

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2001

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File Number 1-10709

PS BUSINESS PARKS, INC.

(Exact name of registrant as specified in its charter)

California
(State or Other Jurisdiction
of Incorporation)

95-4300881
(I.R.S. Employer
Identification Number)

701 Western Avenue, Glendale, California 91201-2397
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(818) 244-8080**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Number of shares outstanding of each of the issuer's classes of common stock, as of August 10, 2001:

Common Stock, \$0.01 par value, 22,478,378 shares outstanding

PS BUSINESS PARKS, INC.

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PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2001 (unaudited)	December 31, 2000
<u>ASSETS</u>		
Cash and cash equivalents	\$ 24,054,000	\$ 49,295,000
Marketable securities	8,605,000	6,065,000
Real estate facilities, at cost:		
Land	235,933,000	214,020,000
Buildings and equipment	775,876,000	709,328,000
	1,011,809,000	923,348,000
Accumulated depreciation	(102,375,000)	(83,841,000)
	909,434,000	839,507,000
Properties held for disposition, net	5,110,000	-
Land held for development	5,837,000	5,737,000
Construction in progress	26,993,000	19,467,000
	947,374,000	864,711,000
Receivables	496,000	461,000
Deferred rent receivables	8,580,000	7,697,000
Intangible assets, net	830,000	981,000
Other assets	1,123,000	1,546,000
Total assets	\$ 991,062,000	\$ 930,756,000

LIABILITIES AND SHAREHOLDERS' EQUITY

Accrued and other liabilities	\$ 32,414,000	\$ 28,964,000
Mortgage notes payable	30,563,000	30,971,000
Total liabilities	62,977,000	59,935,000
Minority interest:		
Preferred units	144,750,000	144,750,000
Common units	162,272,000	161,728,000
Shareholders' equity:		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, 4,840 shares issued and outstanding at June 30, 2001 (2,200 shares issued and outstanding at December 31, 2000)	121,000,000	55,000,000
Common stock, \$0.01 par value, 100,000,000 shares authorized, 22,475,178 shares issued and outstanding at June 30, 2001 (23,044,635 shares issued and outstanding at December 31, 2000)	225,000	230,000
Paid-in capital	448,510,000	464,855,000
Cumulative net income	149,285,000	124,990,000
Other comprehensive loss	(836,000)	-
Cumulative distributions	(97,121,000)	(80,732,000)
Total shareholders' equity	621,063,000	564,343,000
Total liabilities and shareholders' equity	\$ 991,062,000	\$ 930,756,000

See accompanying notes.

PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2001	2000	2001	2000
Revenues:				
Rental income.....	\$ 40,281,000	\$ 36,414,000	\$ 78,674,000	\$ 70,467,000
Facility management fees primarily from affiliates	168,000	129,000	329,000	252,000
Business services.....	76,000	267,000	233,000	267,000
Interest income	553,000	741,000	1,313,000	2,011,000
Dividend income	4,000	440,000	8,000	858,000
	<u>41,082,000</u>	<u>37,991,000</u>	<u>80,557,000</u>	<u>73,855,000</u>
Expenses:				
Cost of operations.....	10,475,000	10,118,000	20,846,000	19,670,000
Cost of facility management	37,000	25,000	73,000	50,000
Cost of business services	129,000	64,000	313,000	64,000
Depreciation and amortization.....	9,733,000	8,898,000	19,379,000	17,274,000
General and administrative	992,000	981,000	2,120,000	1,864,000
Interest expense.....	157,000	370,000	394,000	744,000
	<u>21,523,000</u>	<u>20,456,000</u>	<u>43,125,000</u>	<u>39,666,000</u>
Income before gain on investment and minority interest	19,559,000	17,535,000	37,432,000	34,189,000
Gain on disposition of real estate	-	97,000	-	97,000
Gain on investment in Pacific Gulf Properties Inc.	-	-	15,000	-
Income before minority interest.....	<u>19,559,000</u>	<u>17,632,000</u>	<u>37,447,000</u>	<u>34,286,000</u>
Minority interest in income – preferred units ...	(3,186,000)	(2,921,000)	(6,373,000)	(5,841,000)
Minority interest in income – common units	<u>(3,543,000)</u>	<u>(3,199,000)</u>	<u>(6,779,000)</u>	<u>(6,190,000)</u>
Net income.....	<u>\$ 12,830,000</u>	<u>\$ 11,512,000</u>	<u>\$ 24,295,000</u>	<u>\$ 22,255,000</u>
Net income allocation:				
Allocable to preferred shareholders.....	\$ 1,903,000	\$ 1,272,000	\$ 3,175,000	\$ 2,544,000
Allocable to common shareholders.....	10,927,000	10,240,000	21,120,000	19,711,000
	<u>\$ 12,830,000</u>	<u>\$ 11,512,000</u>	<u>\$ 24,295,000</u>	<u>\$ 22,255,000</u>
Net income per common share:				
Basic	<u>\$ 0.48</u>	<u>\$ 0.44</u>	<u>\$ 0.93</u>	<u>\$ 0.84</u>
Diluted.....	<u>\$ 0.48</u>	<u>\$ 0.44</u>	<u>\$ 0.92</u>	<u>\$ 0.84</u>
Weighted average common shares outstanding:				
Basic	<u>22,610,000</u>	<u>23,356,000</u>	<u>22,814,000</u>	<u>23,474,000</u>
Diluted.....	<u>22,679,000</u>	<u>23,428,000</u>	<u>22,885,000</u>	<u>23,537,000</u>

See accompanying notes.

PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2001
(Unaudited)

	Preferred Stock		Common Stock		Paid-in Capital	Cumulative Net Income	Other Comprehensive Loss	Cumulative Distributions	Shareholders' Equity
	Shares	Amount	Shares	Amount					
Balances at December 31, 2000	2,200	\$55,000,000	23,044,635	\$ 230,000	\$464,855,000	\$124,990,000	-	\$ (80,732,000)	\$ 564,343,000
Issuance of preferred stock	2,640	66,000,000	-	-	(1,474,000)	-	-	-	64,526,000
Exercise of stock options	-	-	78,443	1,000	1,330,000	-	-	-	1,331,000
Unrealized loss – depreciation in marketable securities.....	-	-	-	-	-	-	(836,000)	-	(836,000)
Repurchase of common stock.....	-	-	(647,900)	(6,000)	(17,385,000)	-	-	-	(17,391,000)
Net income	-	-	-	-	-	24,295,000	-	-	24,295,000
Distributions paid:									
Preferred stock.....	-	-	-	-	-	-	-	(3,175,000)	(3,175,000)
Common stock.....	-	-	-	-	-	-	-	(13,214,000)	(13,214,000)
Adjustment to reflect minority interest to underlying ownership interest	-	-	-	-	1,184,000	-	-	-	1,184,000
Balances at June 30, 2001	<u>4,840</u>	<u>\$121,000,000</u>	<u>22,475,178</u>	<u>\$ 225,000</u>	<u>\$448,510,000</u>	<u>\$149,285,000</u>	<u>\$ (836,000)</u>	<u>\$(97,121,000)</u>	<u>\$ 621,063,000</u>

See accompanying notes.

PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six Months Ended June 30,	
	2001	2000
Cash flows from operating activities:		
Net income.....	\$ 24,295,000	\$ 22,255,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on investment in Pacific Gulf Properties Inc.	(15,000)	-
Depreciation and amortization expense.....	19,379,000	17,274,000
Minority interest in income	13,152,000	12,031,000
Decrease in receivables and other assets.....	(495,000)	(1,778,000)
Increase in accrued and other liabilities	3,445,000	5,289,000
Total adjustments	35,466,000	32,816,000
Net cash provided by operating activities.....	59,761,000	55,071,000
Cash flows from investing activities:		
Investment in marketable securities	(9,440,000)	(1,732,000)
Sale of marketable securities.....	6,079,000	-
Acquisition of real estate facilities	(90,425,000)	(29,497,000)
Disposition of real estate facilities	-	5,756,000
Capital improvements to real estate facilities.....	(3,840,000)	(4,747,000)
Land held for development and construction in progress.....	(7,626,000)	(8,414,000)
Net cash used in investing activities	(105,252,000)	(38,634,000)
Cash flows from financing activities:		
Principal payments on mortgage notes payable	(408,000)	(5,704,000)
Net proceeds from the issuance of preferred stock	64,526,000	-
Exercise of stock options	1,331,000	60,000
Repurchase of common stock	(17,391,000)	(12,378,000)
Redemption of common operating partnership units	(808,000)	-
Distributions paid to preferred shareholders.....	(3,175,000)	(2,544,000)
Distributions paid to minority interests – preferred units.....	(6,373,000)	(5,841,000)
Distributions paid to common shareholders.....	(13,214,000)	(11,702,000)
Distributions paid to minority interests – common units	(4,238,000)	(3,695,000)
Net cash provided by (used in) financing activities.....	20,250,000	(41,804,000)
Net decrease in cash and cash equivalents	(25,241,000)	(25,367,000)
Cash and cash equivalents at the beginning of the period	49,295,000	74,220,000
Cash and cash equivalents at the end of the period	\$ 24,054,000	\$ 48,853,000

See accompanying notes.

PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six Months Ended June 30,	
	2001	2000
Supplemental schedule of non cash investing and financing activities:		
Conversion of common OP units into shares of common stock:		
Minority interest – common units	\$ -	\$ (2,531,000)
Common stock	-	1,000
Paid-in capital	-	2,530,000
Adjustment to reflect minority interest to underlying ownership interest:		
Minority interest – common units	(1,184,000)	1,501,000
Paid-in capital	1,184,000	(1,501,000)
Capitalization of developed properties:		
Real estate facilities	-	(3,323,000)
Construction in progress	-	3,323,000
Unrealized gain/loss:		
Marketable securities	836,000	(4,809,000)
Other comprehensive (loss) income	(836,000)	4,809,000

See accompanying notes.

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2001

1. Organization and description of business

PS Business Parks, Inc. ("PSB") was incorporated in the state of California in 1990. As of June 30, 2001, PSB owned an approximate 75% general and limited partnership interest in PS Business Parks, L.P. (the "Operating Partnership" or "OP"). PSB, as the sole general partner of the Operating Partnership, has full, exclusive and complete responsibility and discretion in managing and controlling the Operating Partnership. PSB and the Operating Partnership are collectively referred to as the "Company."

