CATELLUS DEVELOPMENT CORP
Form 10-Q
May 15, 2003
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# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE**

**SECURITIES EXCHANGE ACT OF 1934**

For the fiscal quarter ended March 31, 2003 Commission file number 1-10622

# CATELLUS DEVELOPMENT CORPORATION

**(Exact name of Registrant as specified in its charter)**

| | |
|---|---|
| **Delaware** | **94-2953477** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

**201 Mission Street**

**San Francisco, California 94105**

**(Address of principal executive offices and zip code)**

**Registrant s telephone number, including area code:**

**(415) 974-4500**

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

As of May 12, 2003, there were 87,374,238, issued and outstanding shares of the Registrant s Common Stock.

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**CATELLUS DEVELOPMENT CORPORATION**

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**PART I**

**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements (Unaudited)**

**CATELLUS DEVELOPMENT CORPORATION**

**Condensed Consolidated Balance Sheet**

**(In thousands)**

| | March 31, 2003 | December 31, 2002 |
|---|---|---|
| | (Unaudited) | |
| **Assets** | | |
| Properties | $ 2,476,382 | $ 2,448,081 |
| Less accumulated depreciation | (413,127) | (399,923) |
| | 2,063,255 | 2,048,158 |
| Other assets and deferred charges, net | 287,792 | 273,853 |
| Notes receivable, less allowance | 31,408 | 44,947 |
| Accounts receivable, less allowance | 13,565 | 14,211 |
| Assets held for sale | | 2,760 |
| Restricted cash and investments | 41,801 | 36,593 |
| Cash and cash equivalents | 201,499 | 274,927 |
| Total | $ 2,639,320 | $ 2,695,449 |
| **Liabilities and stockholders equity** | | |
| Mortgage and other debt | $ 1,498,321 | $ 1,500,955 |
| Accounts payable and accrued expenses | 97,339 | 117,493 |
| Deferred credits and other liabilities | 155,670 | 151,466 |
| Liabilities associated with assets held for sale | | 3,233 |
| Deferred income taxes | 316,277 | 318,970 |
| Total liabilities | 2,067,607 | 2,092,117 |
| Commitments and contingencies (Note 8) | | |
| Minority interests | | 57,363 |
| Stockholders equity | | |
| Common stock, 110,965 and 110,817 shares issued and 87,318 and 87,170 shares outstanding at March 31, 2003 and December 31, 2002, respectively | 1,109 | 1,108 |

| | | |
|---|---|---|
| Paid-in capital | 533,694 | 531,362 |
| Treasury stock, at cost (23,647 shares at March 31, 2003 and December 31, 2002) | (401,082) | (401,082) |
| Accumulated earnings | 437,992 | 414,581 |
| Total stockholders equity | 571,713 | 545,969 |
| Total | $ 2,639,320 | $ 2,695,449 |

See notes to Condensed Consolidated Financial Statements



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**CATELLUS DEVELOPMENT CORPORATION**

**CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS**

**(In thousands, except per share data)**

| | Three Months Ended March 31, | |
|---|---|---|
| | **2003** | **2002** |
| | **(Unaudited)** | |
| **Rental properties** | | |
| Rental revenue | $ 74,137 | $ 62,967 |
| Property operating costs | (19,446) | (15,701) |
| Equity in earnings of operating joint ventures, net | 2,523 | 3,521 |
| | 57,214 | 50,787 |
| **Property sales and fee services** | | |
| Sales revenue | 8,010 | 54,694 |
| Cost of sales | (2,972) | (39,085) |
| Gain on property sales | 5,038 | 15,609 |
| Equity in earnings of development joint ventures, net | 3,854 | 7,447 |
| Total gain on property sales | 8,892 | 23,056 |
| Management and development fees | 2,084 | 1,132 |
| Selling, general and administrative expenses | (5,492) | (7,850) |
| Other, net | 2,825 | 9,954 |
| | 8,309 | 26,292 |
| Interest expense | (16,807) | (12,571) |
| Depreciation and amortization | (16,568) | (13,438) |

| | | |
|---|---|---|
| Corporate administrative costs | (4,399) | (4,102) |
| Gain (loss) on non-strategic asset sales | 5,879 | (238) |
| Other, net | 249 | 67 |
| REIT transition costs | (1,558) | |
| **Income before minority interests, income taxes, and discontinued operations** | 32,319 | 46,797 |
| Minority interests | | (1,527) |
| **Income before income taxes and discontinued operations** | 32,319 | 45,270 |
| Income tax expense | (11,732) | (18,209) |
| **Income from continuing operations** | 20,587 | 27,061 |
| Discontinued operations, net of income tax: | | |
| Gain from disposal of discontinued operations | 2,639 | 4,505 |
| Income (loss) from discontinued operations | 185 | (82) |
| Gain from discontinued operations | 2,824 | 4,423 |
| **Net income** | $ 23,411 | $ 31,484 |
| **Income per share from continuing operations** | | |
| Basic | $ 0.24 | $ 0.31 |
| Assuming dilution | $ 0.23 | $ 0.30 |
| **Income per share from discontinued operations** | | |
| Basic | $ 0.03 | $ 0.05 |
| Assuming dilution | $ 0.03 | $ 0.05 |
| **Net income per share** | | |
| Basic | $ 0.27 | $ 0.36 |
| Assuming dilution | $ 0.26 | $ 0.35 |
| Average number of common shares outstanding basic | 87,255 | 86,652 |
| Average number of common shares outstanding diluted | 89,944 | 89,115 |

See notes to Condensed Consolidated Financial Statements



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**CATELLUS DEVELOPMENT CORPORATION**

**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**

**(In thousands)**

| | Three Months Ended March 31, | |
|---|---|---|
| | **2003** | **2002** |
| | (Unaudited) | |
| **Cash flows from operating activities:** | | |
| Net income | $ 23,411 | $ 31,484 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 16,568 | 13,438 |
| Deferred income taxes | (2,972) | 10,595 |
| Deferred gain recognized | (544) | (13,265) |
| Amortization of deferred loan fees and other costs | 1,119 | 1,945 |
| Equity in earnings of joint ventures | (6,377) | (10,968) |
| Operating distributions from joint ventures | 7,338 | 29,878 |
| Gain on sales of investment property | (4,398) | (7,536) |
| Cost of development property and non-strategic assets sold | 2,538 | 25,840 |
| Capital expenditures for development property | (14,541) | (17,324) |
| Other, net | (2,190) | 5,351 |
| Change in deferred credits and other liabilities | 6,520 | 3,707 |
| Change in other operating assets and liabilities | 4,679 | (7,386) |
| Net cash provided by operating activities | 31,151 | 65,759 |
| **Cash flows from investing activities:** | | |
| Net proceeds from sale of investment property | 24,202 | 9,084 |
| Capital expenditures for investment property | (112,126) | (86,104) |
| Payment of reimbursable construction costs | (6,845) | (12,428) |
| Distributions from joint ventures | 8,601 | |
| Contributions to joint ventures | (4,523) | (5,005) |
| Net increase in restricted cash | (5,208) | (1,830) |
| Net cash used in investing activities | (95,899) | (96,283) |
| **Cash flows from financing activities:** | | |
| Borrowings | 14,221 | 114,449 |
| Repayment of borrowings | (20,326) | (92,418) |
| Distributions to minority partners | (4,540) | (4,540) |
| Proceeds from issuance of common stock | 1,965 | 5,187 |
| Net cash (used in) provided by financing activities | (8,680) | 22,678 |
| **Net decrease in cash and cash equivalents** | (73,428) | (7,846) |
| Cash and cash equivalents at beginning of period | 274,927 | 222,695 |
| Cash and cash equivalents at end of period | $ 201,499 | $ 214,849 |
| **Supplemental disclosures of cash flow information:** | | |
| Cash paid during the period for: | | |
| Interest (net of amount capitalized) | $ 15,921 | $ 11,526 |
| Income taxes | $ 11,014 | $ 6,071 |
| Non-cash financing activities: | | |
| Debt forgiveness-property reconveyance | $ 324 | $ |

See notes to Condensed Consolidated Financial Statements





**CATELLUS DEVELOPMENT CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2003**

**(Unaudited)**

**NOTE 1. DESCRIPTION OF BUSINESS**

Catellus Development Corporation, together with its consolidated subsidiaries ( Catellus or the Company ), is a diversified real estate operating company, with a large portfolio of rental properties and developable land, that manages and develops real estate for its own account and those of others. Interests of third parties in entities controlled and consolidated by the Company are separately reflected as minority interests in the accompanying financial statements. The Company s rental portfolio and developable land, consisting of industrial, residential, retail, office, and other projects are located mainly in major markets in California, Illinois, Texas, Colorado, and Oregon.

On March 3, 2003, the Company announced that its Board of Directors has authorized it to restructure its business operations in order to qualify as a real estate investment trust ( REIT ), effective January 1, 2004. The REIT conversion is subject to shareholder approval as well as final Board approval. The Company anticipates that its shareholders meeting will be in the third quarter of 2003 (see Note 11).

**NOTE 2. INTERIM FINANCIAL DATA**

The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Company s 2002 Annual Report on Form 10-K as filed with the Securities and Exchange Commission. In the opinion of management, the accompanying financial information includes all adjustments necessary to present fairly the financial position, results of operations, and cash flows for the interim periods presented. Certain prior period financial data have been reclassified to conform to the current period presentation.

