(iv) foreign currency exchange gains and losses from the remeasurement (based on current foreign currency exchange rates) of certain third party debt of our foreign consolidated subsidiaries and our foreign unconsolidated investees; and

(v) mark-to-market adjustments associated with derivative financial instruments utilized to manage foreign currency risks.

FFO of our unconsolidated investees is calculated on the same basis.

The items that we exclude from net earnings computed under GAAP, while not infrequent or unusual, are subject to significant fluctuations from period to period that cause both positive and negative effects on our results of operations, in inconsistent and unpredictable directions. Most importantly, the economics underlying the items that we exclude from net earnings computed under GAAP are not the primary drivers in management s decision-making process and capital investment decisions. Period to period fluctuations in these items can be driven by accounting for short-term factors that are not relevant to long-term investment decisions, long-term capital structures or long-term tax planning and tax structuring decisions. Accordingly, we believe investors are best served if the information that is made available to them allows them to align their analysis and evaluation of our operating results along the same lines that our management uses in planning and executing our business strategy.

Real estate is a capital-intensive business. Investors analyses of the performance of real estate companies tend to be centered on understanding the asset value created by real estate investment decisions and understanding current operating returns that are being generated by those same investment decisions. The adjustments to net earnings computed under GAAP that are included in arriving at our FFO measure are helpful to management in making real estate investment decisions and evaluating our current operating performance. We believe these adjustments are also helpful to industry analysts, potential investors and shareholders in their understanding and evaluation of our performance on the key measures of net asset value and current operating returns generated on real estate investments.

While we believe our defined FFO measure is an important supplemental measure, neither NAREIT s nor our measure of FFO should be used alone because they exclude significant economic components of net earnings computed under GAAP and are, therefore, limited as an analytical tool. Some of these limitations are:

The current income tax expenses that are excluded from our defined FFO measure represent the taxes that are payable.

Depreciation and amortization of real estate assets are economic costs that are excluded from FFO. FFO is limited, as it does not reflect the cash requirements that may be necessary for future replacements of the real estate assets. Further, the amortization of capital expenditures and leasing costs necessary to maintain the operating performance of distribution properties are not reflected in FFO.

Gains or losses from property dispositions represent changes in the value of the disposed properties. By excluding these gains and losses, FFO does not capture realized changes in the value of disposed properties arising from changes in market conditions.

The deferred income tax benefits and expenses that are excluded from our defined FFO measure result from the creation of a deferred income tax asset or liability that may have to be settled at some future point. Our defined FFO measure does not currently reflect any income or expense that may result from such settlement.

The foreign currency exchange gains and losses that are excluded from our defined FFO measure are generally recognized based on movements in foreign currency exchange rates through a specific point in time. The ultimate settlement of our foreign currency-denominated net assets is indefinite as to timing and amount. Our FFO measure is limited in that it does not reflect the current period changes in these net assets that result from

periodic foreign currency exchange rate movements.

We compensate for these limitations by using the FFO measure only in conjunction with net earnings computed under GAAP. To further compensate, we always reconcile our defined FFO measure to net earnings computed under GAAP in our financial reports. Additionally, we provide investors with (i) our complete financial statements prepared under GAAP; (ii) our definition of FFO, which includes a discussion of the limitations of using our non-GAAP measure; and (iii) a reconciliation of our GAAP measure (net earnings) to our non-GAAP measure (FFO, as we define it), so that investors can appropriately incorporate this measure and its limitations into their analyses.

FFO attributable to common shares as defined by us was $1.0 billion and $656.3 million for the nine months ended September 30, 2007 and 2006, respectively. The reconciliations of FFO attributable to common shares as defined by us to net earnings attributable to common shares computed under GAAP are as follows for the periods indicated (in thousands):

	Nine months ended September 30,	
	2007	**2006**
FFO:		
Reconciliation of net earnings to FFO:		
Net earnings attributable to common shares	$ 935,639	$ 517,861
Add (deduct) NAREIT defined adjustments:		
Real estate related depreciation and amortization	217,209	200,860
Adjustments to CDFS dispositions for depreciation	(3,583)	466
Gains recognized on dispositions of certain non-CDFS business assets	(145,374)	(13,709)
Reconciling items attributable to discontinued operations:		
Gains recognized on dispositions of non-CDFS business assets	(38,732)	(80,037)
Real estate related depreciation and amortization	2,240	9,148
Totals discontinued operations	(36,492)	(70,889)
Our share of reconciling items from unconsolidated investees:		
Real estate related depreciation and amortization	63,669	47,834
Gains on dispositions of non-CDFS business assets	(34,491)	(6,753)
Other amortization items	(6,376)	(14,199)
Totals unconsolidated investees	22,802	26,882
Totals NAREIT defined adjustments	54,562	143,610
Subtotals NAREIT defined FFO	990,201	661,471
Add (deduct) our defined adjustments:		
Foreign currency exchange losses (gains), net	11,595	(9,115)
Current income tax expense	3,038	23,191
Deferred income tax expense (benefit)	5,710	(16,780)
Our share of reconciling items from unconsolidated investees:		
Foreign currency exchange losses, net	5,828	130
Deferred income tax benefit	(599)	(2,634)
Totals unconsolidated investees	5,229	(2,504)
Totals our defined adjustments	25,572	(5,208)