The Company is a fully-integrated, self-advised and self-managed real estate investment trust ("REIT") that acquires, develops, owns and operates commercial properties containing commercial and industrial rental space. As of June 30, 2001, the Company owned and operated approximately 13.3 million net rentable square feet located in 9 states. The Company also managed approximately 1.3 million net rentable square feet on behalf of Public Storage, Inc. ("PSI"), affiliated entities and a third party owner.

2. Summary of significant accounting policies

Basis of presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The preparation of the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from estimates. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ended December 31, 2001. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

The condensed consolidated financial statements include the accounts of PSB and the Operating Partnership. All significant intercompany balances and transactions have been eliminated in the condensed consolidated financial statements.

Financial instruments

The methods and assumptions used to estimate the fair value of financial instruments is described below. The Company has estimated the fair value of financial instruments using available market information and appropriate valuation methodologies. Considerable judgment is required in interpreting market data to develop estimates of market value. Accordingly, estimated fair values are not necessarily indicative of the amounts that could be realized in current market exchanges.

The Company considers all highly liquid investments with an original maturity of three months or less at the date of purchase to be cash equivalents. Due to the short period to maturity of the Company's cash and cash equivalents, accounts receivable, other assets and accrued and other liabilities, the carrying values as presented on the condensed consolidated balance sheets are reasonable estimates of fair value. Based on borrowing rates currently available to the Company, the carrying amount of debt approximates fair value.

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2001

Financial assets that are exposed to credit risk consist primarily of cash and cash equivalents and accounts receivable. Cash and cash equivalents, which consist primarily of short-term investments, including commercial paper, are only invested in entities with an investment grade rating. Accounts receivable are not a significant portion of total assets and are comprised of a large number of customers.

Marketable securities

Marketable securities are classified as “available-for-sale” in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 115, Accounting for Certain Investments in Debt and Equity Securities. Investments are reflected on the balance sheet at fair market value based upon the quoted market price. The unrealized loss of \$836,000 is excluded from earnings and reported in a separate component of shareholders’ equity. Dividend income is recognized when earned.

The Company sold its investment in Pacific Gulf Properties Inc. during the six months ended June 30, 2001 and recognized a gain of \$15,000.

Real estate facilities

Real estate facilities are recorded at cost. Costs related to the renovation or improvement of the properties are capitalized. Expenditures for repairs and maintenance are expensed as incurred. Buildings and equipment are depreciated on the straight-line method over the estimated useful lives, which are generally 30 and 5 years, respectively.

Interest cost and property taxes incurred during the period of construction of real estate facilities are capitalized. The Company capitalized \$898,000 and \$688,000 of interest expense during the six months ended June 30, 2001 and 2000, respectively.

Intangible assets

Intangible assets consist of property management contracts for properties managed, but not owned, by the Company. The intangible assets are being amortized over seven years. Intangible assets are net of accumulated amortization of \$1,326,000 and \$1,175,000 at June 30, 2001 and December 31, 2000, respectively.

Evaluation of asset impairment

The Company evaluates its assets used in operations by identifying indicators of impairment and by comparing the sum of the estimated undiscounted future cash flows for each asset to the asset’s carrying amount. When indicators of impairment are present and the sum of the undiscounted future cash flows is less than the carrying value of such asset, an impairment loss is recorded equal to the difference between the asset’s current carrying value and its value based on discounting its estimated future cash flows. At June 30, 2001, no such indicators of impairment have been identified.

Loans to affiliate

The Company loaned an aggregate of \$77 million to PSI and received \$153,000 in interest income during the period of January 5, 2000 through March 20, 2000. The notes bore interest at 5.9% (per annum) and were repaid as of March 20, 2000.

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2001

Revenue and expense recognition

All leases are classified as operating leases. Rental income is recognized on a straight-line basis over the terms of the leases. Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as revenues in the period the applicable costs are incurred.

Costs incurred in connection with leasing (primarily tenant improvements and leasing commissions) are capitalized and amortized over the lease period.

Property management fees are recognized in the period earned.

General and administrative expense

General and administrative expense includes executive compensation, office expense, professional fees, state income taxes, cost of acquisition personnel and other such administrative items. Such amounts include amounts incurred by PSI on behalf of the Company, which were subsequently charged to the Company in accordance with the allocation methodology set forth in the cost allocation and administrative service agreement between the Company and PSI.

Acquisition costs

In March 1998, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board issued guidance (the "97-11 Guidance") with respect to Issue No. 97-11, "Accounting for Internal Acquisition Costs Relating to Real Estate Property Acquisitions." The 97-11 Guidance provides that a company shall expense internal pre-acquisition costs (such as costs of an internal acquisitions department) related to the purchase of an operating property. The Company does not capitalize such internal pre-acquisition costs with respect to the acquisition of operating real estate facilities. Accordingly, the 97-11 Guidance had no impact upon the consolidated financial statements and would have had no impact upon financial statements for periods prior to the issuance of the 97-11 Guidance.

Income taxes

The Company qualified and intends to continue to qualify as a REIT, as defined in Section 856 of the Internal Revenue Code. As a REIT, the Company is not subject to federal income tax to the extent that it distributes its taxable income to its shareholders. A REIT must distribute at least 90% of its taxable income each year. In addition, REITs are subject to a number of organizational and operating requirements. If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to federal income tax (including any applicable alternative minimum tax) based on its taxable income using corporate income tax rates. Even if the Company qualifies for taxation as a REIT, the Company may be subject to certain state and local taxes on its income and property and to federal income and excise taxes on its undistributed taxable income. The Company believes it met all organization and operating requirements to maintain its REIT status during 2000 and intends to continue to meet such requirements for 2001. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2001

Net income per common share

Per share amounts are computed using the weighted average common shares outstanding. "Diluted" weighted average common shares outstanding include the dilutive effect of stock options under the treasury stock method. "Basic" weighted average common shares outstanding excludes such effect. Earnings per share has been calculated as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2001	2000	2001	2000
Net income allocable to common shareholders.....	\$ 10,927,000	\$ 10,240,000	\$ 21,120,000	\$ 19,711,000
Weighted average common shares outstanding:				
Basic weighted average common shares outstanding	22,610,000	23,356,000	22,814,000	23,474,000
Net effect of dilutive stock options - based on treasury stock method using average market price	69,000	72,000	71,000	63,000
Diluted weighted average common shares outstanding	<u>22,679,000</u>	<u>23,428,000</u>	<u>22,885,000</u>	<u>23,537,000</u>
Basic earnings per common share.....	<u>\$ 0.48</u>	<u>\$ 0.44</u>	<u>\$ 0.93</u>	<u>\$ 0.84</u>
Diluted earnings per common share.....	<u>\$ 0.48</u>	<u>\$ 0.44</u>	<u>\$ 0.92</u>	<u>\$ 0.84</u>

Reclassifications

Certain reclassifications have been made to the condensed consolidated financial statements for 2000 in order to conform to the 2001 presentation.

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2001

3. Real estate facilities

The activity in real estate facilities for the six months ended June 30, 2001 is as follows:

	<u>Land</u>	<u>Buildings</u>	<u>Accumulated Depreciation</u>	<u>Total</u>
Balances at December 31, 2000	\$ 214,020,000	\$ 709,328,000	\$(83,841,000)	\$ 839,507,000
Property acquisitions	23,147,000	67,278,000	-	90,425,000
Capital improvements.....	-	3,840,000	-	3,840,000
Properties held for disposition.....	(1,234,000)	(4,570,000)	694,000	(5,110,000)
Depreciation expense	-	-	(19,228,000)	(19,228,000)
Balances at June 30, 2001	<u>\$ 235,933,000</u>	<u>\$ 775,876,000</u>	<u>\$(102,375,000)</u>	<u>\$ 909,434,000</u>

During the six months ended June 30, 2001, the Company incurred \$7,626,000 in development costs.

Certain properties have been identified as not meeting the Company's ongoing investment strategy and have been designated as properties held for disposition at June 30, 2001. These properties are currently being marketed and the Company anticipates a gain on the sale during this fiscal year. The following summarizes the condensed results of operations of the properties held for disposition which are included in the condensed consolidated statements of income:

	For the Six Months Ended June 30,	
	<u>2001</u>	<u>2000</u>
Rental income.....	\$ 891,000	\$ 770,000
Cost of operations	(385,000)	(273,000)
Depreciation	(82,000)	(79,000)
Net operating income	<u>\$ 424,000</u>	<u>\$ 418,000</u>

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2001

4. Leasing activity

The Company leases space in its real estate facilities to tenants under non-cancelable leases generally ranging from one to ten years. Future minimum rental revenues excluding recovery of expenses as of June 30, 2001 under these leases are as follows:

2001 (July – December)	\$ 69,310,000
2002.....	116,525,000
2003.....	90,012,000
2004.....	63,635,000
2005.....	44,540,000
Thereafter	56,165,000
	\$ 440,187,000

In addition to minimum rental payments, tenants pay reimbursements for their pro rata share of specified operating expenses, which amounted to \$11,038,000 and \$9,175,000 for the six months ended June 30, 2001 and 2000, respectively. These amounts are included as rental income and cost of operations in the accompanying condensed consolidated statements of income.

5. Revolving line of credit

In September 2000, the Company extended its unsecured line of credit (the “Credit Facility”) with Wells Fargo Bank. The Credit Facility has a borrowing limit of \$100 million and an expiration date of August 6, 2003. The expiration date may be extended by one year on each anniversary of the Credit Facility. Interest on outstanding borrowings is payable monthly. At the option of the Company, the rate of interest charged is equal to (i) the prime rate or (ii) a rate ranging from the London Interbank Offered Rate (“LIBOR”) plus 0.75% to LIBOR plus 1.35% depending on the Company’s credit ratings and coverage ratios, as defined (currently LIBOR plus 1.00%). In addition, the Company is required to pay an annual commitment fee of 0.25% of the borrowing limit. The Company had no outstanding balance and \$100 million available on its line of credit at June 30, 2001 and December 31, 2000.