At March 31, 2003, the Company has five stock-based employee compensation plans. The Company accounts for those plans under the recognition and measurement principles of Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards Board ( FASB ) No. 123, *Accounting forStock-Based Compensation*, to stock-based employee compensation.

| | Three Months Ended March 31, | |
|---|---|---|
| | 2003 | 2002 |
| | (In thousands, except income per share data) | |
| Net income, as reported | $ 23,411 | $ 31,484 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (1,414) | (1,329) |
| Pro forma net income | $ 21,997 | $ 30,155 |
| Earnings per share: | | |
| Basic as reported | $ 0.27 | $ 0.36 |
| Basic pro forma | $ 0.25 | $ 0.35 |
| Diluted as reported | $ 0.26 | $ 0.35 |
| Diluted pro forma | $ 0.24 | $ 0.34 |

Income tax (expense) benefit on income from continuing operations for the three months ended March 31, 2003 and 2002 consisted of the following:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2003 | 2002 |
| | (In thousands) | |
| Current | $ (14,704) | $ (7,614) |
| Deferred | 2,972 | (10,595) |
| Total | $ (11,732) | $ (18,209) |



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The Company s sales of non-strategic assets are summarized as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2003 | 2002 |
| | (In thousands) | |
| Sales | $ 6,203 | $ 130 |
| Cost of sales | (324) | (368) |

| | | |
|---|---|---|
| Gain (loss) | $ 5,879 | $ (238) |

**NOTE 3. RESTRICTED CASH AND INVESTMENTS**

Of the total restricted cash and investments of $41.8 million at March 31, 2003, and $36.6 million at December 31, 2002, $8.4 million and $5.1 million, respectively, represent proceeds from property sales held in separate cash accounts at trust companies in order to preserve the Company s option to reinvest the proceeds on a tax-deferred basis. Approximately $23.4 million and $24.6 million at March 31, 2003 and December 31, 2002, respectively, represents funds held in pledge accounts at a bank until certain loan collateral pool requirements are met, and $4.0 million at March 31, 2003, represents a reserve fund held by a lender in anticipation of substitution of real property collateral. In addition, restricted investments of $6.0 million and $6.9 million at March 31, 2003 and December 31, 2002, respectively, represent certificates of deposits used to guarantee lease performance for certain properties that secure debt.

**NOTE 4. INCOME PER SHARE**

Income from continuing and discontinued operations per share of common stock is computed by dividing respective income by the weighted average number of shares of common stock and equivalents outstanding during the period (*see* table below for effect of dilutive securities, and Notes 2 and 10).

| | Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2003 | | | 2002 | | |
| | Income | Shares | Per Share Amount | Income | Shares | Per Share Amount |
| | (In thousands, except per share data) | | | | | |
| Income from continuing operations | $ 20,587 | 87,255 | $ 0.24 | $ 27,061 | 86,652 | $ 0.31 |
| Effect of dilutive securities: stock options | | 2,689 | | | 2,463 | |
| Income from continuing operations assuming dilution | $ 20,587 | 89,944 | $ 0.23 | $ 27,061 | 89,115 | $ 0.30 |
| Gain from discontinued operations | $ 2,824 | 87,255 | $ 0.03 | $ 4,423 | 86,652 | $ 0.05 |
| Effect of dilutive securities: stock options | | 2,689 | | | 2,463 | |
| Gain from discontinued operations assuming dilution | $ 2,824 | 89,944 | $ 0.03 | $ 4,423 | 89,115 | $ 0.05 |
| Net income | $ 23,411 | 87,255 | $ 0.27 | $ 31,484 | 86,652 | $ 0.36 |
| Effect of dilutive securities: stock options | | 2,689 | | | 2,463 | |
| Net income assuming dilution | $ 23,411 | 89,944 | $ 0.26 | $ 31,484 | 89,115 | $ 0.35 |

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**NOTE 5. MORTGAGE AND OTHER DEBT**

Mortgage and other debt at March 31, 2003 and December 31, 2002, are summarized as follows:

| | March 31, 2003 | December 31, 2002 |
|---|---|---|
| | (In thousands) | |
| Fixed rate mortgage loans | $ 1,070,897 | $ 1,080,655 |
| Floating rate mortgage loans | 206,278 | 207,212 |
| Construction loans | 86,534 | 78,244 |
| Land acquisition and development loans | 22,241 | 22,241 |
| Assessment district bonds | 103,799 | 103,935 |
| Other loans | 8,572 | 8,668 |
| Mortgage and other debt | 1,498,321 | 1,500,955 |
| Liabilities of assets held for sale: | | |
| Fixed rate mortgage loans | | 2,849 |
| Floating rate mortgage loans | | 298 |
| Total mortgage and other debt | $ 1,498,321 | $ 1,504,102 |
| Due within one year | $ 154,855 | $ 154,152 |

Interest costs relating to mortgage and other debt for the three-months ended March 31, 2003 and 2002, are summarized as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2003 | 2002 |
| | (In thousands) | |
| Total interest incurred | $ 21,939 | $ 20,149 |
| Interest capitalized | (5,118) | (7,347) |
| Interest expensed | 16,821 | 12,802 |
| Less discontinued operations | (14) | (231) |
| Interest expense for continuing operations | $ 16,807 | $ 12,571 |

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**NOTE 6. PROPERTIES**

Book value by property type at March 31, 2003 and December 31, 2002, consisted of the following:

| | March 31, 2003 | December 31, 2002 |
|---|---|---|
| | (In thousands) | |
| Rental properties: | | |
| Industrial buildings | $ 1,141,371 | $ 1,134,890 |
| Office buildings | 378,055 | 372,795 |
| Retail buildings | 103,104 | 100,882 |
| Ground leases and other | 177,155 | 176,430 |
| Investment in operating joint ventures | (17,495) | (10,920) |
| | 1,782,190 | 1,774,077 |
| Developable land: | | |
| Commercial | 187,431 | 171,924 |
| Residential | 50,943 | 52,850 |
| Urban | 272,063 | 279,495 |
| Investment in development joint ventures | 63,834 | 58,071 |
| | 574,271 | 562,340 |
| Work-in-process: | | |
| Commercial | 55,402 | 49,938 |
| Urban | 19,679 | 16,915 |
| | 75,081 | 66,853 |
| Furniture and equipment | 38,015 | 38,096 |
| Other | 6,825 | 6,715 |
| Gross book value | 2,476,382 | 2,448,081 |
| Accumulated depreciation | (413,127) | (399,923) |
| Net book value | $ 2,063,255 | $ 2,048,158 |

**NOTE 7. SEGMENT REPORTING**

The Company s reportable segments are based on the Company s method of internal reporting, which disaggregates its business by type and before the adjustments for discontinued operations. The Company has five reportable segments: Asset Management; Suburban, which includes two reportable segments, Commercial and Residential; Urban; and Corporate. The Asset Management segment leases and manages the Company-owned commercial buildings and ground leases. The Suburban Commercial segment develops real estate for the Company s own account or for third parties and acquires and sells developable land and commercial buildings. The Suburban Residential segment acquires and develops suburban residential communities and sells finished lots to homebuilders via direct ownership or through joint ventures. The Urban segment develops major mixed-use sites including development for residential, office, and retail purposes for the Company s own account and for joint ventures. The Corporate segment consists of administrative services.

Inter-segment gains and losses are not recognized. Debt and interest-bearing assets are allocated to segments based upon the grouping of the underlying assets. All other assets and liabilities are specifically identified and allocated to the segments.



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Financial data by reportable segment is as follows:

| | Asset Management | Suburban Commercial | Suburban Residential | Urban | Corporate | Subtotal | Discontinued Operations | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | (In thousands) | | | | |
| **Three Months Ended March 31, 2003** | | | | | | | | |
| **Rental properties:** | | | | | | | | |
| Rental revenue | $ 74,728 | $ | $ | $ | $ | $ 74,728 | $ (591) | $ 74,137 |
| Property operating costs | (19,589) | | | | | (19,589) | 143 | (19,446) |
| Income from operating joint ventures, net | 2,523 | | | | | 2,523 | | 2,523 |
| | 57,662 | | | | | 57,662 | (448) | 57,214 |
| **Property sales and fee services:** | | | | | | | | |
| Sales revenue | 24,949 | 3,998 | 3,465 | | | 32,412 | (24,402) | 8,010 |
| Cost of sales | (20,194) | (2,331) | (451) | | | (22,976) | 20,004 | (2,972) |
| Gain on property sales | 4,755 | 1,667 | 3,014 | | | 9,436 | (4,398) | 5,038 |
| Income from development joint ventures, net | | | 3,854 | | | 3,854 | | 3,854 |
| Total gain on property sales | 4,755 | 1,667 | 6,868 | | | 13,290 | (4,398) | 8,892 |
| Management and development fees | 5 | 824 | 94 | 1,161 | | 2,084 | | 2,084 |
| Selling, G & A expenses | (280) | (2,627) | (782) | (1,803) | | (5,492) | | (5,492) |
| Other, net | 1,481 | 173 | 887 | 289 | | 2,830 | (5) | 2,825 |
| | 5,961 | 37 | 7,067 | (353) | | 12,712 | (4,403) | 8,309 |
| Interest expense | (21,254) | | | | 4,433 | (16,821) | 14 | (16,807) |
| Depreciation and amortization | (15,831) | | (30) | (266) | (572) | (16,699) | 131 | (16,568) |
| Corporate administrative costs | | | | | (4,399) | (4,399) | | (4,399) |
| Gain on non-strategic asset sales | 5,879 | | | | | 5,879 | | 5,879 |
| Other, net | | | | | 249 | 249 | | 249 |
| REIT transition costs | | | | | (1,558) | (1,558) | | (1,558) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Minority interests | | | | | | | | |
| Income taxes | (11,919) | (14) | (2,588) | 228 | 679 | (13,614) | 1,882 | (11,732) |
| **Income (loss) from continuing operations** | 20,498 | 23 | 4,449 | (391) | (1,168) | 23,411 | (2,824) | 20,587 |
| **Discontinued operations, net of tax:** | | | | | | | | |
| Gain from disposal of discontinued operations | | | | | | | 2,639 | 2,639 |
| Income from discontinued operations | | | | | | | 185 | 185 |
| Gain from discontinued operations | | | | | | | 2,824 | 2,824 |
| **Net income (loss)** | $ 20,498 | $ 23 | $ 4,449 | $ (391) | $ (1,168) | $ 23,411 | $ | $ 23,411 |



