

AMERIVEST PROPERTIES INC  
Form 10-Q  
August 09, 2004  
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## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

### FORM 10-Q

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended **June 30, 2004**.

OR

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number **1-14462**

## AMERIVEST PROPERTIES INC.

(Exact name of registrant as specified in its charter)

**Maryland**

(State or other jurisdiction of  
incorporation or organization)

**84-1240264**

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

**1780 South Bellaire Street  
Suite 100, Denver, Colorado**  
(Address of principal executive offices)

**80222**  
(Zip Code)

**(303) 297-1800**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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The number of shares of the registrant's common stock outstanding as of August 5, 2004 was 23,932,392.

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## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

## AMERIVEST PROPERTIES INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

|   | June 30,<br>2004<br>(unaudited) | December 31,<br>2003 |
|---|---------------------------------|----------------------|
| <b>ASSETS</b>   |                                 |                      |
| Investment in real estate                             |                                 |                      |
| Land  | \$ 37,607,272                   | \$ 28,838,214        |
| Buildings and improvements                            | 226,587,118                     | 184,519,890          |
| Furniture, fixtures and equipment                     | 1,144,438                       | 799,730              |
| Tenant improvements                                   | 11,161,115                      | 6,144,440            |
| Tenant leasing commissions                            | 2,097,777                       | 1,061,160            |
| Intangible assets                                     | 17,657,776                      | 11,468,120           |
| Less: accumulated depreciation and amortization       | (18,686,505)                    | (12,134,025)         |
| Net investment in real estate                         | 277,568,991                     | 220,697,529          |
| Cash and cash equivalents                             | 2,828,615                       | 1,477,585            |
| Escrow deposits                                       | 8,579,577                       | 5,778,427            |
| Assets held for sale                                  |                                 | 3,196,877            |
| Investment in affiliate                               |                                 | 1,364,032            |
| Due from related party                                |                                 | 3,371,526            |
| Due from affiliate                                    |                                 | 262,347              |
| Accounts receivable                                   | 798,768                         | 296,377              |
| Deferred rents receivable                             | 2,084,806                       | 1,401,455            |
| Deferred financing costs, net                         | 2,186,199                       | 2,301,043            |
| Prepaid expenses and other assets                     | 829,542                         | 353,264              |
| Total assets  | \$ 294,876,498                  | \$ 240,500,462       |
| <b>LIABILITIES</b>                                    |                                 |                      |
| Mortgage loans and notes payable                      | \$ 176,637,287                  | \$ 158,237,661       |
| Liabilities held for sale                             |                                 | 1,296,049            |
| Accounts payable and accrued expenses                 | 2,796,019                       | 2,736,657            |
| Accrued real estate taxes                             | 3,034,605                       | 3,169,183            |
| Prepaid rents, deferred revenue and security deposits | 3,244,960                       | 2,694,335            |
| Dividends payable                                     | 3,110,750                       | 2,262,170            |
| Total liabilities                                     | 188,823,621                     | 170,396,055          |
| MINORITY INTEREST                                     | 1,775,186                       |                      |
| <b>STOCKHOLDERS EQUITY</b>                            |                                 |                      |
| Preferred stock, \$.001 par value                     |                                 |                      |
| Authorized 5,000,000 shares                           |                                 |                      |
| Issued and outstanding none                           | 23,929                          | 17,401               |

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|   |                |                |
|---|----------------|----------------|
| Common stock, \$.001 par value  |                |                |
| Authorized 75,000,000 shares  |                |                |
| Issued and outstanding 23,928,849 and 17,401,309 shares, respectively |                |                |
| Capital in excess of par value  | 132,184,673    | 91,706,371     |
| Distributions in excess of accumulated earnings                       | (27,930,911)   | (21,619,365)   |
| Total stockholders' equity  | 104,277,691    | 70,104,407     |
| Total liabilities and stockholders' equity                            | \$ 294,876,498 | \$ 240,500,462 |

See accompanying notes to the condensed consolidated financial statements.

## AMERIVEST PROPERTIES INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

|   | For the three months ended<br>June 30, |                | For the six months ended<br>June 30, |               |
|---|--|----------------|--------------------------------------|---------------|
|   | 2004                                   | 2003           | 2004                                 | 2003          |
| <b>REAL ESTATE OPERATING REVENUE</b>              |  |                |                                      |               |
| Rental revenue                                    | \$ 11,402,649                          | \$ 6,680,723   | \$ 20,996,544                        | \$ 13,229,350 |
| <b>REAL ESTATE OPERATING EXPENSES</b>             |  |                |                                      |               |
| Property operating expenses-                      |  |                |                                      |               |
| Operating expenses                                | 3,105,339                              | 1,660,895      | 5,911,233                            | 3,209,600     |
| Real estate taxes                                 | 1,477,758                              | 762,939        | 2,715,622                            | 1,514,777     |
| Management fees                                   | 17,428                                 | 33,297         | 34,750                               | 67,174        |
| General and administrative expenses               | 984,265                                | 742,773        | 1,916,814                            | 1,579,853     |
| Ground rent expense                               | 160,542                                |                | 321,683                              |               |
| Interest expense                                  | 2,831,282                              | 1,781,535      | 5,553,349                            | 3,506,970     |
| Depreciation and amortization expense             | 3,445,634                              | 1,414,553      | 6,222,725                            | 2,742,519     |
| Impairment of investment in real estate           |  | 1,465,932      |                                      | 1,465,932     |
| Total operating expenses                          | 12,022,248                             | 7,861,924      | 22,676,176                           | 14,086,825    |
| <b>LOSS FROM CONTINUING OPERATIONS</b>            | (619,599)                              | (1,181,201)    | (1,679,632)                          | (857,475)     |
| <b>OTHER INCOME/(LOSS)</b>                        |  |                |                                      |               |
| Interest income                                   | 10,893                                 | 11,936         | 26,256                               | 17,753        |
| Equity in loss of affiliate                       |  | (13,312)       | (18,076)                             | (23,914)      |
| Minority interest                                 | 61,118                                 |                | 61,118                               |               |
| Total other income/(loss)                         | 72,011                                 | (1,376)        | 69,298                               | (6,161)       |
| <b>LOSS BEFORE DISCONTINUED OPERATIONS</b>        | (547,588)                              | (1,182,577)    | (1,610,334)                          | (863,636)     |
| <b>DISCONTINUED OPERATIONS</b>                    |  | 72,526         | 687,735                              | 158,549       |
| <b>NET LOSS</b>                                   | \$ (547,588)                           | \$ (1,110,051) | \$ (922,599)                         | \$ (705,087)  |
| <b>LOSS PER SHARE</b>                             |  |                |                                      |               |
| Basic   | \$ (0.02)                              | \$ (0.09)      | \$ (0.04)                            | \$ (0.06)     |
| Diluted   | \$ (0.02)                              | \$ (0.09)      | \$ (0.04)                            | \$ (0.06)     |
| <b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING</b> |  |                |                                      |               |
| Basic   | 23,898,957                             | 12,806,389     | 20,733,185                           | 11,958,053    |
| Diluted   | 23,898,957                             | 12,806,389     | 20,733,185                           | 11,958,053    |