The Credit Facility requires the Company to meet certain covenants including (i) maintaining a balance sheet leverage ratio (as defined) of less than 0.50 to 1.00, (ii) maintaining interest and fixed charge coverage ratios (as defined) of not less than 2.25 to 1.0 and 1.75 to 1.0, respectively, (iii) maintaining a minimum total shareholders’ equity (as defined) and (iv) limiting distributions to 95% of funds from operations. In addition, the Company is limited in its ability to incur additional borrowings (the Company is required to maintain unencumbered assets with an aggregate book value equal to or greater than two times the Company’s unsecured recourse debt) or sell assets. The Company was in compliance with the covenants of the Credit Facility at June 30, 2001.

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2001

6. Mortgage notes payable

Mortgage notes consist of the following:

	June 30, 2001	December 31, 2000
7.050% mortgage note, principal and interest payable monthly, due May 2006.....	\$ 8,474,000	\$ 8,570,000
8.190% mortgage note, principal and interest payable monthly, due March 2007	6,384,000	6,482,000
7.290% mortgage note, principal and interest payable monthly, due February 2009.....	6,219,000	6,272,000
7.280% mortgage note, principal and interest payable monthly, due February 2003.....	4,124,000	4,186,000
8.000% mortgage note, principal and interest payable monthly, due April 2003	1,977,000	2,022,000
8.500% mortgage note, principal and interest payable monthly, due July 2007	1,824,000	1,850,000
8.000% mortgage note, principal and interest payable monthly, due April 2003	1,561,000	1,589,000
	\$30,563,000	\$30,971,000

At June 30, 2001, approximate principal maturities of mortgage notes payable are as follows:

2001 (July - December)	\$ 423,000
2002.....	898,000
2003.....	7,874,000
2004.....	699,000
2005.....	755,000
Thereafter	19,914,000
	\$ 30,563,000

PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2001

7. Minority interests

Common units

The Company presents the accounts of PSB and the Operating Partnership on a consolidated basis. Ownership interests in the Operating Partnership, other than PSB's interest, are classified as minority interest in the condensed consolidated financial statements. Minority interest in income consists of the minority interests' share of the condensed consolidated operating results.

Beginning one year from the date of admission as a limited partner and subject to certain limitations described below, each limited partner other than PSB has the right to require the redemption of its partnership interest.

A limited partner that exercises its redemption right will receive cash from the Operating Partnership in an amount equal to the market value (as defined in the Operating Partnership Agreement) of the partnership interests redeemed. In lieu of the Operating Partnership redeeming the partner for cash, PSB, as general partner, has the right to elect to acquire the partnership interest directly from a limited partner exercising its redemption right, in exchange for cash in the amount specified above or by issuance of one share of PSB common stock for each unit of limited partnership interest redeemed.

A limited partner cannot exercise its redemption right if delivery of shares of PSB common stock would be prohibited under the Company's articles of incorporation or if the general partner believes that there is a risk that delivery of shares of common stock would cause the general partner to no longer qualify as a REIT, would cause a violation of the applicable securities laws, or would result in the Operating Partnership no longer being treated as a partnership for federal income tax purposes.

On January 12, 2001, the Company redeemed 30,484 common units from unaffiliated third parties for an aggregate cost of \$808,000.

At June 30, 2001, there were 7,305,355 OP units owned by PSI and affiliated entities. On a fully converted basis, assuming all 7,305,355 minority interest OP units were converted into shares of common stock of PSB at June 30, 2001, the minority interest units would convert into approximately 25% of the common shares outstanding. At the end of each reporting period, PSB determines the amount of equity (book value of net assets) which is allocable to the minority interest based upon the ownership interest and an adjustment is made to the minority interest, with a corresponding adjustment to paid-in capital, to reflect the minority interest's equity in the Company.

Preferred units

On April 23, 1999, the Operating Partnership completed a private placement of 510,000 preferred units with a preferred distribution rate of 8 7/8%. The net proceeds from the placement of preferred units were approximately \$12.5 million and were used to repay borrowings from an affiliate.

On September 3, 1999, the Operating Partnership completed a private placement of 3,200,000 preferred units with a preferred distribution rate of 8 3/4%. The net proceeds from the placement of preferred units were approximately \$78 million and part of the proceeds was used to prepay a mortgage note payable of approximately \$8.5 million.

On September 7 and 23, 1999, the Operating Partnership completed private placements of 1,200,000 and 400,000 preferred units, respectively, with a preferred distribution rate of 8 7/8%. The net proceeds from the placement of preferred units were approximately \$39.2 million.

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On July 12, 2000, the Operating Partnership completed a private placement of 480,000 preferred units with a preferred distribution rate of 8 7/8%. The net proceeds from the placement of preferred units were approximately \$11.7 million.

The Operating Partnership has the right to redeem preferred units on or after the fifth anniversary of the applicable issuance date at the original capital contribution plus the cumulative priority return, as defined, to the redemption date to the extent not previously distributed. The preferred units are exchangeable for Cumulative Redeemable Preferred Stock of the respective series of PS Business Parks, Inc. on or after the tenth anniversary of the date of issuance at the option of the Operating Partnership or a majority of the holders of the respective preferred units. The Preferred Stock will have the same distribution rate and par value as the respective units and will have equivalent terms to those described in Note 9.

8. Property management contracts

The Operating Partnership manages industrial, office and retail facilities for PSI and affiliated entities. These facilities, all located in the United States, operate under the "Public Storage" or "PS Business Parks" name. In addition, the Operating Partnership manages an office building for a third party owner.

The property management contracts provide for compensation of a percentage of the gross revenues of the facilities managed. Under the supervision of the property owners, the Operating Partnership coordinates rental policies, rent collections, marketing activities, the purchase of equipment and supplies, maintenance activities, and the selection and engagement of vendors, suppliers and independent contractors. In addition, the Operating Partnership assists and advises the property owners in establishing policies for the hire, discharge and supervision of employees for the operation of these facilities, including property managers and leasing, billing and maintenance personnel.

The property management contract with PSI is for a seven year term with the term being extended one year on each anniversary. The property management contracts with affiliates of PSI are cancelable by either party upon sixty days notice.

9. Shareholders' equity

Preferred stock

As of June 30, 2001 and December 31, 2000, the Company had the following series of preferred stock outstanding:

Series	Dividend Rate	June 30, 2001		December 31, 2000	
		Shares Outstanding	Carrying Amount	Shares Outstanding	Carrying Amount
Series A	9.250%	2,200	\$ 55,000,000	2,200	\$ 55,000,000
Series D	9.500%	2,640	66,000,000	-	-
		<u>4,840</u>	<u>\$ 121,000,000</u>	<u>2,200</u>	<u>\$ 55,000,000</u>

On April 30, 1999, the Company issued 2,200,000 depositary shares, each representing 1/1,000 of a share of 9 1/4% Cumulative Preferred Stock, Series A. Net proceeds from the public perpetual preferred stock offering were approximately \$53.1 million and were used to repay borrowings from an affiliate and a mortgage note payable of approximately \$11 million. The remaining proceeds were used for investment in real estate.

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On May 10, 2001, the Company issued 1,840,000 depositary shares, each representing 1/1,000 of a share of 9½% Cumulative Preferred Stock, Series D in a public offering. On June 18, 2001, the Company issued 800,000 depositary shares, each representing 1/1,000 of a share of 9½% Cumulative Preferred Stock, Series D in a directed placement. Net proceeds from the offerings were approximately \$64.5 million and were used for investment in real estate and general corporate purposes.

Holders of the Company's preferred stock will not be entitled to vote on most matters, except under certain conditions. In the event of a cumulative arrearage equal to six quarterly dividends, the holders of the preferred stock will have the right to elect two additional members to serve on the Company's Board of Directors until all events of default have been cured. At June 30, 2001, there were no dividends in arrears.

Except under certain conditions relating to the Company's qualification as a REIT, the preferred stock is not redeemable prior to the following dates: Series A - April 30, 2004 and Series D - May 10, 2006. On or after the respective dates, the respective series of preferred stock will be redeemable, at the option of the Company, in whole or in part, at \$25 per depositary share, plus any accrued and unpaid dividends.

The Company paid \$3,175,000 and \$2,544,000 in distributions to its preferred shareholders for the six months ended June 30, 2001 and 2000, respectively.

Common stock

On March 2, 2000, the Board of Directors authorized the repurchase from time to time of up to 1,000,000 shares of the Company's common stock on the open market or in privately negotiated transactions. On July 27, 2000, the Board of Directors authorized the repurchase of up to an additional 600,000 shares of the Company's common stock on the open market or in privately negotiated transactions. On May 8, 2001, the Board of Directors increased the number of common shares authorized for repurchase from 1,600,000 to 2,500,000. Purchases will be made subject to market conditions and other investment opportunities available to the Company. As of December 31, 2000, the Company had repurchased 722,600 shares of common stock at an aggregate cost of approximately \$16.6 million. The Company repurchased an additional 647,900 shares of common stock at an aggregate cost of approximately \$17.4 million for the six months ended June 30, 2001.

On March 31, 2000, a holder of common OP units exercised its option and converted its 107,517 common OP units into an equal number of shares of PSB common stock. The conversion resulted in an increase in shareholders' equity and a corresponding decrease in minority interest of approximately \$2,531,000, representing the book value of the OP units at the time of conversion.

The Company paid \$13,214,000 (\$0.58 per common share) and \$11,702,000 (\$0.50 per common share) in distributions to its common shareholders for the six months ended June 30, 2001 and 2000, respectively. Pursuant to restrictions on the Credit Facility, distributions may not exceed 95% of funds from operations, as defined.

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Equity stock

In addition to common and preferred stock, the Company is authorized to issue 100,000,000 shares of Equity Stock. The Articles of Incorporation provide that the Equity Stock may be issued from time to time in one or more series and gives the Board of Directors broad authority to fix the dividend and distribution rights, conversion and voting rights, redemption provisions and liquidation rights of each series of Equity Stock.

10. Recent accounting pronouncements

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which is required to be adopted by the Company on January 1, 2001. This statement provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. The Company adopted SFAS No. 133 on January 1, 2001. This adoption had no material impact on the Company's consolidated financial statements.

11. Commitments and contingencies

Substantially all of the Company's properties have been subjected to Phase I environmental reviews. Such reviews have not revealed, nor is management aware of, any probable or reasonably possible environmental costs that management believes would have a material adverse effect on the Company's business, assets or results of operations, nor is the Company aware of any potentially material environmental liability, except as discussed below.