FFO attributable to common shares, as defined by us	$ 1,015,773	$ 656,263

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We define our market risk exposure as: (i) the potential loss in future earnings and cash flows due to interest rate exposure and (ii) the potential loss in future earnings with respect to foreign currency exchange exposure.

Interest Rate Risk

Our interest rate risk management objective is to limit the impact of interest rate changes on earnings and cash flows. To achieve this objective, we borrow on a fixed rate basis for longer-term debt issuances. In anticipation of a financing expected to occur in early 2007, we entered into several interest rate swap contracts that were designated as cash flow hedges to fix the interest rate on a portion of the expected financing. The financing occurred in March 2007 with the issuance of $1.25 billion of convertible senior notes. At September 30, 2007, we had no interest rate swap contracts outstanding.

Our primary interest rate risk is created by our variable rate lines of credit and other variable rate debt. During the first quarter of 2007, in connection with the Parkridge acquisition, we entered into a senior unsecured facility that bears interest at LIBOR plus a margin. At September 30, 2007, we had outstanding borrowings of $2.5 billion on our variable rate lines of credit and $0.6 billion of other variable rate debt, including the new facility. Based on the results of a sensitivity analysis with a 10% adverse change in interest rates on our variable rate debt, our estimated market risk exposure was approximately $7.8 million on our cash flow for the nine months ended September 30, 2007.

See Notes 10 and 14 to our Consolidated Financial Statements in Item 1 for more discussion of our debt and information related to instruments we utilize to manage certain of these risks.

Foreign Currency Risk

We primarily incur foreign currency exchange risk related to third party and intercompany debt of our foreign consolidated subsidiaries and unconsolidated investees that are not denominated in the functional currency of the subsidiary or investee. The remeasurement of certain of this debt results in the recognition of foreign currency exchange gains or losses. We use foreign currency forward contracts to manage the foreign currency fluctuations of certain intercompany loans. During the second quarter of 2007, we also entered into foreign currency forward contracts related to the acquisition of MPR that was completed in July 2007. We used the foreign currency forward contracts to manage the risk associated with the purchase price denominated in Australian dollars. These contracts allowed us to sell foreign currency at a fixed exchange rate to the U.S. dollar and settled in July 2007. At September 30, 2007, we had forward contracts for euros and pound sterling outstanding with an aggregate notional amount of $1.5 billion related primarily to our intercompany debt transactions.

We primarily use foreign currency put option contracts to manage foreign currency exchange rate risk associated with the projected net operating income (operating income net of foreign denominated interest expense) of our foreign consolidated subsidiaries and unconsolidated investees. At September 30, 2007, we had no put option contracts outstanding.

See Note 14 to our Consolidated Financial Statements in Item 1 for more information related to instruments we utilize to manage certain of these risks.

Item 4. Controls and Procedures

An evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the disclosure controls and procedures (as defined in Rule 13a-14(c)) under the Securities and Exchange Act of 1934 (the Exchange Act) as of September 30, 2007. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms.

PART II

Item 1. Legal Proceedings

From time to time, we and our unconsolidated investees are party to a variety of legal proceedings arising in the ordinary course of business. We believe that, with respect to any such matters that we are currently a party to, the ultimate disposition of any such matters will not result in a material adverse effect on our business, financial position or results of operations.

Item 1A. Risk Factors

As of September 30, 2007, no material changes had occurred in our risk factors as discussed in Item 1A of our 2006 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

12.1 Computation of Ratio of Earnings to Fixed Charges

12.2 Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Share Dividends

15.1 KPMG LLP Awareness Letter

31.1 Certification of Chief Executive Officer

31.2 Certification of Chief Financial Officer

32.1 Certification of Chief Executive Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Chief Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

SIGNATURES

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

PROLOGIS

By: /s/ William E. Sullivan

William E. Sullivan
Chief Financial Officer

By: /s/ Jeffrey S. Finnin

Jeffrey S. Finnin
Senior Vice President and Chief Accounting Officer

Date: November 6, 2007

Index to Exhibits

12.1 Computation of Ratio of Earnings to Fixed Charges

12.2 Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Share Dividends

15.1 KPMG LLP Awareness Letter

31.1 Certification of Chief Executive Officer

31.2 Certification of Chief Financial Officer

32.1 Certification of Chief Executive Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Chief Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002