See accompanying notes to the condensed consolidated financial statements.



## AMERIVEST PROPERTIES INC.

## CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

For the six months ended June 30, 2004

(unaudited)

|   | Common Stock |           | Capital in             | Distributions                           | Total          |
|---|--------------|-----------|------------------------|---|----------------|
|   | Shares       | Amount    | Excess of<br>Par Value | in Excess of<br>Accumulated<br>Earnings |                |
| Balance at December 31, 2003                                  | 17,401,309   | \$ 17,401 | \$ 91,706,371          | \$ (21,619,365)                         | \$ 70,104,407  |
| Issuance of common stock                                      |              |           |                        |   |                |
| Public offering, net of offering costs                        | 6,325,000    | 6,325     | 39,889,104             |   | 39,895,429     |
| Warrants exercised  | 92,962       | 93        | 63,457                 |   | 63,550         |
| Stock options exercised                                       | 70,753       | 71        | 355,528                |   | 355,599        |
| Dividend Reinvestment Plan (DRIP),<br>net of purchased shares | 5,570        | 6         | 38,549                 |   | 38,555         |
| Equity-based compensation                                     | 33,255       | 33        | 131,664                |   | 131,697        |
| Dividends declared  |              |           |                        | (5,388,947)                             | (5,388,947)    |
| Net loss  |              |           |                        | (922,599)                               | (922,599)      |
| Balance at June 30, 2004                                      | 23,928,849   | \$ 23,929 | \$ 132,184,673         | \$ (27,930,911)                         | \$ 104,277,691 |

See accompanying notes to the condensed consolidated financial statements.

## AMERIVEST PROPERTIES INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

|   | For the six months ended |              |
|---|--------------------------|--------------|
|   | 2004                     | 2003         |
|   | June 30,                 |              |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                     |                          |              |
| Net loss  | \$ (922,599)             | \$ (705,087) |
| Adjustments to reconcile net loss to net cash provided by operating activities- |                          |              |
| Depreciation and amortization expense   | 6,250,295                | 2,808,139    |
| Impairment of investment in real estate   |                          | 1,465,932    |
| Gain on sale  | (574,276)                |              |
| Amortization of deferred financing costs  | 351,342                  | 248,502      |
| Equity in loss of affiliate   | 18,076                   | 23,914       |
| Minority interest   | (61,118)                 |              |
| Equity-based compensation   | 131,697                  | 36,505       |
| Changes in assets and liabilities-  |                          |              |
| Accounts receivable   | (484,572)                | (5,607)      |
| Deferred rents receivable   | (809,453)                | (298,297)    |
| Prepaid expenses and other assets   | (24,778)                 | 123,115      |
| Accounts payable and accrued expenses   | (63,597)                 | 897,850      |
| Other accrued liabilities   | 277,994                  | (21,169)     |
| Net cash flows provided by operating activities                                 | 4,089,011                | 4,573,797    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                     |                          |              |
| Acquisitions of real estate, net  | (36,638,928)             | (17,039,573) |
| Capital expenditures  | (2,263,867)              | (2,135,050)  |
| Tenant improvements   | (4,261,393)              | (712,373)    |
| Leasing commissions   | (880,062)                | (322,239)    |
| Deposits on pending real estate acquisitions                                    | (226,500)                | (510,000)    |
| Proceeds from sale, net of closing costs  | 4,049,229                |              |
| Proceeds held in escrow for Section 1031 exchange                               | (2,700,274)              |              |
| Ending cash balance of newly consolidated affiliate                             | 92,732                   |              |
| Amounts (paid to)/received from affiliate                                       | (94,707)                 | 52,522       |
| Net cash flows used in investing activities                                     | (42,923,770)             | (20,666,713) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                     |                          |              |
| Proceeds from mortgage loans and notes payable                                  | 46,305,894               | 17,000,000   |
| Payments on mortgage loans and notes payable                                    | (41,406,270)             | (25,344,682) |
| Payment of deferred financing costs   | (200,724)                | (345,567)    |
| Deposits for pending refinance  | (225,000)                | (130,000)    |
| Net proceeds from common stock offering   | 39,895,429               | 33,326,741   |
| Net proceeds from exercising of options and warrants                            | 419,149                  | 1,408,046    |
| Net change in escrow deposits   | (100,876)                | (977,254)    |
| Dividends paid  | (4,501,813)              | (2,706,046)  |
| Net cash flows provided by financing activities                                 | 40,185,789               | 22,231,238   |
| <b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>                                  | 1,351,030                | 6,138,322    |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>                           | 1,477,585                | 2,318,566    |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>                                 | \$ 2,828,615             | \$ 8,456,888 |