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| | Asset Management | Suburban Commercial | Suburban Residential | Urban | Corporate | Subtotal | Discontinued Operations | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | (In thousands) | | | | |
| **Three Months Ended March 31, 2002** | | | | | | | | |
| **Rental properties:** | | | | | | | | |
| Rental revenue | $ 63,280 | $ | $ | $ | $ | $ 63,280 | $ (313) | $ 62,967 |
| Property operating costs | (15,808) | | | | | (15,808) | 107 | (15,701) |
| Income from operating joint ventures, net | 3,521 | | | | | 3,521 | | 3,521 |
| | 50,993 | | | | | 50,993 | (206) | 50,787 |
| **Property sales and fee services:** | | | | | | | | |
| Sales revenue | 9,764 | 26,238 | 28,003 | | | 64,005 | (9,311) | 54,694 |
| Cost of sales | (2,037) | (23,735) | (14,738) | | (350) | (40,860) | 1,775 | (39,085) |
| Gain on property sales | 7,727 | 2,503 | 13,265 | | (350) | 23,145 | (7,536) | 15,609 |
| Income from development joint ventures, net | | | 7,960 | | (513) | 7,447 | | 7,447 |
| Total gain on property sales | 7,727 | 2,503 | 21,225 | | (863) | 30,592 | (7,536) | 23,056 |
| Management and development fees | 25 | 549 | 286 | 272 | | 1,132 | | 1,132 |
| Selling, G & A expenses | (136) | (1,949) | (4,168) | (1,597) | | (7,850) | | (7,850) |
| Other, net | 7,985 | 473 | 1,425 | 71 | | 9,954 | | 9,954 |
| | 15,601 | 1,576 | 18,768 | (1,254) | (863) | 33,828 | (7,536) | 26,292 |
| Interest expense | (18,748) | | | (5) | 5,951 | (12,802) | 231 | (12,571) |
| Depreciation and amortization | (12,603) | (154) | (37) | (243) | (514) | (13,551) | 113 | (13,438) |
| Corporate administrative costs | | | | | (4,102) | (4,102) | | (4,102) |
| Loss on non-strategic asset sales | (238) | | | | | (238) | | (238) |
| Other, net | | | | | 67 | 67 | | 67 |
| Minority interests | (1,527) | | | | | (1,527) | | (1,527) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Income taxes | (13,464) | (573) | (7,534) | 604 | (217) | (21,184) | 2,975 | (18,209) |
| **Income (loss) from continuing operations** | 20,014 | 849 | 11,197 | (898) | 322 | 31,484 | (4,423) | 27,061 |
| **Discontinued operations, net of tax:** | | | | | | | | |
| Gain from disposal of discontinued operations | | | | | | | 4,505 | 4,505 |
| Loss from discontinued operations | | | | | | | (82) | (82) |
| Gain from discontinued operations | | | | | | | 4,423 | 4,423 |
| **Net income (loss)** | $ 20,014 | $ 849 | $ 11,197 | $ (898) | $ 322 | $ 31,484 | $ | $ 31,484 |



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**NOTE 8. COMMITMENTS AND CONTINGENCIES**

The Company has surety bonds and standby letters of credit related to various development projects, lease payment guarantees, various debt and debt service guarantees, and capital contribution commitments related to certain unconsolidated real estate joint ventures. These surety bond, standby letters of credit, guarantees and capital contribution commitments as of March 31, 2003, are summarized in the following categories (in thousands):

| | |
|---|---|
| **Off-balance sheet liabilities:** | |
| Surety bonds | $ 198,933 |
| Standby letters of credit | 51,681 |
| Debt service guarantees | 46,204 |
| Contribution requirements | 17,049 |
| Lease payment guarantee | 1,456 |
| Sub-total | 315,323 |
| **Liabilities included in balance sheet:** | |
| Standby letters of credit | 53,475 |
| Total | $ 368,798 |

Surety bonds are to guarantee the construction of infrastructure and public improvements. Surety bonds are commonly required by public agencies from developers in real estate development, are renewable, and expire upon completion of the required improvements. The typical development period of the Company s development projects is approximately one to three years. An example of the type of event that would require the Company to perform under these surety bonds would be the failure of the Company to construct or complete the required improvements. At March 31, 2003, the Company has not been required to fund any of the surety bonds.

Standby letters of credit consist of two types: performance and financial. Performance standby letters of credit are similar in nature and term as the surety bonds described above. Financial standby letters of credit are a form of credit enhancement commonly required in real estate development when bonds are issued to finance public improvements; these financial standby letters of credit are scheduled to expire between December 2005 and May 2007. As of March 31, 2003, the Company has a total of $105.2 million in standby letters of credit; $51.7 million of the total is off-balance sheet ($40.0 million in financial letters of credit and $11.7 million in performance letters of credit), while the remaining $53.5 million are related to obligations that are reflected in the Company s Condensed Consolidated Balance Sheet ($47.5 million in Mortgage and other debt and $6 million in Restricted cash and investments ). An example of the type of event that would require the Company to perform under the performance standby letters of credit would be the failure of the Company to construct or complete the required improvements. An example of the type of event that would require the Company to perform under the financial standby letters of credit would be a debt service shortfall in the municipal district that issued the municipal bonds. At March 31, 2003, the Company has not been required to satisfy any of these standby letters of credit.

The Company has made debt service guarantees for certain of its unconsolidated joint ventures. At March 31, 2003, based on the joint ventures outstanding balance, these debt guarantees totaled $46.2 million. These debt service guarantees are scheduled to expire between January 2004 and September 2005. These debt service guarantees are typical business arrangements commonly required of developers in real estate development. An example of the types of event that would require the Company to provide a cash payment pursuant to a guarantee include a loan default, which would result from failure of the primary borrower to service its debt when due, or non-compliance of the primary borrower with financial covenants or inadequacy of asset collateral. At March 31, 2003, the Company has not been required to satisfy any amounts under these debt service guarantees.

The Company is required to make additional capital contributions to five of its unconsolidated joint ventures should additional capital contributions be necessary to fund development costs or operating shortfall. At March 31, 2003, the Company has contributed $23.7 million of the $25 million to be funded for development costs for one of its joint ventures and does not expect to fund any additional capital contributions beyond this amount. The Company is also required to make additional capital contributions to another three of its unconsolidated joint ventures should additional capital contributions be necessary to fund excess costs. Based upon the joint venture agreements, the Company is required to fund up to an aggregate maximum contribution of $72 million, of which $56.3 million has been contributed. As of March 31, 2003, the Company does not expect to fund any additional capital contributions beyond the maximum capital requirements. The Company agreed with another unconsolidated joint venture to make additional contributions should there be insufficient funds to meet its current or projected financial requirements. As of March 31, 2003, the Company cumulatively contributed $48 million to this unconsolidated joint venture, including $30.7 million of initial contribution. As of March 31, 2003, the Company is not required to make any additional contributions.



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The Company has guaranteed $1.5 million of lease payments through September 2003 of a third party in connection with a development project. As of March 31, 2003, the Company has not been required to satisfy any amounts under this guarantee.

In addition to the contingent liabilities summarized in the table above, the Company also has the following contingencies:

The Company has recorded in its consolidated balance sheet $0.9 million estimated residual home warranty related liability from home-building activities prior to the selling of its home-building assets in 2000. The estimate is based on past claims and experience. These home warranty related reserves are charged to cost of sales when established.

As of March 31, 2003, $163.3 million of Community Facility District bonds were sold to finance public infrastructure improvements at several Company projects. The Company provided a letter of credit totaling $40 million in support of one of these bonds. The $40 million is included in the standby letters of credit and surety bonds amounts disclosed above. The Company, along with other landowners, is required to satisfy any shortfall in annual debt service obligation for these bonds if incremental tax revenues generated by the projects are insufficient.

The Company is a party to a number of legal actions arising in the ordinary course of business. The Company cannot predict with certainty the final outcome of these proceedings. Considering current insurance coverages and the substantial legal defenses available, however, management believes that none of these actions, when finally resolved, will have a material adverse effect on the consolidated financial conditions, results of operations, or cash flows of the Company. Where appropriate, the Company has established reserves for potential liabilities related to legal actions or threatened legal actions. These reserves are necessarily based on estimates and probabilities of the occurrence of events and therefore are subject to revision from time to time.

Some of the legal actions to which the Company is party seek to restrain actions related to the development process or challenge title to or possession of the Company s properties. Typically, such actions, if successful, would not result in significant financial liability for the Company but might instead prevent the completion of the development process originally planned, and therefore, impairment may occur in certain development assets.

Inherent in the operations of the real estate business is the possibility that environmental liability may arise from the current or past ownership, or current or past operation, of real properties. The Company may be required in the future to take action to correct or reduce the environmental effects of prior disposal or release of hazardous substances by third parties, the Company, or its corporate predecessors. Future environmental costs are difficult to estimate because of such factors as the unknown magnitude of possible contamination, the unknown timing and extent of the corrective actions that may be required, the determination of the Company s potential liability in proportion to that of other potentially responsible parties, and the extent to which such costs are recoverable from insurance. Also, the Company does not generally have access to properties sold by it in the past.