The Company acquired a property in Beaverton, Oregon ("Creekside Corporate Park") in May 1998. A portion of Creekside Corporate Park, as well as properties adjacent to Creekside Corporate Park, are currently the subject of an environmental remedial investigation/feasibility study ("RI/FS") that is being conducted by two current and past owner/operators of an industrial facility on adjacent property, pursuant to an order issued by the Oregon Department of Environmental Quality ("ODEQ"). As part of that study, ODEQ ordered the owner/operators of the industrial facility to sample soil and groundwater on the Company's property to determine the nature and extent of contamination resulting from past operations at the industrial facility. The Company, which is not a party to the Order on Consent, executed separate Access Agreements with the two owner/operators to allow access to portions of Creekside Corporate Park to conduct the required sampling and testing. The sampling and testing is ongoing; results to date indicate that the contamination from the industrial facility has migrated onto portions of Creekside Corporate Park owned by the Company.

There is no evidence that the Company's past or current use of the Creekside Corporate Park property contributed in any way to the contamination that is the subject of the current investigation. Nevertheless, upon completion of the RI/FS, it is likely that removal or remedial measures will be required to address contamination detected during the current investigation, including any contamination on or under the Creekside Corporate Park property. Because of the preliminary nature of the investigation, the Company cannot predict the outcome of the investigation, nor can it estimate the costs of any remediation or removal activities that may be required.

One of the two owner/operators that are conducting the RI/FS pursuant to the Order on Consent recently filed for Chapter 11 bankruptcy protection. It is not clear at this point what impact, if any, this filing will have on the completion of the RI/FS, or on any removal or remedial activities ordered by the ODEQ. It is possible that the ODEQ could require the Company to participate in completing the RI/FS and implementing removal or remedial actions that may be required on the Company's property, or to pay a portion of the costs to do so. In the event the Company is ultimately deemed responsible for any costs relating to this matter, the Company believes that the party from whom the property was purchased will be responsible for any expenses or liabilities that the Company may incur as a result of this contamination. In addition, the Company believes it may have recourse

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against other potentially responsible parties, including, but not limited to, one or both of the owner/operators of the adjacent industrial facility.

On November 3, 1999, the Company filed an action entitled *PS Business Parks, Inc. v. Larry Howard, et al.* (Case No. BC219580) in the Los Angeles Superior court seeking damages in excess of \$1 million, as well as equitable relief. The complaint alleges that Mr. Howard and entities controlled by him engaged in unfair trade practices, including (1) negotiating kickbacks, secret rebates and/or unearned discounts from third party suppliers for "providing" Company business to those suppliers and (2) disrupting the Company's relationship with various suppliers. Mr. Howard is not an officer, employee or authorized agent of the Company. On November 13, 2000, the Court entered a summary judgement against the Company. The Company appealed the Court's decision, and on June 4, 2001, the Court of Appeal filed its opinion reversing the grant of summary judgement against the Company, and permitted the Company to amend its complaint to add, among other things, Mary Jane Howard as a defendant. The litigation is proceeding.

On or about February 14, 2000, Mr. Howard and entities controlled by him filed a cross-complaint against the Company, Public Storage, Inc., and several other cross-defendants alleging, among other things, (1) interference with Mr. Howard's contractual relations with various third party suppliers, (2) violation of Title VII of the Civil Rights Act and (3) abuse of process. None of the cross-complaints assigned any dollar amount in the cross-complaint to the claims. All of the claims in this cross-complaint against the Company has been dismissed with the exception of one claim for interference. The Company intends to vigorously contest this remaining claim in the cross-complaint.

On November 27, 2000, Mary Jayne Howard, a former officer of the Company, filed a demand for arbitration with the American Arbitration alleging claims against the Company for breach of contract, gender discrimination, marital discrimination, and wrongful termination based on public policy. The demand seeks damages of approximately \$2 million. On June 8, 2001, Mrs. Howard filed an amended claim. The Company plans to vigorously contest these claims.

On November 27, 2000, the Company filed an action in the Los Angeles Superior Court seeking damages in excess of \$1 million, as well as equitable relief, against Mr. Howard, entities controlled by him, and Mrs. Howard alleging claims for breach of fiduciary duty, fraud, constructive fraud, aiding and abetting, intentional interference with prospective economic advantage and unfair competition, among other things. This action was filed for protective purposes, and in view of the ruling by the Court of Appeal in the Larry Howard case described above, the Company expects to voluntarily dismiss this action without prejudice in the near future.

On February 2, 2000, the Company filed an action against Mary Piper, its former Vice President of operations, in Riverside County Superior Court, alleging claims for breach of fiduciary duties, fraud and deceit, constructive fraud, negligent misrepresentation, violation of Section 17000 of the Business and Professions Code, violation of Section 17200 of the Business and Professions Code and culpable negligence. The Company's claims arose from Ms. Piper's alleged participation in a plan that resulted in the payment of improper kickbacks to Larry Howard, a former vendor of the Company and the husband of Mary Jayne Howard, a former officer of the Company.

On March 6, 2000, Ms. Piper filed a cross-complaint against the Company, alleging that the Company had breached her written stock option agreement by refusing to allow her to exercise certain options. Thereafter, on July 19, 2001, Ms. Piper obtained leave to file an amended cross-complaint against the Company, alleging a number of additional claims arising from the termination of her employment on February 2, 2000. Specifically, Ms. Piper's cross-complaint alleged claims for breach of an oral employment agreement, wrongful termination based on gender discrimination, breach of the implied covenant of good faith and fair dealing, intentional infliction of emotional distress, breach of a written contract for stock options and age discrimination. Ms.

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Piper's amended cross-complaint seeks \$103,773.62 in alleged lost profits with respect to the stock options, additional compensatory damages according to proof, attorneys' fees, prejudgment interest and punitive damages. No trial date has been set. The Company denies Ms. Piper's allegations and intends to vigorously contest these claims.

The Company currently is neither subject to any other material litigation nor, to management's knowledge, is any material litigation currently threatened against the Company other than routine litigation and administrative proceedings arising in the ordinary course of business. Management believes that these items will not have a material adverse impact on the Company's condensed consolidated financial position or results of operations.

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

Forward-Looking Statements: Forward-looking statements are made throughout this Quarterly Report on Form 10-Q. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects," "seeks," "estimates," and similar expressions are intended to identify forward-looking statements. There are a number of important factors that could cause the results of the Company to differ materially from those indicated by such forward-looking statements, including those detailed under the heading "Item 2A. Risk Factors." In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. Moreover, we assume no obligation to update these forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

Overview: During 2000 and the six months ended June 30, 2001, the Company focused on increasing cash flow from its existing core portfolio of properties, expanding its presence in existing markets through strategic acquisitions and developments and strengthening its balance sheet primarily through the issuance of preferred stock/units. The Company has maintained low debt and overall leverage levels including preferred stock/units to facilitate future growth.

During the six months ended June 30, 2001, the Company expanded its presence in Northern Virginia. The Company acquired 12 buildings known as the Prosperity Business Campus in Fairfax County, Virginia at a cost of \$88.4 million. The acquisition was funded with the Company's existing cash, including proceeds from the issuance of depositary shares. The 12 buildings consist of four office buildings (355,000 square feet) and eight flex-space buildings (302,000 square feet). The Company plans to continue to build its presence in existing markets by acquiring high quality facilities in selected markets. The Company targets properties with below market rents which offer the Company the ability to raise rents to market as leases expire in addition to achieving economies of scale resulting in more efficient operations.

During 2000, the Company added approximately 0.8 million square feet to its portfolio at an aggregate cost of approximately \$82 million. These acquisitions increased the Company's presence in its existing markets, which the Company believes have the characteristics necessary for long-term growth. The Company acquired 454,000 square feet in Southern California for \$40 million, 178,000 square feet in Northern California for \$23 million, 210,000 square feet in Northern Virginia for approximately \$19 million. In addition, the Company completed development on a property totaling 22,000 square feet in Oregon for approximately \$3 million. The Company also sold five properties aggregating 627,000 square feet for approximately \$23.8 million in non-core markets.

Results of Operations: Net income for the three months ended June 30, 2001 was \$12,830,000 compared to \$11,512,000 for the same period in 2000. Net income allocable to common shareholders (net income less preferred stock dividends) for the three months ended June 30, 2001 was \$10,927,000 compared to \$10,240,000 for the same period in 2000. Net income per common share on a diluted basis was \$0.48 for the three months ended June 30, 2001 compared to \$0.44 for the same period in 2000 (based on weighted average diluted common shares outstanding of 22,679,000 and 23,428,000, respectively). Net income for the six months ended June 30, 2001 was \$24,295,000 compared to \$22,255,000 for the same period in 2000. Net income allocable to common shareholders (net income less preferred stock dividends) for the six months ended June 30, 2001 was \$21,120,000 compared to \$19,711,000 for the same period in 2000. Net income per common share on a diluted basis was \$0.92 for the six months ended June 30, 2001 compared to \$0.84 for the same period in 2000 (based on weighted average diluted common shares outstanding of 22,885,000 and 23,537,000, respectively).