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SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

|                        |    |           |    |           |
|------------------------|----|-----------|----|-----------|
| Cash paid for interest | \$ | 4,861,853 | \$ | 3,121,237 |
|------------------------|----|-----------|----|-----------|

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES

|   |    |            |    |         |
|---|----|------------|----|---------|
| Mortgage loans assumed and related real estate acquired | \$ | 12,207,253 | \$ |         |
| Stock issued to the DRIP                                | \$ | 38,555     | \$ | 232,341 |

See accompanying notes to the condensed consolidated financial statements.

## SUPPLEMENTAL INFORMATION

Due to the Company's adoption of Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 46 (Revised), "Consolidation of Variable Interest Entities", the assets and liabilities of Panorama Falls have been consolidated with those of the Company since March 31, 2004 (See note 5 to the condensed consolidated financial statements). The following table details the asset and liability amounts related to the Panorama Falls property as of June 30, 2004:

|   |              |
|---|--------------|
| <b>Assets</b>   |              |
| Investment in real estate                             |              |
| Land  | \$ 1,051,372 |
| Buildings and improvements                            | 5,376,313    |
| Furniture, fixtures and equipment                     | 29,426       |
| Tenant improvements                                   | 965,714      |
| Tenant leasing commissions                            | 194,114      |
| Less: accumulated depreciation and amortization       | (848,572)    |
| Net investment in real estate                         | 6,768,367    |
| Cash and cash equivalents                             | 41,081       |
| Accounts receivable                                   | 21,184       |
| Deferred rents receivable                             | 160,042      |
| Deferred financing costs, net                         | 30,126       |
| Total assets  | \$ 7,020,800 |
| <b>Liabilities</b>                                    |              |
| Accounts payable and accrued expenses                 | \$ 38,566    |
| Accrued real estate taxes                             | 72,348       |
| Prepaid rents, deferred revenue and security deposits | 75,444       |
| Total liabilities                                     | \$ 186,358   |
| Minority Interest                                     | \$ 1,775,186 |

See accompanying notes to the condensed consolidated financial statements.

**AMERIVEST PROPERTIES INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**June 30, 2004**

**(unaudited)**

**1 Organization**

AmeriVest Properties Inc. (the Company) is incorporated under the laws of the State of Maryland and operates as a self-administered and self-managed real estate investment trust (REIT). The Company primarily invests in and operates commercial office buildings in selective markets and leases the commercial office buildings to small and medium size tenants. At June 30, 2004, the Company owned, through its wholly-owned subsidiaries, 28 office properties located in metropolitan Denver, Dallas, Phoenix and Indianapolis and several small cities in Texas.

**2 Interim Financial Reporting**

The unaudited condensed consolidated financial statements included herein were prepared from the records of the Company in accordance with accounting principles generally accepted in the United States of America and reflect all adjustments which are, in the opinion of management, necessary to provide a fair statement of the results of operations and financial position for the interim periods. While the Company believes that the disclosures presented are adequate for interim financial reporting, these interim financial statements should be read in conjunction with the financial statements and notes included in the Company's 2003 Form 10-KSB filed with the Securities and Exchange Commission. The results of operations for the six months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Certain prior period balances have been reclassified to conform to current period presentation.

**3 Equity-Based Compensation**

The Company applies Accounting Principles Board (APB) Opinion No. 25 and related interpretations in accounting for its equity-based compensation. Accordingly, the Company does not recognize compensation cost for options granted to employees whose exercise price is equal to or exceeds the fair value of the underlying stock as of the grant date and which qualify for fixed plan accounting.

Equity-based compensation issued to non-employees is accounted for based on the fair value of the equity instruments issued and is recorded as a general and administrative expense, which is amortized by the Company over the instruments' vesting period. The measurement date is considered to be the issuance date, or if there are performance vesting provisions, when earned.

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The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123. Had compensation cost for the Company's stock option plan been determined based on the fair value at the grant date consistent with the provisions of SFAS No. 148, the Company's net loss and loss per share for the three and six months ended June 30, 2004 and 2003 would have been changed to the pro forma amounts indicated below:

|   | For the three months ended<br>June 30, |                | For the six months ended<br>June 30, |              |
|---|--|----------------|--------------------------------------|--------------|
|   | 2004                                   | 2003           | 2004                                 | 2003         |
| Net loss as reported  | \$ (547,588)                           | \$ (1,110,051) | \$ (922,599)                         | \$ (705,087) |
| Add: Recognized equity-based compensation                           | 43,371                                 | 27,318         | 131,697                              | 36,505       |
| Deduct: Total equity-based compensation expense based on fair value | (37,423)                               | (3,360)        | (74,846)                             | (27,084)     |
| Net loss pro forma  | \$ (541,640)                           | \$ (1,086,093) | \$ (865,748)                         | \$ (695,666) |
| Loss per basic share as reported                                    | \$ (0.02)                              | \$ (0.09)      | \$ (0.04)                            | \$ (0.06)    |
| Loss per diluted share as reported                                  | \$ (0.02)                              | \$ (0.09)      | \$ (0.04)                            | \$ (0.06)    |
| Loss per basic share pro forma                                      | \$ (0.02)                              | \$ (0.08)      | \$ (0.04)                            | \$ (0.06)    |
| Loss per diluted share pro forma                                    | \$ (0.02)                              | \$ (0.08)      | \$ (0.04)                            | \$ (0.06)    |

The fair value of each grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

|                        | 2004  | 2003  |
|------------------------|-------|-------|
| Dividend yield         | 7.5%  | 7.9%  |
| Volatility             | 27.0% | 27.0% |
| Discount rate          | 2.7%  | 2.9%  |
| Expected life in years | 5.0   | 4.6   |

#### 4 Transactions

##### *Camelback Lakes acquisition*

On March 16, 2004, the Company acquired the Camelback Lakes office complex located in Phoenix, Arizona. The purchase price for Camelback Lakes was \$31,980,000, which was paid with \$21,000,000 from the \$42,000,000 senior secured revolving line of credit with Fleet National Bank (the Secured Fleet Facility) and the balance in cash.