At March 31, 2003, management estimates that future costs for remediation of environmental contamination on operating properties and properties previously sold approximate $9.0 million, and has provided a reserve for that amount. It is anticipated that such costs will be incurred over the next several years. Management also estimates approximately $12.4 million of similar costs relating to the Company s properties to be developed or sold. The Company may incur additional costs related to management of excess contaminated soil from our projects; however, the necessity of this activity depends on the type of future development activities, and, therefore, the related costs are not currently determinable. These costs will be capitalized as components of development costs when incurred, which is anticipated to be over a period of approximately twenty years, or will be deferred and charged to cost of sales when the properties are sold. Environmental costs capitalized during the three months ended March 31, 2003, totaled $0.4 million. The Company s estimates were developed based on reviews that took place over several years based upon then-prevailing law and identified site conditions. Because of the breadth of its portfolio, and past sales, the Company is unable to review each property extensively on a regular basis. Such estimates are not precise and are always subject to the availability of further information about the prevailing conditions at the site, the future requirements of regulatory agencies, and the availability and ability of other parties to pay some or all of such costs.

**NOTE 9. RELATED PARTY TRANSACTIONS**

The Company provides development and management services and loan guarantees to various unconsolidated joint venture investments. Fees earned were $1.4 million and $0.3 million for the three months ended March 31, 2003 and 2002, respectively. Deferred fees of $1.8 million at March 31, 2003, will be earned as completed projects are sold or the venture is sold or liquidated.

In 2001, the Company entered into a 99-year ground lease with one of its unconsolidated joint venture investments. Rent payments of $0.9 million were received and recognized as rental income during each of the three months ended March 31, 2003 and 2002. Rent payments of $1.3

million of previously received rent was deferred at March 31, 2003, and will be recognized, together with annual rents, over the life of the lease.



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The Company has a $4.8 million collateralized 9.0% note receivable from an unconsolidated joint venture for project costs plus accrued interest. The note is collateralized by property owned by the venture and matures in October 2028. The Company entered into various lease agreements with this unconsolidated joint venture. As lessee, rent expense was $34,000 in each of the three-month periods ended March 31, 2003 and 2002; this lease will expire in November 2011. As lessor, the Company entered into a ground lease, which will expire in August 2054. The Company earned rental income of $0.1 million in each of the three-month periods ended March 31, 2003 and 2002, and recorded a $1.9 million receivable associated with this lease.

**NOTE 10. DISCONTINUED OPERATIONS**

In general, sales of rental property are classified as discontinued operations. Therefore, income or loss attributed to the operations and sale of rental properties sold or held for sale is presented in the statement of operations as discontinued operations, net of applicable income tax. Prior period statements of operations have been reclassified to reflect as discontinued operations the income or loss related to rental properties that were sold or held for sale and presented as discontinued operations during the period up to March 31, 2003. Additionally, all periods presented will likely require further reclassification in future periods as additional, similar sales of rental properties occur.

In the three-month periods ended March 31, 2003 and 2002, the Company sold rental properties with proceeds of $24.4 million and $9.3 million, respectively, and gains from the disposal of discontinued operations of $2.6 million and $4.5 million, net of income taxes of $1.8 million and $3.0 million. Rents from these properties and properties under contract to be sold were $0.6 million and $0.3 million for the three-month periods ended March 31, 2003 and 2002. Income (loss) from discontinued operations from these properties was $0.2 million net of income tax expense of $0.1 million and ($82,000) net of income tax benefit of $56,000, for the three months ended March 31, 2003 and 2002, respectively.

Asset and liability balances of rental properties under contract to be sold at December 31, 2002 (none at March 31, 2003), consist of the following:

| | December 31, 2002 |
|---|---|
| | (In thousands) |
| **Assets** | |
| Properties | $ 3,216 |
| Accumulated depreciation | (744) |
| Net | 2,472 |
| Other assets | 288 |
| Total assets | 2,760 |
| **Liabilities** | |

| | | |
|---|---|---|
| Mortgage and other debt | | 3,147 |
| Payables | | 62 |
| Other liabilities | | 24 |
| Total liabilities | | 3,233 |
| Net liabilities | $ | 473 |

**NOTE 11. REAL ESTATE INVESTMENT TRUST ( REIT ) CONVERSION**

On March 3, 2003, the Company announced that its Board of Directors has authorized it to restructure its business operations in order to qualify as a real estate investment trust ( REIT ), effective January 1, 2004. The REIT conversion is subject to a shareholder approval process, which is expected to conclude in the third quarter of 2003, as well as final Board approval. This announcement has no material effect on the financial statements, except for $1.6 million of transition costs, which relates to the REIT conversion and was incurred and expensed during the three-months ended March 31, 2003; however, it will likely have an impact on future operating results in the following areas, if approved by the shareholder vote:

a one-time distribution of pre-REIT earnings and profits, projected to be approximately $100 million in cash and $200 million in common stock, will be declared in the fourth quarter and be paid in the first quarter of 2004; certain aspects of this distribution are subject to ruling by the Internal Revenue Service

commencing with the third quarter of 2003, a quarterly dividend of approximately $0.30 per existing share of common stock will be paid

conversion and related restructure costs are currently estimated to be $15 million

one-time costs associated with the proposed stock option exchange offer estimated at $35 million to be realized over three years

certain deferred tax liabilities associated with assets in the REIT would be reversed through income and result in a one-time increase in income currently estimated in the $200 to $250 million range

The Company has filed a preliminary proxy statement/prospectus with the Securities and Exchange Commission that provides important information, including detailed risk factors, regarding the proposed transaction.



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

**The Company:**

Catellus Development Corporation is a publicly traded real estate operating company with a significant portfolio of rental properties and developable land. Catellus specializes in developing, managing, and investing in a broad range of product types including industrial, office, residential, retail, and major urban development projects. It owns a portfolio of rental properties totaling 36.7 million square feet and one of the largest supplies of developable land in the western United States capable of supporting more than 42.8 million square feet of new commercial development and an estimated 9,000 residential lots and units.

**Recent Developments**

On March 3, 2003, we announced that our Board of Directors ( Board ) has authorized us to restructure our business operations to qualify as a real estate investment trust, effective January 1, 2004, subject to stockholder and Board approvals. We have spent the past several years successfully transforming what was one of the country s largest land portfolios into predominantly industrial rental property and capital that has been reinvested back into our business. We are now embarking upon a transition period to restructure our operations and change our business strategy to focus increasingly on industrial development and reducing focus on other product types.

In anticipation of the REIT conversion, we will take steps during 2003 to better position its businesses for operation as a REIT. This will include looking for ways to operate more efficiently, consistent with a focus of new development on industrial product. We plan to continue our Urban mixed use projects that are underway, but do not plan to seek new ones. Since the Urban Group (*see* Urban Group below) will no longer be pursuing new activities, and given the considerable progress made on existing projects, it is also anticipated that the scope of activities will be reduced, resulting in a reduction in work force over 2003 and 2004. It is anticipated that Doug Gardner, President, and Mark Schuh, Executive Vice President, both of the Urban Group, will continue to lead their group during the transition for the balance of 2003, after which they will leave Catellus. The Urban Group currently reports to the chief executive officer of Catellus, and this reporting relationship will continue. The Urban Group projects will be operated in a taxable REIT subsidiary ( TRS ), and we expect to recycle surplus capital from the Urban Group projects through continuing development with greater emphasis on third party parcel sales, land leases, and joint ventures. During 2003, the Suburban Residential Group (*see* Suburban Residential Group below) projects will be positioned for sale and any remaining assets will be operated in a TRS upon REIT conversion.

We plan to present the REIT conversion to our shareholders for approval at our annual meeting, which is expected to be held in the third quarter of 2003. If the REIT conversion is consummated, Catellus will operate as an umbrella partnership real estate investment trust, with wholly-owned taxable REIT subsidiaries. As part of the REIT conversion, we will provide to shareholders a one-time distribution of pre-REIT earnings and profits, in compliance with the requirements to elect REIT status. Furthermore, subject to final Board approval, we anticipate that we will begin paying a quarterly dividend commencing with a payment of $0.30 per common share for the third quarter of 2003. Catellus SubCo, Inc., a wholly owned subsidiary, filed a Form S-4 registration statement, which contains a preliminary proxy statement/prospectus, with the Securities and Exchange Commission on May 2, 2003. The preliminary proxy statement/prospectus provides important information, including detailed risk factors, regarding the proposed REIT conversion. A copy of the preliminary proxy statement/prospectus and other relevant documents are available free of charge at the SEC s website (www.sec.gov) or can be obtained free of charge by directing a request to us at 201 Mission Street, Second Floor, San Francisco, California 94105, Attn.: Director of Investor Relations, or by telephone at (415) 974-4649, or by email at InvestorRelations@catellus.com or through our website (www.Catellus.com) as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. There is no assurance that the proposed REIT conversion will be consummated or that the terms of the REIT conversion or the timing or effects thereof will not differ materially from those described in the preliminary proxy statement/prospectus and other relevant documents.

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Following is a brief summary of the first quarter activity:

At March 31, 2003, the rental portfolio totaled 36.7 million square feet. This represents a slight decrease from December 31, 2002, due to the disposition of three buildings totaling 747,000 square feet, offset by the completion of two development properties totaling 494,000 square feet.

Three rental properties were sold during the quarter. A 607,000 square foot industrial building was sold to a tenant who exercised a purchase option, and, consistent with the company s continuing effort to upgrade its rental portfolio and target for disposition less occupied or older buildings, a 125,000 square foot industrial building that was 48 percent leased and a 15,000 square foot industrial building that was more than 60 years old were sold.