The Company's property operations account for almost all of the net operating income earned by the Company. The following table presents the pre-depreciation operating results of the properties:

	Three Months Ended June 30,		Change
	2001	2000	
Rental income:			
“Same Park” facilities (11.5 million net rentable square feet).....	\$35,922,000	\$33,940,000	5.8%
Other facilities	4,359,000	2,474,000	76.2%
Total rental income	<u>\$40,281,000</u>	<u>\$36,414,000</u>	10.6%
Cost of operations (excluding depreciation):			
“Same Park” facilities	\$9,441,000	\$9,406,000	0.4%
Other facilities	1,034,000	712,000	45.2%
Total cost of operations	<u>\$10,475,000</u>	<u>\$10,118,000</u>	3.5%
Net operating income (rental income less cost of operations):			
“Same Park” facilities	\$26,481,000	\$24,534,000	7.9%
Other facilities	3,325,000	1,762,000	88.7%
Total net operating income	<u>\$29,806,000</u>	<u>\$26,296,000</u>	13.3%

	Six Months Ended June 30,		Change
	2001	2000	
Rental income:			
“Same Park” facilities (11.5 million net rentable square feet).....	\$70,819,000	\$66,276,000	6.9%
Other facilities	7,855,000	4,191,000	87.4%
Total rental income	<u>\$78,674,000</u>	<u>\$70,467,000</u>	11.6%
Cost of operations (excluding depreciation):			
“Same Park” facilities	\$18,895,000	\$18,250,000	3.5%
Other facilities	1,951,000	1,420,000	37.4%
Total cost of operations	<u>\$20,846,000</u>	<u>\$19,670,000</u>	6.0%
Net operating income (rental income less cost of operations):			
“Same Park” facilities	\$51,924,000	\$48,026,000	8.1%
Other facilities	5,904,000	2,771,000	113.1%
Total net operating income	<u>\$57,828,000</u>	<u>\$50,797,000</u>	13.8%

Rental income and rental income less cost of operations or net operating income (“NOI”) prior to depreciation are summarized for the three months ended June 30, 2001 by major geographic region below:

Region	Square Footage	Percent of Total	Rental Income	Percent of Total	NOI	Percent of Total
Southern California	3,548,000	26.8%	\$11,099,000	27.5%	\$8,321,000	27.9%
Northern California	1,495,000	11.3%	4,883,000	12.1%	3,765,000	12.6%
Southern Texas	1,032,000	7.8%	3,020,000	7.5%	1,975,000	6.6%
Northern Texas	1,849,000	13.9%	4,587,000	11.4%	3,134,000	10.5%
Virginia	2,480,000	18.7%	7,802,000	19.4%	5,933,000	19.9%
Maryland	866,000	6.5%	2,410,000	6.0%	1,882,000	6.3%
Oregon	1,191,000	9.0%	4,656,000	11.6%	3,757,000	12.6%
Other	797,000	6.0%	1,824,000	4.5%	1,039,000	3.6%
	<u>13,258,000</u>	<u>100.0%</u>	<u>\$40,281,000</u>	<u>100.0%</u>	<u>\$29,806,000</u>	<u>100.0%</u>

Rental income and rental income less cost of operations or net operating income (“NOI”) prior to depreciation are summarized for the six months ended June 30, 2001 by major geographic region below:

Region	Square Footage	Percent of Total	Rental Income	Percent of Total	NOI	Percent of Total
Southern California	3,548,000	26.8%	\$21,857,000	27.8%	\$16,300,000	28.2%
Northern California	1,495,000	11.3%	9,511,000	12.1%	7,301,000	12.6%
Southern Texas	1,032,000	7.8%	5,963,000	7.6%	3,677,000	6.4%
Northern Texas	1,849,000	13.9%	9,333,000	11.9%	6,500,000	11.2%
Virginia	2,480,000	18.7%	14,139,000	18.0%	10,549,000	18.2%
Maryland	866,000	6.5%	4,899,000	6.2%	3,733,000	6.5%
Oregon	1,191,000	9.0%	9,305,000	11.8%	7,522,000	13.0%
Other	797,000	6.0%	3,667,000	4.6%	2,246,000	3.9%
	<u>13,258,000</u>	<u>100.0%</u>	<u>\$78,674,000</u>	<u>100.0%</u>	<u>\$57,828,000</u>	<u>100.0%</u>

Supplemental Property Data and Trends: In order to evaluate the performance of the Company’s overall portfolio, management analyzes the operating performance of a consistent group of properties (11.5 million net rentable square feet). These properties in which the Company currently has an ownership interest (herein referred to as the “Same Park” facilities) have been owned and operated by the Company for the comparable periods. The square footage has been reduced since the end of the first quarter of 2001 for planned dispositions. The “Same Park” facilities represent approximately 86% of the square footage of the Company’s portfolio at June 30, 2001.

The following table summarizes the pre-depreciation historical operating results of the “Same Park” facilities excluding the effects of accounting for rental income on a straight-line basis.

“Same Park” Facilities (11.5 million square feet)

	Three Months Ended June 30,		Change
	2001	2000	
Rental income ⁽¹⁾	\$ 35,465,000	\$ 33,386,000	6.2%
Cost of operations	9,441,000	9,406,000	0.4%
Net operating income	<u>\$ 26,024,000</u>	<u>\$ 23,980,000</u>	8.5%

Gross margin ⁽²⁾	73.4%	71.8%	1.6%
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Weighted average for period:

Occupancy	95.5%	96.5%	(1.0%)
Annualized realized rent per occupied sq. ft. ⁽³⁾	\$12.86	\$11.98	7.3%

.....

	Six Months Ended June 30,		Change
	2001	2000	
Rental income ⁽¹⁾	\$ 70,024,000	\$ 65,125,000	7.5%
Cost of operations	18,895,000	18,250,000	3.5%
Net operating income	<u>\$ 51,129,000</u>	<u>\$ 46,875,000</u>	9.1%

Gross margin ⁽²⁾	73.0%	72.0%	1.0%
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Weighted average for period:

Occupancy	95.9%	96.5%	(0.6%)
Annualized realized rent per occupied sq. ft. ⁽³⁾	\$12.64	\$11.69	8.1%

(1) Rental income does not include the effect of straight-line accounting.

(2) Gross margin is computed by dividing property net operating income by rental income.

(3) Realized rent per square foot represents the actual revenues earned per occupied square foot.

The following tables summarize the “Same Park” operating results by major geographic region for the three months ended June 30, 2001 and 2000:

Region	Revenues 2001	Revenues 2000	Increase (Decrease)	NOI 2001	NOI 2000	Increase (Decrease)
Southern California....	\$9,337,000	\$8,915,000	4.7%	\$7,175,000	\$6,817,000	5.3%
Northern California....	4,153,000	3,648,000	13.8%	3,148,000	2,626,000	19.9%
Southern Texas	3,021,000	2,626,000	15.0%	1,955,000	1,501,000	30.2%
Northern Texas	4,477,000	4,385,000	2.1%	3,023,000	2,893,000	4.5%
Virginia.....	6,078,000	5,741,000	5.9%	4,449,000	4,134,000	7.6%
Maryland.....	2,410,000	2,472,000	(2.5%)	1,871,000	1,847,000	1.3%
Oregon.....	4,103,000	3,798,000	8.0%	3,344,000	3,075,000	8.7%
Other.....	1,886,000	1,801,000	4.7%	1,059,000	1,087,000	(2.6%)
	<u>\$35,465,000</u>	<u>\$33,386,000</u>	6.2%	<u>\$26,024,000</u>	<u>\$23,980,000</u>	8.5%

Northern California and Oregon continue to benefit from the expirations of leases with below market rents. Southern Texas revenues increased in comparison to 2000 primarily due to increased occupancy and rental rate increases at certain Austin facilities. Other markets grew to a lesser extent resulting in revenue and NOI increases in most of our markets.

The following tables summarize the “Same Park” operating results by major geographic region for the six months ended June 30, 2001 and 2000:

Region	Revenues 2001	Revenues 2000	Increase	NOI 2001	NOI 2000	Increase
Southern California....	\$18,385,000	\$17,279,000	6.4%	\$14,016,000	\$13,243,000	5.8%
Northern California....	8,019,000	7,213,000	11.2%	6,046,000	5,235,000	15.5%
Southern Texas	5,941,000	5,172,000	14.9%	3,629,000	2,986,000	21.5%
Northern Texas	9,097,000	8,561,000	6.3%	6,284,000	5,652,000	11.2%
Virginia.....	11,758,000	11,003,000	6.9%	8,507,000	7,962,000	6.8%
Maryland.....	4,882,000	4,851,000	0.6%	3,701,000	3,587,000	3.2%
Oregon.....	8,153,000	7,452,000	9.4%	6,644,000	6,028,000	10.2%
Other.....	3,789,000	3,594,000	5.4%	2,302,000	2,182,000	5.5%
	<u>\$70,024,000</u>	<u>\$65,125,000</u>	7.5%	<u>\$51,129,000</u>	<u>\$46,875,000</u>	9.1%

Northern California and Oregon continue to benefit from the expirations of leases with below market rents. Southern Texas revenues increased in comparison to 2000 primarily due to increased occupancy and rental rate increases at certain Austin facilities. Other markets grew to a lesser extent resulting in revenue and NOI increases in all of our markets.

Facility Management Operations: The Company's facility management accounts for a small portion of the Company's net operating income. During the three months ended June 30, 2001, \$131,000 in net operating income was recognized from facility management operations compared to \$104,000 for the same period in 2000. During the six months ended June 30, 2001, \$256,000 in net operating income was recognized from facility management operations compared to \$202,000 for the same period in 2000. Facility management fees have increased due to the increase in rental rates of the properties managed by the Company and an additional property brought under management during 2000.

Business Services: Business services include construction management fees and fees from telecommunication service providers. During the three months ended June 30, 2001, the Company generated a net operating loss of \$53,000 compared to net operating income of \$203,000 for the same period in 2000. During the six months ended June 30, 2001, the Company generated a net operating loss of \$80,000 compared to net operating income of \$203,000 for the same period in 2000.

Interest Income: Interest income reflects earnings on cash balances. Interest income was \$553,000 for the three months ended June 30, 2001 compared to \$741,000 for the same period in 2000. Interest income was \$1,313,000 for the six months ended June 30, 2001 compared to \$2,011,000 for the same period in 2000. The decreases are attributable to lower average cash balances and interest rates. Average cash balances for the three months ended June 30, 2001 were approximately \$51 million compared to \$49 million for the same period in 2000. Average cash balances for the six months ended June 30, 2001 were approximately \$55 million compared to \$70 million for the same period in 2000.

Dividend Income: Dividend income reflects dividends received from marketable securities. Dividend income was \$4,000 for the three months ended June 30, 2001 compared to \$440,000 for the same period in 2000. Dividend income was \$8,000 for the six months ended June 30, 2001 compared to \$858,000 for the same period in 2000. No dividend income was received from Pacific Gulf Properties, Inc. during the three and six months ended June 30, 2001.