##### *Texas Bank Buildings sale*

On March 16, 2004, the Company sold its Texas Bank Buildings for \$4,100,000. The four properties are located in Clifton, Georgetown, Henderson and Mineral Wells, Texas. The sale resulted in a gain of \$574,276 which is included in discontinued operations on the accompanying consolidated statements of operations. See Note 7 Discontinued Operations for additional information.

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### *Hackberry View acquisition*

On May 7, 2004, the Company acquired the Hackberry View office property located in Irving, Texas. The purchase price for Hackberry View was \$16,800,000, which was paid with approximately \$12,200,000 from the assumption of the existing first and second mortgage loans and the balance in cash.

### *Properties Under Contract*

During the quarter, the Company entered into a contract to acquire an office property in a submarket of Dallas. In July, 2004, the Company entered into a contract to acquire an office property, also in the Dallas area. Both contracts are subject to a number of contingencies and there is no assurance that either of these acquisitions will occur.

5 Variable Interest Entity

The Company has adopted Financial Accounting Standards Board (FASB) Interpretation (FIN) No.46 (Revised). Under FIN 46R guidelines, qualifying entities should be consolidated as Variable Interest Entities ( VIE s ) based on certain risk and control factors. Because the Company currently finances the Panorama Falls joint venture through its Unsecured Credit Facility and manages the property on a day-to-day basis, it is management s determination that the Panorama Falls property does qualify as a VIE, with the company being the primary beneficiary of the VIE, and, as such, has been consolidated as of and since March 31, 2004. Prior to this date, the venture was accounted for using the equity method. The status of the venture as a VIE is reviewed by management on a quarterly basis.

6 - Long-Term Debt

As part of the acquisition of the Hackberry View property, the Company assumed a first mortgage of approximately \$11,500,000 with an interest rate of 6.57% and a second mortgage of approximately \$700,000 with an interest rate of 15%. The second mortgage has been revalued to record a basis of approximately \$990,000 at 8%, based on the estimated current interest rate for second mortgages with similar maturities. The resulting \$290,000 adjustment to the debt balance has been recorded as an increase in the gross book value of the acquired property.

7 Common Stock Offering

During March 2004, the Company completed an offering of 6,325,000 shares of common stock, including 825,000 shares to cover over-allotments, at a price of \$6.75 per share. The Company received approximately \$39,895,000, net of underwriting commissions and expenses. The proceeds were used to repay the outstanding balance on the Unsecured Fleet Facility and a portion of the outstanding balance on the Secured Fleet Facility. The Company intends to use available amounts under these facilities to fund future property acquisitions and other working capital and cash needs of the business.

8 Discontinued Operations

On March 16, 2004, the Company sold its Texas Bank Buildings for \$4,100,000. The net cash proceeds of approximately \$2,700,000 are being held in escrow as the Company is considering using them to complete a tax deferred exchange under Section 1031 of the Internal Revenue Code. In accordance with SFAS No. 144, the Company has classified the operations of these properties as discontinued operations for the three and six months ended June 30, 2004 and 2003, and the Company has shown these properties as available for sale as of December 31, 2003 as if the properties were available for sale at that date. The following is a summary of the operating results of these properties:

|                                       | For the three<br>months ended<br>June 30, |            | For the six<br>months ended<br>June 30, |            |
|---------------------------------------|---|------------|---|------------|
|                                       | 2004                                      | 2003       | 2004                                    | 2003       |
| Rental revenue                        | \$  | \$ 266,994 | \$ 272,003                              | \$ 532,895 |
| Property operating expenses-          |   |            |   |            |
| Operating expenses                    |   | 100,920    | 82,141                                  | 187,693    |
| Real estate taxes                     |   | 20,703     | 16,373                                  | 40,626     |
| Management fees                       |   | 9,600      | 8,335                                   | 19,200     |
| Interest expense                      |   | 30,372     | 24,125                                  | 61,207     |
| Depreciation and amortization expense |   | 32,873     | 27,570                                  | 65,620     |
|                                       |   | 194,468    | 158,544                                 | 374,346    |

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|              |    |    |        |    |         |    |         |
|--------------|----|----|--------|----|---------|----|---------|
| Gain on sale |    |    |        |    | 574,276 |    |         |
| Net income   | \$ | \$ | 72,526 | \$ | 687,735 | \$ | 158,549 |

9 Loss Per Share

There are no adjustments necessary to the basic weighted average common shares outstanding to arrive at the diluted weighted average common shares outstanding for the three and six months ended June 30, 2004 and 2003 as the Company recognized a net loss and the impact would be anti-dilutive.

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

The following discussion and analysis of the consolidated financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and notes thereto included in this Form 10-Q and elsewhere.