Development properties completed and added to the portfolio during the quarter included a 346,000 square foot industrial building in Romeoville, Illinois, and a 148,000 square foot industrial building in Denver, Colorado. The two buildings are 85 percent leased and represent a total investment of $18.8 million with a projected return on cost, when fully leased, of 9.8 percent.

At March 31, 2003, the rental portfolio occupancy was 93.9 percent, as compared to 94.5 percent at December 31, 2002.

For the first quarter of 2003, rental revenue less operating costs from the rental portfolio, including equity in earnings of operating joint ventures, increased 12.6 percent to $57.2 million, from $50.8 million for the same period in 2002.

During the first quarter of 2003, Catellus completed lease transactions on 1.2 million square feet of second-generation space. This includes approximately 627,000 square feet of space that had been vacant for more than 12 months and 614,000 square feet of space that was renewed with an existing tenant or re-leased to a new tenant within 12 months of prior occupancy.

Construction starts during the first quarter of 2003 totaled 1.2 million square feet in four buildings, all of which will be added to the rental portfolio upon completion: a 223,000 square foot industrial building in Shawnee, Kansas, leased to Ford Motor Company, and three distribution/warehouse buildings totaling 977,000 square feet in Atlanta, Georgia, leased to APL Logistics.

At March 31, 2003, total construction in progress was 4.7 million square feet, of which 2.6 million square feet will be added to the rental portfolio upon completion; 1.0 million square feet will be owned in joint ventures; 845,000 square feet will be sold upon completion; and 185,000 square feet is being developed for a fee on land sold to others.

For the 2.6 million square feet under construction that will be added to the rental portfolio, the projected total cost of development is $95.2 million. These buildings are 87.2 percent pre-leased and, when fully leased, are projected to yield a return on cost of approximately 10.3 percent.

During the quarter, a 145,000 square foot building was completed as a fee development for Champion Windows in Denver, Colorado.

During the quarter, Catellus acquired 216 net acres of land in Aurora, Colorado, a suburb of Denver, for $7.1 million. The property is capable of supporting approximately 4 million square feet of commercial space.

Residential lot and home sales during the quarter, in direct sales and through joint ventures, totaled 329. These sales included 21 lots at Victoria by the Bay in Hercules, California; 7 lots at Serrano in El Dorado Hills, a suburb of Sacramento, California; and 259 lots and

42 homes at Talega in San Clemente, California.

As recently announced, subsequent to the quarter end, Kellogg USA, Inc. signed a five-year lease for a 450,000 square foot build-to-suit distribution facility at Kaiser Commerce Center in Fontana, California.

Also subsequent to the quarter end, Ford Motor Company signed a 10-year lease for a 250,000 square foot build-to-suit distribution facility in Winchester, Virginia. Upon this building s completion, which is projected for January 2004, Ford will lease from Catellus a total of 1.8 million square feet of distribution/warehouse space in six locations, all of which will have been developed since May of 2002.



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**General**

Our reportable segments are based on our method of internal reporting, which disaggregates our business by type and before the adjustments for discontinued operations. We have five reportable segments: Asset Management; Suburban, which includes two reportable segments, Commercial and Residential; Urban; and Corporate.

**Business Segment Descriptions:**

**Asset Management:**

The Asset Management segment consists of the rental activities of our assets, our share of income from operating joint ventures, and activity related to our desert portfolio. Growth in this segment is attributed primarily to the transfer of property developed by the Suburban Commercial and Urban segments that we intend to hold and operate. Revenue consists of rental property operations and gains from the sale of rental properties (*see* Note 10 of the accompanying Condensed Consolidated Financial Statements for a discussion of discontinued operations).

| **Rental Building Occupancy:** | **March 31,** | | |
|---|---|---|---|
| | **2003** | **2002** | **Difference** |
| | **(In thousands of square feet, except percentages)** | | |
| Owned[1] | 36,716 | 31,257 | 5,459 |
| Occupied[1] | 34,491 | 29,715 | 4,776 |
| Occupancy percentage | 93.9% | 95.1% | (1.2%) |

(1) New buildings are added to our rental portfolio at the earlier of twelve months after completion of the building shell or commencement of rent on 50% of the space. Space is considered occupied upon commencement of rent.

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The table below provides the rental portfolio rental revenue less property operating costs for the three months ended March 31, 2003, and square feet by state (in thousands):

**Rental Revenue less Property Operating Costs by State**

| | Industrial | | Office | | Retail | | Total | |
|---|---|---|---|---|---|---|---|---|
| | Rental Revenue less Property Operating Expenses | % of Total | Rental Revenue less Property Operating Expenses | % of Total | Rental Revenue less Property Operating Expenses | % of Total | Rental Revenue less Property Operating Expenses | % of Total |
| | (In thousands, except percentages) | | | | | | | |
| Southern California | $ 13,419 | 23.3% | $ 1,545 | 2.7% | $ 654 | 1.1% | $ 15,618 | 27.1% |
| Northern California | 7,487 | 13.0% | 5,517 | 9.6% | 1,669 | 2.9% | 14,673 | 25.5% |
| Illinois | 5,394 | 9.4% | 1,204 | 2.1% | | | 6,598 | 11.5% |
| Texas | 2,446 | 4.2% | 1,633 | 2.8% | | | 4,079 | 7.0% |
| Colorado | 1,861 | 3.2% | 931 | 1.6% | 252 | 0.4% | 3,044 | 5.2% |
| Arizona | 962 | 1.7% | | | 163 | 0.3% | 1,125 | 2.0% |
| Maryland | 780 | 1.4% | | | | | 780 | 1.4% |
| Oregon | 599 | 1.0% | 110 | 0.2% | 122 | 0.2% | 831 | 1.4% |
| Ohio | 537 | 0.9% | | | | | 537 | 0.9% |
| Other | 351 | 0.6% | | | | | 351 | 0.6% |
| Subtotal | $ 33,836 | 58.7% | $ 10,940 | 19.0% | $ 2,860 | 4.9% | 47,636 | 82.6% |
| Ground Leases and other | | | | | | | 6,555 | 11.4% |
| Other Properties | | | | | | | 948 | 1.6% |
| Equity in Earnings of Operating Joint Ventures | | | | | | | 2,523 | 4.4% |
| Total | | | | | | | 57,662 | 100% |
| Less: discontinued operations | | | | | | | (448) | |
| Rental revenue less property operating costs from continuing operations | | | | | | | $ 57,214 | |

**Square Feet by State**

| | Industrial | | Office | | Retail | | Total | |
|---|---|---|---|---|---|---|---|---|
| | | % of Total | | % of Total | | % of Total | | % of Total |

| | Square Feet | | Square Feet | | Square Feet | | Square Feet | |
|---|---|---|---|---|---|---|---|---|
| | (In thousands, except percentages) | | | | | | | |
| Southern California | 11,569 | 31.5% | 574 | 1.5% | 176 | 0.5% | 12,319 | 33.5% |
| Illinois | 6,268 | 17.1% | 584 | 1.6% | | | 6,852 | 18.7% |
| Northern California | 5,773 | 15.7% | 808 | 2.2% | 481 | 1.3% | 7,062 | 19.2% |
| Texas | 3,264 | 8.9% | 869 | 2.4% | | | 4,133 | 11.3% |
| Colorado | 2,181 | 5.9% | 273 | 0.7% | 100 | 0.3% | 2,554 | 6.9% |
| Arizona | 1,123 | 3.1% | | | 74 | 0.2% | 1,197 | 3.3% |
| Ohio | 966 | 2.6% | | | | | 966 | 2.6% |
| Maryland | 471 | 1.3% | | | | | 471 | 1.3% |
| Oregon | 449 | 1.2% | 57 | 0.2% | 37 | 0.1% | 543 | 1.5% |
| Other | 619 | 1.7% | | | | | 619 | 1.7% |
| Total | 32,683 | 89.0% | 3,165 | 8.6% | 868 | 2.4% | 36,716 | 100% |

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**Suburban Commercial:**

The Suburban Commercial segment acquires and develops suburban commercial business parks for our own account and the account of others. Net income consists primarily of sales gains from development properties sold and construction management, developer, and loan guarantee fees.

The table below provides the development potential of our Suburban Commercial land portfolio:

| Project Name | City | March 31, 2003 |
|---|---|---|
| | | Square feet (In thousands) |
| **Southern California** | | |
| Kaiser Commerce Center | Fontana | 3,214 |
| Crossroads Business Park | Ontario | 2,016(1) |
| Rancho Pacific Distribution Centre | Rancho Cucamonga | 318 |
| Pacific Center | Anaheim | 44 |
| Subtotal Southern Calif. | | 5,592 |
| **Northern California** | | |
| Pacific Commons | Fremont | 3,634 |
| Duck Creek | Stockton | 2,000 |
| Alameda FISC (controlled) | Alameda | 1,300 |
| Spreckels Business Park | Manteca | 686 |
| Regatta Business Park | Richmond | 89 |

| | | |
|---|---|---|
| Subtotal Northern Calif. | | 7,709 |
| **Total California** | | 13,301 |
| **Illinois** | | |
| Minooka | Minooka | 3,393(2) |
| Internationale Centre | Woodridge | 975 |
| Prairie Glen Corporate Campus | Glenview | 437(3) |
| Joliet | Joliet | 403 |
| International Centre West | Romeoville | 17 |
| Subtotal Illinois | | 5,225 |
| **Texas** | | |
| Hobby Business Park | Houston | 1,700 |
| Gateway Corporate Center | Coppell | 1,120 |
| Stellar Way Business Park | Grand Prairie | 814 |
| Gateway East Business Park | Garland | 763 |
| Plano | Plano | 403 |
| Ft. Worth | Ft. Worth | 104 |
| Subtotal Texas | | 4,904 |
| **Other** | | |
| Eastgate | Aurora, CO | 4,000 |
| Stapleton Business Park | Denver, CO | 840 |
| South Shore Corp. Park | Gresham/Portland, OR | 765 |
| Circle Point Corporate Center | Westminster, CO | 685 |
| Cedar Grove Business Park | Louisville, KY | 545 |
| APL | Atlanta, GA | 294 |
| **Subtotal Other** | | 7,129 |
| **Total Outside California** | | 17,258 |
| **Total Suburban Commercial Inventory** | | 30,559 |

(1) All entitled, except for 1,327,000 square feet included in Crossroads Business Park in which entitlement is in progress.
(2) Excluded from this balance is approximately 2.8 million square feet under option.
(3) Included in this balance is 335,000 square feet that is under option.