Cost of Operations: Cost of operations for the three months ended June 30, 2001 was \$10,475,000 compared to \$10,118,000 for the same period in 2000. Cost of operations for the six months ended June 30, 2001 was \$20,846,000 compared to \$19,670,000 for the same period in 2000. The increases are due primarily to increased utilities, repairs and maintenance and payroll costs and the growth in the total square footage of the Company's portfolio of properties. Cost of operations for the three months ended June 30, 2001 consisted primarily of property taxes (\$3,487,000), property maintenance (\$1,947,000), utilities (\$1,605,000) and direct payroll (\$1,557,000). Cost of operations for the six months ended June 30, 2001 consisted primarily of property taxes (\$6,860,000), property maintenance (\$4,016,000), utilities (\$3,542,000) and direct payroll (\$3,267,000). Cost of operations as a percentage of rental income decreased from 27.8% to 26.0% and from 27.9% to 26.5% for the three and six months ended June 30, 2001, respectively, as a result of economies of scale achieved through the acquisition and development of properties in core markets and the disposition of properties outside of the Company's core markets in addition to revenue increases in excess of expense increases at the Company's "Same Park" facilities.

Depreciation and Amortization Expense: Depreciation and amortization expense for the three months ended June 30, 2001 was \$9,733,000 compared to \$8,898,000 for the same period in 2000. Depreciation and amortization expense for the six months ended June 30, 2001 was \$19,379,000 compared to \$17,274,000 for the same period in 2000. The increase is primarily due to the acquisition and development of real estate facilities during 2000 and 2001.

General and Administrative Expense: General and administrative expense was \$992,000 for the three months ended June 30, 2001 compared to \$981,000 for the same period in 2000. General and administrative expense was \$2,120,000 for the six months ended June 30, 2001 compared to \$1,864,000 for the same period in 2000. The increases are due primarily to the increased size and activities of the Company. Included in general and administrative costs are acquisition costs and abandoned transaction costs. Acquisition expenses were \$114,000 and \$117,000 for the three months ended June 30, 2001 and 2000, respectively. Abandoned transaction costs were \$5,000 and none for the three months ended June 30, 2001 and 2000, respectively. Acquisition expenses were \$317,000 and \$248,000 for the six months ended June 30, 2001 and 2000, respectively. Abandoned transaction costs were \$7,000 and \$7,000 for the six months ended June 30, 2001 and 2000, respectively.

Interest Expense: Interest expense was \$157,000 for the three months ended June 30, 2001 compared to \$370,000 for the same period in 2000. Interest expense was \$394,000 for the six months ended June 30, 2001 compared to \$744,000 for the same period in 2000. The decreases are attributable to lower average debt balances during the period and greater capitalized interest in 2001 as a result of greater construction in progress. Interest expense of \$486,000 and \$290,000 was capitalized as part of building costs associated with properties under development during the three months ended June 30, 2001 and 2000, respectively. Interest expense of \$898,000 and \$688,000 was capitalized as part of building costs associated with properties under development during the six months ended June 30, 2001 and 2000, respectively.

Gain on Investment in Pacific Gulf Properties Inc. ("PAG"): The Company sold its investment in PAG during the six months ended June 30, 2001 and recognized a gain of \$15,000.

Minority Interest in Income: Minority interest in income reflects the income allocable to equity interests in the Operating Partnership that are not owned by the Company. Minority interest in income for the three months ended June 30, 2001 was \$6,729,000 (\$3,186,000 allocated to preferred unitholders and \$3,543,000 allocated to common unitholders) compared to \$6,120,000 (\$2,921,000 allocated to preferred unitholders and \$3,199,000 allocated to common unitholders) for the same period in 2000. Minority interest in income for the six months ended June 30, 2001 was \$13,152,000 (\$6,373,000 allocated to preferred unitholders and \$6,779,000 allocated to common unitholders) compared to \$12,031,000 (\$5,841,000 allocated to preferred unitholders and \$6,190,000 allocated to common unitholders) for the same period in 2000. The increases in minority interest in income are due primarily to the issuance of preferred operating partnership units during 2000 and higher earnings at the operating partnership level, partially offset by a conversion of units to common stock during 2000.

Liquidity and Capital Resources

Net cash provided by operating activities for the six months ended June 30, 2001 and 2000 was \$59,761,000 and \$55,071,000, respectively. Management believes that its internally generated net cash provided by operating activities will continue to be sufficient to enable it to meet its operating expenses, capital improvements and debt service requirements and to maintain the current level of distributions to shareholders.

The following table summarizes the Company's cash flow from operating activities:

	Six Months Ended June 30,	
	2001	2000
Net income.....	\$24,295,000	\$22,255,000
Gain on investment in Pacific Gulf Properties, Inc.....	(15,000)	-
Depreciation and amortization.....	19,379,000	17,274,000
Minority interest in income.....	13,152,000	12,031,000
Change in working capital.....	(2,950,000)	3,511,000
Net cash provided by operating activities.....	<u>59,761,000</u>	<u>55,071,000</u>
Maintenance capital expenditures.....	(1,223,000)	(1,181,000)
Tenant improvements.....	(1,638,000)	(2,074,000)
Capitalized lease commissions.....	<u>(979,000)</u>	<u>(1,492,000)</u>
Funds available for distributions to shareholders, minority interests, acquisitions and other corporate purposes.....	55,921,000	50,324,000
Cash distributions to shareholders and minority interests.....	<u>(27,000,000)</u>	<u>(23,782,000)</u>
Excess funds available for principal payments on debt, investments in real estate and other corporate purposes.....	<u>\$ 28,921,000</u>	<u>\$ 26,542,000</u>

The Company's capital structure is characterized by a low level of leverage. As of June 30, 2001, the Company had seven fixed rate mortgage notes payable totaling \$30,563,000, which represented 3.2% of its total capitalization (based on book value, including minority interest and debt). The weighted average interest rate for the mortgage notes is 7.56%.

The Company expects to fund its growth strategies with permanent capital, including issuances of common and preferred stock, and retained internally generated cash flows. In addition, the Company may sell properties that no longer meet its investment criteria. The Company may finance acquisitions on a temporary basis with borrowings from its unsecured line of credit (the "Credit Facility"). The Company intends to repay amounts borrowed under the Credit Facility from undistributed cash flow or, as market conditions permit and as determined to be advantageous, from the public or private placement of preferred and common stock/OP units of the Company or Operating Partnership or the formation of joint ventures. The Company targets a leverage ratio of 40% (defined as debt and preferred equity as a percentage of market capitalization). In addition, the Company targets a Funds from Operations ("FFO") to combined fixed charges and preferred distributions ratio of 3.0 to 1.0. As of June 30, 2001 and for the six months then ended, the leverage ratio was 26% and the FFO to fixed charges and preferred distributions coverage ratio was 5.2 to 1.0.

On May 10, 2001, the Company issued 1,840,000 depositary shares, each representing 1/1,000 of a share of 9% Cumulative Preferred Stock, Series D in a public offering. On June 18, 2001, the Company issued 800,000 depositary shares, each representing 1/1,000 of a share of 9% Cumulative Preferred Stock, Series D in a directed placement. Net proceeds from the offerings were approximately \$64.5 million and were used for investment in real estate and general corporate purposes.

In September 2000, the Company extended its Credit Facility with Wells Fargo Bank. The Credit Facility has a borrowing limit of \$100 million and an expiration date of August 6, 2003. The expiration date may be extended by one year on each anniversary of the Credit Facility. Interest on outstanding borrowings is payable monthly. At the option of the Company, the rate of interest charged is equal to (i) the prime rate or (ii) a rate ranging from the London Interbank Offered Rate ("LIBOR") plus 0.75% to LIBOR plus 1.35% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 1.00%). In addition, the Company is required to pay an annual commitment fee of 0.25% of the borrowing limit. As of June 30, 2001, the Company had no balance outstanding on the Credit Facility.

Funds from Operations: FFO is defined as net income, computed in accordance with accounting principles generally accepted in the United States, before depreciation, amortization, minority interest in income, straight-line rent adjustments and extraordinary or non-recurring items. FFO is presented because the Company considers FFO to be a useful measure of the operating performance of a REIT which, together with net income and cash flows, provides investors with a basis to evaluate the operating and cash flow performances of a REIT. FFO does not represent net income or cash flows from operations as defined by accounting principles generally accepted in the United States. FFO does not take into consideration scheduled principal payments on debt or capital improvements. Accordingly, FFO is not necessarily a substitute for cash flow or net income as a measure of liquidity or operating performance or ability to make acquisitions and capital improvements or ability to pay distributions or debt principal payments. Also, FFO as computed and disclosed by the Company may not be comparable to FFO computed and disclosed by other REITs.

FFO for the Company is computed as follows:

	Six Months Ended June 30,	
	2001	2000
Net income allocable to common shareholders.....	\$ 21,120,000	\$ 19,711,000
Less: Gain on investment in Pacific Gulf Properties Inc.....	(15,000)	-
Less: Gain on disposition of real estate.....	-	(97,000)
Depreciation and amortization	19,379,000	17,274,000
Minority interest in income – common units.....	6,779,000	6,190,000
Less: Straight-line rent adjustment.....	(883,000)	(1,224,000)
Consolidated FFO allocable to common shareholders and minority interests	46,380,000	41,854,000
FFO allocated to common minority interest – common units	(11,270,000)	(10,003,000)
FFO allocated to common shareholders.....	<u>\$ 35,110,000</u>	<u>\$ 31,851,000</u>

Capital Expenditures: During the six months ended June 30, 2001, the Company incurred \$3.8 million in maintenance capital expenditures, tenant improvements and capitalized lease commissions. On a recurring annual basis, the Company expects \$0.90 to \$1.20 per square foot in recurring capital expenditures (\$12 - \$16 million based on square footage at June 30, 2001). In addition, the Company expects to make \$1.0 million in renovations on a property in Southern California during the second half of 2001.

Stock Repurchase: On May 8, 2001, the Board of Directors increased the number of common shares authorized to be repurchased from 1,600,000 to 2,500,000. The shares may be repurchased periodically on the open market or in privately negotiated transactions. The Company repurchased 647,900 shares of common stock at an aggregate cost of approximately \$17.4 million during the six months ended June 30, 2001.

Distributions: The Company has elected and intends to qualify as a REIT for federal income tax purposes. In order to maintain its status as a REIT, the Company must meet, among other tests, sources of income, share ownership and certain asset tests. As a REIT, the Company is not taxed on that portion of its taxable income that is distributed to its shareholders provided that at least 90% of its taxable income is distributed to its shareholders prior to filing of its tax return.

ITEM 2A. RISK FACTORS

In addition to the other information in this Form 10-Q, the following factors should be considered in evaluating our company and our business.