The Company

AmeriVest Properties is a Real Estate Investment Trust which owns and operates commercial office buildings in select markets catering to small and medium size businesses. At June 30, 2003, the Company owned 27 properties totaling 1,563,063 square feet. In the subsequent twelve month period, the Company acquired an additional five properties and sold its four non-core Texas Bank Buildings. At June 30, 2004, it owned 28 properties totaling 2,480,232 square feet. We generate revenue primarily through the rental of office space at our properties. The demand for our products is correlated, in general, to the national economy, and more specifically, to the demand for office space by small and medium size tenants in metropolitan Denver, Dallas, Phoenix and Indianapolis.

Due to the sale of the Texas Bank Buildings, the operations of these properties, including the gain on sale, have been classified as discontinued operations for the periods presented in accordance with SFAS No. 144.

Forward-Looking Statements

Certain statements in this Form 10-Q that are not historical facts are forward-looking statements as that term is defined under the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on the Company's current expectations, beliefs, assumptions, estimates and projections about the industry and markets in which the Company operates. Words such as expects, anticipates, intends, plans, believes, seeks, estimates and variations of such words and similar expressions are intended to identify such forward-looking statements. Information concerning expected investment balances, expected funding sources, planned investments, forecasted dates and revenue and expense growth assumptions are examples of forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict and many of which are beyond the Company's control. Therefore, actual outcomes and results may differ materially from what is expressed, forecasted or implied in such forward-looking statements. The Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable law.

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Results Of Operations

Comparison of the three months ended June 30, 2004 to June 30, 2003:

|  | Three months ended<br>June 30, |                |              |
|--|--------------------------------|----------------|--------------|
|  | 2004                           | 2003           | Change       |
| <b>REAL ESTATE OPERATING REVENUE</b>       |                                |                |              |
| Rental revenue                             | \$ 11,402,649                  | \$ 6,680,723   | \$ 4,721,926 |
| <b>REAL ESTATE OPERATING EXPENSES</b>      |                                |                |              |
| Property operating expenses-               |                                |                |              |
| Operating expenses                         | 3,105,339                      | 1,660,895      | 1,444,444    |
| Real estate taxes                          | 1,477,758                      | 762,939        | 714,819      |
| Management fees                            | 17,428                         | 33,297         | (15,869)     |
| General and administrative expenses        | 984,265                        | 742,773        | 241,492      |
| Ground rent expense                        | 160,542                        |                | 160,542      |
| Interest expense                           | 2,831,282                      | 1,781,535      | 1,049,747    |
| Depreciation and amortization expense      | 3,445,634                      | 1,414,553      | 2,031,081    |
| Impairment of investment in real estate    |                                | 1,465,932      | (1,465,932)  |
| Total operating expenses                   | 12,022,248                     | 7,861,924      | 4,160,324    |
| <b>LOSS FROM CONTINUING OPERATIONS</b>     | (619,599)                      | (1,181,201)    | 561,602      |
| <b>OTHER INCOME/(LOSS)</b>                 |                                |                |              |
| Interest income                            | 10,893                         | 11,936         | (1,043)      |
| Equity in loss of affiliate                |                                | (13,312)       | 13,312       |
| Minority interest                          | 61,118                         |                | 61,118       |
| Total other income/(loss)                  | 72,011                         | (1,376)        | 73,387       |
| <b>LOSS BEFORE DISCONTINUED OPERATIONS</b> | (547,588)                      | (1,182,577)    | 634,989      |
| <b>DISCONTINUED OPERATIONS</b>             |                                | 72,526         | (72,526)     |
| <b>NET LOSS</b>                            | \$ (547,588)                   | \$ (1,110,051) | \$ 562,463   |

Rental revenue increased by \$4,721,926, or 71%, from the second quarter of 2003 to the same period of 2004. Approximately \$2,817,000 of the increase is due to the inclusion of the operating results from the late-2003 acquisitions (Financial Plaza, Scottsdale Norte and Greenhill Park) and \$1,667,000 is due to the inclusion of the 2004 acquisitions (Camelback Lakes for a full quarter and Hackberry View for a partial quarter). Additionally, \$223,000 of the increase is due to the inclusion of Panorama Falls due to the adoption of FIN 46R whereby its operations are consolidated with those of the Company beginning March 31, 2004.

Property operating expenses increased by \$2,143,394, or 87%, from the second quarter of 2003 to the same period of 2004. Approximately \$1,273,000 of the increase is due to the inclusion of the late-2003 acquisitions, \$544,000 is due to the 2004 acquisitions and \$112,000 is due to the consolidation of Panorama Falls. The remainder of the increase was experienced in our existing portfolio (properties owned for the full quarter of both years). The main components of the additional expense consisted of increases in property tax accruals, utilities and regional property management personnel. Property taxes for the second quarter increased from \$763,000, or 11% of revenue, in 2003 to \$1,478,000, or 13% of revenue, in 2004. Currently, nine of the fourteen core properties have been acquired in the past two years. Upon acquisition, the properties are often reassessed by the local municipalities at the purchase price and real estate taxes increase accordingly. While the Company utilizes outside property tax consulting firms to protest the valuations of any properties that are deemed to be overvalued, it accrues the expense

based on the most recent property tax bills with any amounts refunded to the Company

through this process recorded when realized. The Company focuses on the control of operating expenses as a percent of revenue and as it continues to grow and gain scale in each of its markets, believes that it will be able to maintain or increase its operating margins.

General and administrative expenses increased by \$241,492, or 33% from \$742,773, 11% of revenue, for the second quarter of 2003 to \$984,265, 9% of revenue, for the same period in 2004. This increase in overall general and administrative expense is primarily due to the addition of corporate personnel hired during the latter half of 2003 to support the continued growth of the Company. Further, we expect to incur, in excess of \$150,000 in additional cost over the last six months of 2004 solely related to the cost of compliance with the Sarbanes Oxley Act of 2002.