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**Suburban Residential:**

The Suburban Residential segment acquires and develops land primarily for single-family residential property, via direct investment or through joint ventures, and sells finished lots to homebuilders. This segment also owns an interest in a joint venture that develops senior housing. As part of the REIT conversion, we anticipate the level of activities in the Suburban Residential segment will decrease.

The table below provides the development potential, by lots/homes, of our Suburban Residential land portfolio.

| | Ownership Interest | Lots/Units at March 31, 2003 |
|---|---|---|
| **Colorado** | | |
| Vista Range, Commerce City | 100% | 2,149 |
| **Northern California** | | |
| Alameda (controlled) | 100% | 485 |
| Hercules | 100% | 1[2] |
| Serrano, Sacramento | 50% | 1,183 |
| Parkway, Sacramento (multi-family) | 50% | 538 |
| | | 2,207 |
| **Southern California** | | |
| Talega Seniors, San Clemente | 50% | 23 |
| Talega, San Clemente | 30% | 967 |
| West Bluffs, Playa del Rey[1] | 100% | 114 |
| | | 1,104 |
| Total | | 5,460 |

(1) We have entitlements for this project; however, the entitlements are being challenged under the California Environmental Quality Act and the California Coastal Act (*see* Legal Proceedings section).

(2) A commercial site

**Urban:**

The Urban segment entitles and develops urban mixed-use sites in San Francisco, Los Angeles, and San Diego. The principal active project of the segment is Mission Bay in San Francisco.

As discussed in Recent Developments section, as part of the REIT conversion, we plan to continue our Urban mixed-use projects that are currently underway, but do not plan to seek new ones. As such, it is anticipated that the scope of activities will be reduced over the next several years.

The table below provides the entitled development potential by square feet, of our Urban land portfolio:

| | R&D, Biotech & Office | CBD Office | Retail/ Entertainment | Residential | Hotel |
|---|---|---|---|---|---|

| | (Net Rentable Sq. Ft.) | | | (Units) | (Rooms) |
|---|---|---|---|---|---|
| Mission Bay (SF, CA) | 4,537,000 | | 548,000 | 3,263 | 500 |
| Union Station (LA, CA) | | 5,175,000 | 675,000 | | |
| Santa Fe Depot (SD, CA) | | 1,052,000 | 270,000 | 285 | |
| **Total** | 4,537,000 | 6,227,000 | 1,493,000 | 3,548 | 500 |

**Corporate:**

Corporate consists primarily of administrative costs and interest contra-expense. Corporate interest (contra-expense) represents required capitalized interest, on qualifying assets in the Suburban and Urban segments, in excess of interest directly incurred by these segments. As these qualifying assets are sold, the corresponding capitalized interest is reflected as cost of sales in the Corporate segment or, for those assets transferred to Asset Management, as the assets are placed in service the corresponding interest capitalized is added to the cost basis of the asset and depreciated over the life of the building.



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**Critical Accounting Policies**

Our discussion and analysis of financial condition and results of operations is based on our Condensed Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our Condensed Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, impairment of real estate assets, capitalization of costs, allowances for doubtful accounts, environmental and legal reserves, and income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies reflect our more significant judgments and estimates used in the preparation of the Condensed Consolidated Financial Statements.

*Revenue recognition*

Our revenue is primarily derived from two sources: rental revenue from our rental portfolio and property sales. Rental revenue is recognized when due from tenants. Revenue from leases with rent concessions or fixed escalations is recognized on a straight-line basis over the initial term of the related lease. The financial terms of leases are contractually defined. Rental revenue is not accrued when a tenant vacates the premises and ceases to make rent payments or files for bankruptcy.

Revenue from sales of properties is recognized using the accrual method. If a sale does not qualify for the accrual method of recognition, deferral methods are used as appropriate including the percentage-of-completion method. In certain cases, we retain the right to repurchase property from the buyer at a specified price. These sales are not recognized until our right to repurchase expires. In other instances, when we receive an inadequate cash down payment and take a promissory note for the balance of the sale prices, sale is deferred until such time as sufficient cash is received to meet minimum down payment requirements. Also, in general, specific identification and relative sales value methods are used to determine the cost of sales. Management estimates of future costs to complete infrastructure are included in cost of sales. A change in circumstances that causes the estimate of future costs to increase or decrease significantly would affect the gain or loss recognized on future sales.

*Impairment of real estate assets*

We assess the impairment of a real estate asset when events or changes in circumstances indicate that the net book value may not be recoverable. Indicators we consider important which could trigger an impairment review include the following:

- significant negative industry or economic trend;
- a significant underperformance relative to historical or projected future operating results;
- a significant change in the manner in which an asset is used; and
- an accumulation of costs significantly in excess of the amount originally expected to construct an asset.

Real estate is stated at the lower of cost or estimated fair value using the methodology described as follows: (a) for operating properties and properties held for investment, a write-down to estimated fair value is recognized when a property s estimated undiscounted future cash flow is less than its net book value; and (b) for properties held for sale, a write-down to estimated fair value is recorded when we determine that the net book value exceeds the estimated selling price less cost to sell. These evaluations are made on a property-by-property basis. When we determine that the net book value of an asset may not be recoverable based upon the estimated undiscounted cash flow, we measure any impairment write-down based on a projected discounted cash flow method using an estimated market discount rate. When performing an impairment review, we consider capitalized interest and other expenses as costs of development in costs projections and the value from comparable property sales. The evaluation of future cash flows, discount rates, and fair value of individual properties requires significant judgment and assumptions, including estimates of market value, lease terms, development absorption, development costs, lease up costs, and financings. Significant adverse changes in circumstances affecting these judgments and assumptions in future periods could cause a significant impairment adjustment to be recorded.

*Capitalization of costs*

We capitalize direct construction and development costs, including predevelopment costs, property taxes, insurance, and certain indirect project costs, including a portion of our general and administrative costs that are associated with the acquisition, development, or construction of a project. Interest is capitalized in accordance with FAS 34. Costs previously capitalized related to any abandoned development opportunities are written off, if we determine such costs will not provide any future benefits. Should development activity decrease, a portion of interest, property taxes, insurance, and certain general and administrative costs would no longer be eligible for capitalization and would be expensed as incurred.

*Allowance for doubtful accounts*

We make estimates with respect to the collectability of our receivables and provide for doubtful accounts based on several factors, including our estimate of collectability and the age of the outstanding balances. Our estimate of collectability is based on our contacts with the debtors, collection agencies, our knowledge of the debtors credit and financial condition, debtors payment terms, and current economic trends. If a debtor becomes insolvent or files for bankruptcy, we provide an allowance for the entire outstanding amount of the debtors receivable. Significant judgments and estimates must be made and used in connection with establishing allowances in any accounting period. Material differences may result in the amount and timing of our allowances for any period if adverse general economic conditions cause widespread financial difficulties among our tenants.

*Environmental and legal reserves*

We incur ongoing environmental remediation costs, including clean up costs, consulting fees for environmental studies and investigations, monitoring costs, and legal costs relating to clean up, litigation defense, and the pursuit of responsible third parties. We maintain a reserve for estimated costs of environmental remediation to be incurred in connection with operating properties and properties previously sold; these reserves, when established, are expensed. Costs relating to undeveloped land are capitalized as part of development costs, and costs incurred for properties to be sold are deferred and charged to cost of sales when the properties are sold; these costs are anticipated to be incurred over a period of twenty years. Our estimates are developed based on reviews that took place over many years based upon then-prevailing law and identified site conditions. Because of the breadth of our portfolio, and past sales, we are unable to review each property extensively on a regular basis. Such estimates are not precise and are always subject to the availability of further information about the prevailing conditions at the site, the future requirements of regulatory agencies, and the availability and ability of other parties to pay some or all of such costs. Should a previously undetected, substantial environmental hazard be found on our properties, significant liquidity could be consumed by the resulting clean up requirements, and a material expense may be recorded.

We are a party to a number of legal actions arising in the ordinary course of business. We cannot predict with certainty the final outcome of the proceedings. Where appropriate, we have established reserves for potential liabilities related to legal actions or threatened legal actions. Environmental and legal reserves are established based on estimates and probabilities of the occurrence of events and therefore are subject to revision from time to time. Should the circumstances affecting these estimates change significantly, a material expense would be recognized.

*Income taxes*

As part of the process of preparing our Condensed Consolidated Financial Statements, significant management judgment is required to estimate our income taxes. Our estimates are based on interpretation of tax laws. We estimate our actual current tax due and assess temporary differences resulting from differing treatment of items for tax and accounting purposes. The temporary differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. Adjustments may be required by a change in assessment of our deferred tax assets and liabilities, changes due to audit adjustments by Federal and State tax authorities, and changes in tax laws. To the extent adjustments are required in any given period we would include the adjustments within the tax provision in the statement of operations and/or balance sheet. Any applicable interest charges would be recorded as an expense. These adjustments could materially impact our statement of operations and liquidity.