PSI has significant influence over us.

PSI owns a substantial number of our shares: At June 30, 2001, PSI owned 24% of the outstanding shares of our common stock (43% upon conversion of its interest in our operating partnership). Consequently, PSI has the ability to significantly influence all matters submitted to a vote of our shareholders, including electing directors, changing our articles of incorporation, dissolving and approving other extraordinary transactions. In addition, PSI's ownership may make it more difficult for another party to take over our company without PSI's approval.

PSI has a voting agreement with another large shareholder: PSI and an institutional shareholder owning 27% of our common stock as of June 30, 2001 have both agreed to vote their shares to support specified nominees to our board of directors until the voting agreement expires, which is not before December 2001. This voting agreement may further increase PSI's influence over our company.

Provisions in our organizational documents may prevent changes in control.

Our articles generally prohibit owning more than 7% of our shares: Our articles of incorporation restrict the number of shares that may be owned by any person (other than PSI and certain other specified shareholders), and the partnership agreement of our operating partnership contains an anti-takeover provision. No shareholder (other than PSI and certain other specified shareholders) may own more than 7% of the outstanding shares of our common stock, unless our board of directors waives this limitation. We imposed this limitation to avoid, to the extent possible, a concentration of ownership that might jeopardize our ability to qualify as a real estate investment trust, or REIT. This limitation, however, also makes a change of control much more difficult even if it may be favorable to our public shareholders. These provisions will prevent future takeover attempts not approved by PSI even if a majority of our public shareholders consider it to be in their best interests because they would receive a premium for their shares over the shares' then market value or for other reasons.

Our board can set the terms of certain securities without shareholder approval: Our board of directors is authorized, without shareholder approval, to issue up to 50,000,000 shares of preferred stock and up to 100,000,000 shares of equity stock, in each case in one or more series. Our board has the right to set the terms of each of these series of stock. Consequently, the board could set the terms of a series of stock that could make it difficult (if not impossible) for another party to take over our company even if it might be favorable to our public shareholders. Our articles of incorporation also contain other provisions that could have the same effect. We can also cause our operating partnership to issue additional interests for cash or in exchange for property.

The partnership agreement of our operating partnership restricts mergers: The partnership agreement of our operating partnership provides that generally we may not merge or engage in a similar transaction unless limited partners of our operating partnership are entitled to receive the same proportionate payments as our shareholders. In addition, we have agreed not to merge with another entity unless the merger would have been approved had the limited partners been able to vote together with our shareholders. These provisions may make it more difficult for us to merge with another entity.

Our operating partnership poses additional risks to us.

Limited partners of our operating partnership, including PSI, have the right to vote on certain changes to the partnership agreement. They may vote in a way that is contrary to the interests of our shareholders. Also, as general partner of our operating partnership, we are required to protect the interests of the limited partners of our operating partnership. The interests of the limited partners and of our shareholders may differ.

We cannot sell certain properties without PSI's approval.

Before 2007, we may not sell 13 specified properties without PSI's approval. Since PSI would be taxed on a sale of these properties, the interests of PSI and our shareholders may differ as to the best time to sell.

Certain institutional investors have special rights.

Certain institutional investors have rights, such as the right to approve nominees to our board of directors, the right to purchase our securities in certain circumstances and the right to require registration of their shares, not available to our public shareholders.

We would incur adverse tax consequences if we fail to qualify as a REIT.

Our cash flow would be reduced if we fail to qualify as a REIT: While we believe that we have qualified since 1990 to be taxed as a REIT, and will continue to be qualified, we cannot be certain. To continue to qualify as a REIT, we need to satisfy certain requirements under the federal income tax laws relating to our income, assets, distributions to shareholders and shareholder base. In this regard, the share ownership limits in our articles of incorporation do not necessarily ensure that our shareholder base is sufficiently diverse for us to qualify as a REIT. For any year we fail to qualify as a REIT, we would be taxed at regular corporate tax rates on our taxable income unless certain relief provisions apply. Taxes would reduce our cash available for distributions to shareholders or for reinvestment, which could adversely affect us and our shareholders. Also we would not be allowed to elect REIT status for five years after we fail to qualify unless certain relief provisions apply.

Our cash flow would be reduced if our predecessor failed to qualify as a REIT: For us to qualify to be taxed as a REIT, our predecessor, American Office Park Properties, also needed to qualify to be taxed as a REIT. We believe American Office Park Properties qualified as a REIT beginning in 1997 until its March 1998 merger with us. If it is determined that it did not qualify as a REIT, we could also lose our REIT qualification. Before 1997, our predecessor was a taxable corporation and, to qualify as a REIT, was required to distribute all of its profits before the end of 1996. While we believe American Office Park Properties qualified as a REIT since 1997, we did not obtain an opinion of an outside expert at the time of its merger with us.

We may need to borrow funds to meet our REIT distribution requirements: To qualify as a REIT, we must generally distribute to our shareholders 90% of our taxable income. Our income consists primarily of our share of our operating partnership's income. We intend to make sufficient distributions to qualify as a REIT and otherwise avoid corporate tax. However, differences in timing between income and expenses and the need to make nondeductible expenditures such as capital improvements and principal payments on debt could force us to borrow funds to make necessary shareholder distributions.

Since we buy and operate real estate, we are subject to general real estate investment and operating risks.

Summary of real estate risks: We own and operate commercial properties and are subject to the risks of owning real estate generally and commercial properties in particular. These risks include:

- the national, state and local economic climate and real estate conditions, such as oversupply of or reduced demand for space and changes in market rental rates;
- how prospective tenants perceive the attractiveness, convenience and safety of our properties;
- our ability to provide adequate management, maintenance and insurance;
- our ability to collect rent from tenants on a timely basis;
- the expense of periodically renovating, repairing and reletting spaces;

- increasing operating costs, including real estate taxes and utilities, if these increased costs cannot be passed through to tenants; and
- changes in tax, real estate and zoning laws.

Certain significant costs, such as mortgage payments, real estate taxes, insurance and maintenance costs, generally are not reduced even when a property's rental income is reduced. In addition, environmental and tax laws, interest rate levels, the availability of financing and other factors may affect real estate values and property income. Furthermore, the supply of commercial space fluctuates with market conditions.

If our properties do not generate sufficient income to meet operating expenses, including any debt service, tenant improvements, leasing commissions and other capital expenditures, we may have to borrow additional amounts to cover fixed costs, and we may have to reduce our distributions to shareholders.

We may encounter significant delays in reletting vacant space, resulting in losses of income: When leases expire, we will incur expenses and we may not be able to release the space on the same terms. Certain leases provide tenants with the right to terminate early if they pay a fee. While we have estimated our cost of renewing leases that expire in 2001, our estimates could be wrong. If we are unable to release space promptly, if the terms are significantly less favorable than anticipated or if the costs are higher, we may have to reduce our distributions to shareholders.

Tenant defaults and bankruptcies may reduce our cash flow and distributions: We may have difficulty in collecting from tenants in default, particularly if they declare bankruptcies. This could reduce our cash flow and distributions to shareholders.

We may be adversely affected by significant competition among commercial properties: Many other commercial properties compete with our properties for tenants and we expect that new properties will be built in our markets. Also, we compete with other buyers, many of whom are larger than us, in seeking to acquire commercial properties. Therefore, we may not be able to grow as rapidly as we would like.

We may be adversely affected if losses on our properties are not covered by insurance: We carry insurance on our properties that we believe is comparable to the insurance carried by other operators for similar properties. However, we could suffer uninsured losses that adversely affect us or even result in loss of the property. We might still remain liable on any mortgage debt related to that property.

The illiquidity of our real estate investments may prevent us from adjusting our portfolio to respond to market changes: There may be delays and difficulties in selling real estate. Therefore, we cannot easily change our portfolio when economic conditions change. Also, tax laws limit a REIT's ability to sell properties held for less than four years.

We may be adversely affected by changes in laws: Increases in income and service taxes may reduce our cash flow and ability to make expected distributions to our shareholders. Our properties are also subject to various federal, state and local regulatory requirements, such as state and local fire and safety codes. If we fail to comply with these requirements, governmental authorities could fine us or courts could award damages against us. We believe our properties comply with all significant legal requirements. However, these requirements could change in a way that would reduce our cash flow and ability to make distributions to shareholders.

We may incur significant environmental remediation costs: Under various federal, state and local environmental laws an owner or operator of real estate interests may have to clean spills or other releases of hazardous or toxic substances on or from a property. Certain environmental laws impose liability whether or not the owner knew of, or was responsible for, the presence of the hazardous or toxic substances. In some cases, liability may exceed the value of the property. The presence of toxic substances, or the failure to properly remedy any resulting contamination, may make it more difficult for the owner or operator to sell, lease or operate its property or

to borrow money using its property as collateral. Future environmental laws may impose additional material liabilities on us.

We acquired a property in Beaverton, Oregon in May 1998 known as Creekside Corporate Park. A portion of Creekside Corporate Park, as well as properties adjacent to Creekside Corporate Park, are currently the subject of an environmental remedial investigation/feasibility study, or RI/FS, that is being conducted by two current and past owner/operators of an industrial facility on adjacent property, pursuant to a consent order issued by the Oregon Department of Environmental Quality, or ODEQ. As part of that study, ODEQ ordered the owner/operators of the industrial facility to sample soil and groundwater on our property to determine the nature and extent of contamination resulting from past operations at the industrial facility. Because we are not a party to the consent order, we executed separate agreements with the two owner/operators to allow them access to portions of Creekside Corporate Park to conduct the required sampling and testing. The sampling and testing is ongoing; results to date indicate that the contamination from the industrial facility has migrated onto portions of Creekside Corporate Park owned by us.

There is no evidence that our past or current use of the Creekside Corporate Park property contributed in any way to the contamination that is the subject of the current investigation. Nevertheless, upon completion of the RI/FS, it is likely that removal or remedial measures will be required to address contamination detected during the current investigation, including any contamination on or under the Creekside Corporate Park property. Because of the preliminary nature of the investigation, we cannot predict the outcome of the investigation, nor can we estimate the costs of any remediation or removal activities that may be required.