The ground rent expense recognized in 2004 relates to the ground lease for Greenhill Park, acquired in December 2003. The annual rent under this lease increases, and is determined every ten years; the next increase will be effective January 1, 2006, and the lease expires on December 1, 2083. The Company accounts for this lease as an operating lease.

Interest expense increased by \$1,049,747, or 59% from the second quarter of 2003 to the same period of 2004. This increase is due to the additional debt used to acquire the above-mentioned properties. The average outstanding debt balance increased by approximately 42% from the second quarter of 2003 to the same period of 2004 and the weighted average interest rate on this debt was flat from 2003 to 2004. The increase in interest expense is also attributable to the fees related to the Unsecured Credit Facility. This facility provides the Company with more flexibility and a readily available vehicle for financing acquisitions and other capital needs.

The increase in depreciation and amortization expense of \$2,031,081, or 144% is due to the increase in depreciable assets resulting from the above-mentioned acquisitions.

The impairment charges recognized in 2003 related to two of the properties in the Texas State Building portfolio.

The minority interest component represents 80% of the net loss of Panorama Falls which is attributable to the majority shareholder. The Company continues to own a 20% interest in the property.

Included in discontinued operations are the operations of the Texas Bank Buildings which were sold on March 16, 2004.

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Comparison of the six months ended June 30, 2004 to June 30, 2003:

|  | Six months ended<br>June 30, |               |              |
|--|------------------------------|---------------|--------------|
|  | 2004                         | 2003          | Change       |
| <b>REAL ESTATE OPERATING REVENUE</b>       |                              |               |              |
| Rental revenue                             | \$ 20,996,544                | \$ 13,229,350 | \$ 7,767,194 |
| <b>REAL ESTATE OPERATING EXPENSES</b>      |                              |               |              |
| Property operating expenses-               |                              |               |              |
| Operating expenses                         | 5,911,233                    | 3,209,600     | 2,701,633    |
| Real estate taxes                          | 2,715,622                    | 1,514,777     | 1,200,845    |
| Management fees                            | 34,750                       | 67,174        | (32,424)     |
| General and administrative expenses        | 1,916,814                    | 1,579,853     | 336,961      |
| Ground rent expense                        | 321,683                      |               | 321,683      |
| Interest expense                           | 5,553,349                    | 3,506,970     | 2,046,379    |
| Depreciation and amortization expense      | 6,222,725                    | 2,742,519     | 3,480,206    |
| Impairment of investment in real estate    |                              | 1,465,932     | (1,465,932)  |
| Total operating expenses                   | 22,676,176                   | 14,086,825    | 8,589,351    |
| <b>LOSS FROM CONTINUING OPERATIONS</b>     | (1,679,632)                  | (857,475)     | (822,157)    |
| <b>OTHER INCOME/(LOSS)</b>                 |                              |               |              |
| Interest income                            | 26,256                       | 17,753        | 8,503        |
| Equity in loss of affiliate                | (18,076)                     | (23,914)      | 5,838        |
| Minority interest                          | 61,118                       |               | 61,118       |
| Total other income/(loss)                  | 69,298                       | (6,161)       | 75,459       |
| <b>LOSS BEFORE DISCONTINUED OPERATIONS</b> | (1,610,334)                  | (863,636)     | (746,698)    |
| <b>DISCONTINUED OPERATIONS</b>             | 687,735                      | 158,549       | 529,186      |
| <b>NET LOSS</b>                            | \$ (922,599)                 | \$ (705,087)  | \$ (217,512) |

Rental revenue for the six months ended June 30 increased by \$7,767,194, or 59%, from 2003 to 2004. Approximately \$5,613,000 of the increase is due to the inclusion of the operating results from the late-2003 acquisitions, \$1,830,000 is due to the inclusion of the 2004 acquisitions and \$223,000 is due to the consolidation of Panorama Falls.

Property operating expenses for the six months ended June 30 increased by \$3,870,054, or 81%, from 2003 to 2004. Approximately \$2,565,000 of the increase is due to the inclusion of the late-2003 acquisitions, \$609,000 is due to the 2004 acquisitions and \$112,000 is due to the consolidation of Panorama Falls. The remainder of the increase was experienced in our existing portfolio with the main components of the additional expense consisting of increases in property tax accruals, to be consistent with quarterly analysis, utilities and regional property management personnel.

General and administrative expenses increased by \$336,961 or 21% from \$1,579,853, or 12% of revenue, for the six months ended June 30, 2003 to \$1,916,814, or 9% of revenue, for the same period in 2004. This increase in overall general and administrative expense is primarily due to the addition of corporate personnel hired during the latter half of 2003 to support the continued growth of the Company.

The ground rent expense recognized in 2004 relates to the ground lease for Greenhill Park, acquired in December 2003.

Interest expense increased by \$2,046,379, or 58% from the six months ended June 30, 2003 to the same period of 2004. This increase is due to the additional debt used to acquire the above-mentioned properties.

The increase in depreciation and amortization expense by \$3,480,206, or 127% is due to the increase in depreciable assets resulting from the above-mentioned acquisitions.

The impairment charges recognized in 2003 related to two of the properties in the Texas State Building portfolio.

The minority interest component represents 80% of the net loss of Panorama Falls which is attributable to the majority shareholder. The Company continues to own a 20% interest in the property.

Included in discontinued operations are the operations of the Texas Bank Buildings. These properties were sold on March 16, 2004 for \$4,100,000. This sale resulted in a gain of \$574,276, which is reflected in the 2004 amount.

#### Liquidity and Capital Resources

##### *Operating Activities*

Net cash flows provided by operations were approximately \$4,089,000 for the six months ended June 30, 2004. This results primarily from the Company's operating results adjusted for non-cash expenses and a general increase in our receivables in excess of the prior year period. Cash flow from operations is the primary source to fund dividend payments, debt service and capital expenditures. See Results of Operations for a more complete discussion on the factors impacting the Company's operating performance.