**Financial Condition and Results of Operations**

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the Condensed Consolidated Financial Statements and related Notes appearing elsewhere in this Form 10-Q. This discussion and analysis covers our five business segments: Asset Management; Suburban, which includes a Commercial and Residential division; Urban; and Corporate.



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**Below is a summary of Net income by segment for the Three Months Ended March 31, 2003:**

| | | Suburban | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Asset Management | Commercial | Residential | Urban | Corporate | Subtotal | Discontinued Operations | Total |
| | | | | (In thousands) | | | | |
| **Rental properties:** | | | | | | | | |
| Rental revenue | $ 74,728 | $ | $ | $ | $ | $ 74,728 | $ (591) | $ 74,137 |
| Property operating costs | (19,589) | | | | | (19,589) | 143 | (19,446) |
| Equity in earnings of operating joint ventures, net | 2,523 | | | | | 2,523 | | 2,523 |
| | 57,662 | | | | | 57,662 | (448) | 57,214 |
| **Property sales and fee services:** | | | | | | | | |
| Gain (loss) on property sales | 4,755 | 1,667 | 3,014 | | | 9,436 | (4,398) | 5,038 |
| Equity in earnings of development joint ventures, net | | | 3,854 | | | 3,854 | | 3,854 |
| Management and development fees | 5 | 824 | 94 | 1,161 | | 2,084 | | 2,084 |
| Selling, general and administrative expenses | (280) | (2,627) | (782) | (1,803) | | (5,492) | | (5,492) |
| Other, net | 1,481 | 173 | 887 | 289 | | 2,830 | (5) | 2,825 |
| | 5,961 | 37 | 7,067 | (353) | | 12,712 | (4,403) | 8,309 |
| Interest expense | (21,254) | | | | 4,433 | (16,821) | 14 | (16,807) |
| Depreciation and amortization | (15,831) | | (30) | (266) | (572) | (16,699) | 131 | (16,568) |
| Corporate administrative costs | | | | | (4,399) | (4,399) | | (4,399) |
| Gain on non-strategic asset sales | 5,879 | | | | | 5,879 | | 5,879 |
| Other, net | | | | | 249 | 249 | | 249 |
| REIT transition costs | | | | | (1,558) | (1,558) | | (1,558) |
| Income (taxes) benefit | (11,919) | (14) | (2,588) | 228 | 679 | (13,614) | 1,882 | (11,732) |
| **Income from continuing operations** | 20,498 | 23 | 4,449 | (391) | (1,168) | 23,411 | (2,824) | 20,587 |

| | Asset Management | Commercial | Residential | Urban | Corporate | Subtotal | Discontinued Operations | Total |
|---|---|---|---|---|---|---|---|---|
| **Discontinued operations, net of tax:** | | | | | | | | |
| Gain from disposal of discontinued operations | | | | | | | 2,639 | 2,639 |
| Income from discontinued operations | | | | | | | 185 | 185 |
| Gain from discontinued operations | | | | | | | 2,824 | 2,824 |
| **Net income (loss)** | $ 20,498 | $ 23 | $ 4,449 | $ (391) | $ (1,168) | $ 23,411 | $ | $ 23,411 |

**Below is a summary of Net income by segment for the Three Months Ended March 31, 2002:**

| | | Suburban | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Asset Management | Commercial | Residential | Urban | Corporate | Subtotal | Discontinued Operations | Total |
| | | | | (In thousands) | | | | |
| **Rental properties:** | | | | | | | | |
| Rental revenue | $ 63,280 | $ | $ | $ | $ | $ 63,280 | $ (313) | $ 62,967 |
| Property operating costs | (15,808) | | | | | (15,808) | 107 | (15,701) |
| Equity in earnings of operating joint ventures, net | 3,521 | | | | | 3,521 | | 3,521 |
| | 50,993 | | | | | 50,993 | (206) | 50,787 |
| **Property sales and fee services:** | | | | | | | | |
| Gain (loss) on property sales | 7,727 | 2,503 | 13,265 | | (350) | 23,145 | (7,536) | 15,609 |
| Equity in earnings of development joint ventures, net | | | 7,960 | | (513) | 7,447 | | 7,447 |
| Management and development fees | 25 | 549 | 286 | 272 | | 1,132 | | 1,132 |
| Selling, general and administrative expenses | (136) | (1,949) | (4,168) | (1,597) | | (7,850) | | (7,850) |
| Other, net | 7,985 | 473 | 1,425 | 71 | | 9,954 | | 9,954 |
| | 15,601 | 1,576 | 18,768 | (1,254) | (863) | 33,828 | (7,536) | 26,292 |
| Interest expense | (18,748) | | | (5) | 5,951 | (12,802) | 231 | (12,571) |
| Depreciation and amortization | (12,603) | (154) | (37) | (243) | (514) | (13,551) | 113 | (13,438) |
| Corporate administrative costs | | | | | (4,102) | (4,102) | | (4,102) |
| Loss on non-strategic asset sales | (238) | | | | | (238) | | (238) |
| Other, net | | | | | 67 | 67 | | 67 |
| REIT transition costs | | | | | | | | |
| Minority interests | (1,527) | | | | | (1,527) | | (1,527) |
| Income (taxes) benefit | (13,464) | (573) | (7,534) | 604 | (217) | (21,184) | 2,975 | (18,209) |
| **Income from continuing operations** | 20,014 | 849 | 11,197 | (898) | 322 | 31,484 | (4,423) | 27,061 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Discontinued operations, net of tax:** | | | | | | | | |
| Gain from disposal of discontinued operations | | | | | | | 4,505 | 4,505 |
| Loss from discontinued operations | | | | | | | (82) | (82) |
| Gain from discontinued operations | | | | | | | 4,423 | 4,423 |
| **Net income (loss)** | $ 20,014 | $ 849 | $ 11,197 | $ (898) | $ 322 | $ 31,484 | $ | $ 31,484 |



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**Variance Three Months Ended March 31, 2003 vs Three Months Ended March 31, 2002:**

| | Asset Management | Suburban Commercial | Suburban Residential | Urban | Corporate | Subtotal | Discontinued Operations | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | (In thousands) | | | | |
| **Rental properties:** | | | | | | | | |
| Rental revenue | $ 11,448 | $ | $ | $ | $ | $ 11,448 | $ (278) | $ 11,170 |
| Property operating costs | (3,781) | | | | | (3,781) | 36 | (3,745) |
| Equity in earnings of operating joint ventures, net | (998) | | | | | (998) | | (998) |
| | 6,669 | | | | | 6,669 | (242) | 6,427 |
| **Property sales and fee services:** | | | | | | | | |
| Gain (loss) on property sales | (2,972) | (836) | (10,251) | | 350 | (13,709) | 3,138 | (10,571) |
| Equity in earnings of development joint ventures, net | | | (4,106) | | 513 | (3,593) | | (3,593) |
| Management and development fees | (20) | 275 | (192) | 889 | | 952 | | 952 |
| Selling, general and administrative expenses | (144) | (678) | 3,386 | (206) | | 2,358 | | 2,358 |
| Other, net | (6,504) | (300) | (538) | 218 | | (7,124) | (5) | (7,129) |
| | (9,640) | (1,539) | (11,701) | 901 | 863 | (21,116) | 3,133 | (17,983) |
| Interest expense | (2,506) | | | 5 | (1,518) | (4,019) | (217) | (4,236) |
| Depreciation and amortization | (3,228) | 154 | 7 | (23) | (58) | (3,148) | 18 | (3,130) |
| Corporate administrative costs | | | | | (297) | (297) | | (297) |
| Gain on non-strategic asset sales | 6,117 | | | | | 6,117 | | 6,117 |
| Other, net | | | | | 182 | 182 | | 182 |
| REIT transition costs | | | | | (1,558) | (1,558) | | (1,558) |
| Minority interests | 1,527 | | | | | 1,527 | | 1,527 |
| Income (taxes) benefit | 1,545 | 559 | 4,946 | (376) | 896 | 7,570 | (1,093) | 6,477 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Income from continuing operations** | 484 | (826) | (6,748) | 507 | (1,490) | (8,073) | 1,599 | (6,474) |
| **Discontinued operations, net of tax:** | | | | | | | | |
| Gain from disposal of discontinued operations | | | | | | | (1,866) | (1,866) |
| Income from discontinued operations | | | | | | | 267 | 267 |
| | | | | | | | | |
| Gain from discontinued operations | | | | | | | (1,599) | (1,599) |
| | | | | | | | | |
| **Net income (loss)** | $ 484 | $ (826) | $ (6,748) | $ 507 | $ (1,490) | $ (8,073) | $ | $ (8,073) |



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The following is a schedule of the largest ten tenants of our rental portfolio, based on GAAP rents:

| Customer Name | State | Type of Product Leased | % of Total Base Rent as of March 31, 2003 |
|---|---|---|---|
| The Gap | CA | Office | 6.8% |
| APL Logistics, Inc | CA, IL, KY, TX | Industrial | 5.3% |
| Ford Motor Company | CA, CO, TX | Industrial | 2.2% |
| Kellogg s USA, Inc. | CA, IL, CO | Industrial | 2.0% |
| J.C. Penney Company | TX | Office | 2.0% |
| Exel Corporation | CA | Industrial | 1.8% |
| Home Depot USA, Inc. | CA | Industrial/Retail | 1.6% |
| Office Depot, Inc. | CA | Industrial/Retail | 1.5% |
| Gillette Company | CA, IL | Industrial | 1.4% |
| MCI Telecommunications[(1)] | CA, WA, IL, MN, TX, OK, OR | Office/Easement | 1.4% |

(1) The Company has ten leases with MCI WORLDCOM Communications, Inc. or its affiliates ( MCI ). Three of the leases are office leases and seven are easement leases. On July 21, 2002, a group of MCI Companies filed for Chapter 11 reorganization. Pursuant to an order of the United States Bankruptcy Court, the MCI Companies have until September 22, 2003, to assume or reject the leases, but they remain obligated under the Bankruptcy Code to continue to perform their obligations under each lease in a timely manner pending the assumption or rejection of that lease. The MCI Companies have rejected two of the office leases. The third office lease has been modified to reduce the leased space by 52% and to reduce rent by 16.6% per square foot. However, the modifications are subject to approval by the Bankruptcy Court. The MCI Companies have not yet assumed or rejected the seven easement leases.