One of the two owner/operators that are conducting the RI/FS pursuant to the consent order recently filed for Chapter 11 bankruptcy protection. It is not clear at this point what impact, if any, this filing will have on the completion of the RI/FS, or on any removal or remedial activities ordered by the ODEQ. It is possible that the ODEQ could require us to participate in completing the RI/FS and implementing removal or remedial actions that may be required on our property, or to pay a portion of the costs to do so. In the event we are ultimately deemed responsible for any costs relating to this matter, we believe that the party from whom the property was purchased will be responsible for any expenses or liabilities that we may incur as a result of this contamination. In addition, we believe that we may have recourse against other potentially responsible parties, including, but not limited to, one or both of the owner/operators of the adjacent industrial facility. However, if we are deemed responsible for any expenses related to removal or remedial actions on the property, and we are not successful in obtaining reimbursement from one or more third parties, our operations and financial condition could be harmed.

We may be affected by the Americans with Disabilities Act: The Americans with Disabilities Act of 1990 requires that access and use by disabled persons of all public accommodations and commercial properties be facilitated. Existing commercial properties must be made accessible to disabled persons. While we have not estimated the cost of complying with this act, we do not believe the cost will be material.

Our ability to control our properties may be adversely affected by ownership through partnerships and joint ventures.

We own most of our properties through our operating partnership. Our organizational documents do not limit our ability to invest funds with others in partnerships or joint ventures. This type of investment may present additional risks. For example, our partners may have interests that differ from ours or that conflict with ours, or our partners may become bankrupt.

We can change our business policies and increase our level of debt without shareholder approval.

Our board of directors establishes our investment, financing, distribution and our other business policies and may change these policies without shareholder approval. Our organizational documents do not limit our level of debt. A change in our policies or an increase in our level of debt could adversely affect our operations or the price of our common stock.

We can issue additional securities without shareholder approval.

We can issue preferred and common stock without shareholder approval. Holders of preferred stock have priority over holders of common stock, and the issuance of additional shares of common stock reduces the interest of existing holders in our company.

Increases in interest rates may adversely affect the market price of our common stock.

One of the factors that influences the market price of our common stock is the annual rate of distributions that we pay on our common stock, as compared with interest rates. An increase in interest rates may lead purchasers of REIT shares to demand higher annual distribution rates, which could adversely affect the market price of our common stock.

Shares that become available for future sale may adversely affect the market price of our common stock.

Substantial sales of our common stock, or the perception that substantial sales may occur, could adversely affect the market price of our common stock. Certain of our shareholders hold significant numbers of shares of our common stock and, subject to compliance with applicable securities laws, could sell their shares.

We depend on key personnel.

We depend on our executive officers, including Ronald L. Havner, Jr., our chief executive officer and president. The loss of Mr. Havner could adversely affect our operations. We maintain no key person insurance on him.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

To limit the Company's exposure to market risk, the Company principally finances its operations and growth with permanent equity capital consisting of either common or preferred stock. At June 30, 2001, the Company's debt as a percentage of shareholders' equity (based on book values) was 4.9%.

The Company's market risk sensitive instruments include mortgage notes payable which totaled \$30,563,000 at June 30, 2001. All of the Company's mortgage notes payable bear interest at fixed rates. See Note 6 of the Notes to Consolidated Financial Statements for terms, valuations and approximate principal maturities of the mortgage notes payable as of June 30, 2001. Based on borrowing rates currently available to the Company, the carrying amount of debt approximates fair value.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On February 2, 2000, the Company filed an action against Mary Piper, its former Vice President of operations, in Riverside County Superior Court, alleging claims for breach of fiduciary duties, fraud and deceit, constructive fraud, negligent misrepresentation, violation of Section 17000 of the Business and Professions Code, violation of Section 17200 of the Business and Professions Code and culpable negligence. The Company's claims arose from Ms. Piper's alleged participation in a plan that resulted in the payment of improper kickbacks to Larry Howard, a former vendor of the Company and the husband of Mary Jayne Howard, a former officer of the Company.

On March 6, 2000, Ms. Piper filed a cross-complaint against the Company, alleging that the Company had breached her written stock option agreement by refusing to allow her to exercise certain options. Thereafter, on July 19, 2001, Ms. Piper obtained leave to file an amended cross-complaint against the Company, alleging a number of additional claims arising from the termination of her employment on February 2, 2000. Specifically, Ms. Piper's cross-complaint alleged claims for breach of an oral employment agreement, wrongful termination based on gender discrimination, breach of the implied covenant of good faith and fair dealing, intentional infliction of emotional distress, breach of a written contract for stock options and age discrimination. Ms. Piper's amended cross-complaint seeks \$103,773.62 in alleged lost profits with respect to the stock options, additional compensatory damages according to proof, attorneys' fees, prejudgment interest and punitive damages. No trial date has been set. The Company denies Ms. Piper's allegations and intends to vigorously contest these claims.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company held an annual meeting of shareholders on May 8, 2001. Proxies for the annual meeting were solicited pursuant to Regulation 14 under the Securities Exchange Act of 1934. The annual meeting involved the following matter:

Election of Directors

	Number of Shares of Common Stock	
	Voted For	Withheld
Ronald L. Havner, Jr.	12,945,497	1,879,679
Harvey Lenkin	14,678,424	146,752
Vern O. Curtis	14,799,324	25,852
Arthur M. Friedman	14,798,824	26,352
James H. Kropp	14,678,924	146,252
Alan K. Pribble	14,799,324	25,852
Jack D. Steele	14,797,824	27,352

There was no solicitation in opposition to the management's nominees to the Board of Directors listed in the proxy statement.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

12 Statement re: Computation of Ratio of Earnings to Fixed Charges. Filed herewith.

(b) Reports on Form 8-K

The Registrant filed a Current Report on Form 8-K dated May 3, 2001 (filed May 4, 2001) pursuant to Item 9, relating to Regulation FD Disclosure.

The Registrant filed a Current Report on Form 8-K dated May 7, 2001 (filed May 9, 2001) pursuant to Item 5, which filed certain exhibits relating to the Registrant's public offering of Depositary Shares, each representing 1/1,000 of a share of the Company's 9 1/2% Cumulative Preferred Stock, Series D.

The Registrant filed a Current Report on Form 8-K dated June 1, 2001 (filed June 4, 2001) pursuant to Item 9, relating to Regulation FD Disclosure.

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.

Dated: August 10, 2001

PS BUSINESS PARKS, INC.

BY: /s/ Jack Corrigan

Jack Corrigan

Vice President and Chief Financial Officer

PS BUSINESS PARKS, INC.
EXHIBIT 12:
STATEMENT RE: COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

	Six Months Ended June 30,	
	2001	2000
Net income	\$ 24,295,000	\$ 22,255,000
Minority interest.....	13,152,000	12,031,000
Interest expense	394,000	744,000
Earnings available to cover fixed charges	\$ 37,841,000	\$ 35,030,000
Fixed charges (1).....	\$ 1,292,000	\$ 1,432,000
Preferred distributions	9,548,000	8,385,000
Combined fixed charges and preferred distributions	\$ 10,840,000	\$ 9,817,000
Ratio of earnings to fixed charges	29.29	24.46
Ratio of earnings to combined fixed charges and preferred distributions	3.49	3.57

	Years Ended December 31,				
	2000	1999	1998	1997	1996
Net income.....	\$51,181,000	\$41,255,000	\$29,400,000	\$ 3,836,000	\$ 519,000
Minority interest	26,741,000	16,049,000	11,208,000	8,566,000	-
Interest expense	1,481,000	3,153,000	2,361,000	1,000	-
Earnings available to cover fixed charges	\$79,403,000	\$60,457,000	\$42,969,000	\$12,403,000	\$ 519,000
Fixed charges (1).....	\$ 2,896,000	\$ 4,142,000	\$ 2,629,000	\$ 1,000	\$ -
Preferred distributions	17,273,000	7,562,000	-	-	-
Combined fixed charges and preferred distributions	\$20,169,000	\$11,704,000	\$ 2,629,000	\$ 1,000	\$ -
Ratio of earnings to fixed charges	27.42	14.60	16.34	12,403	N/A
Ratio of earnings to combined fixed charges and preferred distributions.....	3.94	5.17	16.34	12,403	N/A

(1) Fixed charges include interest expense plus capitalized interest.

PS BUSINESS PARKS, INC.
EXHIBIT 12
STATEMENT RE: COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

Supplemental disclosure of Ratio of Funds from Operations (“FFO”) to fixed charges:

	Six Months Ended	
	June 30,	
	2001	2000
FFO.....	\$ 46,380,000	\$ 41,854,000
Interest expense	394,000	744,000
Minority interest in income – preferred units.....	6,373,000	5,841,000
Preferred dividends.....	3,175,000	2,544,000
Adjusted FFO available to cover fixed charges.....	\$ 56,322,000	\$ 50,983,000
Fixed charges (1).....	\$ 1,292,000	\$ 1,432,000
Preferred distributions	9,548,000	8,385,000
Combined fixed charges and preferred distributions	\$ 10,840,000	\$ 9,817,000
Ratio of FFO to fixed charges	43.59	35.60
Ratio of FFO to combined fixed charges and preferred distributions	5.20	5.19

	Years Ended December 31,				
	2000	1999	1998	1997	1996
FFO.....	\$ 85,977,000	\$ 76,353,000	\$ 57,430,000	\$ 17,597,000	\$ 303,000
Interest expense	1,481,000	3,153,000	2,361,000	1,000	-
Minority interest in income – preferred units	12,185,000	4,156,000	-	-	-
Preferred dividends.....	5,088,000	3,406,000	-	-	-
Adjusted FFO available to cover fixed charges	\$104,731,000	\$ 87,068,000	\$ 59,791,000	\$ 17,598,000	\$ 303,000
Fixed charges (1).....	\$ 2,896,000	\$ 4,142,000	\$ 2,629,000	\$ 1,000	\$ -
Preferred distributions	17,273,000	7,562,000	-	-	-
Combined fixed charges and preferred distributions	\$ 20,169,000	\$ 11,704,000	\$ 2,629,000	\$ 1,000	\$ -
Ratio of FFO to fixed charges.....	36.16	21.02	22.74	17,598	N/A
Ratio of FFO to combined fixed charges and preferred distributions.....	5.19	7.44	22.74	17,598	N/A

(1) Fixed charges include interest expense plus capitalized interest.