##### *Investing Activities*

Net cash flows used in investing activities were approximately \$42,924,000 for the six months ended June 30, 2004, of which approximately \$36,639,000 was used to acquire the Camelback Lakes and Hackberry View properties, net of debt assumed. The remainder is primarily composed of capital improvement, tenant improvement and leasing commission costs offset by the net proceeds from the sale of the Texas Bank Buildings of approximately \$4,049,000.

##### *Financing Activities*

Net cash flows provided by financing activities were approximately \$40,186,000 for the six months ended June 30, 2004. Included in this amount is approximately \$39,895,000 which represents the net proceeds from the March 2004 common stock offering; of this amount, approximately \$39,000,000 was immediately used to pay down the Company's secured and unsecured credit facilities. The Company subsequently recorded additions to mortgage loans and notes payable of approximately \$46,300,000 related to the acquisitions of the Camelback Lakes and Hackberry View properties. The remainder of the change is primarily composed of scheduled principal payments on mortgage loans, dividend payments and payments into escrow accounts as required by certain lenders.

*Future Sources of Capital*

The Company receives base rent under non-cancelable tenant leases and most leases provide for additional rent based on increases in operating expenses.

The Company desires to acquire additional properties. In order to do so, it will utilize current sources of debt financing and possibly incur additional debt and/or obtain additional equity capital. The Company also intends to obtain credit facilities for short and long-term borrowing with commercial banks or other financial institutions. The issuance of such securities or increase in debt to acquire additional properties, of which there is no assurance, could adversely affect the amount of cash available to pay dividends to stockholders.

The Company has two credit facilities with Fleet National Bank. At June 30, 2004, there was \$40,650,000 outstanding with \$1,350,000 available under the Secured Fleet Facility and there was no outstanding balance with \$30,000,000 available under the Unsecured Fleet Facility. Available amounts under these facilities will be used to acquire and improve new and existing properties, as well as for

working capital.

*Future Uses of Capital, Contractual Commitments and Off-Balance Sheet Arrangements*

The following table details the contractual obligations at June 30, 2004. These include scheduled maturities of mortgage loans and notes payable as well as estimated amounts on the ground lease for Greenhill Park that resets the payment amount every ten years based on the appraised value and expires on December 1, 2083:

| For the years<br>ended December 31, | Mortgage<br>Loans and<br>Notes Payable | Ground Lease   | Total          |
|-------------------------------------|--|----------------|----------------|
| 2004                                | \$ 1,119,300                           | \$ 321,082     | \$ 1,425,209   |
| 2005                                | 43,113,577                             | 642,165        | 43,727,899     |
| 2006                                | 16,674,529                             | 863,016        | 17,507,534     |
| 2007                                | 2,587,128                              | 863,016        | 3,417,809      |
| 2008                                | 37,348,319                             | 863,016        | 38,176,509     |
| Thereafter                          | 75,794,434                             | 225,671,046    | 301,317,236    |
| Total                               | \$ 176,637,287                         | \$ 229,223,341 | \$ 405,572,196 |

*Interest Rate Information*

As of June 30, 2004, approximately 77% of the total mortgage loans outstanding are fixed rate loans with a weighted-average interest rate of 6.5% and 23% are variable rate loans with a weighted-average interest rate of 3.9%.

*Debt Covenants*

Certain of the Company's debt instruments contain covenants common to that type of facility or borrowing, including financial covenants establishing minimum debt service coverage and maximum leverage ratios. The Company was in compliance with all financial covenants pertaining to its debt instruments during the three and six months ended June 30, 2004.

Critical Accounting Policies

The discussion and analysis of the Company's financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements require management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, which would potentially result in materially different results under different assumptions and conditions. The Company believes that its critical accounting policies include those items described below.

*Investment in Real Estate*

Upon acquisition, the purchase price of a property is allocated to land, building and improvements and other intangible assets and associated liabilities as required by SFAS No. 141 Business Combinations. The allocation to land is based on an estimate of its fair value based on all available information including appraisals. The allocation to other intangible assets represents the value associated with the in-place leases, including leasing commission, legal and other related costs. Also required by SFAS No. 141, is the creation of an intangible asset or liability resulting from in-place leases being above or below the market rental rates on the date of acquisition. This asset or liability is amortized over the life of the related in-place leases as an adjustment to revenue.

Investment in real estate is stated at cost. Depreciation and amortization are computed on a straight-line basis over the estimated useful lives as follows:

| Description   | Estimated Useful Lives |
|---|------------------------|
| Land  | Not depreciated        |
| Buildings and improvements  | 20 to 40 years         |
| Furniture, fixtures and equipment   | 5 to 7 years           |
| Tenant improvements, tenant leasing commissions and other intangible assets | Term of related lease  |

Maintenance and repairs are expensed as incurred and improvements are capitalized. The cost of assets sold or retired and the related accumulated depreciation and/or amortization are removed from the accounts and the resulting gain or loss is reflected in operations in the period in which such sale or retirement occurs. Allocating the purchase price of a property to the different components of investment in real estate, determining whether expenditures meet the criteria for capitalization and assigning depreciable lives is considered to be critical because it requires management to exercise significant judgment.

#### *Valuation of Real Estate Assets*

Long-lived assets to be held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company continually evaluates the recoverability of its long-lived assets based on estimated future cash flows from and the estimated liquidation value of such long-lived assets, and provides for impairment if such undiscounted cash flows are insufficient to recover the carrying amount of the long-lived asset. Valuation of real estate assets is considered to be critical because the evaluation of impairment and the determination of fair values involve management's assumptions relating to future economic events that could materially affect the determination of the fair value, and therefore the carrying value of real estate.