*Rental Revenue less Property Operating Costs*

Rental revenue less property operating costs has increased primarily because of additions of buildings and new ground leases. From April 2002 to March 2003, we added a net 5.5 million square feet to our rental portfolio. Rental revenue less operating costs for the three months ended March 31, 2003 and 2002, are summarized as follows:

| | Three Months Ended March 31, | | |
|---|---|---|---|
| | 2003 | 2002 | Difference 2003/2002 |
| | (In thousands) | | |
| **Rental revenue less property operating costs:** | | | |
| Same space[1] | $ 38,214 | $ 39,579 | $ (1,365) |
| Properties added to portfolio | 8,868 | 216 | 8,652 |
| Properties sold from portfolio | 449 | 365 | 84 |
| Ground leases | 7,608 | 7,312 | 296 |
| Total[2] | $ 55,139 | $ 47,472 | $ 7,667 |
| Less: discontinued operations | (448) | (206) | (242) |
| Rental revenue less property operating costs from continuing operations | $ 54,691 | $ 47,266 | $ 7,425 |

(1) Same Space properties were owned and operated for the entire current year and the entire immediate preceding year.

(2) Generally accepted accounting principles require rental revenue to be recognized in a straight-line basis over the initial term of the related lease. Revenue recognized may differ from cash collected from the related lease.

We do not expect substantial changes in rental income from our Same Space rental portfolio; rather, we expect growth in overall portfolio rental income will result primarily from new properties we will add to our rental portfolio over time.

The increase in rental revenue less operating costs of $7.7 million for the three months ended March 31, 2003, as compared to the same period in 2002, is primarily attributable to $8.9 million from the additions of buildings and new ground leases due primarily to sixteen buildings added in the last three quarters of 2002, and two buildings added in the first quarter of 2003, partially offset by a $1.4 million decrease from Same Space due primarily to higher insurance expense and lower occupancy rate.

*Equity in Earnings of Operating Joint Ventures*

Equity in earnings of operating joint ventures, net, decreased by $1 million for the three months ended March 31, 2003, over the same period of 2002, primarily because of lower occupancies in hotels owned by two joint ventures and higher interest expense due to a refinancing at a joint venture in 2003 (*see* Variability in Results section).

*Gain on Property Sales:*

**Three Months Ended March 31, 2003**

| | Asset Management | Suburban Commercial | Suburban Residential | Urban | Corporate | Total |
|---|---|---|---|---|---|---|
| | | | (In thousands) | | | |
| **Building Sales** | | | | | | |
| Sales Proceeds | $ 24,402 | $ | $ | $ | $ | $ 24,402 |
| Cost of Sales | (20,004) | | | | | (20,004) |
| Gain | 4,398 | | | | | 4,398 |
| **Land/Lot Sales** | | | | | | |
| Sales Proceeds | | 3,936 | 3,465 | | | 7,401 |
| Cost of Sales | | (2,323) | (201) | | | (2,524) |
| Gain | | 1,613 | 3,264 | | | 4,877 |
| **Ground Lease and Other Sales** | | | | | | |
| Sales Proceeds | 547 | 62 | | | | 609 |
| Cost of Sales | (190) | (8) | (250) | | | (448) |
| Gain (loss) | 357 | 54 | (250) | | | 161 |
| **Total sales proceeds** | 24,949 | 3,998 | 3,465 | | | 32,412 |
| **Total cost of sales** | (20,194) | (2,331) | (451) | | | (22,976) |
| **Total gain on property sales** | 4,755 | 1,667 | 3,014 | | | 9,436 |
| Less: discontinued operations | (4,398) | | | | | (4,398) |
| Total gain on property sales from continuing operations | $ 357 | $ 1,667 | $ 3,014 | $ | $ | $ 5,038 |

**Three Months Ended March 31, 2002**

| | Asset Management | Suburban Commercial | Suburban Residential | Urban | Corporate | Total |
|---|---|---|---|---|---|---|
| | | | (In thousands) | | | |
| **Building Sales** | | | | | | |
| Sales Proceeds | $ 5,861 | $ | $ | $ | $ | $ 5,861 |
| Cost of Sales | (1,228) | | | | | (1,228) |

| | Asset Management | Commercial | Residential | Urban | Corporate | Total |
|---|---|---|---|---|---|---|
| Gain | 4,633 | | | | | 4,633 |
| **Land/Lot Sales** | | | | | | |
| Sales Proceeds | | 26,238 | 26,532 | | | 52,770 |
| Cost of Sales | | (23,735) | (14,738) | | | (38,473) |
| Gain | | 2,503 | 11,794 | | | 14,297 |
| **Ground Lease and Other sales** | | | | | | |
| Sales Proceeds | 3,903 | | 1,471 | | | 5,374 |
| Cost of Sales | (809) | | | | (350) | (1,159) |
| Gain (loss) | 3,094 | | 1,471 | | (350) | 4,215 |
| **Total sales proceeds** | 9,764 | 26,238 | 28,003 | | | 64,005 |
| **Total cost of sales** | (2,037) | (23,735) | (14,738) | | (350) | (40,860) |
| **Total gain (loss) on property sales** | 7,727 | 2,503 | 13,265 | | (350) | 23,145 |
| Less: discontinued operations | (7,536) | | | | | (7,536) |
| Total gain (loss) on property sales from continuing operations | $ 191 | $ 2,503 | $ 13,265 | $ | $ (350) | $ 15,609 |

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**Variance Three Months Ended March 31, 2003 vs Three Months Ended March 31, 2002**

| | Asset Management | Suburban | | Urban | Corporate | Total |
|---|---|---|---|---|---|---|
| | | Commercial | Residential | | | |
| | | | (In thousands) | | | |
| **Building Sales** | | | | | | |
| Sales Proceeds | $ 18,541 | $ | $ | $ | $ | $ 18,541 |
| Cost of Sales | (18,776) | | | | | (18,776) |
| Loss | (235) | | | | | (235) |
| **Land/Lot Sales** | | | | | | |
| Sales Proceeds | | (22,302) | (23,067) | | | (45,369) |
| Cost of Sales | | 21,412 | 14,537 | | | 35,949 |
| Gain (loss) | | (890) | (8,530) | | | (9,420) |
| **Ground Lease and Other Sales** | | | | | | |
| Sales Proceeds | (3,356) | 62 | (1,471) | | | (4,765) |
| Cost of Sales | 619 | (8) | (250) | | 350 | 711 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Gain (loss) | (2,737) | 54 | (1,721) | | 350 | (4,054) |
| **Total sales proceeds** | 15,185 | (22,240) | (24,538) | | | (31,593) |
| **Total cost of sales** | (18,157) | 21,404 | 14,287 | | 350 | 17,884 |
| **Total gain (loss) on property sales** | (2,972) | (836) | (10,251) | | 350 | (13,709) |
| Less: discontinued operations | 3,138 | | | | | 3,138 |
| Total gain (loss) on property sales from continuing operations | $ 166 | $ (836) | $ (10,251) | $ | $ 350 | $ (10,571) |



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During the three months ended March 31, 2003, we sold three operating properties totaling 747,000 square feet of building space, closed on the sale of improved land capable of supporting 0.4 million square feet of commercial development, and sold 98.4 acres of ground leases. In addition, $0.4 million of deferred profits were recognized during the three months ended March 31, 2003. During the three months ended March 31, 2002, we sold three operating properties totaling 305,000 square feet of building space, closed on the sale of improved land capable of supporting 2.2 million square feet of commercial development, and sold 112.1 acres of ground leases. (*see* Variability in Results section).

For the three months ended March 31, 2003, we also closed on the sales of 21 residential lots, as compared to 138 residential lots during the same period in 2002. In addition, for the three months ended March 31, 2002, the gain also included $1.5 million of our portion of profit participation related to certain properties that were sold in the prior year (*see* Variability in Results section).

*Equity in Earnings of Development Joint Ventures, Net*

Our equity in earnings of development joint ventures, net is generated from our Suburban Residential investments. The tables below summarize our share of the activities of joint ventures for the three months ended March 31, 2003 and 2002. The decrease for the three months ended March 31, 2003, as compared to the same period in 2002, in our share of gain from sales is primarily because of lower sales volumes from Parkway, partially offset by higher sales margins from Serrano and Talega; and higher sales volume at Talega Village. During the three months ended March 31, 2003, $3.6 million of deferred revenue was recognized as compared to $1.7 million of deferred revenue recognized during the three months ended March 31, 2002 (*see* Variability in Results section).

| | **Three Months ended March 31, 2003** | | | | **Three Months ended March 31, 2002** | | | |
|---|---|---|---|---|---|---|---|---|
| **Projects** | **Lots/Homes Sold** | **Sales** | **Cost of Sales** | **Gain (loss)** | **Lots/Homes Sold** | **Sales** | **Cost of Sales** | **Gain** |
| | | | | **(In thousands)** | | | | |
| Talega Village | 42 | $ 23,051 | $ (21,605) | $ 1,446 | 11 | $ 6,259 | $ (6,085) | $ 174 |
| Serrano | 7 | | | | | | | |