#### *Revenue Recognition*

Certain leases provide for tenant occupancy during periods for which no rent is due or where minimum rent payments increase during the term of the lease. Rental revenue is recorded for the full term of each lease on a straight-line basis. Accordingly, the Company records a receivable from tenants for rents that it expects to collect over the remaining lease term as deferred rents receivable. When the Company acquires a property, the term of the existing leases is considered to commence as of the acquisition date for the purposes of this calculation. Revenue recognition is considered to be critical because the evaluation of the realizability of such deferred rents receivable involves management's assumptions relating to such tenant's viability.

#### *Inflation*

Management believes that inflation should not have a material adverse effect on the Company. The Company's office leases generally require the tenants to pay increases in operating expenses should any inflationary pressures materialize.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our future earnings, cash flows and fair values relevant to financial instruments depend upon prevalent market rates for those financial instruments. Market risk is the risk of loss from adverse changes in market prices and interest rates. We manage our market risk by matching projected cash inflows from operating, investing and financing activities with projected cash outflows to fund debt service, acquisitions, capital expenditures, dividends and other cash requirements. The majority of our outstanding debt obligations have fixed interest rates which limit the risk of fluctuating interest rates. At June 30, 2004, our interest rate risk only related to our \$42,000,000 Secured Fleet Facility and our \$30,000,000 Unsecured Fleet Facility, of which there was \$40,650,000 and \$0 outstanding, respectively. Based on the amounts outstanding at

June 30, 2004, the annual impact of a 1% change in interest rates would be approximately \$407,000.

The Company's operating results depend primarily on income from its properties, which are substantially influenced by supply and demand for such properties, operating expense levels, property level operations and the pace and price at which the Company can develop, acquire or dispose of such properties. Capital and credit market conditions, which affect the Company's cost of capital, also influence operating results. See the Company's 2003 Form 10-KSB Item 1. Description of Business for a more complete discussion of risk factors that could impact the Company's future financial performance.

Item 4. Controls and Procedures

The Company carried out an evaluation under the supervision and with participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 as of June 30, 2004. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that disclosure controls and procedures were effective as of the end of the period covered by this report to ensure that information required to be disclosed by the Company in its reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. There was no change in the Company's internal controls over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings

No changes.

Item 2. Changes in Securities and Use of Proceeds

Issuance of Equity Securities Upon Exercise of Warrants

During the three month period ended June 30, 2004, the Company issued 5,210 shares of common stock upon exercise of previously issued warrants. The issuance of the shares of common stock was made pursuant to an exemption from registration in accordance with Section 4(2) of the Securities Act based on a representation to us from the entity receiving the shares that such entity was a sophisticated investor who was knowledgeable about our operations and financial condition and was able to evaluate the risks and merits of receipt of the shares.

Purchases of Equity Securities

Certain information regarding purchases made by or on behalf of the Company or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934, as amended) of our common stock during the three months ended June 30, 2004 is provided below:

| Period      | Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans (1) | Maximum Number of Shares That May Yet Be Purchased Under the Plan (2) |
|-------------|----------------------------|------------------------------|--|---|
| April, 2004 | 6,690                      | \$ 6.10                      | 6,690  | N/A   |

(1) On August 11, 2000, the Company's Board of Directors approved adoption of the Dividend Reinvestment Plan (the Plan). Under the Plan, the Company is authorized to instruct the plan administrator to repurchase shares of its common stock from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to the Company in order to offset some or all such shares issued pursuant to the Plan. The Company announced the Plan in September, 2000. The Plan has no expiration date.

(2) One million shares of Company common stock are registered for sale by the Company under the plan. The Plan has no limits as to the number of shares or dollar value that may be repurchased by the Company to satisfy the shares needed under the Plan.

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

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At the annual meeting of stockholders held June 2, 2004, stockholders elected the following individuals to serve on the Board of Directors of the Company, each as a Class 2 Director:

| <b>Name</b>         | <b>Shares<br/>Vote in Favor</b> | <b>Abstentions and<br/>Non-Votes</b> |
|---------------------|---------------------------------|--------------------------------------|
| Alexander S. Hewitt | 21,527,567                      | 199,271                              |
| Charles K. Knight   | 21,521,167                      | 205,671                              |
| Jerry J. Tepper     | 21,508,517                      | 218,321                              |

Additionally, at the annual meeting the stockholders voted to approve Articles of Amendment to the Company's Amended and Restated Articles of Incorporation (the Amendment) for the purposes of declassifying the Company's Board of Directors. At the annual meeting 21,220,502 shares of common stock voted in favor of the Amendment; 305,174 shares of common stock voted against; and 201,162 shares of common stock were recorded as abstentions or broker non-votes.

Following the meeting, William T. Atkins, Patrice Derrington, Harry P. Gelles, Robert W. Holman, Jr. and John A. Labate continued as Directors.

The term of each Director, including those elected at the June 2, 2004 meeting, will end at the 2005 annual meeting of the stockholders or until such Director's successor is duly elected and qualified.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

3.1B Articles of Amendment to Amended and Restated Articles of Incorporation dated June 8, 2004.

31. Certifications of Chief Executive Officer and Chief Financial Officer pursuant to section

302 of the Sarbanes-Oxley Act of 2002.

32. Certification of Chief Executive Officer and Chief Financial Officer pursuant to section

906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

None.

**SIGNATURES**

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

AMERIVEST PROPERTIES INC.

August 9, 2004

By: /s/ Kathryn L. Hale  
Kathryn L. Hale  
Chief Financial Officer  
(Principal Financial Officer and  
Principal Accounting Officer)